

Review

Corporate Finance



Capital Markets Practice

News round-up

Market abuse edition

Introduction

Welcome to the latest in our series of regular alerts containing a round-up of news from our capital markets practice.

In this issue, we consider in more detail the developments we mentioned briefly in our March edition relating to the market abuse regime and the latest proposals regarding the transfer of responsibility for regulating market conduct from the Financial Services Authority (FSA) to the new Financial Conduct Authority.

UK financial services regulatory structure: market abuse regime: the new Financial Conduct Authority

We have previously reported on proposals for the new regulatory structure for the UK services industry contained in the Government's consultation paper of July 2010: *A new approach to financial regulation: judgement, focus and stability*.¹

On 17 February 2011, the Government published a further consultation document, *A new approach to financial regulation: building a stronger system*, which expands on the Government's earlier consultation. Amongst its other proposals, the Government now proposes that, with one exception², all the markets regulatory functions currently carried out by the FSA, including its role as the UK Listing Authority, be transferred to a new body called the Financial Conduct Authority (FCA)³.

Accordingly, the FCA will be the body responsible for exercising the powers currently exercised by the FSA under the Financial Services and Markets Act 2000 (FSMA) to combat market abuse together with the power to institute proceedings for the criminal offence of insider dealing under Part V of the Criminal Justice Act 1993.

The Government has announced that Martin Wheatley, currently the chief executive officer of the Hong Kong Securities and Futures Commission, will be the chief executive of the FCA. Mr Wheatley, who has a reputation for taking a strong line on enforcement policies, will, as from 1 September 2011, be joining the FSA as the managing director of its consumer and markets business unit in order to help the team prepare for its transition to the FCA pending his formal appointment to that body once it has been established.

The Government has signalled that it does not propose to make any changes to the powers currently vested in the FSA to regulate market conduct and all the indications are that the FCA will continue to build on the 'credible deterrence' policy developed by the FSA. A key plank of this policy, adopted by the FSA in 2007, has been the use of its enforcement powers to regulate

¹ Capital Markets Practice News round-up: issue no. 1/2011

² The exception being the responsibility for the prudential oversight of clearing and settlement which will transfer to the Bank of England.

³ The FCA had originally been given the working name of 'The Consumer Protection and Markets Authority'.

market conduct. As well as pursuing civil actions for market abuse, the FSA has been determined to bring criminal prosecutions for insider dealing. In the past two years, the FSA has prosecuted six successful criminal cases leading to the convictions of ten individuals, all of whom have received custodial sentences. Charges have been brought against a further thirteen people who are due to stand trial this year. As part of the policy, the FSA ensures that news of successful convictions, as well as of the arrests of suspects, is widely publicised.

Comments on the latest consultation paper are requested by 14 April 2011. The Government intends to publish a further consultation on detailed proposals and draft legislation by the end of June this year with a view to setting up the new regulatory structure by the end of 2012.

HM Treasury consultation paper: A new approach to financial regulation: building a stronger system: February 2011 available at:

http://www.hm-treasury.gov.uk/d/consult_newfinancial_regulation170211.pdf

Market abuse: Code of Market Conduct amended following decision of the European Court of Justice to remove evidential requirement of intent

The decision of the European Court of Justice (ECJ)

In a case⁴ regarding the interpretation of the expression 'use of inside information' in Article 2(1) of the Market Abuse Directive (2003/6/EC), the ECJ ruled in December 2009 that, where a person with inside information deals in securities to which the information relates, it will not be necessary to show that there was any intent to use the inside information as the basis of the trades in order to establish that insider dealing has taken place.

The UK regime

Section 118(2) of FSMA, implementing Article 2 of the Market Abuse Directive, requires that an insider deals 'on the basis of' the inside information for insider dealing to have occurred. The Code of Market Conduct, in MAR 1.3.3E⁵ and MAR 1.3.5E⁶, lists circumstances which, in the opinion of the FSA, indicate that behaviour is not 'on the basis of' inside information. MAR 1.3.4E reflected the FSA's opinion that if the inside information was the reason for, or a material influence on, the decision to deal that indicated that the person's behaviour was 'on the basis of' inside information.

Changes to the Code of Market Conduct: deletion of MAR 1.3.4E

Following the Spector case, the FSA no longer considers it necessary to show evidence of intention in order to prove market abuse in the form of insider dealing. Its quarterly consultation paper, CP10/22, proposed that MAR 1.3.4E (which in its view suggested that the FSA would need evidence of a person's intention as a separate element in a case to prove insider dealing) be deleted from the Code of Market Conduct. FSA Handbook Notice 107, published on 25 February 2011, confirmed that the deletion would take effect on 6 March 2011⁷.

Impact

The amendment to the Code of Market Conduct will strengthen the hand of the FSA in its fight against market abuse under FSMA and lead to a greater risk that any dealing which takes place while a person is in possession of inside information will constitute market abuse. It is, however, worth noting that MAR 1.3.3E and MAR 1.3.5E remain in force.

⁴ Spector Photo Group NV, Chris Van Raemdonck v Commissie voor het Bank, Financier- en Assurantiewezen (CBFA) C-45/08

⁵ In the opinion of the FSA, the following factors are to be taken into account in determining whether or not a person's behaviour is "on the basis of" inside information, and are each indications that it is not: (1) if the decision to deal or attempt to deal was made before the person possessed the relevant inside information; or (2) if the person concerned is dealing to satisfy a legal or regulatory obligation which came into being before he possessed the relevant inside information; or (3) if a person is an organisation, if none of the individuals in possession of the inside information: (a) had any involvement in the decision to deal; or (b) behaved in such a way as to influence, directly or indirectly, the decision to engage in the dealing; or (c) had any contact with those who were involved in the decision to engage in the dealing whereby the information could have been transmitted: MAR 1.3.3E.

⁶ In the opinion of the FSA, if the inside information is held behind an effective Chinese wall, or similarly effective arrangements, from the individuals who are involved in or who influence the decision to deal, that indicates that the decision to deal by an organisation is not "on the basis of" inside information: MAR 1.3.5E.

⁷ Deletion effected by Market Conduct Sourcebook (Amendment No 10) Instrument 2011 (FSA 2011/9).

With regard to FSMA, the FSA has confirmed its view that the language of section 118(2) is consistent with the decision in Spector and that, accordingly, there will be no amendments to the legislation.

FSA Handbook Notice 107 available at: http://www.fsa.gov.uk/pubs/handbook/hb_notice107.pdf

Market Conduct Sourcebook (Amendment No. 10) Instrument 2011 (FSA 2011/9) available at: http://fsahandbook.info/FSA/handbook/LI/2011/2011_9.pdf

Market Abuse Directive: on-going review likely to extend scope of regime and to strengthen sanctions

The European Commission is currently undertaking a review of the Market Abuse Directive and is expected to publish draft amending legislation later this year.

Among its other proposals, the Commission proposes to extend the scope of the Directive (so that, for example, it would cover all financial instruments admitted or traded on a multilateral facility but not traded on a regulated market) and reinforcing the role of the regulatory authorities by providing for greater investigatory powers and introducing tougher sanctions.

European Commission: Public consultation: a revision of the Market Abuse Directive available at: http://ec.europa.eu/internal_market/consultations/docs/2010/mad/consultation_paper.pdf

How Squire Sanders Hammonds can help

We would be pleased to discuss with you in more detail any of the matters raised in this article.

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