

ZENTRALER KREDITAUSSCHUSS

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BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E.V. BERLIN • DEUTSCHER SPARKASSEN- UND GIROVERBAND E.V. BERLIN-BONN
VERBAND DEUTSCHER HYPOTHEKENBANKEN E.V. BERLIN

**Comments of the
Zentraler Kreditausschuss¹
on Market Abuse,
Additional Level 2
Implementing Measures
- Consultation Paper -**

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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.

I. General Remarks

We attach fundamental importance to the technical implementing measures for the Market Abuse Directive since they serve to specify in greater detail material aspects of the Directive. We therefore once more welcome the fact that a Call for Evidence has preceded the publication of the Consultation Paper.

In addition to this, it ought to be mentioned positively that the market players have already been heard on the present Consultation Paper. Practitioners' input is of fundamental importance in answering the question whether a certain practice amounts to market abuse or not. We should therefore once more like to draw attention to the fact that an adequate deadline for the submission of opinions is of paramount importance (cf. Recital 43, 4th indent of the Market Abuse Directive). This is the only way of ensuring input from practical experience i.e. something that is equally in line with a request that has been made by CESR (cf. no. 21 of the Consultation Paper). In this process, time is of the essence. After all, the coordination of a position with the various stakeholders requires an adequate timeline. Due to the tight timetable it has therefore not been possible for us to accommodate one further suggestion made by the CESR and to provide all our comments with an alternative draft wording. Hence we have strong regrets over the fact that CESR – as has already been the case during the Second Call for Evidence – once more decided to further reduce the deadline for comments.

Last but not least we should like to voice the urgent request that all proposed measures be subjected to a detailed cost-benefit analysis (cf. Recital 43, 8th indent of the Market Abuse Directive). This particularly concerns the areas of 'insider lists' and 'suspicious transactions' where comprehensive and costly obligations are created for the target group without proving beyond reasonable doubt that these obligations are indeed relevant for the issue of market manipulative behaviours. Under no. 65, the Consultation Paper for instance explicitly accepts that the suggested measures regarding the insider lists will generate major costs. Yet, whilst failing to give any further explanation, the Consultation Paper directly

comes to the conclusion that such additional costs are acceptable since the market would benefit from these measures (no. 65).

II. Accepted Market Practices

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

Yes, the proposed approach is appropriate. The question whether an activity constitutes an accepted market practice requires both guidelines for the assessment of the behaviour under investigation and also pointers for an appropriate procedure that the competent authority should follow.

2. 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?

Whilst the Level 2 advice under no. 34 is, on principle, acceptable since the markets are subject to ongoing change and thus also the supervision should adapt to this evolution, the approach chosen under no. 35 is worth reviewing. We are not entirely convinced of the principle mentioned under the 1st bullet point according to which a high transparency of an activity is a direct indicator of its acceptance in the market and wonder whether this might be an over-generalisation. This principle should thus take a subordinate role in any respective investigation. The same applies to the scope of retail customer involvement in any given market (6th bullet point).

Initially, the primary point of departure should be a description of the relevant market on which the market practice and/or activity under investigation took place. As a rule, the accepted market practice hinges on the market on which the transaction (the quality of which is under investigation) was carried out. As has already been suggested in

our statement during the second Call for Evidence, in a second step the prevailing regulatory framework on the relevant market should be taken as a yardstick because it can be assumed that the respective, applicable regulatory framework of this market stipulates which modes of behaviour are permissible and which are not. Along with the written standards, these legitimate practices could also be based on so-called market customs (*Usancen*). These market customs are binding rules which the parties involved apply in a consistent and uniform manner on a voluntary basis over a due period of time. This means that these market customs have become firmly entrenched so that they – although they still lack a written codification – have a similarly binding nature.

On the foregoing grounds we therefore suggest to replace no. 34, 3rd bullet point ‘considered by the market participants’ with ‘considered by the participants on the market concerned’.

- 3. 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)?**

First Question:

Yes, the OTC market is not comparable to other ‘regulated markets’ as contemplated by the Investment Services Directive. Although rules and market customs (*Usancen*) can be identical, this is not compulsory. I.e. for instance the advice under no. 35 (2nd bullet point, 2nd clause) can by no means be transferred to OTC markets since *ipso facto* not all market players can participate in the trading activity in an equal manner.

Second question:

Yes, since the different market models lead to different requirements for the market participants. These may largely be reflected in the respective regulatory frameworks which – as has already been mentioned under 2 – absolutely have to be taken into consideration in any investigation into whether a behaviour falls into the category of an acceptable market practice or not.

