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# UK Securities Law Update – Q2, 2010

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## Introduction

In this edition of our UK securities law update we discuss the government's proposals to abolish the Financial Services Authority ("FSA") and the impact that this will have on the regulation of listed securities in the UK. We also consider the recent announcement of the Office of Fair Trading ("OFT") in relation to its intended market study of equity underwriting, as well as the recent FSA sanction against Photo-Me for its delay in disclosing inside information. Finally, we look at the European Commission's consultation communication regarding the European regulation of short selling and credit default swaps.

This briefing will be of interest to issuers with or contemplating a UK listing, as well as investors in UK securities.

## I. Proposed Abolition of the FSA

On 16 June 2010, George Osborne, Chancellor of the Exchequer, announced the government's proposals to reform the UK financial services regulatory structure and the proposals were supplemented by a statement to the House of Commons from Mark Hoban MP, the Financial Secretary to the Treasury.

### *A. Background*

Until further details are announced by the government, the precise form that the implemented changes will take is not certain. However, what is clear is that the FSA and the existing tripartite system of regulation (between the FSA, the Bank of England ("BoE") and the Treasury) are to be abolished in their current forms and macro-prudential supervision will be transferred from the FSA to the BoE. In this process, the government intends to replace the functions of the FSA by introducing the following new bodies:

- the Financial Policy Committee, which will be responsible as a division of the BoE for macroeconomic and financial regulation;
- the Prudential Regulation Authority, which will be a subsidiary of the BoE and responsible for micro-prudential regulation (i.e. for regulation of sectors such as deposit-takers, insurers and investment banks);
- the Consumer Protection and Markets Authority ("CPMA"), which will be pro-actively responsible for consumer protection and conduct regulation of all firms, both retail and wholesale; and
- the serious economic crime agency, which would take over the work currently dispersed among the Serious Fraud Office, the Enforcement Division of the FSA and the OFT.

The government intends to release a detailed policy document for consultation prior to the end of July 2010.

### *B. Impact of Reform on the Regulation of Listed Securities in the UK*

Of importance to UK listed securities issuers and investors and for those contemplating a London main market listing is the broad impact that these changes will have on the regulation of the UK listing regime. Currently, the FSA is the UK's competent authority and the markets division of the FSA has various responsibilities as the UK Listing Authority ("UKLA") for regulating the UK listing regime, including:

- admitting securities to the Official List;
- making, reviewing and amending the Listing Rules, and the Disclosure and Transparency Rules ("DTRs");
- enforcing compliance with the Listing Rules and the DTRs (including suspension and cancellation of listing, if necessary); and
- making decisions relating to listing matters such as applications for listing, continuing obligations or applications of the UKLA rules.

Neither Mr Osborne's speech, nor Mr Hoban's statement, referred to the FSA's role as the UKLA or the impact of the proposed changes on that role. Although it appears that the CPMA could be the likely candidate in both name and remit to inherit the FSA's role as competent authority, it is possible that a further body or authority could be set up to carry out this function, and further details of the proposals are awaited from the government.

## II. OFT Prepares the Scope of Its Equity Underwriting Market Study

The UK's OFT announced on 10 June 2010 that it is intending to launch a market study shortly in relation to equity underwriters' fees. For this purpose, it has released a scoping paper and will consult with stakeholders to consider precisely what scope its review should take.

### *A. Background*

The proposed study is intended to be launched primarily in response to initial discussions with users of the equity underwriting market who have expressed some dissatisfaction with services received in relation to rights issues.

The last investigation by the competition authorities in this area was in 1999 which was undertaken by the Monopolies and Mergers Commission. This followed three reports on equity underwriting that were published by the OFT in the mid-1990s.

Given the developments in the equity capital markets in recent years and the adverse issues apparently raised with the OFT by some users of the market, the OFT has decided that this is a timely opportunity to investigate these services.

