13 November 2012

Mr Gary Brook
Market Conduct
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

FSA Soundings Questionnaire

Dear Gary

We thank you for providing an opportunity for AFME to respond to the questions raised in the FSA Soundings Questionnaire. We agree that soundings are very important to maintain effective and orderly markets. We agree that there are risks present in the soundings context: improper disclosure of inside information, insider dealing, and market manipulation. We support strong efforts to minimise these risks which, if realised, will be damaging to market confidence.

While we share the FSA's goal of minimising the risks of market abuse emanating from the sounding process, we are concerned that the proposals embedded in the questions would establish an excessively broad scope of regulation. This is because the FSA approach is to define "sounding" as meaning an approach to investors to test their interest in respect of a particular transaction that is not yet announced. That could be done on a wall-crossed or open basis, so both types of sounding are caught by the proposal. This would require the same level of documentation of numerous discussions between the sell-side and the buy-side which do not involve the risk of the communication, intentional or inadvertent, of inside information because they do not occur in contemplation of a transaction. In our view, the regulatory focus should be on wall-crossings in the context of communications concerning transactions for which a mandate has been granted or in respect of a known pending transaction (e.g., in soliciting investment banking business).

As you are aware, there is a well established practice through which the sell-side and buy-side determine whether a wall-crossing is acceptable to a buy-side investor. Prior to communication of inside information, this practice involves the sell-side's obtaining an oral acknowledgement from a proposed buy-side recipient of inside information that he understands his obligation not to disclose such information or use it for trading purposes until the inside information is publicly disclosed or ceases to be inside information. Inside information will be disclosed only after the necessary undertaking is received from the buy-side investor agreeing to be wall-crossed.

It is clear that if no inside information is disclosed in a sounding discussion, there is no reasonable expectation by the sell-side representative that market abuse could result from the discussion. Thus, there would be little reason to create a record of the discussion. Of course, if the recipient believes that it is nonetheless in possession of inside information, either through that

conversation or as a result of aggregating the information it receives with other information already known to it, it would be under an obligation to restrict its activities accordingly. If the buy-side representative disagrees with the sell-side characterization that the conversation in question contained inside information, it would be customary for the buy-side representative to make that known to the sell-side representative.

Secondly, our members consider that the institutional buy-side is generally able to make their own judgements as to whether inside information has been communicated which seems contrary to the indications which you have received. Indeed, it has been the buy side's duty to do so for a long while. If an institutional investor does not feel able to make such determinations, the remedy must be further training and/or hiring experienced professionals to do so. Sell-side representatives are not in a position to advise institutional investors whether they are free to trade, as those investors are not clients of the sell side in this context. In addition, the sell-side is not privy to any information that institutional investors may have obtained from other sources which, when taken together with the information received from the sell-side, *could* constitute inside information. Accordingly, the sell-side representative cannot express a view about matters beyond its knowledge.

Thirdly, our members consider that the proposed limitation of wall-crossing to six investors, which appears in some respects to be analogous to the Takeover Panel's Rule of Six, would not promote an efficient or practical soundings process. Although the proposal is not fully developed in the survey, it seems that the ceiling is intended to aggregate all communications by any sell-side party including those where a wall crossing is not accepted (and, in fact, where no substantive conversation may have occurred). As a practical matter, to achieve an effective market sounding in the context of assessing the viability of a transaction, it is nearly always the case that more than six contacts are required. This may be a function of the shape of a share register or of the distribution strategy. It would be costly to impose the requirement that an issuer or its agent seek permission from the UKLA to exceed six contacts, and it is not clear on what basis the UKLA would approve such a request. In our view, this requirement would undermine the effectiveness of market soundings in the context of a capital markets transaction, and the burden on the UKLA would be disproportionate to any advantage gained.

