

# Market Watch 63

Newsletter on market conduct and transaction reporting issues

May 2020

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in the context of coronavirus

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## Introduction

In this Market Watch, we set out our expectations of market conduct in the context of increased capital raising events and alternative working arrangements due to coronavirus.

Alongside this Market Watch, we have also published a [Primary Market Bulletin 28](#) which provides an update for listed companies on an extension to the timetable for publication of half-yearly financial reports.

## Market conduct and discipline in the context of coronavirus

### Key messages

The FCA has been working with partners nationally and internationally to keep markets open and orderly, help firms continue to operate, protect consumers and small businesses, and to maintain high standards of conduct.

We recognise the uncertainty created by the coronavirus crisis and operational challenges arising from the public policy on social distancing. However, we expect all market participants, including issuers, advisors and anyone handling inside information to continue to act in a manner that supports the integrity and orderly functioning of financial markets. This includes complying with all their obligations under relevant regulation including the Market Abuse Regulation (MAR).

In response to the crisis, we anticipate many issuers will need to seek additional capital, leading to an increase in primary

market activity. This, coupled with alternative working arrangements, will make it as important as ever that the right controls around market abuse, conduct, and managing conflicts of interest are in place.

During this period, we encourage a particular focus on:

- ensuring inside information continues to be appropriately identified and handled by all persons involved in the information chain so that it is not misused for insider dealing or for commercial advantage
- ensuring inside information is appropriately disclosed by issuers so that investors are not misled
- maintaining robust market surveillance and suspicious transaction and order reporting (STORs) by relevant market participants, in the context of changes in market conditions and the current use of alternative working arrangements
- meeting the transparency and short position covering requirements under the Short Selling Regulation (SSR) for market participants to support the effective functioning of the market
- identifying and managing conflicts of interest by market participants that may arise around capital raising events

We will continue to use our range of powers to monitor, make enquiries, investigate, and if necessary take enforcement action to protect the integrity and orderly functioning of the market.

### Background

The FCA has an operational objective to protect and enhance the integrity of financial markets, alongside our strategic objective to ensure markets work well for consumers. The core function of capital markets is to allow companies and other issuers to access capital from investors as efficiently as possible. Confidence that the market is clean, orderly, and transparent is critical for them to be able to raise the funds they require from investors.

Coronavirus has had a significant effect on the businesses of issuers globally, resulting in them needing to raise substantial amounts of debt and equity. This alone potentially gives rise to increased amounts of inside information, which needs to be appropriately controlled.

In the context of the pandemic, the nature of the information that is material to a business's prospects may have altered, and what now constitutes inside information should be carefully assessed. In addition, working from home arrangements may raise new, additional risks around identifying and handling inside information.

Together this makes it important that firms have the right controls to ensure inside information is not mishandled or misused. Such misconduct could undermine investors' confidence and willingness to support companies raising new capital. It could also expose issuers to significant reputational risk.

Market participants should continue to assess whether the procedures, systems, and controls they have put in place to comply with their obligations under MAR for identifying and handling information remain adequate to mitigate any new risks. This includes the impact of new working arrangements. Issuers should also assess their arrangements for meeting their disclosure obligations under MAR.

We call on the market to continue to exercise good judgement and behaviours during recapitalisations that occur in the coming weeks and months, and act in a manner which maintains market integrity.

### **MAR inside information obligations**

The circumstances created by coronavirus will create new challenges and considerations for market participants managing risks around identifying, handling, and disclosing inside information. More issuers preparing and coming to the market to recapitalise or raise other funds will increase the interactions and flows of inside information, as permitted, between issuers, advisors, and other market participants.

Market participants moving to alternative sites or working from home arrangements may also create new challenges around how any existing systems and controls that they have put in place are now applied for handling inside information. Such controls need to continue to effectively protect against the unlawful disclosure of inside information in working from home arrangements in the same manner as in an office environment. Market participants may, for example, consider reviewing the availability or the application of controls for restricting access to inside information on secure IT systems and how staff access to inside information can be remotely supervised.

