BRIEFING NOTE:

THE NEW MARKET ABUSE AND DISCLOSURE REGIME IN THE UK

A GUIDE FOR LISTED COMPANIES

Prepared and written by

Linklaters

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Introduction

The EU Directive on insider dealing and market manipulation (the "**Directive**" or "**MAD**") aims to harmonise market abuse rules across the EU.[1]

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 introduces a number of significant new compliance measures aimed at preventing market abuse.

The Directive imposes new compliance burdens on companies, in particular the requirement for insider lists and enhanced confidentiality procedures

This note summarises the key provisions implementing the MAD as they affect UK-listed companies and their advisers, including:

- the new regime for disclosure of price-sensitive information by listed companies
- the requirement for companies to maintain lists of people who have access to inside information
- the requirement for senior managers and their "connected persons" to disclose dealings in their company's securities
- the obligation on companies to ensure that persons with access to inside information acknowledge their duties and understand the sanctions attaching to misuse of it
- the obligation on companies to establish effective arrangements to deny access to inside information to persons other than those within the company who need to know
- the revised market abuse regime with EU-wide safe harbours for specified stabilisation and share buy-back activities
- the obligation on investment banks to notify suspicious transactions
- the new disclosure regime in relation to investment research and recommendations.

The Directive was due to be implemented in member states by 12 October 2004. The UK implementing measures came into force on 1 July 2005 at the same time as the new Listing Rules and the Prospectus Rules implementing the Prospectus Directive. This was also the implementation date for the Directive in Sweden. Other member states that have already implemented the Directive include Germany, Italy and Spain.

Scope and application of the Directive

As is clear from its title, the primary focus of the Directive is to combat market abuse throughout the EU through the creation of offences of insider dealing and market manipulation. To a large extent these offences overlap with pre-existing UK criminal and civil provisions regulating market conduct.

1 Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) *OJ L96/16 – 12.4.2003.* References throughout to the Directive or the MAD include references to the following Level 2 implementing measures made thereunder: Commission Regulation (EC) No 2273/2003 *OJ L336/33 – 23.12.2003*, Commission Directive 2003/124/EC *OJ L339/70 – 24.12.2003*, Commission Directive 2003/125/EC *OJ L 339/73 – 24.12.2003* and Commission Directive 2004/72/EC *OJ L162/70 – 30.4.2004.*

The Treasury's approach to implementation has been to make as few changes as possible to the UK regime while at the same time ensuring full implementation of the Directive. The result is that the criminal provisions on insider dealing and market manipulation under the Criminal Justice Act 1993 and section 397 of the Financial Services and Markets Act 2000 ("**FSMA**") are left unaltered. The civil market abuse regime under section 118 of FSMA is adapted to be consistent with the Directive. However, elements of the previous UK market abuse regime which are "superequivalent" to the Directive are retained, subject to further review.

The market abuse provisions of the Directive are implemented through amendments to the UK market abuse regime and alongside the criminal provisions

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.[2]

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 IPO applicants will become subject to the continuing disclosure rules before admission has become effective.

The new rules apply, in the case of IPOs, after the request for admission to trading has been made, even though dealings have not yet commenced

Disclosure of inside information

The 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**").

Companies must disclose to the public "inside information" that relates directly to them as soon as possible

The FSA has stated that the new rules are "conceptually and operationally similar" to the previous regime for the disclosure of price-sensitive information and that it has "implemented the Directive so as to align the Directive closely with the existing Listing Rules".[3] However, listed companies and their advisers will need to recognise that the new rules governing the disclosure of information could, in some circumstances, lead to different conclusions as to a company's obligations.

The new rules are set out in the same format as the new Listing Rules and Prospectus Rules. This involves incorporating guidance alongside the rule to which it relates, and means that the UKLA's Guidance Manual, including the

2 The principal market abuse offences will also extend to companies with securities traded on virt-x by virtue of being listed on the Swiss Stock Exchange, as virt-x is a prescribed market for these purposes.