We note also that there seems to be no distinction drawn in the questionnaire between market soundings conducted in respect of companies with no publicly traded securities (i.e., an IPO process) and market soundings for public companies (i.e., a rights issue or placing). Particularly with respect to limitations on the number of conversations permitted to be held with investors, our members believe that it is critical to clearly distinguish between communications involving a wall-crossing (an explicit prohibition of trading activity) and communications that are expected to be kept confidential but do not have an effect on relevant securities within the meaning of the law.

We urge that, before any implementation of these far reaching proposals, there be stakeholders' discussions and a public consultation. Our members

are very willing to participate constructively in such a process in order to avoid unintended consequences and unnecessary complexity and costs.

Please find attached our response to the specific questions posed in the survey.

Thank you very much for your consideration.

Very truly yours

William J Ferrari

Managing Director

Market Soundings

Notwithstanding the clear focus on the responsibility and effect of sharing inside information, the FSA Sounding Questionnaire defines "market sounding" very broadly to include all conversations between the sell-side and the buy-side. It is our members' belief that in order to focus on inside information, the definition should be narrower, i.e. those conversations taking place in contemplation of a specific transaction and in which inside information is expected to be shared. The vast majority of conversations between the sell-side and the buy-side would therefore be excluded and are excluded from our responses below. All of the responses below relate only to instances where inside information is shared with the buy-side by the sell-side ("investor wall-crossing") in the context of a "soundings" conversation.

Q1: Should sell-side firms be required to assist the buy-side firms they have sounded, if requested by the buy-side, to determine whether the information received may constitute inside information (noting that the sell-side's analysis would not remove the responsibility on the buy-side to undertake and document their own determination of whether the information in their possession means they are inside)? Please explain your response, including any implications.

It is very important as a starting point to confirm that it is the clear practice of the sell-side, prior to any substantive conversation with the buy-side, to clearly state its view whether inside information is going to be discussed, and to receive the express acknowledgement of the buy-side that they are willing to proceed with the conversation on that basis including an undertaking not to trade until the information is disclosed or is no longer relevant.. Therefore, we do not believe that circumstances would arise that would lead the buy-side to request this assistance, since the undertaking would apply whether or not the buy-side considered the information to be inside information. However, there may be circumstances where the buy-side believes, following a conversation where inside information was NOT expected to be shared, that they are nonetheless "tainted" with inside information. This is a different fact pattern, dealt with in our responses to Q 6-9 (dealing with "cleansing"), below.

Q2: Should buy-side firms document their analysis to demonstrate their determination of whether information received during the course of a sounding, regardless of whether the sounding was on a wall-crossed basis, nonetheless involved the sharing of inside information?

A number of questions in the FSA's questionnaire deal with the analytical and record-keeping responsibilities of the buy-side. This response speaks principally on behalf of AFME's sell-side members, who are not in a position to answer on behalf of these buy-side investors regarding their internal policies and procedures. However, in our experience, the buy-side has sufficiently experienced professionals to deal with these issues and does so on a frequent and regular basis.

Q3: If the buy-side's analysis of the information received indicates that they are in possession of inside information even though they were not formally wall-crossed, should the buy-side notify the FSA of this discrepancy? Conversely, if the buy-side's analysis of the information received indicates that they are not in possession of inside information even though they were formally wall-crossed, should the buy-side notify the sell-side of this discrepancy? Please explain your responses, including any implications.

In respect of the first question, we refer to our earlier response to Q2. In response to the second question, as part of the wall-crossing process, the buy-side will have undertaken to the sell-side not to trade in relevant securities. If the buy-side, having received the information, takes a different view and trades in violation of that undertaking, whether or not the buy-side has informed the sell-side of that view, the sell-side would have a responsibility to report any known activity by a buy-side investor they have wall-crossed.

Q4: Should the buy-side demonstrate its own determination on whether securities are related securities, by maintaining a full audit trail of its analysis?

We refer to our response to Q2, above.