Market participants should assess the market abuse risks that may arise in their business including in the context of new working conditions. They should consider whether any systems and controls they have put in place continue to mitigate effectively the identified risks. Common industry controls such as a mandatory 2-week holiday for front office staff may be appropriate (and may also support the mitigation of other non-market abuse risks). Repeating or updating training to refresh staff on how they should be handling inside information may also be a sensible consideration for some market participants.

### ***Issuers and advisors***

We remind issuers that it is important to maintain adequate procedures, systems and controls to comply with their disclosure obligations under MAR. Our views on this are set out in [Market Watch 58](#).

Issuers should continue to assess carefully what information constitutes inside information as coronavirus and public policy responses to it may alter the nature of information that is material to a business's prospects, and that is material in the context of its recapitalisation.

Issuers should carefully judge what information a reasonable investor would now be likely to use as part of their investment decisions in the context of coronavirus. For example, information that could have a significant effect on a companies' share price could include (but is not limited to):

- Detail on future financial performance, such as access to finance and funding. This includes through government schemes, significant changes in cash flow patterns, force majeure or termination rights in material contracts or financial arrangements, and changes to dividends or buy-back schemes.
- Their ability to continue or resume business, such as changes in strategy or business plans, business resumption plans, arrangements for staff returning to work, and supply chains.

Issuers should also carefully monitor whether any new information is materially different from previous forecasts, guidance, or signals which they have announced publicly and which would now be likely to be misleading to investors. For example, missing previous forecast earnings, revenue, or related KPIs. If so, issuers should then consider in this context whether the new information is inside information and whether they are obliged to disclose such information to the public as soon as possible.

### ***Insider lists***

In order to handle and control inside information, issuers should continue to meet their obligations to ensure that all staff who have access to inside information are included on insider lists. Issuers remain responsible for insider list obligations under MAR where they delegate maintaining the insider list to a third party. [ESMA's MAR Q&A questions 10.1/10.2](#) state that persons, such as advisors, acting on the behalf or account of issuers are also required to maintain and be responsible for their own insider list.

Given the different risks that arise from working from home, issuers may want to re-affirm that persons on insider lists continue to be aware of when they have access to inside information and their legal and regulatory duties in relation to insider dealing and the unlawful disclosure of that information. We noted in [Market Watch 58](#) that issuers often use additional lists, including confidential / project / prohibited dealing lists, to record individuals who may have access to confidential information that has not been deemed inside information. Such lists can be an important tool at this time for identifying, monitoring, and assessing new sources of potential inside information.

### ***Disclosure of inside information***

Subject to the provisions on delayed disclosure referred to below, issuers should comply with their MAR obligation to disclose inside information that directly concerns them as soon as possible. Where financial reporting deadlines have been extended, meeting this obligation will ensure markets remain informed and are not misled. Issuers should be careful to verify that announcements are complete and accurate and contain no false or misleading information.

Where judgement is used and we have questions on the decisions reached, issuers who maintain contemporaneous and complete records of decisions and actions regarding the disclosure of inside information will find it easier to reconstruct and justify their approach.

### ***Delayed disclosure***

Issuers should only delay the disclosure of inside information when **all** the conditions under MAR Article 17(4) (or where applicable Article 17(5)) are met. [ESMA's guidelines on delay in the disclosure of inside information](#) give examples of circumstances when the disclosure of inside information may prejudice the issuer's legitimate interests and situations in which delay of disclosure is likely to mislead the public under Article 17(4).

If the issuer has made previous statements or given signals that have created market expectations, it would be likely to mislead the public if the disclosure the issuer intends to delay is materially different from those statements or in contrast to such expectations. Issuers must also be able to ensure the confidentiality of inside information when delaying disclosure. This could include considering their arrangements for how it is securely accessed, stored, and communicated.

Given market uncertainties and changed working arrangements, issuers need to be extra vigilant about the possibility of leaks and rumours, and identify whether there has been a breach of confidentiality. Companies should prepare holding announcements to be used if there is an actual or likely breach. They should also disclose inside information as soon as possible when the conditions for delay are no longer met (see DTR [2.6/2.7](#) & [Technical Note 520.2](#) for further guidance on dealing with leaks and rumours).

### ***All market participants – including issuers, advisory, firms and natural persons***

#### ***Natural persons handling inside information***

The prohibitions on unlawful disclosure and insider dealing apply to natural persons in the situations set out in MAR Article 8(4). In particular, the prohibitions will apply to anyone who knows or ought to know that the information they possess is inside information. Furthermore, it is important to note that information may become inside information when combined with other information held by that person.

