DEVELOPMENTS IN THE LONDON LISTING MARKETS: MARKET ABUSE AND RECOMMENDATIONS IN RELATION TO SECONDARY FUNDRAISINGS

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"The FCA's strategy for 2022 to 2025 includes 'delivering assertive action on market abuse'."

In this article, we report on some recent decisions of the Financial Conduct Authority ("FCA") which are indicative of its stated more pro-active approach to deter market abuse and manipulation, as well as the key recommendations made last summer by the UK Secondary Capital Raising Review in relation to secondary fundraisings. Our previous articles in relation to developments in the London listing markets can be found here.

MARKET ABUSE – RECENT NOTICES AND FINES

During 2022, the FCA issued various fines and notices to firms and individuals in relation to market abuse and manipulation. This follows the FCA's strategy for 2022 to 2025 which includes "delivering assertive action on market abuse" and was further highlighted by the FCA in June 2022 in its statement on its work on market abuse and manipulation, signalling an increase in scrutiny to deter and take action against market abuse. We highlight a number of these decisions below.

Sir Christopher Gent – unlawful disclosure of inside information

On 5 August 2022, the FCA fined Sir Christopher Gent, the former non-executive Chair of ConvaTec Group plc (the "Company"), £80,000 for unlawfully disclosing inside information in breach of Article 10 of the EU Market Abuse Regulation ("EU MAR"). The FCA's published decision contains significant clarification in relation to the identification of inside information and unlawful disclosure.

"The FCA concluded that Sir Christopher's actions amounted to unlawful disclosure of inside information in contravention of EU MAR."

Background

In late September 2018, the Company's board was provided the latest financial information in relation to the Company which indicated that it was at risk of not meeting its published financial guidance. On 3 October 2018, the Company was also made aware that one of its major customers might seek to reduce its orders, which was later confirmed on 5 October 2018.

It became apparent on 9 October 2018 that the impact of the reduction in demand from the customer would have a significant impact on the Company's revenue growth, which would take the Company 'outside of guidance'. Sir Christopher attended calls with the CEO and other senior executives to discuss the position and it was noted that if the financial guidance needed to be revised, the CEO may wish to explore retirement options, which the CEO later confirmed on 10 October 2018. Later on 10 October 2018, Sir Christopher spoke with senior executives at two major shareholders of the Company and notified them that, subject to the board's analysis of its latest forecasts, the Company expected to make a regulatory news announcement on 15 October 2018 relating to the revision of its financial guidance and the retirement of the Company's CEO.

FCA decision

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The FCA concluded that Sir Christopher's actions amounted to unlawful disclosure of inside information in contravention of EU MAR. The FCA determined that the information disclosed by Sir Christopher was inside information by considering the four limbs to the definition of inside information, which includes that the information has to: (i) relate to an issuer or its securities; (ii) not be in the public domain; (iii) be of a precise nature; and (iv) be likely to have a significant effect on the price of the issuer's securities.

Accordingly, the FCA found that, as Sir Christopher expected that the company's financial guidance would have to be revised and it was likely that the CEO would retire, this information was of a precise nature and it was likely to have an effect on the company's share price, which met the criteria of inside information.

The FCA concluded that Sir Christopher acted negligently in disclosing the information to the senior executives at the two major shareholders for the following reasons:

(i) in light of Sir Christopher's considerable experience and position, having received relevant training on EU MAR, Sir Christopher should have realised that the information he disclosed constituted, or may have consisted, inside information;

(ii) although engaging with, and fostering good relations with major shareholders may be considered to be part of a Chair's duties, Sir Christopher's disclosures were not in the normal exercise of his employment, profession or duties as required by Article 10 of EU MAR and were not necessary for Sir Christopher to perform his functions. Sir Christopher's objective was to forewarn the shareholders of the events soon to take place;

(iii) the FCA took into account that, at the time of the disclosures, the Company had not formally classified the information relating to the revision of financial guidance and retirement of the CEO as inside information. The FCA also considered that Sir Christopher had informed a board-level executive and one of the Company's brokers that he was intending to call, and/or had called, the major shareholders but he was not advised against making those calls; and

(iv) the imposition of confidentiality and no-dealing obligations on recipients of inside information would not render a disclosure of inside information lawful if the disclosure was not reasonable in the first place.