The OFT notes that the Rights Issue Fee Inquiry ("RIFI") is also undertaking a similar consultation on equity underwriting practices and procedures in the UK. RIFI was set up by the Institutional Investor Council (the "IIC") following a call by Lord Myners, who was then Financial Services Secretary to the Treasury, for institutional investors to review the equity underwriting process in the UK. The OFT has recognised that these are two pieces of independent but potentially complementary pieces of work, and they will liaise with the IIC during the course of its market study.

### *B. Proposed Scope of the Market Study*

The OFT proposes that the market study will focus on the areas understood to have created the greatest levels of dissatisfaction: underwriting and other associated services for rights issues and other similar types of equity-raising by companies that are typically in the FTSE 350. In addition, the OFT is consulting as to whether its review should be wider than this including, for example, services provided to small-and medium-sized companies (including AIM companies) and/or underwriting in connection with initial public offerings in general.

### *C. Timing of the Study and Its Possible Outcomes*

Depending on the final scope of the market study, the OFT intends to conclude the initial phase of the work before the end of 2010 and has put forward a range of possible outcomes, which include:

- the use of enforcement action by the OFT to pursue specific wrongdoers under its Competition Act powers;
- a referral of the market investigation to the Competition Commission;
- recommendations to government or regulators for legal, regulatory or political reform;
- voluntary action by industry players to address any problems found; or
- a recommendation that the market is operating satisfactorily.

## III. FSA Sanctions Photo-Me International plc

On 21 June 2010, the FSA handed down a fine of £500,000 to Photo-Me International plc ("Photo-Me") for its failure to disclose inside information to the market as soon as possible in breach of DTR 2.2.1R and Listing Principle 4. The delay created a false market in Photo-Me's shares for 44 days.

This is the largest financial penalty handed down by the FSA in response to an offence of this nature and exceeds previous examples including Woolworths Group plc (£350,000 for 29 days), Wolfson Microelectronics plc (£140,000 for 17 days) and Entertainment Rights plc (£245,000 for 78 days). The FSA made no findings of regulatory breach against any past or present directors of Photo-Me in relation to this matter.

The case illustrates the ongoing rigour with which the FSA is carrying out its enforcement of the rules regulating the UK's listing regime. It also serves as a useful reminder of the FSA's expectations of issuers with regard to their ability to monitor, assess and control inside information.

In brief, the main points arising out of this case are that:

- issuers constantly need to be vigilant to assess and identify information that could constitute inside information in a timely manner; particularly where the information could relate to a key determinant for the issuer's ongoing profitability as anticipated in the market (as occurred in relation to Photo-Me);
- issuers should assess whether information is likely to have a significant effect on price in accordance with the "reasonable investor" test in section 118C(6) of the Financial Services and Markets Act 2000;

- as made clear in the guidance to the DTRs, there is no figure (percentage change or otherwise) that can be set when determining what constitutes a significant effect on price;
- issuers must announce all news, positive and negative to the market, and should not try to put off an announcement of bad news in the anticipation that it will be off-set by good news or in the hope that future events may mitigate the impact; investors must be told all the facts and allowed to make their own assessment; and
- issuers are under an obligation to disclose inside information as soon as possible; in the Photo-Me case the failure of a board member to open an email and attachment and subsequently go on leave did not excuse a delay in communicating it to the market.

## IV. Consultation Communication on Short Selling and Credit Default Swaps

The European Commission has released a consultation communication regarding the regulation of financial services for sustainable growth on 2 June 2010. The consultation is open until 10 July 2010 and its purpose is to consult market participants, regulators and other stakeholders on forthcoming legislative proposals that will deal with the potential risks arising out of short selling.

The policy options put forward are to create:

- rules increasing the transparency in short selling;
- rules reducing the risks arising out of uncovered short selling; and
- emergency powers for Competent Authorities to impose temporary short selling restrictions in accordance with the European Securities and Markets Authority.

The European Commission recognises that different member states had reacted differently to short selling issues at a domestic level and feels that working toward a more harmonised regime will increase the resilience and stability of the financial markets in the EU.

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