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FSA IMPLEMENTATION

4.1 This chapter sets out the FSA's approach to amending the Handbook.

Overview

This paper 4.2 As outlined in paragraph 1.7 of this paper, implementation of the market abuse directive and its implementing measures will require amendments to a number of the sections in the FSA Handbook, including the Code of Market Conduct ('the Code'), the Price Stabilising Rules, the Listing Rules and the Conduct of Business Sourcebook ("COB"). The purpose of this section of the joint consultation paper is to outline how the directive requirements will be incorporated into the Handbook and to assess the impact of these changes for market participants.

4.3 The proposals in the paper will be of relevance to:

- ⚡ persons dealing in investments admitted to trading on the markets covered by the regime;
- ⚡ issuers of qualifying investments traded on those markets;
- ⚡ persons discharging managerial responsibilities within issuers admitted to trading on regulated markets in the EU and their close associates; and
- ⚡ firms producing investment recommendations.

The proposals 4.4 The overall approach we are proposing to take is to replace sections of the Code with the directive implementing measures and to provide additional guidance where this may be helpful. This approach has resulted in a number of key changes. Examples are the replacement of some of the existing safe harbours with guidance based on the directive recitals, and the inclusion of additional guidance on the procedures for reporting suspicious transactions to the FSA. The Price Stabilising Rules in MAR 2 have been removed, and reference is made to the level 2 regulation which sets out the detailed safe harbour provisions under Article 8 of the directive.

4.5 The FSA has made a public commitment to reduce and simplify the content of the Handbook. In redrafting the Code to reflect the changes to FSMA and the directive implementing measures, we have taken the opportunity to make a number of changes to the chronology and content of the Code. The overriding principle we have followed in revising the Code is to ensure that it is more clearly focussed on discussing behaviours that may or not amount to market abuse. This means that there is a reduction in the amount of guidance provided on provisions in FSMA, such as on the scope of regime, but we have included the relevant legal provisions in an Appendix to the Code. We have also removed other guidance in the Code, such as some of that on the regular user, which was primarily included prior to N2 to explain what was then a very new regime with some unfamiliar concepts.

4.6 Changes to a number of the chapters in the Listing Rules are also proposed to take account of the directive and its implementing measures. These changes do not reflect the outcome of the wider Listing Review. These chapters will be subject to further simplification and amendment in the Listing Review CP to be published in the autumn. However, following on from consultation in CP 203 and in anticipation of the Listing Rules being set out in FSA Handbook format, we are proposing to incorporate relevant guidance that was formerly detailed in guidance manuals directly into the

Listing Rules (other than that relating to compliance with and enforcement of the Listing Rules) in order to help users in assessing the impact of the directive provisions.

4.7 Following on from the consultation in CP171, additional rules are being included in the COB to reflect the directive's requirements for firms to disclose conflicts of interest relating to research recommendations. These rules complete our programme of regulatory changes to address investment research conflicts.

Consumers 4.8 The proposals in this paper will be of interest to consumers who deal and invest either directly or indirectly through institutions, in qualifying investments traded on the prescribed markets.

The Code of Market Conduct

Introduction 4.9 As noted in paragraph 4.2, we are proposing changes to the Code, the Listing Rules and the new COB rules to take account of the Treasury's proposals to amend legislation and parts of the directive and its implementing measures not dealt with in legislation. We are also proposing to make a number of changes to the structure and content of the Code in line with our commitment to reduce and simplify the content of the Handbook. This has included incorporating guidance contained in the annexes to the Code into the main body of the text where appropriate and re-focussing the Code on descriptions of behaviour rather than providing commentary on FSMA provisions.

Safe Harbours 4.10 The Code currently contains a number of safe harbours that give certainty that behaviour in accordance with them will not be regarded as market abuse. The term "safe harbour" is used in the directive and accompanying regulation to provide that certain behaviour which appears to fall within the definition of market abuse will not be regarded as amounting to market abuse as long as certain requirements are followed. The directive provides two safe harbours of this type covering share buy-backs and price stabilisation (see paragraphs 4.32 to 4.35 and 4.65 to 4.68 below).

4.11 In CP76 (Supplement to the draft Code of Market Conduct) published in November 2000 we discussed at length granting safe harbour status to behaviour complying with a number of specific rules, particularly those in the Listing Rules and the City Code on Takeovers and Mergers (the City Code). The reasoning was that this would provide certainty for market participants on the appropriate standards or conventions that should be observed.

4.12 We are proposing to delete the so-called safe harbours in the Code (and the accompanying evidential provisions and guidance) that are no more than a description of behaviour that does not fall within the definition of market abuse. We consider that the following safe harbours fall into this category – MAR 1.4.20C, MAR 1.4.21C and MAR 1.4.24C. In addition, in the annexed lists of Listing Rules and City Code provisions which are also currently treated as safe harbours, we propose to amend the introductory language to make clear that the relevant provisions do not in our view require or permit market abuse.