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Need for proper controls

Under EU MAR (and the UK version of EU MAR which applies since Brexit), an issuer shall inform the public as soon as possible of inside information which directly concerns that issuer. The FCA's decision reminds directors and issuers that, in determining whether there is inside information, directors and issuers should note that the information does not need to be disclosed immediately, which is how many have interpreted the meaning of "as soon as possible" under the regulations.

The FCA acknowledged that it is possible to have inside information earlier but not be in a position to announce it, which means issuers should arrange for proper controls to be applied to that information. Had the Company arranged for such controls to be applied beforehand, Sir Christopher would not have sought to disclose the information to the shareholders.

Market manipulation by bond traders

On 7 December 2022, the FCA issued decision notices to three bond traders for market manipulation under Article 15 of EU MAR and its predecessor provision under the Financial Services and Markets Act 2000 ("FSMA"). The actions which led to the notices occurred between June and July 2016, while the traders were working at Mizuho International Plc and involved the placing of large and misleading orders of Italian government bond futures ("BTP Futures") on a number of occasions with the aim of creating a false impression as to the supply and demand of the BTP Futures. The traders would place large orders which they did not intend to execute and then place smaller orders which they did intend to execute to create the impression there was more supply and demand in the market than in reality, with the aim of encouraging others to buy or sell BTP Futures that the traders genuinely intended to execute. The FCA considered this conduct to be serious as it undermined the integrity of the market and would have caused other market participants to change their trading decisions based on the manipulation.

FCA decision

The FCA considered the actions to be market manipulation and sanctioned the traders by:

1. issuing an order prohibiting them from performing any functions in relation to any regulated activity carried out by an authorised person, exempt person or exempt professional firm (as set out in FSMA), effectively barring them from trading; and
2. imposing fines of almost £600,000 collectively, with the most senior trader being issued a higher fine of £395,500 to reflect his higher level of responsibility and experience.

The notices have been referred to the Upper Tribunal by the individuals and are currently waiting to be heard. The proposed sanctions will therefore have no effect pending determination of the case by the Upper Tribunal.

Other FCA fines and notices

The FCA has additionally sanctioned firms such as Citigroup Global Markets Ltd who were fined over £12m for failing to properly implement measures to detect market abuse in August 2022 and Sigma Broking Limited who failed to report potential market abuse, leading to the firm and some of its directors being fined for their oversight failures in October 2022. In July 2022, the FCA issued decision notices in respect of Carillion plc (in liquidation) and three of its former executive directors in relation to contraventions of EU MAR and the Listing Rules in connection with announcements that were misleading and did not accurately or fully disclose Carillion plc's true financial performance.

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Commentary

These decisions are an important reminder that issuers and their directors, and other market participants, must ensure that they are fully aware of their obligations under the UK market abuse regime, including what constitutes inside information, and that adequate training is provided and received and that appropriate systems and controls are in place to prevent market abuse or manipulation. This is especially so as the increase in regulatory focus on market abuse and manipulation is likely to mean an increase in criminal and civil sanctions against individuals and firms who breach the UK market abuse regime in the next few years.

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UK SECONDARY CAPITAL RAISING REVIEW

In October 2021, the UK Treasury launched the UK Secondary Capital Raising Review (the "Review"). The purpose of the Review was to consider how to improve secondary capital raising processes for UK listed companies and make recommendations to this effect to the government. On 19 July 2022, the UK government published the recommendations of the Review and confirmed acceptance of all the recommendations.

The Review's recommendations included several key areas of focus:

- the maintenance and enhancement of the pre-emption regime;
- support companies to raise smaller amounts of funds quickly and cheaply;
- provide additional flexibility for capital hungry companies;
- involve retail investors in capital raisings;
- reduce regulatory involvement in larger fundraisings;
- revamp existing fundraising structures to be quicker and cheaper;
- provide a greater range of choice of fundraising structures for companies; and
- prioritise an ambitious "drive to digitisation".

As we have already reported on the updated Pre-Emption Group ("PEG") guidance in our **previous article** in this series, we focus here on the other key recommendations of the Review.

Increasing the formality and transparency of the PEG: Recommendation 1

The PEG should be formalised and should have a website with a searchable database of information. There should be revised terms of reference and a formal, objective and transparent appointment process for members. An objective review should be carried out of the group members to ensure that they fully represent the ownership of the UK capital markets. The PEG should also be made more transparent through an annual report and a contribution towards the Chancellor's State of the City report.

"A prospectus for an admission of shares to trading should remain subject to FCA approval but should only be required for secondary offers where the offer size is at least 75% of the existing share capital."

