

UK Financial Services Authority Market Watch 37 – preventing leaks to the media

Leaks of inside information relating to pending corporate transactions have been on the target list of the UK's Financial Services Authority (FSA) for some time.

The FSA, which has been conducting a series of investigations and enquiries into this area for the past two years, signalled its determination to tackle this issue recently by publishing its views on how leaks to the media should be handled in its Market Watch newsletter.

Market Watch 37 sets out the outcome of the FSA's "intensive enquiries" into particular announcements over the last two years, focusing on the identification of suspicious contact between insiders and the media, as well as the results of a thematic review of firms' systems and controls for handling leaks.

The investigations were prompted by the results of annual market cleanliness studies that were carried out for the FSA. These studies assess the extent of suspicious market movements preceding companies' trading announcements and takeover announcements. Such market movements are seen as an indicator of potential market abuse and insider dealing.

According to these annual studies, more than 20 per cent of takeover announcements continue to be preceded by suspicious market movements, indicating a widespread and persistent culture of dissemination of inside information.

Listed companies have also been subject to the regular leaking of rumours and information about potential bids or rights offers to the media. In many such cases,

companies have had to make announcements before they would otherwise wish to do so.

Although the FSA's focus on this area is clearly prompted by the results of these annual market cleanliness studies, together with its statutory objective of maintaining confidence in the financial system, it is surprising that it currently appears to be alone on the international stage in pursuing this particular area.

The behaviours identified by the FSA, in particular the deliberate "tactical" leaking of information around takeover bids, are unlikely to be confined to the UK. Firms should, therefore, expect that other regulators will follow suit.

Looking at Market Watch 37 itself, the fact that, of a document of almost 12 pages, five pages contain recommendations for improvements to firms' policies in this area indicates that the FSA was not reassured by the findings of its investigations. Moreover, the FSA states in Market Watch 37 that it 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 firms or issuers, 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".

Firms should, therefore, expect significant ongoing interest in this area from the FSA

both as an area of focus on compliance visits and in terms of queries raised when leaks occur. Market Watch gives a clear indication that the FSA sees proper processes for handling leaks to be within the requirements of Principle 3 of the FSA's Principles for Businesses.

The regulatory spotlight will also be turned on issuers and their response to any leaks. We have become aware that the FSA has written to issuers whose securities appear to the regulator to be disproportionately the subject of FSA insider dealing preliminary enquiries or investigations. To the FSA, this is an indicator that the issuer's policies and procedures for preventing sensitive information from being leaked may need to be strengthened.

Under rule DTR 2.5.1R, issuers must establish effective arrangements to deny

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access to inside information to persons other than those who require it for the exercise of their functions within the issuer. Although it would be stretching the ambit of this rule to say that it could be used to require issuers to instigate leak enquiries, the FSA's warning that it may consider rule changes in future, is perhaps aimed at this area as well as potentially requiring the restriction and recording of contacts with the media.

Stopping strategic leaks of inside information

The FSA has identified what it considers to be various flaws in firms' current policies in relation to leaks. It believes that these practices are common in the market. In particular, the FSA is concerned that its investigations into specific leaks have identified a number of instances in which media reports were preceded by lengthy conversations between journalists and insiders who occupied senior roles, and that some firms appear to have unwritten exemptions from their firm's policies in relation to media contacts, permitting senior individuals involved in a transaction to speak freely to the media.

As a result, the FSA has concluded that, in some instances, leaks appear to have been specifically sanctioned either by issuers themselves or by their advisers to gain a perceived tactical advantage in the course of a takeover. The FSA describes such leaks as "strategic leaks". The regulator makes it clear that, in its view, such strategic leaks are at least as objectionable as any other type of leak.

The FSA wishes to put a stop to strategic leaks and believes that it is essential that senior management within firms and issuers establish a robust anti-leaking culture in their organisations.



In relation to systems and controls, the FSA was concerned that there was inconsistency in the handling of media enquiries among insiders at issuers and firms acting as advisers to the transaction. In particular, there was uncertainty as to who was ultimately responsible for contact with the media. Other key points to note from the FSA's recommendations are:

- The need for regulated firms to have a media policy and to ensure that all contacts with journalists involve the media relations team. The media relations team should be responsible for assessing whether media enquiries might appear to relate to inside information. The team should also be responsible for making a record of what is said to the media and escalating any concerns of possible leakage of inside information. This recommendation imposes a significant burden of responsibility on media relations teams, which will not

generally be staffed by approved persons. In addition, as the FSA recognises, many smaller firms will not have a dedicated media relations team and the burden for those firms will fall on their legal and compliance departments.

- The need for regulated firms to have "robust and detailed policies for handling leaks", including the need to conduct internal investigations when leaks have occurred. The FSA suggests that such investigations should be prompted by issuers and be issuer-led, perhaps recognising that commercial pressure from issuers may be a particularly effective trigger for action.
- Detailed suggestions as to what a leak review should comprise, who should be notified of the outcome, including, where appropriate, the Takeover Panel and the FSA, and a description of the processes that

need to employed to act on weaknesses identified by leak reviews.

- The need to communicate with staff frequently about the firm's policies and to remind them that leaks are not permitted.
- Indications that firms should instigate disciplinary action where internal procedures are breached.

Despite being five pages long, the recommendations are not exhaustive and, as with all Market Watch newsletters, do not constitute guidance. The FSA also makes clear that it is not sufficient for a firm simply to copy out FSA recommendations without tailoring them to the firm's particular circumstances.