#### ***Disclosure on a selective basis***

Any persons handling inside information should ensure that it is only disclosed where disclosure is necessary in the normal exercise of employment, a profession, or duties. Inside information cannot be selectively disclosed to any person simply because they owe a duty of confidentiality. For example, it must be necessary for issuers and advisors to disclose inside information to staff even where the member of staff is on an insider list. The reason for a person being included on an insider list and having access to inside

information should be recorded for each person on the insider list. DTR [2.5.7 G](#) provides guidance on possible categories of recipient to whom inside information might be lawfully disclosed.

Confirming to the recipient that the information amounts to inside information and the restrictions around handling this information will reduce the risk of subsequent unlawful disclosures and misuse of the information.

As set out in [Market Watch 60](#), firms should continue to assess whether the procedures, systems, and controls that they put in place to comply with their obligations under MAR mitigate the risk of unlawful disclosure and insider dealing. Such considerations would include continuing to restrict access to inside information to those who need it for the proper fulfilment of their role and reviewing, controlling and monitoring who has access to inside information.

### ***Market soundings***

"Wall-crossings" play an important role in facilitating capital raising transactions. However, the inside information which is disclosed and received should be strictly controlled to prevent the risk of unlawful disclosure and insider dealing.

The MAR market soundings regime provides a framework for controlling inside information when market participants undertake wall-crossings. The intent of the regime, provided it is correctly followed, is to protect against allegations of unlawful disclosure.

Disclosing market participants should maintain appropriate records of their interactions, for example, through recorded lines or written minutes. Receiving participants should assess whether the disclosure includes inside information and be aware of their obligations around being prohibited from trading on that information and keeping it confidential. Receiving participants should be aware that soundings are for issuers to gauge their interest in and views on the terms of a possible transaction. This information should only be internally communicated where necessary to those persons that are fulfilling the specific duty to provide an opinion to the issuer. In [Market Watch 58](#) and [Market Watch 51](#), we recognised the benefit of a gatekeeper model, as a contact point for soundings, controlling the receipt and internal dissemination of soundings.

### ***Personal account dealing***

In [Market Watch 62](#) we shared our concerns about personal account dealing (PAD) – where employees of an authorised firm trade for themselves rather than for clients. Given the potentially heightened risks of personal dealing for staff working from home, firms should consider and ensure that they have appropriate controls around PAD in accordance with [COB 11.7](#) and [11.7A](#), including assessing how they manage conflicts of interest and the risk of market abuse.

## Short selling

As [previously stated](#) on 17 March 2020, we consider that short selling can contribute usefully to liquidity and price discovery, and therefore support open, effective markets that operate with integrity.

However, it is important that market participants ensure that they continue to meet their obligations under the SSR. This gives appropriate transparency to short selling activity and supports the orderly functioning of the market.

## Restrictions on uncovered short sales in shares

SSR restricts uncovered short sales in shares to prevent 'naked' short selling, which could harm market integrity and disrupt settlement. To meet their obligations under SSR, investors must ensure that they only enter into a short sale of a share where they have:

- Borrowed the share.
- Entered into an agreement to borrow the share, or
- Have an arrangement with a third party who confirms that the share has been located. The arrangement should enable settlement of the short sale to be effected when it is due. Third parties need to take measures in order to give this confirmation, such as allocating the shares for borrowing or purchase or referring to an easy to borrow list where the conditions set out in [ESMA's Short Selling Q&A](#) are satisfied.

Agreements or arrangements which do not work in practice are unlikely to satisfy the requirements in the SSR.

Investors may wish to recheck that they have appropriate arrangements in place as well as the necessary evidence to show that they have complied with these obligations.

## Net short position reporting

SSR also requires investors who hold significant net short positions to provide certain notifications. Investors need to notify us when they hold a net short position that equals or exceeds 0.1% of the issued share capital of the company and each time the position increases or reduces by 0.1%. This follows ESMA's [decision](#) temporarily to reduce the minimum threshold. Net short positions of 0.5% or over of the issued share capital of a company are publicly disclosed by the FCA on a daily basis on our [website](#).