Q5: Should the sell-side be required to assist with the buy-side's analysis if requested (noting that the sell-side's analysis would not remove the responsibility on the buy-side to undertake their own determination of the information)? Please explain your responses, including any implications

No. It is not appropriate for the sell-side to be called upon to provide advice to a party (in this case the buy-side) with which it does not have a client relationship. It remains the duty of each party to consider the issues independently together with their internal legal and compliance resources..

Q6: Should the sell-side document its analysis of what the cleansing strategy will be ahead of any soundings?

No. We believe that it is equally important to have a clear cleansing strategy PRIOR TO wall-crossing buy-side investors. The nature of the cleansing event will vary from conversation to conversation, but the sell-side and its issuer client will have considered this in advance. How and whether that is documented ahead of time should be left to the sell-side's internal policies and procedures. The strategy may change in light of a range of factors, not all of which will be known to the sell-side. The sell-side therefore cannot undertake to document the evolution of the strategy. They can undertake to communicate changes agreed with the issuer

Q7: In the absence of an announcement, should the sell-side determine and document its analysis to show the point of cleansing, and share its analysis with the buy-side?

In most cases, it is our experience that the buy-side will not agree to be wall-crossed unless the sell-side communicates a clear cleansing strategy or cleansing date that has been pre-agreed with the issuer PRIOR TO the wall-crossing. The sell-side should be permitted to determine the most appropriate means of analysis of the cleansing strategy and subsequently whether there is a need to document that analysis. How and whether that is documented ahead of time should be left to the sell-side's internal policies and procedures.

Q8: In the absence of a public announcement containing the inside information the buy-side was provided with, should the buy-side ask the sell-side for their assessment of whether the buy-side are still in possession of inside information and to document this response?

This question assumes that the only acceptable method of cleansing is a public announcement of information. In fact, cleansing is wholly dependent on the nature of the information shared. For example, if the inside information is the potential of an offering, and that offering is abandoned, there may be no need for a formal announcement. The sell-side has an obligation to be clear as to its view whether the information they provided the buy-side is still inside information. That obligation does not extend to whether the buy-side is "free to trade", as this can only be assessed by reference to all information held by the buy-side investor, and not by his sell-side contact. Therefore we would resist any suggestion that the sell-side involve itself in the internal analysis of the buy-side.

Q9: Should the buy-side document its own analysis and determination of the point of cleansing?

We refer to our response to Q2, above.

Q10: Should there be a limit on the number of firms sounded ahead of any given corporate event, under ordinary circumstances to a total of 6 (even when there is more than one book runner)? Should the sell-side notify the local competent authority if they intend to approach more than 6 firms? Please explain your response, including any implications.

We do not consider that it would be practical to establish a mandatory ceiling on the number of investors which can be contacted in a formal wall-crossing exercise, nor to require that the issuer or its agents notify the FSA if there is intent to contact more than a specific number of investors or potential investors. In international offerings with a number of book-runners, it is important to achieve a comprehensive mapping of all relevant markets. This suggestion, which appears to mirror the Rule of 6 as applied in the Takeover Code, is unlikely to be practical, for example, in the context of a global offering. The appropriate number of buy-side investors will differ on a transaction by transaction basis, and the question should be viewed in the context of the type of transaction or product in contemplation, the type of company, geography, industry sector, etc. In any case, any measure of contacts should focus on institutions who agree to be wall-crossed and not include those who declined to be made insiders.

Q11: In order to prevent unwanted or inadvertent wall-crossings, should:

a) the buy-side formally inform the sell-side if they never wish to be wall-crossed?

We refer to our response to Q2, above.

b) the sell-side maintain an up-to-date record of the buy-side's wishes in relation to wall-crossings?

The sell-side should be aware of the articulated wishes of an investor, but there should be no bar to inquiring at a later date, since views may change with the issues involved or according to the general market context.

c) the sell-side be prevented from approaching any buy-side firms before it has determined their wishes in relation to the wall-crossing?

It will be necessary to "approach" a buy-side investor each time a wall-cross is contemplated in order to seek their specific approval to do so. Therefore, such a restriction would not be practical. .

d) the buy-side report to the relevant Competent Authority any instances of unwanted wall-crossing approaches (regardless of whether these actually resulted in a wallcrossing)?

