Retail Market Conduct Task Force Report

Initial Findings and Observations About the Impact of COVID-19 on Retail Market Conduct

Final Report

The Board
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

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SECTION I - EXECUTIVE SUMMARY

The onset of the COVID-19 pandemic presented a significant shock to the global economy. The financial services industry and retail investors continue to feel the impact of the COVID-19 turmoil while there remains significant uncertainty about the duration of the pandemic, lock-downs, and other efforts to support the economy and curb the pandemic. Amidst the sudden and unexpected reduction in overall economic activity, it was and continues to be uncertain how extreme market volatility and the effect of closures will ultimately affect the markets. This raises various questions related to the potential impacts of the pandemic on the value of investment products, retail investor trends, and whether there will be an indelible effect on the regulation of the securities market going forward and the way in which supervision is undertaken by regulators.

A positive dimension to these challenges has been the intensive highlighting by regulators of shared experiences and reflections on good practices. This report provides preliminary observations from IOSCO's Retail Market Conduct Task Force (RMCTF), a Board-level group composed of member regulators from around the world, co-chaired by the Australian Securities and Investments Commission (ASIC) and the Central Bank of Ireland (CBoI). The RMCTF assembled earlier this year to look at conduct issues arising from or exacerbated by the crisis created by the COVID-19 pandemic. Its objective is to initiate a discussion on practical regulatory tools to address retail market conduct issues emanating from the COVID-19 crisis and to protect investors. The enhancement of investor protection and promotion of investor confidence in the integrity of markets are fundamental tenets of IOSCO's work (**Section II – Background**).

Observations in this report stem primarily from commonalities across case studies received from IOSCO members focusing on market environment, key drivers of firm and investor behaviour in periods of stress that provide increased opportunities for retail misconduct,[1] and regulatory measures and tools used to address retail losses or mitigate misconduct risks (**Section III – Environment**). Initial observations and findings demonstrate a spectrum of retail misconduct spanning the more egregious examples of fraudulent or predatory practices by unlicensed operators targeting retail investors to those characterised as inadvertent misconduct by regulated firms or other harmful conduct by regulated or unregulated firms. With these are a correlating range of regulatory measures and tools that IOSCO members have deployed, acknowledging the challenging environment (**Section IV – Key Findings and Observations**).

Common types of harmful behaviour during stress times include mis-selling, mis-labelling and misleading disclosure, and other such investment advice. While misconduct relating to complex products that are highly susceptible to market volatility continues to be prevalent (e.g., those involving retail OTC leveraged products such as binary options, CFDs, retail spot forex), the increase in online general share trading and the surge of retail investor interest in the share market during periods of lockdown has been notable. In various jurisdictions, remote working has affected risk management arrangements in firms (e.g., internal surveillance procedures to monitor staff conduct as well as operational, cyber and outsourcing risks), and consequently regulators' supervision and surveillance functions. In essence, the environment noted in case studies was informed by high

[1] The term and scope of misconduct in this report are kept broad to capture the existence of retail investor "harm".

market volatility, pressures created by reduced profitability for many firms, heightened financial and psychological pressures on firms and investors, combined with constraints posed by remote working on firms and regulators.

What is clear as the pandemic continues to unfold is that there are challenges for retail investors in navigating volatile markets amidst rapidly changing information (or misinformation), and possibly limited resources or accessibility to suitable financial advice, particularly where excessive risk-taking or hardship issues are involved. The corresponding challenges for regulated firms to effectively and continuously assess these cumulative effects and support informed decision-making by retail investors are real, as are the challenges for regulators in ensuring behaviour befitting regulatory and community expectations.

The case studies IOSCO analysed to form the basis of this report are distilled into a number of practical findings and observations and an adaptable suggested toolkit for regulators facing shifting priorities during stressed conditions such as the pandemic **(Section V – Suggested Toolkit)**. Regulators may tailor these to the specific circumstances of their respective markets and jurisdictions. As the toolkit suggests continued proactive supervisory scrutiny of firm and investor behaviour during market stress and that regulators be alert against potential signals of firm or investor behaviour that may result in retail investor harm, regulators may use discretion to adjust the toolkit to the specific challenges they face. Furthermore, based on members' experiences during the COVID-19 turmoil, particularly during the March/April 2020 period, the key observations and suggested toolkit highlight how regulatory coordination and cooperation may occur effectively under a stress environment, including on a cross-border basis. They also extract lessons and suggestions on how regulators can make use of their experiences from COVID-19 type stress events to adjust regulatory requirements to the needs of the markets and jurisdictions. Likewise, the key observations and suggested toolkit make suggestions to help regulators monitor the recovery and return to normal following the stress event. One of the key issues the COVID-19 pandemic brought to the fore was certain vulnerabilities and risks emerging from remote working arrangements. The key observations and suggested toolkit provide useful suggestions on how to address such risks and vulnerabilities. Finally, the key observations and suggested toolkit highlight some practices of certain IOSCO members who have taken a proactive approach to address retail misconduct.

The RMCTF will continue to monitor trends arising from IOSCO members' experiences, and its work under the Board-approved mandate to support regulators in their efforts to address retail market conduct issues and to protect investors during and beyond the COVID-19 pandemic.

SECTION II - INTRODUCTION AND BACKGROUND

The responses from IOSCO and other Standard Setting Bodies to the market turmoil caused by COVID-19 have been swift and prompt. IOSCO expressed its clear commitment to helping to ensure continued functioning of equity, credit and funding markets and access to funding and hedging.[2] To help focus on the challenges from the pandemic as well as to adjust to priorities of the members to relieve untoward pressure on them, IOSCO also decided to reprioritise its work program. Some measures IOSCO took to help alleviate the effects of the COVID-19 pandemic on capital markets and the broader economy were to propose member jurisdictions defer final implementation phases of the margin requirements for non-centrally cleared derivatives to provide additional operational capacity for firms (together with the Basel Committee); encourage issuers' fair disclosure about COVID-19 related impacts; and the two recently established Board level groups, the Financial Stability Engagement Group and the Retail Market Conduct Task Force, to address financial stability and investor protection issues related to COVID-19.

As we begin to draw lessons from the current situation, COVID-19 events show some areas of increased opportunities for bad actors' retail misconduct and potential investor harm. COVID-19 type disruptions may create various types of stress such as psychological stress, market stress and economic stress both on firms and retail investors. For example, a stress situation like COVID-19 may cause firms to seek aggressively new revenue streams as existing business lines come under pressure. This behaviour may increase potential retail investor risks and harm. At the same time, as data provided to the IOSCO RMCTF show, the price volatility may induce retail investment flow into riskier products to make profit during extreme market volatility.

Consistent with its investor protection objective and to address the increasing concerns about retail misconduct during COVID-19, IOSCO has decided to analyse retail market conduct implications in times of stress to help diagnose the challenges authorities may face during COVID-19 type stress events. To this end, the IOSCO Board established the RMCTF in February 2020 to focus on examining retail misconduct risks arising in the financial services industry in general.[3] Due to the pressures and turbulence caused by the COVID-19 pandemic, the Board asked the RMCTF to initially focus on COVID-19 related retail market conduct implications and consider types of retail misconduct exacerbated by or resulting from the crisis, including cross-sectoral issues. The Board also asked the RMCTF to prepare a series of measures to assist IOSCO members in addressing the retail market conduct challenges during COVID-19 type stress events. This report is a response to IOSCO Board's request.

During the COVID-19 pandemic, IOSCO members have increasingly been concerned about fraudulent schemes related to COVID-19, which have appeared in different forms and mainly

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[2] https://www.iosco.org/news/pdf/IOSCONEWS559.pdf

Securities regulators coordinate responses to COVID-19 through IOSCO.

[3] IOSCO work on retail market conduct is an adjunct and companion piece to the work IOSCO completed in 2017 in connection with wholesale markets. See IOSCO Task Force Report on Wholesale Market Conduct https://www.iosco.org/library/pubdocs/pdf/IOSCOPD563.pdf

targeted retail investors. IOSCO members took various steps to increase public awareness and prevent potential retail investor harm. As distinct from conduct challenges during normal times, COVID-19 poses various issues including alternative working arrangements introduced to comply with the health measures governments have introduced. Particularly, authorities observed a significant increase in disruptions associated with operational, business continuity and cyber-security risks.

