Alternative Investment Management Association

EUROPEAN SECURITIES AND MARKETS AUTHORITY
103 Rue de Grenelle
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75007
France

Submitted online at: www.esma.europa.eu

31 March 2016

Dear Sirs,

AIMA Response to ESMA Consultation Paper Draft Guidelines on the Market Abuse Regulation

The Alternative Investment Management Association (**AIMA**)[1] welcomes the opportunity to respond to the European Securities and Markets Authority (**ESMA**) Consultation Paper 'Draft guidelines on the Market Abuse Regulation' (**the Consultation**).[2]

AIMA is supportive of the implementation of robust rules to combat and penalise persons engaging in market abuse in all of its forms. We consider, nonetheless, that it is important for proportionality to be maximised and for *bona fide* activities that are fundamental to the functioning of EU capital markets to be able to continue. The regime for market soundings under Article 11 of MAR[3] is invaluable to this functioning of capital markets in light of the MAR regime - helping issuers and secondary offerors assess market sentiment and set an efficient price and volume of a particular issue or transaction.

AIMA is generally supportive of the draft guidelines contained within the Consultation Paper (**the Draft Guidelines**). However, AIMA's substantive comments within our response below focus on the draft guidelines for market sounding recipients (**Draft Guidelines for MSRs**), rather than on the draft guidelines for issuers' legitimate interests in delaying disclosure of inside information and the circumstances where a delay is likely to mislead the public.

AIMA is pleased to say that many of the safeguards dealt with by the Draft Guidelines for MSRs are already established industry practices amongst our hedge fund manager members. This includes: the undertaking of a robust 'own-analysis' as to whether information forming part of a market-sounding is 'inside information'; the maintenance of relevant internal procedures for distributing information received amongst internal staff on a strictly 'need-to-know' basis; and recordkeeping to enable effective proof of compliance with relevant inside information rules upon a supervisory visit or other investigation by a competent authority.

We, nonetheless, suggest that ESMA's final guidelines (**the Final Guidelines**) should take greater account of existing industry best practices for MSRs that are effective and efficient at preventing offences relating to the possession of inside information. We are concerned that additional prescriptive operational requirements would simply increase MSR costs whilst providing no commensurate benefit towards fulfilling the objectives of MAR which should already be med by existing MSR best practices. This is most relevant in the context of Draft Guideline 6 of the Draft Guidelines for MSRs which proposes that all MSRs maintain lists of internal persons in possession of the information passed in the course of market soundings.

[1] Founded in 1990, the Alternative Investment Management Association (AIMA) is the global representative of the hedge fund industry. Our membership is corporate and comprises over 1,500 firms (with over 9,000 individual contacts) in more than 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than $1.5 trillion in assets. See www.aima.org.

[2] Available online: https://www.esma.europa.eu/sites/default/files/library/2016-162.pdf

[3] Article 11 of MAR will deem information passed in conformity with the relevant conditions to have been passed in the course of a person's employment, profession or duties for the purposes of Article 10 of MAR, thus not subject to the offence of unlawful disclosure of inside information under Article 14 of MAR

For many firms with already robust mechanisms for dealing with the internal communication of information to prevent the breach of Articles 8 and 10 of MAR, the introduction of Draft Guideline 6 would simply consume additional compliance resources without providing a commensurate benefit to the regulatory objectives. AIMA believes strongly that it would not be appropriate to introduce a universal obligation for all firms to maintain such lists, although we recognise that the voluntary maintenance of lists by an MSR should count towards the latter's compliance with the internal procedures and staff training obligations under Draft Guideline 5.

AIMA recommends that the Final Guidelines avoid transforming the process of receiving market soundings into a box-ticking exercise. We urge ESMA to ensure that the Final Guidelines preserve MSRs' incentives to develop their own tailored procedures and processes to best minimise the possibility that they inadvertently use or unlawfully disclose inside information in contravention of MAR, at all times taking account of the idiosyncrasies of each MSR's structure and business activities. We believe that prescriptive 'one size fits all' obligations should be avoided.

We elaborate on our position in the Annex to this letter.

