

Market Watch

Markets Division: Newsletter on Market Conduct and Transaction Reporting Issues

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Summary

During the last three years we conducted two pieces of work concerning leaks:

1. During 2008 to 2010 we conducted a number of intensive enquiries into potential disclosures of inside information to the media ahead of certain announcements. We conducted these leak enquiries with the aim of identifying suspicious contact between insiders to a corporate transaction, and the media. This work also included discussions with regulated firms¹ about their policies governing such contact.
2. We continued our thematic work assessing regulated firms' systems and controls on handling leaks.

This article sets out the background and presents our key findings on both work streams. We also give a list of best practice recommendations regarding contact with the media, as we believe improvement is necessary. We appreciate that several recommendations we have made could result in significant changes to current media handling practices at regulated firms. However, we believe that these changes, particularly those concerning restricting/recording contact between non-media-relations personnel and the media, could substantially benefit most firms. For example, these controls could help exonerate the firm and their staff early on in any leak enquiries conducted by their clients, regulators or the firm itself.

Leaks ahead of announcements threaten market integrity. Strategic leaks² — designed to be advantageous to a party to a transaction — are particularly damaging to market confidence and do not serve shareholders' or investors' wider interests. It is therefore in all interests to ensure that senior management of all organisations who handle inside information³ establish (and are seen to establish) a much stricter culture that firmly and actively discourages leaks.

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- 1 Reference to 'regulated firms' in this article means authorised firms, who are made insiders by virtue of the services that they provide directly or indirectly to issuers. It includes authorised firms acting in an advisory capacity, underwriting or investing capacity, or otherwise.
 - 2 We refer to strategic leaks as those deliberate leaks of inside information sanctioned by the senior management of an issuer or its advisers with the
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Background

This work fits into our overall anti-market abuse strategy, where we aim to create a credible deterrence to those who might commit market abuse.

It is extremely important that regulated/unregulated firms and issuers who handle inside information have strong systems and controls to ensure confidentiality, and prevent the risk that inside information they hold is improperly disclosed contrary to our market abuse regime. It is equally important that senior management at regulated/unregulated firms and issuers establish (and are seen to establish) a robust anti-leaking culture within their organisations.

We are particularly concerned about the suspected practice of core insiders strategically leaking inside information; we have stated we will increase our efforts into the causes of leaks in individual cases.⁶ While it is difficult to measure the frequency of these leaks, we believe a significant number of leaks may be strategic. In relation to our takeover market cleanliness statistics published annually, reducing the frequency of leaks is likely to have an impact. To the extent that individuals trade on the leaked information, reducing the frequency of leaks should make takeover announcements less likely to display abnormal pre-announcement price movements on which the statistics are based.¹

Despite our focus on how firms could tighten their controls, the frequency of leaks do not appear to have reduced, and we are concerned that senior management at regulated/unregulated firms and issuers may not be doing enough to set a suitable anti-leaking culture.

Insiders who leak confidential or inside information may be committing civil market abuse under the Financial Services and Markets Act 2000 ('FSMA') and/or criminal insider dealing under section 52 of the Criminal Justice Act 1993. Leaks can be damaging as they can:

- be used to facilitate insider trading;
 - impair the flow of inside information to the market in an orderly and fair manner, thereby increasing market volatility;
 - prevent companies from legitimately delaying disclosure that can detriment the wider interests of shareholders and investors; and
 - result in abnormal price movements ahead of the announcement of transactions, which damages market confidence.
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exemptions were generally not documented but the core insiders we interviewed as part of our enquiries relied on these;

- when an exemption in regulated firms' media policies applied, it was often unclear as to its extent, to whom it applied, and in what circumstances staff could directly converse with the media;

¹ However, we are not able to determine exactly by how much leak prevention reduces the market cleanliness statistics. Factors other than insider trading

- regulated firm's staff did not receive sufficient training on relevant areas of market abuse (e.g. inside information and misusing information); and
- policies were unclear on how to handle a potential leak or how regulated firm's staff should escalate it.