The RMCTF conducted outreach to all IOSCO members to gather case studies. Based on the analysis of various case studies and the measures authorities have taken during COVID-19 and past crises, this report describes some key findings and observations and provides a suggested toolkit for IOSCO members to consider in addressing the specific retail misconduct challenges during times of stress.

In addition to this report, IOSCO will next prepare a report on the stock-take of findings and an associated toolkit of retail market conduct approaches to provide more targeted guidance on what regulators are currently doing to successfully combat misconduct in the retail context, including drawing key lessons from this report and those from other international bodies that may have cross-sectoral implications.

An important issue to consider is the increased threat to retail investors as shareholders of publicly held companies due to conduct risk. According to RMCTF's analysis, in recent years, significant remediation efforts and refunds have occurred in numerous jurisdictions to attempt to compensate for losses due to misconduct in some financial services sectors. The potential increase in conduct risk during COVID-19 may have adversely impacted retail investors that have invested in businesses or regulated financial firms that engaged in misconduct, particularly where regulatory action (e.g., court action or remediation) has been taken, resulting in:

- Reduced/cancelled dividends and/or share price falls;
- Increased reputational risk for businesses or regulated financial firms engaging in misconduct (trust deficits).

There may also be increased challenges for regulated firms in addressing potential misconduct in the COVID-19 environment including:

- Operational challenges for some regulated firms to efficiently remediate customers due to COVID-19 resourcing and social constraints arising from COVID-19 related to safe management/remote working measures;
- Some firms may not have the financial ability to remediate their customers.

SECTION III - MARKET ENVIRONMENT: IMPACT ON FIRM AND INVESTOR BEHAVIOUR AND RESULTING CHALLENGES FOR SUPERVISION

This part of the report describes the environment during the COVID-19 pandemic and its impact on the behaviour of firms and investors, together with the challenges for supervision. This environment was characterised by high market volatility, pressures created by reduced profitability for firms, heightened financial and psychological pressure on investors together with constraints posed by remote working on firms and regulators, described in more detail below.

While it compels deeper investigation and quantitative data linked to COVID-19 related factors and environment, IOSCO findings and observations (based on certain members' feedback) show evidence of an increase in the number of new investors and investor groups participating in trading for the first time during the COVID-19 pandemic. This can perhaps be explained with a combination of pre-existing trends, such as trading becoming more accessible (e.g., through apps offering no-fee trading, fractional shares, etc.), together with some pandemic-specific factors.

IOSCO members' feedback demonstrates that certain retail investor and firm behaviour highlighted in this report are specific to the COVID-19 environment. Amongst others, these include massive investment flow into alternative asset classes (such as commodities) retail investors might not be familiar with; substantial increase in equity trading, on-line day trading and retail OTC products trading; increase in certain types of predatory firm behaviour to abuse retail investor vulnerabilities or COVID-19 relief packages; and increased cyber-security, operational and outsourcing risks due to remote working. It is important to note that while the COVID-19 environment saw examples of increased harmful behaviour, some types of these practices existed before COVID-19.

A. MARKET VOLATILITY

The COVID-19 pandemic period of March/April 2020 demonstrates how market conditions and volatility under extreme stress may provide increased opportunities and pressures that increase the risk of misconduct. During the COVID-19 pandemic, market volatility increased remarkably, especially during March 2020. Under extreme volatility conditions, retail investor interest in securities trading, sometimes in riskier and complex products, may increase - possibly driven by the desire to limit potential losses and take advantage of an expected fall in prices to make profit.

One example of the effect of the extreme market volatility during the COVID-19 pandemic was a sudden change and a steep decline in the value of certain commodities. Commodity prices dropped rapidly affecting securities and derivatives (e.g., CFDs) that track their prices. One commodity sector seriously affected by the pandemic (combined with other factors) was oil. Oil-related securities have been an issue during COVID-19 in certain jurisdictions because of the increased price volatility and retail investors becoming a dominant force in oil futures. Retail investors built up significant long positions through oil ETFs, possibly with expectations of high returns when negative oil prices in near dated futures in the US reverted to positive prices. The unprecedented volatility in the crude oil markets significantly increased the potential risks for retail investors trading in crude oil-related exchange traded products (futures) via ETFs. Many retail investors experienced losses in their more complex investments in oil markets and the related derivative products. The US CFTC issued a

Customer Advisory informing the public about the unique risks associated with commodity ETPs and funds.[4]

The impact of low interest rates on investor behaviour and on increasing company valuations, combined with the addition of many new retail investors, is likely to increase security prices, in some cases above fair value. This creates potential risk of a capital loss if the market corrects and in turn may result in retail investors losing trust in and withdrawing from the capital markets.

B. PRESSURE CREATED BY FALL IN REVENUES FOR FIRMS

Worsening economic outlook as a result of lockdowns and accentuated by higher volatility can create competitive pressure on firms to survive or sustain revenue levels. When commissions fall and firms begin to struggle with profitability or when volatility increases and retail investors seek out or are lured into investing in volatile markets to make profit,[5] firms may start offering riskier products outside investors' risk appetite that can result in potential investor harm.

As certain IOSCO members have observed, the COVID-19 pandemic has revealed some firms' existing deficiencies in safeguarding client assets. There were also incidents of conflict of interests. Both factors may have enabled misconduct that resulted in retail investor losses. In some other cases, the lure of new sources of revenue, combined with poor or misleading disclosure and point-of-sale pressure, may mean that consumers very often agreed to buy products or services that were not in their interests (e.g., add-on insurance).

C. PRESSURE ON RETAIL INVESTORS

The unprecedented nature of the COVID-19 pandemic has created significant uncertainty and contributed to a range of different financial, psychological and social pressures that can manifest in different ways. From retail investors' perspective, key immediate concerns were largely health and income security at the start of the pandemic, followed quickly by mid-to-longer term concern for

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4 https://www.cftc.gov/PressRoom/PressReleases/8167-20

Another example of retail investor rush to commodity asset classes during COVID-19 pandemic was gold. Gold ETFs gathered a record $9.2bn in new cashflows during April 2020, adding to the inflows of $7.7bn registered in March. Products that traditionally seem safe in times of crises, such as gold, attract the attention of fraudsters. In one case, investors were encouraged to invest quickly in one particular junior mining issuer in gold, with the expectation of massive returns related to the effect of the pandemic on the overall economy. Many retail investors received cold calls from fraudsters with a clear sense of urgency. Such attempts are similar to other "pump and dump" scams, but in this case, wrongdoers have used the pandemic to heighten the sense of urgency and opportunity.

See also, FINRA Reg Notice 20-14 https://www.finra.org/rules-guidance/notices/20-14, which addressed market volatility and broker-dealer sales practice obligations regarding oil-linked ETPs and other commodities-linked vehicles.

5 For example, the French AMF findings show that retail purchases of French equities increased fourfold in March 2020 during COVID-19 turmoil and overall volumes tripled. ASIC also released the results of its analysis of markets during the COVID-19 period that revealed a substantial increase in retail activity across the securities markets, as well as greater exposure to risk: *Retail investors at risk in volatile markets*.

their investments given the potential losses. Whilst governments have implemented a wide range of financial and social support measures in their responses, it remains uncertain how the pandemic and lockdowns may evolve, and more importantly, their impact in the medium to long term on markets and the economy in general. Furthermore, central bank interventions during COVID-19, such as asset purchase programs (reaching to the level of fallen angels[6]) and emergency lending tools might have increased the asset price inflation and the trend to move to riskier assets. Given that central bank policies during recent years were main contributors of such asset price inflation and search for yield, COVID-19 might have exacerbated this impact and thus affected asset allocations and investor choices (including retail ones).

Even in non-crisis times, investment decision-making is deeply complex, and bad actors may target certain investors through deployment of choice architecture and other capabilities. In the current context, pressures created by the pandemic may contribute to increased vulnerability of different forms amongst investors that some firms and other scammers may try to exploit. By way of example, some IOSCO members have observed an increased investor susceptibility to (as well as an uptick in) problematic conduct, including aggressive advertising, mis-labelling of products and misleading disclosure.