Question Q1 *Do you agree with this proposed approach?*

Accepted Market Practices 4.13 The directive provides for a defence against market manipulation (when the offence involves transactions or orders to trade which give false or misleading signals or push prices to abnormal or artificial levels) where a person's reasons for entering into a transaction or order to trade are legitimate and the transactions or orders to trade conform to accepted market practices on the regulated market concerned. A level 2 implementing measure sets out the process that should be followed by regulatory

authorities when determining whether a particular practice should be considered as an accepted market practice.

4.14 As explained in paragraph 3.17, these procedural requirements will be incorporated into FSMA, and we will need to follow these procedures. We are not proposing to produce a list of accepted market practices, as we consider that this would result in a regime that was overly prescriptive and inflexible. As part of the work developing level 3, CESR is considering how best to ensure a consistent approach to accepted market practices among Member States, and we are participating in this process.

4.15 However, in amending the section of the Code covering market manipulation (distortion) we are proposing to state that compliance with the London Metal Exchange's paper Market Aberrations: The Way Forward is an accepted market practice. Compliance with the requirements of this paper is currently described in the Code as providing a safe harbour for behaviour that might amount to market abuse, following consultation on the Code before N2. As a result of this previous consultation exercise, we consider that compliance with the guidance in the paper is suitable to be deemed as an accepted market practice.

Question Q2 *Do you agree that this is the correct approach to developing accepted market practices in line with the directive, and that compliance with the 'Market Aberrations: The Way Forward' paper should be considered as an accepted market practice?*

Detailed changes to the Code

4.16 We have amended the first section of the Code, MAR 1.1: Application, to reflect the proposed changes to FSMA and the revised structure of the Code. The current MAR 1.2: The regular user test, and MAR 1.3: Behaviour, have been deleted. Shortened guidance on the regular user test is contained in MAR 1 Appendix 1 and the guidance previously in MAR 1.3 on what constitutes "behaviour" has been deleted on the basis that behaviour is defined in FSMA. As discussed in paragraph 4.5, these changes are driven by the process of Handbook shortening and simplification. A detailed guide in the form of a table of derivations and destinations is included as Annex D.

4.17 As noted in part one of this paper, the application of the regular user test in Part VIII of FSMA has been amended to take account of the specific defences that apply to the directive offences. So, the regular user test will continue to apply to behaviour based on information not generally available (see paragraph 3.13) and other behaviour that might result in a false or misleading impression or distortion (paragraph 3.18).

Question Q3 *Do you agree with the proposed changes to MAR 1.1 – MAR 1.3?*

4.18 We have also reduced the amount of guidance on the scope of the regime currently contained in MAR 1.11. This shortened guidance now appears in the new MAR 1.2.

4.19 In line with the directive's requirements, the revised UK market abuse regime will apply to behaviour that occurs in relation to qualifying investments admitted to trading on a prescribed market, or where a request for admission to trading has been made. We believe that the intention of the directive is to capture 'when issued' or grey market trading and other trading activity, particularly in products which may be the subject matter of the qualifying investment that is to be admitted to trading, before admission takes place. Such trading could have an impact on the price at which the qualifying investment starts to trade and the scope of the directive appears to capture such trading. Guidance to this effect is contained in the new MAR 1.2.3E.

Question 04 *Do you agree with this revised guidance on whether behaviour is likely to fall within the scope of the regime?*

Insider dealing, improper disclosure and misuse of information (new MAR 1.3 – MAR 1.5)

4.20 The misuse of information section of the Code (currently MAR 1.4) has been amended to reflect the changes to Section 118(2) of FSMA. However, as noted in paragraphs 3.13 – 3.14 in part two of this joint consultation paper, the misuse offence of behaviour based on relevant information which is not generally available (or 'RINGA') has been retained.

4.21 The Code has been re-structured so that most forms of market abuse have their own dedicated section. The exception is the new MAR 1.9 which covers both misleading behaviour and distortion. For the offences dealing with the use of certain information, this means that the guidance is now contained in sections MAR 1.3, MAR 1.4 and MAR 1.5. The new MAR 1.3 contains guidance on the directive offence of insider dealing, including some guidance on inside information in relation to commodity derivatives and descriptions of behaviour that will not amount to market abuse. The new MAR 1.4 includes guidance on improper disclosure of inside information ('tipping-off') and the circumstances where such disclosure is not considered to be unlawful i.e. in the normal course of the exercise of a person's employment, profession or duties, are also outlined. The new MAR 1.5 addresses the offence of the misuse of information and retains much of the guidance set out in the current MAR 1.4.

Question 05 *Do you consider the proposed restructuring of MAR 1.4 into three separate sections and the additional guidance to be helpful?*

Misuse of Information Safe Harbours – previously MAR 1.4.20 to MAR 1.4.31

4.22 As noted in paragraphs 4.10 to 4.12 above, a number of safe harbours were included in the Code to describe behaviour that does not amount to market abuse. The detailed guidance in MAR 1.4.20 C – MAR 1.4.31C included a series of safe harbours from the offence of misuse of information. These safe harbours are not replicated in the directive text.

