

DISCLOSURE OBLIGATIONS FOR DIRECTORS WHO USE THEIR SHAREHOLDINGS AS SECURITY

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The Financial Services Authority (“FSA”) has recently issued guidance which places emphasis on deals by directors, particularly those involving securities.

Background

On 8 December 2008, Carphone Warehouse Group PLC announced the resignation of David Ross, one of the directors of the Company. Mr Ross' resignation followed his notification to the Company that between 2006 and 2008, he had pledged 136.4 million ordinary shares in the Company against personal loans. This high profile matter drew attention to the reporting obligations relating to directors and other persons discharging managerial responsibilities (“PDMRs”) of a company, and their connected persons, who grant security over their shareholdings. There was uncertainty in the market and the FSA received a number of queries and requests for clarification relating to this subject.

Disclosure Rules and Transparency Rules 3.1.2

For companies that are incorporated in the United Kingdom the relevant rule, which deals with transactions by PDMRs and their connected persons, is contained in Chapter 3 of the Disclosure Rules and Transparency Rules (the “Disclosure Rules”). Rule 3.1.2 of the Disclosure Rules states that *“persons discharging managerial responsibilities and their connected persons, must notify the issuer in writing of the occurrence of all transactions conducted on their own account in the shares of the issuer, or derivatives or any other financial instruments relating to those shares within four business days of the day on which the transaction occurred.”* However, the rule does not define what is meant by the term “transaction” in this context.

FSA Guidance

On 9 January 2009, the FSA published clarification on this issue. It confirmed 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 in Chapter 3 of its Disclosure Rules, and stated that it considered this to be consistent with the general statements it had previously made on the scope of the requirements, in its 2005 Policy Statement and List! Newsletter.

The FSA stated that directors and PDMRs who have granted security over their shares should therefore disclose this to the market as soon as possible and “certainly no later than 23 January 2009”. Given the circumstances, the FSA has stated that it will not be taking retrospective enforcement action in respect of prior failures to notify the market of such grants of security although a failure after that date may be the subject of action.

The Model Code

The FSA has also taken the opportunity to remind listed issuers and their PDMRs that under the Model Code (Annex 1 to Chapter 9 of the Listing Rules), a director or PDMR intending to use his shares as security must disclose this and seek permission from the Company in advance of doing so (paragraph 1(c)(v) Model Code). The purpose of the Model Code is to ensure that PDMRs do not abuse, or place themselves under suspicion of abusing, inside information which they may have, and makes it clear that "dealing" includes "using as security, or otherwise granting a charge, lien or other encumbrance over the securities of the company". The FSA has stated that it "can see no basis on which a director could have a legitimate excuse for not seeking clearance [from the company] in advance", where the company's securities are to be used as collateral for a financing transaction. A listed company has an obligation to ensure that directors and PDMRs comply with the Model Code and take all proper and reasonable steps to secure compliance, and the FSA expects listed issuers to deal with Model Code breaches by their directors.

AIM companies

Chapter 3 of the Disclosure Rules does not apply to AIM listed companies, but these companies must instead comply with Rule 17 of AIM Rules for Companies and disclose without delay "any deals" by directors. "Deal" is defined as including "the grant to, or acceptance by a person of any option relating to such securities or of any other right or obligation, present or future, conditional or unconditional, to acquire or dispose of any such securities", and so would cover the grant of security. In addition most AIM companies will have a share dealing code which will require disclosure of such grants by directors and others caught by it.

Conclusion

Directors are reminded of the importance of disclosing all transactions involving a company's shares which they carry out. Directors who do not comply risk action by the FSA or AIM team, as appropriate.