The current conditions are particularly fertile ground for fraudulent or scam activity by unregulated/fraudulent firms, and there has been an increase in reports of scams and investor loss in this period (see Section IV). Fraudsters use a range of effective and sophisticated tactics to build trust and exploit vulnerabilities to cause significant investor losses. As another observed trend, new trading apps have started more aggressively using behavioural economics inducements (e.g., visually appealing graphics or other sites using leader boards appearing when trading) to attract retail investors to invest. While these new apps may not have specifically emerged due to COVID-19, they make it very easy to trade and some sites do not talk about risks or make them difficult to find on the site, and have very little, if any, educational material.

Social media and online platforms are playing a role in advertising and re-advertising scam activity and fuelling the rise of some share prices and potentially supporting “pump and dump” behaviours by providing channels to promote such activity.

Furthermore, another pressure point on retail investors may result from limited access to financial advice. A similar challenge stems from situations whereby retail investors may not seek financial advice, and as such, they may not benefit from KYC and other retail investor protection and disclosure requirements that may be in place.

D. REMOTE WORKING AT REGULATED FIRMS

Remote working arrangements for firms can give rise to concerns about specific risks for retail investors. For example, under remote working risk, control managers may no longer have direct lines of sight over some key functions, as observed in certain jurisdictions. The COVID-19 experience has

[6] A fallen angel is a bond that was initially given an investment-grade rating but has since been reduced to junk bond status.

also highlighted various issues in firms' internal controls, surveillance and monitoring of employee behaviour under market stress. As one example, the lack of investment bank/fund manager's controls in handling third party receipts, orders, or instructions where the investment bank/fund manager did not apply proper controls or question the reason behind the increase in third party deposits or inconsistencies between the fraudsters' instructions, nor took adequate steps to check the veracity of the information provided. In various cases, firms have struggled/failed in confirming client identity. From an internal controls and audit perspective, firms have re-tasked second and third lines of defence, which reflects how the urgencies of the current COVID-19 environment may affect priority setting. Deficiencies in internal control arrangements may increase when the first and second lines of defence are required to work remotely or are under-staffed.

The nature of internal surveillance will need to evolve to reflect how firms conduct assurance tasks when video conferencing becomes more and more accepted and some offshore capabilities are no longer as effective or available as during normal times. For example, one IOSCO member is watching the situation carefully and expects to review firms' internal audit functions through ongoing onsite review once the impact of COVID-19 subsides. The fear is that deficiencies in internal supervision due to the COVID-19 pandemic could create an enabling environment for unauthorised trades or fraudulent activity. To address the concerns, firms have started using novel techniques in monitoring employee behaviour. For example, some of the world's biggest banks are testing new technology that would help them record and monitor employees' messages with clients sent via the popular messaging app WhatsApp amid a massive spike in use of the encrypted messaging during the COVID-19 pandemic. HR teams at financial firms are also assessing the pressure the COVID-19 lockdowns are putting on their employees' mental health, as the pandemic is forcing a new focus on mental health and its attendant risks, such as errors by stressed-out staff.

Under remote working arrangements, staff place orders remotely. This poses a challenge both to firms and regulators to ensure compliance with ***order recording and taping requirements***. As a result, it was difficult to ensure that order records are complete and accurate and there is reliable evidence about the particulars of a trade order, especially in instances of trade disputes with clients. Some regulators have provided relief on certain recording and taping requirements to help firms with the challenges of the COVID-19 environment.

In certain jurisdictions, COVID-19 disrupted retail investors' communication with firms due to degraded customer service capabilities, majority of staff working remotely, branch closures or staff shortages combined with dislocated access to outsourced overseas capabilities and shutdown of overseas centres. As noted by some IOSCO members, the risk of ***poor complaints handling or claims handling*** has increased and firms' ability to deal with customer complaints was impacted.[7] Many investor complaints concerned an inability to get in touch with the financial intermediary (e.g., telephone waiting queues for financial difficulty matters). Some investors complained that they could

7 The Quebec AMF published on its website a reminder regarding complaint management and dispute resolution by financial sector stakeholders. The Quebec AMF recalled that, despite the difficult conditions linked to the COVID-19 pandemic, it is essential to ensure proper handling of consumer complaints and take all necessary measures to respond to it within the time limits set for this purpose.

not reach their advisor in a timely manner to give trading instructions. Some complained that they could not access their accounts to trade, or their orders were delayed or not completed.

Cyber-security, operational risk, outsourcing risk and ***ensuring business continuity*** became pressing issues for some firms and IOSCO members under remote working arrangements. In the case of cyber-security, increased access to intermediaries' internal networks and systems from outside the office and holding meetings through videoconferencing platforms created vulnerabilities that may be exploited by hackers and other wrongdoers.[8] Security issues associated with videoconferencing platforms have been reported from time to time, giving rise to the risk of unauthorised access and leakage of critical data. There were incidents of fraudsters e-mailing firms a falsified voided check[9] to verify (steal) new bank account information of clients. In response to cyber-security risks, authorities have highlighted several measures for staff working-from-home, such as using a regulated wi-fi broadband, regular software updates, installing anti-virus software, gaining knowledge about what the scammers are doing, and ignoring malicious links in e-mails. Firms can also provide secure connection to the systems, provide staff with adequate training and alert IT support to help guard against suspicious activity.

In light of the COVID-19 related problems, some authorities have issued advisory notes and guidelines to financial institutions on business continuity management and advised them to adopt additional measures and precautions when carrying out their business continuity plans.[10] One IOSCO member has ordered firms to submit reports explaining how they would improve their operational risk management and enhance their internal control arrangements so that misconduct cases would not reoccur.

Recognising the effect of COVID-19 on the ability of market participants to continue to meet regulatory requirements, *authorities provided firms with measured relief from certain obligations to address challenges posed by COVID-19,* while at the same time ensuring sound financial reporting to keep investors informed. Key objectives underlying these initiatives, included easing cashflow constraints, allowing firms to focus on COVID-19 priorities, and instilling confidence in market participants that regulatory systems were functioning and that markets could operate to price the impact of COVID-19 on the real economy in time.

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8 For example, one IOSCO member highlighted the example of a recent cybersecurity incident reported by a firm regarding how vulnerabilities of Virtual Private Network ("VPN") software could be exploited by a cyber-criminal to infiltrate the firm's network, access client data and instruct unauthorised fund transfers.

9 A voided check usually has "void" written on it, which means it should not be accepted for payments. It contains information on personal details necessary for online transfer payments and can easily be misused by fraudsters.

10 In one voluntary good practice example, a registered firm had to address a major ransomware cyberattack resulting in complete interruption of its IT infrastructure, at a time when it had to deal with extreme market volatility during COVID-19. Although the firm was not required to notify the regulator when a cyberattack occurs or if its business continuity plan is triggered, it voluntarily did so. The firm also quickly communicated with its clients through social media (as telephone systems were also down).

MAS Singapore published an "*Advisory on Business Continuity Management*".

Authorities have adjusted regulatory requirements[11] and issued guidance in various areas, some of which include:

- Revising leverage limits during the extreme volatility of COVID-19;
- Analysing whether KIDs work as intended when markets are highly volatile due to COVID-19;[12]
- Postponing Annual General Meetings (AGMs) and encouraging virtual meetings and voting by proxy or electronically;[13]
- Relaxing requirements on unsolicited debit cards to ensure investors can access their funds;[14]
- Simplifying the process for operators of frozen investment schemes to grant hardship withdrawals to investors in circumstances where they would be experiencing financial hardship;[15]
- Facilitating the early release of superannuation to help investors who suffer the effects of COVID-19;
- Assisting the boards of listed companies to navigate their decisions on executive variable pay in the context of the COVID-19 pandemic.[16]

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11 Where authorities are not in a position to adjust regulatory requirements, they have applied supervisory flexibility, where possible.

12 Although KIDs may work well during normal times, they may not in an environment like COVID-19. While it was not necessarily a matter of misconduct, one IOSCO member questioned whether KID disclosure adequately discloses the potential risk to the customer during times of stress and discussed with the National Consumer Agency the challenges related to the standardisation of KIDs.