These notifications ensure transparency, providing information to other market participants about short selling activity in shares and enabling us to monitor such activity.

### **Short selling monitoring, restrictions and enforcement powers**

We will continue to monitor short selling activity as part of our market monitoring. Where appropriate, we will ask firms about the nature, purpose, and construction of the net positions that they have reported to us. Where we have concerns that there are significant opportunities for abusive behaviour, our monitoring will increase in intensity accordingly.

We have a range of powers in relation to investors failing to meet their obligations under the SSR including the power to require the provision of specified information, investigate, censure, or impose fines. For any abusive trading contravening MAR, we could prohibit a person from managing or dealing and impose penalties. The penalties may include imprisonment where the investor has committed the criminal offence of insider dealing under the Criminal Justice Act 1993 or an offence under Part 7 of the Financial Services Act 2012. If we have concerns that abusive trading is occurring, we will use our enforcement powers to take action. We could also use our short selling powers to restrict or prohibit short selling activity for specific shares or other financial instruments, which we will consider if we have evidence suggesting it is necessary.

### **Managing conflicts when providing corporate finance facilities**

We have heard reports of a small number of banks failing to treat their corporate clients fairly when negotiating new or existing debt facilities. As stated in our [Dear CEO Letter on 28 April 2020](#), we have heard that some banks may have used their lending relationship to exert pressure on corporate clients to secure roles on equity mandates that the issuer would not otherwise appoint them to. We will take action if we find that banks are in breach of our rules or Principles.

Firms should compete on the merits of their services and terms rather than imposing undue pressure on issuers or restricting their choice.

### **Market conduct during credit events**

Recapitalisation exercises involve many forms of valuable and legitimate engagement between issuers and their creditors, including those which also hold positions in credit default swaps (CDS).

In [June](#) and [September](#) 2019 statements, the FCA, alongside the Chairs of the SEC and CFTC, set out our shared concerns regarding "opportunistic strategies" and their adverse impact on the integrity, confidence and reputation of markets. The FCA expects market participants to comply with their obligations under MAR in this area and will continue to monitor and enforce against any breaches identified.

Issuers may wish to consider how creditors' motivations may be influenced by other financial instruments they hold and how such motivations could affect them, and seek advice about whether there are ways to protect their interests.

### Market surveillance

In previous Market Watches ([56](#) & [58](#)), we highlighted the importance of relevant firms undertaking risk assessments to identify the market abuse risks that they could be exposed to and what controls are necessary to mitigate them. Reviewing and updating risk assessments in response to coronavirus could enable firms to modify their surveillance systems to ensure they remain adequately and appropriately calibrated to detect any new or heightened market abuse risks that they have recognised.

Risks could include the unlawful disclosure, and subsequent misuse of, inside information concerning recapitalisations, as well as types of manipulative behaviour which might be disruptive to those companies recapitalising and the price formation process. Firms' surveillance systems should already be calibrated to identify these risks, but firms should consider whether to review and update risk assessments and surveillance tools to incorporate other new and emerging risks. [ESMA's MAR Q&A 6.1](#) clarifies that MAR market surveillance requirements apply broadly to persons professionally arranging and executing transactions which includes asset managers, alternative asset managers and proprietary traders.

We are aware that increased market volumes and volatility have caused a surge in the number of surveillance alerts in a number of markets. We understand that firms are handling this challenge in different ways. Firms should ensure that their approach is tailored to the risks they are exposed to and does not diminish the appropriateness and effectiveness of their surveillance. This may include subsequent thematic analysis, or a retrospective review focusing on areas that are either higher risk or may have been masked due to the volumes of alerts.

### FCA market monitoring

During this period, we will be monitoring both primary market and associated secondary market activities to identify behaviours which may impact the integrity and orderly functioning of the market. We will use our full range of tools to do so, including transaction reporting, order book reporting, inside information disclosures, price movement monitoring, and reporting on net short positions.

We will continue using our powers to request information and make enquiries where we identify behaviour which is potentially abusive or in danger of creating a disorderly market. We may ask market participants to provide further information on their activities to explain how they are meeting their regulatory obligations. Where necessary, we will use our enforcement powers to take action against those breaching our rules.