Our 2008-2010 enquiries into leaks to the media

As part of actively monitoring the market, we identified several articles in the media that contained specific and precise information about corporate transactions before they were formally announced by issuers. These articles were published in newspapers, and in online and TV media and included information specific to the transaction, such as its size, main terms, proposed announcement date, and the reasons for undertaking it.

As a result we initiated a number of leak enquiries, the purpose of which was to:

- (a) determine whether there were circumstances suggesting that an insider improperly disclosed inside information or information not generally available, to the press before an announcement of a corporate transaction, breaching sections 118(3) or (4) of FSMA; and
- (b) understand the nature and purpose of the communications between issuers, their advisers and the media; and what controls regulated/unregulated firms have in place in relation to such contact.

To determine the nature and extent of any leaks, we obtained the insiders lists and the timetable of events relevant to each transaction. We also conducted formal interviews with insiders we believed had been in contact with the media.

Our findings

Our enquiries revealed that media reports containing leaks were often closely preceded by telephone conversations between insiders occupying senior roles on a corporate transaction, and the journalists who published those media reports. Due to their position as insiders, these senior individuals held detailed knowledge of the transaction. The calls between the insiders and journalists lasted up to 20 minutes in length and in some cases took place with journalists the afternoon or evening before the leak was first published. Such suspicious communication between the insiders occupying senior roles and journalists is a cause for concern, especially in the context of the level of leaks that occur in our markets. While we acknowledge that some of the insiders we identified as speaking to journalists may have been asked to confirm details the journalist already held, insiders who confirm information put to them by a journalist still potentially commit market abuse as they are in effect disclosing inside information through affirmation (even though the information was sourced first elsewhere).

As a result, we believe regulated/unregulated firms and issuers can improve controls and we believe it is essential that senior management establish a robust anti-leaking culture in their organisations.

We were also concerned about the apparent deficiencies in regulated firms' media and compliance policies. Our review of regulated firms' controls revealed several concerns about handling inside information in the context of media enquiries. In particular we found:

- inconsistency in the handling of media enquiries amongst insiders at issuers and firms acting as advisers to the transaction, and uncertainty as to who was ultimately responsible;
- that when insiders corresponded with a journalist there was no requirement at regulated firms to advise either media relations personnel or compliance/legal personnel;
- a lack of harmonisation between regulated firms' media policies and compliance policies about inside information and price sensitive information;
- regulated firms usually have unwritten informal exemptions to their general policy, permitting staff members to respond to the media without the media relations team's authorisation. These unwritten exemptions effectively gave a blanket permission to senior staff to speak to the media. These

Thematic review into leak policies

In Market Watch No.21 we reported the outcome of our major review of controls over inside information relating to public takeovers. In Market Watch No.27, we reported on how regulated firms had strengthened their controls and we introduced principles of good practice on how to handle inside information by unregulated firms.

In Market Watch No.21 we identified how few firms had a formal policy that sets out the circumstances in which they would consider undertaking an internal leak enquiry where they were involved as a core insider to a corporate transaction and a leak had occurred. In response to this, several firms began to draft policies.

To assess the progress regulated firms had made, and to consider whether it would be useful to publish any further good practice points, we have further reviewed policies in place at major regulated firms that conduct corporate finance activities.

Our findings

We believe all regulated firms we saw could at least evidence they had been working on the issues we previously raised, and most had a draft or final policy document.

There was a broad range of policies in place:

- Several regulated firms replicated the outline suggestions we set out in Market Watch 27 without additional thought to adjusting policies to their own businesses, (e.g. considering any additional triggers that might be relevant). We would encourage them to ensure their own policy fully reflects their own particular circumstances.
- A small number had developed more detailed procedures in addition to those we had highlighted and clearly thought how a leak enquiry policy could add value to their existing controls.
- Only a few regulated firms gave examples of leak enquiries they had actually undertaken using their policies. Conducting enquiries after an apparent leak of information may identify the cause of the leak, provide useful future intelligence and give insights to improving controls. It also issues a strong message to staff that leaks are unacceptable and a firm's policies will be rigorously enforced (acting as a useful deterrent to staff who might contemplate improper disclosure).
- Some regulated firms directly communicated to staff that leaks of any kind were expressly forbidden (even if a leak was strategically thought to be in the best interests of a transaction) and action by these firms would follow. It was positive to see that many regulated firms were trying to foster a stronger reporting culture and had established policies for staff to raise concerns about leaks outside normal business reporting lines — these were in addition to strong whistle-blowing procedures.

