

TECH 18/03

MARKET ABUSE – ADDITIONAL LEVEL 2 IMPLEMENTING MEASURES

Memorandum of Comment submitted in June 2003, by the Institute of Chartered Accountants in England and Wales, to the Committee of European Securities Regulators [CESR], in response to their consultation on their advice to the European Commission on level 2 implementing guidance on the Market Abuse Directive.

CONTENTS

	Paragraphs
Introduction and General	1 - 3
Accepted Market Practices	
General	4
Inside Information in Commodity Derivative Markets	
General	5
Insiders' Lists	
General	6 - 9
Answers to specific questions for consultation	10 - 20
Disclosure of Transactions	
Answers to specific questions for consultation	21 - 25
Notification of Suspicious Transactions	
General	26 - 27
Answers to specific questions for consultation	28 - 31

Introduction and General

1. We are grateful for the opportunity to comment on CESR's proposals for level 2 Guidance, in support of the Market Abuse Directive. Our comments mainly suggest changes aimed at making the proposals less expensive and bureaucratic to implement by issuers, without undermining their effectiveness or the promotion of consistently high standards of market practice throughout the European Union.
2. The most important factor in the avoidance of market abuse is the development of a good compliance culture among market participants and their staff and third party contacts. Many of CESR's suggestions represent the imposition of bureaucratic procedures, which will assist in the prevention or detection of abuse in the event of failure of a compliance culture, but will only be called into play where that culture has proved inadequate. We would consider it acceptable for less rigorous and costly procedures to be required for markets, sectors or even individual issuers where a good compliance culture is evident, but that where evidence of market abuse becomes apparent, more rigorous procedures could be required.
3. In consideration of its level 2 advice, CESR should take into account that one of the principles for implementation identified in preamble 43 of the Directive is the importance of reducing the costs of, and increasing access to, capital. No requirements should be included, which by their inflexibility, or by the requirements for procedures or information, unnecessarily increase costs for issuers or their advisers.

Accepted Market Practices

Question 1: Is the proposed approach appropriate, focussing both on the characteristics of particular market practices and the procedures that Competent Authorities should follow?

Question 2: Are the suggested principles, factors and procedures appropriate? Would you consider adding more factors such as the degree to which a practice has a significant effect on prices and in particular on reference prices?

Question 3: The Directive focuses on accepted market practices "on the regulated market concerned", but the prohibitions of the Directive also apply to OTC trading. Is

it necessary to make any distinction between standards of acceptable market practices on regulated markets and OTC practices? Is it also necessary to make distinctions between standards of acceptable market practices in different kind of regulated markets or MTFs (e.g. order driven or price driven)?

Question 4: Do you agree that a practice need not be identifiable as already having been explicitly accepted by a competent authority before it can be undertaken?

Question 5: CESR is committed to the future discussion of specific market practices as part of the Level 3 work necessary to increase the harmonisation of accepted practices where appropriate. Please specify any examples of particular practices which you consider could be classified as accepted market practices for the purposes of the Directive.

4. The Institute does not consider that it has sufficient specialist experience to respond to questions 1 to 5 in detail, but we would like to make the point that it is in the interests of all market participants, as well as in the interests of the economic development of the European Union, for markets to be allowed to develop in as flexible a way as possible. This has been recognised in preamble 43 to the directive, not only in the principle of the encouragement of innovation, but also in the principle of providing investors with a wide range of competing investments. We strongly agree with the conclusion of CESR that a practice need not be identifiable as already having been explicitly accepted by a competent authority before it can be undertaken.

Inside Information in Commodities Derivatives Markets

Question 6: Has CESR correctly identified all the relevant and material market, product and information factors relevant to the definition of “inside information” for commodity derivatives?

Question 7: Is there further information which is material, relevant and disclosable in relation to commodity derivatives markets?

Question 8: Does the draft advice accurately reflect the information relating to underlying commodities which commodity derivatives markets users expect to receive?

Question 9: Is there any additional guidance that CESR should consider giving in relation to the definition of “inside information” for commodity derivatives?

