



Financial Markets Law Committee (“FMLC”)

Securities Markets Scoping Forum

Date: Wednesday 11 December 2019

Time: 9.00am to 10.30am

Location: Linklaters LLP, One Silk St, London EC2Y 8HQ

In Attendance:

Madeleine Wanner (Chair)	Linklaters LLP
Andrew Bryan	Clifford Chance LLP
Mark Chalmers	Davis Polk & Wardwell LLP
Leland Goss	ICMA (International Capital Market Association)
Michael Sholem	Cadwalader, Wickersham & Taft LLP
Ferdisha Snagg	Cleary Gottlieb Steen & Hamilton LLP
Venessa Parekh	FMLC Secretariat
Chhavi Sinha	FMLC Secretariat

Guest Speakers:

Kym Bavcevich-Ikeda	Linklaters LLP
Stuart Willey	White & Case LLP

Regrets:

Emily Bradley	Slaughter and May
James Grand	Simmons & Simmons LLP
Carolyn Jackson	Katten Muchin Rosenman UK LLP
Danielle Kendall	Allen & Overy LLP
Stephanie Lincoln	Deutsche Bank AG
Amanda Thomas	Allen & Overy LLP
Sanjev Warna-kula-suriya	Latham & Watkins LLP

Registered Charity Number: 1164902.

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Minutes:

1. Introductions

- 1.1. Ms Wanner opened the meeting. Attendees introduced themselves.

2. Administration (Venessa Parekh)

- 2.1. Ms Parekh delivered a short presentation providing an overview of the FMLC's engagement with public authorities.¹ She explained that FMLC is a charity which does not engage in lobbying; it does, however, interact closely with legislative and regulatory bodies in the U.K. and E.U. She provided examples of recent projects on which the FMLC had liaised with public authorities.
- 2.2. Ms Parekh turned to the 2020 Forward Schedule noting that the Secretariat had initially suggested that meetings of this Forum be held on Mondays. Owing to feedback, this had been amended to alternating meetings on Mondays and Tuesdays. She asked attendees to let the Secretariat know if this is convenient.

3. *SL Claimants v Tesco Plc* [2019] EQHC 2858 (Ch) (Stuart Willey)

- 3.1. Stuart Willey provided comments on *SL Claimants v Tesco Plc* [2019] EQHC 2858 (Ch) which was decided by the Honourable Mr Justice Hildyard at the end of October. Mr Willey explained that two claimants (hereinafter referred to as the “**Claimants**”) had brought a case against Tesco, the Defendant Company, under Section 90A and Schedule 10A of the Financial Services and Markets Act 2000 (“**FSMA**”). The Claimants wished to recover substantial losses made in respect of investment decisions in relation to shares in Tesco, which they had taken in alleged reliance on information published by Tesco and falling within Schedule 10A of FSMA. Schedule 10A of FSMA provides a right to compensation for losses caused by an untrue or misleading statement. Section 90A makes provision about the liability of issuers of securities to pay compensation to persons who have suffered loss as a result of, *inter alia*, a misleading statement or dishonest omission in certain published information relating to the securities.
- 3.2. The key issue is that the shares were held in a dematerialised form by the Certificate less Registry for Electronic Share Transfer (“**CREST**”), as is common practice. Mr Willey stated that none of the Claimants was a registered member of CREST; they had used banks or financial institutions providing custodian services—which had relied in turn on sub-

¹ Please see Appendix I below.

custodians—to hold the shares in CREST. Further, and again as is entirely usual, most of the shares in Tesco held by custodians were held by them, not for a claimant, but for another intermediary in what is commonly referred to as a “custody chain”. Mr Willey stated that Tesco had submitted a strike-out application. Tesco’s position was that a consequence of the custody chain is that the interests of claimants cannot be considered an “interest in securities” within the meaning of paragraph 8(3) of Schedule 10A. Further, Tesco contended that, in any event, none of the claimants can properly be said to have “acquired, continues to hold or disposed of” any interest in securities.