4.23 In paragraph 4.12, we have outlined a proposal to delete from the Code those former safe harbours that are merely descriptions of behaviour which is not abusive. In addition, the revised text outlined in MAR 1.3.18E makes clear certain behaviour that is not 'based on' inside information. We have included in the amended Code descriptions of behaviour based on a number of the recitals to the directive which cover the activities previously detailed in MAR 1.4.26, MAR 1.4.28 and MAR 1.4.31. This text appears at the new MAR 1.3.5C – MAR 1.3.16E. Whilst these recitals are not part of the directive text, they can be relied upon to facilitate the interpretation of the prohibitions set out in the directive. We believe they enable us to include guidance in the revised Code as to behaviour that does not amount to insider dealing or misuse of information.

4.24 The recitals that form the basis of the revised guidance in MAR 1.3 are:

- ⊘ recital 18 which covers the dutiful execution of orders;
- ⊘ recital 24 which covers the use of Chinese Walls and other means as preventative measures for combating market abuse;
- ⊘ recitals 28 and 29 which cover take-over bids; and
- ⊘ recital 30 which covers dealing based on knowledge of ones own intentions.

In revising the guidance to reflect the directive recitals, we have also taken into account recital 19, which makes clear that 'front-running' of client orders may constitute insider dealing.

Question Q6 *Do you agree with the proposed changes to section 1.4 of the Code, in particular inclusion in the Code of descriptions of behaviour that does not amount to market abuse based on the recitals in the directive?*

Changes to the current MAR 1.5 and MAR 1.6 **4.25** As outlined in paragraph 4.21, the Code now contains individual sections dealing separately with most of the offences of market abuse. Accordingly, the new sections of the Code MAR 1.6, MAR 1.7 and MAR 1.8 provide guidance on:

- ⊘ transactions or orders to trade that give a false or misleading impression as to the supply of, demand for or price or value of a qualifying investment; or

- ⊘ transactions or orders to trade that secure the price of a qualifying investment at an abnormal or artificial level;

unless undertaken for legitimate reasons and in conformity with accepted market practices;

- ⊘ transactions or orders to trade that employ fictitious devices or any other form of deception or contrivance; and

- ⊘ dissemination of information which gives or is likely to give false or misleading signals.

4.26 The new section MAR 1.9 covers other behaviour that is likely to give the regular user of the market a false or misleading impression as to the supply of, demand for, or price or value of a qualifying investment, or which, in the opinion of the regular user, has a distorting effect on the market (see paragraph 3.18 of part two). This new section contains much of the guidance set out in the current MAR 1.5 and MAR 1.6.

4.27 As noted in paragraph 4.13 above, the directive provides for a defence against market manipulation if a person can show that his reasons for entering into a transaction or order to trade are legitimate, and that the transactions or orders to trade conform to accepted market practices on the prescribed market concerned. The current MAR 1.6 provides a safe harbour for behaviour that complies with the London Metal Exchange's document: Market Aberrations: The Way Forward. We consider behaviour in compliance with the guidance in this document to constitute an accepted market practice and have included a statement to this effect at the new MAR 1.6.10E.

Question Q7 *Do you agree with the proposed changes to MAR 1.5: False or Misleading Impressions and MAR 1.6: Distortion and the structure of the new sections MAR 1.6 – MAR 1.9?*

Requiring or Encouraging- MAR 1.8 **4.28** The offence of requiring or encouraging another person to commit market abuse whether by action or inaction is based on section 123 of FSMA which remains unchanged. The revised MAR 1.4 includes guidance on the specific directive offence of disclosing inside information to any other person unless such disclosure is made in the normal course of the exercise of his employment, profession or duties. This makes the existing guidance on this type of behaviour in the current MAR 1.8.5G – MAR 1.8.7G redundant. Shortened guidance on the other elements of requiring or encouraging is included in the Appendix to the Code at 1.1.7G – 1.1.9G.

Suspicious Transactions Reporting **4.29** Article 6(9) of the directive requires any person professionally arranging transactions in qualifying investments who reasonably suspects that a transaction might constitute insider dealing or market manipulation to notify the FSA without delay. Further guidance on this requirement is provided in the implementing measures

to the directive. These detailed requirements are set out in new material to be included in SUP 15.

4.30 You should be aware that the Proceeds of Crime Act 2002 ('POCA') places a requirement on certain firms to report suspicions of money laundering to the National Criminal Intelligence Service (NCIS). There is potential for overlap of the POCA regime and the directive requirements to report transactions that might constitute market abuse, since transactions which appear to constitute criminal insider dealing or market manipulation under the Criminal Justice Act or s397 of FSMA respectively may also appear to constitute market abuse under the directive.

4.31 This appears to result in an obligation on firms to make two reports in respect of the same activity which is likely to be inefficient for firms as well as for the FSA and NCIS. So we are currently exploring with NCIS and the Home Office whether it is possible to provide guidance to firms to enable a single report to be made in cases where a transaction appears to trigger the requirements under both POCA and the directive.

Question 08 *Do you agree that this is a sensible approach to adopt?*

Changes to MAR 2 – The Price Stabilising Rules

4.32 The directive provides two safe harbours from the prohibitions on behaviour that amounts to market abuse. The safe harbours relate to trading in own shares in 'buy-back' programmes and the stabilisation of a qualifying investment providing such trading is carried out in line with the implementing measures.

