The Kyprios near-market abuse final notice: an expensive game of charades and wordplay

by Chris Hamblin and Adam Samuel

The FSA has punished yet another senior manager for recklessly disclosing confidential information without going through the appropriate 'Chinese wall' procedures. The manager in question, Nicholas Kyprios, head of credit sales at Credit Suisse Securities (Europe) must now pay the non-crippling sum (for him) of £210,000 for breaching APER principles 2 and 3, which call for due care, skill and diligence, and proper standards of market conduct respectively. Despite his misdemeanours, he retains his CF30 status as a person approved to perform the customer function.

Kyprios had a lucky escape from the clutches of market abuse as a result of the fact that by pure chance the only markets he could have affected were in investments that do not qualify under section 118 of the Financial Services and Markets Act. Nevertheless, the regulator's use of APER to evade the "qualifying investments" requirement of that section should be a warning to other approved persons who may be tempted to break the office wall-crossing procedures.

The story

The deal in question involved a takeover by an American telecoms company, Liberty, of a German cable TV company, Unitymedia. The plan was that Liberty would stand behind Unitymedia while it issued commercial debt in the form of a new bond issue to cover (a) the costs to Liberty of acquiring it and (b) redeem existing Unitymedia bonds. Liberty engaged Credit Suisse to help it organise the new issue.

Using the secrecy provided by its 'Chinese wall' arrangements, Credit Suisse expected Kyprios to sound out existing and potential investors for their opinions about the coming bond issuance. Kyprios signed a Chinese wall agreement and was therefore 'wall-crossed.' It was his duty to help disclose the confidential information that he had received about all this and in the process wall-cross five pre-selected investors and then seek their views on the new issue. It was also part of his job to persuade potential investors to attend London and Frankfurt road-shows after the issue's announcement. The invitations to the road-shows were issued beforehand, referring to "a potential deal on Thursday." An announcement on Bloomberg indicated that this was expected to result in offerings of 'senior secured and senior bonds.'

Kyprios then telephoned two fund managers from the Credit Suisse trading floor, ostensibly to ensure their attendance at one of the road-shows. Instead, he intentionally let information slip to them without obtaining their agreement first to be wall-crossed, playing a spectacularly unsubtle guessing game about the identity of UnityMedia as the bond issuer and therefore the likely redeemer of its outstanding bonds.

In the first, he started off by confessing to having been wall-crossed himself and therefore having to watch his words but then blatantly stated that the issuer was German, that all outstanding bonds would be redeemed and that the issue was related to an acquisition or a merger. He then invited the fund manager to "be my charades partner" and play a game of "getting warmer," giving the fund manager tips about where in the alphabet the name was and telling him that the issuer had alternative names, which Unitymedia had. When the man finally came round to the name of the issuer, Kyprios indicated falsely that the line was breaking up. The fund manager confirmed their understanding by saying, “I can’t get the unity in my hearing,” to which Kyprios laughed.

On the same day, Kyprios rang a German fund manager, indicating that the individual concerned would know the issuer’s management. “You may have capacity coming,” he said, indicating that some bonds were about to be redeemed. When the fund manager guessed the nationality of the issuer, he confirmed it by saying: “you are a smart man.” He then disclosed the identity of the sector by an obvious word-play on the name of fund manager’s analyst in that sector.

The effect of the conversations for market abuse purposes

These two conversations could only have constituted market abuse if the calls would have disclosed price sensitive information about “qualifying investments admitted to trading on a prescribed market”. The Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 (as amended) defines this as instruments defined by Article 1(3) of the Market Abuse Directive. This covers:

- “transferable securities as defined in Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field,
- units in collective investment undertakings,
- money-market instruments,
- financial-futures contracts, including equivalent cash-settled instruments,
- forward interest-rate agreements,
- interest-rate, currency and equity swaps,
- options to acquire or dispose of any instrument falling into these categories, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates,
- derivatives on commodities,
- any other instrument admitted to trading on a regulated market in a Member State or for which a request for admission to trading on such a market has been made.”

Notable by their absence from this definition are credit default swaps.

A “prescribed market” is under the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 for section 118(3) which would have been the market abuse concerned:

“(a) all markets which are established under the rules of a UK recognised investment exchange,

(b) … OFEX [and]

(c) all other markets which are regulated markets.”

A regulated market is now defined by Article 4.1.14 of MiFID as “a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its nondiscretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions of Title III" of the Directive.

The information could only have been price sensitive if the outstanding Unitymedia bonds that met the requirements of being "qualifying" for our purposes had been trading below the level of their call option, thus presumably reflecting an element of default risk.

Most of Unitymedia's outstanding bonds had only been admitted for trading on the GEM segment of the Irish Stock Exchange – which apparently meant that they were not qualifying investments, presumably because that segment fails to meet the MiFID definition set out above. Credit default swaps effectively insuring the Unitymedia bonds against default risk were not, as we have already seen within the definition of "qualifying investment".

All outstanding bonds that did qualify for the purposes of section 118(3) were trading at or close to their call level, i.e. the price at which they were going to be paid out. Consequently, the leakage of this information could not and did not make any significant difference to the only investments that qualified for market abuse purposes.

The other effects of the conversations

Kyprios' indiscretions did not move the markets at all but the FSA noticed with disapproval that they could have increased the prices of bonds and credit default swaps significantly, regardless of whether these investments "qualified" for market abuse purposes. Even though the disclosure did not affect the market, the two fund managers were given the opportunity to buy the "non-qualifying" bonds and credit default swaps in the knowledge that their prices would rise substantially after the deal was announced.

Effectively, the FSA was not qualifying the information as 'inside information' because of the technical limitations of section 118 and the surrounding statutory instruments, but as something next door to it. Credit Suisse's client, Liberty Global, was treating it internally as such and the FSA considers this serious enough. The figure under discussion was, after all, €2½ billion.

There was an internal Credit Suisse issue here as well. Kyprios seriously contravened the bank's clumsily-named 'handling of client information policy' and compliance manual by failing to treat 'confidential information' as such and by disclosing 'non-public information' to clients. He also failed to protect Libertymedias's information by tipping fund managers A and B off about the client's plans on a trading floor where other Credit Suisse traders could have joined those two fund managers in making an unfair profit. The bank's 'handling of client information policy' clearly bans Credit Suisse employees from disclosing information that could "reasonably lead to the identification of clients or their transactions or implies that a specific client is engaged in a specific transaction." It contains a further warning of the need to protect client's information during telephone conversations, "especially on the trading floor" where anyone could hear. The compliance manual reminds supervisors of the need to lead by example and "set the right tone and culture at all times."

Final thoughts

Kyprios, in short, has been punished for the damage and unfairness that he might have caused by telling his fund manager friends that the Unitymedia bonds were about to be redeemed. He has paid rather heavily for a silly game of charades and a wordplay based on his friendly fund manager's analyst's name.

The more serious side of this final notice lies in the way in which the FSA has used APER principles 2 and 3 to punish someone whose activities do not quite qualify as market abuse under section 118 for technical reasons, either because the investments are not of the right type or because the price of the investments could not have been moved for reasons beyond the approved person's control. These reasons will not stop the FSA from punishing leaky conversations that could give traders unfair advantages or move markets.