

Russia adopts the Law on Insider Trading

This note gives an overview of the newly adopted law on insider trading¹ (the "Law on Insider Trading"). The Law on Insider Trading applies to a wide range of legal entities, their shareholders and employees extending its application far beyond issuers and professional participants in the securities market so as to also cover their consultants, including investment banks, auditors, and legal counsel, as well as government authorities, the Central Bank of Russia (the "CBR") and their officials. The new law will enter into force in stages and, strictly speaking, will not be operational until July next year with some provisions becoming effective even later.

INTRODUCTION

This client briefing discusses the Law on Insider Trading and a number of proposed amendments to various Russian laws including the Criminal Code, the Administrative Offences Code, the Securities Market Law and the Law on Banks and Banking Activity. These were adopted by the Russian parliament on 14 July 2010, and finally were ratified by the Russian President on 27 July 2010.

The Law on Insider Trading introduces statutory definitions of "insider" and "inside information" and amends the definition of "market manipulation". Additionally, the Law on Insider Trading establishes criminal liability for illegitimate use or transfer of inside information and liability for failing to comply with certain requirements of the new law, and furthermore tightens criminal liability for market manipulation. Finally, the Law on Insider Trading imposes disclosure obligations on insiders as well as sets out the functions and authority of the Federal Service for Financial Markets of the Russian Federation (the "FSFM") in its capacity as the competent regulatory body to combat market abuse.

The Law on Insider Trading will come into force in stages, allowing market participants to grow accustomed to the new complicated regulatory environment and providing the FSFM with sufficient time to adopt numerous regulations envisaged by the new law. Most parts of the Law on Insider Trading will come into force 180 days after official publication of the law. Furthermore, certain important provisions, including those setting out what data constitutes inside information and regulating the maintenance of the insiders lists, will become effective one year after the official publication of the law. Most importantly, provisions of the Law on Insider Trading establishing criminal liability for the insider trading and the revocation of a banking license will only come into force 3 years after official publication of the law.

BACKGROUND

Current Russian legislation on insider trading and market manipulation is underdeveloped in comparison to that of Western jurisdictions and does not currently address the concepts of "inside information" or "insider trading" as these terms are understood in more developed Western securities markets. The existing concept of "official information" (*sluzhebnyaya informatsiya*) fails to encompass all types of price-sensitive information or persons having access to such information. Furthermore, the concept's application is limited to issuers and securities issued by them, and does not include other financial instruments such

Key Issues

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¹ The 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".

as derivatives contracts, or neither does it extend to any affiliates of an issuer. Moreover, breaching the restrictions imposed by the securities market legislation on the use of official information only results in administrative liability of the offender. Although the prohibition on market (price) manipulation was set out in the first edition of the Securities Market Law back in 1996, the definition of market (price) manipulation was originally introduced by the amendments to Securities Market Law in 2002 and was further elaborated in 2009. However, it remained vague and uncertain, and was subject to a variety of interpretations and ultimately was not broad enough to catch many of existing market manipulation practices. Although criminal and administrative liability was introduced for market manipulation in 2009, its application remained largely untested.

INSIDE INFORMATION AND INSIDERS

Inside Information

The Law on Insider Trading introduces the concept of "inside information" (*insayderskaya informatsiya*), which is defined as accurate and precise information of any kind (including but not limited to the bank or postal secrecy, official or commercial information or other information protected by law) that has not been made public and that, if it were made public, could have a material effect on the prices of the financial instruments, foreign currency and/or commodities (including information on the issuers, management companies, legal entities holding a dominant position in a particular market, financial instruments, foreign currency and/or commodities) and is included in the list of inside information.

According to the Law on Insider Trading, what is considered inside information differs depending on the type of insiders – as discussed in more detail below.