4.33 The safe harbour provisions covering stabilisation, which are set out in Article 8 of the directive and the related implementing regulation Commission Regulation (EC) No 2273/2003¹ ('the regulation'), detail the procedures that must be followed in order to benefit from the safe harbour. Since the regulation is directly applicable in the United Kingdom, we have removed the Price Stabilising Rules in MAR 2 and now make reference to the key provisions of the regulation. We have also included in the revised MAR 2 reference to the regulation provisions relating to share buy-backs. We acknowledge that trade associations are concerned that additional guidance may be needed in order to clarify some of the Article 8 provisions. We are proposing to work with the Commission and CESR in developing appropriate Level 3 guidance where it is agreed that this is necessary.

4.34 The existing Price Stabilising Rules in MAR 2 provide a safe harbour to the criminal offences of insider dealing and market manipulation set out in Part V of the Criminal Justice Act 1993 and s397 of FSMA respectively. The regulation is drafted from the perspective of only giving a safe harbour in relation to the Directive's offences of market abuse. We do not consider that it is appropriate to maintain two very different safe harbour regimes. Accordingly we are proposing that compliance with the regulation will be sufficient to provide a defence for the criminal offences and we have included guidance on this issue in the revised MAR 2.

4.35 In general, the revised MAR 2 provides market participants with a simplified set of stabilising rules. However, there are some key differences in terminology and permitted activities, which will have an impact on market participants who engage in

¹ O.J. L 336, 23.12.2003, p.33.

stabilisation activity. These changes are discussed further in the cost benefit analysis in Annex E.

Question 09 *Do you agree with our proposed changes to the Price Stabilising Rules reflecting the regulation on stabilisation?*

The Listing Rules

4.36 The proposed changes to Part VI of FSMA (described in part two of this consultation paper) will give powers to the FSA regarding issuers admitted to trading on a regulated market based in the UK, persons discharging managerial responsibilities within such issuers and their close associates. This means that we will make rules relating to the disclosure of certain information that affect a broader range of issuers than issuers admitted to the official list. We will also be empowered to make directly enforceable rules in respect of persons discharging managerial responsibilities within such issuers and their close associates.

As the directive only applies to issuers of financial instruments who have requested or approved admission of their financial instruments on a regulated market, the directive currently does not apply to issuers on the following regulated markets:

- ⌘ LIFFE;
- ⌘ EDX; and
- ⌘ Virt-x.

In addition, AIM has indicated that it intends to change its regulatory status from October 2004 and will no longer be a regulated market.

4.37 Implementation of the directive requires changes to be made to four main areas of the Listing Rules. These are:

- ⌘ Chapter 1 (compliance and enforcement of the Listing Rules);
- ⌘ Chapter 9 (general disclosure obligations for companies);
- ⌘ Chapter 15 (purchase of own securities and provisions relating to shares held in treasury); and
- ⌘ Chapter 16 (directors).

The proposed rules and guidance can be found at Annex C. We have highlighted those parts of the amended text which do not specifically implement directive obligations. The amendments to Chapter 15 are required to align the Listing Rules with Commission Regulation (EC) No 2273/2003 (the regulation and relevant guidance can be found at 4). As these rules do not implement the directive all of the amendments to this chapter have been highlighted.

The directive is required to be implemented prior to completion of the Listing Review. This means that the rule changes put forward in this CP are only those that are required to implement the directive. The amendments do not reflect the outcome of the wider Listing Review in relation to these chapters. As a result, further changes arising from the Listing Review will be put forward in the Listing Review CP to be published in the autumn.

4.38 Parts of the UKLA Guidance Manual have been revised to reflect the wider rule making and enforcement powers that we have been given in Part VI of the Act. The main changes relate to:

- ⚡ the inclusion of persons discharging managerial responsibilities and their close associates within the scope of the manual;
- ⚡ parts of the manual dealing with our decision making and enforcement powers and their extension to issuers admitted to trading on a regulated market, persons discharging managerial responsibilities within such issuers and their close associates (including the power to suspend trading of such issuers on regulated markets within the UK).

4.39 For the first time in the Listing Rules we have introduced guidance under the relevant rules where we feel this is necessary. This guidance replaces the relevant sections of the UKLA Guidance Manual. This brings the rules closer to the look and feel of the FSA Handbook. In particular, the PSI Guide and parts of the Continuing Obligations Guide will be deleted and replaced by the guidance in Chapter 9A. The guidance in chapter 9A is specifically designed to help issuers and their advisers apply the rules in that chapter. As a result, some of the more general guidance given in the PSI Guide has not been included.

Question Q10 *Do you agree with our proposals to include additional guidance in the Listing Rules? In particular, are there aspects of the PSI Guide that remain directly relevant under the new regime that we have not included in Chapter 9A?*

Question Q11 *Are there aspects of the PSI Guide that remain directly relevant under the new regime that we have not included in Chapter 9A?*

4.40 Compliance and enforcement of Part 6 rules 4.40 Part VI of the Act requires us, in our capacity as UKLA, to make rules which implement the parts of the directive dealing with:

- ⚡ the disclosure of inside information by issuers;
- ⚡ the requirement for issuers and those acting on their behalf or for their account to draw up insider lists and keep them for 5 years; and
- ⚡ the requirement for persons discharging managerial responsibilities and their close associates to disclose transactions conducted on their own account in the shares of the issuer or derivatives or other financial instrument(s) relating to those shares.