13 Various IOSCO members encouraged AGMs being held remotely via technology to allow shareholders to participate from home following the lockdown and announced that firms pushing for physical meetings might be violating the regulation. Regulators encouraged innovative options when choosing the technological platforms used; active participation in the form of debates, questions, and voting via polls and not simply raising hands in the virtual AGM; and clear and effective communication by firms.

14 During COVID-19 restrictions, customers without a debit card could not access their funds to make purchases (e.g., for essential goods and services due to the decline in acceptance of cash and self-isolation requirements preventing from withdrawing cash). National law prohibits banks from sending unsolicited debit cards. The respective regulator provided a temporary relief of six months to allow banks to issue unsolicited debit cards to targeted customers.

15 During the 2008-2009 global financial crisis, one regulator provided relief to fund operators, on a case-by-case basis, to enable operators to facilitate withdrawals from frozen funds, to individual members suffering from hardship (generally on financial or medical grounds).

16 One IOSCO member issued guidance as boards were facing difficult decisions on executive variable pay at a time when companies were managing significant impacts to their operations, finances and employees. Amidst the rapid share price movements during COVID-19, robust remuneration arrangements became critical to support effective and informed board decision making in line with the changing circumstances and company's long-term interests. Importantly, decision making on variable pay – a key influencer of behaviour – can send strong signals to executives about conduct that is consistent with the long-term interests of the company. It also signals to investors the type of performance and conduct that is being rewarded in the current environment.

E. CHALLENGES FOR SUPERVISION

Authorities' supervision and surveillance capacity has also been affected in varying degrees by remote working arrangements. Certain IOSCO members have faced challenges, which required effective prioritisation/re-prioritisation of supervisory activities, as well as targeted and continuous (virtual) dialogue with key stakeholders. They also had to provide measured flexibility with regulated firms so as not to over-burden them and adopted an agile approach in their supervisory efforts. Some members deferred "non-critical" regulatory activities including enhanced on-site supervisory work and other activities that are not "time critical," to focus on the challenges posed by COVID-19 whilst enabling institutions to focus on their pandemic response. As a progressive development, remote working arrangements brought by COVID-19 have given some regulators the opportunity to test their e-supervision projects via the use of sup-tech technologies. In this respect, some regulators have conducted e-inspections (remote e-supervision). However, the reduction in some regulators' capacity due to remote working arrangements imposed by the COVID-19 lockdowns has created supervisory challenges in detecting potential misconduct.

Expectedly, with the low interest rate environment, many retail investors have rushed to riskier products, such as oil ETFs and structured products during COVID-19. As a concern, funds that invested in riskier or illiquid corporate debt may count on future central bank interventions similar to the ones during COVID-19 and not adjust their investment, risk management and liquidity strategies. This is an issue that is relevant to retail investors given the rising popularity of exchange traded products, such as ETFs, among retail investors, however, it is not necessarily a retail misconduct issue itself.

IOSCO members have complemented their enhanced supervision efforts with focused and timely enforcement actions against the perpetrators (particularly in cases of unlicensed activity and market manipulation), as well as investor education measures that were put into place to prevent the recurrence of fraudulent schemes. Most of these enforcement actions resulted in various sanctions and fines.

SECTION IV - KEY FINDINGS and OBSERVATIONS

This section provides key findings and observations based on information submitted by individual members to the RMCTF in terms of the vulnerabilities demonstrated by retail investors, the changes exhibited in firms' behaviour and the responses by regulators.

A. CHANGES IN INVESTOR BEHAVIOUR DURING THE COVID-19 PANDEMIC

i. Populations that are vulnerable to misconduct

Investors may experience vulnerability at different points in their lives, and it may be temporary, sporadic, long-term, or permanent in nature. That said, it was noted in case studies that many targeted investors included elderly investors and retirees, particularly in the case of complex and riskier retail product offerings, or those that may have less awareness of potential risks of the products in which they are investing and limited resources or accessibility to suitable financial advice. Notably, there was also a rush among younger investors into the stock market particularly during March/April 2020 with the lock-down and commensurate rise of online trading applications targeting certain demographics with simpler, game-like features. Excessive risk-taking by those wishing to make a profit or limit loss, while not new, appeared to increase. Exposure to predatory scams, unlicensed financial advice, misleading or deceptive advertising, by unsophisticated retail investors and individuals suffering financial hardship as a result of COVID-19 also appeared to have increased significantly. This has been compounded by challenges presented by rapidly changing information (and misinformation) during the crisis environment.

Who are those vulnerable retail investors?

Vulnerability can affect a client of any age or with other attributes and may take many forms. Vulnerability can be caused by an illness, impairment, disability or youth (lack of investment experience) or aging process limitation. It is important for firms to recognise and consider vulnerabilities in their clients, because vulnerable clients may be more susceptible to financial exploitation.

Any individual consumer can experience vulnerability as a result of any number of factors including:

- The actions of the market or individual providers (e.g., being targeted by products that are inappropriate for a particular consumer, or being given inadequate or overly complex documentation);
- Experiencing specific life events or temporary difficulties (e.g., an accident or sudden illness, job loss, or the death of a family member); and
- Personal or social characteristics that can affect a person's ability to manage financial interactions (e.g., speaking a non-native language, having different cultural assumptions or attitudes about investing or experiencing cognitive or behavioural impairments due to intellectual disability, mental illness, chronic health problems or young or old age).

For example, older clients are not a homogenous group and not all older clients are vulnerable or unable to protect their own interests. However, older clients might potentially be more vulnerable to financial exploitation due to various reasons, such as lower income, physical fragility or abuse, or diminished mental capacity, Alzheimer disease or dementia, which may increase substantially as individuals get older. Normal situations or changes in cognition may not be readily observable but may have a noticeable effect on one's ability to perform complex decisions, such as financial planning or deciding to buy or sell investment products. While these changes do not impact every individual in the same way, a study commissioned by the Canadian Securities Administrators (CSA) in 2017 revealed that Canadians aged 65 or older are the likeliest age group to report being the victims of financial fraud. At the same time, many older Canadians are also at risk of financial abuse, which can take the form of theft, misuse or underuse of funds intended for care and other household expenses or abuses of an authorisation over the older person's decision-making.

ii. Increased retail participation in on-line day trading, offerings of riskier and gambling-type products

Authorities are concerned that marketing and trading of complex products that induce addictive behaviour, such as CFDs and binary options, significantly increased during COVID-19. Whilst some of these activities were linked to experienced traders that increased their trading volume during COVID-19, some firms tried to take advantage of the large portion of the population spending additional time on-line due to the lockdown.[17] A few IOSCO members highlighted that the lockdowns have increased the duration of retail investors´ screen exposure. IOSCO members have also highlighted that retail investors have increasingly used online investing platforms and online services. Firms have offered riskier products with an emphasis on the potential for making large gains, with little to no detail on the likelihood of the significant losses that can be incurred.

During COVID-19, regulators have also seen an increase in reports from consumers losing money in crypto-assets/cryptocurrency related scams.[18] The crypto marketplace is online, global and complex. Therefore, the value of a crypto-asset is usually difficult to determine. One of the case

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[17] One IOSCO member noted its discussions with firms that the increase in trade volume has been unprecedented, with one media outlet coining the COVID-19 situation "a one in a 20-year event" for the retail OTC sector. Several problems persist in the retail OTC derivatives sector such as inadequate risk management practices, misleading materials and unclear pricing. Raising industry standards and customer compliance is an immediate necessary action which must be taken in this industry sector.

See the IOSCO Report on Retail OTC Leveraged Products https://www.iosco.org/library/pubdocs/pdf/IOSCOPD613.pdf

[18] For example, reports of scam activity (including crypto scams) ASIC received from March to May 2020 increased 20% compared to the same period last year. ASIC has also observed an increase in romance scams where people meet online and form a romantic connection. A consumer meets someone on an app, and then is encouraged to sign up to a trading platform. The platform may trade in cryptocurrencies or derivatives. The original contact may introduce the victim to a third person who acts as the broker or analyst who can provide advice about trades. A scammer then directs someone to an investment opportunity in crypto-assets or forex trading.

