Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Pandemic Sparks Worries Of Market Abuse Crackdown

By **Richard Crump**

Law360, London (August 5, 2020, 12:56 AM BST) -- With traders working remotely and an explosion of market-moving information percolating as public companies take major steps to deal with COVID-19, attorneys warn that financial firms need to ramp up compliance to avoid becoming a target of financial watchdogs for market abuse.

The FCA in June launched criminal action against three former employees of IT services company Redcentric for making misleading financial reports, and two weeks later fined the former boss of a failed spread-betting company £659,000 for engaging in market abuse before it was floated on the stock exchange.

That marks a jump from the £400,00 penalty the watchdog issued in 2018 to a broker that failed to monitor trades for possible market abuse, showing the FCA is taking a tougher stance on firms that fail to prevent misconduct, according to Anthony Dearing, a barrister at Radcliffe Chambers.

"You can see the level of fines increasing. And with COVID-19 it is likely to increase again for those firms that haven't put in place sufficiently robust controls to deal with the environment created by the pandemic," Dearing said. "I don't think there will be much leeway for firms."

Market abuse risks for financial services firms have increased because of the turmoil in financial markets caused by COVID-19 and the measures taken in response to it. And the FCA has emphasized that regulatory requirements for market abuse have not been relaxed during the pandemic.

All market participants — including issuers, advisers and anyone handling inside information — that fail to comply with obligations under the U.K.'s Market Abuse Regulation to act in a way that supports the integrity of financial markets will likely face enforcement action by the FCA.

Covington LLP partner John Ahern said tackling market abuse appears to be "very close to the heart" of Mark Steward, the FCA's head of enforcement and market oversight, who reiterated in May that the FCA is continuing to monitor and investigate firms' conduct in real time during the pandemic.

For instance, the number of alerts over suspected market manipulation and abuse logged by the FCA increased to 822 from 813 in 2019, according to data published in April by law firm RPC LLP.

"The FCA has been very hot on this for some time. If you look at recent enforcement, the FCA is carrying through on its threat to go in heavy on individuals who flout the rules," Ahern said. "I get the feeling this is not an issue the FCA is prepared to waive. I expect Steward's words do come with some force."

COVID-19 has created an environment where more inside information is generated regarding firms' financial outlooks. And with so many employees working remotely, monitoring compliance has become more difficult, increasing the chances misconduct will occur.

Traditional controls imposed in the office environment may not operate as effectively or be impossible to enforce, such as rules that prevent traders using personal mobile phones to ensure conversations are recorded, explained Dechert LLP's Matthew Banham.

Banham said firms should consider restricting access to inside information to those who need it to fulfill their role and ensure that all staff who have access to inside information are included on insider lists to meet their MAR obligations.

"The out-of-sight mentality has created a situation where those who wish to take advantage may believe they have a great opportunity to get away with leaking or using inside information," Banham said. "Firms need to make sure in this fast-moving environment that all their insider lists are up to date."

The FCA has also raised concerns about personal account dealing — where employees of an authorized firm trade for themselves rather than for clients — and market soundings, where information is communicated before the announcement of a transaction to gauge potential investor interest.

At the same time, greater activity in the capital markets from issuers raising funds in response to the pandemic will lead to increased interactions and flows of inside information between issuers, advisers and other market participants.

Ahern said "wall-crossing protections are really important in capital markets transactions" where a company can provide inside information legitimately to a third party, such as the company's investors, but is restricted from dealing or acting on it.

"When it comes to those dealing with inside information, the FCA is going to take a hard look at any breaches," Ahern said. "The FCA has indicated what its enforcement powers are through this period and won't hesitate to ramp up on the enforcement side."

Steward has said market participants will be expected to maintain robust market surveillance and suspicious transaction reporting. And coupled with the billions of transaction reports received by the FCA under European Union's investment rulebook, known as MiFID II, the FCA can examine what is happening in markets in close to real time.

Firms should review and update their risk assessments and surveillance systems in response to COVID-19, to ensure that they detect any new and heightened market abuse risks, such as the unlawful disclosure and misuse of inside information concerning recapitalizations, as well as manipulative behavior, according to Banham.

"The FCA has more information now as a result of MiFID II and has the potential to mine better data and find better evidence in relation to market abuse," Banham said.

The FCA has told companies listed on the London Stock Exchange not to unreasonably delay making updates to the market on their performance so that investors are not misled after listed companies have been allowed an extra two months to publish their audited annual financial reports.

The likelihood of many issuers needing to refinance has also cast a different light on information that is material to a business' prospects but was not previously deemed to be "inside" information — precise, nonpublic information that would be likely to have a significant effect on price if made public.

"Issuers may change their dividend policy as consequence of financial hardship, and there may be structural, strategic internal issues that now have extra resonance as consequence of COVID-19 and may go beyond confidential information to inside information," said Ahern.

The FCA will expect to be disclosed information on how measures taken in response to COVID-19 could impact financial performance or existing business contracts and that are relied on by investors, according to Dearing.

This might include access to finance and funding through the government-backed coronavirus lending schemes and force majeure or termination rights in material contracts or financial arrangements hit by COVID-19.

"Inside information is going to evolve during COVID-19, particularly for issuers that have availed themselves of government loans where material contracts are affected as a result of COVID-19," Dearing said. "These issues will require disclosure by issuers as well as their cash flow position and the impact of COVID-19 on their balance sheets."

Banham said he expects to see the FCA to look back next year at whether firms took the right approach and adopted controls to limit the risk of market abuse.

"We will see some action 2021 in relation to certain companies that failed to take notice of how they should handle information during the COVID-19 lockdown," Banham said. "The immediate panic is over. But it is only after the tide goes out that you see what is left behind."

--Editing by Rebecca Flanagan.