



The voice of banking
& financial services



Directorate General Internal Market and Services
Unit G3 – Securities Markets
SPA2 - 03/079
B-1049 Brussels
Belgium

[MARKT-G3@ec.europa.eu]

10th June 2009

Dear Sirs,

Subject: Call for evidence on Market Abuse Directive (Directive 2003/6/EC)

The BBA (British Bankers Association) and ICMA (International Capital Markets Association) are pleased to respond to the European Commission's Call for Evidence on the Review of Directive 2003/6/EC on insider dealing and market manipulation (the Market Abuse Directive).

The BBA is the leading association for the UK banking and financial services sector, speaking for 223 banking members from 60 countries on the full range of UK or international banking issues and engaging with 37 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy.

ICMA is the self-regulatory organisation and trade association representing the financial institutions active in the international capital markets worldwide. ICMA's members are located in some 50 countries across the globe, including all the world's main financial centres, and currently number almost 400 firms in total.

We welcome the European Commission's efforts in facilitating the convergent implementation and application of the Market Abuse Regime through its current Call for Evidence with regard to its review of Directive 2003/6/EC – The Market Abuse Directive. The Call for Evidence will only serve to aid this process and ultimately encourage member states in establishing a pan-European common approach to the operation of the Directive. Please refer to our previous joint responses to various earlier CESR (the Committee of European Securities Regulators) consultations¹ which form a relevant preface for our response to this current Call for Evidence.

¹ (CESR / 08-274 - <http://www.cesr-eu.org/index.php?page=responses&id=112>)
(CESR / 08-717 - <http://www.cesr-eu.org/index.php?page=responses&id=121>)
(CESR / 06-562 - <http://www.cesr-eu.org/index.php?page=responses&id=80>)

The memberships of our associations largely view the Market Abuse Directive in a positive light, which for the most part, appears to be working well. However, cross-boarder differences continue to exist as a result of the way the Market Abuse Directive was implemented in practice across Member States. This lack of harmonisation has created unnecessary burdens and superfluous costs on market participants that operate on a cross-boarder basis when attempting to comply with MAD.

We acknowledge the Commission's statement outlining that the issue of supervisory and enforcement powers under MAD will not be considered as part of the Call for Evidence, and we appreciate the reasoning behind taking such an approach. Some of the discrepancies witnessed between Member States with regard to the implementation of MAD can certainly be improved by the work referred to in this Call for Evidence, for instance, the national differences in respect of Insider List requirements. However, we consider that, to some degree at least, the lack of harmonisation in the implementation of MAD between Member States is down to some of the Directive's wording itself, and the second level measures. The issue of harmonising sanctioning powers across EU Member States does indeed go beyond the functioning of the EU Market Abusive Directive. However, we would take this opportunity to highlight the importance of this issue. Indeed, the BBA is currently in the process of drafting a position paper in association with Clifford Chance. We will of course send this paper to the appropriate persons within the Commission to help assist with any future work in this area.

We set out our responses on the Call for Evidence's individual questions within Annex 1 to this letter. If you would like to discuss any of the points raised in this paper in further detail, please contact either Christopher Ford, or Ruari Ewing.

Yours sincerely,



Christopher Ford
Advisor – Capital Markets
British Bankers Association
christopher.ford@bba.org.uk
+44 20 7216 8895



Ruari Ewing
Advisor – Primary Markets
International Capital Markets Association
ruari.ewing@icmagroup.org
+44 20 7517 3225

APPENDIX I

2.1. THE SCOPE OF THE MAD

2.1.1. Only regulated markets? (Articles 1(3) and 9 of Directive 2003/6/EC)

Question: *Do you consider that the scope of the MAD should go beyond regulated markets? In particular, should it be extended to cover MTFs?*

We are unconvinced that the marginal benefits potentially realised by extending the Market Abuse Directive's scope beyond regulated markets (specifically Multilateral Trading Facilities) would be justified given the large amount of disruption and expense the regulated community would experience as a result. In addition, we do not consider there to be sufficient clarity behind any existing concerns the Commission may have with behaviour in context of MTFs.

A distinction should be made between, on one hand the pan-European equity trading platforms operated by Market Operators and Investment Firms and on the other those junior / growth markets operated by the Market Operators.

Pan-European Equity Trading Platform MTFs:

We consider that pan-European equity trading platform MTFs are effectively covered by existing MAD requirements, and an explicit inclusion would prove burdensome for regulated firms without providing any additional benefit in terms of reducing market abuse. It is essential secondary markets possess the ability to oversee secondary trading, which allows the competent authorities of Europe to detect cases of market abuse, especially given that the 'non-regulated' MTF markets are intended to be genuine competitors to regulated markets. However, this ability already exists. These MTFs will typically be set up to compete with a Recognised Investment Exchange (RIE), providing an alternative trading venue for shares admitted to trading on a Regulated Market. The securities traded on the MTF therefore, will already be subject to the relevant provisions within the Market Abuse Directive. The operators of the MTFs are themselves regulated, and are also obliged to monitor transactions on their systems for potential market abuse, reporting any significant rule breaches or potentially abusive trading (Article 26 Level 1 MiFID).

Junior / Growth Market MTFs:

Junior / growth market MTFs operated by market operators offer small and mid-size companies the opportunity to access capital markets without having to fulfil the same extensive suite of requirements that Regulated Markets are subject to. Indeed, these requirements which would ultimately prove too costly if imposed on these smaller firms. We consider it to be important that if any new requirements are placed on the junior / growth market MTFs, they are done so in a proportionate manner that recognises the specific characteristics of these markets. A 'one-size fits all' would be inappropriate.

