Disclosing inside information
Can investors still be brought ‘over the wall’?

A string of recent, high-profile enforcement actions by the FSA has highlighted the risk for companies and financial advisers of improperly disclosing inside information. It also serves as a reminder of the need for robust procedures to ensure that inside information is only communicated to third parties in those limited circumstances where disclosure is permitted.

“Wall-crossing”
The practice of “wall-crossing” investors has also been brought under scrutiny. This is where a number of investors are briefed about a major, forthcoming transaction by a publicly traded company ahead of any announcement to the market. The usual purpose of making such a disclosure is to elicit support from shareholders for the transaction in question or to ascertain the investor’s appetite for participating in a fund raising. It also allows the company a degree of comfort that the transaction will be well-received when launched.

This sort of pre-briefing of investors (a role typically undertaken by the company’s corporate broker) has been standard practice in the UK for many years. Indeed, in its recently published consultation on changes to the Stewardship Code, the Financial Reporting Council suggests revising the current language to remove any inference that institutional investors should not become insiders in appropriate circumstances. However, information concerning potential transactions will, in many cases, amount to inside information, so disclosure must be undertaken with the utmost care in order not to amount to market abuse.

The market abuse regime and “improper disclosure”
Under market abuse regime in the Financial Services and Markets Act 2000 (“FSMA”) a civil offence is committed where abusive behaviour occurs in relation to securities traded on a “prescribed market” (which includes the London Stock Exchange Main Market and AIM). One of the types of behaviour specified in FSMA which amounts to market abuse is where inside information is disclosed by an insider other than in the proper course of the execution of his employment, profession or duties (improper disclosure – s118(3)).

It is important to be aware that the improper disclosure offence does not require anyone to act or deal on, or make a personal gain from, the disclosure of inside information. Nor does there need to be any intention to commit market abuse or even an awareness that the information being disclosed is actually inside information.

Before companies and their advisers disclose any information about the company’s situation to investors, it is essential to consider the nature of the information being disclosed. Inside information is defined in FSMA as information which is:

- of a precise nature, which means information:
  - indicating circumstances that exist or are reasonably expected to come into existence; and
  - specific enough to draw a conclusion as to the possible effect on price (this is thought to mean the direction of movement i.e. upwards or downwards);
- not generally available;
- relates to a company with securities traded on a “prescribed market”; and
- would, if generally available, be likely to have a significant effect on the price of the securities or related securities (FSMA provides that this would only be the case if a reasonable investor would be likely to use the information in making his investment decisions).

Depending on the circumstances of each case, there is a high risk that information concerning an imminent transaction would fall within this definition. It is also worth bearing in mind that the FSA has the benefit of hindsight when making its assessment, so the point should be judged with additional care at the time of making the disclosure.
The context of the disclosure is also important in determining if the information disclosed is “inside” in nature. The FSA recently fined the corporate broker, Andrew Osborne, for improperly disclosing inside information during a call with a shareholder in Punch Taverns plc ahead of a proposed equity issue by the company, even though he had not provided definitive information on the terms or actual timing of the transaction. The investor, David Einhorn, (who was separately fined by the FSA for market abuse) had initially refused to be wall-crossed in relation to the transaction but the call with management proceeded on an “open” basis. The FSA acknowledged that none of the pieces of information provided during the call would amount to inside information in isolation. However, when taken as a whole and in the context of the attempted wall crossing, the information provided constituted inside information because it disclosed the purpose, approximate size, anticipated timing and likelihood of the issue (Mr Osborne indicated there was broad support from shareholders).

When is disclosure permitted?

If there is a risk information could be inside information, it should only be disclosed in the proper course of employment, profession or duties. The FSA provides some guidance in its Code of Market Conduct (“MAR”) on the factors it will take into account in deciding whether inside information is being disclosed in the proper course. These include whether the disclosure is:

- accompanied by the imposition of confidentiality requirements upon the recipient;
- reasonable;
- for the purpose of either seeking or giving advice on a transaction, facilitating a commercial, financial or investment transaction (including securing prospective places); or
- in fulfilment of a legal obligation.

