THE CITY OF LONDON LAW SOCIETY

4 College Hill
London EC4R 2RB

Telephone 020 7329 2173
Facsimile 020 7329 2190
DX 98936 – Cheapside 2
mail@citysolicitors.org.uk
www.citysolicitors.org.uk

BY E-MAIL

To: Michael Treip
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

E-mail: cp10_22@fsa.gov.uk

8 December 2010

Dear Sirs,

FSA Quarterly consultation No.26 (CP10/22) – Chapter 6: Amendment to the Code of Market Conduct following the ECJ's decision in the Spector Case

The City of London Law Society ("**CLLS**") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Regulatory Committee (the "**Committee**"). Members of the Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

We wish to make some specific observations on the FSA's proposal in Chapter 6 of the Quarterly Consultation Paper (CP10/22) to amend the Code of Market Conduct ("**CMC**").

We do not consider that the discussion in Chapter 6 of the CP, and the proposed change to the CMC, goes far enough to:

- reflect fully the implications of the *Spector* judgment; and
- give guidance on the practical effect of those implications for market participants.

The discussion and the proposed amendment also fail to take account of the pre-MAD provisions relating to "relevant information not generally available" ("**RINGA**").

Given the significant issues raised by the proposed changes we consider that the FSA should carry out a fuller consultation.

The Implications of *Spector*

In brief, *Spector* has established that:

- There is a presumption of "use" of inside information if a putative insider deals when in possession of inside information;
- This presumption is, however rebuttable by the putative insider; but
- whether or not the use of inside information is prohibited by MAD requires the application of a purposive (objective) test, as evidenced by certain of MADs recitals.

It appears to us that CP10/22 deals only with the first point, albeit in a way which emphasises its implication for the regulator – not having to show "evidence of a person's intention". We consider that the CMC should make clear what the FSA's views are as to when a person would be regarded as having dealt "on the basis of" inside information in the light of the Spector decision, as the decision represents a radical departure from the previous understanding of the statutory provisions.[1]

We consider that the FSA should also make clear on the face of the CMC what *Spector* means for the examples of dealing set out in MAR 1.3.3 and MAR 1.3.5:

- is it now for the dealer to rebut a *Spector* presumption in these cases? or
- is the CMC to be read as saying that the FSA takes a successful rebuttal for granted in these cases?

We believe it is open to the FSA to confirm the latter.

Legitimate Use

Alternatively (or additionally) the FSA could explore further the principle of "legitimate use" laid down by the ECJ in *Spector.*

Although the ECJ derived this principle from the recitals expressly excepting certain "legitimate" practices as falling outside the scope of MAD (such examples being faithfully referenced in the CMC as "C" provisions), it seems clear from the body of the judgment and the formal ruling (para 1) that the class of "legitimate uses" is not a closed one but a matter for objective analysis in each case.

If this is so, then it would be open to the FSA to recast some or all of the cases presently falling within MAR 1.3.3 and MAR 1.3.5 as likely (i.e. of "E" status) examples of legitimate use.

This would be of significant benefit to market participants and especially pertinent in the case of Chinese walls, given the favourable reference to such arrangements in Recital 24 of MAD and the widespread and effective use of walling as a means of controlling sensitive information within multi-service financial institutions.

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[1] The CP also asserts that the reference in s.118 of FSMA to dealing "on the basis of" inside information is, without more, consistent with the presumption of use found in *Spector.* It is only consistent if one applies the interpretive rule that an English statute must be construed, so far as possible, to give effect to relevant EU law. We suggest that in this case, the application of the rule leads to a fairly strained result, as a matter of plain English usage.

We also consider that the FSA should include additional provisions specifying examples of when it is legitimate for a person to deal in securities even though he possesses inside information (and thus could, in the light of the *Spector* decision, be presumed to be using the information). In particular, we consider that FSA should make clear that a person does not engage in market abuse where he trades as a result of orders placed before he came into possession of inside information.

In addition, a person should not be regarded as engaging in market abuse where he enters into transactions in accordance with a plan made by that person before he possessed the information specifying the amount of financial instruments proposed to be acquired or disposed of and the proposed dates and prices for the transactions (or a formula, algorithm or computer programme for determining those matters) or giving another person who does not possess the information the discretion to determine those matters. This latter provision will be of particular importance to companies that create regular buy back programmes either according to a pre-determined formula or by appointing a broker to trade on their behalf, including during close periods. Otherwise, companies would have to interrupt repurchase programmes for no externally apparent reason if they come into possession of inside information. The sudden interruption of a regular programme can give rise to false markets. Speculators can also take advantage of the fact that companies have to cease repurchase programmes when they have inside information in the run up to results announcements.

The RINGA provisions of the CMC

A further important point overlooked in CP10/22 is that MAR 1.3.3 to MAR 1.3.5 are not just relevant to the MAD-derived provisions of FSMA. They are also relevant to s.118(4) (misuse of information) and the related MAR 1.5.5E, which are UK-specific. *Spector* does not compel any change to policy or drafting insofar as these provisions are concerned and we believe the FSA should resist extending the policy impact of *Spector* to those provisions.

We would be happy to discuss any of our comments with you. Please contact Margaret Chamberlain on +44 (0)20 7295 3233 or by e-mail at: margaret.chamberlain@traverssmith.com.

Yours faithfully

Margaret Chamberlain

Margaret Chamberlain
Chair, CLLS Regulatory Law Committee

Members of the Committee:
Chris Bates, Clifford Chance LLP
David Berman, Macfarlanes LLP
Peter Bevan, Linklaters LLP
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