

**CESR CONSULTATION PAPER
ON ADDITIONAL LEVEL 2
IMPLEMENTING MEASURES FOR THE MARKET ABUSE DIRECTIVE**

This paper has been prepared by the Standing Committee on Company Law of the Law Society in England and Wales and by a working party of the Company Law Sub-Committee of the City of London Law Society. The paper is also supported by the Law Reform Committee of the General Council of the Bar in England and Wales. The Law Society of England and Wales is the professional body representing the interests of its 100,000 solicitor members. It is responsible for regulating the legal profession and also carries out law reform and representational work, including European legislation which will apply in the UK.

Definition of accepted market practices

1. We consider that the approach of the CESR in focussing both on the principles to be observed and the factors to be taken into account by Competent Authorities when they determine what amounts to accepted market practices and on the procedures to be followed is sensible.
2. We support the proposed principle that new or emerging market practices should not be assumed to be unacceptable simply because they have not been previously described as acceptable by the Competent Authority.

The consultation paper notes in paragraph 31 that the advice given should have regard, amongst other things, to requirements for harmonisation and the need to respect different national market practices. We note that the factors which are proposed to be taken into account by Competent Authorities in their assessment of practices (as stated in paragraph 35) appears to require in bullet points 4 and 5 that participants in one market may have to have regard to the practices and rules of other markets on which relevant financial instruments are traded. We consider this requirement to be impractical. For example, if a person is dealing in the UK in a security that is traded on multiple exchanges in other member states, this would imply that he may need to be aware of accepted market practice on each of those other exchanges, even though he is only dealing in the UK. Of course, if harmonisation were achieved between the market practices and rules in each Member State, then there would be no need to make reference to practices and rules of other markets, but, in the absence of harmonisation, the inclusion of these factors are likely to cause considerable difficulty for market participants in determining whether or not a particular course amounts to an accepted market practice.

3. It is clearly important that the accepted market practice defence should be available in respect of dealings on OTC markets which are not regulated markets and the CESR's advice ought specifically to recognise this. It is likely that OTC markets may well have different characteristics from those of regulated exchanges and therefore the advice should recognise that different factors may be relevant to the determination of whether something amounts to an accepted market practice on an OTC market as opposed to a regulated market. We would suggest that the determination as to whether or not a particular practice is acceptable should be made by reference to the particular market in relation to which the conduct takes place.
4. We agree with the proposal that a practice need not be identifiable as having been explicitly accepted by a Competent Authority before it can be undertaken. The CESR proposals recognise that market practices evolve rapidly and therefore it could

seriously hamper efficiency and innovation on a market if participants needed to wait for official sanction for each practice.

5. We leave it to market participants to respond on this question.

Definition of inside information for derivatives on commodities markets

6. We do not understand why there is any need in the Level 2 advice to refer to the expectation of users to receive information which is generally available to the users of those markets. If the information is generally available then we do not see how in any circumstances it could amount to "inside information".

Furthermore in relation to sub-paragraph (ii) and (iii) of paragraph 46 we assume that the use of the term "required as a result of" is in fact meant to connote "required to be made public pursuant to" - we think that there would some merit in clarifying this. Also we are unclear as to why there is a reference to information which is required to be disclosed pursuant to contracts - it is surely only where the relevant law, regulations or custom dictate that information must be disclosed that market participants should consider themselves entitled to receive relevant information.

Insiders' lists

- 10/16 We have a number of serious concerns about the proposals relating to the above.

First, we would propose that the advice of the CESR should make it clear that insider lists are only concerned with inside information which would have an effect on the securities of the relevant issuer which are publicly traded. Many issuers will have debt securities which are traded on public markets but will not have any traded equity securities. It would not make sense to impose a requirement on such issuers to maintain lists relating to information about their equity securities in such circumstances.

Our particular concern regarding the proposals of the CESR in relation to insider lists is that they exceed the requirements of the Directive and are likely to impose disproportionate costs on issuers - furthermore we doubt that the resulting information will be of particular use to Competent Authorities.

Furthermore we consider that the requirement for issuers to compile an insider list in respect of each matter or event that becomes inside information is likely to create major difficulties in terms of implementation. In the first place, issuers will generally have so many overlapping matters which might constitute inside information that it may be very difficult for them to determine at what specific time they come under an obligation to create such an ad hoc list. Even if an issuer only has one matter which might constitute inside information our experience is that it can be very difficult for an issuer to decide if the information is inside information. Issuers often involve external advisers (such as their brokers) in helping them reach this decision. It would be unduly burdensome to require issuers to do this in every case. If the proposals are left as drafted, there is a risk that issuers will err on the side of including more people than is strictly necessary, which will make the information less useful to the Competent Authority. Secondly, the time and expense that issuers will need to devote to maintaining such lists is likely to be significant and probably necessitate additional personnel being employed just for the purpose of meeting this requirement. It is difficult to see that the resulting benefit would merit the imposition of this additional cost on issuers, as there is no reason to suppose that imposing such a

layer of bureaucracy will have any impact on the extent to which inside information is actually misused.

We are concerned that the imposition of such requirements on issuers in European markets could well deter issuers from listing their securities in Member States and that accordingly this advice would seriously undermine the competitiveness of the securities markets in the EU. In our view the correct approach would be for the CESR to add as little as possible to what is required by the Directive itself. We support the view that insider lists should not be "information specific" and should be limited to individuals who have regular access to inside information by virtue of their position within a company. Furthermore we would suggest that provision should be made for such lists to be updated at stated periodic intervals rather than continuously. The proposals go beyond the requirement in the Directive to update the lists regularly. We also think there will be practical problems for issuers and others in knowing when they can stop keeping a list. In many cases the information which is considered to be inside information may not be made public. Even if the information is made public, it will be difficult for those keeping the lists to determine when it will not longer be possible to bring proceedings for insider dealing.