The rules made under these Part VI powers are known as 'Disclosure Rules'. This means that under Part VI we will make:

- ⚡ Disclosure Rules in respect of issuers admitted to trading on a regulated market (this includes issuers admitted to the official list), persons discharging managerial responsibilities within such issuers and their close associates; and
- ⚡ Listing Rules in respect of issuers admitted to the official list.

The Disclosure Rules and the Listing Rules are collectively known as 'Part 6 Rules'. In future we anticipate making rules which have a wider scope than the Listing Rules to implement the Prospectus Directive (which applies to issuers admitted to trading on a regulated market and to public offers) and the Transparency Directive.

4.41 The proposed amendments to Chapter 1 reflect the changes to our Part VI powers by introducing provisions regarding compliance with and enforcement of the Disclosure Rules. The new rules in Chapter 1 extend the scope of, but broadly follow, the existing listing powers and allow us to:

- ⌘ gather information to verify that the Disclosure Rules are being and have been complied with;
- ⌘ to conduct investigations into suggested breaches of the Disclosure Rules and the Act;
- ⌘ to impose sanctions on persons discharging managerial responsibilities and their close associates (including the power to impose financial penalties) for breaches of the Disclosure Rules;
- ⌘ require the payment of a fee in respect of the continued admission of financial instruments to trading on a regulated market; and
- ⌘ suspend trading of securities on regulated markets in certain circumstances.

In addition, we propose to make similar consequential amendments to chapters 1, 7, 8, 9, 10, 11 and 12 of the UKLA Guidance Manual in line with the Chapter 1 changes.

4.42 As the Disclosure Rules will, for the time being, only apply to listed issuers, we have not set a separate fee under the Disclosure Rules at this stage. We will work over the summer to establish what part of the listing fee relates specifically to the Disclosure Rules and charge a separate fee in the future.

Question Q12 *Do you agree with our proposed amendments to Chapter 1?*

Dissemination of Inside Information

4.43 Chapter 9A implements the issuer disclosure requirements in the directive and will replace Listing Rules 9.1 to 9.8 (except for Listing Rule 9.3A) (which will continue to apply to listed issuers). This chapter will apply to issuers with qualifying investments admitted to trading on a regulated market in the UK. The directive makes it clear that the issuer disclosure regime plays an important role in preventing market abuse by ensuring that the market operates on the basis of prompt and fair disclosure of information to the public. It is important that issuers view their obligations in this context.

4.44 Paragraphs 9.1 and 9.2 of the Listing Rules require issuers to disclose via a Regulatory Information Service information that is not public knowledge that, if known, would lead to a substantial movement in the price of its listed securities (i.e. price sensitive information).

4.45 As set out in sections 2.3 and 3.15 of this paper, the directive requires issuers to disclose inside information which directly concerns the issuers. Inside information is defined in the directive, in respect of instruments other than commodity derivatives, as information which:

- ⌘ is precise;
- ⌘ has not been made public;
- ⌘ relates directly or indirectly to issuers; and
- ⌘ if made public would have a significant effect on the price of its qualifying investments (i.e. financial instruments actually issued by the issuer).

4.46 As noted in 2.3 of this paper, information that would be likely to have a significant effect on the price of the qualifying investment in question is information a reasonable investor would be likely to use as part of the basis of his investment decision(s).

4.47 The new rules and guidance make it clear that information has to satisfy each limb of the test (described in paragraph 4.45) before it can be classified as inside information requiring disclosure.

4.48 We believe that the directive ad hoc disclosure regime is conceptually and operationally similar to the existing Listing Rules regime.

4.49 The 'reasonable investor test' does not usurp the requirement that, in order for the information to be inside information, the information must be likely to have a significant price effect if it were made public. The 'reasonable investor test' simply sets the context in which an issuer will need to make its assessment of the likely price significance of the information in question.

4.50 We believe that in most cases the change in approach to determining what information should be disclosed and in what form should not lead to a different conclusion than under the current regime.

4.51 The Listing Rules require issuers to announce all price sensitive information without delay. Disclosure Rule 9A.1 requires issuers to announce inside information as soon as possible. We do not believe that this change allows an issuer a longer period in which to make required disclosures to the market. The current body of knowledge in the market regarding the timing of disclosures of price sensitive information is applicable to the directive definition.

Question Q13 *Do you agree with our analysis of the impact on the timing of disclosures of price sensitive information based on the directive definition?*

Question Q14 *Do you agree with our approach to the implementation of the directive in relation to the disclosure of inside information?*

Delaying Disclosure of Inside Information

4.52 Disclosure Rule 9A.7 allows an issuer to delay disclosure of inside information under its own responsibility such as not to prejudice its legitimate interests, provided that this omission would not be likely to mislead the public and provided the issuer is able to ensure the confidentiality of the information. These rules replace Listing Rules 9.4, 9.5 and 9.8.

