

The new UK market abuse regime

Chris Bates of Clifford Chance summarises some aspects of the the new UK market abuse regime.

The statutory framework for the new UK market abuse regime is now in place. When the Financial Services and Markets Act 2000 comes into force – an announcement on the date for this is expected this spring – it will give the Financial Services Authority (FSA) new powers to sanction anyone who engages in ‘market abuse’. It will cover misuse of information, misleading practices and manipulation relating to investments traded on UK markets, as well as those who require or encourage others to engage in conduct that would amount to market abuse.

Filling the regulatory gap

The primary objective is to fill the regulatory gap by giving the FSA power to punish unregulated market participants whose market conduct falls below acceptable standards, but stops short of being a criminal offence. Therefore, the new provisions overlap with – but go beyond – the criminal prohibitions that will be re-enacted to replace section 47 of the Financial Services Act 1986 and the existing UK insider dealing law (which will remain in place). But for issuers of UK-listed securities and their directors the FSA is being given other additional powers to impose fines for breaches of listing rules. For regulated companies and their staff, the regime covers some of the same ground as the FSA’s principles for business and the statements of principles for approved persons and overlaps with the disciplinary powers of other agencies such as exchanges and the takeover panel.

Key features

The key features of the statutory framework are summarised in *Figure 1*. It covers both on and off market conduct, including trading activity and dissemination of information. The Treasury’s

proposals indicate that it will apply to conduct relating to investments for which recognised exchanges in the UK are the primary trading market (for example, domestic listed securities and on-exchange derivatives) and investments only incidentally traded on those exchanges (for instance, on the London Stock Exchange’s international equity or fixed income markets).

In addition, it will apply to conduct relating to derivatives on those ‘qualifying investments’ (such as OTC derivatives on securities) and conduct relating to instruments underlying exchange traded investments (for example, commodities or securities underlying exchange traded derivatives, structured notes or warrants) – these other instruments are termed ‘relevant products’ in the jargon proposed by the FSA.

It also has extra-territorial reach. It covers misleading practices and manipulative conduct outside the UK that might have an effect on the UK markets. In relation to misuse of information it is not necessary to show any nexus with the UK at all – other than that the behaviour relates to a UK traded investment in the broad sense described above. Compliance with local standards will not necessarily be a defence.

However, at the heart of the regime lies the regular user test. Conduct does not amount to market abuse unless a regular user of the relevant UK market would regard it as falling below an acceptable standard of behaviour.

Code of Market Conduct

The FSA’s Code of Market Conduct will give guidance on what these statutory requirements mean and on the FSA’s views on the types of conduct that amount to market abuse – see *Figure 2* for an outline of the latest draft in CP76 (November 2000). The code will also describe conduct that does not

amount to market abuse and these, safe harbours, will be conclusive.

Otherwise, the code only has evidential force and also does not exhaustively describe every case that might amount to market abuse. It will be taken into account, but in the end the FSA, or the tribunal, will still have to decide whether the statutory conditions are met in any specific case, including whether the conduct fails the regular user test.

Much has been said about the absence of requirements to prove intent to establish market abuse. But the regular user test does import requirements based on knowledge or purpose. This is recognised in the draft code, although it is also clear that in some cases the FSA will be able to impose fines where there has simply been careless conduct.

