UNIVERSITY OF COPENHAGEN
FACULTY OF LAW

European Securities and Markets Authority (ESMA)
SUBMITTED ONLINE AT: www.esma.europa.eu

Response to the ESMA Consultation on the MAR Review

26 NOVEMBER 2019

CME/FOCOFIMA

16 KAREN BLIXENS PLADS
DK - 1550 COPENHAGEN V
VISITING ADRESS:
76 NJALSGADE
DK - 1550 COPENHAGEN V

DIR 45 35323195

jesper.lau.hansen@jur.ku.dk
www.jura.ku.dk/jlh

REF: JLH

In my capacity as an independent university professor, I am pleased to provide my response to some of the questions raised in the ESMA Consultation Paper of 3 October 2019 (ESMA70-156-1459) that forms part of the European Commission's review of MAR.

General Observations

Before providing my response, allow me to draw attention to the general fact that the supervision of financial markets should observe a reasonable balance of costs and benefits.

Regulation of the financial markets is necessary to safeguard its proper functioning, as it is for all markets, but regulation inevitably involves costs and restrictions that may reduce the very efficiency the regulation seeks to further and hence a balance is necessary. In respect of the overall application and enforcement of the Market Abuse Regulation 592/2014 (MAR), it is thus important not to strive for the creation of conditions of perfect competition but to use it more moderately accepting the unorderly nature of a market place, as too high ambitions carry the risk of working against the very purpose that MAR is intended to further.

In respect of combatting insider dealing, it should be remembered that price sensitive information may take many forms and is distributed widely and unevenly. Thus, the ambition of the ban on insider dealing as laid out in MAR art. 8 - 9 and its prophylactic measure in MAR art. 10 on unlawful disclosure should not be to establish a parity of information among investors, as that would seriously destroy the competiveness and efficiency of the European financial markets. What is necessary is to ensure that investors, notably the professional investors who are so important in the price formation process, can act on these markets in the confident knowledge that their anonymous counterparties will only rely on information that is publicly available, even

where that entails the risk that one self is not, intentionally or unintentionally, in possession of the same available information, as that is not fault of the other party to the transaction.

In respect of manipulation, it should be remembered that financial markets do not reflect the right price, because the concept of right as opposed to wrong does not make any sense in the absence of any generally accepted method of establishing what price is right. What appears, however, to be demonstratively true of even less liquid markets is that price formation is affected by the available information and thus it is necessary to ensure that no one provides information that is false or intended to disturb the price signal that arises as a result of the ongoing provision of orders and trades by market participants. This price signal, although of great importance not just to market participants but to the overall allocation of resources and thus to society at large, does not manifest itself by divine intervention but is caused by this interaction of market participants, each of them seeking to favour their own position. In other words, when one trades, one cannot avoid to affect the price formation process of the market and in a greater or smaller way to affect the resulting price signal; but one may not trade to cause such an effect. This difference is not just semantic, it is the difference between legal and illegal.

Consequently, the ambition of the ban on manipulation as laid out in MAR art. 12 and in the delegated acts should not be to provide the right price, but to refrain market participants from actively disturbing the price signal resulting from legitimate market behaviour by providing information that is false or made solely to affect the price formation process and thus corrupt the resulting price signal.

In respect of issuers' continuous obligation of disclosure, attention should again be drawn to the importance of information to the price formation process. However, different investors appreciate different information. Short-term speculators will savour all news, irrespectively of their relevance, because they thrive on any disturbance of the price formation process allowing them to trade frequently on every move. Long-term prudent investors, on the other hand, are only interested in information that pertains to the fundamental value of the issuers and consequently disregard rumours, speculations and uncertain outcomes. The difference between the two is most clearly observable in respect of price-sensitive *uncertain* information, for example information pertaining to the likelihood of an issuer concluding an important contract after prolonged negotiations. The speculator would want to know of these negotiations immediately in order to trade on the impact that the uncertainty of their outcome would have on the price formation process, whereas the prudent long-term investor would disregard it and await news of the contract's conclusion.