If you have any questions or would like to discuss any aspect of our response further, please contact Oliver Robinson (orobinson@aima.org) or Adam Jacobs (ajacobs@aima.org).

Yours sincerely,

Jiri Król,
Deputy CEO, Global Head of Government Affairs,
Alternative Investment Management Association (AIMA)

Annex

Q1: Do you agree with this proposal regarding MSR's assessments as to whether they are in possession of inside information as a result of the market sounding and as to when they cease to be in possession of inside information?

AIMA agrees with this proposal.

Q2: Do you agree with this proposal regarding discrepancies of opinion between DMP and MSR?

AIMA agrees that this proposal, whereby discrepancies are notified by the MSR to the DMP only when the former deems information to be inside information and the DMP does not, is more proportionate than obliging the MSR to inform the DMP of discrepancies on each and every occasion the MSR disagrees with the DMP bearing in mind the regulatory objective of preventing the unlawful disclosure of inside information and the likelihood that the DMP would subsequently inappropriately disclose the same inside information to other MSRs.

However, we have certain concerns that such notifications could still introduce disproportionate risks of inadvertent and unnecessary dissemination of inside information. AIMA notes that a DMP will have its own highly specialised processes for assessing information contained within a market sounding. Therefore, assuming that the MSR's assessment is correct, for an MSR to successfully change the DMP's opinion it would have to provide a robust set of reasons explaining and justifying its conclusion, thus introducing risks of the inadvertent and unnecessary dissemination of sensitive information.

Overall, AIMA supports MSRs undertaking and recording their own assessments of information passed during a sounding, but we believe that the overall objective should be to minimise the communication between the MSR and DMP to minimise the opportunities for inadvertent or deliberate disclosure of inside information. In this regard, we note that DMPs are most often entities that professionally undertake market soundings. DMPs, therefore, are best placed with the necessary information and expertise to make the requisite assessments of information to be passed when compared to MSRs.

Q3: Do you agree with this proposal regarding internal procedures and staff training? Should the Guidelines be more detailed and specific about the internal procedures to prevent the circulation of inside information?

AIMA agrees with the Draft Guidelines on internal procedures and staff training.

Nonetheless, we do not believe that the Final Guidelines should be more detailed and specific. We believe that overly prescriptive rules should be avoided and that firms should be incentivised to implement their own well-tailored systems and processes to meet the regulatory objectives of MAR in the most efficient and effective way possible.

Q4: Do you agree with this proposal regarding a list of MSR's staff that are in possession of the information communicated in the course of the market sounding?

No, AIMA does not agree with this proposal.

Draft Guideline 6 proposes that for each market sounding, MSRs should draw up a list of the persons working for them that are in possession of the information communicated in the course of the market sounding. This was not included within the Discussion Paper.[4]

We recognise and support the objectives of Draft Guideline 6 to: (i) improve the internal management of information flowing from market soundings, (ii) allow MSRs to demonstrate

[4] Available online: https://www.esma.europa.eu/press-news/consultations/esma%E2%80%99s-policy-orientations-possible-implementing-measures-under-market

compliance with the insider information prohibitions; [5] and (iii) better enable competent authorities to reconstruct a series of events in the course of a possible investigation. However, AIMA strongly disagrees that a universal obligation for all MSRs to maintain lists of internal persons in possession of information for every market sounding received is a suitable or proportionate way to further these objectives. We would be even more concerned if the concept of an individual market sounding were to include each time a DMP contacts and MSR with any information, such that an individual list could have to be compiled by the MSR for every telephone call from a DMP rather than on deal-by-deal basis.

Superfluous in light of Draft Guideline 5

AIMA suggests, fundamentally, that the above objectives of ensuring the internal management of the flow of information resulting; allowing the demonstration of compliance with MAR; and reconstruction of information flow, are already covered by Draft Guideline 5 on internal procedures and staff training. We, therefore, believe that Draft Guideline 6 is superfluous to Draft Guideline 5 and would simply introduce unnecessary prescriptiveness within the Final Guidelines - increasing compliance costs for MSRs that should already have robust compliance processes in relation to their receipt of market soundings.