Whilst currently MTF share markets do not explicitly fall within the scope of EU market abuse regime, the FSA – at the time of implementation – did opt to bring both AIM (operated by the London Stock Exchange) and PLUS (operated by PLUS Markets) quoted shares within the scope of the UK domestic regime. Therefore, if the European Commission did opt to explicitly include Multilateral Trading Facilities in MAD, we would encourage it to use the UK model as a blueprint for such an extension. The FSA and the

UK Treasury have sought to recognise the differences between prescribed markets and trading venues offered in the UK via the Prescribed Markets regime. This provides a proportionate, flexible regulatory framework, which enables small and medium sized companies to access to capital cost-effectively.

In practice, such an extension would also require a centralised list of MTFs to be produced. Competent authorities from each Member State would also need to resource themselves for potential further enforcement actions, as responsibility for enforcing cases of abuse would presumably shift from individual markets to competent authorities.

2.1.2. What kind of financial instruments should be covered by the MAD, especially in comparison with the MiFID? (Article 1(3) of Directive 2003/6/EC)

Questions: Do you agree with an alignment of the MAD definition of financial instrument to the definition for the same concept provided for in MiFID? Do you think it could be useful to explain in more detail in the MAD what is meant by a financial instrument "whose value depends on another financial instrument" or to list asset classes, such as CFDs and CDS, which belong to this category?

It is the view of our membership that the MiFID list of financial instruments is already substantially covered by the existing MAD requirements, and therefore, we remain unconvinced of the need to explicitly align the MAD definition of financial instrument with the definition for the same concept within MiFID. Market manipulation by the dissemination of false or misleading information relating to financial instruments "whose value depends on another financial instrument", even if the instrument used is itself not admitted to trading on a regulated market, is covered – and can therefore be sanctioned – under the Market Abuse Directive. Furthermore, by explicitly listing separate asset classes that are within scope of MAD, the regime risks being outpaced by financial innovation. As such, it is imperative the MAD definition retains the reference to financial instruments 'whose value depends on another financial instrument'.

We would, however, consider it useful for the Market Abuse Directive to explain in more detail, and perhaps with practical examples, what is meant by a financial instrument "whose value depends on another financial instrument". This clarification will help to promote further harmonisation in the application of the Market Abuse Directive throughout Europe.

We consider that financial Contracts for Difference (CFDs) are within the scope of the Market Abuse Directive. Despite the fact they are not admitted to trading on a regulated market, their value is clearly dependent on other financial instruments that are, given that their value is referenced to that of the underlying share or index. Furthermore, we would like to highlight that the UK FSA has taken enforcement action with regard to a short position established through a Contract for Difference entered into on the basis of inside information². This again, suggests that the current MAD definition of 'financial instrument' is sufficient, and does not need to be aligned with the same concept within MiFID.

We also consider that Derivative instruments for the transfer of credit risk, commonly known as Credit Default Swaps (CDS), are subject to MAD. The most commonly used forms of CDS contracts provide that on the occurrence of a credit event, the credit protection buyer can choose to deliver a publicly traded security or can receive a cash difference which is arrived at by reference to the price of such a security. It is therefore

² John Shevlin, 1 July 2008 - http://www.fsa.gov.uk/pubs/final/john_shevlin.pdf

apparent that the payout of the CDS will be closely correlated to the price of the security of the issuer. Since the introduction of MAD in the UK it has been standard industry practice to assume that MAD provisions do apply to typical Credit Default Swaps that include publicly traded securities as deliverable obligations (or as reference obligations).

Question: *Do you see a need for introduction of a market abuse framework for physical markets?*

Whilst we agree that there are strong interactions between physical and financial commodity markets, we remain unconvinced that a case has been made to broaden the scope of MAD to explicitly include physical commodities. The Market Abuse Directive was not designed with physical commodity markets in mind. The purpose of the commodities market is primarily commercial and not speculative. It is our view that issues of market abuse in the physical commodities market would be better addressed through a separate, tailored framework, and not through MAD. Furthermore, there is a question as to whether financial regulators are the correct agents to regulate European commodity derivatives markets. Would it not be more appropriate for this responsibility to lie with national bodies (for instance, the Gas and Electricity Markets Authority and Ofgem in the case of the UK)? If regulation is left to such bodies, we accept the need for cooperation and information sharing arrangements between financial regulators and those responsible for regulation of physical markets.

There are ample examples of market abuse involving physical commodities that are already covered by the Market Abuse Directive. European regulators have in the past suggested that, while transactions in a commodity futures contract would fall within the scope of the provisions implementing the Directive, transactions in the underlying commodity would not. For example, if someone has taken a specific position in a commodity futures contract the actual transaction would fall under the scope of MAD. However, it has not always been clear whether it would fall within the scope of MAD if the same individual interfered in the physical commodity market (by limiting supply of the physical commodity) in order to squeeze the related commodity futures contract they hold. It seems very likely that the provisions of the Market Abuse Directive relating to market manipulation apply both to transactions in the instrument admitted to trading on the regulated market (the commodity future) and the underlying commodity, if the interference has the specified effect on the regulated market in question. Unlike the provisions on insider dealing, the relevant provisions are not expressly restricted to dealings in the specified kinds of financial instrument, but merely refer to "transactions or orders to trade" without qualification. (Compare article 1(2) (a) and article 2(1) of MAD).

2.2. INSIDE INFORMATION

2.2.1. Definition of inside information: the general definition (Article 1(1) of Directive 2003/6/EC and Article 1 of Directive 2003/124/EC) and the particular definition for commodity derivatives

Question: *Do you share this view as far as insider dealing prohibition is concerned? (see also next point for disclosure of inside information). If not, which concepts would you advise to modify and how?*

We do not seek any changes or revisions to the concepts used in defining 'inside information' for the purposes of MAD. It is perhaps true that the open nature of MAD's definition of 'inside information' can sometimes raise difficulties in market participants' interpretation. However, we concur that increasingly as a result of competent authorities' publicised enforcement action, and developing jurisprudence in this area, market participants have a sufficient, and increasing understanding of how the definition's concepts (precise nature of information and information which if it were made public, would be likely to have a significant impact on price) limit 'inside information'.

