No financial penalty for bond traders found to have engaged in market abuse: implications for the reasonable grounds defence

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An article considering the implications of the Final Notices issued by the FSA to bond traders Darren Morton and Christopher Parry on 7 October 2009 imposing a public censure on them for committing market abuse.

Travers Smith

Speedread

On 7 October 2009, the FSA published Final Notices in respect of two bond traders, Darren Morton and Christopher Parry. The decision of the Regulatory Decisions Committee (RDC) in this case is significant on a number of levels.

Travers Smith acted for Mr Morton in this case. In this article, Toby Robinson, a partner in Travers Smith's Regulatory Investigations Group, considers the RDC's decision and comments on its implications for the "reasonable grounds" defence in section 123(2)(a) of the Financial Services and Markets Act 2000 (FSMA).

First and foremost, it is instructive to note that, whilst he was found to have engaged in market abuse, the RDC declined to impose either a financial penalty or a prohibition order on Mr Morton. This (together with the related Final Notice in respect of Mr Parry) is the first time that an individual found to have engaged in market abuse has not received a financial penalty. This is all the more significant given the FSA's determination to come down hard on those found to have abused the markets with hefty fines and prohibition orders intended to deter others from market misconduct (see the speech given by Margaret Cole, FSA Director of Enforcement, at the recent Fraud Advisory Panel AGM and note also the FSA's recent consultation paper on enforcement financial penalties (CP09/19), in which the FSA states its intention to impose a minimum fine of £100,000 on individuals found to have engaged in market abuse). The decision to issue a public statement demonstrates that the conduct of both Mr Morton and Mr Parry was perceived to be at the very low end of the spectrum in terms of personal culpability.

In deciding that a statement under section 123(3) of FSMA was the appropriate sanction, the FSA took into account all the circumstances of the case, including the fact that Mr Morton genuinely did not believe that he had received inside information or acted in an abusive manner, he had not made any personal profit and he had acted neither deliberately, recklessly nor in breach of guidelines issued by his compliance department. Accordingly, his fitness and propriety as an approved person was not called into question. The FSA also noted that no clear guidance in relation to the operation of the market abuse regime was provided to Mr Morton or the over-the-counter credit markets generally. This latter point is considered in more detail below.

The Final Notice in respect of Mr Morton is only the second publicised market abuse case concerning the credit markets (following the Steven Harrison decision in September 2008). The case against Mr Morton related to his

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conduct in March 2007 following a standard pre-marketing sounding out that he had received from Barclays Capital in which the maker of the call had sought to ascertain Mr Morton's team's appetite for a proposed new bond issue. Such calls are a regular and necessary feature of the credit markets. The RDC referred to guidance that had been issued to the debt markets in March 2009 - some two years after the events in question - by the International Capital Markets Association (ICMA). That guidance, issued somewhat belatedly, related to the practices to be adopted by those intending to conduct advance sounding of third parties (as opposed to those on the receiving end of such calls) in order to gauge appetite for potential new issues of debt instruments, stating that such discussions "may involve disclosure, to such third parties, of non-public price sensitive information". The fact that there had been no previous guidance is perhaps surprising, and the guidance as issued leaves open a number of questions. It is apparent from that guidance that not all information imparted during such pre-marketing calls will necessarily constitute inside information. Whether or not such information does amount to inside information will presumably depend on the nature of the information, although this was not actually spelt out, meaning that a view will have to be taken by the individual in question. The nature of the guidance reflects the lack of clarity surrounding the application of the market abuse regime to the debt markets as opposed to the equity markets.

As the RDC pointed out, there was as at March 2007 no guidance to the debt markets on the potential regulatory issues involved at the pre-marketing stage and therefore the only specific guidance available to Mr Morton was that reflected in interim guidelines from his compliance department, in which is was stated, amongst other things, that: "In the past it has been determined that [Mr Morton's team] is not routinely privy to price sensitive non-public information." So it can be seen that as at March 2007, Mr Morton was operating in an environment whereby the prevailing attitude was that his team was rarely provided with inside information. As noted below, this was accepted by the RDC.

It was against this background that, as well as arguing that the information provided to him was not inside information, Mr Morton sought in the alternative to rely on the defence to market abuse prescribed by section 123(2)(a) of FSMA. That section provides, in summary, that a person who has engaged in market abuse will escape punishment to the extent that he/she believed on reasonable grounds that his/her behaviour did not amount to market abuse. This defence deals with a person's state of mind at the time that that person engaged in the behaviour in question (in contrast to the defence set out in section 123(2)(b) of FSMA, which relates to a person's actions).

Given the RDC's finding that there was no industry guidance at the time and that "Mr Morton was working in an environment where until a deal had closed, the accepted view was that, in the absence of information generally regarded as inside information, that information was not regarded as specific or price sensitive and therefore any activity related to such information could not be abusive", it seems perverse that the RDC rejected his defence on the ground that he nevertheless "had a responsibility to consider whether the information was capable of being inside information, regardless of the market practice and the guidance from his compliance department." Having accepted that Mr Morton's state of mind was that what he was doing was not abusive and that this belief was conditioned by the working environment in which he operated and market practice, it seems illogical that he was nevertheless under an obligation to consider whether the market abuse regime applied. If the grounds for Mr Morton's belief were reasonable (and nothing in the Final Notice suggests that they were not), then one would have thought that the defence is made out. The RDC's decision, if correct as a matter of law, puts significant restrictions on the availability of the market abuse defence, in effect requiring traders etc. to be in a state of mind that constantly questions whether the guidance they have from compliance is correct and to question whether accepted market practices are acceptable. Whether or not it is a correct application of the law, it will doubtless represent the stance taken by the FSA unless the Financial Services and Markets Tribunal or a court in another case overrules it.

On a practical level, this decision sends a message to the market that an individual in the position of Mr Morton on the receiving end of a pre-marketing call should, given this grey area, contact his or her compliance department immediately in order to ascertain whether that person is restricted in any way from dealing in securities in the same name or sector. Unfortunately this guidance by the back door has come too late for Mr Morton. Finally, firms will need to re-visit the analysis of their activities in the debt and other non-equity markets. Further training of staff may be required and compliance guidelines should be reviewed and updated if necessary.

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