IOSCO's Committee 8 published a report on "*Investor Education on Crypto Assets*".

studies presented by the Belgian FSMA provides a potential toolbox composed of various complementary tools,[19] which regulators can consider in preventing crypto-related online investment fraud with a cross-border nature. Particularly, this case study illustrates the benefits of a good interaction between market authorities and judicial authorities in addressing crypto-related fraud. Additionally, it underscores the importance of cross-border cooperation.

Similarly, some IOSCO members have observed a significant increase in retail investment flow into equities during COVID-19. For example, the French AMF findings show that retail purchases of French equities increased fourfold in March 2020 during COVID-19 turmoil and overall volumes tripled. In certain jurisdictions, where traditional commission-based businesses are experiencing a downward trend in profitability, firms have increased the proportion of revenue from foreign securities transactions.

As indicated by some of the case studies that IOSCO analysed, retail investors have also increased short-term and day trading during the COVID-19 pandemic. Along with this has been a massive growth in online platforms and apps for share trading, and the fractionalisation of shares which allows people to trade in smaller dollar amounts than previously. This appears to have driven a lot of young people into equity markets who previously would not have easily been able to trade.

In another interesting quantitative study in the light of market volatility during the COVID-19 pandemic, the FSMA conducted a quantitative study of the behaviour of Belgian individual investors, based on the data received from transactions reported in accordance with MiFID. The study analysed the behaviour of investors by age group and investment frequency and is based on a sample of more than 3 million transactions, a total volume of more than 10 billion euros, which were carried out by nearly 323,000 individuals. The FSMA study found that during the COVID-19 turmoil (between 24 February and 30 April 2020), Belgians traded up to five times more BEL 20 shares than in the period before the crisis created by the COVID-19 pandemic. As an interesting finding, the volume of shares bought was disproportionately higher than the volume of shares sold. As another striking finding, young and infrequent investors were much more active during the crisis period.[20]

iii. Increased retail participation in in unlicensed product offerings

During the COVID-19 pandemic, IOSCO members observed an increase in the provision of unlicensed financial services and marketing campaigns that emphasise the potential for investors to

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[19] The FSMA initiative included various pillars of action, including investor warnings and awareness campaigns (an extensive digital fraud prevention campaign in cooperation with the Federal Public Service Economy), collaboration and joint press release with public and judicial authorities (Belgian Financial Intelligence Unit, Brussels Prosecutor's Office), blocking websites, actions related to banking flows (communication with compliance officers of credit institutions), actions related to facilitate easy communication with investors that faced harm, several communications linked to online investment fraud during the COVID-19 period, and international cooperation with French authorities with the support of Eurojust and Europol to take action against a criminal network which committed large-scale international fraud with the sale of bitcoins and other crypto-currencies.

http://www.eurojust.europa.eu/press/PressReleases/Pages/2020/2020-01-30.aspx

[20] See: https://www.fsma.be/en/news/belgians-trade-five-times-many-shares-during-coronavirus-crisis

make large gains, without adequately disclosing the risk of incurring significant losses.[21] Generally, such schemes are directed to retail investors and often concern shares of companies who are not covered by regular financial research activity. Retails investors may believe in these promotions, especially if high profits are promised and in market situations where the investment opportunities seem to be limited.

B. CHANGES IN FIRMS' BEHAVIOUR DURING THE COVID-19 PANDEMIC

i. Changes in revenue lines

Proportion of revenues from foreign securities and complex products, such as retail OTC leveraged products and ETFs has increased. In certain jurisdictions, where traditional commission-based businesses are experiencing a downward trend in profitability, firms have aimed to increase the proportion of revenue from foreign securities transactions (mostly foreign equities). To increase revenue, some sales staff have deployed specific tactics to introduce themselves as trustworthy intermediaries to specifically target older or retired clients. In some cases, licensed foreign firms have targeted local investors to invest in shares of American or European pharmaceutical laboratories that are currently conducting clinical research for a COVID-19 vaccine or increasingly to offer riskier and complex retail products. Furthermore, firm revenues from trading of complex, leveraged products such as binary options, CFDs and retail spot forex have increased.

ii. Increase in misconduct

Both licensed and unlicensed activities may result in potential misconduct. IOSCO members have observed cases where licensed firms might be involved in behaviour that may potentially result in investor harm, although firm behaviour may not be fraud in the legal sense (legal but harmful). This may happen where no breach of law occurs or the current case law allows the presumption that the behaviour is permitted, and firms are allowed to take risks. However, firms are responsible for managing the risks appropriately. Additionally, unlicensed firms might be involved in fraudulent activity that results in investor harm. Offerings of retail OTC leveraged products is a good example highlighting the importance of this differentiation, where IOSCO members observed retail investor harm caused both by the behaviour of licensed and unlicensed firms. Some illegal/lawful but harmful conduct might fall outside the scope or ambit of the regulators' powers, especially if unlicensed, and this continues to be a challenge for regulators.

- ***Mis-labelling, mis-selling, and misleading disclosures.*** During COVID-19, some firms were mis-labelling products, such as investment funds, by giving the misleading impression that investing in funds is equal to an investment in cash-equivalent products or bank-guaranteed term deposits. For example, some fund operators used the word "cash" in labelling of their fund, and extensively used the word "cash" in promotional materials and description of the fund, despite a significant share of the underlying assets bore no relationship to cash or cash-equivalent assets. Moreover, important information on such instruments was concealed or deliberately misrepresented. Although such mis-labelling practices existed before COVID-19,

[21] For example, BaFin highlights that, retail investors are very likely to be exposed to such misconduct

the RMCTF findings and observations demonstrate that the COVID-19 environment might have increased such practices.

Various members' case studies submitted to the RMCTF were related to widespread stock promotions in certain jurisdictions linked to COVID-19 related products as a common market abuse pattern. This misconduct may take various forms. There were widespread false and misleading disclosures by firms or intermediaries regarding COVID-19 related products, tests, development of medicines, disinfectants and protective equipment, which could have a positive impact on the share price of the firm. Firms with mal-intent sought to manipulate their stock price by giving the false impression that their revenues will increase with sales, production or invention of COVID-19 related products/treatment. Sometimes it was not the firm itself, but a broker, who was offering unbalanced and aggressive investment advice to investors to invest in shares of pharmaceutical laboratories that are currently in a race to develop a vaccine against COVID-19 and doing clinical research. Persons publishing such promotions might themselves be holders of the same financial instrument being recommended. They can spread these scams via market letters, news releases or via telephone marketing (cold calling).

Even if firms make all the required disclosure, some evidence may show that there are limitations to the effectiveness of disclosure as a tool for preventing potential consumer harm. The strong available evidence suggests that disclosure can often be less effective than intended, which might be relevant to all contexts including the COVID-19 environment.[22] A key implication is that regulators should be exploring the use of additional regulatory and policy tools, beyond disclosure, to address the identified drivers of particular harms.

During COVID-19, authorities undertook further efforts to inform retail investors about mis-selling practices and encourage them to conduct increased due diligence while investing. In some cases, after having received investor complaints, the authorities published press releases and investor warnings describing the scheme to prevent retail investors from opening accounts with the broker. Authorities also worked closely with SROs and other authorities to address mis-selling. Addressing widespread mis-selling practices is particularly crucial in stress times, where retail investors are attracted to complex products that are highly susceptible to heightened market volatility.[23] Unrealistic sales targets, the promise of bonuses or other remuneration incentives may motivate sales managers and staff to exercise unscrupulous selling practices.

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[22] For example, see the 2019 joint report by ASIC and The Netherlands' AFM, "*Disclosure: Why it shouldn't be the default*". This report draws together a significant body of evidence on the limitations of disclosure, based on many years of research by regulators, academics and other consumer and industry bodies. It shows there are a number of threshold conditions that must be, yet rarely are, met for disclosure to be effective. In practice there are significant barriers that impede users from meeting each of these conditions. The report shows that these limitations apply to both 'simplified' or shorter disclosure forms as well as to longer and more complex traditional or 'technical' forms. Critically, the evidence shows that it is incredibly difficult to "improve" disclosure to the extent that it improves decision-making and consumer outcomes.