Given that it is costly to remain a listed company, notably due to compliance costs, and that the number of listed companies are dwindling at an alarming rate, probably for that reason, it should be noticed that listed companies find it a burden to disclose information that is yet uncertain, whereas they can more readily accept to disclose relevant news as they come to fruition. Considering that the interest of listed issuers and long-term prudent investors thus overlap, the disclosure obligation in MAR art. 17 should be construed to fit their preferences, even if this involves disregarding the interests of more speculatively inclined market participants. It is especially important to ensure that listed issuers may delay price-sensitive information as long as its outcome is uncertain where they have a legitimate commercial interest in awaiting the final outcome and can ensure the confidentiality of the information.

A final observation is that legal instruments, like all instruments, should be used only for their intended purpose. Thus, the purpose of disclosure is to inform market participants correctly so that they may enter into contracts that are Pareto efficient; the purpose of the ban on insider dealing is to prevent the abuse of a monopolistic informational advantage to the detriment of others; and the purpose of the ban on manipulation is to prevent the distribution of false or misleading information that may distort the price formation process of the market.

An instrument should not be used for another purpose, e.g. to use disclosure to prevent insider dealing, as there is a considerable risk that issuers are required to inform the market of uncertain information that may actually mislead the market, which may not only fail to achieve the intended purpose of disclosure but also effectively harm the market participants that should be shielded by the ban on manipulation.

With these general observations in mind, I have the following response to some of your questions:

Re. Para. 5, Q13-Q19: Definition of 'Inside Information', MAR Art. 7

First, it is of paramount importance to realise that the concept of inside information applies in a dual setting: the insider dealing ban in MAR art. 8 – 9 and the continuous disclosure obligation of issuers in MAR art. 17, respectively. Furthermore, the different purposes of these instruments of law should be kept in mind, cf. my initial general observations.

In its decision of 28 June 2012 in case C-19/11, *Geltl v Daimler*, the CJEU emphasised the need to strike a proper balance between the purpose of insider dealing (to prevent the abuse of an informational advantage to the detriment

of others) and that of the continuous disclosure obligation (to provide reliable information to the market), cf. paras. 47 – 48.

Over time, the original definition of inside information, provided within the insider dealing context of the 1989 Insider Dealing Directive, has evolved into a multi-pronged test and is furthermore subdivided into four distinct categories in MAR art. 7, subsection 1, as you rightly observe in your Consultation Paper at pp. 29 – 30.

I am not sure that this development has been useful. In law, the attempt to strive for greater clarity by adding yet another layer of detail often ends up obscuring the intended regulation and may make both the application by market participants and the enforcement by public authorities less efficient. Although I am aware that you are seeking answers to specific questions, I recommend that you perhaps reconsider the trend to perfect the definition of inside information by adding ever more details.

If one observes the two decisions made so far by the CJEU on the definition of inside information, the *Geltl* case mentioned above, and its decision of 11 March 2015 in case C-628/13, *Lafonta v AMF*, although both concerned only one part of the multi-pronged test, that of 'precise nature', and although both cases concerned different elements of that requirement which the Court is keen to keep apart, the Court effectively appears to have emphasised the same element: *the information's capacity to affect the price*.[1]

Considering that the other test concerns the 'reasonable investor', which is essentially about whether the information would be part of a reasonable investor's investment decision, that is, the information would affect the pricing of the security, it is arguable, that the multi-pronged test could be reduced to only two elements: i) that the information is capable of affecting the price; and ii) that it is non-public.

The first element constitutes what in American federal securities regulation is known as 'materiality' and the second concerns the notion of monopoly in the sense known from competition law, which in the context of information is a question of whether the information is legally available or not.

[1] This is expressed by the Court in the negative, in *Geltl* para. 48 that the information should not be 'unlikely to influence the prices', and in *Lafonta* para. 31 that information is not deemed inside information if 'it is impossible to draw a conclusion as regards its possible effect on the prices', or to express the same positively: the inside information must be capable of affecting the price.

