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Financial Services and Markets

FSA sends a strong message on debt issues

7 October 2009

The FSA has today issued final notices finding market abuse in connection with debt issues. Unusually (and perhaps reflecting the representations that the conduct reflected accepted practice in these markets at the time), the findings were not accompanied by fines or prohibition orders.

What happened?

A number of calls were received by a Dresdner structured investment vehicle known as K2 in order to test likely appetite for a new issue of debt by Barclays. At no point during the calls was it certain that the issue would proceed, although the levels of uncertainty, particularly as to timing, varied as the calls proceeded.

Having received the calls, K2 dealt in an existing debt security of the same issuer.

The key issues

Pre-marketing calls of this nature are common in the debt markets but (in contrast to the equity markets) they have generally been regarded by market participants as either not specific or not price sensitive for market abuse purposes, leaving them free to deal following receipt of the call. Indeed, it seems that Dresdner's view was that K2 (which regularly received similar calls) was "not routinely privy to price sensitive non-public [information]". The FSA sends a clear message that this analysis is incorrect. The debt markets must reconsider their practices.

The FSA repeats its view that "price sensitivity" should be assessed by reference to whether the information will be relevant to an investor's decision to buy or sell the securities (a test for which an actual or expected price movement may not be an essential element). However, where a price movement is envisaged it should not be disregarded solely on the basis that it is expected to be temporary - if a brief peak or drop is expected while the market digests the news, this may be enough if it is otherwise "significant".

The market abuse defence, which excuses behaviour if the person believed on reasonable grounds that his behaviour did not amount to market abuse, is considered. The FSA states that reliance on a combination of guidance from the Dresdner compliance department and market practice at the time was not sufficient to establish the reasonableness of a person's belief. This would appear to erect an almost impossible hurdle to jump before the defence can be relied on and would also appear to be far more restrictive than the draftsman intended.

Lessons to be learnt

It is vital that firms re-visit the analysis of their activities in the debt and other non-equity markets. Parallels should be drawn with the more considerable body of analysis in the equity markets, where appropriate.

Firms marketing debt issues should implement appropriate procedures for inviting recipients of marketing calls to become **insiders.**

Training should be provided which is tailored to business models: firms should not assume that staff will apply the necessary (or correct) read-across to examples designed for different business models or markets.

Compliance guidelines should be reviewed and updated.

Comment

There are a number of unusual aspects to these cases

- It appears that the conduct may have conformed with accepted market practice and that there was a genuine belief that the behaviour was not abusive. The FSA accepts that the behaviour was neither deliberate nor reckless. It therefore seems extremely harsh to make examples of two individuals, who it seems were also complying with internal guidelines, when FSA guidance would have sent the same message to the market.
- This is the first time that the market abuse defence has been analysed in any detail in any reported decision. The comments in relation to the defence send a clear signal that the FSA has set the "reasonable belief" test almost impossibly high.
- It is exceptional for the FSA to issue a finding of market abuse but not to impose either a prohibition order or a fine, all the more so given the FSA's credible deterrence policy. Perhaps this is the true expression of the (lack of) real culpability of the individuals involved.

The final notices can be found HERE for Morton and HERE for Parry.

Travers Smith's Regulatory Investigations team advised Darren Morton, one of the individuals involved, in relation to this matter.

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