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Dealing with confidential and price sensitive information

Introduction

Members of the LMA regularly come into possession of information that is confidential and/or price sensitive in their capacity as lenders. This note describes why this leads to legal and other concerns and the types of steps that members may wish to consider to reduce the associated risks.

Confidentiality and Price Sensitivity - two separate concepts

Members should note that confidentiality and price sensitivity are two quite separate concepts - although a single piece of information may be both confidential and price sensitive. Further details are set out below. However, in general terms, it is common that confidentiality obligations are imposed by the borrower due to particular concerns over the commercial sensitivity of information. These obligations are imposed by means of contract - through confidentiality undertakings imposed by borrowers on lenders or potential lenders. In the standard form LMA Confidentiality Undertakings the obligation to keep information confidential ceases on execution of the relevant Facility Agreement. This is because at that point the borrower is the customer of the lender and under English common law there is a duty of confidentiality owed by a bank to its customer which is an implied term of their contract. Restrictions on use of price sensitive-information or inside-information are imposed through laws, applied both in the UK and elsewhere. Where the borrower's securities are traded on a securities market it is likely that there will be some form of restriction on the use of price sensitive information - as further defined below. Contravention of these restrictions is generally subject to either criminal or civil sanctions.

Privileged Information

Borrowers regularly provide information about themselves and their financial or trading status or prospects to their lenders and potential lenders at a time when that information is in some way privileged or not generally known to the financial markets or the public generally. It is important to note that just because information has been

disclosed to a syndicate of lenders, that does not equate to making information available to the public, as information is often disclosed to a syndicate on a privileged or confidential basis. In such circumstances, the information may be price-sensitive or inside-information, meaning that, were it known to the public, it would be likely to have an effect on the price of securities issued by the relevant borrower that are publicly traded.

There may be reasons why a borrower wishes to restrict the circulation of information relating to itself - for example, because the information may be commercially sensitive - and therefore the borrower may seek to impose a contractual obligation of confidentiality on the lenders or potential lenders who have access to it.

Where a lender is under a duty of confidentiality, that lender could be sued if it breaches that duty by disclosing relevant information to a third party. The quantum of damages for breach of confidentiality will vary depending on the effect of the breach on the borrowers involved. However, the effects of a breach of confidentiality relating to commercially sensitive information could be very substantial. Consequently, damages could also be substantial. Lenders must note that disclosing relevant information to, or discussing it with, any third party that is not subject to the same confidentiality constraints (e.g. those other than members of the syndicate of lenders in question) is likely to constitute a breach of confidentiality. This would include disclosure to journalists.

Members are also reminded that LMA standard form documentation contains confidentiality undertakings to be entered into between sellers and buyers in the secondary loan market. Through these confidentiality undertakings, buyers of interests in loans in the secondary market are made subject to confidentiality restrictions in relation to information concerning a relevant borrower where that information is received in the context of their participation in the relevant loan(s) through the secondary market. These confidentiality undertakings make clear that any breach by the buyer may lead not only to damages claims but also to injunctive relief or remedies of specific performance being granted to the seller or any other member of the relevant syndicate, either in respect of actual or threatened breach. As noted above, the common law implied duty of confidentiality between a banker and its customer may apply once a buyer acquires an interest in the relevant Facility Agreement. Consequently, confidentiality obligations are as much a part of the secondary loans market as the primary market and mean that buyers in the secondary market are often equally subject to confidentiality requirements as the original lender.

Information in the possession of a lender, or a potential lender, in relation to a borrower may also be price-sensitive or inside-information i.e. information that relates to an issuer, or an issue, of publicly traded securities that has not been made public but which, were it to be made public, would have a significant impact on the price at which relevant securities would trade. This will potentially be an issue therefore where a lender has such information relating to a borrower whose securities are listed. This issue is equally relevant to those who purchase interests in the secondary market as to those who take interests in the primary markets: any entity that comes into possession of inside-information relating to a borrower will have the same issue.

Examples of situations where price-sensitive or inside-information might arise and be known to lenders or potential lenders in relation to borrowers would potentially include: information on a planned securities issuance by the borrower; discussions relating to a potential acquisition or sale of a business by the borrower; a planned buy-out or recapitalisation of the borrower; a covenant waiver or other restructuring; financial projections relating to the borrower; or, the award or loss of a major commercial contract, which might have a significant impact on the perception of the business prospects and performance of the borrower.

