

# FCA Thematic Review of Confidential and Inside Information Flows

March 7, 2016

Financial Services and Regulation

---

In December 2015, the United Kingdom's Financial Conduct Authority (FCA) published the results of its Thematic Review on flows of confidential and inside information in small and medium enterprises (SMEs) in the investment banking sector. The report unearthed some serious conduct and conflict of interest failings which the FCA states are likely to result in heightened risk for market participants as well as UK regulatory and legal breaches. Whilst this review targeted mostly SMEs, its relevance and findings are of key importance for all UK-based and FCA-regulated firms. The FCA advises all such firms to consider if their own arrangements meet the standards outlined in the review. Further, its Business Plan for 2015/16 makes it clear that conflicts of interest and conduct failings remain high on the FCA's agenda. What are you doing to comply?

## The Thematic Review

---

As promised in its 2014/15 Business Plan, during 2015 the FCA conducted a thematic review of confidential and inside information flows within a sample of 16 mostly SME-sized investment banks in connection with their debt capital markets and mergers and acquisitions teams. The FCA requested the policies and procedures relating to confidential and inside information for each of the firms it visited, and also went onsite to review a sample of deals in which they had acted for clients. The FCA also reviewed how senior management disseminated messages through each organisation, the level of management oversight, what employees understood of key concepts and the role of the compliance function - all in the context of controlling confidential and inside information. During the process, the FCA explained that it met with CEOs, senior management, relevant business unit heads, junior staff and compliance staff. On December 10, 2015, the FCA published its report of the thematic review (TR15/13).

In particular, this found that firms were able to recognise the main risks associated with flows of confidential or inside information, but that management of these risks required more attention. TR15/13:

- recommends that firms should do more work to assess higher risk business strategies and the knock-on impact that these may have for the risk of misuse of confidential and inside information;
- emphasises that all three of the so-called "lines of defence" have roles to play with regard to the control of confidential and inside information. Senior management have ultimate responsibility for control of this information, but the FCA found that many senior managers did not know the difference between the two types of information; and
- highlights certain types of systems and controls the FCA had reviewed, including manual surveillance mechanisms, inadequate physical separation of specific

## Financial Services and Regulation

individuals, unfocused and untailored training for staff on information flows, as well as policies and procedures that were not user-friendly.

What is particularly interesting about TR15/13, however, is that whilst the review was carried out at a comparatively small sample of firms, the FCA believes that the findings in the report are important for all FCA-regulated firms to understand. Its subject matter also links in with and cross-refers to a number of different current FCA and Europe-wide regulatory initiatives. It all serves to reiterate that robust systems and controls in relation to flows of information are absolutely crucial to business in this sector. The FCA has not declared that it will be taking specific follow-up action as a result of TR15/13, but it is likely that once the new Market Abuse Regulation applies from July 2016, it will use TR15/13 as a benchmark and a means to review how firms are complying with its requirements in this area.

### FCA Key Messages

---

The FCA highlighted four key messages in the review results for all FCA-regulated firms arising from its findings:

- Employees at all levels should understand their role in controlling flows of confidential and inside information and make it an integral part of how they carry out their work;
- While firms and or senior management had identified and considered the main risks that flows of confidential and inside information posed to clients, firms themselves and the financial markets, they were not doing enough to manage the risks;
- The FCA expects to see business heads acting in a supervisory capacity taking responsibility for controlling flows of information, with appropriate challenge and monitoring from the second and third lines of defence; and
- Firms should place assessment of circumstances that could present heightened regulatory and conduct risks at the centre of their on-going risk assessment. Such circumstances could also give rise to misuse of confidential and inside information.

In addition, the FCA reminds firms that they have a duty to keep themselves updated with regard to their external environment, and to remain up-to-date with any changes in conduct risks they face which may arise due to external factors. The FCA offers some specific examples of this, including keeping apprised of new regulatory measures and changes to market practice which are often prompted by market-wide reviews such as The Fair and Effective Markets Review (FEMR) currently being conducted by HM Treasury.

### Link to On-going FCA Work on Conflicts of Interest and Culture

---

TR15/13 also ties in with a statement the FCA made in its Business Plan for 2015/16 regarding its belief that conflicts of interest lie at the root of many conduct risks, particularly in the wholesale marketplace. Indeed, the review makes the explicit link between inappropriate sharing of information and potential for conflicts of interest by spelling out the damaging conflicts which might arise in an industry where firms often provide a range of different services to different firms in the same sector. Information relating to competitors would be useful to all teams working for the different clients however it is obtained.

## Financial Services and Regulation

The FCA also highlights that a positive culture within firms is crucial to compliance in this area, since where employees take responsibility for their conduct and escalate concerns appropriately, risks relating to misuse and sharing of confidential and inside information may be greatly reduced. Also, senior management needs to take a hand in actively promoting this positive culture. Thus, it is crucial that they understand the difference between inside information and confidential information and be aware of the consequences and risks of handling inside information inappropriately.

## An Increasing Regulatory Burden

---

The FCA's reminder in TR15/13 about keeping up-to-date with regulatory matters is also particularly pertinent given the raft of new European initiatives being applied across the European Economic Area (EEA) over the next few years, such as the Market Abuse Regulation (as mentioned above), the recast Markets in Financial Instruments Directive and Regulation and the Central Securities Depositories Regulation, to name a few. These new frameworks are already changing the landscape of financial services regulation, not just in Europe, but across the globe due to their extra-territorial reach and requirements for incoming non-European firms (some of which apply to firms that have no actual presence in the EEA).

All FCA-regulated firms, therefore, have been warned - if it were not clear enough already - that conduct risk, conflicts of interest and the flow and management of confidential and inside information remain very much a priority for the FCA in 2016. Complying with these requirements and maintaining a steady focus on them at a time when some of the key pillars of the European financial services framework are being remoulded is essential.

If you have any questions concerning the material discussed in this client alert, please contact the following member of our Financial Services and Regulation practice group:

Charlotte Hill

+44 20 7067 2190

[chill@cov.com](mailto:chill@cov.com)

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to [unsubscribe@cov.com](mailto:unsubscribe@cov.com) if you do not wish to receive future emails or electronic alerts.