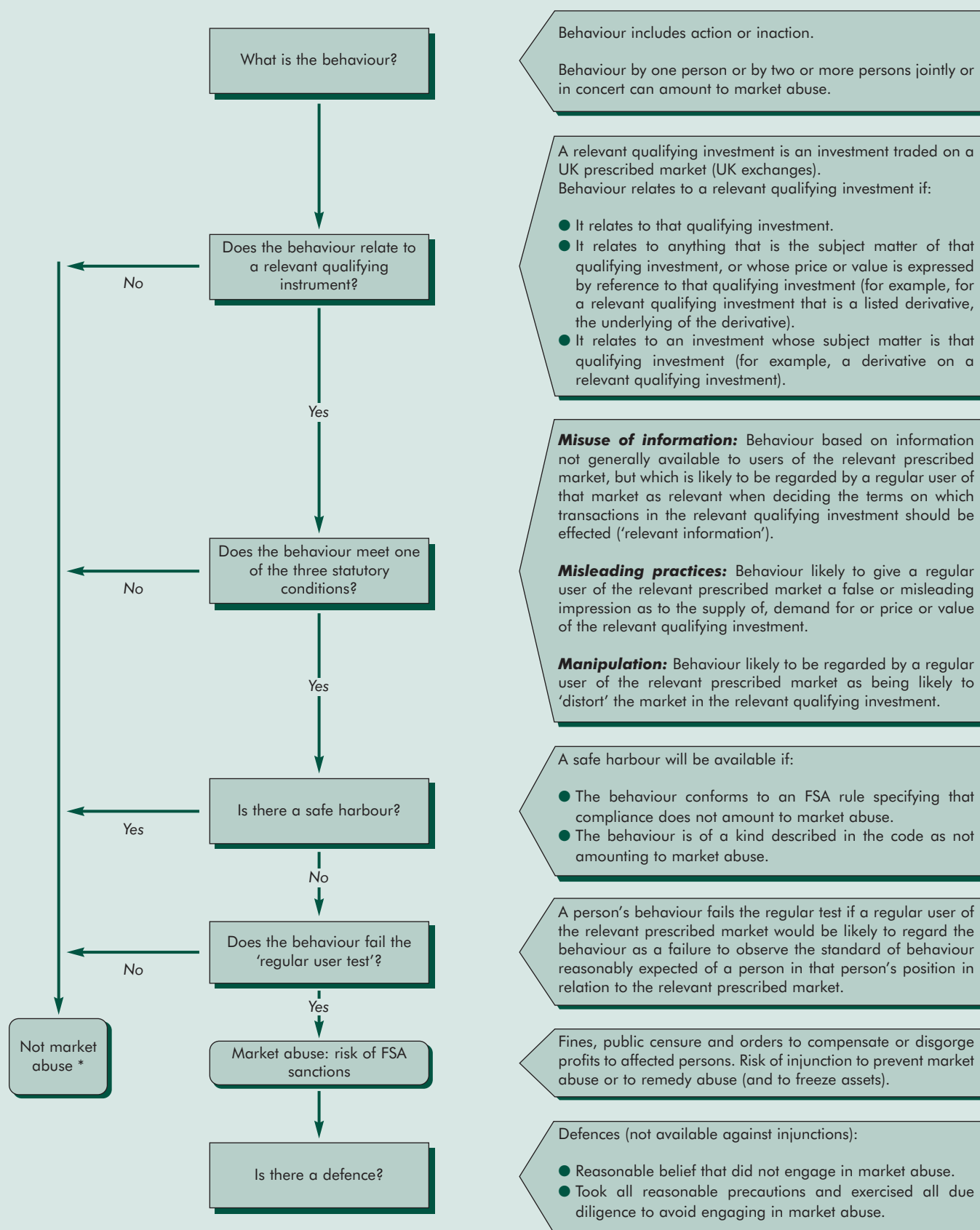
Something old, something new

There is a lot in the regime that is familiar. It provides new means to stamp out old misdeeds such as insider dealing and deception. But there is also much that is new, for example in its extraterritorial reach, the regular user test itself and the draft code’s redefinition of insider dealing, its transposition of insider dealing concepts to commodities and other non-securities-related transactions and its definition of abusive squeezes. Accepted standards may not always prove acceptable.

One thing is clear. The FSA will want to use its new powers. There will be a spotlight on market conduct issues. All market participants need to re-examine how they handle these issues and to consider their response to the new regime. ■

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Figure 1: Market abuse - the statutory framework



* But consider whether 'requires or encourages' another person to engage in conduct amounting to market abuse.