In addition, we would suggest that the list should relate to individuals within the issuer's organisation and not to external advisers due to the cost and administrative burden that such an additional requirement would impose on issuers. Third party advisers will generally be under a duty of confidentiality to the issuer in any case and may also be subject to separate regulatory requirements where they provide regulated services and can always provide lists of the individuals within them who have had access to inside information as and when any Competent Authority requests. We think the proposed requirements would be unduly burdensome for advisers and very difficult to comply with in practice. We believe that at present the number of requests which investment banks receive from a Competent Authority to provide details of persons who knew of a particular proposed transaction are relatively few. However, the number of matters worked on which may involve inside information would be very numerous.

We note that the CESR draft advice provides that persons acting on behalf of an issuer may include rating agencies, but we would not have thought that they would normally be regarded as acting as agent for an issuer. The list given also includes financial intermediaries involved in executing relevant transactions, but such intermediaries will themselves have detailed procedures relating to the management of inside information. We strongly feel that for the reasons set out above the level 2 advice in relation to insider lists needs to be revised and streamlined so as not to cause lasting damage to the prospects for EU markets.

17. We consider that the description of "persons discharging managerial responsibilities within an issuer" as persons who typically have access to inside information and who have decision making powers is not sufficiently clear to enable an issuer to assess with certainty who does or does not fall within this category. Given that the directive imposes a notification obligation on such persons, we think that it is important that there is absolute clarity as to who comes under this obligation and we would propose that the individuals mentioned in the bullet points at paragraph 73 are specified as being the persons discharging managerial responsibilities rather than being merely put forward as examples, although we would add to the second bullet point relating to senior managers that such managers must have access to inside information.
18. We are not convinced that the proposed definition of "persons closely associated" with someone discharging managerial responsibilities as being all persons sharing

the same household is the right test - this definition would produce the result that children of a manager who live with an ex-spouse would not be treated as being closely associated, but a nanny and stepchildren who live with the manager would. Furthermore the reference to trusts and companies in which the manager has an interest need further clarification - it is not clear if this extends to trusts in which the manager or his close associates are interested as beneficiaries or if it extends to companies over which the persons associated with the manager as opposed to the manager himself have control.

19. We would suggest that the disclosure obligation should relate solely to transactions for value.
20. We consider that the description of the matters to be included in the disclosure are sufficient.

Suspicious transactions

21. The Directive imposes a requirement for professional persons who **reasonably** suspect that a transaction might constitute insider dealing or market manipulation to notify the Competent Authority without delay. It seems inconsistent with this requirement for reasonableness for the advice to propose that suspicions should be reported even where there is no evidence to support the suspicion.

We note that the CESR considers that it is outside the scope of its mandate to deal with the question of whether notification in good faith to the Competent Authority under these provisions could constitute a breach of the duty of confidentiality. However, we would strongly recommend that CESR give consideration to this as it is a particularly important aspect of the Directive as far as the legal profession in the UK is concerned. (In this context the term "duty of confidentiality", which in many European jurisdictions encompasses all of a lawyer's statutory obligations of confidentiality to a client, should be construed broadly so to cover in the UK context both confidentiality and legal professional privilege ("LPP"). This is important since the profession is bound by obligations of "confidentiality" both as a matter of law, having regard to the nature of the contract of retainer, and as a matter of conduct. LPP meanwhile is a *right* of the client which a solicitor has a duty to protect. LPP is recognised by the English courts as a substantive common law right as well as a human right recognised under Articles 6 and 8 of the European Convention on Human Rights.) Under the UK system a solicitor's duty of confidentiality is fundamental to the relationship of solicitor and client and can only be overridden in exceptional circumstances. We regard the maintenance of this duty of confidentiality and the linked principle of legal professional privilege as of particular importance, since it is imperative that in a free society people should be able to consult with their lawyers openly and with confidence that their discussions and the advice which they receive will not be disclosed to third parties. Accordingly it is in our view essential that detailed consideration should be given as to how the obligation to notify suspicious transactions can be introduced in a way which does not cut across this principle to any significant extent.

We also note that the assessment of whether or not the transaction might constitute insider dealing or market manipulation and therefore as to whether or not a transaction should be regarded as suspicious should take into account the diagnostic factors proposed in the advice of the CESR. We think that it would be sensible to make it clear that merely because a transaction might fall within the net of one of these diagnostic flags should not be regarded as leading to a conclusion that the

transaction is suspicious, since this may only be one of many factors and the other factors involved may lead to the opposite conclusion. We imagine that this is what the CESR intend, but we think that it would be worth clarifying this point.

We note that no clarification has been given as to which persons constitute "persons professionally arranging transactions in financial instruments". We would assume that the term is meant to cover solely brokers and dealers and not for example lawyers who may be involved in a corporate finance transaction.

22/23 We have no comment on these questions.

24. We agree that the proposed advice regarding the method of notification is appropriate, although we would suggest that the written confirmation following notification by telephone should be sent as **reasonably** possible.

We would mention that we have seen a draft of the response from the International Primary Market Association on aspects of the consultation paper and support the points which they make as regards the definition of "accepted market practices" and the measures concerning insiders' lists.

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