4. 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?

Yes, we do agree. Having said this, the current version of the CESR recommendation leaves unclear who is to bear the onus of proof for the admissibility or illegality of the respective market practice. Here it must fall within the remit of the prudential supervision authorities to prove the illegality of the respective practice in controversial cases (cf. Recital 20 of the Market Abuse Directive). Otherwise, in this respect, the implementing measures would have defeated their initial object. Under the provisions of the Market Abuse Directive they are meant to further specify the process for the assessment of market practices in greater detail so as to ensure the necessary acceptance of practices introduced; yet this should take place without curbing the emergence of new market practices and financial innovations (cf. Recital 43, 5th indent of the Market Abuse Directive). However, exactly this would be the case if the market players – under the impending threat of sanctions - had to prove that their behaviour was in line with the practices on the respective markets. What is more, this kind of approach would meet with considerable concerns in terms of constitutionality.

III. Definitions of “Inside information” for Derivatives on Commodities Markets

The peculiarity of the separate definition of the term ‘inside information’ in relation to commodity derivatives under Art. 1 para. 1 of the Market Abuse Directive consists in the

fact that categorization of an information as inside information hinges on the expectation scenario of the market players of the respective markets.

With its recommendations (no. 46 and 47), CESR attempts to paraphrase this expectation scenario in general terms. No 46 first of all contains a description of these expectations in terms of content followed by a description in terms of time (no. 47). The mentioned criteria are very broadly defined. The disclosure obligation which is founded here with a view to any information that is generally available to users of such markets (no 45 i./no. 47 i.) would lead to a situation where issuers of such commodity derivatives would have to publish a host of information that have already been made ‘generally available’ through other sources, notably through the media. From our point of view this is hardly manageable. The facts of this matter therefore are in need of a clearer definition. Here, it may be especially worth considering the introduction of a criterion that the information must have a potentially significant impact on prices or a cumulative linking of the prerequisites under no. 46 i./47 i. on the one hand with the alternatives no. 46 ii., iii./47 ii., iii. on the other hand (replacement of the „or“ under no. 46 i./47 i. through an “and“).

IV. Insiders’ Lists

We should preface our comments on CESR’s recommendations regarding the more specific paraphrasing of Art. 6 para. 3, subpara. 3 of the Market Abuse Directive with the following remarks:

We are well aware of the fact that the obligation of keeping insider lists incumbent upon issuers has a broader focus than the current systems which regularly only concern investment firms. This notwithstanding, we should not forget that it is particularly those companies that make up a significant part of the target group which is affected by these provisions. After all, as issuers they are frequently not only under the obligation to keep such respective lists but they will also be largely identical with the group of ‘persons acting on their behalf or for their account’ who will be subject to this obligation.

Against this backdrop we should like to draw attention to the fact that - due to organisational obligations - already today investment firms (cf. Art. 10, 1st and 5th indent of the Securities Investment Directive 93/22/EEC) are at any time in a position to provide timely information on which staff members possess which specific inside information at any given moment in time and/or – based on their remit – may be in possession/have been in possession of respective inside information (in Germany e.g. based on communication of inside information to the compliance officers and/or the general categorization of staff members who regularly come into contact with inside information as ‘members of staff with key functions’). When it comes to meeting the requirements under Art. 6 para. 3, subpara. 3 of the Market Abuse Directive, investment firms must be allowed to draw upon those existing procedures that are already accepted by the authorities; this is especially true since – in this respect - the intention of the provisions under the Investment Services Directive is largely identical with the intention of the Market Abuse Directive (cf. also no. 49 of the Consultation Paper). Contrary to this, the CESR approach is far too schematic. It would force the investment firms to draw up additional lists along with the already existing information sources. This process would not lead to any additional insight allowing the investment firms to meet the requirements under Art. 6 para. 3, subpara. 3 of the Market Abuse Directive and equally fail to assist the authorities for the purposes of inside monitoring. Under no. 66, CESR also admits that there are already equivalent approaches. We therefore deem it necessary to adopt no. 66 into the recommendation with the content that equivalent procedures are permissible provided they meet the requirements under Art. 6 para. 3, subpara. 3 of the Market Abuse Directive.