3 FSA Policy Statement 05/3, paragraphs 3.6 and 3.7.

PSI Guide, largely disappears. 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?

Information is price-significant only if likely to be used by a reasonable investor as part of his investment decisions

"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"[4].

This reference to a reasonable investor's investment decisions could be read as broadening the scope of the definition. However, it is helpful that the Disclosure Rules indicate that information that would be used by a reasonable investor "would therefore have a significant effect on the price of the issuer's securities". This suggests that, to fall within the definition, information should be significant *as well as* of a kind which a reasonable investor would take into account.

In guidance, which is based in part on the old Listing Rules 9.1 and 9.2 setting out a listed company's general obligations of disclosure, 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.[5]

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 current 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.

4 s.118C(6) FSMA
5 DR 2.2.6G

Concerns emerged during the process of consultation on the draft Disclosure Rules that they would require companies to monitor market rumours and issue denials of untrue rumours, thus running counter to many companies' "no comment" policies. This concern was 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. Even if it does amount to inside information, the FSA indicates that in most cases an issuer will be able to delay disclosure (often indefinitely) in accordance with the Disclosure Rules. 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.

Companies should not have to comment on rumours in the absence of an actual or likely leak

LIST! No. 9 gives a helpful example on this point: a company known to have previously been in discussions regarding a potential US merger need not respond to a report that it is again in discussions with a potential US merger-partner, even if this is true. However, if the report contains more concrete information, such as the name of the other party, dates of meetings, or details of deal terms or structure, this would suggest there has been a breach of confidence, and an announcement would be required.[6]

Disclose when?

Disclosure must be made as soon as possible via a Regulatory Information Service and then on the company's website

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

Disclosure may be delayed to protect a legitimate interest provided that the public is not misled and confidentiality is preserved

As under the old regime, a company may delay the disclosure of inside information in certain circumstances. However, the new rules are in some respects narrower than the provisions formerly contained in Listing Rules 9.4 and 9.5.

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.[7]

6 LIST!, No. 9 (June 2005), paragraph 5.4.
7 DR 2.5.1R.

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. At first sight, this may seem to make it very difficult to delay any disclosure. The FSA's guidance states, however, that "delaying disclosure of inside information will not always mislead the public".[8] It is accepted that some information must be kept confidential until developments are sufficiently advanced for disclosure not to prejudice the interests of the company, although this will not provide blanket protection for companies.

A holding announcement should be prepared as a matter of course if the announcement of inside information is being delayed

Delay is not permitted where confidentiality cannot be ensured. Therefore, as under the previous rules, information must be announced if a leak has occurred or is likely. Specifically, issuers must have in place measures to ensure that an announcement can be made as soon as possible if confidentiality cannot be ensured. Where the announcement of inside information is being delayed, a holding announcement should be prepared (see below).[9]

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.[10]

This approach reflects a number of the FSA's recent pronouncements in this area where the search for a solution has been rejected as a reason to justify delaying the disclosure of a problem. Instead, companies should announce the existence of a problem to the market and subsequently, when a solution is found, announce the solution.

Companies cannot delay disclosure while they look for a solution to a problem

Holding announcements

Timeliness is of the essence when making regulatory disclosures under both the old and the new regime. However, the new rules do recognise that if an issuer is faced with an unexpected and significant event, a "short" delay may be

A short delay is permissible while a significant and unexpected event is clarified

8 DR 2.5.2G.
9 DR 2.6.2R and 2.6.3G.
10 DR 2.5.3R and 2.5.4G.

acceptable while the situation is clarified. The length of the delay will obviously depend upon the nature of the event and the steps needed to confirm its significance and impact. If the issuer is not able to avoid a danger of the information leaking, it should publish a holding announcement. A holding announcement in these circumstances (or wherever the confidentiality of inside information whose disclosure is being delayed cannot be ensured) should:

- explain as much of the subject matter as possible
- give the reasons why a fuller announcement cannot be made
- undertake to announce further details as soon as possible.

