

FCA Fines Former Chairman of Convatec for Unlawful Disclosure of Inside Information

by Mark Taylor, Kate Francis, and Kanika Mathew

GENERAL

The Financial Conduct Authority (*FCA*) which regulates financial services and markets in the UK has fined Sir Christopher Gent, the former non-executive Chairman of ConvaTec Group Plc (the *Company*), for unlawfully disclosing inside information in breach of Article 14(c) of the EU Market Abuse Regulation (*EU MAR*).

Unlawful disclosure arises where a person discloses inside information otherwise than in the normal exercise of an employment, a profession or duties. In this case, the inside information, which related to (i) an impending revision of the financial guidance issued by the Company for its full year and (ii) the likely retirement of the Company's CEO, was disclosed to two shareholders of the Company two days prior to the formal announcement of the inside information.

It was accepted that the Chairman believed that he was acting in the best interests of the Company and did not profit in any way from his actions. However, on the facts, the FCA was satisfied that the information disclosed was inside information and that the disclosures were not made in the normal exercise of the duties of the Chairman and it imposed a penalty of £80,000 for market abuse.

The Final Notice serves as a helpful reminder on (i) what constitutes inside information and (ii) the circumstances in which inside information can legitimately be shared on a selective basis.

THE FACTS

In the announcement of its year end results for 2017, the Company had provided financial guidance for 2018 with revenue growth of 2.5% to 3.0% and an adjusted EBIT margin of 24% to 25%. This guidance was reaffirmed at the time of publication of its interim results which also indicated that the Q3 trading update would be issued on 31st October 2018.

Related People

- Mark Taylor
- Kate Francis
- Kanika Mathew

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On 28th September 2018, during the course of a routine board meeting to review the Q3 financials and the full year financial guidance, the board was made aware that an important customer of the Company intended to reduce its orders through to the end of the financial year. Over the ensuing days, the board took steps to obtain clarity on the scale of the reduction and its likely implications on the Company's financial guidance to the market. The Company also consulted with its brokers on the actions to be taken.

By 9th October, it was clear that the reduction in orders would in all likelihood take the Company below the guidance it had given (although work was continuing with a view to understanding the best and worst case outcomes). In an account of a meeting between senior management and the brokers that day the CEO said that advice was given that the information available to the board was not precise enough to trigger an announcement to the markets and that more information was required.

On 10th October, the CEO indicated that he was considering retirement subject to agreeing satisfactory terms with the board.

During the course of the afternoon of 10th October, the Chairman made private calls to two of the Company's major shareholders in which he disclosed that the Company expected to make an RNS announcement on Monday 15th October, depending on the board's analysis and that the Company was expected to say that it would be revising guidance and that the CEO was retiring.

The Chairman indicated to the FCA that he had imposed an obligation of confidentiality and no-dealing on the individuals he spoke to and that the main purpose of the conversations was to inform them of the likely retirement of the CEO. He also explained that he did not want to surprise shareholders of scale with announcements.

There are two additional pieces of factual information which are relevant to these disclosures. First that the first shareholder (*Shareholder A*) was one of the Company's largest shareholders. Not only did that shareholder have a relationship agreement with the Company which imposed confidentiality and no-dealing obligations, but it had also exercised a right under that agreement to appoint a director to the board of the Company), and, second, that the other shareholder who received a call (*Shareholder B*) had, on 8th October, asked its brokers to make enquiries with a view to purchasing a large block of the Company's shares, although no order had been placed. Subsequent to the call, Shareholder B put that request on hold.

On 15th October, the Company released two separate RNS announcements, one relating to the Q3 numbers and a downgrade of the full year financial guidance and the other dealing with the resignation of the CEO. Following the simultaneous release of the announcements, the Company's share price dropped significantly.

FCA NOTICE

The FCA focussed on the two calls made by the Chairman.

The critical issues to be established were:

- whether the information communicated by the Chairman was in fact inside information; and
- whether that information had been unlawfully disclosed.

Was the information “inside information”?

The definition of “Inside Information” (Article 7(1) of EU MAR) is:

“Information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments”.

One of the representations put forward by the Chairman was that the information he disclosed was not inside information within the scope of Article 7 of EU MAR as it was not “precise” and was “fundamentally unsuitable for announcement” at the time of disclosure.

The FCA considered whether the information was “precise” and rejected this argument because:

- Article 7(2) of EU MAR specifically states that information will be treated as being “precise” if *“it indicates a set of circumstances which exists or which may reasonably be expected to come into existence, or an event which has occurred or which may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effects of that set of circumstances or event on the prices of the financial instruments”*; and
- at the time of the disclosure, there was a realistic prospect that both the revenue growth guidance would be revised and the CEO would retire, notwithstanding that the board awaited further clarity on the Company’s financial position and had not yet received the CEO’s retirement letter. The FCA concluded that this was sufficient to meet the “reasonably expected” element in Article 7(2) and the information was also specific enough to enable a conclusion to be drawn as to its possible effect on the price of the Company’s shares (noting that the legal principle has already been established that there is no need to conclude whether the price movement would be up or down). The FCA specifically noted that the fact that the CEO still had to agree terms of his exit did not mean that his retirement was not a realistic prospect.