We agree with the European Securities Markets Expert Group's (ESME) conclusion that the definition of 'inside information' works well as a test for whether an individual in possession of such information should use that information as a basis for decisions on whether or not to trade. However, we consider that it should be made clear that the provisions of article 1(2) of Commission Directive 2003/124/EC³ have not displaced the requirement that information can only constitute 'inside information' if it would be likely to have a significant effect on price if made public.

It is our understanding that the UK Financial Services Authority has been actively lobbying the European Commission to consider including certain national superequivalences of the UK market abuse framework into the EU Market Abuse Directive. The superequivalences include:

- the concept of 'relevant information not generally available' ('RINGA'), which is wider in scope than 'inside information' (which has a prescribed meaning); and
- the 'behaviour' principle which can capture market abuse through inaction (e.g. failure to correct information that gives a false or misleading impression), as opposed to MAD which requires some positive action (e.g. dealing, effecting trades, disseminating information etc.)

The UK Treasury consulted in February 2008 as to whether or not it should renew the aforementioned superequivalences (which were implemented in the form of sunset clauses). However, it concluded it would renew them until 2010 on the basis of the possibility the European Commission would implement post-MAD review changes to the definition of 'inside information' to accommodate a RINGA-type distinction. In our response to this consultation⁴ we recommended that the superequivalences be left to expire. We would strongly oppose the introduction of these provisions into the EU Market Abuse Directive. There have been no cases of market abuse brought forward under any of the superequivalent UK provisions since the 2005 implementation of MAD. Furthermore, there has not been a single case of market abuse that could have been launched solely on the superequivalences since N2. Whilst several cases have been considered under the superequivalent provisions, they were withdrawn for evidential reasons.

Whilst market awareness of the UK superequivalences is high, we do not consider there to be a detailed level of understanding, in either their rationale or operational value. This creates an unnecessary complication to the UK market abuse framework, with HMT estimating the additional cost of compliance directly down to the superequivalences to be approximately £5 million per year across the industry. Furthermore, as much as 20% of advice relating to the UK market abuse regime purchased by UK authorised firms is

³ This provision states that "For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC, "information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative financial instruments" shall mean information a reasonable investor would be likely to use as part of the basis of his investment decisions."

⁴ <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=1568&a=13553&artpage=all>

spent looking directly at issues and uncertainties surrounding the superequivalences. The superequivalent provisions divert internal resource away from other purposes which could bring a larger impact in terms of reducing or detecting market abuse. The superequivalences would reduce the efficiency of the EU market abuse framework, rather than furthering the Commission's action plan to reduce administrative burdens on EU companies by 25% by the end of 2012.

The UK 'RINGA' superequivalent provision is accompanied by the FSA's 'regular user test'. In order for a specific action or behaviour to be classed as market abuse under RINGA, it must be shown that a 'regular user' of the market would regard the behaviour to fall below the standards reasonably expected of a person in their position within the prescribed market. Whether or not a regular user would deem a specific piece of behaviour based on 'relevant information' as unacceptable or not quickly turns to whether or not that piece of 'relevant information' is price sensitive. Price sensitive information is classed as disclosable under FSA 'Disclosure and Transparency Rules', and thus information of this nature would automatically fall within the scope of MAD.

Therefore, the FSA's 'regular user test' renders the RINGA superequivalence ineffectual. However, without a test such as this there would be very significant implications if a distinction between 'inside information' and RINGA was introduced into MAD; this would imply that an individual who reasonably ought to be aware they possess 'relevant information that is not generally available' is prohibited from dealing, regardless of whether or not the specific piece of information is disclosable to the market, or price-sensitive in nature. This would represent a hugely inappropriate expansion to the current EU market abuse regime. Whilst there have been case examples put forward by HMT of instances where the RINGA superequivalence apparently capture cases of market abuse where the MAD definition of insider information would not, our response to the original consultation⁵ questioned these applications with regard to: fixed-odds betting; the pre-briefing of analysts; underlying commodities; non-dealing off insider information; the source of insider information; and Credit Default Swaps.

Question: *Do you support an alignment of the inside information definition for commodity derivatives with the general definition of the directive?*

We do not seek an alignment of the insider information definition for commodity derivatives with the general definition of the directive. We believe that the definition of insider information for commodity derivatives is fit for purpose. In any event, many energy groups, etc, have listed entities within them, meaning the entities would be required to consider both regimes.

2.2.2. Dissemination of inside information and deferred disclosure mechanism (Article 6 of Directive 2003/6/EC and Article 3 of Directive 2003/124/EC)

2.2.2.1 General obligation of disclosure of inside information

Question: *Do you consider that any changes to the definition of inside information for disclosure purposes is necessary?*

⁵ <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=1568&a=13553&artpage=all>

We do not consider that any changes to the definition of insider information for disclosures purposes are required at this time. Our following answers do, however, suggest specific improvements to help tackle the deficiencies of the deferred disclosure mechanism that are cited within the Call for Evidence.

Question: *Do you agree that the described deficiencies of the deferred disclosure mechanism need to be addressed, possibly by way of amendments to the MAD framework? Do you consider that Level 3 guidance could be sufficient?*

Whilst we do not consider that any changes to the definition of ‘inside information’ for disclosures purposes are required at this time, we acknowledge that the described deficiencies of the deferred disclosure mechanism need to be addressed. Rather than a change to the definition of ‘inside information’, we believe the issues could be better addressed through amendments/clarifications to the proposed exemptions and the second level measures, especially given the third level measures are partly responsible for allowing Member States to adopt divergent practices. Level 3 guidance has no legislative support in some European jurisdictions (including the UK), and is accordingly not recognised by the courts as binding. It is of course, however, technically the decision the national regulator in question whether or not to adopt the guidance as its own.

