ZENTRALER KREDITAUSSCHUSS

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Comments of the Zentraler Kreditausschuss[1] on an Additional Mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Directive on Insider Dealing and Market Manipulation (Market Abuse) – Second Call for Evidence –

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[1] The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the public-sector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Hypothekenbanken (VDH)*, for the mortgage banks. Collectively, they represent more than 2,500 banks.

A. Introduction

We regard the fact that the CESR has received a mandate by the European Commission to deliver advice for the technical implementing provisions on the Market Abuse Directive as highly significant. Said implementing provisions will specify in greater detail material capital market obligations for issuers and market participants. In this context, special attention needs to be paid to the de-facto and legal situations prevailing both within the companies and in the markets.

In our view it is very unfortunate that the consultation process has once more been shortened (to a three week's deadline for comments in terms of 'Call for Evidence' and a maximum deadline of two an a half months for the consultation paper) thus failing to reflect the high-profile initially envisaged by the Lamfalussy report. In our view there is a danger that failure to meet the necessary conditions for an adequate consultation will result in lasting damage for acceptance of the Lamfalussy approach.
Regarding the individual areas of the Call for Evidence we would like to submit following comments:

B. 3. 1. Implementing measures related to the definition of "Accepted market practices", and of "Inside information" for derivatives on commodities (Article 1 of the Directive)

(1) Implementing measures consisting of guidelines related to the definition of "Accepted market practices" (Article 1 paragraph 5 of the Directive)

An important aspect in the semantics of **'accepted market practices'** is the definition of the **relevant market** for the market practice under investigation. In other words: As a rule, the accepted market practice can only be seen in the context of the specific market on which the transaction (the quality of which is under investigation) was carried out. If the relevant market is a 'market maker'-market then the practices will differ from the ones adopted on a market that is 'order driven'. Hence, there is no uniform, standard definition of 'accepted market practices' since the latter is always based on the market setting. Therefore, the national authority will always be required to establish the specific market where an individual transaction took place before it can turn to the question whether the practices adopted were 'accepted market practices' or not. The only standard criterion which can be checked in any such review is that the market under investigation has to be a regulated market as contem-

plated by the provisions of the Investment Services Directive (93/22/EEC cf. Art. 1 paragraph 4 of the Market Abuse Directive).

Once the relevant market has been ascertained, the competent national authority can begin its investigation whether the given practices fall under the heading of market manipulation as contemplated by the Market Abuse Directive (Art. 1 paragraph 2). Should the authority come to the conclusion that the practices can be regarded as market manipulation and that they do not meet the criteria of 'safe harbour' the party concerned by this investigation can still have recourse to the assertion that they complied with 'accepted market practices (cf. Art. 1 paragraph 2 a of the Market Abuse Directive).

Before addressing the required qualities of accepted market practices we should like to point out that the investigative approach as provided under Art. 1 paragraph 2 a of the Market Abuse Directive gives rise to considerable concerns in terms of constitutionality. In Europe, actions prosecuted under criminal law, but partly also misdemeanours are generally subject to the principle of presumed innocence until the accused is found guilty (for criminal offences cf. e. g. Art. 6 paragraph 2 of the European Human Rights Convention; for misdemeanours also cf. Art. 2, 1 paragraph 2 of the Constitution of the Federal Republic of Germany). Under the aforesaid provision, the honus of proof i. e. proving that the suspect is guilty, lies upon the national prosecution authority and not on the accused, since – under the aforesaid legal provisions – the accused per se needs to be deemed innocent until proven otherwise. During the translation into national law, the aforementioned 'reversal of the honus of proof' as provided for under Art. 1 paragraph 2 a of the Market Abuse Directive would thus needs further review.

Another issue in terms of concept clarification of 'accepted market practices' is the question whether the practices under investigation are legal on the respective market previously identified by the authority. Here, the initial assumption needs to be that the **respective regulatory framework** establishes which approaches that are legitimate and which are not. Apart from written standards, the legitimacy of such practices could also be warranted by so-called common law customs (*Usancen* under German Commercial Law). These customs are binding rules which the various parties apply in a consistent and uniform manner on a voluntary basis over an ap-

propriate period of time.[2] This means that these customs have already become firmly entrenched and that they – despite the lack of their written codification – have a similarly binding nature.