3.3. Mr Willey highlighted Tesco’s reliance on academic commentaries by Professors Benjamin and Gullifer on the applicability of Section 90A of FSMA.² Furthermore, Tesco had relied on the FMLC’s paper published in 2004, which had recommended legislative intervention,³ and on the Law Commission’s observation, made in 2014, that the law might have been outpaced by technological developments in this area.⁴ Tesco contended that only the first intermediary in the chain in CREST had equitable rights against it; the other/next intermediaries in the chain had a sub-trust right.

3.4. Both these arguments failed and Mr Justice Hildyard dismissed Tesco’s strike-out application. Mr Willey drew attention to Mr Justice Hildyard’s comments that it is unsettling that this issue remains open to such discussion and doubt given the integral role of intermediation in the financial markets today.⁵ He also noted that Mr Justice Hildyard had indicated willingness to hear arguments in respect of declaratory relief. In light of this, Mr Willey proposed to Forum members that a recommendation should be made either to the Law Commission or HM Government to address the issue of legal uncertainty around the rights of second/other intermediaries in the custody chain. This might be achieved by resuscitating the FMLC’s recommendations from 2004. He noted that there might be willingness to engage with this issue after Brexit.

² Professor Benjamin and Gullifer have recently noted that a claim under Section 90 FSMA “*is likely to run into difficulties in practice*” because “*it only applies where the claimant has ‘acquired securities’*” and “*it is not at all clear that this would include the situation where the claimant acquired intermediated securities.*” J Benjamin and L Gullifer, ‘Stewardship and Collateral: The Advantages and Disadvantages of No Look Through System’ in L Gullifer and J Payne, *Intermediation and Beyond* (2019), 237. See also A Hudson, *Securities Law* (2nd edn 2013), para 23-13.

³ FMLC, ‘Property Interests in Investment Securities: Analysis of the Need for and nature of Legislation relating to Property Interests in Indirectly held Investment Securities’ (July 2004); available at: <http://fmlc.org/wp-content/uploads/2018/02/Issue-3-Property-Interests-in-Investment-Securities.pdf>

⁴ ‘intermediated securities’, noting that there is ‘uncertainty as the legal redress available to investors in certain situations.’ Law Commission, ‘Intermediated Securities : Call for Evidence’ (August 2019); available at: https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2019/08/6.5925_LC_Intermediated-securities-call-for-evidence-web.pdf

⁵ *SL Claimants v Tesco Plc*, at [73]

3.5. Forum members discussed which organisation or authority might be best positioned to address this issue. Ms Parekh drew attention to the limited scope of the Law Commission's current work on intermediated securities. Forum members also discussed other instances in which this issue had been raised, indirectly perhaps. Mr Willey agreed to forward to the Secretariat an article which analysed a number of such cases.

4. **Market Soundings under the Market Abuse Regulation (Mark Chalmers)**⁶

4.1. Mr Chalmers presented an overview on the Consultation Paper published by the European Securities and Markets Authority ("ESMA") on Regulation (EU) No 596/2014 on market abuse (the "**Market Abuse Regulation**" or "**MAR**"). Mr Chalmers highlighted that the Consultation covers a wide range of topics; he was going to focus on the questions on Market Soundings. He also observed that the Consultation had now closed but that it would be helpful to discuss these issues in anticipation of future action around Market Soundings. Mr Chalmers explained that, at this stage, three issues can be identified: (1) the enforceability of Market Soundings; (2) the definition of Market Sounding; and (3) the simplification of the Market Sounding procedures and requirements.

4.2. As to the first, Mr Chalmers explained that, when carrying out a market sounding, ESMA is of the view that disclosing market participants are under the obligation to follow the requirements set out in Article 11 of MAR. When they do, they can benefit from protection against the unlawful disclosure of inside information. This view is supported by requirements provided in implementing legislation (see: Commission Delegated Regulation 2016/960 with regard to regulatory technical standards for the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings) and by its resonance with one of the main goals of the market sounding regime, which is ensuring that National Competent Authorities ("**NCAs**") may obtain a full audit trail. The Consultation Paper noted that ESMA has been made aware of a different reading wherein the requirements under Article 11 were treated as an optional safe harbour. ESMA wished to clarify the obligatory nature of the requirements.

