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FCA to Review Hedge Fund Polling Data Use

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Political reaction to significant market movements and perceived hedge fund profits will result in regulatory scrutiny and possibly legislation, especially when elided with the desire to protect democratic integrity and politically sensitive events.

Background

A recent Bloomberg Report¹ described how hedge funds' access to Brexit polling data allowed them to profit from the subsequent crash in the Pound. The Report explained that by buying early access to exit poll data, as it was created, fund managers gained two key strategic advantages. Firstly, they could see what market-moving polls would conclude when announced on television at 10pm on referendum night. Secondly, irrespective of a polling company's predictions, hedge fund data analysts could use the data to gain their own insight into the referendum result.

In response to the Report, Nicky Morgan MP, Chair of the Treasury Select Committee ("Committee"), wrote to the British Polling Council ("BPC"), copying the Chief Executive of the Financial Conduct Authority ("FCA"). The letter identified two issues affecting UK financial market integrity. Firstly, the practice of selling private polls to hedge funds and other market participants could undermine the public's trust and confidence in election polls. Secondly, it created a perverse incentive for polling companies to publically provide misleading or inaccurate data. This would increase the advantage gained by fund managers purchasing accurate data, thereby increasing the value of a polling company's data set. The letter proposed measures to increase transparency in how polling data is used, and by whom.

The BPC firmly declined to adopt the proposed measures. Instead, it suggested that if it is *"undesirable for a hedge fund to commission polls of how people will vote [...] because they might acquire an undesirable 'trading advantage' [...] then perhaps it is their ability to commission such polls that needs to be regulated."*

The FCA has recently confirmed it will meet with the BPC. Although the FCA does not regulate polling, the Agency made clear that it *"will take appropriate action including investigating and prosecuting alleged offenders [...] In our view, any person holding information that is not in the public domain should be mindful that such information could be inside information for the purposes of the market abuse regime."*² The Committee welcomed the FCA's approach, requesting cooperation and information sharing from them after their meeting.³

¹ <https://www.bloomberg.com/news/features/2018-06-25/brexit-big-short-how-pollsters-helped-hedge-funds-beat-the-crash>

² <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/181016-FCA-to-Chair-polling-data.pdf>

³ <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/181024-Chair-to-FCA-polling-data.pdf>

Governmental Intervention

There is significant political appetite to appear strong on supposedly unfair use of information and resulting profits. The Committee's comments and the recent House of Lords inquiry⁴ into the distorting effect of polls on democracy demonstrate this. Hedge fund use of early information has been linked by Parliament to undermining financial markets and democratic processes. Association with these factors clearly increases the possibility of legislative response. However, any wholesale legislative intervention remains improbable, not least because it is hard to see what it would achieve. As the BPC notes, prohibitions on hedge fund use of election data would create inside markets in that data. It would also create arbitrary distinctions between hedge funds and other financial organisations seeking to mitigate risk, such as banks, and broadcasting organisations, whose use of polling data has never been challenged.

However, given Parliament's stance, the BPC's refusal may not be the last word. Funds and polling companies should be under no doubt as to the activism of the approach taken by the Committee. By copying the FCA, the Committee called on an independent body – over which it has no authority – for its assistance in upholding the integrity not only of markets, but also of the democratic process. The political force of that request rendered FCA activity inevitable: their upcoming meeting with the BPC demonstrates this. The FCA's statement that it *"regularly assess the fitness of [its] regulatory framework and tools against the changing nature of the threats to our financial markets"*, underlines the real possibility of regulatory reaction. In that context, the BPC's best interests, and those of funds, may have been better served by accepting the Committee's transparency measures, in hope of staving off more serious FCA or legislative reprisals. Indeed, the strength of the influential Committee's response – despite focussing on pollsters – hints at a shift in political attitudes, raising the possibility of an increasingly hostile regulatory climate for fund managers.

Reputational Risk

Whilst it can be convincingly argued that using polling data is inconsequential to democratic and market integrity, public impressions remain significant. Brexit-related issues have been emotively supercharged by the referendum's divisiveness and its perceived detriment to the UK. Although the Report only asserts the involvement of twelve funds, the profit taken by each of those funds was extraordinary. In this context, the association of industry success with the politically toxic Brexit referendum is clearly undesirable, as it risks the public perception of profiteering. Public sentiment of that sort clearly increases the likelihood of detrimental regulatory or legislative reaction. To that end, fund managers should be prepared for further regulatory interest following the FCA's meetings, and might consider FCA cooperation to reach mutually agreeable solutions. Trading around particularly politically toxic events has always borne reputational risks, but it seems these are only likely to increase.

The Law

On the reported facts, it is questionable whether fund managers committed any offence by trading on early exit poll data. Electoral law requires that no exit poll data is published before 10pm on the night of a vote. Publishing is defined as making available to any section of the public.⁵ On advice, YouGov – a leading poll provider – is reported to have deliberately provided data to only one fund, so as to avoid criminal "publishing" of exit polls. Whether other funds

⁴ <https://publications.parliament.uk/pa/ld201719/ldselect/ldppdm/106/106.pdf>

⁵ S.66A, Representation of the People Act 1983

followed their suit is unclear. Exit polls hypothetically “published” by pollsters could create accessory criminal liability for receiving fund managers. Such charges are notoriously hard to prove and are fact specific. If publishing indeed requires provision to more than one fund, it would be against the interests of fund managers to procure such publication. The wider publication would have impaired the very competitive edge that funds sought by acquiring the data at all. In such circumstances polling companies, rather than funds, would be at greater risk of prosecution.

The other legal issue raised by Mrs. Morgan’s letter is that of “*damaging the integrity of UK financial markets*.” Any charge would be best framed as either insider trading or market abuse. Indeed, the FCA’s approach in its letter expressly focusses on those two offences. The facts are uncharacteristic of insider trading: polling companies could not be described as conventional “insiders.” Market abuse, if considered, would fall under the Market Abuse Regulation 2014 (“MAR”). Charges would require conspiracy between fund managers and pollsters to disseminate misinformation to the public, so as to affect the value of financial instruments.⁶ As the BPC’s response points out, given that polling companies rely on the accuracy of their predictions for ongoing business, it is unlikely they could be persuaded to jeopardise their wider business in such a manner. Ultimately – as the FCA recognises – “*how the market abuse regime applies to a particular case can be complex*” and the FCA will need to “*clarify with the BPC [...] how the FCA’s regulatory remit may interact with the work of their members*”.⁷

Conclusions

The governmental and regulatory attention paid to hedge fund profits evinces a political appetite for confrontation with the industry. This prospect is made more likely by Parliament’s disputable association of hedge fund profits with the issues of market and democratic integrity. Such confrontation may yet culminate in legislative or FCA reaction: the FCA is examining the situation, and is expected to report to the Committee soon.

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⁶ See Arts.12(1)(b) and (c), and Art.3(1)(1) MAR, leading to Art. 4(1)(15) MIFID II, and Annex I, Section C, Para. 4, MIFID II for definition of “financial instrument” that includes “currencies”.

⁷ <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/181016-FCA-to-Chair-polling-data.pdf>

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