4.53 The guidance makes it clear that:

- ⊘ any decision to delay disclosure of inside information is taken at the issuer's own risk;
- ⊘ we believe that instances where an issuer may delay disclosure are limited and, other than in relation to impending developments or matters under negotiation, there are unlikely to be other circumstances where delay would be justified;
- ⊘ issuers should be careful to distinguish between an event which gives rise to inside information (e.g. the loss of an important contract) that requires disclosure under Disclosure Rule 9A.1 and subsequent events (e.g. attempts to renegotiate the contract) that may be covered by the exemption from disclosure in Disclosure Rule 9A.7; and

the market understands that in appropriate circumstances certain information can be withheld from the market and a delay in disclosing such information will not automatically mislead the market. However, the obligation not to mislead the market means that if a false market in the issuer's financial instrument(s) is created on the basis of a market rumour, the exemption from the requirement to disclose inside information as soon as possible may be lost. In addition, if a market rumour suggests that a breach of confidence has occurred, an immediate announcement may be required because the issuer is no longer able to ensure the confidentiality of the information.

4.54 We acknowledge that this is often a difficult area in practice where fine judgements are required. For this reason we encourage issuers to approach us early if an issuer is in doubt as to its ability to delay disclosure of inside information.

Question Q15 *Do you agree with our approach to directive implementation in this area?*

Selective Disclosure 4.55 Where an issuer is delaying disclosure of inside information in accordance with the Disclosure Rules (described in paragraphs 4.52 and 4.53 above), the issuer may selectively disclose the information to persons owing the issuer a duty of confidentiality. The Disclosure rules allow issuers to selectively disclose inside information in these circumstances to a wider group than is allowed under the Listing Rules. We have set out in guidance the circumstances where we believe selective disclosure may be acceptable.

4.56 Issuers have an overriding obligation to ensure that the market is not misled by the delay in disclosure of inside information. For this reason issuers should take care to limit the number of persons to whom selective disclosure is made. In addition, issuers also have an obligation to ensure the confidentiality of inside information that has been selectively disclosed. The wider the information is selectively disclosed, the more chance there is of a leak and the information being used to commit market abuse.

Question Q16 *Do you agree with this approach?*

Insider Lists 4.57 The Disclosure Rules (9A.13 to 9A.18) implement the directive requirement for issuers to compile lists of persons with access to inside information relating, directly or indirectly, to the issuer. Issuers are also required to ensure that persons acting on their behalf or for their account compile such lists. These lists will need to be kept for five years.

4.58 Issuers are required by the Model Code and other legal and regulatory requirements to identify and track employees with access to inside information. The Disclosure Rules will formalise this process and require certain information such as the date on which the person became an insider to be added to the list.

4.59 We do not believe that the requirement to stipulate the reason why a person is on the list requires the issuer to give a detailed description of the reason why the person has access to the relevant inside information. All that is required is a statement that the person is on the list because he has access to the inside information in question.

Disclosure of Dealings by persons discharging managerial responsibility

4.60 The Disclosure Rules require persons discharging managerial responsibilities within an issuer and their close associates to disclose to the issuer transactions conducted on their own account in the shares of the issuer, or derivatives or any other financial instrument(s) relating to those shares. Persons discharging managerial responsibilities are:

- ⊘ the directors of the issuer; and
- ⊘ senior executives who are not directors but who have regular access to inside information concerning the issuer and the power to make managerial decisions concerning the issuer.

These rules are implemented in chapter 16A and replace Listing Rules 16.13 to 16.17.

4.61 Disclosures are required to be made in respect transactions in relevant financial instrument(s) of issuers admitted to trading on any regulated market in the EU. Persons discharging managerial responsibilities and their close associates disclosure obligations will be determined by the laws/regulations of:

- ⊘ the place of incorporation of the issuer if the issuer is registered in the EU; or
- ⊘ the member state determined in accordance with article 6(1) of Commission Directive 2004/72/EC if the issuer is not registered in the EU.

For example, if a UK incorporated issuer is admitted to trading on a regulated market in Germany, a transaction conducted by a person discharging managerial responsibilities on that market would need to be reported to the issuer in accordance with the rules in Chapter 16A.

4.62 Issuers will be under an obligation to disclose via a Regulatory Information Service all transactions that are notified to them in accordance with the Disclosure Rules. To ensure that issuers make the relevant disclosures to the market, it will be necessary for them to establish the identity of such persons and to keep the list under review to ensure that the correct people within the issuer understand and comply with their obligations.

4.63 The Listing Rules currently require issuers to disclose (via a Regulatory Information Service) information concerning directors' dealings that have been notified to them in accordance with the Companies Act 1985. The disclosure of transactions required by the Disclosure Rules are concurrent with and overlap directors' disclosure obligations under the Companies Act. Issuers will be required to disclose all notifications of dealings received to the market, whether under the Companies Act or the Disclosure Rules.

4.64 To prevent confusion in the market as to dealings and to avoid double counting (because a Companies Act notification will often relate to the same dealing as a notification under the Disclosure Rules) our guidance indicates that only one public disclosure is required to be made by the issuer where two dealing notifications have been received concerning the same dealing.