We note that some MSRs already voluntarily maintain such lists and believe that it should remain open for MSRs to maintain them, or to maintain them in certain particularly sensitive cases. However, AIMA believes that the voluntary maintenance of these lists should be viewed as contributing to the MSR's compliance with Draft Guideline 5 rather than the standalone obligation under Draft Guideline 6.

AIMA, therefore, recommends that Draft Guideline 6 be deleted, with any voluntary maintenance of insider lists by MSRs contributing to each MSR's compliance with Draft Guideline 5.

Insider lists not a panacea

AIMA believes that information possessor lists are not sufficiently useful as to justify their inclusion as a universal obligation for all MSRs. We are concerned that such lists are open to error and/or omission, such that a competent authority cannot rely upon them *prima facie* when investigating a particular MSR; instead needing to undertake its own extensive enquiries. For example, we do not envisage that the omission of an individual staff member from an internal list of information possessors would provide any persuasive proof of an MSR's compliance with MAR or any defence to an MSR should an action be brought for insider information offences. Conversely, AIMA would be highly concerned if an MSR were to be held in breach its MAR obligations solely by virtue of the fact that it had not compiled a deal-specific information-possessor list for a particular market sounding.

AIMA believes that competent authorities should consider each MSR's MAR compliance processes holistically, with the voluntary maintenance of such lists representing only one component of the overall management of information received in the course of a sounding.

We note that information-possessor lists could be beneficial to help reconstruct the internal flow of information. However, as we describe above, the ease with which inadvertent or deliberate errors can slip into such lists means the lists cannot be relied upon by either MSRs or competent authorities *prima facie*. It would, therefore, be disproportionate to introduce a standalone obligation to maintain information-possessor lists under Draft Guideline 6 separate to the general obligation for internal procedures and staff training under Draft Guideline 5. AIMA suggests that an MSR with robust internal procedures for the management of information in compliance with Draft Guideline 5 would often be able to reconstruct the internal flow of information upon a competent authority request in a no less reliable manner than had a deal-specific list be compiled *ex ante*.

[5] as is the mandate for ESMA to develop Level 3 Guidelines under Article 11(11) of MAR. To provide 'the steps that [MSRs] are to take if inside information has been disclosed to them to in order to comply with Articles 8 and 10 of [MAR]'.

Current mechanisms that meet the MAR objectives - e.g., the 'restrict-all' and 'information-barrier' models

As we describe above, AIMA contends that existing mechanisms already meet the regulatory objectives of MAR and Draft Guideline 6.[6] Such mechanisms will be employed to comply with Draft Guideline 5, thus we consider that Draft Guideline 5 alone is sufficient to meet the relevant objectives of MAR. We note that some MSRs may voluntarily maintain information-possessor lists as part of their overall compliance processes in line with Draft Guideline 5. These could be definite lists of persons known to have the information, as well as grey lists of persons who may have the information.

Mechanisms used by AIMA member MSRs when dealing with information passed during the course of a market sounding include the 'restrict-all' approach, as well as the 'information-barrier' approach.

In line with Draft Guideline 1, buy-side firms receiving a large number market soundings will often condition their DMP counterparties to direct any and all market soundings to a walled-off, independent compliance team that is the relevant 'contact point'. Such compliance teams are often physically segregated from the firm's trading and portfolio management functions.

Once a sounding has been received by the separate compliance team, the buy-side firm may employ a 'restrict-all' model which will restrict all trading (including personal account dealing) in all relevant FIs by all staff of the firm. This will occur before any non-compliance member of staff receives the information contained within the market sounding. Trading is only de-restricted once confirmation of the information being cleansed is disseminated.