[23] Mis-selling of investment products to investors has been one of the major concerns of the HK SFC during the Global Financial Crisis (GFC). Wide scale mis-selling came to light after the wave of investigations into the conduct of distributors of Lehman Brothers-related investment products and the resulting enforcement actions taken against thirty intermediaries. In these cases, the SFC exercised its power to take disciplinary actions against the intermediaries, the penalties of which included substantial fines, partial suspension of license and a public

- ***Suitability requirements.*** Given the potential impact of the COVID-19 pandemic on market volatility and liquidity, IOSCO members sought to ensure that intermediaries fulfilled their suitability obligations. This is particularly important when intermediaries distribute complex products that may be highly susceptible to the implications of a volatile market. There were incidents where firms did not fulfil suitability requirements. One IOSCO member highlighted that the credulity of the vulnerable/at-risk population makes it easy during COVID-19 for financial firms to entice a retail investor to sign all necessary documents without close scrutiny.

  When providing advice, firms are expected to have meaningful interactions with their clients to appropriately establish their investment needs and objectives, financial circumstances and risk tolerance, which may materially change during a market downturn like COVID-19.[24] Clients may have the ability to financially withstand a downturn in the market or a partial or total loss of their investments, though they may also want to adjust their risk tolerance. At the same time, clients may have unrealistic expectations and ask the intermediary to invest in higher-risk products or follow investment strategies that are unsuitable for them, mainly to benefit from the market volatility. The firm should have a detailed discussion of the relationship between risk and return and inform clients about possible scenarios with regard to the risk-return relationship during market stress.

- ***Misconduct via inaction, such as delaying and denying client orders and instructions.*** Misconduct patterns in a stress environment may include both active and inactive/passive harm. In addition to traditional patterns of misconduct, authorities should be alert to misconduct patterns and potential retail investor harm from inertia/inaction, such as wilful blindness, accidental omission, and ignorance in the discharge of duties to clients, or failure to discharge these duties to a high standard, which may increase during stress times.

  For example, in one case under investigation, the retail client alleged that the individual investment advisor did not follow his instructions to rebalance his portfolio and secure his assets at the beginning of the COVID-19 pandemic. As a result, the level of risk of the client's portfolio was too high compared to the client's risk tolerance. This incident demonstrates that it is more critical for firms to carefully assess consumer risk tolerance during COVID-19 type situations. Proper execution of buy and sell orders following customers' instructions also remains a central issue in times of market volatility.

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reprimand. Where in the public interest, the SFC also exercised its power to resolve cases involving intermediaries on terms that are appropriate in the circumstances, including restitution.

ASIC continues to focus on the retail OTC derivatives sector, given misconduct identified across the sector. ASIC has taken action where it has observed unconscionable conduct, targeting unsophisticated investors and harming vulnerable consumers. ASIC is also monitoring advertising in the retail OTC derivatives sectors to identify mis-selling. Significant fines have recently been imposed by courts in Australia for firms who engage in this sort of misconduct.

[24] In one of the case studies submitted to the RMCTF, the firm did not adjust the investor's risk tolerance upon his request during COVID-19 pandemic and this resulted in substantial loss.

During COVID-19, authorities also received an increased volume of complaints regarding instances of late transfers of assets between firms, intentional delays of investor instructions and difficulties in closing accounts. There were incidents of transfers being delayed for various weeks (which would normally take 7-10 days). Some firms were using various tactics to prevent transfer orders to avoid client withdrawals, such as alleging clerical errors on transfer forms; absence of senior executives to approve transactions; extra internal procedures; requests to make the application at a branch office rather than online (in one case from a disabled client), charging account closure fees, requiring update of ID information; and requesting early notice from the client.[25]

Late transfers may result in economic and financial difficulty for retail investors, particularly in situations like COVID-19. In certain cases, the transfer orders did not materialise until the investor filed a complaint with the regulator. One member conducted investor surveys to analyse the problem and followed up closely with the complainants to ensure implementation of the regulatory requirements relating to account transfer or closure, and to reduce misconduct in this regard. Another member received various retail investor complaints about market making practices and behaviour of retail derivatives market makers which negatively affected price determination in the highly volatile market during COVID-19 turmoil. Complaints were mainly about market makers suspending quotation or quoting uncompetitive prices.

The number of clients is an important measurement of revenue and profit for an intermediary and can also be an essential performance indicator of a branch or staff. Thus, during COVID-19 turmoil, some branches tried to delay the procedure of account transfer or closure, with an aim to maintain the number of clients. In some cases, temporary rules were put in place due to the pandemic to allow investors to open or close accounts online. However, due to information asymmetry, these new temporary rules were not conveyed in an effective manner to the investors. Therefore, investors were not aware that they could close accounts online and instead continue with the intermediary, thereby increasing/maintaining the revenues of the intermediary.

- ***Misconduct risk in fund management.*** In one case, the head of sales and managers instructed branches not to exceed the target redemption level, which was difficult to achieve during COVID-19 stress period. This practice had the objective of reducing the number of redemptions, thereby extending the average holding period of fund units. In another case, there was mis-labelling of funds to give the impression that investing in the fund was equal to an investment in cash-equivalent products or bank-guaranteed term deposits.

- ***Misconduct targeted at recipients of COVID-19 relief.*** The case studies indicate that in certain jurisdictions, some firms (both in the unregulated and regulated space) may have deliberately or inadvertently misused some of the measures taken by authorities to alleviate the impact of COVID-19. One example was fraudulent scam activity by unregulated firms targeting individuals who received funds from the governments as COVID-19 relief packages, or those

[25] It should be noted, however, that the failure to act on instructions may emanate from an operational failure.

unwittingly providing financial advice on those funds. [26] Similarly, in the US, the SEC Office of Investor Education and Advocacy has sought to raise awareness with alerts and bulletins around fraudsters and other bad actors that have tried to take advantage of the CARES Act, which provided relief to individuals and firms affected by COVID-19 by expanding the window for income tax payments.[27] Fraudsters and other bad actors have tried to entice individuals to invest the remaining money in high-risk, high-return investments. Similarly, early release of superannuation to help retail investors who suffer from the effects of COVID-19 gave firms the opportunity to entice retail investors to invest their funds. In response to such abusive behaviour, regulators took steps to increase awareness of predatory practices by promoters.

iii. Aggressive advertising, on-line marketing and digital offerings by firms

The current pandemic environment has increased the amount of harmful behaviour as some firms have become more aggressive in marketing riskier products on social media platforms to attract investors, by nudging and offering enticements for retail investors to make easy/quick money and engaging in day trading while in lockdown. [28] In certain jurisdictions, regulators had to crack down fake endorsements on Facebook and other social media platforms of Bitcoin and other riskier products customised for local investors, sometimes through the use of fake local celebrity endorsements.

In one jurisdiction, certain securities firms and asset managers started using online livestreaming to sell financial products, provide financial advice, conduct roadshows and educate investors during the COVID-19 pandemic, as firms explored new ways to connect with investors. According to the regulator, while livestreaming can be adapted to a wide range of businesses to reach out to a large number of recipients in an efficient way, it can also create new types of risks, such as provision of certain inappropriate services which are not allowed (e.g., public promotion of privately-offered fund products); failure to disclose adequate information to investors (to distinguish legal firms from illegal ones); or failure to inform investors about risks in general. The regulator noted that the surging use of livestreaming by firms during COVID-19 requires specific attention to address these potential risks.

Authorities have observed a significant increase in COVID-19 related investment scam reports from investors. Scammers are using age-old tactics in new and sophisticated ways and enhancing their marketing skills to appeal in an emotional way to retail customers. Common fraud tactics mostly include "falling for good-cause-scams" where fraudsters ask for investment for a vaccine, masks,

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[26] Following a program for early release of superannuation by the Australian government to assist those suffering financial hardship during COVID-19, a new wave of unlicensed advice, scams and fraudulent behaviour was observed. This has resulted in stronger collaborative efforts between regulators to adopt a variety of measures to raise awareness, warn and minimise consumer harm (e.g., targeted surveillance; tracking of unlicensed activities; use of public messaging to warn about potential misconduct and consumer rights).