4.3. Mr Chalmers observed that in respect of the debt capital markets, market participants are typically advised to follow the requirements set out in Article 11(3) and (8) in addition to Article 11 (5) and (6) if inside information is disclosed. In practice, however, this was often overlooked. In addition, no Member State has imposed sanctions on market participants who fail to follow Article 11. Mr Chalmers noted that the Financial Conduct Authority

⁶ Please see Appendix II below.

had, tacitly, supported the optional safe harbour view of Article 11. Mr Chalmers highlighted ESMA's proposal that any changes to the market sounding regime should be done in order to: clarify the obligatory nature of the requirements in Article 11 of MAR; confirm that when these requirements are followed the disclosing market participant shall be granted full protection against allegations of unlawfully disclosing inside information; ensure that administrative sanctions are established for not complying with the market sounding requirements. He suggested that the FMLC might wish to consider and examine the legislative proposal when it is published.

4.4. Moving on to the second issue of the definition of market sounding, Mr Chalmers explained that ESMA is assessing whether the definition should be limited, for example, by excluding certain types of transactions or whether additional clarification on the scope of the definition should be provided. He further suggested that ESMA is seeking input from market participants on the stages of interaction during market soundings that should/should not be covered by the definition. Mr Chalmers turned to the third issue—that of the simplification of the market sounding procedures and requirements—in respect of which ESMA is assessing if some requirements may be simplified while ensuring an adequate level of audit trail for NCAs to investigate potential abuse. The proposals include: (1) making the use of recording facilities mandatory for all soundings and (2) streamlining the cleansing procedure, particularly in relation to parked or failed transactions.

4.5. Forum members agreed that they would welcome the opportunity to review the legislative proposal when it was published.

5. Joint ESA Supervisory Statement on the scope of the application of PRIIPS Regulations to the bond market—“callable features” (Kym Bavcevich-Ikeda)

5.1. Kym Bavcevich-Ikeda presented her comments on a Joint Supervisory Statement by the European Supervisory Authorities (the “ESA”) on the scope of the application of Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (the “PRIIPs Regulation”) to the bond market. Ms. Bavcevich-Ikeda referred to the Annex of the Supervisory Statement that provides guidance on the practical application of the provisions determining the scope of the PRIIPS Regulation to different types of common bond features. She particularly brought attention to the main considerations on the extent to which “callable bonds” would fall within the scope of the PRIIPS Regulation. She noted that while the supervisory statement usefully confirmed the market consensus with respect to whether certain bond features would render a bond a packaged retail and insurance-based investment product (a “PRIIP”) or otherwise,

it was less helpful in definitively addressing certain other features where no consensus existed. In particular, she highlighted the lack of clarity in the language of the text as to what would constitute a PRIIP in relation to callable bonds and noted that the ambiguity of the text was such the usefulness of the supervisory statement to market participants was limited.

- 5.2. Forum members agreed that the statements with respect to callable bonds did little to alleviate confusion as to circumstances where such bonds would be a PRIIP or not. An attendee drew attention to work by the International Capital Markets Association (“ICMA”) on the PRIIPs Regulation. Another attendee noted that this too was an area where regulation would struggle to keep pace with market innovation.

6. Any other business

- 6.1. No further business was raised at the meeting.⁷

⁷ The next meeting of the Securities Markets Scoping Forum will be held on Monday 16 March between 2.00pm to 3.30pm.

Did you know that although the FMLC is a charity and not a lobbying organisation...it has engaged significantly with public authorities?

Venessa Parekh, Research Manager



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The FMLC's charitable remit

According to its charitable remit, the FMLC has a tripartite mission:

- to *identify* relevant issues (the **radar** function);
- to *consider* such issues (the **research** function); and
- to *address* such issues (the **public education** function).

FMLC's engagement with public authorities

- The FMLC is NOT a lobbying organisation, but it has engaged significantly and effectively with public authorities;
- The engagement with public authorities is a natural adjunct to its radar, research and public education functions of identifying, considering and addressing issues of legal uncertainties;
- A few examples of topics on which the FMLC has corresponded with public authorities and has achieved effective outcomes and impact are set out in slides below.