Insiders

The Law on Insider Trading distinguishes between sovereign and all other insiders. For the purposes of this client briefing we have divided insiders into two groups: corporate and sovereign insiders. Corporate insiders (the "**Corporate Insiders**") include:

- i. issuers and management companies,
- ii. corporate entities holding a dominant position in any particular market,
- iii. exchanges, clearing companies, depositories and non-bank credit institutions making settlements in accordance with the results of deals performed on exchanges,
- iv. professional participants of the securities market,
- v. information agencies,

- vi. rating agencies,
- vii. auditors, appraisers, banks, insurance companies as well as other persons which by virtue of a contract have access to inside information of entities listed in **i** to **iv** above² (the "**Consultants**"),
- viii. persons holding 25% or more of votes in the share capital of entities listed in **i** to **iv** above or other shareholders having access to inside information of these entities pursuant to the charter or the law (the "**Affiliates**"),
- ix. directors, members of the management and internal audit bodies of entities listed in **i** to **iv**, **v** and **vi**, of their Consultants and Affiliates (the "**Executives**"),
- x. persons having access to information about tender offers (the "**Tender Officers**"), and
- xi. employees of the persons named in **i** to **x** who have access to inside information (the "**Employees**").

Corporate Insiders (save for the Consultants, Affiliates, Executives, Tender Officers and Employees) are required to adopt their own lists of inside information (*perechen' insayderskoy informatsiyi*) on the basis of the exhaustive index of inside information to be provided for in the FSFM's regulation. The insiders lists must be posted on websites of the relevant Corporate Insider.

In addition to the Corporate Insiders, the Law on Insider Trading provides that federal, regional and municipal authorities and managers of the non-budget state funds having the right to invest in financial instruments, as well as the Central Bank of the Russian Federation (the "**CBR**") (the "**Sovereign Insiders**") are also considered to be insiders.

The Sovereign Insiders are required to create their own lists of inside information based on the FSFM's recommendations and post them on their official websites. The Law on Insider Trading specifically provides that the following information must be regarded as inside information by the Sovereign Insiders: (i) information on the results of tenders; (ii) information obtained in the course of inspections as well as results of such inspections; (iii) information on the issuance or revocation of licenses or other permits and (iv) information on administrative proceedings with respect to the Corporate Insiders and their employees.

² Obviously, this definition should capture various consultants, including investment banks, legal counsels, appraisers, etc engaged by the Corporate Insiders listed in **i-iv**, however, it omits the fact that consultants may be engaged not by the Russian company directly but by its foreign parent company.

MARKET MANIPULATION

The definition of "market manipulation" set out in the Securities Market Law has been amended several times since 2002. The new definition contained in the Law on Insider Trading will replace all current provisions of the Securities Market Law relating to the market manipulation practices. For the purposes of the Law on Insider Trading, the definition of the market manipulation primarily refers to:

- the intentional dissemination of false information through media, including Internet;
- transactions or bids; and
- sham transactions or bids done or issued without any intention to execute them,

that create or secure the price, demand, offer or volume of trade of a financial instrument, foreign currency and/or commodity at a level significantly different to that created in usual market conditions. Some activities in the market, such as market maker services, are specifically excluded from the list of market manipulation practices.

The definition of the market manipulation is broadly formulated so as to encompass as many types of market manipulation practices as possible. The criteria for a "significant difference" in price, demand, offer or volume of trade of a financial instrument, foreign currency and/or commodity from that created in usual market conditions, are to be further specified in the FSFM's regulations.

RESTRICTIONS ON INSIDER TRADING AND MARKET MANIPULATION

The Law on Insider Trading restricts the use of the inside information, including through prohibiting (i) insider trading (i.e. transactions with the financial instruments, foreign currencies and commodities to which inside information relates); (ii) disclosing inside information to any other person unless such disclosure is made to a person included in the insiders list as required by law or in the normal course of the employee's duties; and (iii) recommending to or instructing or inducing another person (on the basis of inside information) to acquire or dispose of financial instruments, foreign currency and/or commodities. The Law on Insider Trading expressly prohibits any market manipulation practices.

According to the amendments to the Code of Administrative Offences and the Criminal Code proposed in the Law on Insider Trading, illegitimate use of the inside information and market manipulation will constitute an administrative offence, or a criminal offence if it results in severe damages, or gain or avoidance of losses, as the case may be, in the amount of more than RUB 2.5 million.