Question: *Do you agree that the issuer may be exempted from disclosing inside information in situations when that information concerns emergency measures being prepared in case the issuer's financial stability is endangered?*

Under general conditions we would suggest maintaining the same broad definition of ‘inside information’ for both dealing and disclosure restrictions. Any problems experienced by issuers relating to the broad nature of the definition could be dealt with by ensuring that the appropriate carve outs and disclosures are present within the Market Abuse Directive. We would, for instance, support a specific carve out that allowed for delayed disclosure of ‘inside information’ by issuers in cases where emergency measures were actively being put in place, and disclosure of these measures would put at risk their outcome, and endanger the financial stability of the issuer. This point is particularly pertinent in relation to financial services firms and other issuers that are systematically important for financial stability.

2.2.2.2 Disclosure duty in commodity derivatives markets

Question: *Do you agree with this approach? Can you identify cases where a modification or deletion of the obligation may be undesirable for market integrity?*

We agree with the proposal to revisit the existing approach towards the obligation to disclose insider information in respect of commodity derivatives, but as the commodities market covers a wide range of different products and practices we ask that these differences be taken into account and that the Commission does not seek to impose a ‘one size fits all’ approach.

2.2.3. Prohibition of insider dealing (Articles 2, 3 and 4 of Directive 2003/6/EC)

Question: *Would you support this approach?*

We have been studying with great interest developments in the Spector Photo Group NV and Chris Van Raemdonck v CBFA case, currently residing with the European Court of Justice (ECJ). This case will examine the different interpretations of 'using' inside information, and consider if a market participant in possession of inside information who trades (or attempts to trade) in securities relating to the piece of information is automatically in a breach of the insider dealing prohibition. We agree with the European Commission's approach to await the outcome of the aforementioned case (the ECJ preliminary hearing) before proposing measures that would seek to clarify the apparent divergence in national interpretations of the insider dealing prohibition. However, we would request that this matter is addressed as soon as is possible.

We strongly consider that the concept of trading "*on the basis of*" inside information should remain, in respect of the insider dealing prohibition. Without this, the prohibition could be detrimental to market efficiency. We strongly consider that the concept of "using" inside information necessarily implies something more than mere possession coupled with the fact of a trade. Recital 30 of the MAD indicates that what is significant is the decision to trade, not the carrying out of the trading. There must be some taking advantage of the possession of the information – the information must be the reason for, or a material influence on, the decision to trade. The responsibility of distinguishing between innocent trades whilst in possession of 'inside information', and those trades actually made on the basis of 'inside information', should lie with the national regulators who can take into account all relevant circumstances surrounding a trade. In our view, the fact that there is no presumption of use of inside information through mere possession does not prevent a competent authority from seeking to draw inferences from the evidence available. For example, a competent authority may be able to demonstrate that a person's decision to trade was based on 'inside information' through the absence of any evidence of research or previous similar trading patterns on the part of the person concerned, or through the timing of the trade/s.

Any alternative interpretation of the above would impair market efficiency. It is for this reason that Recital 18 advocates that the pursuit of legitimate market-making business and the lawful execution of orders (while in possession of inside information) should not in itself be deemed to constitute use of such inside information. We also note the carve out in Recital 29 which provides that the use of inside information relating to another company and using it in the context of a public take-over bid for the purpose of gaining control of that company or proposing a merger with that company should not in itself be deemed to constitute insider dealing.

2.2.4 Three new tools to help to detect suspicious transactions

2.2.4.1 Insider lists (Article 6(3) of Directive 2003/6/EC and Article 5 of Directive 2004/72/EC)

Question: *Do you consider that the obligations to draw up lists of insiders are proportionate?*

No. We do not consider that the current obligations to draw up lists of insiders are proportionate. The UK requirements for insider lists are proportionate and thus do not place an undue administrative burden on authorised firms. There is, however, a distinct divergence between the various competent authorities of Europe, whereby some respective authority's requirements are unnecessarily bureaucratic and burdensome, creating difficulties for international firms.

It is important that insider lists are viewed in the context of their objective. They are used to provide a 'first instance' tool in market abuse inquiries, where the Member State regulator in question can then, without prejudice, request additional information from the issuer if necessary at a later stage. Competent Authorities should continue to view insider lists as such, and not as a replacement for a forensic enforcement investigation.

The BBA and ICMA collectively supported CESR's proposals for a system of mutual recognition of Member States' insider list requirements. We also welcomed CESR's recommendation that "for issuers subject to the jurisdiction of more than one EU or EEA Member State with respect to insider list requirements, the relevant competent authorities should recognise insider lists prepared according to the requirements of the Member State where the issuer in question has its registered office". This recommendation has gone some way to reducing the administrative burden of the insider list requirement imposed upon those of our members who are internationally active.

We remain concerned by the uneven playing field that has developed across Europe in respect of the content of insider lists. From a UK perspective, institutions are only required to include the first name and surname of each individual included in an insider list, except in the case where more than one individuals on the same list have the exact same name. This approach is consistent with CESR's notion of insiders' lists as a 'first instance' tool in market abuse investigations. Further details of individuals on the insider list can then be gathered at a later stage, should a regulator submit such a request.

There is a distinct lack of convergence between the various competent authorities of Europe, which is seemingly caused by different regulators having varying views on what constitutes evidence of identity. This in turn, has meant certain competent authority's requirements with regard to the content of insider lists are unnecessarily burdensome which creates difficulties for international firms. For example, certain supervisors require that the data to be entered for each individual insider must include their first and family names, date and place of birth, and their private and business addresses. We fail to see how this additional data will serve to enhance insider lists as a tool used to supervise the circulation of insider information. Nor do we consider it will significantly aid competent authorities in the process of investigating a potential case of market abuse.