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

No, we do not agree to this, if this is to be an inflexible provision. Keeping separate lists in relation to certain events may be useful in many cases and is currently already being practiced. What is more, numerous issuers – be it intermediaries or industrial undertakings - are only occasionally involved in the management of inside information and not on a permanent basis. Yet, also the keeping of those lists referred to as 'perma-

nent lists' should be permissible on principle, since many issuers and their agents – e.g. notably credit institutions – will employ a group of people who regularly have access to inside information. We therefore call for a flexible solution which leaves it to the Member States to regulate whether lists have to be kept on a case-by-case basis or on a permanent basis. This solution should expressly also permit the choice on the part of the obliged issuer and agent. This is the only way in which the obligation to prepare insider lists can be met at a reasonable cost. After all, this is the ultimate prerequisite allowing Member States to revert to tried and tested systems that are already in existence.

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

On material grounds and in order to safeguard a minimum degree of harmonisation, the answer is essentially yes. In cross-border projects, this already guarantees a homogenous handling of such lists. Having said this, the provisions should confine themselves to a minimum, given the heterogeneous nature in terms of the target group's structure. This is why the need to indicate the 'functions and responsibilities' of the respective person (no. 60, 2nd bullet point) should be dropped. Furthermore, it will not be possible to definitively ascertain in every case as of which point in time a member of staff gained access to an inside information (no. 60, 3rd bullet point). E.g. an investment firm can regularly provide respective information only with regard to those members of staff who have dutifully informed the compliance officers of the existence of inside information. In any other cases, the compliance officers will only be left guessing as to which members of staff may have been in possession of additional, specific inside information and as of which point in time this might have been the case. The same applies to no. 60, 4th bullet point. What is more, it remains unclear which information is specifically required under no. 60, 4th bullet point. Last but not least, a mandatory information on no. 60, 3rd and 4th bullet point is objectionable since it would unduly shift the task of inside prosecution that is currently incumbent upon the supervisory and/or the criminal investigation authorities onto investment firms.

As a general rule, the implementing measures should therefore, in this respect, facilitate a maximum degree of flexibility. Last but not least this also applies to the extent to which certain facts of the matter (such as e.g. with a view to investment firms) are already regulated elsewhere.

3. 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?

No, given the host of differently organised stakeholders and possible shareholdings, from our point of view a regulation at Level 3 is advisable. This would allow a clearer description of the respective group of individuals and customisation of the latter with a view to the idiosyncrasies of the respective area in the respective Member State.

4. 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?

As has already been pointed out under question 10, we deem it appropriate and feasible to allow issuers and their agents to keep permanent lists as an alternative or in addition to event based lists. This will allow catering both to the interests of companies which only have inside information on an occasional basis and possibly in different areas and also to the interests of those companies within which members of staff have regular access to such information.

In addition to this, it should be left to the companies’ discretion to specify – based on their business area and their organisational structure – which members of staff generally tend to have access to inside knowledge and whose names thus need to be put on those lists. Decisive is thus always the specific situation at hand at the company. At most, a list of ‘permanent insiders’ can contain examples that may apply in one company – yet, which do not have to apply. Considering the host of business areas and/or organisational structures amongst the companies (both for the issuers and also for

those persons acting on their behalf or for their account) notably in the individual Member States, it appears questionable whether a catalogue of examples is at all appropriate.

If – despite our vote – the target group of the Market Abuse Directive should be subjected to the obligation of keeping project based lists on a permanent basis, then there will no longer be any need for additional lists of ‘permanent insiders’ since the individuals disposing of inside information would then also appear on the project based insider list.

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

From our point of view, the examples for ‘permanent insiders’ may at most be implemented and further developed at Level 3, cf. representations under question no. 13.

6. 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?

In practice there is basically the need to clarify who is among the group of individuals working for the issuers without being steadily employed by them on a regular basis. Yet, respective provisions should only cover those individuals who are substantially involved in the relevant project work on a long-term basis.

7. Question 16: Do you agree with the approach adopted regarding the criteria which trigger the duty to update insider lists?

No, we do not agree. The cost benefit ratio is unbalanced, both with a view to the drawing up of insider lists for each and every circumstance and also with a view to the contained recommendation (no. 69) on the ‘continuous’ update of the ad-hoc lists

in the currently envisaged form. An update at regular intervals instead of on a continuous basis would also suffice to meet the obligation pursuant to Art. 6 para. 3, subpara. 3 of the Market Abuse Directive. What is more, this more specific interpretation would be equally in line with the intention of the Directive's legislator (cf. Art. 6 para. 3, subpara. 3 of the Market Abuse Directive: 'regularly update'; the provisions made under no. 64 and 67 of the Consultation Paper thus exceed the scope laid down in the Directive).