We would like to point out that a concept clarification of the term 'accepted market practices' hinges on following aspects:

- the relevant market on which the respective transaction took place and
- the regulatory framework laid down or well established for this market.

3. 2. Implementing measures regarding some preventative measures related to issuers, corporate managers and professional intermediaries (Article 6 of the Directive)

(1) Implementing measures concerning the conditions under which issuers, or entities acting on their behalf, are to draw up a list of those persons working for them and having access to inside information; implementing measures concerning the conditions under which such lists are to be updated (Article 6 paragraph 10 fourth indent of the Directive)

- **Issuers**

Regarding the conditions under which issuers are to draw up aforementioned list, it would be possible to resort to deliberations that have already taken place in Germany leading to the passage of regulatory requirements with regard to investment firms and staff transactions (staff principles). These staff principles have been laid down by the *Bundesaufsichtsamt für das Kreditwesen* and by the *Bundesaufsichtsamt für den Wertpapierhandel* (called *Bundesanstalt für Finanzdienstleistungsaufsicht* as of 01 May 2002). These principles inter alia clarify which members of staff are subject to special insider supervision within a company ('members of staff with key functions'). An insider list under the provisions of Art. 6 paragraph 3 of the Market Abuse Directive could be based on such **'members of staff with key functions'**. 'Members of staff with key functions' are those members of staff who, in the course of their daily duties, regularly receive information which potentially could have a major impact on market conditions for securities trading as well as on the trading with derivatives i. e. members of staff 'having access to inside information'. Under the provisions of the staff principles, this term also covers

[2] Cf. § 346 of the German Commercial Code; for further reference cf. Baumbach/Duden/Hopt, Commercial Code of Justice, 30 th edition, 2000, § 346, 1ff.

staff members working for business divisions such as Compliance or Underwriting Department.

In line with the respective business unit, issuers could draw up a list of those members of staff with a high exposure to inside information i. e. a list of 'members of staff with key functions'. This policy could be adopted by staff departments such as the legal department as well as the research and development departments in the manufacturing industry.

This list would be **updated** through changes in the staff structure, such as new hirings, change within the company or termination of the job contract.

- **Persons acting on behalf or on account of issuers**

When charged with the task of keeping insider lists, persons keeping so-called **watch-lists** acting on behalf or on account of issuers should be entitled to draw upon the corollary information contained in the 'watch-list'. In Germany, the 'watch-list' is one possible instrument to meet certain organisational obligations particularly for those investment firms that regularly have access to information relating to compliance relevant matters (e. g. inside information)[3]. It is a non-public, real-time list of securities or derivatives on which the investment firms possess compliance relevant facts. Contrary to the requirements under Art. 6 paragraph 3 of the Market Abuse Directive, this list focuses on the security and not on the person. Yet, in the context of the watch-list there are also ongoing records of the names of those members of staff who triggered the notification for the watch-list.

The list of 'staff members with key functions', perhaps also in combination with the watch-list, could help produce an up-to-date insider list meeting the requirements under Art. 6 paragraph 3 of the Market Abuse Directive.

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[3] Cf. section 3, particularly subsection 3.3.3. of the directive for implementing the organisational duties of investment firms under the provisions of § 33 paragraph 1 German Securities Trading Act of the *Bundesaufsichtsamt für den Wertpapierhandel* (now: *Bundesanstalt für Finanzdienstleistungsaufsicht*) dated 25 October 1999

(2) Implementing measures concerning the categories of persons subject to a duty of disclosure of transactions conducted on their own account and the characteristics of a transaction, including its size, which triggers that duty; implementing measures concerning the technical arrangements for disclosure to the competent authority (Article 6 paragraph 10 fifth indent of the Directive)

Members of the management board and of the supervisory body as well as personally liable partners of an issuer regularly bear **management responsibility** within the company, hence they may be considered for disclosure obligations under Art. 6 paragraph 4 of the Market Abuse Directive.[4] Contrary to this, members of staff from the second tier of hierarchy should not be subject to disclosure obligations. For individual investors, regardless whether they bear management responsibility or not, a disclosure of their securities dealings would not have the same emblematic meaning as disclosure of securities dealings of members of the board. Only the latter decide on the future of the issuer and thus exert a crucial influence on the further business trend and on the issuers' strategies. This is also the reason why investors view securities dealings of board members as a pointer for future trends of the issuer's securities. Hence, for the purposes of Art. 6 paragraph 4 of the Market Abuse Directive we recommend that only the aforementioned board members should become subject to disclosure obligations.