Issuers should be careful how they deal with enquiries in respect of market rumours. There is no regulatory obligation to deny false rumours, and we have previously publicised our position on this. But should a company choose to make a denial, it should use the correct channel (i.e. an announcement via an RIS), which ensures the whole market is informed. There is also further commentary on this. ¹⁰

Issuers, whose instruments are admitted to trading on prescribed markets which are not regulated markets (such as AIM), are also advised to have appropriate arrangements in place to help ensure their employees do not improperly disclose inside information contrary to the market abuse regime.

Although our reviews have mainly highlighted issues at regulated firms, issuers should consider applying those recommendations or good practice points that are specifically highlighted to apply to issuers. They may also wish to consider the other recommendations or good practice points we also highlight for regulated firms, and apply them as they feel is appropriate to meet their obligations.

However, we expect that in most cases where an enquiry is potentially related to inside information, enquiries will solely be handled by the regulated firm's media relations team with standard protocol responses. It is unlikely to be necessary to involve non-media-relations personnel.

5. Internal policies for both regulated firms and issuers should make clear that if, during discussions with the media, there is concern that inside information may already have been leaked (e.g. the journalist already appears to have inside information) these concerns should be escalated immediately to compliance at the firm and to the relevant issuer, so consideration can then be given as to whether an immediate announcement is required by the issuer under the relevant disclosure rules. In the case of a takeover deal, consideration would need to be given as to whether a Rule 2 announcement under the Takeover Code is also required.¹²

Handling leaks

6. Regulated firms should have robust and detailed policies for handling leaks. In Market Watch 27, we detailed the factors to be considered when developing a leak enquiry policy.
7. Internal policies for regulated firms should state they will conduct their own leak reviews where there appears to have been a clear leak of inside or price-sensitive information. Regulated firms should not wait for contact from an issuer, the Takeover Panel or the FSA before considering whether an enquiry is appropriate. Instead they should inform the Takeover Panel (in the case of a transaction to which the City Code on Takeovers and Mergers ('City Code') applies), and our Market Conduct team when they are launching one and give the reasons why.
8. If there has been a clear leak, regulated firms and issuers should agree on who will take the lead role in the enquiry. We encourage issuers to take the lead and request all regulated/unregulated firms who are working for them, and who received inside information before the leak, to undertake a leak enquiry. Issuers could then robustly monitor progress and seek regular updates from those regulated/unregulated firms involved in the leak enquiry. We have seen this approach taken by at least one issuer with positive results. Issuer-led leak enquiries are likely to be effective at preventing future leaks due to the commercial pressure issuers can bring to bear on their advisers and other contracted third parties.
9. As well as contact from an issuer, the Takeover Panel or the FSA, regulated firms should consider the following factors to decide if they should initiate a leak review:
 - media articles or other published documents containing accurate non-public information;
 - contact by journalists which may indicate a potential leak;
 - market rumours heard by the firm indicating a potential leak;
 - large unexplained movements in the price or increased volumes of the issue(s securities (or the offeror or offeree's securities in a takeover);
 - rule 2 announcements prompted because the offeree company was subject to accurate rumour, speculation, reporting or a movement in its share price; and
 - if firms or the issuer in receipt of inside information, would gain a strategic benefit from leaking.

review the transaction chronology and insider lists to determine if any information was circulating in close proximity to the leak; collect and review relevant records to identify suspicious contact with people not on the insiders list; conduct formal compliance/legal-led interviews with relevant staff; and identify and target specific weaknesses, such as:

- o breaching Chinese Walls;
- o insiders who have recently joined or left the organisation;
- o insiders under disciplinary proceedings;
- o insiders that have raised a grievance against their employer;
- o insiders under undue workload pressures;
- o insiders who are normally responsible for or are known to speak with the media;
- o recently added insiders;

- o insiders who failed to comply with other internal procedures (e.g. controlling access to document or data storage areas);
- o whistle-blowing reports;
- o suspicious PA or proprietary dealing patterns.