The administrative and criminal penalties for illegitimate use of inside information and market manipulation practices are set forth in Annex to this client briefing.

In addition to the above liabilities, the Law on Insider Trading amends the Law on Banks and Banking Activity to provide that a repeated breach by a credit organisation (including a bank) of the Law on Insider Trading and related regulations could constitute grounds for the revocation of the banking licence of such credit organization by the CBR.

The Law on Insider Trading excludes liability for the illegitimate use of inside information and/or market manipulation in certain cases, including:

- by a person using inside information if this person was not aware of the inside nature of such information;
- by a person disseminating false data if this person was not aware of that such data is false;
- by the media in publishing false data, if such data was accurately reproduced from announcements, interviews and press-releases of individuals or legal entities or from data published elsewhere in the media provided that the source of such data is referred to; or
- insider trading by professional participants of the securities market if they acted upon the instruction of their clients.

In addition, insider trading by employees of certain professional participants of the securities market (such as brokers, dealers and securities and fund managers) will not result in the suspension or revocation of their respective licences if the market participants can prove that they have taken every necessary measure to prevent their employees from committing the relevant offence.

OBLIGATIONS OF INSIDERS

The Law on Insider Trading imposes certain obligations on insiders.

In particular, insiders must disclose insider information in a manner to be provided in a separate regulation of the FSFM.

In addition, every legal entity which is an insider (including Corporate Insiders) and the Sovereign Insiders will be obliged to (i) keep an insiders list, (ii) notify each particular insider of its newly acquired status as the insider, (iii) send the insiders list to the relevant exchange (not required for the Sovereign Insiders) and (iv) file the insiders list with the FSFM upon the FSFM's request.

Furthermore, the Law on Insider Trading provides that any insider included in the insiders list of an issuer, management company, a legal entity holding a dominant position in a particular market, certain participants of the securities market or any of their contractors which may have access to the inside information, will be obliged to notify such entities and the FSFM of any insider trading.

The Law on Insider Trading also sets out the requirements for the corporate governance of legal entities which are insiders (including the Corporate Insiders) and the Sovereign Insiders, including requirements to adopt an internal policy on inside information and create an internal division or employ a dedicated person who will be responsible for supervising the use of inside information.

ROLE OF THE FSFM AND EXCHANGES

According to the Law on Insider Trading, the FSFM will be the main competent authority exercising extensive rule-making, executive and supervisory functions in connection with the regulation of insider trading and market manipulation.

The FSFM's rule-making functions will include, amongst other things, adopting various regulations specifying in more details the general and broadly defined provisions of the Law on Insider Trading; issuing clarifications on the implementation of uncertain provisions of the Law on Insider Trading and summarising the implementation of market abuse legislation.

In addition, the FSFM will have authority to initiate investigations relating to market abuse; conduct inspections and compliance checks; request explanations and documents necessary for audits and investigations; cooperate with the Ministry of Internal Affairs to restrain the illegitimate use of inside information and market manipulation practices; take decisions on suspending or revoking licences of professional securities markets participants violating the market abuse legislation and cooperating with the CBR and other licensing authorities in order to suspend or revoke licenses of entities violating market abuse legislation.

Supervisory functions over operations with financial instruments, foreign currency and commodities are also granted to the exchanges, which should adopt rules for preventing, identifying and restricting insider trading and market manipulation, inspect and report on any suspicious transaction to the FSFM and request the documents necessary for an inspection. Inspections of suspicious transactions on behalf of exchanges can also be performed by self-regulated organisations, such as NAUFOR.

In addition, market participants acting on behalf of their clients should report all suspicious transactions undertaken by their clients to the FSFM in a manner to be provided in the FSFM's yet-to-be enacted regulations.