5. The Institute has insufficient specialist experience to respond appropriately to Questions 6 to 9.

Insiders' Lists

6. We agree that the establishment of a list or lists of insiders will represent an appropriate enforcement mechanism for the minimisation of market abuse by means of insider dealing. However, it could potentially be a very costly exercise for issuers and their advisers and suppliers. In most cases, particularly in the case of well run markets and issuers, this will be an unnecessary expense, incurred for the purposes of investigation in the event of market failure which hopefully will not occur. For this reason, the complexity of the requirements should be kept at a minimum, and should be kept as flexible as possible, to enable those with an obligation to maintain lists to do so by the most cost effective means. No additional obligations to maintain lists of insiders, not required by the Directive, be required as a result of level 2 advice.
7. The requirement of the Directive, in Article 6 paragraph 3, appears to be limited to a single list of permanent insiders, kept by the issuer or persons acting on their behalf or for their account. This should not be extended unnecessarily.
8. In the event of market abuse becoming apparent means should be available to allow for stronger control and enforcement measures to be put into place, either in the case of an individual issuer or a market as a whole. But we suggest that the occurrences leading to the application of these additional controls could be left for level 3 discussion and agreement.
9. There is also currently a lack of clarity in the requirements as to where the responsibility for the maintenance of lists of insiders should lie. In our view, in no circumstances should issuers be responsible for the maintenance of lists by their advisers and other persons acting on their behalf. On the contrary, issuers should be required to record those organisations to which they have supplied inside information. If lists of insiders within the advisors are required, they should themselves keep a record of persons with access to the information.

Question 10: Do you agree on the relevance of establishing a list for each matter or event when it becomes inside information?

10. Some issuers will have a large number of potential newsworthy events, with complex and continuing structures of inside information, such as those companies whose prosperity depends on the continuing development of new products with complex research and approval procedures, including pharmaceutical companies. In addition, events may arise unexpectedly, leading to unplanned inside information. In view of the very wide variation in the possibilities for the occurrence of inside information and the need for its control, we do not think a high level of prescription in the way in which lists of insiders is maintained is appropriate.

11. For these reasons, we do not consider it necessary or desirable for detailed requirements to be included (particularly at level 2) on how the lists should be maintained, or what they should include, but this should be left to the issuer or other list holder to maintain on the most cost effective means possible, subject to the necessary information being able to be retrieved, in the event of an enquiry. In particular, issuers should be permitted to maintain a single list of insiders, if this would be a more cost effective means of having the necessary information available.

Question 11: Should the minimum content of the list be specified at Level 2?

12. We consider that at level 2 it should be sufficient to require that the list has sufficient information to identify each insider, the first date to which they had access to inside information and an indication of the matters or events to which that information related.

Question 12: Should Level 2 give examples of those persons acting on behalf of or for the account of the issuer who should be required to draw up lists?

13. Some advisers (such as major firms of auditors) will have many clients, with complex networks of people with access to varying types of inside information. They will also tend to have existing records of those people who have been involved (say) on particular audits. Experience suggests that they have not had significant difficulty in producing lists of insiders, for the purposes of the competent authority undertaking an investigation into apparent insider dealing. We do not think it necessary for such advisers to draw up complex lists, in an attempt to cover every circumstance where inside information may be encountered, but where no market abuse has occurred. This would represent a wholly unnecessary cost, adding unjustifiably to the cost of capital of issuers. It should be sufficient for them to maintain records in a form which enables them to identify insiders to the competent authority, in the circumstances where an investigation takes place.
14. We have no problem with examples being given at level 2 of those persons acting for or on behalf of an issuer who may have access to insider information, but the limitations of such a list should be recognised. It should be made very clear that the list does not include all possible classes of insider, but should be expanded according to the issuer's circumstances.
15. The list currently included in the consultation paper is somewhat limited and should at least be expanded to include other advisers who may provide or become aware of price-sensitive information, such as environmental advisers or surveyors, actuaries or tax advisers. In addition, regulators may frequently have access to inside information, and also non-financial suppliers such as confidential printers.

***Question 13: To what extent is drawing up a list of “permanent insiders” useful?
Should Level 2 identify the jobs which typically provide access to inside information?***

16. For many issuers, the ability to draw up a list of permanent insiders will be a useful and cost effective procedure. As indicated above, we believe that issuers should be given the option of maintaining lists of permanent insiders, rather than lists for individual events leading to the generation of inside information, where they consider this to be the more cost effective procedure.
17. As with our answer to Question 12, in theory, we believe that the provision of examples of typical jobs giving access to inside information could be useful, but we are concerned that such examples could be seen as being comprehensive, and that no action need be taken in respect of other persons with access to inside information on a regular basis. On balance, we would prefer the giving of examples to be avoided. If they are given, they should be clearly marked as being intended to give an indication only, not to be comprehensive. We would strongly disagree with any proposal that the identification of such jobs should be a mandatory list, rather than the provision of useful guidance.

Question 14: Would it be useful to further develop at Level 3 the “illustrative system” outlined?

18. The further development of an illustrative system could be useful, but should not be allowed to evolve into a system of mandatory requirements.

Question 15: Would it be useful to describe the meaning of the expression ‘working for them’ (article 6, paragraph 3) for example, to give clarification regarding people who are not employees of the issuer?

19. We would not consider it necessary for clarification of the phrase “working for them” and, in our view, expansion of this phrase in isolation could be misleading. The aim of this legislation should be to catch all those with access to inside information, whether or not they work for a particular organisation.

Question 16: Do you agree with the approach adopted regarding the criteria which trigger the duty to update insiders' lists?