EU Market Abuse Directive

With the implementation of the Market Abuse Directive (MAD) across the EU, EU states have adopted the following common definition of inside information:

"*…information of a precise nature which has not been made public, relating directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were to be made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.*" (Article 1(1) of MAD (2003/6/EC))

MAD renders unlawful throughout the EU any dealing in securities on the basis of inside-information, as well as recommending others to deal on the basis of, or improper disclosure to others of, inside-information. MAD relates to any information meeting the definition above concerning an issuer of securities where those securities are admitted to trading on an EU regulated market. These laws apply equally to dealing in fixed income securities and dealing in instruments such as credit derivatives that relate to fixed income securities as they do to dealing in equities. Consequently, for example, a potential lender may be guilty of insider-dealing if it buys credit protection ahead of taking on exposure to a new loan if: the relevant borrower's intent to enter into the loan is unknown to the securities market where relevant securities are traded; that knowledge would impact the price of securities issued by the borrower; and, the credit protection arrangement involves the prospective lender dealing in securities whose price would be affected by that knowledge. MAD also makes unlawful the passing on of inside-information to a third party as well as encouraging a third party to deal on the basis of inside-information, even where the inside-information itself is not passed on. Additionally, many states outside the EU have similar prohibitions on the use of inside-information relating to traded securities and their issuers - e.g. federal securities laws in the US prohibit the use of material non-public information.

The laws implementing MAD in the UK create civil offences relating to the misuse of inside-information. Additionally, the UK also has a criminal offence of insider dealing, which continues in effect. The existence of a civil, in addition to a criminal, offence, means that to obtain a successful prosecution for insider dealing, the prosecution only needs to demonstrate its case on a "balance of probabilities" - rather than to the higher criminal standard of "beyond reasonable doubt". This inevitably means that prosecutions are easier to mount and more likely to be successful. There have, as yet, been no prosecutions of those operating within the loan markets for misuse of

information or for insider dealing. However, with the broadening and tightening of the regime that has occurred in recent years, including the implementation of MAD, together with the increasing overlap between loans and other products and the greater danger that brings for confusion and inappropriate use of information, whether accidentally or otherwise, it is increasingly important that market participants maintain a high level of diligence around these issues.

MAD generally requires issuers to inform the public as soon as possible of inside information relating to them/their securities. The aim of this requirement is to limit the potential circumstances/period during which inside information is likely to exist. However, there are exceptions to this obligation - specifically in relation to ongoing, commercially sensitive negotiations (e.g. such as negotiations with lenders over major lending commitments, etc.) and where the issuer can assure confidentiality. Consequently, confidentiality may also be expressly required of lenders by borrowers as a result of obligations arising under insider dealing law as well as in relation to maintaining confidence around otherwise commercially sensitive information.

Effective Organisation

Firms are organised in a variety of ways. Consequently, the means that they deploy to ensure that they do not breach confidentiality requirements or insider dealing restrictions will vary. This note therefore does not seek to prescribe the methods that firms should use for these purposes. Rather, its purpose is to suggest methods that may be effective, whilst also raising awareness of these issues among the LMA membership generally. It should also be noted that this note does not, in itself, constitute advice on how to treat confidential and/or inside-information (referred to collectively in this note as "privileged information"). Rather, the note seeks to inform LMA members about steps that, depending on how a member is constituted or does business, may be suitable to adopt to limit the flow of privileged information as part of the relevant firm's compliance processes. Individual firms will need to tailor suitable processes to their own individual position and circumstances and should seek independent advice to the extent that they have any doubts or questions as to the impact of confidentiality obligations or insider dealing restrictions on their own particular circumstances.

Firms should note that, as policies on how information is used and held vary from organisation to organisation, they should not take for granted that this is handled in the same way in other firms. For example, the line between private side and public side personnel is drawn differently. Consequently, for example, in sounding out a potential participant for a syndicate relating to a new loan, or where an existing lender seeks to sound out a potential purchaser of a position in a loan in the secondary market, in seeking to discuss privileged information relating to a borrower with personnel from another lender or potential buyer, it is important to ensure that the relevant discussions are with those on the private side of the recipient firm's information wall. However, these obligations should not be seen as resting only with the entity sounding out interest in the potential participant/buyer. The potential participant/buyer also has a

responsibility to alert the other party who has possession of the privileged information if receipt of that information would cause the potential participant/buyer difficulties because the relevant individuals are on the public side of the potential participant's/buyer's information wall.

