Financial Conduct Authority

FCA
FINANCIAL CONDUCT AUTHORITY

Provisions to delay disclosure of inside information within the FCA's Disclosure and Transparency Rules

November 2015

Consultation Paper

CP15/38**

Contents

Abbreviations used in this paper 3

1 Overview 5

2 Consultation 7

Annex

1 List of questions 14

2 Cost benefit analysis 15

2 Compatibility statement 16

Appendix

1 Draft Handbook text 19

We are asking for comments on this Consultation Paper by 20 February 2016.

You can send them to us using the form on our website at:
www.fca.org.uk/your-fca/documents/consultation-papers/cp15-38-response-form.

Or in writing to:

Marta Alonso
Enforcement and Market Oversight Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 8384
Email: cp15-38@fca.org.uk

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Consultation Paper from our website: www.fca.org.uk. Or contact our order line for paper copies: 0845 608 2372.

Abbreviations used in this paper

DTR	Disclosure & Transparency Rules
MAR	Market Abuse Regulation
MAD	Market Abuse Directive
MTF	Multilateral Trading Facility
CESR	Committee of European Securities Regulators
EU	European Union
ESMA	European Securities and Markets Authority

1. Overview

Introduction

1.1 In this consultation paper we address recent developments around the disclosure of inside information by issuers with securities admitted to trading on a regulated market.

Who does this consultation affect?

1.2 This consultation will be of interest to:

- issuers with securities admitted to trading to regulated markets in the UK
- firms who advise these issuers
- firms or people investing in securities which are traded on a regulated market in the UK

Context

1.3 Following the Upper Tribunal decision in *Ian Hannam v FCA [2014] UKUT 0233 (TCC)*, we have discussed the issues involved with a number of stakeholders. As a result, we have decided to review our rules and guidance about delaying disclosure of inside information in the Disclosure & Transparency Rules (DTR).

1.4 We are proposing to amend guidance on when an issuer can legitimately delay disclosure of inside information. This consultation paper set outs our proposals which we believe will maintain the integrity of the regime and are consistent with the Market Abuse Directive (MAD) and the Market Abuse Regulation (MAR), which comes into effect in the UK from July 2016.

1.5 Our CP15/35 on the implementation of the Market Abuse Regulation is also relevant to aspects of this consultation. CP15/35 discusses amendments to both FSMA and the DTR sourcebook required to comply with the new Market Abuse Regulation. We will assess feedback from both consultations to ensure a consistent approach.

Summary of our proposals

1.6 We propose to amend the DTR guidance which covers the issuer's legitimate reasons for delaying disclosure.

Equality and diversity considerations

1.7 We have assessed the likely equality and diversity impacts of the proposals and do not think they give rise to any concerns. But we would welcome your comments.

Next steps

1.8 We want to know what you think of our proposals. Please send us your comments by 20 February 2016 in writing. To do so, you can use the online response form on our website or write to us at the address on page 2.

What will we do?

1.9 We will consider your feedback and publish our response in a Policy Statement.

2. Consultation

Background

2.1 The case of *Ian Hannam v FCA [2014] UKUT 0233 (TCC)*[1] (the Tribunal Decision) involved the improper disclosure of inside information. In April 2012 the FCA's predecessor body, the FSA, announced it had decided to fine Mr Hannam for improper disclosure of inside information. This involved two emails that he had sent about his client, Heritage Oil PLC.

2.2 The decision notice set out the FSA's view that sending the two emails was behaviour amounting to market abuse. This was because each email contained inside information and Mr Hannam's disclosure of the information was not made in the proper course of exercising his employment, profession or duties.

2.3 Mr Hannam referred the case to the Upper Tribunal, which handed down its judgment on 27 May 2014. The Tribunal judged that Mr Hannam had committed market abuse by disclosing inside information other than in the proper course of the exercise of his employment under section 118(3) of the Financial Services and Markets Act 2000.