20. We agree that any record maintained of insiders should be kept up to date and be sufficient to identify when a new natural or legal person is informed of the relevant inside information or obtains access to it. However, we do not agree that a formal list should necessarily need to be maintained, separately from the other records available, in advance of such a list being needed for the purposes of investigation by competent authorities.

Disclosure of Transactions

Question 17: Is the above description for "persons discharging managerial responsibilities within an issuer" sufficient for level 2 legislation? Are there other persons that should be considered as belonging to the management of the issuer or should there be a specific restriction to persons who can assess the economic and financial situation of the company?

21. We are content with the definition given for persons discharging managerial responsibilities within an issuer.

Question 18: Is the above description sufficient for level 2 legislation? Are there other persons that should be considered as belonging to this category?

22. We would prefer the definition given for persons with a close connection with the persons discharging managerial responsibilities to be given on a less prescriptive basis. The description given could include many persons not likely to share information with the insider, act in accordance with their instructions or to share their economic interests (such as adult children) but could exclude those whose actions or interests coincide more closely, such as infant children residing elsewhere.

Question 19: Is the above description sufficient for level 2 legislation? Should there be a threshold concerning the disclosure obligation to the competent authority?

23. We agree that all transactions in an issuer's securities by managers or their closely connected persons should be reported to the competent authorities, with no de minimis limit. This should not be limited to transactions in the shares of the issuer, but should include other securities, such as the issuer's debt instruments, the price of which is also likely to be affected by inside information.

Question 20: Is the above description sufficient for level 2 legislation? Are there any other details that should be covered on this level, for example the number of the relevant securities that the person holds after the transaction?

24. The information suggested in the consultation, which should be disclosed, appears to us to be sufficient to identify the nature and extent of the transaction.
25. Substantial holdings of the securities of the issuer, by those charged with management or their associates, should already be available to competent authorities under other provisions. We would not think it necessary to provide additional information on the size of an individual's remaining holding, in addition to that requirement.

Notification of Suspicious Transactions by Persons Professionally arranging Transactions

26. We note that there does not appear to be included, either in the Directive itself, or the proposals for level 2 advice, a general provision to the effect that a disclosure of a suspicious transaction, made in good faith, will not be taken as a breach of any requirement of confidentiality, however imposed. We consider this a serious omission, which could seriously impede the operation of the requirements of the Directive. We suggest that CESR should take action to try and ensure that this omission is brought to the notice of individual member states, to ensure that they insert such a confidentiality over-ride in the implementing provisions of the Directive in each state subject to the Directive.
27. We also note that this section of the Directive applies to “any person professionally arranging transactions in financial instruments”. We are aware that this term has been defined in some member states, but are concerned that if the definition is not consistent across the European Union, the objective of convergence could be undermined. We suggest that CESR should consider the desirability of giving advice at level 2 on this matter, which we believe would be covered by the current mandate.

Question 21: Do you agree with the proposed approach regarding the criteria for determining the notifiable transactions?

28. We are concerned at the tenor of the current draft of the level 2 advice, and in particular at the inclusion of guidance that “no evidence is required”. We believe this could lead to ill-considered reporting, for which there is no appropriate foundation. We agree that the evidence supporting the suspicion may arise from widely varying sources and may in some circumstances appear to be tenuous, although backed by experienced market judgement. We do not agree that reports should be made where there is no evidence to support a suspicion.

Question 22: Do you think that other possibilities, in the interpretation of “without delay”, should be taken into account?

29. We strongly believe that it would be against the interests of all market participants (including investors) for the phrase “without delay” to be re-interpreted in the level 2 advice as “immediately”. The word “immediately” suggests a level of haste which could preclude the appropriate level of investigation and due diligence within the organisation required to make the report. This would tend to unnecessarily undermine market confidence by encouraging reports which upon reflection turn out to be unfounded. It would also add to costs being incurred for no purpose, in their investigation by the competent authority. It could also lead to a level of over-reporting which would obscure the more important issues and events.

Question 23: Do you think that other elements should be mentioned, in the list of items that should be included in the notification to the competent authority?

30. We do not have strong opinions on the current draft list of items of information that should be included in the notification to the competent authority, as a list of examples of matters that should be included. However, we would not agree with the proposed advice listing matters as mandatory requirements for disclosure. As with other lists included in the draft advice, this list could be misleading in particular circumstances, and would be better used as a guide to what should be included than as a prescriptive list.

Question 24: Do you think that the proposed advice, on the means by which notification can be carried out, is appropriate?

- 31 We have no objections to this proposed advice, which seems to us to be sufficiently flexible to cover the circumstances. However, there may be other circumstances where persons with suspicions of market abuse may wish to communicate them to the competent authorities, such as during pre-arranged meetings with those authorities. Though we agree that discussions of suspicions in those circumstances should not necessarily be sufficient to ensure compliance with the requirements, we do consider that they should be covered by any confidentiality over-ride provisions.

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