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Prevention of Market Abuse

Act IV of 2005 titled the Prevention of Financial Markets Abuse Act (the "Act") replaced the Insider Dealing and Market Abuse Offences Act (Chapter 375 of the Laws of Malta). The Act transposes and implements Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse), more commonly known as the Market Abuse Directive. The Act is supplemented by the following Regulations (the "Regulations"):

- Prevention of Market Abuse (Disclosure and Notification) Regulations, 2005
- Prevention of Market Abuse (Fair Presentation of Investment Recommendations and Disclosure of Conflicts of Interest) Regulations, 2005
- Prevention of Market Abuse (Market Practices and Manipulative Behaviour) Regulations, 2005

The Act and the Regulations came into force on the 1st April 2005. Their purpose is to create a framework which provides more comfort to the investing public and strengthens confidence in the financial markets by limiting opportunities for insider dealing and market manipulation (together referred to as "market abuse"). On 1st October 2005 the MFSA issued a set of Guidance Notes which is available at www.mfsa.com.mt.

The Act has extensive provisions defining the criminal offence of market abuse. By way of example, insider dealing occurs through (i) the illegitimate use by an insider (eg. a company official) of confidential company information for the purpose of trading for gain on the same company's securities listed on the stock exchange; or (ii) significant trading by major shareholders or other insiders before the announcement of important events; or (iii) employees' own account transactions and related orders timed just before clients' transactions. Market manipulation, on the other hand, may be committed in various ways, for example by sending false signals to deceive the investing public thereby influencing the market price of a listed security. One false signal could be the deliberate spreading of false rumours, or the creation of fictitious or simulated trades on a security between persons acting in collusion. Under the Insider Dealing and Market Abuse Offences Act, these offences already ranked as criminal offences similar to more traditional crimes, such as fraud, misappropriation and forgery. In the Act, administrative sanctions against market abuse offences now co-exist side by side with the criminal sanction. The imposition of an administrative penalty does not however preclude the institution of criminal or civil proceedings.

The Act and the Regulations issued apply to financial instruments:

- a. admitted to trading on a regulated market in Malta or in any other EU or EEA state; or
- b. for which a request for admission to trading on a regulated market has been made; or
- c. whose value depends on a financial instrument in (a) or (b) above.

The Act and the Regulations place responsibilities on:

- (i) issuers of financial instruments and their managers;
- (ii) financial intermediaries and
- (iii) disseminators of financial recommendations eg. researchers and journalists.

Article 9 of the Act endeavours to increase transparency and early disclosure of price sensitive information. The chances of insider trading or market abuse are likely to be reduced if proper and timely disclosure is made by public issuers. This aims to place all investors on a level playing field and safeguards against the dangers of selective or abusive use of confidential information.

Issuers are obliged to inform the general public upon the coming into existence of any set of circumstances or the occurrence of an event, even if not yet formalised, giving rise to inside information concerning the said issuer. Issuers are required to promptly issue a public announcement by:

- a. posting a notice on the web site of the said issuer; and
- b. publishing it on one or more newspapers widely distributed in Malta or other Member State or EEA State/s concerned.

Such information must be published in a clear form and must not be combined with the marketing of the issuer's activities. Where it is not practical to publish all relevant inside information in a newspaper, the public announcement made should indicate where and at what times such information is freely available. We would recommend that issuers book publication space in advance for all known major corporate events (e.g. general meeting, declaration of dividend),

The issuer may however delay the public disclosure of inside information so as not prejudice his legitimate interests provided that:

- a. such delay is not likely to mislead the public and
- b. the issuer is in a position to ensure the confidentiality of the information, the disclosure of which, was delayed.

Regulation 6 of the Prevention of Financial Markets Abuse (Disclosure and Notification) Regulations, provides a non-exhaustive list of circumstances relating to "legitimate interests" of an issuer. Such circumstances include:

- a. negotiations where the outcome or normal pattern of those negotiations would be likely to be affected by public disclosure;
- b. decisions taken or contracts made by the management of an issuer which need the approval of another body of the issuer in order to become effective, where the organisation of such an issuer requires the separation between these bodies eg. where a decision required the approval of the Board of Directors.

In the above scenario, the issuer must take adequate measures and establish effective arrangements to control access to confidential inside information. Additionally, the MFSA must be informed of the issuer's decision to delay the public disclosure of inside information.

Issuers are required to draw up a list of persons working for them, whether under a contract of employment or otherwise, who have access to inside information. Such list should include:

- a. the identity of the persons having access to inside information;
- b. the reason for their being on such list; and
- c. the date at which the list of insiders was created and updated.

When drawing up the list of "insiders", the issuer must take the necessary steps to ensure that the persons on such list acknowledge their legal and regulatory duties and are aware of the sanctions attaching to the misuse or improper circulation of such information. This list is to be promptly updated with any change in information and must be promptly transmitted to the MFSA.

Persons discharging managerial responsibilities within an issuer, and persons closely associated to them are obliged to notify the MFSA within 5 working days of transactions conducted on their own account where these relate to:

- (i) bonds and shares of the issuer,
- (ii) derivatives linked to the shares of the issuer or
- (iii) other financial instruments linked to the shares of the issuer.