Inconsistencies across Member States also create issues when individuals are placed on several insider lists in different EU jurisdictions. If an individual is simultaneously included in two different insider lists created in different Member States, with one list containing full personal details and the other just the individuals first and last name, it could not be said the individual in question is being treated in a consistent manner by the two different jurisdictions. Furthermore, too extensive insider lists can be questionable in respect of privacy protection. We therefore consider that information gathering in the context of insider lists should be subject to reasonable limits, which we consider to be the first and last name of the individual in question.

In light of this uneven playing field, our members believe that the competent authorities throughout the EU should apply a consistent approach in respect of what information is included within insider lists. CESR should propose a standard harmonised format for insider lists, which specifies the level of information required in line with the relevant

articles of the Directive. This would go some way to reducing the significant and costly duplication of time and effort for those issuers with listings in multiple jurisdictions. This would in turn, enhance the European single market.

Whilst we acknowledge CESR's recommendation that competent authorities recognise insider lists prepared by an issuer that is regulated in another EU jurisdiction, the differential requirements in member states about what constitutes evidence of identity still remains unhelpful for those firms who operate on a cross-border basis. This is because firms operating in several jurisdictions are likely to use a single, harmonised, Europe-wide approach to producing their insider lists – and consequently they tend to produce their lists in accordance with the most detailed requirements imposed on them as a single institution-wide solution, even if such a solution is not required by the majority of regulators whose supervision they are under.

2.2.4.2 Transaction reporting by managers and closely associated persons and subsequent disclosure (Article 6(4) of Directive 2003/6/EC and Article 6 of Directive 2004/72/EC)

***Question:** Do you see a need for a regulatory action in the above areas? Would you suggest further improvements?*

We consider that the existing requirements are onerous and would welcome a reassessment of these measures.

2.2.4.3 Reporting of suspicious transactions (Article 6(9) of Directive 2003/6/EC and Article 7(11) of Directive 2004/72/EC)

***Question:** Do you agree that rules on suspicious transactions reporting do not require modifications?*

We agree that rules on suspicious transactions reporting do not require modification. Investment firms have properly assumed their obligation to report suspicious transactions. Banks operating within Europe are principally concerned that the business they engage in, or potentially engage in, is both legal and within the scope of the rules. Our members want clean markets within which to operate, and are the FSA's - or indeed any other relevant competent authority's - greatest partners in the prevention and detection of market abuse.

2.2.5. The competent authorities' right of access to telephone and existing data traffic records (Article 12 of Directive 2003/6/EC)

***Question:** Do you consider that an amendment of the MAD is necessary?*

From a UK perspective, we do not consider that it is necessary to amend the Market Abuse Directive to remove uncertainties on the rights of competent authorities to require traffic data. We note that the Data Retention Directive (2006/24/EC) requires communications services providers to retain traffic data for the purposes of the investigation, detection and prevention of serious crime.

2.3. MARKET MANIPULATION

2.3.1. Definition of market manipulation by transactions/orders to trade (Article 1(2) of Directive 2003/6/EC)

Question: *Do you think that the definition of market manipulation should be amended? If this is the case, what elements of the definition should be reconsidered?*

No comment.

2.3.2. Accepted market practices (AMP) (Articles 1(2)(a) and 1(5) of Directive 2003/6/EC)

Question: *Do you consider that the rules on accepted market practices should be amended in the MAD? Do you think there is room for greater convergence among competent authorities in this area?*

We would welcome the removal of any uncertainties and recognise that further level 3 work could assist in achieving greater harmonisation.

2.3.3. Exemption for buy-back programmes and stabilisation activities (Article 8 of Directive 2003/6/EC and Commission Regulation 2273/2003)

Question: *Do you consider that the safe harbours for buy-back programmes and stabilisation activities should be revisited? Do you think that greater convergence is desirable in the application of the Regulation 2273/2003? What would be the most appropriate way forward in this respect?*

We address this question from the perspective of the debt capital markets.

ICMA raised with the Committee of European Securities Regulators concerns regarding the Market Abuse Directive in three previous submissions⁶ of 31 October 2006, 3 December 2007 and (jointly with the BBA) on 9 January 2009.

Over this period, institutions involved in the primary debt markets have continued to invest substantial resources in understanding and adjusting to the MAD, including the current safe harbours under Article 8. These institutions have now got comfortable with the legal and regulatory subtleties involved, substantially helped by the recent CESR

⁶ <http://www.icmagroup.org/ICMAGroup/files/d3/d3e2907e-4410-454a-94b7-f965a22bd8b1.pdf>,
<http://www.icmagroup.org/ICMAGroup/files/f7/f7f8430f-6b31-4a51-bea3-9dc37452e959.pdf> and
<http://www.icmagroup.org/ICMAGroup/files/8e/8eaea504-3966-4a73-ab76-c8bf672168a9.pdf>.

guidance that activities falling outside the regime's safe harbours do not *per se* constitute market abuse (as well as CESR efforts regarding reporting processes).

In this context, some amendments previously sought to the MAD regime are no longer seen as being absolutely essential to market function. The reduced perceived potential gain of such amendments is now felt to be outweighed by the risk of unexpected new uncertainties resulting (even if just temporarily) from new legislation – notably because of the anticipated expense in developing an understanding of the changed legal and regulatory subtleties involved. Consequently, whilst the underlying substance of the previously expressed concerns endures, some such concerns are not repeated in this response.

We do not consider that the safe harbours should be revisited.

The current safe harbour is helpful for stabilisation transactions and should be maintained. Though over-allotments beyond 5% do at times occur when necessary, we do not however believe that any particular higher threshold would be meaningful.

