



FINANCIAL REGULATOR
Rialtóir Airgeadais

Disclosure of Grants of Security over Shares



The Consultation Process

The closing date for submissions is **Friday 22 May 2009**.

We welcome submissions from all interested parties. Please make your submissions in writing and, if possible, by e-mail or on a disk. You can post them, fax them or e-mail them to us.

We place a high value on openness of the Consultation Process. We intend to make all submissions available on our website after the deadline for receiving submissions has passed. For this reason we would ask you not to include commercially or personally sensitive material in your submission. If you do include such material, please highlight it clearly so that we may take reasonable steps to avoid publishing that material. This may involve publishing submissions with the sensitive material deleted and indicating the deletions. In some cases it may not be possible to publish the submission at all. Despite the approach outlined above, we make no guarantee not to publish any information that you deem confidential. So be aware that, unless you clearly identify any commercially or personally sensitive information, you are making a submission on the basis that you consent to it being published in full. We will not publish any material that we deem potentially libellous.

Please clearly mark your submission "Disclosure of Grants of Security over Shares" and send it to:

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Introduction


The Financial Regulator believes that good market transparency concerning important information is increasingly critical to the effective operation of markets in shares and other securities. Disclosures in respect of transactions in shares by persons discharging managerial responsibilities within an issuer, and where applicable, persons closely associated with them ("PDMRs")¹ are among the types of information widely noted and commented on in the market. The appropriateness of the market having regard to the level or nature of a PDMRs shareholding has been officially supported by the practice being legally required. Specifically, disclosure obligations are imposed under the Market Abuse (Directive 2003/6/EC) Regulations 2005 ("the Regulations"), which are derived from the EU Market Abuse Directive 2003/6/EC².

In the aftermath of developments concerning Carphone Warehouse in the UK³, the question has arisen as to whether there are or should be disclosure obligations in respect of grants of security over shareholdings by PDMRs, where the shares are issued by the company with respect to which the managerial responsibilities of the PDMR arise. While granting security over shares is not equivalent to purchasing or selling those shares, it can indicate a significant change in the level or nature of the commitment of a PDMR to the company. Where a PDMR is known by the market to have a significant shareholding and the market does not know that those shares are pledged to finance other activities, regard might be had to the shareholding on the basis of an incorrect estimation of its significance.

¹ As defined in Regulation 12 of the Market Abuse (Directive 2003/6/EC) Regulations 2005.

² Article 6(4) of Directive 2003/6/EC and Article 6 of Directive 2004/72/EC refers. Recital 7 of Directive 2004/72/EC states that the notification of transactions by PDMRs "is not only a valuable information for market participants, but also constitutes an additional means for competent authorities to supervise markets".

³ In December 2008, the Deputy Chairman of Carphone Warehouse in the UK was forced to resign after admitting that he hadn't disclosed that he had used company shares to secure personal loans.



Disclosure of such information also seems to be within the spirit of the EU Market Abuse Directive (2003/6/EC), on which the Regulations are based. The Regulations state in Part 1, Regulation 2(1) that “ ‘information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative financial instruments’ means information that a reasonable investor would be likely to use as part of the basis of the investor’s investment decisions”. This could be the case, at least in some situations, where PDMRs have granted security over their shareholdings.


However, it is not current market practice, although the legal interpretation underpinning this practice is not free from doubt, for PDMRs to disclose grants of security over their shareholdings. Therefore, the Financial Regulator is not currently in a position to pursue cases where a failure to disclose is uncovered.

The Financial Regulator, through this document, now wishes to consult with market participants to obtain views relating to disclosure obligations in respect of transactions by PDMRs which involve the granting of security over their shareholdings.

Regulatory Background to Consultation

Regulation 12 of the Regulations sets out the requirements in relation to transactions by PDMRs. This Regulation states that “PDMRs within an issuer of financial instruments registered in the State and, where applicable, persons closely associated with them, shall notify to the Bank⁴ transactions conducted on their own account relating to shares of the issuer, or to derivative or other financial instruments linked to them”.

⁴ The “Bank” being defined as the Central Bank and Financial Services Authority of Ireland. By virtue of Schedule 2 of the Central Bank Act, 1942, this function of the Bank is delegated to the Financial Regulator.



The Regulations, which are derived from the EU Market Abuse Directive (2003/6/EC), do not provide a definition of what is meant by the term 'transactions' in this context, and so it might be argued that it is not clear whether the term 'transactions' includes or excludes the granting of security over shareholdings.

Section 7 of the Financial Regulator's Market Abuse Rules of September 2008 sets out the rules relating to transactions by PDMRs and also includes guidance in this area. However, neither these rules nor guidance currently provide additional clarity on whether granting security over shareholdings should be disclosed by PDMRs.