The FCA also emphasised that information does not have to be in a state which is ready to be announced for it to constitute inside information. It merely has to meet the core requirements of the definition, namely that it is precise and that if made public it would be likely to have a significant effect on the price of securities. It should be noted that the obligation to announce Inside Information (Article 17(1) of EU MAR) which provides that *“An issuer shall inform the public as soon as possible of inside information which directly concerns that issuer, and that that issuer shall ensure that the inside information is made public in a manner which enables fast access and complete, correct and timely assessment of the information by the public”*. The requirement to announce “as soon as possible” anticipates that it may take time to get the information to the point where it is

sufficiently complete and correct to enable a timely assessment to be made by the public. Specifically, the FCA agreed that the Company did not have to make an announcement to the market just because there was a prospect of the CEO retiring since, as mentioned above, Article 17(1) does not require the immediate publication of inside information.

In addition to the requirement for it to be “precise” (discussed above), the definition of inside information also requires it to be information which *“if it were made public, would be likely to have a significant effect on the prices of financial instruments ...”*. The use of the word “significant” in the terminology of EU MAR is, frankly, unhelpful since Article 7(4) of EU MAR deems this to be the case whenever that information is *“information a reasonable investor would be likely to use as part of the basis of his or her investment decisions”*. The bar for meeting this test is therefore a very low one and the FCA was satisfied that it had been met in this case. In any event, the fact that, following the release of the RNS announcements, the Company’s share price fell from 224.2 pence to 175 pence (and closed at 150 pence) rendered any debate on the point academic.

Was the information lawfully disclosed?

Article 10(1) of EU MAR provides that:

“Unlawful disclosure of inside information arises where a person possesses inside information and discloses that information to any other person, except where the disclosure is made in the normal exercise of an employment, a profession or duties”.

The Chairman argued that he had disclosed the likely developments in the normal exercise of his employment, profession or duties citing that “he did not want to surprise shareholders of scale with announcements” and alluding to a broader role to consult with shareholders.

The FCA rejected these and other arguments and concluded that:

- the disclosures were not reasonable or necessary to be made in order for the Chairman to perform his proper functions. Note that while the FCA accepted that shareholder engagement was part of the duties of the Chairman (indeed EU MAR provides that discussions of a general nature regarding business and market developments are permissible between shareholders and management (Recital 19, EU MAR), disclosing inside information was not consistent with the objectives of EU MAR which seeks to prevent “unfair advantage being obtained from inside information to the detriment of third parties who are unaware of such information”;
- the imposition of confidentiality and no-dealing requirements could not legitimise the disclosures;
- there was no evidence of it being necessary for the Chairman to consult with individuals at Shareholder A and Shareholder B. In the case of Shareholder A, the FCA noted that that shareholder already had a nominee director on the board to whom the Chairman could have legitimately disclosed the information, but he chose to speak to another individual, and, in the case of Shareholder B, the disclosure was particularly inappropriate given that the Chairman was aware of Shareholder B’s active intention to build a more significant shareholding in the Company; and

- there was no justification for the timing of the disclosures, which took place at least two working days before the Chairman believed any announcement would be released.

Was following the advice of in-house legal and the Company's brokers a defence?

The Chairman pointed out that he had mentioned his intention to make the advance disclosures to an executive in the Company charged with giving legal and compliance advice and at no point was he advised against making the calls. Additionally, one of the brokers engaged by the Company had actually encouraged him to make the call to Shareholder B.

The FCA was of the view that it was not sufficient for the Chairman to place reliance on these matters. Given his own considerable experience and his position, and the fact that he had recently received external training on EU MAR, he ought to have realised that it was not in the normal exercise of his employment, profession or duties to make the disclosures, and that he was being negligent in doing so. Additionally, he should have obtained clear, formal advice regarding the specific question of what information, if any, he might properly disclose, as well as when, in what manner and to whom, before making the disclosures.

Whilst the FCA acknowledged that the Chairman believed that the disclosures were made in the best interests of the Company and that he had not made, or intended to make, any personal gain pursuant to such disclosures, it conclusively held that these matters did not constitute a defence to market abuse.

BEST PRACTICES

The FCA's finding of market abuse and the imposition of a financial penalty (as opposed to the alternative sanction of a public censure) underline the FCA's determination to pursue its statutory objective to enhance the integrity of the UK financial system including by taking action to prevent market abuse. The FCA's Decision Procedure and Penalties Manual states that the principal purpose of imposing a penalty is to promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour.

The decision underlines the need for listed companies to review their policies and procedures for dealing with inside information. In terms of "Best Practices", we recommend the following:

- the adoption and regular review of written policies for the treatment of inside information. Such policies should:
 - emphasise the need to obtain clear and formal external advice on what constitutes inside information and on whether there are circumstances that render it legitimate to make a selective disclosure of such information in advance of any public announcement. Had such advice been sought and obtained in this case, a finding

of negligence would have been significantly harder to establish;

- note that an internal decision to classify or not classify information as inside information in line with such policies will not necessarily be recognised by the FCA who will make a determination on the facts of each case;
 - emphasise that information does not need to be at the point where it can be announced before it becomes “inside information”;
 - explain the formal wall-crossing procedures that should be followed in cases where the Market Abuse Regulation (as now incorporated into our national law) permits selective disclosure (for example in the context of a placing, where an existing shareholder is to be approached as a possible placee);
 - require written records to be kept of internal discussions and communications relating to inside information; and
 - encourage the board and senior executives to keep in mind the “level playing field” principle which is central to the legislation. A key question must always be whether a proposed disclosure of information on a selective basis would confer an advantage on the recipient or be to the disadvantage of others.
- the provision of regular training for members of the board and senior executives on the concept of “inside information” and how it should be treated.

Read the full text of the [Formal Notice](#).

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Please contact Mark Taylor, Kate Francis or Kanika Mathew for further information.

This e-bulletin is issued to provide general guidance on the above topic. It is not comprehensive or exhaustive and does not constitute legal advice given by this Firm.