V. Disclosure of Transactions

- 1. 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?**

For reasons of legal certainty, the nomenclature ‘persons discharging managerial responsibilities within an issuer’ should only designate members of the management or of the supervisory board. ‘Senior managers’ i.e. a term that presumably refers to members of staff responsible at the second tier of hierarchy. Such ‘senior managers’ should by no means be subject to the respective disclosure obligation since a disclosure of their securities transactions does not have the same announcement effect for investors as the securities transactions of said members of the management or of the supervisory board. Only the latter two groups decide on the future of the issuer and thus have a decisive influence on the further business trend and on the issuers’ strategies. This is also the reason why investors see securities dealings of management or supervisory board members as a compass for future trends for the issuer’s securities. In addition to this, it is suggested – provided the Level 2 advice listed under no. 73 remains – to leave the specification of the nomenclature to the individual Member States at Level 3. In a more specific definition of the term ‘senior managers’, the Member States can then consider the respective idiosyncrasies under their respective national company laws.

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

The description of the Level 2 advice on "closely associated persons" given under no. 75 is basically appropriate. Yet, it would be better to base this criterion on tight family ties or close relatives. If this interpretation were to be adopted, in Germany following individuals would become subject to disclosure: Spouses, officially registered partners and first degree relatives (as per § 1589 German Civil Code). Yet, should the definition remain limited to those individuals living in the same household as the members of the management or supervisory board who are subject to disclosure (registrants), then there should definitely be a note clarifying that this obligation does only refer to individuals who live in this household on a long-term basis. By no means should those individuals be added to the group of registrants who may have personal affiliations with the person who has to be officially registered (registrant), yet who themselves only spend part of their time in the household of the registrant (i.e. friends, acquaintances, guests etc.); otherwise, distinguishing between individuals who have to be officially registered and individuals who do not have to be officially registered will become virtually unmanageable.

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

Basically, the approach of a brief description under no. 77 is fit for purpose. Yet, in terms of content, we hold the view that there are two items that require clarification.

First of all, the term 'transaction' needs to be specified in greater detail. Otherwise, under this proposal for instance also a transfer of financial instruments as part of a compensation package or as a gift would have to be disclosed. Neither does the acquisition of financial instruments through an inheritance take place as a result of an active

decision on the part of the member of the management or supervisory board. Therefore, the market cannot treat this as an indication of existing inside knowledge. Information which does not date back to an active decision on the part of the member of the management or supervisory board is not helpful for market players nor can such information assist the prudential supervision authorities in fulfilling their tasks.

In addition to this, there are plans to introduce a so-called *de minimis* threshold for securities transactions. In Germany this threshold is currently at EUR25,000. Under this provision there is a waiver for disclosure of those transactions whose aggregate value in terms of the total number of transactions carried out by the party subject to the disclosure requirement within 30 days does not exceed EUR25,000. This is a way of preventing that the prudential supervision authorities and the market will be flooded with notices of small sales or purchases thus watering down the meaningfulness of the notices under this provision. The practical problems of the ongoing calculation of a respective 30 day deadline which would be retriggered with each new transaction could be prevented by reverting to the calendar months for this purpose.

4. 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?

The information provided under 79 appears appropriate. Yet, it might be worth considering whether the 2 day deadline should be based on trading days at which the stock exchange is open for business instead of 'working days'. After all, the stock exchange dealings are the relevant point of reference; in addition to this, this would also guarantee a standard approach regardless of regional bank holidays.

VI. Suspicious Transactions

1. Question 21: Do you agree with the proposed approach?

No, we don't agree with the proposed approach, since it ought to be guaranteed in any case that the registrant will not be subjected to an active inspection obligation neither before nor after completion of a transaction. These obligations are rather more incumbent upon the market operators (Art. 6 para. 6 and Recital 27 of the Market Abuse Directive) as well as upon the authorities. Therefore, the 'Advices' should be worded in a way so that a disclosure obligation for investment firms will only become an option if facts have emerged in the daily operations which obviously lead to the conclusion that the transaction needs to be regarded as inside dealing under the provisions of art. 2 of the Market Abuse Directive or as 'market manipulation'. We therefore suggest deleting no. 94, 2nd bullet point, sentence 1 and 2 and instead replace the sentence 3 expression '...has sufficient indications' with 'has palpable indications'. Only in the event of such indications can one 'reasonably suspect[s]' pursuant to Art. 6 para. 9 of the Directive. Since they subject the registrant to the obligation of proactive inspections, no. 94, 1st and 3rd bullet point should be equally deleted.

