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UK FINANCIAL CONDUCT AUTHORITY OUTLINES EXPECTATIONS FOR MANAGING ENHANCED MARKET CONDUCT RISKS IN THE CONTEXT OF THE PANDEMIC

To Our Clients and Friends:

On 27 May 2020, the UK Financial Conduct Authority (the "**FCA**") published Market Watch 63 ("**MW63**"). MW63 highlights that market participants (including issuers, their advisers and all other market participants) may be subject to new and emerging market conduct risks as a result of the current increase in primary market activity and working from home arrangements widely mandated as a result of public policy to deal with the COVID-19 pandemic. It then sets out the FCA's expectations on market participants in terms of identifying and mitigating those risks in the current environment.

It is clear that while we have seen some limited regulatory forbearance from the FCA in certain areas in order to alleviate operational burden on market participants and the markets, there is no room for reducing risk appetites or anything other than strict adherence to rules and regulatory expectations in the context of market conduct. The FCA acknowledges the current challenges faced by market participants during the crisis, however the expectation remains that all continue to act in a manner that supports the integrity and orderly functioning of financial markets. As a warning, the FCA also stressed that it will continue to use the tools at its disposal to monitor, investigate and (as necessary) take enforcement action to ensure that requirements relating to market conduct are complied with.

This bulletin outlines the messages of MW63 and provides some practical guidance on the steps that market participants might take in order to ensure they meet the FCA's expectations in the current environment.

Considerations for all market participants

The market conditions created by COVID-19 are giving rise to new challenges and considerations for all market participants attempting to manage their risks around identifying, handling and disclosing inside information for the purposes of Regulation 596/2014/EU on market abuse ("**MAR**"). This is a result of several factors, including (i) an increased number of capital raising events leading to greater flows of inside information; and (ii) existing systems and controls to restrict flows of inside information may not address working from home arrangements.

In previous Market Watch newsletters[1], the FCA highlighted the importance of relevant firms undertaking a comprehensive risk assessment to identify the market abuse risks to which they are or may be exposed and the controls necessary to mitigate those risks. Firms are strongly advised to revisit those risk assessments in response to the Coronavirus pandemic and update them to reflect new and emerging risks, and to modify or enhance their systems and controls, including surveillance techniques, to ensure they remain adequate and effective, especially in light of the working from home environment and the heightened risk environment.

The new types of risk which market participants may be exposed to include unlawful disclosure of inside information, as well as manipulative behaviour stemming from short selling activities. The FCA specifically addresses risks arising from short selling activity and makes it clear that the FCA will focus monitoring efforts on short selling activities in the secondary markets as part of its market monitoring. While the FCA does not specifically say so, it is clear when reading between the lines that the FCA is concerned that there is some evidence of abusive behaviour. The FCA will not shy away from bringing appropriate criminal or regulatory action where this is justified.

Some firms are experiencing increased numbers of surveillance alerts as a result of increased market volume and volatility. It is key that firms address this operational challenge by tailoring their response to the risks they are exposed to and ensuring that the response does not diminish the appropriateness and effectiveness of surveillance techniques. Firms may need to consider conducting retrospective reviews concentrating on areas of heightened risk.

Some specific issues raised

Short selling

In terms of compliance by market participants with their obligations under Regulation 236/2012/EU on short selling and certain aspects of credit default swaps ("**SSR**"), the FCA reminds market participants that they must, at all times, comply with:

- the prohibition on "naked" short sales; and
- the net short position reporting requirements.

Where market participants engage in short selling activity, it would be prudent for them to confirm that their cover arrangements remain appropriate and that they have adequate documentary evidence of their compliance with the cover requirements.

Market soundings

The MAR market soundings regime was introduced to provide a framework for controlling inside information when market participants undertake wall-crossings. The intent of the regime is to provide protection from allegations of unlawful disclosure of inside information. However, in order for market participants to have the benefit of this protection, the framework set out under MAR must be correctly followed. It is possible that in the current working from home environment firms may find it harder to adhere to the framework rules. It would be prudent for market participants to review their market sounding procedures to ensure they remain adequate and effective in the current environment. In particular, market participants should consider the following:

- disclosing market participants should ensure that they are maintaining appropriate records of their interactions, for example, through the use of recorded lines or written minutes (and that those written minutes are approved by the receiving market participant);

- receiving market participants should be aware that the purpose of the sounding is for issuers to gauge interest in and views on the proposed transaction. The information relating to the proposed transaction should only be shared internally on a strict need-to-know basis to enable relevant individuals to provide the necessary input to the issuer and for no other purpose; and

- the FCA has previously recognised the benefit of the gatekeeper model[2]; receiving market participants should consider whether their chosen method of receiving soundings remains adequate in the current environment and whether instructions to sell-side market participants need to be updated.

Personal account dealing

Given the FCA's concern around the heightened risks relating to inside information in light of the current market environment, it would be prudent for all firms to revisit their arrangements for personal account dealing to ensure they adequately address the enhanced risks of most staff currently working from home. Market participants should remind their employees of relevant policies and address in particular how the policies apply in the current environment. This is particularly advisable as a result of the concerns expressed by the FCA in its preceding Market Watch newsletter[3] in relation to firms' controls relating to personal account dealing, as it is highly likely that the FCA will conduct further thematic work in this area in the future. To the extent that firms have not reviewed and enhanced their policies and procedures in this area in response to Market Watch 62, now would be an opportune time to do so.

Considerations for issuers

In the context of increased capital raising activities, the FCA has specifically addressed some of the risks faced by issuers. We have set out a summary of the risks and some of the practical steps that issuers should take in order to mitigate those risks in the current environment.

Types of heightened risks	Practical steps to take

· Primary markets activity increases the amount of inside information
· Nature of the information that is material to a business's prospects may have been altered in the context of the pandemic, e.g.:
  · ability to resume business, changes in strategy, return-to-work plans, supply chains;
  · future financial performance, such as access to finance and funding, including
	· Ensure that existing procedures, systems and controls remain adequate to identify items of inside information and enhance them if necessary
	· Consider whether new information is inside information and whether disclosure is required
	· Consider refresher training and compliance bulletins for relevant staff on the appropriate handling of inside information, their duties in

through government schemes, changes to dividends and buy-back schemes · New information may be materially different from previous forecasts, etc. which have previously been publicly announced and may now be misleading to the market, e.g. missing previous forecast earnings, revenue or related KPIs and, if so, announcement of that information is unlikely to be able to be delayed · Working from home may give rise to new risks of unlawful disclosure of inside information · Working from home may give rise to new risks for ensuring confidentiality of inside information when delaying disclosure	relation to insider dealing and unlawful disclosure and risk mitigants in the context of working from home · Consider how inside information is securely accessed, stored and communicated especially where disclosure is being delayed · Where financial reporting deadlines are extended, consider whether any additional information needs to be published in the interim to ensure compliance with MAR · Consult with advisers and keep contemporaneous and complete records of decisions taken regarding the disclosure of inside information · Ensure insider lists are maintained and that inside information is only disclosed on a "need to know" basis in accordance with MAR · Only delay disclosure when all the conditions in MAR are met, and only selectively disclose information where disclosure is necessary in the normal exercise of employment, a profession, or duties and is on a confidential basis · When permitted to delay disclosure, ensure a leak announcement is prepared · Be especially vigilant about the possibility of leaks and rumours Ensure announcements are verified as being complete and accurate and do not contain false or misleading information

[1] Market Watch 56 and Market Watch 58

[2] Market Watch 58 and Market Watch 51

[3] Market Watch 62

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. For additional information, please contact your usual Gibson Dunn contacts or the following authors:

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