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UK Securities Law Update – Q1, 2011

BY RONAN O'SULLIVAN, ROSS MCNAUGHTON & JAMES WRIGHT

Introduction

In this edition of our UK Securities Law Update we look at the proposals contained in the HM Treasury's latest consultation paper on the reforms to the UK financial services regulatory architecture. We also discuss the amendment made to the Financial Services Authority's Code of Market Conduct following the recent decision of the European Court of Justice ("ECJ") in *Spector Photo Group NV*, the findings of the market study of equity underwriting conducted by the Office of Fair Trading ("OFT"), as well as the London Stock Exchange's Alternative Investment Market's latest newsletter. Finally, we consider the proposed EU amendments to the Prospectus Directive and the Transparency Directive, as well as the new supervisory framework for financial services in Europe.

1. Reforms to UK Regulatory Architecture

On 17 February 2011, the UK HM Treasury published a consultation paper providing further detail on the Coalition Government's proposals for reforming the framework of financial regulation in the UK. The paper builds on the Government's earlier consultation, published in July 2010, which proposed the abolition of the current tripartite system of regulation of the Financial Services Authority ("FSA"), the Bank of England ("BoE") and HM Treasury. From a securities law perspective, we now have more clarity as to how the regulation of listings and market supervision will be structured going forward.

The proposed framework of financial regulation is as follows:

- Financial Policy Committee ("FPC") – this committee within the BoE will be responsible for delivering systemic financial stability through macro-prudential regulation. An interim FPC has already been established. As a policy committee with responsibility for regulation of stability and resiliance of the financial system as a whole, the FPC will not supervise financial firms or markets directly;

- Prudential Regulation Authority ("PRA") – the micro-prudential regulation of individual firms will be transferred to the PRA, a subsidiary of the BoE, which will authorise and supervise all banks, building societies, credit unions and insurers, as well as certain investment firms;

- Financial Conduct Authority ("FCA") - the body labelled as the Consumer Protection and Markets Authority in earlier consultations has been renamed the Financial Conduct Authority. The FCA will be a standalone independent regulator, operating under the recommendations and directions of the FPC, and will be responsible for the supervision of market discipline, including enforcement of market abuse. It will also be the body that represents the UK's interests in the European markets regulation of the new European Securities and Markets

Authority (see below). In addition, the UK Listing Authority ("UKLA"), a division of the FSA, which currently regulates the UK listing regime, will form part of the FCA. The Government's previous suggestion (as discussed in our UK Securities Law Update, Q3 2010) that the UKLA might be merged with another regulatory function relating to companies and corporate information, such as the Financial Reporting Council, has been dropped.

As part of this reform process, the Government also intends to take the opportunity to make some minor enhancements to the powers of the UKLA, including extending powers to impose sanctions on sponsors and primary information providers, allowing the UKLA to discontinue or suspend listings at the request of an issuer without following the warning notice and decision notice procedure and to extend the limitation period for taking action for breaches of the Listing Rules from two years to three years.

Following the consultation period the Government is expected to publish a white paper and draft bill to amend the Financial Services and Markets Act 2000 ("FSMA"). It is anticipated that bill will be presented to Parliament in mid-2011, with a view to receiving Royal assent in mid-2012 and for the new regulatory architecture to be fully implemented by the end of 2012.

2. Amendment to Code of Market Conduct

The provisions of the Code of Market Conduct regarding the offence of insider dealing have been amended with effect from 6 March 2011 following an important decision by the ECJ. In *Spector Photo Group NV and Chris Van Raemdonck v CBFA* ("Spector"), the ECJ ruled that the insider dealing offence as drafted in the EU Market Abuse Directive (2003/6/EC) implies that certain insiders "in possession of" inside information are presumed to have "used" that information when dealing in investments to which that information relates.

A number of Member States, including the UK (at s.118(2), FSMA), had interpreted this EU legislative concept of "using" inside information so as to prohibit dealing "on the basis of" that inside information. Further MAR 1.3.4E of the FSA's Code of Market Conduct contained evidential guidance that the FSA's opinion was that if the inside information was the reason for, or material influence on, the decision to deal, this would indicate that the person's behaviour was "on the basis of" inside information.

Whilst the FSA considers that s.118(2), FSMA remains consistent with the ECJ's decision in *Spector*, it has deleted MAR 1.3.4E from its Code of Market Conduct as it considered that this provision suggested that the FSA would have to provide evidence of a person's intention, as a separate element, to prove insider dealing. There is now a higher risk that dealing when in possession of inside information relevant to that transaction will constitute market abuse, as it will be presumed that the trading was carried out using that information (i.e. the FSA's view is that in order to prove insider dealing it is now not necessary to provide evidence of a person's intention). The burden would now fall on the person dealing to prove that the decision to deal was not influenced by the inside information (such as where a decision to deal had been made prior to the possession of the inside information).

3. Findings of the OFT Equity Underwriting Market Study

In our UK Securities Law Update, Q2 2010, we discussed the launch of a market study by the OFT in relation to equity underwriters' fees. In addition, the Rights Issue Fee Inquiry ("RIFI"), set up by the Institutional Investor Council ("IIC"), also undertook a similar consultation on equity underwriting practices and procedures in the UK.