Rather than dividing and multiplying the definition seeking an elusive perfection, regulation may be better served by simply reducing the definition of inside information into these two elements: Is the information *material*, i.e. does it affect the price formation process and thereby the price resulting from it, which is essentially a reasonable investor test, and is the information *non-public*, i.e. is the information legally available to market participants.

Obviously, it is true that even such a shortened test may raise its own problems of understanding, however, it may still be a considerable improvement to the existing multi-pronged test.

In respect of materiality and the 'reasonable investor', the test should rely on the typical market participant, which is neither the ignorant amateur, the excitable speculator or the inhumanly sangfroid analyst, but as the name indicates a reasonable investor taking into consideration how the professional traders, who make up the bulk of the markets, act and respond. Whether the information could affect the price is a concept that would be intuitively understandable to courts and market participants alike, at least as much as the currently deployed concepts of 'precise' and 'significant effect' and it promises a single standard in lieu of the three different standards currently at play in MAR art. 7, section 1 (a)-(c) to cover different financial instruments and their markets, which will enable participants of these markets to take into account the special traits of their markets much better than can be done by legislative drafting.

The concept of 'non-public' should entail all information that is legally available, be it on other markets or jurisdictions or for a price. Again, the question should be whether the person in possession of the information understands or ought to understand that the information is available to the other party of the transaction. If that is possible, then the information is public and it makes no difference if the other party has failed to obtain it.

Re. Para. 6, Q25-Q26: Delay of Disclosure of Inside Information, MAR Art. 17

It is absolutely correct, as observed in the Consultation Paper at p. 36 that inside information can undergo different levels of maturity and degree of precision through its lifecycle and therefore in certain situations inside information is mature enough to trigger a prohibition of market abuse but insufficiently mature to be disclosed to the public without misleading it.

This pertains to the problem of *uncertain* inside information, cf. my initial general observations, where information may qualify as inside information in respect of the insider dealing ban but, due to its uncertain or immature nature, is not fit to disclose because that would risk misleading the public. Under the Market Abuse Directive (MAD), although Member States applied

varied methods, they all appreciated the need to avoid obliging issuers to disclose uncertain and thus potentially misleading information to the public. The Commission itself strived for a solution to this problem in its original proposal for MAR by suggesting that '[i]nside information can be abused before an issuer is under the obligation to disclose it.'[2] The outcome of the negotiations in MAR, as influenced by the outcome of the *Geltl* decision, was to abandoned the proposed distinction between inside information in relation to the insider dealing ban and the continuous disclosure obligation and maintain a unified concept of 'inside information' and instead solve the problem by expanding the access for delay that had been carried over from MAD art. 6, subsection 2, to include a special paragraph on inside information that is part of a 'protracted process that occurs in stages', that is, uncertain or immature information, in what became MAR art. 17, subsection 4, to supplement the three criteria from the previous directive.

It is my opinion that the access to delay in MAR art. 17, subsection 4, works well among the Member States that appreciate that the access has been thus expanded and is now available for issuers that find themselves in possession of such uncertain information about an ongoing procedure. A uniform understanding of this expanded access should be applied by NCAs.

Especially, it should be made clear that the access to delay is *expanded* by the new paragraph added in MAR art. 17, subsection 4, to serve the special situation of uncertain inside information. It is not likely that the new paragraph simply replicates the existing provisions on delay, notably the three criteria carried over from MAD, because that would have made its inclusion in MAR unnecessary. If uncertain inside information arising from an ongoing process were to be subjected to exactly the same test as all other inside information, the inclusion would have been unnecessary since the fact that inside information may be of an uncertain nature had already been inserted in the very definition of inside information in MAR art. 7. That the new paragraph in MAR art. 17, subsection 4, is meant to solve the problem of disclosure of uncertain inside information is also evident from the fact that the observation by the Commission in the original proposal's recital 14 was taken out of the negotiated draft at the very meeting where the new paragraph on delay was inserted.