Question 017 *Do you agree with our proposals for the disclosure of dealings by persons discharging managerial responsibility?*

**Purchase of
own Securities**

4.65 Changes to chapter 15 of the Listing Rules in relation to purchases of own shares are required to ensure that the Listing Rules are aligned with the safe harbour provisions in implementing regulation Commission Regulation (EC) No 2273/2003.

4.66 The main changes proposed to chapter 15 are:

- ⌘ to conform the announcement obligations in relation to the purchase of own equity shares in the Listing Rules with the regulation; and
- ⌘ to align the provisions allowing issuers to purchase their own shares during a prohibited period with the exemptions provided by the regulation.

The detailed regulation provisions relating to share buy-backs are included in the revised MAR 2.

4.67 The post-purchase announcement required by paragraph 15.9C has been amended to the regulation requirement that such announcements contain the information specified in Article 20(1) of Directive 93/22/EC. We are aware that this requirement may present practical difficulties for issuers and will review these requirements during the summer.

4.68 The majority of tender or partial offers envisaged by chapter 15 will be outside the provisions of the safe harbour, as such offers usually relate to buy-backs which exceed the maximum volume permitted by the Regulation. However, we are retaining the rules in Chapter 15 that require a tender or partial offer to be made for buy-backs of over 15% and certain buy-backs from related parties, as we believe that the fundamental principle of shareholder equality encompassed in these rules should be retained. As stated in paragraph 3.19, activities which fall outside the safe harbour are not necessarily to be regarded as abusive. However, an issuer wishing to undertake a buyback where a tender or partial offer is required will need to satisfy itself that the purchase(s) do not constitute market abuse under Part VIII of FSMA. The proposed changes to chapter 15 do not reflect the outcome of the Listing Review. This chapter will be subject to further simplification as part of the Listing Review.

Question Q18 *Do you agree with the proposed changes to Chapter 15?*

Research Disclosure Obligations

4.69 Directive 2003/125/EC which provides implementing measures under Article 6(5) of the directive sets out requirements for firms to disclose both information about research sources and methods and to disclose the conflicts of interest that may impact on the impartiality of a research recommendation.

4.70 These new requirements to disclose also complement our wider consideration of the management of conflicts of interest in the production of investment research. A number of important changes to our regulatory requirements relating to investment research have already been made. Namely:

- ⌘ requirements for conflicts management in relation to investment research²;
- ⌘ amendments to the general prohibition on knowingly dealing ahead of investment research³; and

² March 2004 Policy Statement 04/6. Rules to be implemented as of 1 July 2004.

³ October 2003 Consultation Paper 205. Rules implemented as of 1 May 2004.

⚡ amendments to existing rules on personal account dealing by analysts⁴.

4.71 In CP 205 we said that the disclosures element of our conflict of interest management framework would proceed as part of the implementation of this directive. These proposed new disclosure rules, which are broadly similar to those consulted on in CP171, complete the FSA's programme of regulatory changes to address investment research conflicts as well as forming part of the implementation of this directive.

Our Approach to Implementation

4.72 Our approach to implementation is to rely on the appropriate provisions of the directive and of the relevant implementing measures to the extent that this is consistent with the FSA's powers and in the light of established UK regulatory terminology⁵. We propose no additional substantive rules or guidance. The effect of this approach is that firms will be afforded a relatively large degree of flexibility in the application of the rules. We expect this flexibility to be employed in a manner appropriate to the corresponding senior level responsibility firms have for ensuring that they satisfy the underlying regulatory objective which in the case of these provisions will be that expressed in the directive and its implementing measures. Firms will recognise this as being consistent with the wider FSA approach to principles-based regulation, which seeks to safeguard regulatory objectives while respecting the diversity of the market place.

4.73 We discussed this approach with a number of trade associations in March 2004. Apart from certain specific issues, discussed in greater detail below, a broad level of support was received.

Specific Issues

Further Guidance

4.74 Our informal discussions with the industry indicated a preference for further guidance in relation to the following provisions:

- ⚡ the application of the rules to oral communications – the directive requires that Member States ensure that a number of the provisions are adapted in such a way as not to be disproportionate in the case of non-written recommendations;
- ⚡ the requirement that disclosures be made clearly and prominently; and
- ⚡ the application of the rules to different financial instruments.

4.75 We consider that firms should be capable of accepting responsibility for interpreting these provisions in a manner appropriate to the nature of the communication and their business models. We are concerned that providing further guidance might reduce the degree to which the new provisions can be applied flexibly across the industry, and whether guidance can be truly applicable across the industry generally, without adding undue complexity to the Handbook. For this reason we do not propose to make an exception to the approach outlined in 4.72.

Question Q19 *Do respondents agree with our general approach to the implementation of the directive disclosure provisions?*

⁴ October 2003 Consultation Paper 205. Rules implemented as of 1 May 2004.

⁵ The draft definition of a research recommendation brings together the directive definitions contained in Articles 1.3 and 1.4 (a) and (b). It should be noted that in preparing this definition we have taken the view that there are no regulated firms in Article 1.4 (b), given the way Article 1.4(a) is written.