We believe that greater convergence is desirable in the application of the Stabilisation Regulation. The December 2007 submission detailed (see box 1) the challenges arising from discrepancies between the simultaneously applicable jurisdictions of many Member States and thoughts as to the most appropriate way forward in this respect (namely application of a single 'home' Member State's jurisdiction). In the January 2009 submission, we stated that, given the MAD regime's objective of harmonising stabilisation practices across the 27 Member States, either its provisions should be applied uniformly across Europe or only one 'home' Member State's regime should apply. We sought CESR support for any Commission moves to amend the MAD in respect of the latter approach (detailed on pages 3/4 of the December 2007 submission). In its 15 May feedback statement, CESR indicated that it continues to believe that uniform application is best addressed by CESR's ongoing work in reducing discrepancies between CESR members. Whilst this is an important task, where CESR has made substantial progress in the six years since the MAD was adopted, many Level 3 discrepancies continue to subsist (we detailed several in the January 2009 submission – see box 2). Whilst such inconsistencies seem to be presenting less of an obstacle than previously, the 2008 reduction of market activity may be contributing to this impression. The December 2007 submission noted that an amendment to the MAD or the Stabilisation Regulation would not appear strictly speaking necessary to give effect to the 'home' Member State approach (as it can be interpreted from the current text). CESR's decision to focus on reducing discrepancies leaves express confirmation of this approach in an amendment to the Stabilisation Regulation as the preferable option.

The issue of greater convergence similarly extends to the global level. In this context, the issues relating to stabilisation overlap with the wider separate debate, which we do not pursue further here, of regulatory recognition potentially involving many jurisdictions – be it multilateral, bilateral and also even unilateral (and not necessarily involving 'equivalence' of verbatim individual 'output' rules). In our January 2009 response, we suggested that the welcome recent CESR guidance, that activities falling outside the regime's safe harbours do not *per se* constitute market abuse, be confirmed to cover stabilisation activity outside the Directive's safe harbour but complying with US or other countries' stabilisation rules. In this respect CESR reiterated its commitment to work to minimise divergence, with its formal guidelines⁷ expressing CESR to be "hopeful" that its above-mentioned guidance might contribute to a resolution of this concern. The guidelines acknowledge that certain inconsistencies would likely remain and refers to the

⁷ <http://www.cesr.eu/popup2.php?id=5727>.

possibility of achieving further convergence as part of the ongoing dialogue between the EU and US authorities. We hope the Commission will be able to progress such dialogue in time to include any related conclusion in its forthcoming amendments to the MAD regime. By way of illustration, certain examples of divergence between the MAD and US regimes were included in the January 2009 submission and are repeated in box 3.

Box 1 – single ‘home’ Member State jurisdiction

In cross-border transactions, stabilisation may be caught by several Member States’ regimes.

In international debt issues, it is common for an issue of securities admitted to trading on a regulated market in a Member State A to be aimed primarily at investors in Member States B, C and D and to be actually stabilised from a Member State E. The Market Abuse Directive does not designate one Member State as responsible for market abuse aspects of a particular transaction. On the contrary (and quite rightly), each Member State is required to police any conduct carried out within its territory or which concerns financial instruments admitted to trading on its territory. Similarly, the Stabilisation Regulation does not specify the Member State responsible for policing the stabilisation regime (i.e. it does not specify which Member State’s rules apply to the permissibility of stabilisation, form and content of notifications to the competent authority and method of disclosure to the market, etc.). It does, however, provide that details of stabilisation transactions are notified only to the competent authority of the “relevant market.”

Stabilisation activity in a particular case may therefore fall to be regulated and supervised by several Member States at once. If their stabilisation regimes were uniform, this would not matter. In practice, however, they are often different or even inconsistent. The banks conducting the stabilisation are consequently exposed to a considerable legal risk because it is often not possible to comply with the regimes of all the Member States potentially affected. In addition to this legal uncertainty and risk, it increases time and effort required for the banks involved in a transaction to investigate the applicable law, agree on the logistics of the stabilisation and co-ordinate it.

It would therefore be very helpful if the Member State effectively responsible for regulating stabilisation was specified. The Stabilisation Regulation provides that details of the stabilisation transactions are notified only to the competent authority of the “relevant market”, i.e., the competent authority of the Member State where the securities are (to be) admitted to trading on a regulated market. It seems a logical conclusion that this Member State should be the Member State whose stabilisation regime (permissibility of stabilisation, form and content of notifications and method of disclosure) should be followed. If the requirements of the law of this Member State were followed, other Member States should recognise that the stabilisation activity is legitimate and not abusive of itself – even if it did not accord with their interpretation and application of the Stabilisation Regulation.

Although much depends on details (the policy would, for example, have to consider issues admitted to trading in several Member States), such an approach would constitute a clear and unambiguous solution, which would also be consistent with other EU securities directives.

Box 2 - Ongoing national discrepancies⁸

The concept of "adequate public disclosure" has been raised as a specific notable inconsistency. For practical purposes in Germany and Austria for example, there are specifically print media (as opposed to electronic/RIS/newswire media) publication requirements. This means that stabilisation disclosures are subject to printed press publication timelines (overnight print runs). Consequently, the stabilisation trades needed to immediately address unexpected market disturbances will be delayed to the following day. In this respect, we refer to our response below on the use of TD information dissemination and storage mechanisms.

National inconsistencies in the implementation of the Directive have created considerable variations between market participants in the interpretation and application of stabilisation guidelines. Some firms do not publish pre or post stabilisation notices, others will disclose if the stabilisation was greater than 5% of the initial offer size, whilst others will disclose all stabilisations irrespective of size. There is also considerable disparity in the treatment of ancillary stabilisation/over allotment facilities. These practical differences can be problematic, particularly in issuances involving multiple book-runners/joint lead managers. Greater consistency and direction from national regulators on stabilisations (what constitutes a stabilisation, when is a disclosure necessary and to whom and how should the disclosure be made?) would be most helpful.

In Spain, the CNMV as competent authority requests the removal of stabilisation legends from offering documents. The stabilisation safe harbour under the Market Abuse Directive should be recognised by retaining this legend. The CNMV is an example of a competent authority where publication of an email address or fax number for stabilisation transaction reports (as envisaged under 'Reporting mechanisms') would be welcome.