Where an issuer is unable or unwilling to make a holding announcement, a suspension of trading may be appropriate.[11]

Selective disclosure

The categories of person to whom information can be selectively disclosed now include major shareholders, lending banks and credit-rating agencies

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. The duty of confidentiality does not necessarily need to be reflected in a formal confidentiality undertaking. However, the FSA has stated that the company should, in the absence of a written obligation, document the nature of the duty of confidentiality. For example, in the case of a disclosure to legal advisers, the fact that the company is relying on the lawyer's duty of confidentiality should be recorded, although where an issuer has an ongoing relationship with an adviser who owes it a duty of confidentiality (such as its sponsor or lawyers), it may rely on the standard terms of engagement it has with that adviser.[12]

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.[13] This is in line with market practice in this area. In addition, the list of persons set out in the rules is clearly stated not to be exhaustive. Nevertheless, 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

Companies are subject to new obligations to train employees and to protect the confidential nature of inside information before it is disclosed

As before, companies are required to take all reasonable care to ensure that announcements they make are not false or misleading. A new requirement is to ensure that the company does not combine marketing of its services with a Regulatory Information Service announcement in a manner likely to be misleading. In addition, all companies with securities admitted to regulated markets are under new specific obligations to:

- have in place measures to preserve the confidentiality of information and

11 DR 2.2.9.
12 Market Watch, No.12 (June 2005), FAQ 19.
13 DR 2.5.7.

- limit access to inside information to those that strictly require the information to carry out their job.

The significance of these new process requirements is bolstered by the Listing Principles under the new Listing Rules. These require companies with a primary listing of equity securities to have adequate systems, procedures and controls in place to ensure compliance with obligations under the Disclosure Rules. They also require companies to communicate information in such a way as to avoid the creation or continuation of a false market.

In particular, guidance on Listing Principle 2 indicates that companies must ensure they are in a position to identify information which requires disclosure in a timely manner and ensure that such information is properly considered by the directors. Such consideration should encompass the question of whether the information should be disclosed.[14]

The LIST! recommendations (derived from the former PSI Guide) focus to a large extent on measures to ensure confidentiality by preventing unauthorised or unintentional disclosure of inside information, for example to the press or analysts. Procedures to prevent such breaches of confidence include ensuring that only a limited number of persons are authorised to speak to the press, and ensuring that all staff are aware of who these people are.[15]

Practical impact

In summary, the FSA's expectation is that the new definition of inside information should generally not lead to a different result when analysing what a company should disclose. However:

- companies should focus on ensuring that they have clear procedures in place to identify, escalate and disclose announceable information
- where disclosure of inside information is to be delayed this must be justifiable on the grounds of the company's "legitimate interest" and
- the rules have an increased focus on the need to prepare draft holding announcements and release them if the confidentiality of information is endangered or breached.

14 LR 7.2.3.

15 LIST!, No. 9 (June 2005).

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.

Companies and those acting on their behalf must maintain lists of people with access to inside information

These provisions, as implemented through the Disclosure Rules,[16] require companies to draw up and maintain lists of those with access to inside information, containing the following information:

- the names of all individuals within the company with access to inside information relating directly or indirectly to the company, whether on a regular or an occasional basis
- the reason why the person is on the insider list
- the dates on which the list was created and updated
- the names of the issuer's principal contact(s) at any other firm or company acting for it, with whom it has direct contact and who have access to inside information about it.

Insider lists 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 it (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 it. 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.

The preparation of insider lists is a considerable administrative task. In its impact assessment for the new regime, the Treasury argued that listed companies already maintain such lists as a matter of best practice. In our experience, however, detailed lists of the type contemplated by the new rules were maintained by some companies in connection with individual major transactions, but not generally on an ongoing basis. Professional advisers would also draw up such lists in response to specific regulatory inquiries but would not otherwise normally do so.

