

Conduct Rules Scenarios

Letscoff IPO

Scenario

You are the Senior Manager in charge of the corporate advisory division of Mega Bank PLC. You and your team have been appointed to advise on the initial public offering (IPO) of shares in Letscoff, the food delivery app.

The shares of Letscoff were initially priced at a target range of between 460p and 390p.

Last week, one of your salespeople, Andy Fraser, (a Certification Employee) told a set of institutional investor clients that the institutional book was four or five times oversubscribed and was a “no brainer” in terms of an investment. The salesperson knew that he had no real basis for this assertion. In reality, it is known within Mega Bank that demand for Letscoff shares is very low due to concerns about the company’s business model and general profitability. Relying (at least in part) on this statement, a number of institutional clients choose to invest in the Letscoff IPO.

As it turned out, it seems that the institutional book was not oversubscribed at all. In the last few days before the IPO, the target range had narrowed to between 410p and 390p. On the day before the IPO, the opening price of shares in Letscoff had been set towards the bottom of its target range at 390p.

On the first day of trading, shares in Letscoff app fell 26%, wiping almost £2 billion from its opening £7.6 billion market capitalisation.

A number of clients who invested have complained about the losses they have suffered, feeling that they have been misled by your team.

What conduct rules may have been breached?

- Individual Conduct Rule 1: “You must act with integrity”.
- Individual Conduct Rule 2: “You must act with due skill, care and diligence”.
- Individual Conduct Rule 4: “You must pay due regard to the interests of customers and treat them fairly”.
- Individual Conduct Rule 5: “You must observe proper standards of market conduct”.
- Senior Manager Conduct Rule 1: “You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively”.
- Senior Manager Conduct Rule 2: “You must take reasonable steps to ensure that

the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system”.

Points to consider

General

The conduct in question does relate to the regulated or unregulated “financial activities” of the firm. As such, the conduct should be considered as being in-scope for the purposes of the Conduct Rules.

Bear in mind that, under COCON 3.1.3G, a person will only be in breach of a Conduct Rule where they are personally culpable. In other words, the person’s conduct must have been:

1. Deliberate, or
2. Below the standard of conduct that would be reasonable in all of the circumstances.

Pursuant to COCON 3.1.2G, in assessing whether a breach of the Conduct Rules has occurred, the FCA will have regard to the context in which a course of conduct was undertaken, including:

1. The precise circumstances of the individual case,
2. The characteristics of the particular function performed by the individual in question, and
3. The behaviour expected of that function.

The FCA will also take into account whether the conduct in question (a) relates to activities that are subject to other provisions of the FCA Handbook, or (b) is consistent with the requirements and standards of the regulatory system (as far as it applies to the firm).

Pursuant to COCON 3.1.5G and 3.1.6G, in determining whether a breach of the Senior Manager Conduct Rules has occurred, the FCA will take into account:

1. Whether the Senior Manager exercised reasonable care when considering the information available to them,
2. Whether the Senior Manager reached a reasonable conclusion upon which to act,
3. The nature, scale and complexity of the firm’s business (the smaller and less complex the business, the less detailed and extensive the systems of control in place need to be – and vice versa),
4. The role and responsibility of the Senior Manager as determined by reference to his/her Statement of Responsibilities, and
5. The knowledge which the Senior Manager had, or should have had, of regulatory concerns (if any) relating to their role and responsibilities.

Andy Fraser

It would not be unusual in IPO situations like Letscoff that salespeople provide the best possible picture of the company which is about to float.

On the facts, it is possible that Andy Fraser's assertion that the institutional book was four or five times oversubscribed and that the investment was a "no brainer" may well just be regarded as 'marketing fluff'. In addition, he has not actually recommended that any investor purchase shares in Letscoff and does not exercise discretionary authority to invest with respect to any client.

However, it seems that Andy may have strayed into the territory of making a misrepresentation as he appears to have made a statement which he knows to be false (or at least knows may be false). Moreover, a number of investors have relied on this statement in making an investment and have suffered losses as a result. As such, all of the elements necessary to sustain a claim for damages due to misrepresentation under the Misrepresentation Act 1967 have been satisfied.

'Misleading (or attempting to mislead) a client' and 'not paying due regard to the interests of a customer' are two of the examples provided by the FCA of conduct that would be a breach of **Individual Conduct Rule 1**: "You must act with integrity".

Whether Andy made his statement about the demand for Letscoff shares knowingly or recklessly, it could also be argued that he has failed to act with 'due skill and care' as required by **Individual Conduct Rule 2**.

'Failing to inform a customer of material information in circumstances where they were aware, or ought to have been aware, of such information' is provided as an example of a breach of **Individual Conduct Rule 4**: "You must pay due regard to the interests of customers and treat them fairly".

Making misrepresentations about the state of an order book is difficult to reconcile with **Individual Conduct Rule 5**: "You must observe proper standards of market conduct".

Andy Fraser's behaviour may also trigger an in-year assessment of whether Andy remains **fit and proper** to perform his role. The main focus of this assessment would be whether Andy has the requisite "honesty, integrity and reputation".

You as Andy Fraser's manager

On the facts of the case, there seems nothing which leads inevitably to the conclusion that a breach of **Senior Manager Conduct Rule 1**: "You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively" has occurred. However, there are still various aspects of compliance with **Senior Manager Conduct Rule 1** which should be considered.

As the Senior Manager to whom Andy Fraser reports, you are obliged (under **Senior**

Manager Conduct Rule 1) to take reasonable steps to satisfy yourself, on reasonable grounds, that each area of the business for which you are responsible has appropriate policies and procedures in place for reviewing the competence, knowledge, skills and performance of each individual member of staff. Moreover, if an individual's performance is unsatisfactory, you should review "carefully" whether to allow that individual to continue in their role. The fact that Andy Fraser has caused loss to a number of clients, ostensibly through his own dishonesty, should at least trigger a review process in this area. A failure to do so would put you at risk of being in breach of **Senior Manager Conduct Rule 1**.

Senior Manager Conduct Rule 2 requires you to take "reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system". Again, as with **Senior Manager Conduct Rule 1**, on the facts of the matter, there is nothing that leads inevitably to the conclusion that a breach of **Senior Manager Conduct Rule 2** has occurred. However, Andy Fraser's behaviour should, at least, trigger a review process into whether sufficiently robust procedures exist in order to monitor and maintain compliance with the requirements of the regulatory regime, the root cause of the current issue and what (if any) remedial actions can be implemented. Failure to do so may render you in breach of **Senior Manager Conduct Rule 2**.