From our point of view, particularly the explanatory text under no. 89 and 90 ought to be deleted. There, with a view to the indications of market abuse that need to be taken into consideration, reference is made to the recommendations issued within the framework of the first CESR mandate. Yet, the 'factors' and 'diagnostic flags' contained therein are in our view not suitable as a means of orientation for investment firms carrying out the transactions. This is owed to the fact that they are, first and foremost, geared to the activity of the prudential supervision authorities and of the market operators – they are meant to provide them with possible clues as to the conditions under which further investigations need to be carried out – yet they have not been designed with a view to potentially incriminating facts that may lead to penalization. In addition to this, they are unsuitable also in terms of content since, taken as such, the clues contained therein generally describe customary market practices.

The disclosure obligation places the registrants in a strained situation. On the one hand – in the event of non-compliance – they have to face sanctions under Art. 14 of the Market Abuse Directive, on the other hand – due to contractual and legal obligations vis à vis their clients – they are under the obligation to treat customer data as confidential (cf. no. 83 of the Consultation Paper). This circumstance requires a maximum degree of legal certainty for the registrants which can only be achieved via a concrete specification of the notification duty that possibly leaves no room for ambiguities (cf. our foregoing proposal above). Otherwise this might lead to an avalanche of false alarms; there is an apparent lack of synchronisation between the CESR proposals and data protection provisions. From our point of view, CESR's argument, that it had no Commission mandate for consideration of the foregoing aspects (cf. no. 84 of the Consultation Paper) appears excessively formal and in this respect it only takes inadequate account of the registrants' conundrum. We should like to re-emphasize that the CESR can considerably ease the strains for the registrants' predicament by way of a specification that is in line with Art. 6 para. 9 of the Market Abuse Directive thus creating legal certainty and a predictable environment. It is also absolutely necessary to take into consideration that the notification of suspicious transactions involves a certain degree of interpretation and that it can thus not be put on an equal footing with prudential supervision measures.

The proposed changes are also appropriate because under Article 20 para. 1 b) of the Investment Services Directive 93/22/EEC, any transactions involving financial instruments traded on a regulated market already have to be reported to the competent authority. In combination with other information that has to be given to the authority and to the market such as the ad hoc information, the authority can proactively decide to carry out its investigations as to whether a certain behaviour and/or a trading activity qualifies as market manipulation. This investigation duty of the competent authority should by no means be relegated to the credit institutions as a result of an excessively broad interpretation of Art. 6 para. 9 of the Market Abuse Directive. In the area of money laundering, where this has partly been the case, elaborate and costly sys-

tems had to be put into place to remedy this effect. As has already been mentioned above, there is no manifest need in the field of securities transactions, since those notifications are already carried out in line with Article 20 para. 1 b) of the Investment Services Directive. For this reason, the proposals on suspicious transactions should be reviewed *in toto*, clarifying above all that the investigation duty remains incumbent upon the competent authority.

2. Question 22: Do you think that other possibilities should be taken into account?

The Level 2 advice listed under no. 96 should not refer to the point in time at which the transaction took place but should relate to that point in time at which the registrant became aware of the transaction. If – in this process - the registrant should come to the conclusion that this transaction is obviously abusive then the registrant should be under the obligation to immediately notify the competent authority without any culpable delay. To this effect, the first bullet point under no. 96 would have to be deleted. In terms of the second bullet point under no. 96, we see the danger that this requirement will once more result in an active investigation duty, this time after completion of the transaction. We kindly ask you to consider that e.g. approximately 2 million transactions based on Art. 20 para. 1 b) of the Investment Services Directive are reported in Germany on a daily basis. In practice, the staff of the registrants will therefore not be in a position to subsequently look into certain transactions and find out which ones showed suspicious features. If, contrary to our vote, no. 96, 2nd bullet point should not be abandoned, then its final provisions should contain a qualification that is in line with Art. 6 para. 9 of the Market Abuse Directive: "...of which the transaction **reasonably** seems to be suspicious".

3. Question 23: Do you think that other elements should be mentioned?

The Level 2 advice mentioned under no. 99 should be deleted completely and ought to be left to Level 3 instead. This way, individual Member States will be able to draw upon pre-existing systems within the banking industry and/or other sources of infor-

mation that are already available to the competent authorities making an additional information request within the framework of Art. 6 para. 9 of the Market Abuse Directive redundant, so that the introduction of this new disclosure obligation in the securities area can be implemented as expeditiously and cost efficiently as possible.

4. Question 24: Do you think that the proposed advice is appropriate?

Yes, the proposed advice is appropriate.