15. Regulated firms should conclude their leak enquiry with a report outlining their findings. If the potential source of the leak is not discovered, enquiry records should nevertheless be retained for audit and intelligence purposes - we may request these in the future. If a potential source of the leak is discovered, the firm should immediately contact our Market Conduct team and the Takeover Panel (in transactions to which the City Code applies).

16. Findings should also be communicated to:

- senior management at the relevant regulated firms and issuers;
- internal audit, group risk or another oversight function at regulated firms and issuers; and senior management at unregulated firms where weaknesses in their controls have been found.

17. Where enquiries identify weaknesses in information or handling leaks, these should be fed into an immediate strengthening of controls. Weaknesses could be in the following areas:

- insider lists;

- files systems access (e.g. were deal files or files containing other inside information segregated? was access to such files restricted?);

- access to inside information by support staff (e.g. did the control room see files? was viewing recorded or monitored?);
- records of contact between insiders and journalists;

- third-party relationships and confidentiality agreements (e.g. were agreements in place? were they explained?);

Introduction to recommendations

Before we set out our recommendations for regulated/unregulated firms and issuers, we have highlighted the context in how the recommendations should be understood. The list of recommendations then follows in the section below.

Regulated firms

As highlighted in our 2008-2010 leak enquiries, we found that the contact between regulated firms and the media was generally poorly controlled. We understand that media liaison is an important element of corporate communications. However, it is imperative that regulated firms improve their systems and controls to ensure that contact with the media is appropriately handled to prevent market abuse from occurring (while also maintaining a channel for media liaison).

While the findings from our thematic review into leak policies was generally more positive, firms can continue to make further improvements.

Regulated firms are reminded that under our system and controls requirements (SYSC), they must establish, implement and maintain policies and procedures sufficient to ensure they comply with regulatory obligations and they counter the risk that their firm might be used to further financial crime.⁸ As part of these obligations, regulated firms should have effective systems and controls in place regarding the management of inside information, including media relations, to counter the risk their employees could (inadvertently or otherwise) improperly disclose inside information to non-insiders.

We hope regulated firms will compare their policies against the recommendations and good practice points and consider improvements or amendments to their policies. Regulated firms should also regularly review their policies and procedures in this area.

Unregulated firms

In Market Watch 21 and 27, we shared good practice points with unregulated firms, as those involved in our capital markets generally share a desire to help eliminate the misuse of inside information. Unregulated firms often occupy key roles for issuers and will receive and/or pass on inside information. These roles can include acting as a PR, legal or accountancy adviser, conducting printing work or acting as a potential investor.

Unregulated firms who hold inside information may wish to consider the recommendations or good practice points that we have made for regulated firms and issuers below, and apply them as they feel appropriate. This will benefit them by ensuring they and their staff do not deliberately or inadvertently commit market abuse, potentially causing them significant reputational damage.

Issuers

Issuers, whose instruments are admitted to trading on a regulated market, are subject to requirements on control of inside information under our Disclosure & Transparency Rules (DTRs).⁹ We recognise that such issuers operate under separate, but related regulatory regimes concerning inside information. The UKLA monitors the market and adheres to the DTRs in real time and, where appropriate, will engage with issuers and their advisers as to whether a Regulatory Information Service (RIS) announcement is required. The UKLA may also initiate enquiries to decide whether inside information was announced in a timely manner.

Recommendations

For the avoidance of doubt:

The recommendations in this section are directed at situations where a regulated/unregulated firm or issuer is handling inside information (whether this inside information relates to a corporate transaction, a trading update, regular financial information or otherwise).

When regulated firms are also issuers, the recommendations we have made for regulated firms and issuers are both relevant.