2.4 During the hearing, the Tribunal heard detailed submissions about the relevant legislative provisions. The Tribunal Decision provided a detailed analysis of these provisions, including the definition of inside information which derives from the EU Market Abuse Directive (MAD) and is contained in s118C of the Financial Services and Markets Act. The Tribunal also commented on the circumstances in which an issuer could delay disclosing inside information, but did not analyse the FCA's guidance in DTR 2.5.5G in its judgment.

2.5 The definition of inside information underpins both the rules about disclosure of information by issuers and the rules prohibiting abusive trading in UK markets in s118C of the Financial Services and Markets Act 2000. The rules are implemented in the UK through the FCA's Disclosure and Transparency Rules (DTR) and apply to issuers with financial instruments admitted to trading on a regulated market. The DTR also explain when issuers can delay disclosing inside information.

2.6 Developments in the analysis of legislative provisions covering inside information will help issuers understand an important area of the disclosure obligations.

2.7 Practitioners have told us they are concerned that recent case law will lead to changes in regulatory approaches and could affect how issuers communicate with their investors. One example involves the recent changes in the EU Transparency Directive, which removed the requirement for issuers to provide a quarterly trading update. We understand that in some cases, less structured discussions are now taking place between issuers and investors at these times and that both parties can have different views on whether inside information is being given.

1 www.tribunals.gov.uk/financeandtax/Documents/decisions/Hannam-v-FCA.pdf

2.8 In the interests of both parties, there should be clarity on whether inside information is being passed. Therefore, both issuers and investors have a clear interest in understanding the basis for classifying information as inside information so that they can properly understand their obligations.

Disclosure of inside information

2.9 Issuers trading on a regulated market must assess the information they have using the statutory test within FSMA s118C. This states that:

'inside information is information of a precise nature which—

a. is not generally available

b. relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments and

c. would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related investments.'

2.10 If an issuer possesses inside information, the DTR requires it must be disclosed publicly as soon as possible, unless there are grounds for delaying disclosure.

2.11 Feedback from stakeholders following the Tribunal Decision was that the definition of inside information was being applied increasingly widely. Both the 'precise' and 'significant effect on price' tests in the legislative provisions have prompted debate following a number of cases in the UK and the ECJ in recent years.

2.12 As set out in CP 15/35, the Market Abuse Regulation will be implemented in the UK in July 2016. As a result, various parts of FSMA and the DTR, including the definition of inside information currently in s118C FSMA, will be repealed and replaced in UK law by the MAR. However, the wording of the definition of inside information in MAR is materially unchanged from the definition in s118C FSMA.

2.13 In this paper we refer to s118C FSMA when highlighting specific provisions in the definition of inside information, as it most clearly follows the case law we refer to. The relevant provisions within MAR are in Article 17.[2]

Significant effect on price

2.14 FSMA s118C(2)(c) states that inside information 'would, if generally available, be likely to have a significant effect on the price of the qualifying investments'. The link between this provision and the provision in s118C(6) that information would be likely to have a significant effect on price 'if and only if it is information of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions', has been debated in the market for some time and has been referred to in previous final notices and Upper Tribunal judgments.

2 http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014R0596&from=EN

2.15 The Final Notice issued to JJB Sports plc on 25 January 2011 states that JJB Sports plc breached the DTR in two announcements it made. In considering whether the information contained within each announcement was price sensitive under the terms of FSMA s118C, the notice states[3]: 'The information was information of a kind which a reasonable investor would be likely to use as part of the basis of his or her investment decisions, and pursuant to section 118C(6) of the Act was therefore information that would, if generally available, be likely to have a significant effect on the price of JJB shares'

2.16 The Upper Tribunal handed down its decision in the case of David Massey v FSA [2011] UKUT 49 (TCC) on 2 February 2011. As part of its assessment of whether Mr Massey had engaged in market abuse, the Tribunal appears to consider that the reasonable investor test is conclusive, stating: "we have to apply the specially extended meaning assigned to this expression by s118C(6). Whether or not the information was (in the ordinary sense) likely to have a significant effect on the price, we consider it is clear that it was information 'of a kind which a reasonable investor would be likely to use as part of the basis of his investment decisions".[4]