All firms should, in any event, consider adopting policies and procedures aimed to ensure that the firm neither uses nor discloses privileged information improperly.

The following practical steps might be considered in framing policies and processes in this area:

- Information walls
- Restrictions on trading
- Staff dealing rules
- Staff training
- Imposition of confidentiality obligations on third parties

Information walls: These are designed to ensure that those within a firm who have access to privileged information - often referred to as the "private side" of the information or Chinese wall - do not communicate that information to those within the firm involved in decisions to trade in securities that are dealt in through the securities markets - often referred to as those on the "public side" of the information or Chinese wall. For LMA members who trade in the securities markets - whether for proprietary purposes or on behalf of clients - such information walls provide a means of, in principle, allowing a firm to continue to trade in securities whilst in possession, elsewhere within the firm, of privileged information relating to those securities or their issuer. Consequently, within firms that adopt information walls, it will generally be the case that those who have access to privileged information relating to borrowers will be on the other side of the information wall from the securities trading function.

The practical measures that are appropriate to secure information behind an information wall will vary from firm to firm. However, measures might include: physical segregation of staff who are on the different sides of the information wall (e.g. on different floors or possibly in different buildings and with separate access arrangements/authority for access to areas on the private side of the wall), privileged information being placed in lockable cabinets when available in hard copy form and password protected/held on a secure drive when available electronically, requiring specific approval to be obtained for transactions in securities to which privileged information relates.

Restrictions on trading: However, not all firms that trade in loans will have an information wall in place. In these firms, due to the lack of an information wall, everyone will be deemed to have access to any privileged information that comes into possession of the firm or any of its employees in the pursuance of the firm's business. Consequently, if such a firm trades in securities of an issuer whilst in possession of privileged information relating to that issuer, this is likely to constitute insider dealing

and misuse of information. Such firms will therefore need to consider what compliance arrangements to put in place to ensure that such privileged information is not used to trade in publicly traded securities. They may also wish to consider putting in place compliance arrangements to ensure that any privileged information in possession of the firm is not passed on to any third party outside the firm. Such arrangements, which would be implicit in an information wall arrangement, would help to avoid the firm or its employees committing the offences relating to passing on or tipping off of third parties to the existence of privileged information.

Staff dealing rules: Because individual employees within member firms will, from time to time, have access to privileged information, putting in place rules limiting or placing an approval process around dealings in securities by employees may be a sensible precautionary measure. This will help protect employees from undertaking dealing in securities for their own account whilst in possession of privileged information. Such measures will also assist a firm in demonstrating that it has taken all reasonable steps to ensure that employees do not deal for their own account on the basis of privileged information that they have obtained as a result of their employment. Such processes will vary depending on the firm and the regularity with which employees come into contact with privileged information. Typically, however, staff dealing rules involve a requirement placed on employees to obtain prior approval to any own account dealings in securities. Approval would typically not be given where the individual employee or parts of the firm in which he/she works have access to privileged information at the relevant time.

Staff training: Raising awareness of these issues will be important in any firm. The more aware and sensitive staff are to the concerns around possession and handling of privileged information, the less likely it is that the firm will find itself in unwitting breach of confidentiality undertakings and insider dealing laws. Also, for firms that are regulated by the FSA, they will be subject to obligations to train staff on key compliance issues, such as issues and concerns relating to the handling of inside and other privileged information.

Imposition of confidentiality obligations on third parties: Where an arranger or a syndicate seeks to involve other lenders in a deal and also, potentially, where interests in a loan are sold to third parties, there will be a need to obtain a confidentiality undertaking either in relation to any information memorandum relating to the borrower and/or the relevant loan or in relation to any particular piece or collection of privileged information. Firms may want to consider adopting a process whereby granting access to such privileged information is dependent on receipt of such a signed confidentiality undertaking. As mentioned above, the LMA documentation contains standard form confidentiality undertakings that cover situations where information is passed from seller to buyer in the secondary loans market.