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Impact of Covid-19 on market abuse risks

Understandably, over the past year, the focus of most businesses has been on adjusting to the myriad challenges posed by the Covid-19 pandemic. However, an important yet overlooked aspect of this adjustment process may have been the treatment of price-sensitive information.

The Covid-19 pandemic has created new, and exacerbated existing, market abuse risks. Those risks are principally associated with economic turbulence, and the shift to working from home. They include:

- **Increased volumes, and changes to the nature, of inside information.** The uptick in capital raising activity since the start of the pandemic – in the first six months of 2020, the UK saw a greater volume of follow-on equity issuance than the next seven major European exchanges combined – and M&A activity,[1] especially from the latter half of last year onwards, has contributed to a significant increase in the quantity of price sensitive information. The nature of inside information has changed, too: issues which may not have been material in the past now are;
- **Security over inside information.** Within a company, operational challenges may have resulted in the treatment of price sensitive information being less rigid than may have been the case in 'normal' times. A relaxation of such controls can give rise to questions over who has had access to that information and whether there is a proper record of those people;
- **Working from home.** The transition to remote working has created obvious security issues, not least the risk of inside information being inadvertently shared with members of households or flatmates, or simply not being controlled in as rigid a fashion as at a company's premises. This is coupled with the reduced abilities of organisations to monitor communication channels and staff behaviour remotely;
- **Incentives towards misconduct.** Market volatility[2] creates risks, but also potential rewards. The possibility of such rewards[3] - especially in the context of share dealing – may provide a strong incentive towards misconduct for insiders in possession of inside information;
- **Transitional phase – the 'half in/half out' problem.** As restrictions eventually ease, the risks highlighted above will not fall away but will evolve. Companies may, for example, need to consider how appropriate controls can be implemented to ensure the security of price

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[1] In the fourth quarter of 2020, deal volumes and values globally were up by 2% and 18% respectively compared with the same quarter the previous year: https://www.pwc.com/gx/en/services/deals/trends.html. The FCA has also reported an overall increase of 34% in transactions and transaction reports in 2020.

[2] The Vix index, which measures the short-term expected volatility of the S&P 500 index from derivatives prices, entered last year at around the 12 to 13 points level. By March 2020, it had soared to a peak of over 85 points: https://www.ft.com/content/2e431bdf-f8a6-4b7f-aaed-c6d83259f6ae

[3] In these unpredictable times, increases in market value by up to 400% are not uncommon.

sensitive information as staff begin returning to the office, whilst others continue working from home. The FCA has made it clear that "*our expectation is that going forward, office and working from home arrangements should be equivalent – this is not a market for information that we wish to see be arbitraged*".[4]

Companies should ensure that risk assessments are updated to reflect these risk factors, and, where necessary, mitigating steps should be taken. In the context of inside information, for example, appropriate controls will be required in relation to the handling and distribution of such information. The FCA acknowledges that often simple steps "*can make the greatest difference*"[5] in this respect: regularly reviewing the composition of a permanent insiders list, for example, is a relatively straightforward task, but one with significant potential benefits.

The FCA's overarching message in respect of compliance with market abuse obligations is clear: even in these exceptional times, "*we expect all market participants, including issuers, advisors and anyone handling inside information to continue to act in a manner that supports the integrity and orderly functioning of financial markets*".[6]

These are not empty threats. In February of this year, the FCA announced that it had commenced two sets of criminal proceedings for insider dealing offences against four individuals.[7]

The importance placed by the FCA on the monitoring of potential market abuse activity has also been recently highlighted by the introduction of a new 'market cleanliness' measure - the Potentially Anomalous Trading Ratio ("**PATR**") – which assesses whether underlying trading behaviour ahead of unexpected price sensitive announcements may be deemed anomalous.[8]

Should you wish to discuss the impact of market abuse obligations on your business, please contact any of the listed authors, or your usual Stephenson Harwood contact.

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[4] Speech by Julia Hoggett, Director, Market Oversight (12 October 2020).
[5] Speech by Julia Hoggett, Director, Market Oversight (12 October 2020).
[6] FCA Market Watch 63, available here.
[7] The press releases are available here and here.
[8] Speech by Mark Steward, Executive Director of Enforcement and Market Oversight (25 February 2021).