A "person discharging managerial responsibilities within an Issuer" is deemed to be a person who is:

- a. a member of the administrative, management or supervisory bodies of the issuer (such as the Board of Directors and the Company Secretary);. or
- b. a senior executive who has regular access to inside information relating to the issuer and who has the power to make managerial decisions affecting the future developments and business prospects of the issuer (such as a CEO)

(For all intents and purposes, an employee carrying out secretarial or administrative duties with such bodies or with such senior executives is considered to fall within such list even if such employee may not occupy a managerial grade within the organisation.)

A "person closely associated with a person discharging managerial responsibilities within an Issuer" means:

- a. the spouse or common law partner of the person discharging managerial responsibilities;
- b. dependent children of the person discharging managerial responsibilities;
- c. other relatives of the person discharging managerial responsibilities, who have shared the same household as that person for at least one year on the date of the transaction concerned;
- d. any legal person, trust or partnership, whose managerial responsibilities are discharged by any of the above-mentioned persons or by a person discharging managerial responsibilities within the issuer; or which is controlled by such a person, or that is set up for the benefit of such a person, or whose economic interests are substantially equivalent to those of such person.

Notifications are to be made using the form set out in Schedule 1 of the Prevention of Financial Markets Abuse (Disclosure and Notification) Regulations, 2005. No notification is required for transactions not exceeding 5,000 Euros or equivalent conducted on own account or by a closely associated person in one calendar year. The MFSA grants public access to the information concerning such transactions, on an individual basis. The two month "black out" period preceding the preliminary notification of a listed company's annual results and of the notification of the half yearly results continues to apply.

An obligation has been imposed on banks and investment firms to inform the MFSA upon reasonable suspicion that a transaction might constitute the prohibited use of inside information or market manipulation.

The bank or investment firm is to decide on a case-by-case basis whether there are reasonable grounds for suspecting that a transaction involves the prohibited use of inside information or market manipulation, taking into consideration the elements constituting the prohibited use of inside information or market manipulation referred to in the Act and Regulations. Notification is to be made promptly using the form set out in Schedule II of the Prevention of Financial Markets Abuse (Disclosure and Notification) Regulations, 2005.

In the event that the information required by the MFSA is not available at the time of notification, the issuer is to include in Schedule II at least the reasons why it suspects that the transaction might constitute the prohibited use of inside information or market manipulation. All remaining information is to be furnished to the MFSA as soon as it becomes available. In fulfilling its notifying obligations under these Regulations, the issuer is strictly precluded from informing any other person of the suspicious transaction, and particularly those persons on behalf of whom the transaction was carried out or parties related to those persons.

By virtue of Article 12 of the Act, any person who produces or disseminates research concerning financial instruments or issuers of financial instruments and any person who produces or disseminates other information recommending or suggesting an investment strategy intended for distribution channels or for the public, is to take reasonable care to ensure that such information is fairly presented and shall disclose his interests or indicate conflicts of interest concerning the financial instruments to which that information relates. "Research or other information recommending or suggesting investment strategy" is defined under the Regulations as being:

- a. information produced by an independent analyst, an investment firm, a credit institution or any other person whose main business is to produce recommendations or a natural person working for them under a contract of employment or otherwise that expresses a particular investment recommendation in respect of a financial instrument or an issuer of financial instrument such as for example, investment analysts.
- b. Information produced by persons other than the persons mentioned in para. (a) which directly recommends a particular investment decision in respect of a financial instruments.

For the purpose of these Regulations, a "recommendation" means research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public.

The Prevention of Financial Markets Abuse (Fair Presentation of Investment Recommendations and Disclosure of Conflicts of Interest) Regulations 2005, inter alia provide that:

- i. a recommendation must clearly and prominently disclose the identity of the person responsible for its production i.e. the name and job title of the individual who prepared the recommendation and the legal person responsible for its production.
- ii. in a recommendation, facts must be clearly distinguished from interpretations, estimates, opinions and other types of non-factual information. All sources must be reliable and indicated. Projections, forecasts and price-targets should be clearly indicated as such.
- iii. any basis of valuation or methodology used to evaluate a financial instrument or an issuer of financial instrument or to set a price target for a financial instrument, is adequately summarised.
- iv. the meaning of any recommendation made eg. buy, sell or hold, should be adequately explained and any appropriate risk warnings indicated.
- v. the date at which the recommendation was first released for distribution is clearly and prominently indicated, as well as the relevant date and time for any financial instrument price mentioned.
- vi. where a recommendation differs from a recommendation concerning the same financial instrument or issuer, issued during the twelve month period immediately preceding its release, this change and the date of the earlier recommendation are designated clearly and prominently.

Finally, investment firms and credit institutions are obliged to disclose on a quarterly basis, the proportion of all recommendations that are "buy", "hold" or "sell" or equivalent terms, as well as the proportion of issuers corresponding to each of these categories to which the investment firm or credit institution has supplied material investment banking services over the previous 12 months.

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