The term **'closely associated persons'** could be defined in accordance with tight family ties or close relatives. If this interpretation were to be adapted, in Germany following individuals would become subject to disclosure: spouses, officially registered partners and first degree relatives (as per § 1589 German Civil Code of Justice).

With regard to a definition of a **transaction triggering a disclosure obligation** we recommend that only the de facto or completed transaction and not plans for a transaction should fall under this term. Firstly this is indicated by the wording of Art. 6 paragraph 4 of the Market Abuse Directive (notification of all transactions for own account). And for the market, in terms of information content, an obligation to report the mere intention of carrying out a specific transaction would not present any added value. This is also due to the fact that no one can be denied the right to change their mind and

[4] Cf. also § 15 German Securities Trading Act

abandon an undertaking at the last moment. But in such a case, the bottom line would be that the wrong signals filtered through to the market. On the other hand, a subsequent rectification notice saying that certain undertakings were abandoned would only give rise to further uncertainty. Limiting the disclosure obligation to actual transactions and excluding planned transactions is also preferable for the persons who are under the disclosure obligations. Disclosure of sales plans on the part of influential personalities from the business world would at least increase the likelihood of price drops, whilst disclosure of plans to buy could drive share prices up. The respective member of the board would be faced with extremely volatile prices. Therefore, after due consideration of both the right of ownership and investor protection principles we come to the conclusion that the disclosure obligation should only apply to de facto transactions i. e. transactions that have already taken place.

For harmonisation reasons, deadlines for the notification requirement ought to be geared towards international standards prevailing for instance in the US. In the US, since the end of August 2002, a **two day deadline** has been in place for the disclosure of securities transactions. In Germany, the provision is more stringent and requires an immediate disclosure. In our view the aforementioned fixed and specific deadline which is also in line with international practices is preferable e. g. due to the fact that the term 'immediate disclosure' is not very tangible and is a matter of interpretation.

Another practice that has proven useful is the **minor cases threshold** for securities transactions. For instance in Germany, this threshold lies at EUR 25,000 entailing a waiver for the disclosure of transactions below this cap (i. e. for a period of 30 days, the total volume of all transactions made by the party concerned does not exceed EUR 25,000). This is a way of preventing that the market is flooded with notices of small sales or purchases because such disclosures could water down the overall meaningfulness of the disclosure obligation under this provision.

Following information should be included in the **transaction disclosure**:

1. the designation of the security or title as well as the securities identification number,
2. the date of the annual account,
3. price, number and nominal value of the securities or titles.

The data relevant under this provision would then be communicated to the competent authority. Reference ought to be made to the disclosure's origin. This disclosure should similarly be **published on the internet** under the issuer's address for the duration of approximately one month. This way, the general public will receive notice of the securities transaction.

(3) Implementing measures concerning technical arrangements governing notification or suspicious transactions to the competent authority by any person professionally arranging transactions in financial instruments (Article 6 paragraph 10 last indent of the Directive)

The **notification obligation** always applies to the company proper.

Yet, the companies should not be under the obligation to proactively carry out enquiries. Rather, the notification obligation should only be considered if the daily operations reveal facts that automatically give rise to the strong suspicion that the transaction obviously falls under the heading of insider dealing or 'market manipulation' under the provisions of Art. 2 of the Market Abuse Directive. Notifications have to be made without delay either orally, via the telephone, fax, cable or digitally to the competent supervisory authorities. In order to enhance the quality of notifications, there ought to be a regulatory provision for a feedback mechanism so that the receiving authority gives feedback to the institute issuing the notification regarding the action prompted by the notification.