This list should not be treated as exhaustive and should be read in conjunction with the recommendations made in Market Watch 21 and 27. If there is any inconsistency, the best practice recommendations in this article should prevail.

Media policies

1. Regulated firms should have a robust and detailed media policy. Media policies and procedures should also be aligned with policies concerning confidential and inside information.
2. Internal policies should require all initial media enquiries received by a regulated firm's staff to be immediately directed to the firm's media relations team.¹¹ All non-media-relations personnel at regulated firms should be prohibited from directly responding to any initial enquiry from the media, regardless of seniority.
3. Internal policies should also require that once an initial media enquiry has been passed to a regulated firm's media relations team, the media relations personnel should review the enquiry to decide if it potentially relates to inside information. In determining this, the team should err on the side of caution if the enquiry's nature is unclear. If the enquiry does not potentially relate to inside information, paragraphs 4 and 5 are not relevant.
4. If the enquiry potentially relates to inside information, internal policies should state that the media relations team then needs to determine if it is necessary to involve non-media-relations personnel (e.g. insiders on a corporate transaction). If it is necessary to involve non-media relations personnel, the media relations team must only grant authorisation to other staff members to communicate with the media on the following basis:

Verbal communication:

- a. where a member of the media relations team is leading on or is present at any conversation between the other staff member and journalist, and a contemporaneous record of the conversation is noted by media relations personnel; or
- b. where the conversation between the other staff member and the journalist is held on a recorded telephone line.

Written communication: if media relations personnel are copied into all written correspondence between the other staff member and the journalist, including emails.

¹¹ In some smaller regulated firms, a media relations team may not exist or if it does, it may not have the required skills and expertise to appreciate the sensitivity of the issues we have raised in this article. In such firms, and other firms which believe it appropriate, the compliance/legal function can be

10. Regulated firms should conduct an initial scoping exercise to direct the focus of a review which they should discuss with the Takeover Panel (in the case of a transaction to which the City Code applies) and our Market Conduct team. We accept that any enquiries may need to be risk-based and proportionate, but costs should not feature as a primary reason for not conducting a Leak enquiry. In conducting the scoping exercise, the following information should be gathered without delay:

a chronology of events; a prime date range for the leak; ● trading data; media articles; ● evidence of suspicious behaviour; and identification of parties or individuals most likely to benefit from a leak.

11. The scoping exercise should also identify:

if a special investigation department should be consulted/set up;

- whether any suspensions of staff may be needed to protect from further leaks; whether to bring in independent external reviewers (e.g. law firms); and
- whether technical support is required (e.g IT or information services).

12. When bringing in independent external reviewers, regulated firms should liaise with our Market Conduct team at the outset about any proposed use of confidentiality or legal restrictions that prevent sharing enquiry details and findings with us. This does not mean regulated firms are obliged to share the content of legally privileged reports they are given or advice they receive, and firms must decide whether they should provide us with this material. However, a firm's willingness to volunteer its own investigation's results - whether protected by privilege or otherwise - is something we may take into account when deciding what enforcement action to take (if any). Further information on our approach to regulated firms conducting their own investigations in anticipation of our enforcement action is set out in the Enforcement Guide 3.17-3.31,¹³

13. Regulated firms should categorise the type of leaks they may encounter and tailor their Leak enquiry policies to distinguish between the different types of leaks (e.g. leaks to facilitate insider dealing, strategic leaks, accidental leaks). This identifies different approaches for different types of leaks, so resources can be efficiently directed.

14. When conducting the leak enquiry, regulated firms should:

- establish a list of information to be reviewed and task staff with delivery by certain dates (note: we have compiled a detailed list of information sources and can discuss this directly with the regulated firms and issuers conducting leak enquiries);
- establish a Leak enquiry committee, comprised of people from different teams (e.g. compliance, legal, HR, audit non-executive directors (in the case of issuers), and deal teams); ● check the reliability of insider lists and other transaction records;

scripts and non-disclosure agreements for wall-crossing third-parties; and media policies.

