The UK's new Market Abuse and Disclosure Regime

The Market Abuse Directive aims to create a regime to tackle market manipulation in the EC and update the existing EC insider dealing legislation, together with prescribing an orderly process for disclosing important information to the market.

The EU Directive on insider dealing and market manipulation (the Directive or MAD) aims to harmonise market abuse rules across the EU. Although the UK market abuse regime introduced in 2001 means that we have something of a head start in this area, the implementation of the MAD has introduced a number of significant new compliance measures aimed at preventing market abuse and insider dealing.

The UK implementing measures came into force on 1 July 2005.

SCOPE AND APPLICATION OF THE DIRECTIVE Broadly speaking, the Directive applies where securities or other financial instruments are admitted to trading on a "regulated market". However, as implemented under UK law, the principal market abuse offences extend to other prescribed markets, including the Alternative Investment Market (AIM). The new disclosure of inside information, insider lists and disclosure of management transactions provisions apply only to companies with securities admitted to trading on "regulated markets", which, following the decision by the London Stock Exchange to operate AIM as an "exchange-regulated" market from 12 October 2004, does not include companies traded on AIM.

The provisions also apply not only where securities are already traded on a regulated market, but also where a request for admission to trading has been made. This means that grey market dealings will be caught, and Initial Public Offering (IPO) applicants will become subject to the continuing disclosure rules before admission has become effective.

DISCLOSURE OF INSIDE INFORMATION The Financial Service Authority's (FSA's) Disclosure Rules implement the Directive's provisions on the disclosure of material information by companies which have securities admitted, or have requested admission, to trading in the UK. Companies are required to announce publicly any "inside information" relating directly to them as soon as possible. This regime replaces the obligations to disclose price-sensitive information to the market under Chapter 9 of the old Listing Rules and the UKLA's Guidance on the Dissemination of Price-Sensitive Information (the PSI Guide).

Much of the material previously in the PSI Guide regarding matters such as a company's internal procedures for handling inside information and best practice for dealing with analysts is helpfully reproduced and updated where appropriate in the UKLA's LIST! Newsletter (Issue No. 9 dated June 2005). While not constituting formal FSA guidance, this edition of LIST! does provide an insight into the FSA's approach to the application of the Disclosure Rules in practice, together with some useful guidance for companies on communicating with the market.

DISCLOSE WHAT? "Inside information" is defined as information of a precise nature that is not generally available but which, if made generally available, would be likely to have a significant effect on the price of the company's securities. Information is defined as likely to have a significant effect on price "if and only if it is information of a kind which a reasonable investor would use as part of the basis for his investment decisions".

In guidance the FSA indicates that inside information would potentially include significant information relating to:

- the assets and liabilities, performance or expectations, financial condition or business of the company;
- major new developments in the company's business or;
- information previously disclosed to the market.

While each of these were elements of the disclosure obligation under the old Listing Rules, the basic definition of inside information is wider, in that it includes all information which "directly or indirectly" concerns the company or its securities. Although issuers have only to disclose information which "directly" concerns them, disclosure may be required of matters which do not necessarily impact the company's business but which are nonetheless considered price-sensitive.

For example, if a company becomes aware that a major shareholder is planning to sell a large portion of its holding, this would not necessarily impact the company's business and require disclosure under the old regime. However, under the new regime, it could be considered as information directly applicable to the company which when made public would have a significant effect on the company's share price and, as such, would require disclosure.

There was a concern based on the possibility that "inside information" could include knowledge of the fact that a market rumour was untrue. Guidance in the Disclosure Rules now states that the knowledge that press speculation or market rumour is false is not likely to amount to inside information. However, an announcement may be required where press speculation or a market rumour is "largely accurate" since the issuer will no longer be able to ensure the confidentiality of the inside information.

DISCLOSE WHEN? The old Listing Rules required companies to announce all price-sensitive information "without delay". The new Disclosure Rules require companies to announce inside information "as soon as possible". In practice, this change in form is unlikely to have a significant impact.

DISCLOSE WHERE? In addition to disclosing inside information via a Regulatory Information Service, under the new regime the information must be posted on the company's website by the day after its official announcement and remain there for one year. Care must be taken to ensure that information is not released on the company's website before it has been officially announced.

WHEN DISCLOSURE CAN BE DELAYED Delaying disclosure of inside information will only be permitted where:

- the company has "legitimate interests" to protect;
- the omission is not likely to mislead the public;
- any recipient of the information before its public disclosure owes a duty of confidentiality to the company; and
- the company is able to ensure the confidentiality of the information.

It is the company's responsibility to determine whether it can satisfy the above requirements.

As was formerly the case, delay may be permitted in relation to a matter subject to negotiation or an impending development that could be jeopardised by premature disclosure or which threatens the financial viability of the company. In addition, companies with dual board structures are permitted to delay disclosure where, for example, the ratification of a supervisory board is required.

WHEN DISCLOSURE CANNOT BE DELAYED As indicated above, disclosure should not be delayed if the market is being misled as a result.

Delay is not permitted where confidentiality cannot be ensured.

The rules state that delaying disclosure may be in the company's legitimate interest if the financial viability of the company is in "grave and imminent danger". However, this does not detract from the principle that if a company is experiencing financial difficulties or a worsening of its financial condition, disclosure must be made as soon as possible. In a few cases, for example where there is a question as to a possible default under a company's banking facilities that could result in insolvency, a delay in disclosure may be justified to enable the company to negotiate with its banks as to whether the default will be waived or not. By contrast, the disclosure of a gap in the company's balance sheet or the loss of a major trading contract cannot be delayed just because the company is trying to negotiate a solution.

