

# FINANCIAL CONDUCT AUTHORITY (FCA) FINES COMPANY FOR FAILURE TO IMPLEMENT ADEQUATE EXECUTIVE SHARE DEALING RULES

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## SUMMARY

The FCA recently fined Reckitt Benckiser Group plc (RB) £539,800 for failure to implement adequate systems and controls in monitoring share dealings by its senior executives in RB's shares. The FCA found that this contributed to late and incomplete disclosure to the market of share dealings by two of RB's senior executives. RB's fine was reduced from £771,190 for early settlement. This latest decision follows a similar decision by the FSA (the FCA's predecessor) against Nestor Healthcare Group in 2013, reaffirming to premium listed companies that putting in place a share dealing code and requiring annual certification by senior executives that they understand and comply with the code, is not sufficient.

## BACKGROUND

### The rules

Premium listed companies must ensure that all persons discharging managerial responsibility (which includes directors) (PDMRs) comply with the Model Code (appended to the FCA's Listing Rules (the Listing Rules)). The Model Code imposes restrictions on dealing in the securities of a company beyond those imposed by law. Its purpose is to ensure that PDMRs do not abuse, and do not place themselves under suspicion of abusing, inside information that they may be thought to have, especially in periods leading up to an announcement of the company's results. The FCA does not have the power directly to enforce the Model Code against PDMRs or their connected persons, but the Listing Rules and Listing Principles require the company to ensure that its PDMRs "*comply with the [Model] Code and... take all proper and reasonable steps to ensure their compliance*". In addition to the Model Code regulating dealings, the Disclosure Rules and Transparency Rules (DTRs) contain a disclosure of dealings regime which applies to PDMRs. The PDMR must notify the company of transactions conducted on their own account in the company's shares which the company must then onward notify to the market via a Regulatory Information Service. Unlike the Model Code, the FCA can directly enforce breaches of the DTRs against PDMRs.

### The decision

RB was found to have breached provisions of the Listing Rules and DTRs and to have failed to identify breaches of the Model Code.

The FCA found that between 1 July 2005 and 8 October 2012 RB breached:

- ◆ Listing Rule 9.2.8R by failing to require PDMRs to take all reasonable steps to secure their compliance with the Model Code. The FCA stated that in their view it is "... reasonable to expect a listed company to take proactive steps to comply with LR9.2.8R and to have in place procedures, systems and controls that serve to facilitate and encourage the compliance of its PDMRs with the Model Code...";
- ◆ DTR 3.1.4R(2) by failing to notify the market of share dealings by two PDMRs as soon as possible, and in any event by no later than the end of the business day following receipt of the information; and
- ◆ DTR 3.1.5R by failing to include all the required information in the notification to the market of share dealings by PDMRs.

In addition to breaching specific Listing Rules and DTRs, the FCA also found that RB had breached two of the Listing Principles (Listing Principles 1 and 2) by failing to take reasonable steps to enable its directors to understand their responsibilities and obligations to comply with the Model Code resulting in a breach of the Model Code; and by failing to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

The FCA found that the breaches had occurred because:

- ◆ RB's systems and controls were not adequate in that they did not enable it to monitor effectively all share dealings by its PDMRs or to identify potential or actual breaches of its share dealing policy and the Model Code, with the result that it failed to detect breaches in a timely manner;
- ◆ RB failed to review its share dealing policy to identify or mitigate certain risks which subsequently crystallised in the form of share dealings by two PDMRs in breach of the Model Code;
- ◆ RB placed an over-reliance on the knowledge and experience of its PDMRs to comply with the Model Code and to enable it, in turn, to comply with its regulatory obligations under the Listing Rules and Listing Principles;
- ◆ RB used an informal process for clearance to deal under the Model Code without keeping adequate records of any such clearance given, in breach of the Model Code;

- ◆ RB provided a copy of the Model Code and an explanatory document to its PDMRs in July 2005, but failed to follow this up with regular or structured training or reminders (save in advance of close periods, when it reminded PDMRs of the prohibition on trading at such times and as part of RB's annual certification process);
- ◆ when RB became aware of the share dealing by the two PDMRs referred to above, it did not make the necessary notifications to the market within the required timeframe; and
- ◆ the notifications to the market did not include all of the required information; RB omitted the precise dates, place and price of the transactions and the dates when it was notified of them.