2.17 In relation to the Ian Hannam v FCA case, the Tribunal Decision concludes[5] that the tests must be read in conjunction with one another and that the "reasonable investor" test provides a definition as to what would be likely to have a significant effect on price.[6] In terms of what should be considered "significant", the judgment states[7] that "the reasonable investor will surely take account of information which may have a non-trivial effect on price: such information may have an effect on price which is significant to the reasonable investor".[8]

2.18 The Tribunal also concludes[9] that the word "likely" in s118C(2)(c) should be read as meaning that there is a more than a fanciful prospect of the information having a significant effect on price.[10] It is clear that it is not necessary for a potential future event to be more likely than not to happen to meet this test. We understand from our discussions with stakeholders that this may represent a departure from market practice in some cases.

2.19 Therefore the Tribunal Decision clarifies that information which would have a "non-trivial" effect, and which has a more than fanciful chance of causing an effect, would meet the tests in FSMA s118C (2)(c) and (6) which relate to the price sensitivity of information.

Precise

2.20 FSMA s 118C (5) provides:

(5)Information is precise if it—

a. indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur and

3 [52], [56], JJB Sports plc Final Notice 25 January 2011 www.fsa.gov.uk/pubs/final/jjbsports.pdf
4 [41] David Massey v FSA [2011] UKUT 49 (TCC) www.tribunals.gov.uk/financeandtax/Documents/decisions/DavidMassey_v_FSA.pdf
5 [121] Ian Hannam v FCA [2014] UKUT 0233 (TCC) www.tribunals.gov.uk/financeandtax/Documents/decisions/Hannam-v-FCA.pdf
6 [100] Ian Hannam v FCA [2014] UKUT 0233 (TCC)
7 [102] Ian Hannam v FCA [2014] UKUT 0233 (TCC)
8 [102] Ian Hannam v FCA [2014] UKUT 0233 (TCC)
9 [118] Ian Hannam v FCA [2014] UKUT 0233 (TCC)
10 [118] Ian Hannam v FCA [2014] UKUT 0233 (TCC)

b. is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.

2.21 The ECJ ruled, in the *Markus Geltl v Daimler AG (Case C-19/11)*[11], that information must have a realistic prospect of occurring in order to be considered precise. The Tribunal Decision cited this[12] in concluding that where information refers to future circumstances or events (FSMA s118C (5)(a)), there must be a more than merely fanciful chance of these occurring, but that the threshold was lower than the event or circumstance being more likely than not to occur. We understand from our discussions with market participants that the "more likely than not" test has been commonly used in analysing possible disclosure obligations by issuers.

2.22 In deciding when information is specific enough to allow an issuer to draw a conclusion about the possible effect on price (FSMA s118C (5)(b)), the Tribunal Decision concluded that 'the information must indicate the direction of movement in the price which would or might occur if the information were made public. The information does not need to indicate the extent to which the price would or might be affected'.[13]

2.23 Subsequently, the ECJ gave its judgment in *Jean-Bernard Lafonta -v- Autorité des marchés financiers (Case C-628/13)*.[14] This states that 'it need not be possible to infer from that information, with a sufficient degree of probability, that, once it is made public, its potential effect on the prices of the financial instruments concerned will be in a particular direction'.

2.24 Recent case law therefore concludes that information can be considered precise in nature for the purposes of the definition of inside information when it has a more than fanciful chance of occurring and where it can be concluded that the information would move the price in any direction.

Delaying disclosure of inside information

2.25 Under the DTR, issuers can also delay disclosing inside information to protect their legitimate interest, for instance while negotiating a transaction. However, the rules state that issuers must meet certain overriding conditions to do so, including that the delay must not mislead the market.

2.26 The balance between the requirement to disclose inside information as soon as possible and the ability to delay it in appropriate circumstances is crucial to setting an appropriate framework for disclosures. It must support timely access to inside information but also allow for some delay to protect issuers' legitimate interests.