The preparation of insider lists is likely to be a considerable administrative burden for many companies

In practice, many companies, rather than operating a single insider list, will find it administratively more convenient to keep separate lists for different projects that do or could involve inside information, as well as a general list of those people who have regular access to inside information, such as senior executives, finance and accounting staff, or those who compile statistics relating to other price-sensitive performance indicators. The FSA has not specifically endorsed this approach. It has, however, stated that it is not being prescriptive about the form in which insider lists are kept. Keeping lists in electronic form is acceptable.[17]

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16 DR 2.8.

17 Market Watch, No.12 (June 2005), FAQ 12.

In addition, issuers are obliged to ensure their insider employees acknowledge their legal and regulatory duties, and are aware of the sanctions attaching to market abuse. They must also ensure that other organisations acting for them have taken the necessary measures to ensure their own employees similarly understand and acknowledge the implications of market abuse.

These obligations suggest that both issuers and their advisers should provide appropriate market abuse training for both existing and future employees.

Management dealings

Those discharging managerial responsibilities within a company and their "connected persons" are required to disclose transactions

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 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".[18]

Persons discharging managerial responsibilities

"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.[19]

Connected persons

"Connected persons", who are also obliged to notify their transactions, are defined as:

- "connected persons" under section 346 of the Companies Act 1985 – this broad definition catches a spouse or child together with any entities controlled by those exercising managerial responsibilities as well as any trusts of which they, their families or controlled entities are beneficiaries
- any relatives who have shared the same household for at least 12 months
- any other body corporate of which the person discharging managerial responsibilities or a connected person (as set out above) is a director or senior executive who has the power to make management decisions affecting the future development and business prospects of that body corporate.[20]

A company will only be a "connected person" by virtue of the third bullet point above if the person discharging managerial responsibilities (or his connected person) is the sole director of the company or personally has control over decisions affecting its future development and prospects.

Notifications required

Notification must be made to the company within four working days of the transaction and the company must announce this to the market as soon as possible

Any transaction conducted on the account of persons discharging managerial responsibilities or their connected persons in the shares of the company or in derivatives or other financial instruments relating to those shares must be notified. Notification of the transaction must be given to the company within four working days of the transaction taking place. Where a company receives a notification that a transaction has taken place, it must disclose this via a

18 DR 3. Under the Disclosure Rules, this obligation will apply in respect of EU companies with securities admitted to trading on regulated markets in the UK, and in respect of non-EU companies whose home member state, in respect of the listing of their shares in the EU, is the UK.

19 FSMA Section 96B(1).

20 FSMA Section 96B(2).

Regulatory Information Service as soon as possible (and, in any event, no later than the day after receipt of the notification).

Companies should make sure that the correct people within the company understand and comply with these notification obligations. As a practical matter, companies should consider the scope of internal authorities and management practices, to determine who within the company, other than the directors, exercises managerial responsibilities within the scope of the definition. Generally, we would expect that this will not be a large number of people, and we understand that the FSA does not wish that the new rules should give rise to a large volume of additional notifications by persons who are not very senior.

Directors' interests under the Companies Act 1985 must also be notified.

The provisions of section 324 of the Companies Act, requiring the notification of dealings in shares and debentures by directors, are not affected by the new regime. Directors may therefore have to notify the same transaction under both the Companies Act and the new Disclosure Rules. In these circumstances, issuers must, when announcing the transaction, make clear that a single transaction is involved. A single form for notifications by issuers, covering both the Disclosure Rules and the Companies Act notification obligations, is made available by the FSA on its website.

The FSA has the power under FSMA to fine companies, managers and persons connected to them if they fail to comply with these obligations.

The new terminology and definitions are reflected in the Model Code.