Question Q20 *Are there any supplementary difficulties associated with this approach that need to be addressed?*

Application to Take Over Advice 4.76 Another issue arising from the informal consultation was whether the disclosure provisions would apply where an investment bank provides advice to shareholders on either side of a take-over scenario. It is our understanding that the disclosure provisions are not intended to apply in this case.

Chinese Walls 4.77 There is some tension in the directive between recital 7 and Articles 5.2(b) and 6.1(a) and (b). Recital 7 states that 'this Directive should not require relevant persons producing investment recommendations to breach effective information barriers put in place in order to prevent and avoid conflicts of interest'. The requirements of Articles 5.2(b) and 6.1 (a) and (b) could be read as requiring firms to breach established Chinese walls in order to comply with some of the disclosure requirements. In our view the clear intention of the directive recital is to acknowledge the potential usefulness of Chinese walls in managing conflicts of interest, and to assert that the directive is not intended to adversely impact on their operation. We intend to import this aspect of the recital into the implementing provisions as guidance. It is also clear that the directive intends firms to make the required disclosures. So we believe that firms should utilise appropriate arrangements for ensuring that the required disclosures could be added prior to the issuing of a recommendation.

Question Q21 *Do you agree that arrangements can be put in place to ensure that the disclosure requirements can be met without analysts having to breach effective Chinese walls?*

Disclosure of financial holdings 4.78 Under the provisions of the directive, Member States are obliged to require firms to disclose shareholdings exceeding 5% of total issued share capital held by the firm in the issuer and also held by the issuer in the firm. However, Member States are further permitted to require the disclosure of holdings below the recommended 5%. We see no reason to implement a disclosure threshold less than the recommended 5%. However, we also recognise that firms may choose to disclose at a lower threshold, and believe they should be able to continue doing so.

Question Q22 *Do you agree with our proposal to adopt the 5% disclosure threshold and to allow firms to disclose at a lower threshold should they so wish?*

4.79 The directive is silent on the detail of how shareholdings should be calculated in circumstances where the firm is part of a group that is spread across different jurisdictions. In particular, there is no indication of whether a firm should use the applicable company law of the top member of the group to calculate the holding, or whether the applicable company law of each member of the group should be used.

4.80 We have at this stage an open mind as to how firms should comply with this aspect of the directive. Our preferred approach is not to provide guidance on the method of calculation and certainly not to provide a detailed calculation template. Rather, we think that, in complying with the directive requirement as implemented, firms should have the flexibility to choose either to calculate shareholdings on the basis of the applicable company law of the top-company or on the basis of the prevailing local law for each entity in a group. We think that our approach to both the shareholding disclosure threshold and the calculation method should be to give firms maximum flexibility to apply the directive implementing provisions in a manner consistent with other existing regulatory disclosure requirements – firms would however retain the legal responsibility for compliance with the terms of the directive as implemented.

Question Q23 *Do you consider that you would be able to comply with the terms of the directive as implemented on this basis?*

4.81 The draft measures for the implementation of Directive 2003/125/EC are contained in Annex C.

Changes to the Enforcement Manual

4.82 We propose to make a few minor amendments to the Enforcement manual as a result of the Treasury's draft Regulations.

4.83 A minor amendment to paragraph 13.1.1G (4) is proposed to reflect the fact that the FSA's power to impose financial penalties under section 91 of the Act will be extended to cases where it considers that one of the following has contravened the Part 6 rules: an issuer who has requested or approved the admission of financial instruments to trading on a regulated market, a person discharging managerial responsibilities within such an issuer, or a close associate of such a person.

4.84 Paragraph 14.9.6G of the manual sets out the principal circumstances in which the FSA is likely to consider whether it is appropriate to exercise its powers under the market abuse regime, in the context of a case where the behaviour of concern is behaviour to which the Takeover Code or SARs are relevant. One of these circumstances is where the behaviour falls within section 118(2)a (Information not generally available). Under the proposed amendments to the Act, sections 118(2), (3) and (4) will deal with behaviour involving inside information and/or information not generally available. Accordingly, the FSA is proposing to amend ENF 14.9.6G (2) so that it refers to these sections.

4.85 In addition to these changes, many of the references to 'listing rules' in the manual will need to be changed to 'Part 6 rules'.

Structure of the FSA Handbook

4.86 As this paper has illustrated, implementation of the directive will require amendment of various sections of the Handbook, not just MAR 1 and MAR 2. In doing this, we need to take into account how best to incorporate the directive requirements, given the breadth of the directive's application. We consider that the rule changes need to lie where they fall (i.e. the COB rule changes will need to appear in the COB sourcebook, etc.) so that they can be co-ordinated with other rules governing similar situations such as the COB rules governing the management of conflicts of interest and other Listing Rules applying to issuers. However, to help those covered by the regime, particularly unauthorised entities who may be subject to requirements under the Directive but not to other rules in the Handbook, we are proposing to publish a special Market Abuse Directive implementation guide to bring all the relevant rules and guidance into one volume for ease of reference.

Question Q24 *Do you agree with our proposal to publish a special Market Abuse Directive implementation guide?*