

## **MARKET ABUSE**

### **Best Practice Points for Firms**

The FSA has published several items recently on the area of market abuse. This includes:

- A Factsheet giving information on the revised Code of Market Conduct;
- A new instrument (the Short Selling Instrument 2008) which brings additional disclosure requirements on short selling into effect on 20<sup>th</sup> June 2008;
- An edition of MarketWatch, No 27, devoted to the results its thematic review of controls over inside information on public takeovers;
- A good practice paper for unregulated firms on insider dealing which resulted from a working group (made up of various organisations involved in merger and acquisition work (M&A) and facilitated by the FSA).

It has also taken an increasingly robust public stance, particularly in the wake of trading in UK financial shares, particularly HBOS, over the past few weeks. Newly appointed Managing Director, Wholesale and Institutional Markets, Sally Dewar, said in March 2008:

"We will not tolerate market participants taking advantage of the current market conditions to commit abuse by spreading false rumours and dealing on the back of them.

We remind market participants of the need to take extra care, in this market climate, to adhere to the Market Code of Conduct."

#### **1. KEY POINTS**

##### **1.1 Legislation**

The EU Market Abuse Directive provides an EU wide market abuse regime aimed at reducing the incidence of market abuse. It came into force on 1<sup>st</sup> July 2005. In the UK, Market Abuse is defined in section 118 of the Financial Services and Markets Act 2000 (FSMA); it imposes additional requirements to the Directive. The Directive is currently under review, and HM Treasury has, through a statutory instrument laid before Parliament on 6<sup>th</sup> June 2008, just announced the extension of the the UK's super equivalent provisions until 31<sup>st</sup> December 2009. It is expected that by then the EU review will have been completed.

The FSMA created a new regime complementing existing laws dealing with misconduct in financial markets. The central part of the new regime is the Code of Market Conduct (the Code).

##### **1.2 Inside Information and Market Abuse**

Abuse of the financial markets involves either insider dealing (using or seeking to use certain information that is not publicly available for one's own advantage) or market manipulation (distorting the market by giving false signals and misleading others). Inside information can be considered as information that is not generally available and that a reasonable investor would use to help him/her/it make investment decisions. It is also information that, if generally available, would be likely to significantly affect the price of an investment.

The following are types of behaviour which can amount to market abuse:

- Insider dealing – this is when an insider deals, or tries to deal, on the basis of inside information;
- Improper disclosure – where an insider improperly discloses inside information to another person.

- Misuse of information – behaviour based on information that is not generally available but would affect an investor's decision about the terms on which to deal.
- Manipulating transactions – trading, or placing orders to trade, that gives a false or misleading impression of the supply of, or demand for, one or more investments, raising the price of the investment to an abnormal or artificial level.
- Manipulating devices – trading, or placing orders to trade, which employs fictitious devices or any other form of deception or contrivance.
- Dissemination – giving out information that conveys a false or misleading impression about an investment or the issuer of an investment where the person doing this knows the information to be false or misleading.
- Distortion and misleading behaviour – behaviour that gives a false or misleading impression of either the supply of, or demand for, an investment; or behaviour that otherwise distorts the market in an investment.

In some cases, behaviour will be market abuse where it is below the standard expected of a 'regular user'. A regular user is considered to be someone who deals regularly and understands the workings of the market concerned.

### 1.3 What is covered?

The FSA's Code of Market Conduct (the Code) covers all investments traded on the UK's 'prescribed markets', as well as those traded on other European regulated markets.

The prescribed markets in the UK are:

- EDX London Ltd;
- London Stock Exchange Plc (including AIM);
- virt-x;
- International Petroleum Exchange;
- LIFFE;
- London Metal Exchange;
- OFEX.

The Code covers trading of these investments and related products that is carried out both via exchanges and 'over-the-counter'. Any individual or firm who deals in stocks and shares, bonds, unit trusts and investment trusts, futures and options, or 'over-the-counter' products such as spread bets in stocks.

### 1.4 Who is covered?

The Code affects everyone who participates in, or whose conduct affects, the UK's financial markets. It is immaterial whether or not the person is regulated by the FSA, or based in the UK or overseas, or whether they are a professional or a retail investor. The Code also covers behaviour that takes place in the UK in relation to investments traded on other European regulated markets.

This has implications for non-regulated firms, such as printers, public relations consultants and professional advisers, who may, during the course of their activities come into possession of inside information. All these types of firms should be just as careful about the treatment of insider information as regulated firms.

### 1.5 Criminal and FSA Sanctions available

Both insider dealing and market manipulation are criminal offences in the UK – the penalty is a maximum of seven years in jail. Market Abuse is not a criminal offence, and thus a conviction will not result in a jail sentence, but the FSA can seek an unlimited fine, and prevent a convicted person from working in financial services.