#### **WHAT SHOULD COMPANIES BE DOING NOW?**

RB was found to be in breach of the relevant rules and principles despite having a share dealing policy in place during the relevant period which:

- ◆ required PDMRs to seek clearance from the CEO in advance of dealing in RB shares, in accordance with the Model Code;
- ◆ required PDMRs to complete a prescribed form (referred to by RB as an "Intention to Deal" form) to request clearance, to be submitted to the company secretary and then on to the CEO for consideration as to whether to grant clearance;
- ◆ stipulated that dealing by PDMRs must take place within two business days of clearance being granted or the clearance would have to be re-validated through the company secretary's office, in accordance with the Model Code;
- ◆ required PDMRs to notify RB that the dealing had taken place within four business days of the date of dealing, in accordance with the DTRs; and
- ◆ prohibited PDMRs from dealing during close periods, in accordance with the Model Code.

RB's company secretary had provided the PDMRs with a copy of the Model Code and an explanatory document and made the Model Code generally available via RB's intranet. PDMRs were requested to acknowledge in writing that they had read,

and would comply with the code. In addition, RB required every employee (including PDMRs) on an annual basis to certify electronically that they had reviewed, and would adhere to, RB's Code of Conduct. The Code of Conduct referred to insider trading and included a prohibition on employees trading on the basis of inside information pertaining to RB. Each executive who had to seek pre-clearance to deal in RB's shares (which included PDMRs) also had to provide an additional hard-copy certification.

#### **Ensure PDMRs understand their share dealing and notification obligations**

Following this decision it is clear that a premium listed company must do much more than providing their PDMRs with a copy of the Model Code and requiring annual certification of their compliance. Echoing the 2013 decision in Nestor Healthcare Group, the FCA emphasised again in RB's case that the company had failed to provide adequate training to its PDMRs as to their obligations. Companies would be advised to ensure that they take all reasonable steps to enable their PDMRs actually to understand their responsibilities and obligations to comply with the Model Code. Companies should regularly reinforce to their PDMRs the need to comply with the Model Code through structured training and should not rely on the PDMRs' knowledge or experience. It may be appropriate to speak to each PDMR in person about their obligations.

#### **Review the company's share dealing and notification procedures**

Companies must take reasonable steps to establish and maintain adequate procedures, systems and controls to ensure compliance with their obligations. For example, in addition to regular training and reminders to PDMRs on their share dealing and notification obligations, the company should consider:

- ◆ adding a term to PDMRs' employment contracts or letters of appointment (as the case may be) obliging them to comply with the Model Code;
- ◆ requesting PDMRs to confirm (and evidence) their shareholdings annually, including details of any nominee or custodian arrangements along with confirmation that their shares are not subject to any security arrangements;
- ◆ arranging for markers to be put against all PDMR shareholdings so that any movement in shareholdings is immediately notified to the company secretary and weekly reports generated. It is not sufficient to rely on third parties, such as share plan administrators, to notify the company of any dealings; and

- ◆ establishing a process to ensure that the company's share dealing policy and notification procedures are regularly reviewed and measures are put in place to identify and mitigate any risks arising. Mere lip-service to the company's obligations is not sufficient. In this case, RB had not monitored compliance with, or always complied with its code, for example, sometimes providing informal consent to deal in PDMRs' shares.

## CONCLUSION

This action by the FCA serves as a useful reminder to premium listed companies of the need to be aware of their continuing obligations and the benefit of regular training for companies and their PDMRs on their obligations. It is also an example of the FCA's increasing willingness to bring an action for breach of the Listing Principles. The FCA found that while there was an expectation that RB's PDMRs would comply with the company's share dealing policy, the Model Code and DTRs, the importance and necessity of doing so was not reinforced or emphasised to the PDMRs on any formal or regular basis. The decision also highlighted the importance of good record keeping; all requests, clearances and notifications in respect of share dealings should be in writing and companies should also record whether or not dealings actually take place following the grant of a clearance to deal.

Finally this decision is of broader relevance in highlighting the benefit to companies of having in place an adequate compliance function with responsibility for monitoring the company and its directors' compliance with their continuing obligations under the Listing Rules and DTRs. In the RB decision, the FCA noted that during the period of non-compliance by RB the FCA had published a number of documents regarding PDMRs and the importance of complying with the Model Code. Companies would be well-advised to ensure that all relevant FCA publications are reviewed and actioned in a timely manner. The FCA announced in November last year (Primary Market Bulletin No. 9) that they had issued a number of private warnings in respect of poor compliance by PDMRs with their obligations and would in future consider taking public disciplinary action.

They also announced a consultation on their technical guidance on transactions by PDMRs (Note: UKLA/TN/540.1). Companies should be clear about which senior executives are PDMRs and take immediate steps to educate them about their reporting obligations, including the identity of their connected persons. Action should not be postponed pending publication of the FCA's revised guidance.

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