

# Insider Trading Law Virtually Here

The Insider Trading Law<sup>1</sup> that was adopted a year ago and has been gradually implemented since then is due to come into full effect on 31 July 2011. Despite the one-year suspension the secondary legislation necessary to make the provisions of the Insider Trading Law operational was unofficially published only in mid-July 2011 and is expected to come into effect on 31 July 2011. Recognising the virtual impossibility for the market to comply with these new regulations the Federal Service for Financial Markets (the "FSFM") has granted insiders another "grace period" in respect of a number of their duties imposed on them by the new legislation.

In this briefing we summarise the current state of play and some of the issues the market may be facing.

## Secondary Legislation Adopted but Postponed

With the enactment of the Order approving the List of Inside Information for entities listed in Article 4 of the Insider Trading Law and procedure and timeframe for inside information disclosure (the "**Order on Inside Information and its Disclosure**")<sup>2</sup> and the Order establishing the procedure for maintenance of insiders lists and their transmission to stock exchanges and the procedure and timeframe for reporting by insiders of their dealings in the relevant instruments (as subsequently amended)<sup>3</sup>, the FSFM has almost accomplished the task of making the Insider Trading Law operational (the only missing piece of regulation is the procedure for professional participants of the securities market ("**PPSMs**") and banks on notifying the FSFM about "suspicious" transactions of their clients).

The late arrival of the secondary legislation prompted the FSFM to introduce additional grace periods for the insiders to comply with a number of their obligations under the Insider Trading Law:

- obligation to submit the insiders lists to stock exchanges has been postponed till 6 pm on 30 December 2011;
- obligation of the insiders to report their dealings in the relevant instruments has been postponed till 31 December 2011; and
- obligation of the insiders to compile their own insiders lists and disclose inside information in the manner prescribed by the FSFM Order on Inside Information and its Disclosure is postponed till 31 December 2011.

## List of Inside Information

The key characteristic of the Insider Trading Law differentiating it from similar regulation in many other jurisdictions is that, as far as issuers are concerned, it operates an exhaustive list of facts information on which qualifies as inside information. Thus, the List of Inside Information effectively represents the most important piece of regulation which defines what constitutes inside information for each type of corporate insiders listed in Article 4 of the Insider Trading Law.

### Key Issues:

- The Insider Trading Law comes into effect on 31 July 2011, but a number of statutory duties of the insiders are postponed
- List of Inside Information is approved by the FSFM
- A number of issues concerning practical operation of the Insider Trading Law are yet to be resolved

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<sup>1</sup> Federal Law No. 224-FZ dated 27 July 2010 "On Prevention of Illegitimate Use of Inside Information and Market Manipulation and on Amendments to Certain Laws of the Russian Federation".

<sup>2</sup> Order of the FSFM No. 11-18/pz-n dated 12 May 2011.

<sup>3</sup> Order of the FSFM No. 11-3/pz-n dated 21 January 2011 as amended by Order of the FSFM No. 11-28/pz-n dated 28 June 2011.

In this client briefing we will focus on inside information for issuers and PPSMs and other organisations (including banks) which enter into transactions in respect of financial instruments, foreign currencies and commodities for their clients and which have received information from their clients.

### *Inside information for issuers*

The Order on Inside Information and its Disclosure provides for a finite number of facts which constitute inside information for an issuer of securities which are admitted to trading or in respect of which application for admission to trading on a Russian stock exchange has been filed. This is a significant departure from the initial draft which provided that an issuer (which is required to approve its own list of inside information) could widen the list by including other types of facts (information) which disclosure in its opinion may affect the price of its securities.

The list of inside information for issuers almost entirely mirrors the types of information which are subject to disclosure by public companies under the new disclosure rules in effect from April this year<sup>4</sup> (the "**Disclosure Rules**") including, but not limited to, information subject to disclosure in the form of material facts.

However, there are certain exceptions. In particular, information about all decisions taken by the issuer's board of directors is regarded inside information, whereas only a selected (although quite large) number of them is subject to disclosure pursuant to the Disclosure Rules. The Order on Inside Information and its Disclosure provides an exemption from the general rule requiring to disclose inside information in respect of board's decisions which are classified as confidential information by the issuer and are taken on matters lying beyond the scope of the authority reserved for the board of directors under the Joint Stock Companies or Limited Liability Companies Law (as applicable). Hence, certain decisions of the board of directors can remain inside information for an indefinite period of time.