## 2. BEST PRACTICE ACTIONS THAT SHOULD BE TAKEN BY AFFECTED FIRMS

### 2.1 M&A work – non regulated firms

It is particularly important that firms recognise that information on mergers or acquisitions (M&A) is particularly price sensitive. The FSA recently facilitated discussions by an industry working group, which has published a good practice paper on insider dealing with particular reference to unregulated firms. The paper covers several areas which, although aimed at non regulated firms, also give a valuable reminder to regulated firms.

There are six principles covering the following:

- policies and procedures;
- awareness and training;
- “need to know” and other information controls;
- passing price sensitive information to third parties;
- Information Technology security; and
- personal dealing policies.

### 2.2 Regulated Firms

The FSA has published two “MarketWatch” newsletters on this subject. MarketWatch 21 (July 2007) looked at the controls firms had in place to cover inside information on public takeovers. Follow up results were published in MarketWatch 27 (June 2008) and show that in the interim period, firms had generally acted on the areas of weakness highlighted, and generally improved their practice. However, although there has been a “notable improvement”, the FSA noted that much more can be done, particularly to limit the number of insiders on “super sensitive” deals. Both newsletters contain valuable best practice points, which should be studied by firms.

FSA has also called for a number of actions by firms, including a recommendation that they should consider how they would manage a leak enquiry and what areas and actions to take. Firms should consider the following actions if not already in place, and review their provisions and policies regularly in any event:

- Firms should not employ temporary staff in control rooms, or in corporate finance if at all possible;
- Firms should, from time to time, audit whether the number of insiders on deals is appropriate – perhaps on a sampling basis;
- Firms should focus training on sub-contractors where those employed are typically on a three-month rolling contract and may not be as well trained and vetted as permanent full-time staff, if they are employed at all (see above);
- Firms should review their IT systems so that they can identify which individuals have actually accessed specific files on the IT drives and at what times – this is essential if the firm (or the FSA) is trying to assess who could have misused the information;
- Firms should have more detailed discussions with firms (eg in PR or printing) that they make insiders if they think it is important to keep the numbers particularly low; and
- Firms active in corporate finance should ensure they have a policy to cover when, and how, to undertake enquiries into M&A leaks.

## 3. WHAT IS GOING TO HAPPEN NEXT

In view of the high profile and robust stance that the FSA has taken, it is certain that this area will be of interest to it for some time. This is also because the current market position of financial institutions has given rise to rights issues, and the FSA has seen instances of market manipulation which has affected the viability of these, and which therefore has implications for financial stability. Firms should therefore ensure that they have robust systems and controls in place, and review these regularly.

#### 4. FURTHER INFORMATION

The FSA Factsheet on Market Abuse (June 2008) can be found at the following link  
[http://www.fsa.gov.uk/pubs/public/market\\_abuse.pdf](http://www.fsa.gov.uk/pubs/public/market_abuse.pdf)

MarketWatch 21 can be found at the following link:  
[http://www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter21.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter21.pdf)

MarketWatch 27 can be found at the following link:  
[http://www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter27.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter27.pdf) note that this also includes the best practice points for non regulated firms as an appendix

Financial Services and Markets Act (2000) can be found at the following link:  
[http://www.opsi.gov.uk/ACTS/acts2000/ukpga\\_20000008\\_en\\_1](http://www.opsi.gov.uk/ACTS/acts2000/ukpga_20000008_en_1)

EU Market Abuse Directive can be found at the following link:  
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:096:0016:0025:EN:PDF>

#### **WARNING**

Errors and Omissions Excepted.

This communication is for the general information of subscribers. It is not a professional opinion relating to a specific set of circumstances or a specific client. Recipients must not place reliance upon it in relation to their own specific circumstances without seeking professional guidance specific to those circumstances.

Unless recipients are current clients, Resources Compliance will not enter into correspondence with recipients in relation to the content of this communication or provide further guidance or opinion.

#### **COPYRIGHT**

Copyright 18/06/2008. Resources Compliance (UK) Limited is part of the Resources Global Professionals group. Resources Compliance (UK) Limited is Registered in England No. 2487404. Registered Office: 117 Houndsditch, London, EC3A 7BT. All rights reserved.

This publication is for the registered individual entitled as recipient. Copying and/or automatic forwarding of this communication to other individuals without the express written permission of Resources Compliance is prohibited.

Should you or your colleagues require additional copies, please contact us for subscription details and an application via [Jo.Stephens@resources-uk.com](mailto:Jo.Stephens@resources-uk.com)