Under the new Listing Rules, issuers of listed equity securities are also required to comply with the Model Code, which has been amended to correlate with the new terminology of the Directive. The Model Code applies both to employees whose names are required to be on the company's insider list, and to persons discharging managerial responsibilities. It prohibits dealings when undisclosed inside information exists in relation to the company and during close periods. Persons discharging managerial responsibilities are obliged under the Model Code to take reasonable steps to prevent any dealings by or on behalf of their connected persons during a close period (but not if inside information exists outside a close period).

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. In practical terms, this means the breadth of the UK market abuse regime is maintained, overarching the specific types of problematic behaviour identified by 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.

Seven types of abuse

Seven types of market abuse conduct are specified under the new regime

The previous market abuse regime under section 118 of FSMA identified three broad categories of behaviour constituting market abuse: misuse of information, creating a false or misleading impression and market distortion. The amended section 118 of FSMA 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 (unless the transaction is carried out for a legitimate reason and in conformity with an "accepted market practice")
- **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 superequivalent categories are subject to a "sunset clause" under which they will cease to have effect on 1 July 2008 unless preserved by prior legislation. HM Treasury will consult on the

operation of the regime and of these provisions before deciding whether or not to retain them.

Behaviour in connection with the market abuse regime includes both action and inaction. This is one of the areas of superequivalence of the UK regime over that set out in the Directive. 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.

Inside information

Inside information is more widely defined in respect of market abuse than under the disclosure regime

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 in this note. 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.

There are slightly different definitions of inside information applicable to commodity derivatives and to persons responsible for executing clients' orders in securities transactions.[21]

Insiders

Insiders include anyone who could reasonably be expected to know that they have inside information

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.[22]

Regular user

The application of the "regular user" test has been reduced under the new regime

As indicated above, the "regular user" test, which under the current regime provides a benchmark for acceptable behaviour, no longer operates across the whole range of market abuse offences. As the Directive does not recognise the concept of the regular user, the test only remains relevant to the residual categories of market abuse and not to the five specific offences based on the Directive. For the offences derived from the Directive a patchwork of different defences or qualifications may apply. For example, in relation to the manipulating transactions offence, if behaviour is carried out for legitimate reasons *and* in conformity with "accepted market practices" then an offence will not be committed. The FSA has identified only one category of accepted market

21 s.118C.
22 s.118B.

practices for these purposes – activities in accordance with the London Metal Exchange's document "Market Aberrations: The Way Forward".

Safe harbours

Stabilising activities and share buy-backs will benefit from safe harbour protection

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.

Other currently acceptable corporate finance activities, eg in relation to takeovers, will remain acceptable under the new regime

However, the Code of Market Conduct continues to set out conclusive descriptions of types of behaviour that will not amount to market abuse. These include:

- dealing with the benefit of trading information, for example where the inside information you hold is the knowledge that you are planning to deal
- takeover activity, including stakebuilding, the seeking of irrevocable undertakings and the making of arrangements to issue securities or offer cash as part of a takeover offer
- disclosure of inside information which is required by the Listing Rules, Disclosure Rules or Prospectus Rules and
- behaviour conforming with certain express provisions of the Takeover Code, provided the behaviour also conforms with the General Principles under the Code.

Repurchases of own shares

Repurchases of own shares must comply with specified requirements as to price and volume in order to fall within the safe harbour

Companies repurchasing shares under a general shareholder authority for on-market purchases in the UK may do so within the terms of a safe harbour under the market abuse regime. The safe harbour is set out in an EU regulation, on which limited guidance is provided by the FSA.[23] It contains detailed conditions that must be satisfied in order for buy-backs to fall within the safe harbour. Under the old regime, no safe harbour was provided for share buy-backs and market abuse was not generally seen as a concern, provided that the repurchases were conducted in accordance with the requirements of the Companies Act and the Listing Rules. In principle, this remains the case: where share buy-back activities do not fall within the specific provisions of the safe harbour, that is not to say that they will necessarily constitute market abuse.