Box 3 - Examples of divergence between the MAD and US regimes

Some specific differences in approach that we are currently aware of in the context of the US's 'Regulation M' regime are:

- different scope of the regimes, with the US regime being generally focused on conduct before the completion of the offering and the EU regime on the conduct in later stages;
- different rules on the pre-stabilisation disclosures; and
- absence of a limit on over-allotments in the US stabilisation regime.

Furthermore, given the time difference between Europe and US, it will often not be possible for prestabilisation disclosures made during the latter end of New York's working day to be effective, under the EU regime and within the short timetables intrinsic to the stabilisation process, as EU regulatory news services will have closed for the night.

⁸ Note: CESR announced, in its 15 May feedback statement, measures it is intending to take to address the "adequate public disclosure" issue referred to in the first paragraph.

2.3.4. Short selling

The BBA has engaged heavily with the UK FSA on the subject of short selling. In addition to our answers below, you may wish to refer to our response to FSA DP 09-01: Short Selling⁹, which discusses many of the issues touched upon in this Call for Evidence.

Question: *Do you see a need for a comprehensive framework for short selling? If so, should it be addressed in the Market Abuse Directive? What issues should such a regime cover?*

We consider it inappropriate to seek to regulate short selling through the market abuse regime, both in respect of emergency interventions in times of market fragility, and also with regard to any permanent disclosure regime. We consider that manipulative conduct associated with short selling is amply covered by the existing regime.

In light of the recent controversy surrounding short selling, and in the context of the global financial crisis, it should be borne in mind that conceptually short selling is no different to a firm going long on a particular stock – and yet there are no prominent concerns raised when investors speculate that the price of a stock will rise. Restrictions or bans on short selling will increase the cost of risk management and potentially adversely impact market efficiency. The ability of firms to offer downside protection to their clients is dependent on them being able to hedge their positions with other participants in the market. It has a legitimate role to play in the market and is a useful financial tool. Short selling aids price formation – that is, it helps to more quickly correct overvalued securities, and provides additional liquidity to the market in times of significant short-term demand, helping to smooth out pricing peaks. It is also generally agreed that short selling helps to enhance liquidity and cut spreads.

Whilst we agreed with the implementation of temporary short selling measures that were put in place in 2008, the short notice period and lack of either European, or international coordination imposed a considerable strain on market participants, especially those operating in multiple jurisdictions. Regulated firms faced a situation whereby they were immediately made subject to specific temporary short selling measures that diverged greatly across different Member States. The measures lacked clarity with regard to both scope and exemptions.

We would therefore, strongly encourage any steps that could be taken to create a more harmonious application of short selling requirements (including future temporary measures) across jurisdictions, if not globally then within the EEA. Currently firms manage a multiplicity of dissimilar requirements on a country by country basis, notwithstanding that ostensibly they are all intended to create the same effect, i.e. prevent market abuse. Inconsistencies are the main cause of costs incurred to market participants.

Considering the international dimension of markets and that both CESR & IOSCO are carrying out work in this field, we would prefer any measures to be closely coordinated with European & Global authorities, in order to avoid the confusion and extra cost we have experienced since the implementation of the various measures in the field of short selling. We would stress the need for international consistency. Issues such as consistent reporting thresholds and deadlines, reporting on a fully netted, single level group position, and consistent reporting scope are creating cross border difficulties.

⁹ <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=155&a=15964>

Within the EU, some regulators now appear to be making their own considerations as to what disclosure requirements to implement.

Question: *Should short sellers be required to report positions to competent authorities? Under which conditions should naked short selling be allowed? Should competent authorities be able to take emergency measures (e.g. temporary bans on short selling or on naked short selling) within prescribed limits when they need to address specific market risks and disruptions?*

Short Selling Disclosures

General:

Given the temporary nature of the current disclosure obligations implemented throughout Europe as well as the revised regime contemplated by EU regulators, resourcing /costs are unbudgeted and met by the reallocation of headcount engaged in other activities. In the event that a permanent regime is implemented; additional costs will be incurred to manage disclosure obligations via a fully automated systems solution as opposed to the current processes which include some manual elements.

Costs vary significantly depending on the complexity and size of a firm. Automation is currently out of question due to the jurisdictional inconsistencies, with which IT systems alone cannot cope, without heavy manual intervention. It has to be emphasised that it is not just the reporting work that should be taken into account but also the time spent on collating data from different sources, analysing it and working out net economic short positions.

If the Commission intends to make short-selling notifications a more permanent requirement a major upgrade of the banks' monitoring tools would be needed to meet this demand. At first glance the business review and budgetary implications of such an exercise would most likely be very significant. We do not agree with multi layered disclosure of short positions. The simpler the regime, and the more widely & consistently it is applied across Europe, the better.

We are, however, unswerving in our view that the regulatory responsibility to report should lie with the ultimate holder of the position. As outlined in IOSCO's paper on 'the regulation of short selling'¹⁰, it will be impossible for the bank / broker to be aware of the full position of its clients. It is extremely unlikely the client will reveal its full financial position to an intermediary. This is particularly pertinent given the focus on net reporting (see below).

Net or Gross:

Any changes to short selling regulation, especially the imposition of new disclosure obligations, must seek to promote reporting and disclosure of information that is useful and usable by market participants and investors. We believe that careful consideration should be given to how the disclosure regime around short selling can be improved, i.e. what are the objectives of enhanced disclosure, what information is useful and usable, and how information can contribute towards price discovery and achieving an efficient market.

¹⁰ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD289.pdf>

Our members would support the reporting on a net rather than gross basis. Gross reporting will create a lot of 'white noise', that is actually representative of hedging or client facilitation. However regulators will have to consider whether this should be done on a legal entity or a group basis. We would urge the EC to be mindful that group-wide reporting will limit the timescale for reporting to T+1 as an absolute minimum. This limit is due to the intricacies of netting out, on a group-wide basis, the overall position. We agree that reporting should be timely and consider that T+1 is probably the most appropriate point.

