

Market Watch 65

Newsletter on market conduct and transaction reporting issues

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Contents

Confidentiality of information requirements	P1
Legally privileged documentation	P3
Transaction reporting	P4

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You can also find issues on our website at: www.fca.org.uk/firms/markets/market-abuse

Introduction

In this Market Watch we discuss how inappropriate handling of information requirements issued by the FCA can hinder, or even compromise, our preliminary reviews of, and investigations into, suspected market abuse.

We also remind market participants that material that could be subject to legal professional privilege should not be included in suspicious transaction and order reports or market observations submitted to the FCA and, if it is, participants run the risk that any claimed legal privilege may be regarded as waived or lost.

Finally, we share some observations on transaction reporting, following previous Market Watch newsletters on this topic.

Confidentiality of FCA information requirements

As part of our investigative and preliminary review work, we send multiple information requirements to authorised firms and issuers under sections 122B, 165(1) and 173 of the Financial Services and Markets Act 2000 ('FSMA'). The information we typically require includes:

- insider lists
- corporate action chronologies
- copies of communications
- know your client information

This information is essential to enable us to piece together the circumstances surrounding instances of suspected suspicious trading or inappropriate access to, and communication of, inside information.

We state clearly in our requests that they should be kept strictly confidential, and should not be discussed with staff outside Compliance without our prior agreement. In some circumstances, it may be necessary for Compliance to work with other departments to collate the information requested. If you believe you need to take further investigative steps and engage with other parts of your organisation, please discuss this with us first to avoid prejudicing our inquiries or investigations.

After discussions, on a case-by-case basis, we aim to take a proportionate approach in our recommendations to the firm regarding the next steps they should take. However, our primary focus is on avoiding the inappropriate dissemination of knowledge of our enquiries. This includes the risk of tipping off or the risk of inappropriate destruction of evidence.

Example

Below we set out an anonymised example of an employee of an advisory firm, who was a subject in a criminal insider dealing case, being tipped off as a result of the inappropriate handling of a FSMA s.173 request.

Our request was for records of staff access to inside information for a takeover for which the advisory firm was acting as an advisor.

Despite the confidentiality requirement being clearly set out in the request, Compliance, without consulting us, contacted the Deal Team to help collate the information. Compliance analysis identified unauthorised and repeated access to files containing inside information by an individual not on the Deal Team and with no business need to know inside information about that deal. This was then communicated to the Deal Team. Without reference to us or internal legal advice, the manager of the Deal Team questioned the individual who had accessed the information. The individual then resigned and left the country, severely hindering our ability to investigate.

Why this matters

You should be aware that if you do not follow the confidentiality requirements of our requests you run the risk of regulatory scrutiny or action, and the reputational damage that this may cause. You should also be aware that if you inadvertently facilitate tipping off to the fact of our investigation you may also hinder our shared objective of enhancing market integrity.

What you should do

You should ensure that you follow the requirements set out in our requests.

When, having gained our consent, Compliance departments do contact staff in another department for help in responding to our requests, they should ensure that those staff are carefully selected, and then informed:

- that they are required to not contact other staff without informing Compliance, who should then seek our approval
- having gained our consent, that the information is required to fulfil an FCA information requirement

- of the possible consequences of the confidentiality of the information requirement not being maintained

Extracts of relevant FSMA provisions

- s.177(1) – *If a person other than the investigator (“the defaulter”) fails to comply with a requirement imposed on him under this Part the person imposing the requirement may certify that fact in writing to the court.*
- s.177(3)(b) – *A person who knows or suspects that an investigation is being or is likely to be conducted under this Part is guilty of an offence if—(b) he causes or permits the falsification, concealment, destruction or disposal of such a document.*
- s.173(4) – *The investigator may also otherwise require A to give him all assistance in connection with the investigation which A is reasonably able to give.*
- S.122F(1) – *If a person (“A”) fails to comply with a requirement imposed on A under section 122Bthe FCA may certify that fact in writing to the court.*
- S.122F(2) – *If the court is satisfied that A failed without reasonable excuse to comply with the requirement, it may deal with A (and where A is a body corporate, any director or other officer) as if A (or as the case may be the director or officer) were in contempt.*

Firms should understand that the provisions above include complying with the confidentiality requirements set out in our information requirements.

Legally privileged documentation

We have recently seen material relating to firms’ clients that could be subject to legal professional privilege (‘LPP’) being submitted as an attachment to a suspicious transaction report (STOR)/ market observation.

Very broadly, LPP is the common law principle by which communications made for the purposes of litigation or legal advice may be withheld from disclosure. Section 413 FSMA 2000 also prevents us from requiring the production, disclosure or permit the inspection of certain privileged documents which are described as ‘Protected items’.

There are 2 categories of LPP:

- **Litigation Privilege:**

This applies to confidential communications between lawyers and their clients, or the lawyer or client and a third party, which come into existence for the dominant purpose of being used in connection with actual or pending litigation.

- **Legal Advice Privilege:**

This applies to confidential communications between lawyers and their clients made for the purpose of seeking or giving legal advice.

Any material that could be subject to LPP, whether on behalf of a client or the firm itself, should not be submitted alongside a STOR/market observation. In such a case, the material may become disclosable by the FCA in the event of enforcement action being taken.