The FSA is unapologetic that its recommendations may involve substantial changes to firms' existing policies but its black and white approach to these issues glosses over several real difficulties which Market Watch 37 creates for firms.

In addition to the responsibilities which the recommendations place on firms' media relations teams, responsibilities which such teams are not necessarily equipped to discharge, other difficulties include the following:

- Although the FSA seeks to rely on pressure from issuers to conduct leak enquiries, it does not point to the opposite pressure there may be on advisers in the context of a transaction not to be distracted: a leak enquiry in the middle of a complicated and fast-moving transaction could potentially be very disruptive.
- It ignores altogether the role of the media and the pressure which firms can be put under. In particular,

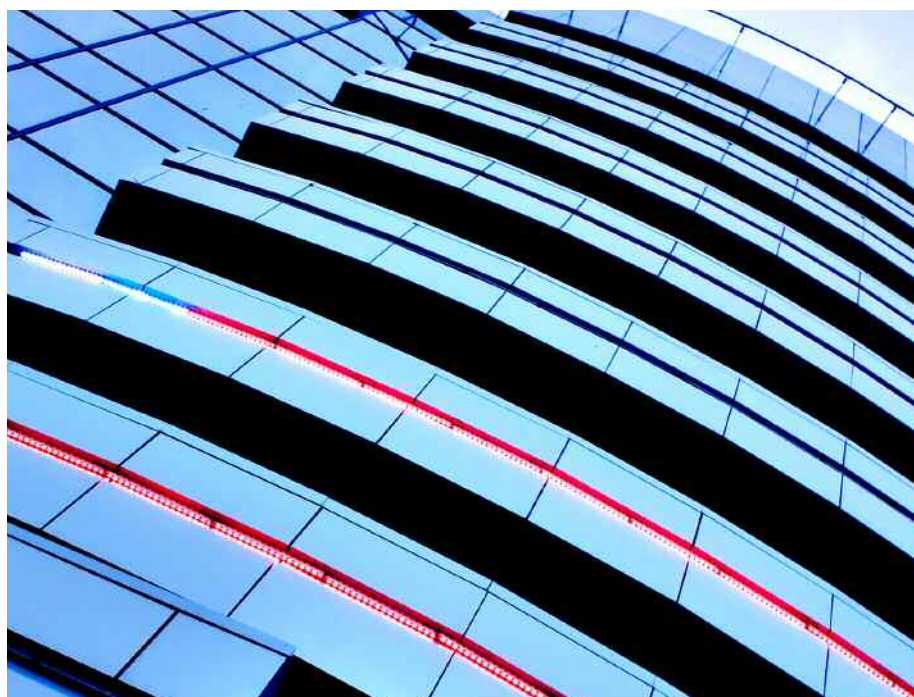
although the FSA is clear that a firm which confirms information already in the possession of a journalist is still transmitting inside information, it gives no consideration to what a firm should do if a journalist calls and cites inaccurate information which he or she proposes to publish. If a firm declines to comment knowing that the information is inaccurate, the market may be misled. If a firm seeks to correct the information, it is potentially subject to censure from the FSA. Guidance in this area would be welcome.

- In this context, it is interesting to see that senior figures from the press have written to the FSA to complain about the potential impact these recommendations will have on financial journalism. Their letter to Hector Sants, chief executive of the FSA, says that it is likely to lead to the publication of "unconfirmed reports and rumours, increasing the flow of

misinformation", and complains about the failure to recognise the impact the recommendations will have on them as well as the failure to consult with them before issuing the recommendations. Hector Sants's response on 17 October was unwavering in its defence of the FSA's position.

What firms and issuers should do

In view of the FSA's clear indication that it regards leak policies as being within the ambit of Principle 3, firms are well-advised to review their policies as a matter of urgency to check that they fulfil the regulator's requirements. Firms are also advised to ensure that relevant staff are made fully aware of those policies and the potential consequences, including possible regulatory and criminal sanctions, which may attach to any breach.



The FSA also expects firms to have in place detailed policies relating to the conduct of leak enquiries.

Issuers are advised to ensure that they have policies in place for dealing with the media and for investigating any leaks which may arise during the course of a transaction.

Some practical steps both firms and issuers could take include the following:

- Consider preparing a pro forma e-mail to everyone involved in a transaction to remind them of their responsibilities with inside information, leaks etc.
- Ensure the firm's insider lists are complete and up-to-date at all times.
- Make sure the media relations team is appropriately briefed on the transaction and what can and cannot be communicated to the media.
- Do not be pressurised into correcting inaccurate rumours and speculation.

- Issuers also need to consider the obligations regarding dealing with rumours, and in particular whether newspaper articles indicate that inside information has leaked, and thus whether an announcement is required.

Leak enquiries

Market Watch 37 sets out in some detail the FSA's expectations as to what a leak enquiry will comprise. In particular, firms should:

- Ascertain the scope of the enquiry and set up a leak investigation committee.
- Check that lists of insiders are up to date and accurate.
- Collect and review relevant documents to ascertain whether relevant information was circulating shortly before the leak.
- Collect and review relevant e-mails and formally interview relevant individuals.

- As a result of the above exercises, identify potential areas of weakness, such as insiders with a particular reason to leak information (eg insiders with a grievance or under work pressure, suspicious personal account dealings).
- Prepare a report detailing their findings which they should be prepared to share with the FSA, senior management and internal audit or risk.
- Follow up in relation to any weaknesses identified by the report where procedures or systems can be tightened up to prevent any repetition.

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