11 Court of Justice of the European Union Case C-19/11 http://curia.europa.eu/juris/document/document.jsf?docid=124466&doclang=EN

12 [76] Ian Hannam v FCA [2014] UKUT 0233 (TCC) www.tribunals.gov.uk/financeandtax/Documents/decisions/Hannam-v-FCA.pdf

13 [121] Ian Hannam v FCA [2014] UKUT 0233 (TCC) www.tribunals.gov.uk/financeandtax/Documents/decisions/Hannam-v-FCA.pdf

14 Court of Justice of the European Union Case ECJ Case C-628/13 http://curia.europa.eu/juris/document/document.jsf?text=&docid=162781&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=263298

2.27 MAD provides this framework. It requires issuers to disclose inside information as soon as possible while allowing them to delay disclosure in limited circumstances to protect their legitimate interests, as long as three conditions are met. If any of the conditions are not met, the issuer must disclose the information, regardless of whether delaying disclosure would be in its legitimate interest. These conditions are contained in DTR 2.5.1 and are that:

- the omission would not be likely to mislead the public
- the person receiving the information is subject to a duty of confidentiality and
- the issuer is able to ensure the confidentiality of the information.

2.28 As the legal definition of inside information underpins both market abuse and disclosure by issuers, the provisions that allow for a delay in disclosure are the differentiator in terms of when information needs to be disclosed to the market by an issuer.

2.29 These provisions are designed to support effective price formation and the smooth functioning of the market and are weighted towards transparency. At times, this means that incomplete information will need to be published, for instance by issuing a holding statement which acknowledges that further developments and disclosures are expected. This framework also needs to ensure issuers can use the delaying provisions in appropriate circumstances.

The issue

2.30 The DTR state that an issuer has to have a legitimate interest to be able to delay announcing inside information, for instance while it is negotiating a transaction. The examples in DTR2.5.3R are copied from the MAD Level 2 directive, which specifies that they are not exhaustive.

2.31 DTR 2.5.5G contains further UK specific guidance which states 'other than in relation to impending developments or matters described in DTR 2.5.3R or DTR 2.5.5AR, there are unlikely to be other circumstances where delay would be justified.'

2.32 Some stakeholders have highlighted that a combination of factors is causing practical difficulties for issuers in deciding what should be disclosed. In particular, feedback has highlighted issuers' concerns that more information should be classified as inside information than had previously been understood, but that the DTR put constraints on an issuer's ability to delay which went further than the EU requirements.

2.33 A common view was that these factors could begin to force issuers into disclosure of information at a stage where it was still significantly unformed and would be of little benefit to the market.

2.34 In considering how to respond to the feedback, we started from a view that the regime has operated broadly effectively so far to balance an issuer's ability to delay with appropriate transparency for investors. In particular, it is common practice in the UK to use 'holding' statements to disclose the most material parts of a developing issue, highlighting that a specific issue has occurred and committing to further information being released as appropriate. In general we have not seen disclosures of this nature which are so speculative as to be unhelpful.

2.35 Therefore in considering the issues, our aim was to ensure the maintenance of a regime which produces transparency which is useful to investors.

Options considered

2.36 In making this proposal, we have considered two options:

- Leaving the rules unchanged: there is no obligation on us to make changes to the rules
- Make changes to the rules now

Our preferred option

2.37 It was clear from our discussions with a range of practitioners that the above issue is currently causing practical challenges for listed companies.

2.38 Some stakeholders also told us that if we amend DTR2.5.5G without also issuing further guidance on our expectations about when disclosure may be legitimately delayed, there is a risk that we could create further uncertainty.

2.39 We consider that it is not appropriate to issue further guidance in relation to legitimate interests or the DTR provisions to delay disclosure more generally and have set out the background to this view in paragraphs 2.48 - 2.49 below.