Additionally, direct text extracts or quotes from any such material should not be included within the body of the STOR/market observation to avoid the risk of any LPP being regarded as waived or lost. However, where relevant to the narrative of the notification, the presence of such material should be disclosed to the FCA.

If you're uncertain whether a document is subject to LPP, you should consider seeking independent legal advice. If your firm is subject to information requirements made under section 165 of FSMA, you should not include any material that has the potential to be subject to LPP as part of your response. For further details, refer to the guidance attached to our section 165 information requirements.

STORs remain an essential tool in our work to identify potential market abuse and maintain the integrity of the UK's financial markets. You should not regard the existence of LPP as an impediment to the continued submission of good quality STORs. Nor should you consider it as grounds not to submit a STOR.

Transaction reporting

Transaction reports remain a fundamental part of our work to prevent, detect and investigate market abuse. Our close supervisory oversight of the transaction reporting regime has led us to identify data quality issues in addition to those highlighted in Market Watch [59](#) and [62](#). Some of these are set out below. We expect firms to take note of these observations and review their transaction reports to verify their completeness and accuracy.

Unreported transactions

As set out in Article 26(2) of MiFIR, the obligation to report transactions applies to:

- a) financial instruments admitted to trading or traded on a trading venue or for which a request for admission to trading has been made
- b) financial instruments where the underlying is a financial instrument traded on a trading venue
- c) financial instruments where the underlying is an index or a basket composed of financial instruments traded on a trading venue

This obligation applies irrespective of whether the transaction was executed on a trading venue.

Some firms have misinterpreted these requirements and failed to submit transaction reports for transactions executed in non-EEA listed indices or baskets composed of one or more financial instruments admitted to trading on an EEA trading venue. We expect firms to have arrangements in place to determine when an instrument is in scope for transaction reporting.

We have also identified investment firms executing transactions in reportable financial instruments while not having the infrastructure in place to submit transaction reports no later than the close of the following working day. Such breaches should be notified to the FCA promptly using the [errors and omissions notification form](#). In line with our broader expectations for the use of this form, we do not expect firms to delay submission of the notification until the issue has been remediated and back reporting completed.

Where a data reporting services provider has indicated that it will stop providing a data reporting service, affected firms should make necessary arrangements to continue meeting their transaction reporting obligations.

The immediate underlying

For transactions executed in derivatives and other financial instruments with an underlying, the underlying instrument code (RTS 22 Field 47) should be reported with the ISIN of the immediate underlying instrument. We have observed transaction reports where the 'ultimate' underlying instrument has been identified and erroneously used to determine whether the financial instrument is in scope for transaction reporting.

For example, where a transaction is executed in a CFD on an equity option, the option contract should be reported as the underlying instrument, and used as the basis for determining scope for transaction reporting. As set out in Section 5.32 of the Guidelines on transaction reporting, order record keeping and clock synchronisation under MiFID II, the underlying equity should not be used to make this determination. Other relevant fields – such as the Price (Field 33) and Price Multiplier (Field 46) – should be reported with consideration to the option contract.

Trading venue transaction identification codes

Trading venue transaction identification codes (TVTICs) are generated by trading venues and disseminated to the buying and selling parties for transactions executed on a trading venue. Investment firms are required to report this code in transaction reports (Field 3) for the market side of a transaction executed directly on a trading venue.

We have identified inconsistent dissemination of TVTICs by trading venues to investment firms. We recommend that trading venues review their procedures for the generation and distribution of TVTICs to ensure they facilitate the consistent reporting of a unique code to be used by both the buying and selling parties.

We have also encountered investment firms failing to report the TVTIC accurately. This includes instances where the field has been left blank, reported with an internal code, or reported with a code that fails to follow any guidelines provided by the respective trading venue. Investment firms should review their processes for reporting to ensure these are accurate.

Country of branch fields

The country of branch for the buyer (Field 8) and seller (Field 17) should only be populated where the buyer or seller was a client of the firm. In that scenario, the respective field should be reported with the country code of the branch that received the order from the client (or made an investment decision for the client in accordance with a discretionary mandate given to it by the client).

We have noticed firms reporting a country code in these fields where the buyer or seller was not a client of the firm, or using this field to highlight the geographic location or nationality of the buyer or seller. These are not permitted by RTS 22.

Systems and controls

We previously reminded firms they should not assume a transaction report was accurate because it was accepted by the FCA. This is because our validation rules are not intended to identify all potential errors and omissions. We are reiterating this message as some firms continue to use transaction report acceptance rate as a standard for assessing the completeness and accuracy of their transaction reports.

We are encouraged by the number of data extract requests being made by firms for the purposes of reconciling their transaction reports with front office records. We remind investment firms not doing so that this is a requirement in Article 15(3) of RTS 22. See our website for further [information on our data extract facility](#).

Investment firms should also consider whether their understanding of transaction reporting requirements is sufficient to identify errors where front office reconciliations may not highlight the issue. This includes common misreporting scenarios such as the trading time being reported in BST and the price being expressed in the minor currency unit.

Back reporting remains a critical aspect of the transaction reporting regime. We expect firms to take steps to ensure that all transaction reports affected by an error or omission have been identified and corrected. As set out in Section 5.18 of the ESMA Guidelines, the same transaction reference number should be used for a corrected transaction report.

There is more [information about transaction reporting](#) on our website. You can also contact the Markets Reporting Team at mrt@fca.org.uk.