The OFT published its findings in January, shortly after the RIFI published its report making a number of recommendations to improve the equity underwriting process for issuers. Although the OFT's market study concluded that there is little competitive tension in the UK market between investment banks in connection with the equity raising process and thereby in the pricing of their fees, a market investigation reference to the Competition Commission was not considered necessary. The OFT rather suggested ways in which issuers may be able to exert greater pressure on banks to reduce their underwriting fees, such as the involvement of institutional shareholders in the negotiation process and the use of tenders.

4. Inside AIM Newsletter (Issue 3)

The London Stock Exchange ("LSE") has published its third edition of its newsletter "Inside AIM".

(a) Related Party Transactions

This edition focuses on Rule 13 governing related party transactions, a key protection for AIM shareholders given that such transactions are often found in companies of the type and size typically listed on AIM and because of the relationship commonly found between directors and founders, who are also often major shareholders. Rule 13 does not require that related party transactions need shareholder consent. This makes the role of assessing whether the transaction is "fair and reasonable", for the purpose of the statement made by the independent directors after consultation with the AIM company's nominated advisor ("NOMAD"), critical in the protection of the shareholders.

Recently, AIM Regulation has received frequent requests by issuers and NOMADs to derogate on the requirement to provide this "fair and reasonable" statement. In this newsletter the LSE clarifies that the relevant wording provided at Rule 13 should not be amended or caveated in any way.

(b) Other Matters of Particular Note

In addition to the clarification surrounding Rule 13, the LSE has taken the opportunity to remind AIM companies and NOMADs of their ongoing obligations to notify price sensitive information. In particular, AIM companies are expected to keep confidential impending developments and matters in the course of negotiation and must ensure they have in place effective systems and controls to ensure confidentiality of price sensitive information. In addition, NOMADs should monitor their AIM clients' share prices and trading volumes, especially at times when there are forthcoming announcements for significant events, and are expected to have draft holding announcements prepared in advance to discuss with AIM Regulation should a potential leak situation arise.

The newsletter also offers guidance on the following topics: (i) suspension on announcement or leak of a reverse takeover (this has not changed despite amendments to the UKLA's approach for premium listed companies, as discussed in our UK Securities Law Update, Q3 2010); (ii) the investing policies of companies which become investing companies after a fundamental change of business under Rule 15; and (iii) working capital statements in admission documents.

5. Prospectus Directive Amended

The Directive (2010/73/EU) amending the Prospectus Directive and Transparency Directive came into force on 31 December 2010, and will have important implications for all issuers of securities in the European capital markets once implemented into national law. The amendments seek to simplify rules on prospectuses for securities and improve investor protection. Some of the key amendments include the following:

- the consideration threshold for an offer of securities for which a prospectus is required will be increased from €2.5 million to €5 million (offer in the EU calculated over a period of 12 months) (Article 1.2(h));
- a prospectus will not be required for offers addressed to fewer than 150 persons per Member State (an increase from 100 persons per Member State) (Article 3.2(b));
- the exemption for offers of securities with a minimum consideration per investor or denomination per unit will be increased from €50,000 to €100,000, to establish a clearer distinction between retail and professional investors (Article 3.2(c) and (d));
- an alignment of the definition of "qualified investor" (relevant in the context of determining whether there is an exemption for the "offer of securities to the public" test as to whether a prospectus is required) with the "professional client" and "eligible counterparty" definitions used in the Markets in Financial Investments Directive (2004/39/EC) (MiFID) (Article 2.1(e));
- there will be a requirement that the prospectus summary will be drawn up in a common format and focus on "key information" in order to assist investors in understanding and comparing similar securities (Article 5.2); and
- prospectuses will have to be published in electronic form on the website of the issuer or financial intermediary (Article 14).

On 17 March 2011, HM Treasury launched a consultation on the early implementation of the first two amendments mentioned above, asking for comments on the proposals by 9 June 2011. The UK Government's intention is that these are implemented into law well in advance of 1 July 2012, which is the date by which Member States must implement the Directive into national law, as it considers that these amendments in particular will be of benefit in reducing the regulatory burden on companies looking to access the capital markets, including in particular smaller public companies.

6. New EU Financial Services Supervisory Framework

The three new European Supervisory Authorities for the supervision of financial activities commenced operation on 1 January 2011. The European Securities and Markets Authority (ESMA), the European Banking Authority and the European Insurance and Occupational Pensions Authority have replaced Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors and the Committee of European Insurance and Occupational Pensions Supervisors.

The intention of this reform to the EU supervisory framework, which the Council of the European Union adopted in November 2010, was to create "a more efficient, integrated and sustainable European system of supervision". It is intended that there will be improved communication and coordination between national supervisory authorities (such as the FSA) and that standards of supervision are raised across the EU.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

London

Ronan O'Sullivan
+44.0.203.023.5127
ronanosullivan@paulhastings.com

Ross McNaughton
+44.0.203.023.5124
rossmcnaughton@paulhastings.com

James Wright
+44 .0.203.023.5284
jameswright@paulhastings.com

Tom O'Riordan
+44.0.203.023.5166
tomoriordan@paulhastings.com