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Top Tips for Complying with the Model Code

The spotlight has been turned on the Model Code recently, with two companies being issued with fines for breaches of their code of dealings. A few weeks ago the FSA (as it then was) issued its first ever fine for breaches of the Model Code to Nestor Healthcare Group Limited, in the sum of £175,000 (reduced from £250,000 because of Nestor's early agreement to settle). Shortly after that it issued a fine of nearly £2,500,000 to Lamprell plc. That fine was issued for the serious offence of failing to inform the market of its deteriorating financial position. A corollary of that failure was that directors' share dealings were approved at a time when the company was in possession of price-sensitive information, in breach of the Model Code. This breach of the Model Code was expressly set out and dealt with in the Final Notice issued by the FSA.

These cases show not only that the FSA is, for the moment at least, focussing on the Model Code, but also that it will levy substantial fines in appropriate cases. Interestingly, in the case of Nestor, the core obligation not to allow directors to deal without approval had been, in broad terms, complied with, it was peripheral obligations, for example, to use the documentation prescribed in the company's own share dealing policy to request and record the approval of dealings, and to deal promptly after clearance has been given, that had been breached.

For our top tips on how to comply with the obligations relating to and contained in the Model Code, read on:-

1. **Tip:** Make sure clearance is obtained from the right person.

   Why: Paragraph 4 of the Model Code sets out precisely who clearance must be sought and obtained from.

   What not to do: One of Nestor's failings was allowing the chairman, who was also the chief executive, to obtain clearance from a single director only. Paragraph 4(d) makes it clear that if the role of chairman and chief executive are combined, that person must obtain clearance from the board.

2. **Tip:** Keep a record of all responses and clearances given.

   Why: Paragraph 6 of the Model Code requires copies of all responses and clearances given to be kept by the company and a copy of each to be given to the relevant restricted person.

   What not to do: In Nestor's case many of the requests for clearance, and responses, were made orally or by email, not using the forms stipulated by the company's own share dealing policy. For certain dealings no copy of the clearance appeared to have been kept or given to the person concerned.

3. **Tip:** Once approved, carry out the dealing promptly.

   Why: Paragraph 7 of the Model Code requires the dealing to take place as soon as possible and in any event within two business days of receiving clearance.

   What not to do: One trade was executed by a director of Nestor over two months after he was given clearance to deal.

4. **Tip:** Make sure the directors understand the requirements of the Model Code and the company's own share dealing policy, provide training if necessary, and remind them of their obligations.

   Why: Listing Principle 1 requires listed companies to take reasonable steps to enable their directors to understand their responsibilities and obligations as directors.

What not to do: Nestor required all of its directors to return a signed statement acknowledging that they had read and understood the company's share dealing policy, and they had all done so. However, the company did not issue any reminders about it or reinforce awareness of it, even though they did issue six-monthly reminders to directors reminding them that they were not allowed to trade during a close period or when in possession of inside information.

5. **Tip:** Keep the company's share dealing policy and its operation under review.

   Why: Listing Principle 2 requires listed companies to take reasonable steps to maintain adequate procedures, systems and controls to enable it to comply with its obligations under the Model Code.

   What not to do: Nestor did not review its share dealing arrangements so failed to spot that breaches of the Model Code were taking place and continued to do so for a period of three and a half years.

And finally, a word of warning for AIM companies. The AIM Rules do not contain a Model Code, there is simply an obligation in AIM Rule 21 on an AIM company to ensure that its "directors and applicable employees do not deal in any of its AIM securities during a close period". The point to watch is that AIM Rule 21 contains only two exceptions to the prohibition on dealings, while the Model Code contains several. An AIM company which based its clearance procedure on the Model Code could inadvertently grant clearance to deal at a time when the company was in a close period and thereby cause a breach of Rule 21.

Kate Ball-Dodd, partner in Mayer Brown's Capital Markets Group, commented "The Model Code and AIM Rule 21 are designed to ensure that PDMRs do not abuse <u>and are not suspected of abusing</u> inside information. Directors should see them as protective measures to help them to stay on the right side of the law. The fact that the FSA (now the Financial Conduct Authority) has shown itself willing to impose substantial financial penalties on companies that do not observe the Model Code should strengthen their resolve to ensure strict compliance."

If you have any questions or require specific advice on any matter discussed in this update, please contact:

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