To fall within the safe harbour regulation, the sole purpose of repurchases must be to reduce the capital of the issuer or to satisfy obligations arising under employee share plans or exchangeable debt instruments. The reasons for the buy-back, the maximum consideration to be paid, the maximum number of shares to be repurchased and the duration of the authority must be disclosed via a Regulatory Information Service. Repurchases may not be at a price higher than the last independent trade or highest current bid on the relevant exchange and may not represent more than 25 per cent of the average daily volume of

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shares traded on the relevant market.[24] Companies may not sell their own shares during the life of the repurchase programme.

Buy-backs of shares within the safe harbour will not be permitted during close periods under the Model Code or when the disclosure of inside information to the market has been delayed by a company, unless:

- the company has in place a programme where the dates, quantities and price of shares to be repurchased are fixed when the programme is set up or
- the programme is managed by an investment firm that makes trading decisions on the timing, etc. of purchases independently of the issuer.

It is possible to conduct buy-backs without complying with the conditions of the safe harbour

As indicated above, it is possible to conduct buy-backs without complying with each of the conditions laid down by the safe harbour regulation. In practice, many companies are likely to find that strict compliance with all of the safe harbour's provisions could restrict their ability to conduct buy-backs effectively. Such companies will continue to comply with the Listing Rules, particularly as regards disclosure and dealings in close periods. The Listing Rules offer issuers a choice in relation to the maximum price specified in general buy-back authorities – either 105 per cent of the latest five-day average (ie the maximum specified under the old Listing Rules) or the maximum price formula specified in the buy-back safe harbour regulation.

Nevertheless, if conducting buy-backs otherwise than in accordance with the regulation, it will be necessary to consider whether the elements of one of the market abuse offences may apply to the buy-back activities. In particular, where the share buy-back could have a distortive effect on the market, the views of the regular user, considering whether the buying activities have been conducted in an acceptable way, are likely to take into account the provisions of the safe harbour. The volume limits, as well as the price limits, may be relevant here.

24 In instances of extremely low liquidity this volume level may be increased to 50 per cent where this has been notified to the FSA and via a Regulatory Information Service.

Other provisions

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.

Investment recommendations

Investment banks and others who publish investment research and other investment recommendations are subject to new provisions requiring fair presentation, including obligations to disclose sources and methodologies used and to distinguish clearly facts from opinions or estimates. In addition, certain relationships with the company subject to any recommendation must also be disclosed to ensure that any potential conflicts of interest are identified. These include corporate finance activities undertaken for the company and holdings of securities in the company in excess of 5 per cent.

The requirements in relation to investment recommendations are in addition to the FSA's rules requiring firms to have in place a policy to ensure the effective management of conflicts of interest in relation to research, which took effect in July 2004.

Conclusions

The breadth of the UK market abuse regime has been maintained through the implementation of the Directive, although the loss of the "regular user" as an indicator of acceptable behaviour for those parts of the regime specifically derived from the Directive could be considered to have widened the regime in some respects.

Equally, the requirement for companies to disclose inside information does not mark a significant departure from the previous Listing Rules requirements in this area. However, the processes and procedures surrounding the management of inside information by companies have become more onerous, in that:

- it is now a regulatory obligation, rather than merely best practice, to have appropriate means in place to ensure the confidentiality of information
- likewise there is an increased emphasis on the importance of having in place proper systems and processes to enable inside information to be disclosed promptly and appropriately – this is likely to involve developing written disclosure practices. Companies may also wish to consider whether changes to their working practices are required. For example, the establishment of a disclosure committee may in some cases be a useful mechanism to aid the disclosure approval process
- lists of those with access to inside information must be kept at all times and maintained for five years
- employees must be trained in order to understand their obligations under the regime, including senior managers as regards their obligations in relation to dealings in securities by themselves or their close associates.

Although the implementation of the Directive is being presented by the FSA in many respects as "business as usual", the new regulatory regime does, as a result of the above, pose new challenges for companies.

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