U.K. withdrawal from the E.U. based on a free trade agreement not covering financial services – evidence to the House of Lords E.U. Financial Affairs Sub-Committee

- As an extension of work conducted by an FMLC Working Group examining whether a withdrawal from the E.U. based on a free trade agreement not covering the provision of financial services would have any legal ramifications for existing financial contracts, Professor Hugh Beale (University of Warwick) and Simon Firth (Linklaters LLP) gave evidence on the topic of post-Brexit contractual continuity to the House of Lords E.U. Financial Affairs sub-committee.



Colloquium on crypto-assets with the Chief of Staff of the U.S. Securities and Exchange Commission

- On 21st June 2019, the FMLC was delighted to welcome Michael Gill, Chief of Staff and Chief Operating Officer of the U.S. Commodity Futures Trading Commission (the “CFTC”), as keynote speaker at a colloquium on regulating crypto-assets. In the U.S., regulation of crypto-assets has evolved into a multifaceted, multi-regulatory approach and oversight is split between several federal and state authorities. The CFTC has responsibility over crypto-assets used in derivatives contract, or if there is fraud or manipulation involving crypto-assets traded in interstate commerce. Mr. Gill provided an overview of the development of crypto-assets and of the approaches taken by U.S. regulators in evaluating them. He outlined the CFTC’s priorities in considering whether and how crypto-assets should be regulated.



Review of Brexit “onshoring” legislation

- In recent months, the FMLC has focused on reviewing statutory instruments published in draft by HM Treasury under the European Union (Withdrawal) Act 2018. These instruments incorporate and amend (i.e., “**onshore**”) the E.U.’s legal and regulatory framework for financial services.
- The FMLC Secretariat was invited by HM Treasury to review draft versions of this legislation and, to facilitate a quick response to such secondary legislation, the Secretariat has organised meetings amongst leading organisations in the City, comprising representatives from the Brexit Law Committee, (the legal wing of the IRSG), the CLLS Financial and Regulatory Law Committees and the Law Society, to discuss coordinated responses.
- The FMLC has also published papers on the statutory instruments onshoring regulations relating to bank recovery and resolution, investment funds and their managers, markets in financial instruments, corporate insolvency, securitisation and the Benchmark regulation.

ESMA update on its Q&A on MAR in response to a letter from the FMLC

- On 5 September 2017, the FMLC received a response from the Financial Conduct Authority (“FCA”) on its paper that explores uncertainties as to the financial instruments that fall within the scope of the Market Abuse Regulation (“MAR”). The letter states that the FMLC’s analysis and recommendations stemming from this paper were circulated to the FCA policy team, who works with the European Securities and Markets Authority (“ESMA”) in its development of its MAR guidance materials. The letter flags that ESMA has updated its Q&A on MAR on 1 September 2017 to include a new Q&A 9 on market soundings, which seeks to provide guidance on some of the issues highlighted in the FMLC paper.

Summary and Conclusion

- The FMLC seeks to accomplish its radar, research and public education remits while also engaging with public authorities;
- Although the FMLC is NOT a lobbying organisation, it has charitable remits which are aligned with engagement with public authorities; engagement which serves to accomplish the charity's objectives of radar, research and public education.

Proposed 2020 Forward Schedule



- Monday 16 March 2.00pm to 3.30pm (U.K.)
- Tuesday 9 June 2.00pm to 3.30pm (U.K.)
- Monday 14 September 2.00pm to 3.30pm (U.K.)
- Tuesday 24 November 2.00pm to 3.30pm (U.K.)

ESMA Consultation Paper: MAR review report

CP published on 3 October and closed on 29 November 2019.

It covers a wide-range of topics and proposes a number of potentially significant changes to MAR, including: expanding the scope of MAR to include spot FX, amending the definition of inside information, modifying the rules on delaying disclosure of inside information and the reporting of buy-back programmes to NCAs.

1. Enforceability of Market Soundings

ESMA is of the view that, when carrying out a market sounding, disclosing market participants are under the obligation to follow the requirements set out in Article 11 and when they do so, they can benefit from the protection against unlawful disclosure of inside information.