Thus, the new paragraph on uncertain inside information arising from an ongoing process in MAR art. 17, subsection 4, should be construed to mean that due to its very nature as uncertain, that is, not yet finalised or 'matured', the issuer may have sufficient grounds for delaying its disclosure if, that is, the issuer can fulfil the three criteria that are carried over from MAD and apply to all delays.

[2] Commission proposal, COM(2011) 651 para. 3.4.2.1 and recital 14.

Of these three criteria, especially the requirement in (b), that the public is not mislead by the delay, has provoked some critical comments. It is right, of course, that any delay would mislead the public to some extent, because disclosure is mandated exactly to inform the public and ensure that they act on the market with access to all price relevant (material) information. However, a more commonsensical understanding is that the issuer may not actively contradict the inside information in its possession while delaying its disclosure, because this would – actively – mislead the public.

This more sensible understanding is also expressed by ESMA, although in its guidance the Authority appears to generally rule out the use of delay also where the inside information would contradict earlier statements made by the issuer or the general market sentiment.[3] While it would generally be true that it may not be in the legitimate interest of the issuer to delay disclosure of inside information that contradicts its own earlier statements, especially where these concern financial results, it may not always be the case and thus a more careful approach should be used and the language of the guidance should be modified accordingly. In respect of the last example, it may be very difficult for the issuer to gauge the prevailing sentiment of the market and as such it should not apply as a requirement for delaying disclosure. The essential test is and should be the statutory legislative text of MAR as the level 1 instrument: does the issuer have a legitimate interest in delay, which should not only entail the issuer's interest in seeing the ongoing process come to its conclusion but also the issuer's interest in avoiding to mislead the public about its affairs with the resulting risk of alienating future potential investors.

Re. Q27: Issuers' effective arrangements, systems and procedures for the identification, handling and disclosure of inside information

I agree with the observations made by ESMA that it would be beneficial to require of issuers that they establish and maintain effective systems that ensure the proper treatment of inside information. This would be a much better and useful substitution for the disproportionally burdensome obligation on issuers to keep and update insider lists. See more on this at Para. 8 below.

Re. Q28: Notification of delay of inside information that is no longer inside information

An obligation on issuers to notify NCAs of a delay of inside information in those cases where the inside information ceases to be inside information, usually because uncertain inside information never matured into certainty because the ongoing process from which it arose was never concluded, would require a change of the statutory wording of MAR as the level 1 instrument. However, this review of MAR is made to consider possible revisions and the need to change or amend MAR is not in itself unthinkable.

[3] ESMA Guidance on Delay of Inside Information (ESMA/2016/1478) at para. 9.

In this case, however, there appears to be little benefit compared to the increase in compliance costs of the issuers. The purpose of such a rule should be to expose those who may have traded on the inside information during its delay. If the ongoing process was never concluded thereby depriving the related information of its character of inside information, whoever traded on the information made the wrong bet and it could be argued that their loss has been a sufficient deterrence that makes further requirements on the issuer unnecessary.

Re. Para. 7, Q33: Market Sounding, MAR Art. 11

The rules in MAR art. 11 on market sounding are new in MAR compared to MAD. There are quite detailed and should perhaps have been dealt with at level 2.

At present, they provide for a safe harbour in respect of the ban on unlawful disclosure in MAR art. 10. A safe harbour is distinct from an exemption in the way that whereas an exemption will exempt certain situations that would otherwise be caught by the main rule, a safe harbour does not in itself change the scope of the main rule but only lays out a more precise and detailed description of actions that are voluntary to take, but which offers the consolation and legal certainty that if followed, the actions taken will be lawful.

In the text accompanying Q33, ESMA enquires whether it would be appropriate to amend MAR art. 11 to make the detailed procedure on market sounding mandatory in order for such activities to be legal. Thus, ESMA wants to change these rules from having the nature of a safe harbour into that of an exemption.