When using this 'restrict all' model, the buy-side firm will often not construct or maintain any information barriers between individual portfolio managers, front office teams or business lines. Instead, the internal management of the flow of information resulting from market soundings is controlled by an experienced front-office member of staff. In line with Draft Guideline 5, this member of staff is responsible for the proper dissemination of information on a strictly 'need-to-know' basis within the firm's front office staff that are already all restricted from trading – both in directly and indirectly related instruments. This experienced front-office staff member will collate any internal demand for the relevant transaction being sounded and will be the conduit through which demand is passed back to the DMP. AIMA considers that the compliance focus of persons using this model should be ensuring that the senior staff member is able to ensure information is passed on a strictly 'need-to-know basis' and that no internal staff breach the firm-wide trading restriction, rather than compiling lists of potential recipients of information.

An alternative to the restrict-all approach is the 'information barriers' approach whereby there is physical barriers between front-office teams in the MSR that prevent the inadvertent passing of information across the MSR. In line with Draft Guideline 5, once the MSR's compliance team responsible for receiving the market sounding has received the information they will disseminate it on a 'need-to-know' basis to teams for which the information is relevant. At all times, the internal barriers prevent the inadvertent sharing of the information, such that the compliance team have satisfaction that the information remains only with the teams to which it has been passed, who are restricted from trading in relevant instruments.

In both cases, the MSR may, of course, voluntarily maintain information-possessor lists. However, we disagree that the maintenance of such lists should be fundamental to compliance with MAR.

Draft Guideline 6 ultra vires

AIMA is concerned that Draft Guideline 6, if implemented, would go beyond what is envisaged by Article 11(11) of the MAR Level 1 text providing the mandate to ESMA to develop guidelines, thus be *ultra vires*.

[6] Objectives listed at page 15 of the Consultation.

At p.15 of the Consultation ESMA notes the lack of overlap with the insider list maintenance obligation for sell-side persons under Article 18 of MAR, stating that 'MSRs may not be issuers or persons acting on their behalf or account and therefore may not be subject to the insider list provisions'. We agree and believe that the MAR Level 1 text was deliberate in its exclusion of MSRs from the need to maintain insider lists under Article 18.[7]

We are concerned, therefore, that Draft Guideline 6 would represent a direct amendment of the Level 1 text through Level 3 guidelines, the purpose of which, of course, is 'establishing consistent, efficient and effective supervisory practices within the ESFS, and [] ensuring the common, uniform and consistent application of Union law'.[8]

Overall, we believe that MSRs should be encouraged to develop and implement their own robust and well-tailored procedures to comply with the inside information offences under MAR. Insider lists could represent part of these procedures for MSRs using particular compliance approaches. However, we disagree that a universal obligation for such lists is necessary or would be proportionate. We recommend the deletion of Draft Guideline 6 and for the industry practice of voluntarily maintaining information-possessor lists to be considered as part of an MSR's compliance with Draft Guideline 5.

Q5: Do you agree with the revised approach regarding the recording of the telephone calls?

AIMA agrees with this approach.

Q6: Do you agree with the proposal regarding MSR's obligation to draw up their own version of the written minutes or notes in case of disagreement with the content of those drafted by the DMP?

AIMA has concerns that a requirement for an MSR to send the DMP its own version of the formal minutes of a meeting not undertaken via a recorded telephone line could introduce additional undue operational costs for firms. In particular, we consider that in the event of a disagreement with a DMP, providing alternative minutes could result in an MSR incurring external counsel costs in order to obtain comfort that their position is correct so as to avoid liability.

We suggest that it could be sufficient for the MSR to keep its own record of non-electronically recorded conversations which, in the event of a competent authority investigation, could be provided for consideration.

Q7: Can you provide possible elements of compliance cost with reference to the regime proposed in the guidelines for MSRs?

AIMA notes that the Draft Guidelines could introduce new administrative tasks on MSRs, all of which would require additional compliance staffing and resources. It is difficult to place an exact quantitative amount on these additional costs, however, AIMA would suggest that ESMA seek to ensure that the Final Guidelines facilitate MSRs' ability to allocate their compliance resources in the most efficient and effective way possible to meet the objectives of MAR, tailored to the specificities of each firm's structure and business activities.

[7] unless those MSRs were also issuers or persons acting on their behalf or on their account.
[8] Article 16 of Regulation (EU) No.1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) Available online: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32010R1095.