No. A wall-crossing approach, in itself, should not be an issue. The buy-side is able to decline the wall-cross and no unwanted wall-crossing should occur.

e) the sell-side report to the relevant Competent Authority any instances where it has reasonable suspicion that a buy-side firm that has refused to be wall-crossed, then sought to probe for details of inside information? Please explain your responses, including any implications.

All reasonable suspicions of market abuse are required to be reported, regardless of the factual circumstances which led to such suspicion.

Q12: In order to apply a more consistent approach to soundings across the industry, should all sellside firms create and use a script for each sounding? Please explain your response, including any implications.

As far as our members are aware, it is already market practice to agree a script or an outline of topics to be covered with the issuer and legal counsel prior to any wall-crossing. It should not be a requirement that a script be read literally, as long as any communication stays within the planned boundaries of disclosure.

Q13: Should the sell-side ensure that written confirmation is issued to the buy-side before inside information is passed? In the event that the details contained within the written confirmation change materially, should the sell-side issue an amended written confirmation without delay?

It is usually the case that a buy-side investor is asked to be wall-crossed orally before information is passed. We also believe that it is market practice to follow up with these agreements in writing; but we do not believe that it is necessary to exchange written communications prior to having wall-crossed discussions.

Q14: Would you be supportive of the written confirmations to the buy-side referred to in Q13 to contain, as a minimum:

a) The names of the individuals at the firm wall-crossed (or to be wall-crossed)?

Yes.

b) The expected date and time those individuals will be made inside?

This is not practical in fast moving markets. In most cases the buy-side will accept the wall-cross and the individuals will be make insiders on the basis of that confirmation.

c) The consequence of being made inside (namely that they are now restricted from trading in the relevant securities or from inappropriately disclosing any inside information and they should be aware that breaching this could be a civil or criminal offence)?

The written confirmation should be clear whether or not inside information will be shared and, if so, clearly document the expectation that the buy-side will be restricted from trading subject to a cleansing event. .

d) An outline of the sell-side and/or issuer's proposed cleansing strategy referred to in Q6?

This is usually a matter for discussion between the sell-side and the buy-side prior to the wall-crossing taking place. It is not necessary for this to be included in the confirmation.

Q15: In addition to insiders list required by the DTR2.8.1, should the sell-side maintain accurate sounding lists in relation to each potential transaction, providing:

a) the names of all firms (and employees at those firms) who were sounded?

Yes, the sell-side should record the name of the employee(s) whom they had the discussion.

b) the date and time of the approach?

Yes.

c) a summary of the information provided?

Yes.

d) whether the intention of the sounding was to wall-cross?

Only soundings including a wall-crossing should require these records.

e) whether the firm that was sounded was actually wall-crossed (in which case they may also appear on the insiders list)?

Yes. It is not unreasonable to record the details of buy-side firms contacted who did not accept the wall-cross.

f) the contact details used (ie. telephone numbers) for the approach in (a) above? Please explain your responses, including any implications.

Yes.

Q16: Should sell-side firms ensure that all soundings are conducted on company recorded mobile and land lines, regardless of whether the intention is to pass inside information?

We believe that this is current market practice whenever a wall-crossing is intended, although exceptions may be allowed in cases where this may not be practicable e.g. unusual circumstances such as unusual call time or during travel abroad.

Q17: Should buy-side firms ensure that all follow-up calls to the sell-side following a sounding approach which didn't result in a wall-crossing are conducted on company recorded mobile and land lines, whether there has been or intended to be a passage of inside information?
Please explain your responses, including any implications.

We believe that, when a wall-crossing is refused, there should be no further conversations with that buy-side investor relating to that matter until after cleansing occurs, such that inadvertent wall-crossings are less likely to occur. Recording should be required only where a wall-crossing is anticipated or has occurred.