In my view, this would not be advisable. The main rule in question, MAR art. 10, has itself a very open ended exemption of disclosure ‘made in the normal exercise of an employment, a profession or duties’. In fact, the provision could be described as a mouse of a ban dragging an elephant of an exemption. Naturally, this is because the ban on unlawful disclosure is only a prophylactic measure intended to safeguard the ban on insider dealing in MAR art. 8, which is in itself the main provision to prevent insider dealing. The importance of the main rule of MAR art. 10, to ban selective disclosure and thereby limit the risk of inside information being used for insider dealing, is thus dwarfed by the practical need to allow disclosure where this is necessary, which is very often the case since inside information is by definition important information that may be necessary to share. Thus, although an exemption like that found in MAR art. 10 on lawful disclosure of inside information outside of public disclosure according to MAR art. 17 should always

be subject to a narrow interpretation, it is of paramount importance not to limit the open ended exemption.[4]

A safe harbour in MAR art. 11 is thus best aligned with the preceding ban on unlawful disclosure in MAR art. 10, because it would allow market participants the discretion of choosing whether to apply the detailed rules in MAR art. 11 and enjoy the legal certainty of the safe harbour or to deviate by choice or necessity from one or more of the rules and still find themselves within the open-ended exemption in MAR art. 10.

Re. Para. 8, Q39: Insider Lists, MAR Art. 18

The obligation in MAR art. 18 on issuers to constantly keep and update lists of all insiders who at some point come into contact with inside information, or ceases to have such contact, is probably the most burdensome of the obligations in MAR second only to the continuous disclosure obligation in MAR art. 17. It is not only an irritant and costly, it is also a cause for anxiety as the failure to keep these lists is sanctioned. The attempts to modify this burden for SMEs is a belated and insufficient recognition of its burdensome and unwelcomed character.

Whereas the continuous disclosure obligation in MAR art. 17 is indispensable for the well-functioning of securities markets, it is highly doubtful whether this is in any way the case with insider lists according to MAR art. 18.

It is undeniable that NCAs like insider lists, and the proposals in the Consultation Paper on how to expand these lists even further is proof thereof, which is no surprise considering that all the costs and inconvenience connected with the maintenance of insider lists are carried by somebody else, namely the issuers.

What makes the insider lists a questionable regulatory tool is the contrast between their usefulness for NCAs and their costs and inconvenience for issuers.

To gauge the usefulness of insider lists, one could ask if these lists are really all the authorities need to investigate allegations of insider dealing. They probably are not, as NCAs cannot rely on the accuracy or completeness of the insider lists and thus have to conduct their own investigations as a supplement. Consequently, the real benefit of insider lists is the relative reduction in investigative effort they provide authorities. Compared to the high costs

[4] That the exemption of course should be construed narrowly was emphasised by the CJEU in its decision of 22 November 2005 in case C-384/02, *Grøngaard & Bang*, paras. 34 – 38, however, and equally important, the CJEU also allowed for the exemption to encompass national law and practices, *in casu* on corporate governance, cf. paras. 39 – 40, which made the selective disclosure lawful under Danish law. This suggests an open ended and potentially wide-ranging exemption, where each case must fulfil the strict requirements of necessity.

for issuers of constantly updating the lists, while communicating to employees and others their inclusion or exclusion on the lists, insider lists appear to be a disproportionally burdensome measure.

The attempt to mitigate this problem by modifying slightly the burdens on SMEs is probably insufficient to stem the steady tide of companies going private or to encourage companies to go public at all. It is better, I think, to replace this ineffective measure originally associated with MAD with a more effective one suitable for the more mature regulatory environment of MAR.

In its Consultation Paper at p. 40, ESMA has suggested obliging issuers to establish and maintain effective arrangements, systems and procedures for the identification, handling and disclosure of inside information, in short to have systems that focuses on the inside information rather than on the people who happen to be in or out of contact with it.

