If you're not on the list...

The UK's Financial Conduct Authority (FCA) published its first 'market cleanliness' metric in 2008, revealing 30% of takeovers had seen abnormal price movements two days prior to announcement. By 2019, this figure stood at 10%.

The FCA's new 'fairer' abnormal trading volume ratio is 6.4% for 2019. It puts this drop down to enhanced detection methods, increased high-profile enforcement and its work to ensure that market participants "behave properly in preventing abuse, protecting inside information from leakage and misuse, and reporting suspicious activity". The obligation for insider lists has been key to the FCA's enforcement strategy. It has helped enhance the care taken when handling inside information.

Selina Sagayam explores the issues involved in preparing and maintaining insider lists and how to ensure compliance and maintain UK securities market integrity – just remember the four Ps...

PURPOSE OF INSIDER LISTS

The primary benefit of insider lists is to support regulators in their investigation into market abuse and insider dealing, and in their enforcement of them. The lists aid and prompt identification of insiders and help rapidly establish any connections between insiders and people involved in suspicious trading at critical times when non-public price-sensitive information is in circulation. Lists must be complete, and confidentiality and integrity of this information must be maintained.

The lists also help issuers manage the flows and confidentiality of inside information, and mitigate the risk of leaks of commercially sensitive business knowledge. The mere existence of lists could deter market abuse. Accurate identification of when and what specific inside information is in circulation, who has had access to it, and effective systems and controls to limit access to a need-to-know basis are all crucial. Lists must be made available to regulators at short notice.

PRINCIPAL OBLIGATIONS

The Market Abuse Regulation 596/2014 (MAR) replaced the Market Abuse Directive in 2016. It requires issuers or any person acting on their behalf to draw up a list of all people who have access to inside information. The European Securities and Markets Authority (ESMA) has stated that advisers engaged to act on a matter that generates confidential information have an obligation to draw up, update and provide an insider list to the relevant regulator. Where an issuer delegates these activities to a third party, it retains responsibility for compliance with MAR.

Legal and financial advisers and consultants, experts, investor relations and PR advisers, brokers and credit ratings agencies may all be found on insider lists. That is likely to expand with more types of advice being sought on transactions.

PROBLEMS IN PRACTICE

While the purpose and objective of insider lists is straightforward and uncontroversial, the objectives have not been met in many cases. Indeed, the usefulness of such lists has come under European Commission scrutiny.

In October 2019, ESMA reviewed the operation of MAR and flagged the disproportionate burden of maintaining lists for some issuers. It also pointed to inaccurate inflation

in the number of people included, resulting in excessive "false positives", inefficiencies in time-critical market abuse investigations and diluting the effectiveness of insider lists.

Earlier last year, the FCA revealed frequent fundamental flaws, including omission of names, individuals not on lists accessing inside information and lists including individuals without access to inside information.

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PRACTICAL CONSIDERATIONS

In light of these problems, what are the questions advisers should ask when discharging their own direct obligation to maintain insider lists?

Understanding obligations

- Do all people on the insider list (UK and overseas) understand and acknowledge their legal and regulatory duties? Do they know the sanctions for misuse or improper circulation of inside information?
- Do all members of staff have regular training on applicable rules and regulations?
- Is training made practical, relevant and understandable, for instance with case studies, examples of inadvertent breaches or dissemination of seemingly innocuous information that comprises confidentiality?

Culture of compliance and care

- How does your firm generate a culture of compliance and care to identify those who really need to know, to limit the people who are brought over the wall or, for those over the wall, to limit the extent of the inside information shared with them? What other specific transaction information (if any) do they need to know?
- How does your firm generate a culture of information security?
- Do deal teams and relevant staff have an understanding of the relevant controls, systems and protocols in the organisation to limit and adhere to access rights (and limitations) to inside information?
- Is training and/or reminders provided on a regular basis or at the commencement of each relevant transaction? How is this recorded?
- Are communications (even internal) generally delivered in a secure fashion, for example using code names at all times?
- How do you ensure that all documents and communications relating to the matter are created and disseminated in a secure way?

Information security

- What IT systems do you have in place to preserve information security, for example, anonymised or code-named folders with restricted permission rights?
- Who is given access or permission rights to these folders and why? Is the person responsible able to justify why access has been given to each relevant individual?
- What other security controls are in place (use of code names and encryption)? And what are the protocols for use of these additional measures?
- How are electronic files containing deal-specific inside information stored? Who has access to them?
- Is access to secure folders and documents monitored or reviewed, for example viewing or opening, editing, printing and deleting? By whom? How regularly? How is this recorded?

Responsibility

- Who has ultimate and day-to-day responsibility for creating and maintaining the list? If it is a junior member of the deal team, who has oversight?
- Who is the named person at your firm for handling queries or requests from the issuer and/or regulator?

Data quality control and timeliness

- Are there any permanent insiders? If so, why? This is typically difficult to justify (particularly for advisers).
- Are the entries for each person on the list compliant with ESMA and FCA expectations? In particular, have the specific pieces of inside information been identified?
- Does each have a tailored/specific list of people who have had access and the date of such access?
- Does the reason for access section provide sufficient detail?
- Is your list updated promptly when a new person is given access to inside information? Or when a person on the list ceases to have access to inside information? Or where there is a change of reason for a person being on the list? ●

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