2.40 On balance, we consider that leaving DTR2.5.5G unchanged or delaying consulting on it would not be the best approach. So we propose to amend the guidance now, to remove the last sentence of DTR2.5.5G which will clarify, for the avoidance of doubt, that issuers may have a legitimate reason to delay disclosure in circumstances other than the non-exhaustive examples listed in DTR2.5.3R or the circumstances described in DTR2.5.5AR.

2.41 However, we have reflected on the challenge described in paragraph 2.38 in the consultation question.

2.42 In proposing this change, we remain clear that the policy intention is to promote a properly functioning market by ensuring that investors have sufficient and timely information in order to make investment decisions. The primary aim of the rules is to create transparency. This is reflected in the construction of the Directive, which places a wide requirement on issuers to disclose all inside information as soon as possible and provides narrower, more prescriptive exceptions for delaying disclosure.

2.43 We note that it is a principle of interpretation of EU law that exceptions or derogations to a rule are strictly construed and this has been the approach which the FCA (and, previously, the FSA) has taken, and continues to take, to application of DTR 2.5.1R.

2.44 Further, one of the conditions for delaying disclosure set out in the DTR is that any delayed disclosure of inside information must not be likely to mislead the public. We believe that this requirement not to 'mislead by delay' provides an appropriate balance within the rules.

2.45 So we do not expect that the proposed change will have a negative impact on the type of transparency that we expect the regime to produce, the quality or amount of disclosures, compared with our position in recent years.

2.46 However, the proposed change will align the rules more closely with the MAD and MAR's policy intent and will provide clarity that an issuer may have a legitimate interest in delaying disclosure in other situations than the non-exhaustive circumstances the rules currently set out.

Legitimate interests

2.47 The Committee of European Securities Regulators (CESR), the predecessor to the European Securities and Markets Authority (ESMA), issued guidance on legitimate interests in 2007. This guidance gives a list of what may constitute a legitimate interest to delay disclosure of inside information, including commercial matters in the course of negotiation and decisions which need to be ratified by a supervisory board, within a dual-board structure. The guidance notes that the implementing directive is clear that the list is non-exhaustive.

2.48 MAR requires ESMA to set technical standards or issue guidelines in various areas. Article 17(11) states that ESMA will issue guidelines to create a non-exhaustive, indicative list of issuers' legitimate interests. We will look closely at this and encourage those with an interest in this area to do the same.

2.49 Against this background, we do not think it would be appropriate to attempt to define a list of legitimate interests within this consultation paper. However, we take this opportunity to clarify two points in relation to the policy concept:

- The DTR state that an issuer can delay disclosing inside information 'such as not to prejudice its legitimate interests'. So in deciding if there is a legitimate interest , and if an issuer can therefore consider delaying disclosure of inside information under the DTR, the issuer must be clear that publishing the inside information would actually prejudice its interest. There are clearly situations where this would not be the case and where it would not be appropriate to delay disclosure of inside information. An example of this is if an issuer has a commercial or PR-related preference to delay disclosure, but public disclosure would not actually damage its interests.

- Our view is that delaying disclosure to protect the price of the relevant security does not fall within the meaning of a legitimate interest, as an issuer does not gain any direct benefit from its security price staying at a specific level. It is unlikely that an issuer trying to delay disclosure of inside information for this reason could demonstrate that the delay would not have a misleading effect.

Annex 1
List of questions

Q1: **Do you agree that making the proposed change to DTR2.5.5G, without issuing further guidance relating to ‘legitimate interest’, supports a properly functioning disclosure regime?**

Annex 2
Cost benefit analysis

1. When we propose new rules we are obliged under FSMA to publish a cost benefit analysis (CBA), unless we consider that the proposals will lead to no or minimal increases in costs. The CBA is an estimate of the costs and an analysis of the benefits that the proposals will deliver. It is a statement of the differences between the baseline (broadly speaking, the current position) and the position that will exist if we implement the proposal.

2. We do not anticipate the proposal in this paper having any significant cost or competition implications and therefore we have not produced a CBA.