SUMMARY

To recap, the key principal changes introduced by the Law on Insider Trading are as follows:

- definitions of "insider", "inside information" and "market manipulation" are introduced and these extend not only to securities but to other financial instruments, foreign currency and commodities which are admitted to trading on a Russian stock, currency or commodities exchange or for which admission to trading is pending;
- an express prohibition on insider trading is established;
- the authority and functions of the FSFM with respect to combatting market abuse are specified;
- the new disclosure requirements in respect of insiders, such as keeping an insiders list and sending notices of transactions by the insiders to the regulator and the relevant legal entity are introduced; and
- the administrative and criminal liability for insider trading is introduced and certain aspects of the administrative and criminal liability for market manipulation are further elaborated and clarified.

Additionally, the Law on Insider Trading explicitly provides that the mere fact that transactions were entered into using inside information or constitute market manipulation does not render such transactions invalid.

An important point to mention is that after the Law on Insider Trading comes into force, many M&A and capital market deals will require greater scrutiny as to whether an entity should be included in the insiders list or not and whether a notice should be sent to the relevant entity and the FSFM in connection with the proposed transaction.

Finally, the implementation of a number of provisions of the Law on Insider Trading remains subject to enactment of the relevant regulations by the FSFM and the practical application of this law will, to a significant extent, depend on those regulations.

ANNEX

ADMINISTRATIVE AND CRIMINAL LIABILITY

	Illegitimate use of inside information	Market manipulation	Failure to comply with certain requirements of the Law on Insider Trading
Administrative liability	<p><i>Individuals:</i></p> <ul style="list-style-type: none"> - up to RUB 5,000 fine <p><i>Executives:</i></p> <ul style="list-style-type: none"> - up to RUB 50,000 fine; or - prohibition on holding certain offices for 1 to 2 years <p><i>Legal entities:</i></p> <p>Fine in the amount of the extra gain as a result of the illegitimate use of the inside information, but not lower than RUB 700,000</p>	<p><i>Individuals:</i></p> <ul style="list-style-type: none"> - up to RUB 5,000 fine <p><i>Executives:</i></p> <ul style="list-style-type: none"> - up to RUB 50,000 fine; or - prohibition on holding certain offices for 1 to 2 years <p><i>Legal entities:</i></p> <p>Fine in the amount of the extra gain as a result of the illegitimate use of the inside information, but not lower than RUB 700,000</p>	<p><i>Individuals:</i></p> <ul style="list-style-type: none"> - up to RUB 5,000 fine <p><i>Executives:</i></p> <ul style="list-style-type: none"> - up to RUB 30,000 fine; or - prohibition on holding certain positions for 1 year (in certain limited cases) <p><i>Legal entities:</i></p> <p>Up to RUB 700,000 fine</p>
Criminal liability	<p><i>Use of inside information:</i></p> <ul style="list-style-type: none"> - up to RUB 500,000 fine or up to three years' salary of those convicted; or - maximum 4-year imprisonment and up to RUB 50,000 fine (or up to 3 months' wage) or without fine but with a prohibition on holding certain positions for a period of up to 3 years or without such a prohibition <p><i>Illegal transfer of inside information:</i></p> <ul style="list-style-type: none"> - up to RUB 1,000,000 fine or up to four years' wage of the convicted; or - maximum 6-year imprisonment and up to RUB 100,000 fine (or up to 2 years' salary) or without fine but with prohibition on holding certain positions for a period of up to 4 years or without such prohibition. 	<ul style="list-style-type: none"> - up to RUB 500,000 fine or up to three years' salary of those convicted; or - maximum 4-year imprisonment and up to RUB 50,000 fine (or up to 3 months' wage) or without fine but with a prohibition on holding certain positions for a period up to 3 years or without such a prohibition <p><i>Same crime committed by an organised group or resulting in severe damages, or gain, or avoidance of losses (in the amount of more than RUB 10 million):</i></p> <ul style="list-style-type: none"> - up to RUB 1,000,000 fine or up to five years' wage of those convicted; or - maximum 7-year imprisonment and up to RUB 100,000 fine (or up to 2 years' salary) or without fine but with a prohibition on holding certain positions for a period up to 5 years or without such a prohibition 	Not established

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