Disclosure Bands:

We are of the view that a banded approach to disclosure should apply in conjunction with a minimum threshold. We would consider 0.1% of issued share capital as the appropriate banding. We agree that there should then be additional disclosure for every 0.1% gradation in position. The benefits of consistency and simplicity for the market are significant.

Naked Short Selling

In some jurisdictions outside the EU, notably the US, there has been a problem with failed trades in relation to naked short selling. It is our view that this has not been a significant problem in the UK or the wider European economic area. As such we do not consider that additional and distinct measures are necessary to deal with naked short selling. There seems to be a particular focus on naked short selling. It is our position that additional restrictions on naked short selling would not significantly alter the impact of short selling behavior in the market. We consider that if a market participant has a 'reasonable expectation' that they will be able to settle their position; they should be allowed to enter the trade initially uncovered.

Emergency Measures

We agree that competent authorities should have the ability to take action in extreme circumstances to alleviate threats to orderly markets. We would envisage that competent authorities should consider the trade-off between restriction of financial markets and the concomitant loss in efficiency. This does not imply that any perceived blip in the functioning of the market should result in strident regulatory action.

Short selling promotes market efficiency and enhances the competitiveness of financial markets. Therefore, it is important for competent authorities to create regulatory frameworks that both maintain the highest levels of market integrity and investor confidence, without hobbling the price formation mechanism. Notwithstanding the benefits of short-selling in normal market conditions, we recognise that particularly financial stocks are in a unique position systemically and in times of extreme market volatility short selling may result in a deterioration of financial institutions market capital and credit ratings, creating a downward spiral. Under such conditions, efforts to temper the decline in share prices may assist in promoting market confidence and mitigating systemic risk. It will be important that regulators remain vigilant and act decisively to prevent the crystallisation of such systemic risk.

However, any measures should, as far as possible, properly consider due process and the need to avoid hastily devised and ill-considered rules. Whilst we agreed with the implementation of the temporary short selling measures that were put in place in 2008, the short notice and lack of either European, or international coordination imposed a considerable strain on market participants, especially those operating in multiple

jurisdictions. Regulated firms faced a situation whereby they were made immediately subject to specific temporary short selling measures that diverged greatly across Member States and lacked clarity with regard to both scope and exemptions.

We would therefore, strongly encourage any steps that could be taken to create a more harmonious application of short selling requirements (including future temporary measures) across jurisdictions, if not globally then within the EEA. Currently firms manage a multiplicity of dissimilar requirements on a country by country basis, notwithstanding that ostensibly they are all intended to create the same effect, i.e. prevent market abuse. Inconsistencies are the main cause of costs incurred to market participants.

Market Makers:

We strongly consider that certain exemptions from short selling regulations should be applied to those acting in the capacity of a market maker. It is our view that defining the nature and extent of 'market making' may cause more problems than it solves. Short selling is part of the suite of tools that market makers use to enhance liquidity / speed of execution. This kind of client facilitation is a widely recognised and accepted benefit. Even under the recent restrictions on short selling, there have been exceptions for market making activities. Any restrictions would either need to contain a similar market making exemption or instead lead to a significant loss of liquidity and therefore higher margins etc. in the trading of financial instruments.

Question: *Is there a need to enhance risk management by financial intermediaries and banks? Should investment firms and banks be required to have necessary arrangements in place to ensure timely delivery of financial instruments traded on own account or in the context of execution of clients' orders?*

We are of the view that the existing requirements with regard to delivery, and for settlement of failed trades, are fit for purpose and that there is no need for additional measures to deal with naked short selling. We consider that if a market participant is covered by a 'reasonable expectation' that they will be able to settle their position, they should be allowed to enter the trade initially uncovered. We also note that the FSA has in the past taken successful enforcement action under the market abuse regime in respect of short selling in circumstances where there were no appropriate plans for settlement of the resulting positions.

Our members would particularly oppose any restrictions on stock lending. We believe that stock lending is not an accurate proxy for short selling and it fulfills a number of valuable functions. Any restriction on stock lending would have knock on effects on clearing & settlement. It is our view that restrictions on stock lending represent a very blunt instrument for dealing with any issues around short selling.

Securities firms and their customers depend on the ability to borrow securities to hedge risks and to arbitrage price differentials across markets. The extent of this arbitrage has an important effect in increasing the efficiency of market prices and in increasing the linkage between securities markets and other markets, such as associated futures and options markets. Short positions are often taken to hedge positions in equity derivatives related to share indices. Without a liquid securities borrowing market, traders would be unable to keep the value of the index contracts in line with the prices of the component

shares by arbitraging between them. Liquidity in the futures contracts would thus deteriorate.

Only a fraction of securities borrowing is used to cover short sales by investors with a simple directional view that a share price will fall. Much more commonly, securities are borrowed to cover short positions taken to hedge long positions in a share or a related instrument. Market Makers, for example, will enter into short positions to hedge long positions taken when they buy shares from clients. Their ability to provide liquidity to clients relies on a well functioning share borrowing market. Many securities are borrowed to facilitate arbitrage strategies, such as convertible bond, merger, statistical or index arbitrage strategies.

There are other legitimate reasons for stock lending. Firstly, short positions will arise as a result of failed settlement. If shares were not made available for borrowing, chains of failed trades would be common, as market participants would be unable to deliver shares themselves because other counterparties had failed to them. Securities lending has already been an important element in shortening settlement cycles and helping to avoid settlement failures. Secondly, financing drives many transactions, particularly in the markets to borrow G-10 government bonds. For example, in the so-called 'collateral upgrade' trade, a bank might borrow G-10 government bonds against equity or high-quality corporate bond collateral with the intention of using those bonds, in turn, to raise cash in the government bond REPO markets.