Annex 3
Compatibility statement

Compatibility with the FCA's general duties

1. This Annex follows the requirements set out in section 138I of the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, we are required by section 138I FSMA to include an explanation of why we believe the proposed rules are compatible with our strategic objective, advance one or more of our operational objectives, and have regard to the regulatory principles in section 3B FSMA. We are also required by section 138K(2) FSMA to state our opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also includes our assessment of the equality and diversity implications of these proposals.

The FCA's objectives and regulatory principles

4. The proposals set out in this Consultation Paper are compatible with our strategic objective of ensuring that the relevant markets function well and are primarily intended to advance our operational objectives of:

   - *Enhancing market integrity* – protecting and enhancing the integrity of the UK financial system, by ensuring that the Disclosure Rules and Transparency Rules remain proportionate and effective.

   - *Delivering consumer protection* – maintaining and securing an appropriate degree of protection for consumers, by ensuring that an appropriate level of information continues to be made available to investors.

5. In preparing our proposals, we have had regard to the regulatory principles set out in section 3B FSMA. In particular:

The desirability of exercising our functions in a way that recognises differences in the nature and objectives of businesses carried on by different persons

We do not believe that our proposals discriminate against any particular business model or approach.

The principle that we should exercise our functions as transparently as possible

2.50

We believe that by consulting on our proposals we are acting in accordance with this principle.

The need to use our resources in the most efficient and economic way

The proposals in this Consultation Paper will have minimal impact on our resources.

The principle that a burden or restriction should be proportionate to the benefits

We believe the proposals in this Consultation Paper are proportionate to the benefits.

The desirability of publishing information relating to persons

We believe that our proposals do not undermine this principle.

Expected effect on mutual societies

6. Section 138K of FSMA requires us to state whether, in our opinion, our proposed rules have a significantly different impact on authorised persons who are mutual societies, compared to other authorised persons. The relevant rules we propose to introduce in the DTRs, and the relevant rules we propose to amend, will apply equally to issuers of securities admitted to trading on a regulated market in the UK – regardless of whether they are a mutual society or another authorised person.

7. We therefore believe that the impact of our proposals would not significantly differ between mutual societies or other authorised persons.

Equality and diversity

8. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

9. Our equality impact assessment suggests that our proposals do not result in direct discrimination for any of the groups with protected characteristics (i.e. age, disability, gender, pregnancy and maternity, race, religion and belief, sexual orientation and transgender), nor do we believe that our proposals should give to rise to indirect discrimination against any of these groups. We would nevertheless welcome any comments respondents may have on any equality issues they believe may arise.

Appendix 1
Draft Handbook text

Appendix

DISCLOSURE RULES AND TRANSPARENCY RULES SOURCEBOOK (DELAYING DISCLOSURE) INSTRUMENT 2016

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the power in section 139A (Guidance) of the Financial Services and Markets Act 2000.

Commencement

B. This instrument comes into force on [*date*] 2016.

Amendments to the FCA Handbook

C. The Disclosure Rules and Transparency Rules sourcebook (DTR) is amended in accordance with the Annex to this instrument.

Citation

D. This instrument may be cited as the Disclosure and Transparency Rules Sourcebook (Delaying Disclosure) Instrument 2016.

By order of the Board
[*date*] 2016

Annex

Amendment to the Disclosure Rules and Transparency Rules sourcebook (DTR)

In this Annex, striking through indicates deleted text.

2.5 Delaying disclosure of inside information

…

Legitimate interests and when delay will not mislead the public

…

2.5.5	G	An *issuer* should not be obliged to disclose impending developments that could be jeopardised by premature disclosure. Whether or not an *issuer* has a legitimate interest which would be prejudiced by the disclosure of certain *inside information* is an assessment which must be made by the *issuer* in the first instance. ~~However, the *FCA* considers that, other than in relation to impending developments or matters described in *DTR* 2.5.3G or *DTR* 2.5.5AR, there are unlikely to be other circumstances where delay would be justified.~~

Financial Conduct Authority

PUB REF: 005149

© Financial Conduct Authority 2015
25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk
All rights reserved