This view is supported by: (i) the fact that a number of the requirements in Commission Delegated Regulation 2016/960 are imposed on disclosing market participants regardless of whether inside information is expected to be disclosed; and (ii) it is consistent with one of the main goals of the market sounding regime, which is ensuring the possibility for NCAs to obtain a full audit trail.

ESMA has been made aware of a different reading whereby the market sounding regime and the relevant requirements would be a mere option for disclosing market participants to benefit from the protection from the allegation of unlawful disclosure of inside information.

ESMA therefore proposes that any changes to the market sounding regime should be done in order to:

- clarify the obligatory nature of the requirements in Article 11 of MAR
- confirm that when these requirements are followed the disclosing market participant shall be granted full protection against allegations of unlawfully disclosing inside information
- ensure that administrative sanctions are established for not complying with the market sounding requirements

2. Definition of market sounding

ESMA is assessing whether the definition should be limited, for example, by excluding certain types of transactions or whether additional clarification on the scope of the definition should be provided.

ESMA is seeking input from market participants on the stages of interaction during market soundings that should / should not be covered by the definition. For example, are there stages of interaction between disclosing market participants and potential investors in which the risk of inside information being unlawfully disclosed is low?

ESMA is also considering the appropriateness of the reference to “prior to the announcement of a transaction” in the market sounding definition.

3. Simplification of the market sounding procedures and requirements

ESMA is assessing if some of the market sounding requirements may be simplified while ensuring an adequate level of audit trail for NCAs to investigate potential abuse.

Proposals include:

- making the use of recording facilities mandatory for all soundings
- streamlining the cleansing procedure, particularly in relation to parked or failed transactions

Article 11

Market soundings

1. A market sounding comprises the communication of information, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as its potential size or pricing, to one or more potential investors by:

- (a) an issuer;
- (b) a secondary offeror of a financial instrument, in such quantity or value that the transaction is distinct from ordinary trading and involves a selling method based on the prior assessment of potential interest from potential investors;
- (c) an emission allowance market participant; or
- (d) a third party acting on behalf or on the account of a person referred to in point (a), (b) or (c).

2. Without prejudice to Article 23(3), disclosure of inside information by a person intending to make a takeover bid for the securities of a company or a merger with a company to parties entitled to the securities, shall also constitute a market sounding, provided that:

- (a) the information is necessary to enable the parties entitled to the securities to form an opinion on their willingness to offer their securities: and
- (b) the willingness of parties entitled to the securities to offer their securities is reasonably required for the decision to make the takeover bid or merger.

3. A disclosing market participant shall, prior to conducting a market sounding, specifically consider whether the market sounding will involve the disclosure of inside information. The disclosing market participant shall make a written record of its conclusion and the reasons therefor. It shall provide such written records to the competent authority upon request. This obligation shall apply to each disclosure of information throughout the course of the market sounding. The disclosing market participant shall update the written records referred to in this paragraph accordingly.

4. For the purposes of Article 10(1), disclosure of inside information made in the course of a market sounding shall be deemed to be made in the normal exercise of a person's employment, profession or duties where the disclosing market participant complies with paragraphs 3 and 5 of this Article.

5. For the purposes of paragraph 4, the disclosing market participant shall, before making the disclosure:

- (a) obtain the consent of the person receiving the market sounding to receive inside information;
- (b) inform the person receiving the market sounding that he is prohibited from using that information, or attempting to use that information, by acquiring or disposing of, for his own account or for the account of a third party, directly or indirectly, financial instruments relating to that information;
- (c) inform the person receiving the market sounding that he is prohibited from using that information, or attempting to use that information, by cancelling or amending an order which has already been placed concerning a financial instrument to which the information relates; and
- (d) inform the person receiving the market sounding that by agreeing to receive the information he is obliged to keep the information confidential.

The disclosing market participant shall make and maintain a record of all information given to the person receiving the market sounding, including the information given in accordance with points (a) to (d) of the first subparagraph, and the identity of the potential investors to whom the information has been disclosed, including but not limited to the legal and natural persons acting on behalf of the potential investor, and the date and time of each disclosure. The disclosing market participant shall provide that record to the competent authority upon request.