It is likely that in most cases where a person pre-briefs an investor or shareholder ahead of a transaction in accordance with strict wall-crossing procedures (see below) they will be acting in the proper course. Disclosure of inside information in other circumstances, however, incurs significant risk. Worth noting is the FSA’s view in the Decision Notice concerning the fine imposed on Ian Hannam for improper disclosure, that acting within a client mandate and to further the client’s commercial interests is not sufficient for a disclosure of inside information to be viewed as being in the proper course.

MAR also states that disclosure of inside information is likely to be in the proper course where it is permitted by FSA rules, the rules of a prescribed market or the City Code on Takeovers and Mergers (the “Code”). The FSA’s Disclosure Rules (DTR 2.5) do permit selective disclosure of inside information in a number of cases, including to shareholders when the company is seeking their support for a major transaction or to prospective places of the company’s securities in a forthcoming issue. This type of briefing would only be permitted, however, if the issuer ensures that any investor owes it a duty of confidentiality. The AIM Rules contain similar provisions (in the Guidance on Rule 11).

Dealing restrictions and “cleansing” statements

Any investor who is made an insider will be restricted from dealing in the securities of the company concerned until the information it has been given is made public. The announcement of the transaction will effectively “cleanse” the investor and allow them to resume trading. Where, however, the information concerns a prospective transaction which does not actually proceed, the position is less clear. In its Decision Notice concerning David Einhorn, the FSA implied that where a transaction does not go ahead, an announcement should be made to the market that a transaction was contemplated but did not proceed. It has since clarified in a letter to the City of London Law Society that, although each case should be judged on its own facts and circumstances, a public cleansing statement would be unnecessary as long as the information passed to the investor was no longer inside information.
Forward thinking

Before communicating with external parties, companies and their advisers should always consider the nature of any information proposed to be disclosed and the purpose of the disclosure. If inside information is likely to be involved, they must be able to demonstrate that disclosure is being made in the proper course in the light of the FSA’s guidance in MAR.

Corporate finance and corporate broking teams should also take the opportunity to review wall-crossing procedures with their compliance advisers to ensure that the necessary protections are in place. Set out below are the sorts of provisions it would be prudent to include:

1. Procedure for wall-crossing requests: Use an agreed form script and limit the information provided to:
   - the name of the company;
   - an estimate of the amount of time the investor will be an insider; and
   - an indication of the broad type of transaction, with no reference to terms, scale, likelihood of proceeding or the expected timing of any announcement.

2. Confidentiality: Ensure the investor enters into a written confidentiality agreement before disclosing details of the transaction.

3. Clarify status: Ensure the investor’s status as an insider is clear at the time of the wall crossing.

4. Restrict dealings: Ensure the investor understands that, as an insider, they will be prohibited from dealing in the company’s securities.

5. Terminate if wall-crossing refused: If the investor does not wish to become an insider clearly no inside information should be disclosed. It is advisable not to proceed with a conceptual-only discussion with the investor given the high risk of providing information during the call which, taken in context of the wall-crossing request, may be enough to make them an insider.

6. Limit information disclosed: Agree in advance the information concerning the transaction which will be disclosed and only disclose information to the extent necessary. Straying into other areas such as undisclosed trading or financial information is likely to be problematic as it may amount to improper disclosure of inside information and leave the investor an insider (and unable to deal) even after the transaction is announced.

7. Limit numbers: Keep the number of investors briefed to a minimum and limit the amount of time they spend over the wall, to help ensure the information remains confidential and avoid leaks.

8. Cleansing investors: If the transaction does not proceed, consider whether all information provided to the investor is no longer inside information before confirming they are no longer an insider.

9. Keep records: Ensure a record is kept of:
   - the identity of investors contacted;
   - whether or not the investor agreed to be made an insider;
   - the exact information provided to the investor (use of recorded lines is advisable); and
   - the basis on which any decision is made to release the investor from restrictions.

10. Involve Compliance: Always consult the compliance team in advance of the wall crossing and on any steps required to cleanse the investor. Senior management and Compliance must be informed promptly if there are any suspicions that inside information may have been inappropriately disclosed.
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