Regulatory Uncertainty

From the foregoing, it can seem somewhat unclear whether grants of security over shares by the creation of a security interest such as a pledge, mortgage, lien, charge or other encumbrance are covered by the disclosure requirements in the Regulations. From a literal reading of the Regulations, a stateable argument might be made that Regulation 12 does encompass the granting of security over shares, but it is not self-evident. If the Financial Regulator adopted this interpretation, it might issue rules or guidance on the back of this extended interpretation. However, the enforceability of such rules could be open to challenge. Whether any such challenge would be successful cannot be predicted with certainty. The resulting uncertainty might not be conducive to confidence in the regulatory framework or clarity about what is actually required under the Regulations. The Financial Regulator believes that, if it issued rules on the current legal basis, it would not be able to proceed to give any public assurance that it would be in a position to impose administrative sanctions on any person who failed to disclose the granting of security over shares.

Other EU Jurisdictions

The Regulations are derived from the EU Market Abuse Directive (2003/6/EC) which does not define specifically which transactions fall within its disclosure requirements. As a result, different approaches have emerged in different European markets in respect of the disclosure of granting of security over shares.

The European Commission and CESR⁵ are endeavouring to reach a common understanding on the detail of the Directive requirements in this area. The issue has yet to be considered formally by CESR, but informal discussion suggests significant divergence of practice among members. This consultation is being conducted in Ireland, in part, to inform the Financial Regulator in contributing to the EU-wide process.

While practices differ across Europe, the UK case is worth highlighting. In response to the Carphone Warehouse case the UK Financial Services Authority ("FSA") has already stated on 9th January 2009 "that grants of security over shares (by the creation of a security interest such as a pledge, mortgage or charge) are covered by the disclosure requirement" of Chapter 3 of their Disclosure and Transparency Rules (DTRs) which deal with transactions by PDMRs. Notwithstanding the already-mentioned absence of a definition of 'transactions' in this context, and mindful of the European Commission's deliberations, the FSA "considers that those PDMRs who have granted security over their shares should disclose this to the market as soon as possible". The FSA adds "however, given the circumstances, we are not intending to take enforcement action in respect of prior failures to notify the market of grants of security".

Scope of Consultation

The Financial Regulator is seeking the views of market participants and other interested parties on the following options:

⁵ Committee of European Securities Regulators

1. **Option One:-** the law is clear that the granting of security over shares by PDMRs **does not** fall within the scope of “transactions” set out in the Regulations; **no** additional disclosure⁶ is required and there is **no** need to seek any legalisative change.
2. **Option Two:-** as in option one, but such transactions **should** be disclosed and, therefore, legislative change **should** be sought to require disclosure in the interests of enhanced market transparency.
3. **Option Three:-** the law is sufficiently clear that the granting of security over shares by PDMRs **does** fall within the scope of “transactions” set out in the Regulations; disclosure **is** therefore required and the Financial Regulator should move now to enforce the obligation.
4. **Option 4:-** as in option 3, but the Financial Regulator should amend its Market Abuse Rules to specify the disclosure requirement and only then enforce it.
5. **Option 5:-** As in Option 3 above, but the Financial Regulator should not seek to use administrative sanctions powers to enforce the requirement.

On the face of it, the Financial Regulator favours Option 2. In the absence of contrary views, the Financial Regulator would intend to recommend to the Department of Enterprise, Trade and Employment that the Regulations be amended (or if necessary, legislation introduced) to include a disclosure obligation in respect of grants of security over shareholdings by PDMRs. Option 1 appears to us no longer to meet the needs of the market for transparency, while Options 3-5 involve a degree of legal uncertainty which is not acceptable. However, we remain open to considering arguments against these views.

⁶ see Listing Rules Appendix on page 7



The Financial Regulator also seeks views on the following related issues:

1. Whether any rule or legal change should apply only to formal grants of security over shares or whether it should be broadly drafted to also cover informal grants of security over shares.
2. The costs/benefits and regulatory impact of requiring disclosure in respect of the grants of security over shareholdings by PDMRs.
3. Whether there are other substantive or legal issues that should be dealt with in respect of the matters outlined in this consultation paper. If so, respondents are requested to detail any such issue and to outline the basis on which they consider the issue to be of importance.

Appendix

Listing Rules Requirements⁷

One possible view, lending support to **Option One** as outlined above, is that the matter is adequately dealt with in the Listing Rules of the Irish Stock Exchange Limited (ISE). Section 6.2.7 of the Listing Rules of the ISE obliges every listed company to require every person discharging managerial responsibilities to comply with the Model Code (Appendix 1 to Chapter 6 of the Listing Rules), in particular the requirement to obtain clearance before “dealing”. The Model Code makes it expressly clear that “dealing” includes *“using as security, or otherwise granting a charge, lien or other encumbrance over the securities of the company”* (paragraph 1(c) (v)).

Therefore, every PDMR should seek clearance in advance from the company where the company’s securities are to be used as collateral for a financing transaction. The Model Code is specific that a director intending to use shares of a company as security requires clearance from the company before doing so, but does not mandate disclosure to the market. Furthermore, the Listing Rules place an obligation on the issuer to require persons to comply with the Model Code, but does not place a direct obligation on the PDMR to comply with the Code.

⁷ Breaches of the Listing Rules are dealt with by the ISE in its capacity as competent authority for the purposes of the European Communities (Admission to Listing and Miscellaneous Provisions) Regulations 2007.



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