At the same time, the Order expressly carves out from the list of inside information the information which is disclosed by the issuer or a third party engaged by the issuer to prospective purchasers of such issuer's securities or is used by the issuer or a third party engaged by the former as a basis for giving recommendations to, or in order to induce, prospective

purchasers to purchase such issuer's securities in the context of a placement (arrangement of placement) or offering (arrangement of offering) of the issuer's securities in Russia or abroad, including in the form of securities of a foreign issuer (such as depositary receipts).

Such information is not regarded inside information for the purposes of the Insider Trading Law provided that the prospective purchasers are warned that information provided to them can be used solely for the purposes of their taking an investment decision in respect of securities on offer.

The exemption is likely to cover information provided to prospective investors in the context of an equity offering (IPO, secondary offering or private placement of shares). Absent legal definition of a term offering it is not clear whether this exemption can also be relied on in the context of an M&A transaction in case it is structured so as to meet the terms of this exemption (i.e. there is an auction sale and it is the issuer which provides information to prospective purchasers which will then purchase shares from the issuer's shareholder(s)).

### *Inside information for professional participants of the securities market*

The approved list of inside information for PPSMs also significantly departs from the latest draft published by the FSFM in March 2011 as references to formal tests have been removed<sup>5</sup>. According to the approved list of inside information it is up to a PPSM's to decide whether execution of a client order may materially affect the price of securities. If this is the case, then such client order is considered to be inside information of the PPSM for the purposes of the Insider Trading Law.

<sup>4</sup> The new disclosure rules were envisaged by Federal Law On Amendments to the Securities Market Law No. 264-FZ dated 4 October 2010 which entered into force (in part of the new disclosure rules) on 7 April 2011. The FSFM's Regulation on Disclosure of Information detailing procedure and form of disclosure has not yet been amended to reflect the new scope of disclosure requirements (although the draft of the revised regulation has already been prepared and made available on the FSFM's website).

<sup>5</sup> In the March draft it was proposed that information contained in a client's order would qualify as inside information in any of the following cases: (i) if the quantity of securities of one issuer of the same type (i.e. vesting their holders with equal rights) is equal to or exceeds 0.2 per cent. of such issuer's outstanding securities of the same type; or (ii) market value of securities of one issuer of the same type in respect of which client order is received is equal to or exceeds RUB 100 million; or (iii) if the client is on the list of insiders of the issuer of securities and (iv) if in a PPSM's opinion execution of such client order may materially affect the price of securities.

## Some Outstanding Issues

Below we have set out some of the issues arising from the Insider Trading Law which have not yet been clarified or otherwise addressed by the regulator:

- it is still not entirely clear what employees and individual contractors should be on the insider list of a PPSM. While the FSFM has clarified that only employees that have actual (as opposed to potential) access, including by virtue of their employment duties, to inside information received from clients must be included on a PPSM's list of insiders, this approach would require thorough delineation of job functions between employees, detailed job descriptions and introduction of proper information barriers.
- applicability of the carve-out for IPOs and private placements to M&A transactions;
- guidelines for determining what client orders (being the source of inside information for a PPSM) contain inside information which disclosure may affect the price of the relevant security or commodity (the FSFM has informally proposed that PPSMs should work out certain quantitative criteria for each of most liquid exchange traded securities and include them into their lists of inside information as guidelines);
- does an investment bank (or other consultant having access to inside information of its client) breaches the Insider Trading Law if it passes the information provided to it by the client to its own advisers (e.g. a legal adviser) and whether in this case the legal adviser will be required to make its own list of insiders (listing its directors and employees). The same concern equally arises for international investment banks and other professional services providers who may engage cross-border teams into projects involving Russian issuers. While the teams may be closely integrated, their members may be employed by different legal entities of the same group. This inevitably poses the same concern for an entity contracting with the client directly: how it should deal with including into the insiders list those individuals who are closely involved into a project but are not employees of that entity.

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