Figure 2: The FSAs draft Code of Market Conduct

	Conduct amounting to market abuse	Safe harbours
Misuse of information	<p>Dealing in a relevant qualifying investment or a relevant product where:</p> <ul style="list-style-type: none"> ● The dealing is based on information; ● The information is not generally available; ● The information is likely to be regarded by a relevant user as 'relevant information'; and ● The information is 'disclosable' (under a legal or regulatory duty) or 'announceable' (that is, usually the subject of public announcement). 	<p>Dealing required to comply with a pre-existing regulatory/legal duty.</p> <p>Dealing pursuant to a previous firm intention to deal.</p> <p>Dealing not influenced by the possession of the relevant information.</p> <p>Dealing based on 'trading information'.</p> <p>Dealing by a bidder in equity stakes in a take-over bid.</p>
Misleading practices	<p>Artificial transactions: Transactions in a qualifying investment or relevant product:</p> <ul style="list-style-type: none"> ● Where you know/ought to know principal effect likely to be artificially to inflate or depress the apparent supply of, demand for, price or value of relevant qualifying investment so as to give a false or misleading impression to a regular user. ● Except where your principal rationale considered by regular user to be a legitimate commercial purpose. <p>Disseminating information: Disseminating information that you know/ought to know is false or misleading in order to create a false or misleading impression.</p> <p>Disseminating information: Disseminating information through an accepted channel of communication for a prescribed market that is likely to give a false/misleading impression where reasonable care not taken to ensure information not false or misleading.</p> <p>Course of conduct: Engaging in a course of conduct:</p> <ul style="list-style-type: none"> ● Where you know/ought to know a principal effect likely to convey a false or misleading impression to regular user; ● Except where your principal rationale considered by regular user to be a legitimate commercial rationale. 	<p>For artificial transactions:</p> <ul style="list-style-type: none"> ● Transactions to take advantage of tax and cross-market arbitrages; ● Lending or borrowing to meet underlying commercial demand. <p>Reporting a legitimate transaction in accordance with legal/regulatory requirements.</p> <p>Reporting cross-trades under IPE and LIFFE rules.</p> <p>Maintaining price quotations in accordance with LSE market making rules.</p> <p>Notification by an issuer of a statement/forecast required or permitted by UK listing rules (and delaying an announcement of a new issue when permitted by UK listing rules).</p> <p>Behaviour conforming with specified rules in the Take-over Code or Rules on Substantial Acquisitions of Shares as to the timing, dissemination or availability, content and standard of care applicable to a disclosure, announcement, communication or release of information if expressly required or permitted by those rules.</p> <p>Behaviour conforming with rule 4.2 of the Take-over Code (restrictions on dealings by offeror and concert parties) if expressly required or permitted by that rule.</p>
Manipulation	<p>Abusive squeeze: Where you:</p> <ul style="list-style-type: none"> ● have significant influence over supply of or delivery mechanism of a market for a qualifying investment or relevant product; and ● hold positions on a prescribed market under which you can require others to deliver/take delivery of qualifying investment/relevant product and use that to distort prices for settlement/release of obligations to you. <p>Price positioning: Transactions with the purpose of positioning the price of a qualifying investment or relevant product at a distorted level dictated by you.</p>	<p>Behaviour conforming with LME rules in 'Market Aberrations: The Way Forward' (Oct 1998).</p> <p>Behaviour conforming with specified rules in the Take-over Code or Rules on Substantial Acquisitions of Shares as to the timing, dissemination or availability, content and standard of care applicable to a disclosure, announcement, communication or release of information if expressly required or permitted by those rules.</p> <p>Behaviour conforming with rule 4.2 of the Take-over Code (restrictions on dealings by offeror and concert parties) if expressly required or permitted by that rule.</p>
General safe harbours	N/A	<p>Behaviour conforming with FSA's:</p> <ul style="list-style-type: none"> ● price stabilising rules; and ● Chinese wall rules.