[27] https://www.sec.gov/oiea/investor-alerts-and-bulletins/COVID-19-related-early-withdrawals-retirement-accounts-be

[28] IOSCO Committees 3 and 4 are working on a report which will include guidance on enforcement as well a toolkit of policy measures to address and mitigate the risks posed by online (cross-border) marketing and distribution by licensed firms.

PPE kits etc.; offering enticing returns or deals that are too good to be true; telling investors to act immediately because market conditions may change (sometimes using fake testimonials); pump and dump schemes; charitable investment scams and community-based financial fraud schemes.

Scammers are increasingly issuing promotions to lure customers into the belief that the investment being offered could help minimise the financial distress induced by COVID-19. Scammers normally pump inaccurate information and induce customers, taking advantage of their lack of knowledge in the investment field. Therefore, investors should not make rash decisions when an unexpected, yet seemingly enticing offer arises. In fact, in certain jurisdictions, authorities warned that microcap stocks may be vulnerable to scammers' investment schemes during COVID-19 stress because of the lack of publicly disclosed information. With the increasing role of social media and online forums, there are also concerns around small/micro-cap companies' share price being driven up by posts by "prominent investors". Authorities have also encouraged investors to report frauds to help others avoid these schemes. Firms engaging in fraudulent behaviour are difficult to catch and investor losses can be difficult to recover, especially when scammers are operating outside of their home jurisdiction. Various authorities have issued warnings that investors should exercise caution with social media and online ads.

C. REGULATORY RESPONSE

i. Some of the traditional tools and measures used by IOSCO members to combat misconduct during stress times

With respect to regulatory responses, IOSCO members have used a wide spectrum of mechanisms to address misconduct ranging from a "deterrent/penalty approach" to more "persuasive softer techniques". Some of the traditional techniques used include:

- public communications and consumer warning notices;
- strategic communication targeting the industry;
- administrative sanctions and fines;
- bans imposed on firms and individuals;
- court litigation and other enforcement actions;
- freezing of assets;
- publishing prohibited or other warning lists;
- forcing firms to take corrective action to refund investor losses, indemnification and settlement with the firm to redress client losses;
- newsletters;[29]
- use of websites to inform investors;
- use of special monitoring tools for advertisings; and
- advertising and engaging campaigns which seek to educate investors on the warning signs of a potential scam.

[29] The Quebec AMF issued a special newsletter on the prevention of fraud related to COVID-19, with a number of examples of fraud recently reported. The newsletter also enjoins people to consult the COVID-19 Content Hub on AMF's website and to call the AMF Information Center for any assistance.

In response to fraudulent disclosures, some regulators suspended trading of shares and took legal action. IOSCO members are carefully monitoring COVID-19 related products and relevant disclosures. IOSCO members have engaged with firms, and in some cases, requested that additional disclosure or information made available to the public on the effect of the pandemic, on the products and potential for loss. Particularly, IOSCO members required that the disclosure of risks and fees should be clear and made upfront to customers prior to the transaction.

ii. Some of the innovative tools and measures used by IOSCO members to combat misconduct during stress times

In addition to the traditional tools mentioned above, IOSCO members have used some of the following innovative and pro-active approaches to combat retail misconduct:

- Targeting vulnerable investors: The CSA has recently proposed measures to establish consistent minimum regulatory requirements and expectations for the securities industry to address financial exploitation of older and vulnerable clients and diminished mental capacity. There are two key aspects of this proposal for investor protection. First, the proposal, as drafted, would require registrants to take reasonable steps to obtain the name and contact information of a trusted contact person (TCP), as well as the client's written consent to contact the TCP in prescribed circumstances. Second, where a registered firm reasonably believes that a vulnerable client is being financially exploited, or a client does not have the mental capacity to make financial decisions, the firm would not be prohibited from placing a temporary hold on a transaction, withdrawal or transfer from a client's account, provided that they follow the steps prescribed in the rule. While the initiative was initiated before the pandemic and not related to COVID-19, the Canadian Foundation for Advancement of Investor Rights has highlighted that the CSAs' proposal is particularly important at the current moment in time when COVID-19 pandemic exacerbates the challenges for many vulnerable investors.

- Special monitoring of websites: French AMF identified a COVID-19 related internet financial scam offering an investment in the medical sector and more specifically in hydro-chloroquine. The website primarily asks for name, phone number, and email address, without that information, it does not move ahead. A retail investor alerted AMF, and AMF has started monitoring the web site. ASIC has also been monitoring promotional content to identify, disrupt and deter the most harmful content arising from communications to consumers about COVID-19 and financial schemes.

- Dedicated COVID-19 sections on regulator websites: The US SEC has extensive sections on its website for investors which include FAQs and investor alerts.[30] As of April 2020, BaFin

[30] https://www.sec.gov/sec-coronavirus-COVID-19-response
https://www.sec.gov/investment/COVID-19-response-faq
https://www.sec.gov/investor/alerts
https://www.sec.gov/oiea/investor-alerts-and-bulletins/COVID-19-related-early-withdrawals-retirement-accounts-be
https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_frauds
https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_coronavirus

has published five concrete consumer warning notices regarding possible pump and dump schemes in light of the COVID-19 pandemic on its website. The Quebec AMF has created a COVID-19 Content Hub on its webpage and named the section “COVID-19: Watch out for potential fraud”. In June 2020, ASIC launched a tailored COVID-19 news hub (newshub.asic.gov.au), augmenting specific content from its main website (www.asic.gov.au) and retail consumer/investor focused website (www.moneysmart.gov.au) to counter misinformation and address scams, misleading advertising and unlicensed advice.[31]

- Special campaigns and remote town-halls: For example, SEC staff in Regional Offices hosted several educational telephone town halls about avoiding scams related to COVID-19. These calls were free and open to all investors and the public.[32]

- Media awareness initiatives: The Quebec AMF launched a fraud prevention campaign to raise awareness and help consumers recognise, avoid and report any attempted fraud of which they may be the target. The awareness campaign, which included the production and broadcasting of three 15-second ads, took place simultaneously on television, on the web and on social media.

- “Dear CEO” letters: FCA used “Dear CEO letters” regarding communications about pension investments. The letters have highlighted specific issues in the market and the FCA responses. The Central Bank of Ireland issued “Dear CEO letters” to firms relating to unregulated activities and compliance with obligations relating to appropriateness. SC Malaysia has also used “Dear CEO letters” as a pre-emptive supervisory tool which enabled the SC to have a uniformed message communicated to the intermediaries to take immediate action on certain matters.

- E-supervision of market intermediaries via SupTech: The UAE SCA conducted the first e-inspection of one of its licensed brokers in April during COVID-19 pandemic through off-site inspection.

iii. Cross-border challenges and cooperation

During the recent market stress, there were cases of foreign firms defrauding several domestic elderly investors by inducing them to trade high risk products – such as CFD or forex instruments - on a foreign trading platform regulated by a foreign authority. These firms were difficult to identify and had induced the targeted investors by agreeing to help them create and manage their foreign trading

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[31] It includes key messages on concerns regarding the increase of scams, misleading communications and unlicensed or poor financial product advice, for example, relating to a COVID-19 economic relief measure introduced by the Australian government to allow individuals facing particular financial hardship to access their superannuation early, up to AU$10,000 in 2019-20 and a further AU$10,000 in 2020-21 (early release scheme).