SELECTIVE DISCLOSURE As under the previous regime, a company may make selective disclosure of inside information to certain categories of person while delaying general disclosure to the market. Under the new regime, it is clear that this will only be permitted where the recipient owes a duty of confidentiality to the company and requires the information to carry out duties to the company.

Helpfully, the categories of person to whom information can be disclosed have been extended to include major shareholders of the company, its lending banks and credit-rating agencies. It is worth noting that the categories of permitted recipients of selective disclosure do not include research analysts at investment banks, so pre-briefing of analysts in a non-advisory capacity ahead of a public announcement remains a questionable practice.

NEW COMPLIANCE PROCESSES AND PROCEDURES As before, companies are required to take all reasonable care to ensure that announcements they make are not false or misleading. They are under new specific obligations to:

- have in place measures to preserve the confidentiality of information; and
- limit access to inside information to those that strictly require the information to carry out their job.

INSIDER LISTS As a measure intended to help prevent market abuse, the Directive requires all companies admitted to trading on a regulated market to prepare and keep up to date lists of all individuals with access to inside information. These should be kept for a period of five years, to be disclosed to the FSA at any time upon request.

Companies must in addition have effective arrangements to ensure that those acting for them (for example banks, accountants and lawyers) maintain, and provide to the issuer on request, their own lists of persons who are acting on behalf of the issuer and have access to inside information on them. This means that issuers should ensure that letters of engagement or terms of business include appropriate obligations with regard to the preparation and production of insider lists where necessary.

MANAGEMENT DEALINGS The Directive extends the scope of the previous UK requirements imposed on directors to disclose transactions in a company's securities to cover a wider category of

Seven types of abuse

The amended section 118 of the Financial Services and Markets Act 2000 specifies seven types of market abuse of which the first five are those mandated by the MAD:

- **insider dealing –** where an insider deals or attempts to deal in securities on the basis of inside information
- **improper disclosure –** where an insider discloses inside information to someone else otherwise than in the proper performance of their duties
- **manipulating transactions –** where a transaction gives a false or misleading impression to the market of the supply, demand, price or value of a security or secures the price of a security at an artificial level
- **manipulating devices –** where a transaction employs a fictitious device or other form of deception or contrivance
- **misleading dissemination –** where false or misleading information is knowingly or negligently disseminated to the market.

In addition, two residual categories remain, based on the existing heads of market abuse in the UK. These cover types of behaviour not caught by one of the above categories but which involve either:

- the **misuse of relevant information** that is not generally available to the market or
- other forms of **misleading behaviour** or **market distortion,**

in each case, that a regular user of the market in question would consider to be a failure to observe reasonable standards of behaviour.

To limit accusations of "gold-plating" these two super-equivalent categories are subject to a "sunset clause" under which they will cease to have effect on 1 July 2008 unless preserved by prior legislation.

It should also be noted that the existing "secondary offence" of requiring or encouraging another person to engage in market abuse is maintained in the new regime.

persons. The new requirement to report transactions in a company's shares or related securities extends to persons discharging managerial responsibilities within that company and to their "connected persons".

"Persons discharging managerial responsibilities" are defined as:

- directors of the company
- senior executives of the company who are not directors but who have:
  - – regular access to inside information concerning the company and
  - – power to make managerial decisions affecting the company's future development and business prospects.

INSIDER DEALING AND MARKET MANIPULATION Since 2001, market conduct has been regulated in the UK by the civil market abuse regime as well as certain criminal provisions. Under the measures implementing the MAD, the previous UK criminal sanctions are retained and the market abuse regime is amended to take account of the specific requirements of the Directive.

The Code of Market Conduct, which gives guidance on market abuse, has been rewritten. It describes factors indicative of market abuse, gives specific examples of behaviour which is, or is not, market abuse, and also sets out certain safe harbours, compliance with which will protect against the possible commission of market abuse.

INSIDE INFORMATION In relation to the insider dealing and improper disclosure offences of the market abuse regime, the definition of inside information is slightly wider than that used in the disclosure regime described earlier and includes the category of relevant information not generally available. Companies are only required to disclose inside information that directly relates to them.

However, in relation to insider dealing and improper disclosure, the definition of inside information is extended to include information that is indirectly related to the company as well. This could include, for example, information such as a change in tax treatment that relates to a particular business sector that could impact the share price of all companies in that sector equally, rather than just a specific issuer.

INSIDERS An insider is a person who has inside information as a result of:

- membership of the administrative, management or supervisory board of a company which has securities admitted to trading;
- holding securities in such a company;
- their employment, profession or duties;
- any criminal activities; or
- other means, but where they know, or could reasonably be expected to know, that they hold inside information.

SAFE HARBOURS This term has a narrower and more specific meaning in the Directive than currently in the UK market abuse regime. Only two safe harbours are expressly provided under the Directive – for price-stabilising activities and repurchases of own shares – in each case only in-so-far as permitted by the detailed requirements of the safe harbours.

WHISTLEBLOWING Financial intermediaries executing transactions in the UK are required to notify the FSA without delay if they "reasonably suspect" that a transaction might constitute insider dealing or market manipulation under the new regime. In such circumstances, there is no need for actual evidence of abuse before a requirement to notify may arise, provided that there is a "sufficient indication" that a transaction might be abusive.

Where the whistleblowing obligation applies, it overrides client confidentiality obligations and will also prevent the financial adviser concerned from notifying the person on whose behalf the transaction is carried out of the fact that a notification has been made.

This article is a summary of the ACT's briefing note: *The New Market Abuse and Disclosure Regime in the UK*, which was prepared and written by Linklaters. The full version is available on www.treasurers.org.

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