This shift in focus from the heterogeneous and ever-changing group of individual insiders to the inside information itself as the objective of the record making makes eminent sense. It is easier for the issuer to identify the inside information and record its development and it is less intrusive than reporting on the people connected with it. Should the need for investigation by the NCA arise, the issuer will be able to provide its record of the inside information and from that the authority will be able to trace the persons with access to the inside information just as well as they can from insider lists, where such an exercise is also always necessary. Finally, whereas insider lists are solely of use to authorities, the record of inside information will assist the issuer that pays for it in many ways, most notably by making sure when to disclose, or to delay disclosure as the case may be, and to verify that selective disclosure subject to the exemption in MAR art. 10 was done legitimately, further secured by the fact that a recipient of inside information by selective disclosure would be discouraged from abusing the information when the disclosure has been recorded by the issuer.

Consequently, an obligation on issuers to record inside information and its development until disclosure is made or is no longer relevant is a welcomed innovation and one that should replace the current obligation on issuers to keep and update insider lists.

Re. Para. 9, Q46-Q57: Managers' Transactions, MAR Art. 19

Again, a good starting point when reviewing the provisions of MAR is to realise their limited use in achieving their aim of well-functioning and fair financial markets.

The obligation on insiders to report their transactions in the securities of the issuer where they are positioned according to MAR art. 19 provides the

markets with an interesting, though by no means effective or reliable information. Insiders' decision to acquire shares may reflect their confidence in the company and their benign expectations of future performance or it may simply reflect a contractual obligation to commit with the company. It may even be designed to install in the unsuspecting public an unwarranted confidence in the company in anticipation of financial problems. A decision to sell shares may warn of trouble ahead, or it may be caused by a need for liquidity due to personal arrangements, like major acquisitions of real estate, divorce, etc.

Considering the poor quality of the information arising from this reporting obligation, it is a redeeming feature that the obligation is not too burdensome or costly to comply with. Nevertheless, any review of this provision should consider whether compliance costs could be reduced even further.

MAR in its present shape allows for Member States to set the reporting threshold between 5,000 to 20,000 EUR. Although this option comes at the cost of having different regimes among Member States, it is probably a wise compromise among different opinions of the use gained from this kind of reporting among NCAs. The threshold ensures that the reporting obligation only arises once the insider has traded more than the threshold by a net calculation in that calendar year. Unfortunately, once this threshold has been passed, the insider is obliged to report every single transaction after that for the remainder of the year irrespectively of its size and relevance to the market, which is an unnecessary burden.

Since only major transactions by the insider is of interest to the market, it is questionable whether setting a fixed threshold is wise. However, only to rely on an obligation to report major transactions, say above 5,000 or 10,000 EUR per transaction, would allow the insider to make a series of minor transactions that could build up a considerable stake without reporting. If, on the other hand, the reporting requirement was triggered when the insider's holding changed with a certain amount, it would be possible both to capture major transactions and a series of minor transactions. Thus, it should be contemplated whether to substitute the present fixed thresholds with an obligation to report once the insider's holding is changed, by buying or selling, by a fixed amount of 5,000 or 10,000 EUR. Such a floating reporting obligation would strike a better balance between the limited importance of the reporting to the market and the compliance costs that it carries. A floating reporting obligation may also prove to offer a compromise among the different opinions of NCAs of its relevance, whereby they may be able to agree on a single standard amount, which would in itself provide for a harmonisation that reduces compliance costs.

A minor change to the existing reporting obligation in MAR art. 19 may help improve the inherently poor quality of the reported information. It is not unusual for high ranking insiders to have a contractual obligation to acquire shares in the company where they serve to ensure their commitment. It is also possible that other contractual obligations may commit the insider to trade at a given time, for example within a time frame after the issuer has disclosed its financial reports (known as an 'open window'). Since the relevance of the reported information is solely drawn from voluntary decisions to trade, because they just might reflect the insider's opinion of the issuer, it would enhance the quality of the reported information if it was accompanied with an obligation to disclose along with the reported transaction that the transaction was due to such a contractual obligation. It would, however, be too burdensome and an unnecessary intrusion into the insider's privacy generally to oblige the insider to explain the motivation behind voluntary decisions to trade, but an obligation to report that a trade was in some way done within a contractual obligation would improve the quality of the reporting considerably.