[32] https://www.sec.gov/news/press-release/2020-129
https://www.sec.gov/san-francisco-regional-office-tele-townhall-coronavirus-scams
https://www.sec.gov/regional-office/free-may-21-telephone-town-hall-avoiding-fraud

account professionally with a promise of guaranteed profit from their investments. Despite the promises, retail investors suffered significant losses, usually their entire deposit. Various IOSCO members have taken actions in response. In some cases, the cross-border nature of this activity obliged national authorities to reach out and cooperate with the foreign authorities of the firms conducting cross-border promotions. The establishment of the RMCTF and its structured outreach to IOSCO members was an effective way for IOSCO to gather information and understand how different regulators were dealing with issues that could cut across borders.

iv. Being pro-active as a regulator

The current environment has further informed regulatory thinking on misconduct risk, where it can potentially occur and what engagement channels with investors can be utilised to good effect. The intensive sharing of experiences and good practices, and in some cases, innovative solutions, has been a positive development during the pandemic. Such pro-active approaches include:

- Pro-actively addressing excessive risk taking and behaviour suggestive of firms being tempted to push regulatory boundaries. Putting the emphasis on early, targeted and systemic intervention to address persistent problems and pre-empt the fallout from emerging threats so as to contain the damage that may arise in case the risk crystalises;
- Working with the industry to surface cases of misconduct at an earlier stage, and identify and record COVID-19 related impacts to allow future data collection;
- Ensuring the early involvement of compliance and marketing staff in the process of offering, advertising and marketing of products to retail investors, to avoid mis-selling and mis-labelling incidents that may cause potential retail investor harm in the future;
- Using monitoring tools (e.g., RegTech solutions) effectively in anticipation of financial scams emerging during COVID-19 in order to detect such scams on the internet;
- As a proactive measure, writing to management of firms to remind them of their duties and legal obligations in light of the market volatility and disruption associated with COVID-19; and
- Proactive intelligence gathering. For example, the restructuring of the British Steel Pension Scheme, alerted the FCA to initial misconduct by local financial advisors and allowed to take immediate robust action.

v. Timely communication and working closely with other authorities

A key lesson from the COVID-19 pandemic is the importance of acting quickly to assess a problem, determine the key risks and inform the public in a quick and timely way with useful information. IOSCO members worked closely with each other and other regulators and authorities in addressing misconduct, taking a multipronged approach. Among others, these authorities include pension regulators, national SROs, financial ombudsman schemes, consumer protection authorities, gambling commissions and financial services compensation schemes.

SECTION V - SUGGESTED TOOLKIT TO ADDRESS RETAIL INVESTOR PROTECTION CONCERNS IN STRESSED CONDITIONS

While all of the recent misconduct may not be directly attributed to COVID-19, as the previous sections show, COVID-19 pandemic has created market conditions and an environment that provide increased opportunities for particular types of behaviour by firms and pressures that increased the risk of misconduct. In addition, the stressful times and stressed market conditions have caused investors to behave in certain ways, and increased vulnerabilities. In response, regulators took actions to respond to these types of behaviour.

Taking into account the above-mentioned experience in the COVID-19 pandemic and previous crises, the RMCTF has developed the following suggested toolkit for consideration by IOSCO members. The suggested toolkit can be tailored to the unique features and components of specific markets and jurisdictions and adapted by IOSCO members as appropriate.

1 – <u>Proactive monitoring of investor behaviour and offerings targeting vulnerable investors</u>

Authorities should continue to proactively and continuously monitor retail investor behaviour and consider conduct implications, particularly during market stress and volatility to detect signals of emerging conduct threats. Among other things, such signals may include:

i. Increased trading/investing activity of vulnerable retail investor population, such as retirees and new and young investors;
ii. Higher participation of retail investors in trading, including of riskier, complex and leveraged products such as binary options, CFDs, rolling spot FX, commodity ETFs, including increased trading in foreign products and through foreign trading platforms;
iii. Increased offerings of unlicensed financial services and products, including on a cross-border basis; and
v. Increased retail investor participation in short-term and day trading.

In regulatory actions, authorities should consider the diversity of retail investor profiles and consider whether to specifically focus on any particular segment of investors who may be more vulnerable to conduct threats.

Authorities should consider ways to be pro-active against potential misconduct risk during stress times and consider early regulatory intervention and enhanced supervision. Early identification, disruption and deterrence are key, and Authorities should aim to take pre-emptive action around risk identification and mitigation before consumer losses occur and pro-actively address excessive risk taking and behaviour suggestive of firms being tempted to push regulatory boundaries.

2 – <u>Supervisory scrutiny of certain firm behaviour which may "flag" potential misconduct</u>

Authorities should continue to develop frameworks and mechanisms to supervise and monitor firm behaviour and conduct implications, particularly during market stress and high levels of volatility to detect indicators of emerging conduct threats (though these indicators may not by themselves necessarily signal misconduct). Among other things, such signals may include unusual trends or irregular spikes, such as:

i. Increase in firm revenues from foreign trading and from riskier, complex and leveraged products, including crypto assets and change in trends in firm revenues;
ii. Increased mis-selling, mis-labelling, and misleading and false information disclosures, and firm behaviour that seek to exploit retail investor vulnerabilities;
ii. Increased aggressive advertising, on-line marketing and digital offerings that may target vulnerable groups, including use of cold callings, celebrity endorsements and social media platforms;
iv. Increased inaction/delay in executing customer instructions and complaints;
v. Increased problems resulting from operational/cyber/outsourcing issues; and
vi. Increased investor complaints.

Authorities should also be alert to any practices of firms that may involve misconduct targeted at recipients of monetary relief provided by authorities to alleviate the impact of a crisis.

3 – <u>Regulatory communication during stressed times</u>

Authorities should continue to maintain open channels of communication with market participants and other authorities to facilitate a quick assessment of the potential misconduct effects of macro-level problems and deploy coordinated solutions, including on a cross-border basis, during stressed times.

Authorities should continue to communicate potential and actual cases of misconduct as soon as reasonably practicable and effectively to alert retail investors and firms, consistent with jurisdictions' laws, through appropriate channels. Among others, such channels may include specific sections on the regulators' websites for information, use of warnings, campaigns and FAQs. Regulatory communication and messages should be short, clear and in plain language understandable to an average retail investor.

<u>4 – Monitoring of return to normal and taking effective enforcement action</u>

Authorities should

i. Monitor the return to normalcy, including reviewing firms' internal audit functions and governance processes during recovery;
ii. Take effective enforcement action on cases that took place in stressed situations exploiting investor vulnerability and conflicts of interest in stressed conditions;
iii. Consider actions for disgorgement and compensation of investors, where possible, so that it sends a strong signal to market participants.

5 – <u>Leveraging on experience from periods of stress (such as COVID 19) to enhance regulatory requirements and approaches:</u>

Authorities should consider retail market conduct implications during market stress and adapt their supervisory actions and regulatory requirements, as needed. Among other things, authorities may consider the following:

i. Targeted investor education initiatives taking into account the experience of the stress period to help ensure that investors understand the nature of investments (for example the difference between investing in oil as a commodity and investing in oil futures or purchasing stock in an oil company);
ii. Reviewing retail market conduct measures to take into account changing market conditions during stress time, as well as longer changes in firm and investor behaviour prompted or accelerated by the stresses (e.g., digitalisation). Examining how regulatory requirements, such as suitability and disclosure requirements, designed for "peace time" function during "crises times" and consider whether any changes or temporary adjustments are needed to address the specific circumstances during stress times;
iii. Increasing investment in SupTech and automated technologies to detect trends and potential retail investor harm and to perform regulatory obligations under remote working conditions via e-supervision and e-inspections to address some of the supervisory challenges;
iv. Ensuring firms review their clients' risk tolerance levels during times of heightened stress and volatility and adjust these if necessary and inform the client about possible scenarios with regard to the risk-return relationship during market stress; and
v. Since remote working may be the "new normal" for many regulated firms, examining its implications for the current rulebook and requirements, such as BCPs, cyber security and recording requirements.

6 – Cross-border cooperation and regulatory coordination

Authorities should continue to use supervisory and enforcement information tools to enhance cross-border cooperation and coordination to effectively deter and address misconduct. Among others, such tools include:

i. Use of IOSCO Information Repository;
ii. Supervisory information sharing in stressed times, especially about retail investor participation in foreign offerings in complex products;[33] and
iii. Continued use of IOSCO MMoU/EMMoU for enforcement related cooperation.

7 – Addressing conduct vulnerabilities and risks emerging from remote working and social distancing requirements

Authorities should address the specific risks and challenges stemming from remote working and physical distancing requirements, such as cyber, operational, business continuity and outsourcing risks, as well as disruptions to internal control functions, complaints handling and order recording. Similarly, authorities may consider deferring, developing alternative methods or reviewing priorities for "non-critical" or less critical regulatory activities, such as on-site supervisions and other activities that may not be time critical.

[33] Information sharing through FUG, IOSCO Regional Committees, Committee 8, supervisory colleges or supervisory directors' meetings are good examples of how this can work in practice.