Prospectus requirements: Recommendations 7 and 8

As part of the wider review of the UK prospectus regime, the Review recommends a shorter period than the current six days (i.e. a maximum of three working days) for a prospectus to be made available to the public for an initial public offering ("IPO") involving a retail offer. The concern was that the six-day rule increased market volatility risk and therefore encouraged issuers to avoid making a public offer to retail investors. The aim of shortening the period to three working days is therefore to encourage issuers to include a wider pool of investors in the marketing of their IPO and give retail investors sufficient time to review the prospectus whilst minimising exposure to market volatility by reducing the period that the offer must remain open, supporting the participation of retail investors generally in the ownership of listed companies. The view is that the inclusion of retail at the secondary offer stage will be more effective if retail investors are more readily able to form part of a company's register from the IPO stage.

Also, a prospectus for an admission of shares to trading should remain subject to FCA approval but should only be required for secondary offers where the offer size is at least 75% of the existing share capital (i.e. raising it materially from the current 20% threshold).

Sponsor: Recommendation 9

A sponsor firm should not be needed in relation to a secondary fundraising.

Working capital requirements: Recommendations 10 and 11

The Review recommends that the FCA re-evaluates its approach to working capital statements to reconsider whether a company's clean statements can be accompanied by disclosure of assumptions made when making its confirmation. A working group has been set up by the FCA and the Financial Reporting Council to look into the overlap between working capital diligence exercises and issuer's going concern statements, viability statements and, in time, resilience statements.

Rights issues: Recommendations 12 and 16

"Instead of having to prepare an offering document for each secondary fundraising, companies should be able to opt-in to an enhanced continuous disclosure regime."

The Review recommends the offer period for rights issues and open offers should be cut down so that an offer is open for acceptance for seven business days instead of the current ten business days. Excess application mechanics should be attached to rights issues allowing existing shareholders to apply to take up shares that are not taken up by other shareholders, at the offer price.

General meeting notice period: Recommendation 13

In the medium term, statute should be amended to give the Secretary of State the ability, without further primary legislative change, to reduce the notice period for shareholder meetings other than annual general meetings to seven clear days.

Authority to allot: Recommendation 14

Companies should be able to extend their annual allotment and pre-emption rights disapplication authorities from their shareholders of up to two thirds of their issued share capital to all forms of fully pre-emptive offers and not just rights issues.

Update the Companies Act 2006 ("CA 2006") to reflect current practice pre-emption provisions: Recommendation 15

The CA 2006 should be amended to reflect the process that is typically followed on a rights issue or open offer when a disapplication resolution has been used to modify statutory pre-emption rights. This includes excluding offers to shareholders in overseas jurisdictions where the cost and burden of extending the offer to them would be disproportionate, aggregating fractional entitlements and selling them, and allowing new shares to be offered to securities holders with a contractual right to them on the same basis as if they were holders of ordinary shares.

Disclosure requirements: Recommendations 17, 18, 19 and 20

Instead of having to prepare an offering document for each secondary fundraising, companies should be able to opt-in to an enhanced continuous disclosure regime. In practice, for example, this could mean adding risk factors in their annual report or by periodic updates on their website.

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Where a secondary issue involving a public offer does not require a prospectus, the Review recommends the use of an Australian style "cleansing notice": a public announcement that the company is not delaying the disclosure of any inside information and is in full compliance with market disclosure obligations. The CA 2006 should also be changed to require disclosure of the identity of the ultimate investment decision maker or beneficial owner in relation to a share in a s793 notice, in addition to shareholder information. Finally, the market should agree and make publicly available standard form terms and conditions with institutional investors for use on secondary fundraises, as is the case with the Master ECM Terms in Australia.

Drive to digitisation: Recommendation 21

A newly created Digitisation Task Force should coordinate the drive towards a fully digitised shareholding system.

Commentary

These recommendations seek to achieve the aim of the Review, namely to improve the efficiency of capital raisings for companies listed on UK capital markets. The Review includes some very practical changes that will be welcomed by companies, such as reducing the notice period for general meetings to seven business days, as well as more ambitious longer-term changes, such as the drive towards a fully digitised shareholding system.

CONCLUSION

Whilst the UK government and regulators are seeking to overhaul the way the London markets are regulated, to make them more attractive and to facilitate capital raising, it is equally important to maintain market integrity and investor confidence. The strong focus of the FCA towards scrutinising market behaviour and stamping out market abuse and manipulation is therefore welcome and the levels of fines it has been dishing out should act as a deterrent!

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