Training staff

18. Relevant staff at regulated firms should receive regular and structured training on their media and leakhandling policies, as well as training on the relevant aspects of the market abuse regime. All staff, including senior staff, should understand that leaking information is unacceptable (including leaks of a strategic nature) and that disciplinary action - as well as any action by the FSA - will follow if individuals have breached internal policies and/or improperly disclosed information.

Regularly communicating with staff

19. Senior management at regulated firms should regularly communicate with all staff directly to reinforce the prohibition against leaking to anyone (including the media). This message could be stressed in relation to strategic leaking. Staff should also be reminded that robust disciplinary action will be taken for breaching internal policies and/or improper disclosure, as well as being referred to the FSA for investigation for potential criminal or civil market abuse, or other regulatory breaches. These regular messages will help ensure senior management at regulated firms establish (and are seen to establish) an anti-leaking culture.
20. Such messages could be reiterated to individuals at the same time as they are made insiders by senior management or compliance/legal personnel.
21. Regular reminders by senior management and compliance/legal personnel can be issued via department briefings, emails and desk drops.

Establishing a strong reporting culture

22. As a stronger reporting culture is essential in ensuring staff feel confident in raising concerns about leaks, regulated firms' policies should establish a separate reporting line so staff can raise concerns outside their normal reporting lines (as well as whistle-blowing controls). This should be to senior staff such as senior compliance/legal personnel or a non-executive director.
23. Any concerns about leaks should be described and retained in a log regardless of whether the concerns warranted further investigation. This log would provide useful future intelligence for regulated firms and us, while also maintaining an important audit trail for compliance purposes.
24. Firms should also monitor for an absence of reporting, as this may prompt a review of whether they have adequate controls.

Disciplinary action

25. As noted above in paragraph 18, all staff must be clear that leaks will not be tolerated and that disciplinary action will follow for breaching internal policies, in addition to any appropriate FSA action. While it is not appropriate to set out the types of disciplinary action a regulated firm should take if a breach of internal policies has been discovered, we urge senior management to adopt a robust stance that seeks to create a culture at their firm that firmly and actively discourages leaks.

We will continue to actively monitor for leaks of inside information and conduct enquiries into these with the aim of identifying contact between the media and individuals at regulated/unregulated firms¹ or issuers,² and to take appropriate action. Furthermore, if no improvement is noticed in the levels of leaking in our markets, we may consider rule changes. We will also take action where we deem unacceptable practices have occurred and/or the relevant existing systems and controls requirements applying to regulated firms and issuers have been breached.

Conclusion

Leaks ahead of announcements pose a threat to market integrity. Even strategic leaks, which might be considered advantageous to a party to a transaction or to their advisers, particularly damage market confidence and do not serve shareholders' and investors' interests. It is therefore in all interests to ensure that senior management of all organisations who handle inside information, establish (and are seen to establish) a much stricter culture that firmly and actively discourages leaks.

We will follow up the points set out in this article with regulated firms to ensure they have given due consideration to the points raised and have taken steps to review their controls accordingly. We appreciate that several recommendations we have made could result in significant changes to the current media-handling practices at regulated firms. However, we believe these changes, particularly those concerning restricting/recording contact between non-media-relations personnel and the media will substantially benefit these firms. For example, these controls could help exonerate the firm and their staff early on in any leak enquiries conducted by their clients, regulators or the firm itself.

We will continue to actively monitor suspected leaks of inside information and conduct enquiries. If no improvement is noticed to the levels of leaking, we may consider rule changes to strengthen the obligations of firms in this area, (e.g. consulting on turning some of the detailed recommendations regarding media handling into Rules and Guidance). We will also take action where we deem unacceptable practices have occurred and/or there have been breaches of relevant existing systems and controls requirements applying to regulated firms or issuers.

Contact details

This newsletter is produced regularly by the Market Conduct and Transaction Monitoring teams in our Markets Division. If you would like to receive this newsletter by email, or have any comments on it, please

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² Reference to 'issuers' in this article means those issuers with instruments admitted to trading on a regulated or prescribed market. 6