MAR art. 19, subsection 11, prohibits insiders from trading in the period of 30 calendar days before the issuer disclose its financial reports (known as a 'closed window'). The reasoning is probably that insiders may be in possession of inside information and thus should not trade as that might constitute insider dealing. However, since this is only a possibility and not a fact and since insiders may have perfectly legitimate and perhaps compelling reasons to trade, the ban's rather harsh limitation of the insider's personal proprietary rights may be set aside according to subsection 12. The responsibility for using subsection 12 lies with the issuer and is not an easy task.

In this way, MAR art. 19, subsections 11 – 12, are similar to MAR arts. 10 – 11 on unlawful disclosure; they are a mere prophylactic measure to safeguard the more important provision on insider dealing in MAR arts. 8 – 9. Considering that these central provisions on insider dealing are subject to a flexible and fair interpretation as laid out by the CJEU in its decision of 23 December 2009 in case C-45/08, *Spector Photo Group*, where emphasis is on whether the insider did not only possess inside information but did also abuse it to the detriment of others, it is highly questionable whether the prophylactic measure in MAR art. 19, subsections 11 – 12, are still necessary. Their abolition would in my view not increase the risk of insider dealing, but would serve to offer issuers a well-needed reduction of compliance. Issuers may decide on their own to maintain a similar system in regard of their insiders by contract, just as some issuers have contracts obliging insiders only to trade in 'open windows', but at least they would have the choice and not face a complicated statutory requirement of doubtful relevance.

Re. Para. 12, Q70-Q71: Sanction and Measure

It is unquestionable that regulation is an indispensable requirement for well-functioning financial markets and that proper and effective enforcement of the regulation is paramount to maintain trust in these markets, not only by their participants but by society at large.

The need to ensure vigilant enforcement has driven some jurisdictions to apply a regime of administrative sanctions as a separate and parallel regime from the criminal regime traditionally favoured to provide enforcement of regulation deemed important to society. This introduction of administrative sanctions was probably justified by considerations of efficiency and expedience. As more Member States introduced administrative sanctions, the question of possible harmonisation arose, and in MAD it was evident that administrative sanctioning were regarded as an effective tool for enforcement that Member States should adopt.

However, it is a development that raises important considerations of fundamental human rights as enshrined in the 1950 European Convention on Fundamental Human Rights and the European Charter. There can be no serious doubt that the purpose of administrative sanctions is the same as criminal sanctions: to discourage from violation and punish violation if it occurs. Thus, except for sanctions of insignificant amounts, an administrative sanction is likely to be viewed as a criminal measure under the Convention and the Charter.

The evolution of human rights has been driven by an understanding that while regulation and its enforcement are crucial for civilised society to function, it is also necessary to curb the immense powers of the State vis-à-vis its citizens in order to ensure that society remains civilised. The presumption of innocence, the right of defence in an independent court or tribunal of unbiased judges, the requirement of clear statutory basis for any sanctioning; these are all rights carefully developed over time and precious elements of a civilised society that should not be jettisoned for efficiency considerations. As was rightly observed by the official Swedish committee considering the implementation of MAD in 2005:

'To justify the introduction of administrative sanctions by the fact that the requirements of proof could be lowered whereby more people could by 'punished' is not compatible with basic principles of the rule of law.'[5]

[5] Cf. SOU 2004:69 at p. 69: 'Att motivera ett införande av ett administrativt sanktionssystem med att beviskraven då skulle kunna sänkas och fler skulle kunna "straffas" kan inte anses förenligt med grundläggande rättssäkerhetsprinciper.'

It is evident that basic principles of human rights law should not be compromised by considerations of efficiency. This has been made clear by the European Human Rights Court[6] and, less emphatically, by the CJEU.[7] Where 'administrative sanctions' are to be applied in parallel with a criminal regime, it is important that they, with the words of the CJEU:

– pursues an objective of general interest which is such as to justify such a duplication of proceedings and penalties, […],
– contains rules ensuring coordination which limits to what is strictly necessary the additional disadvantage which results, for the persons concerned, from a duplication of proceedings, and
– provides for rules making it possible to ensure that the severity of all of the penalties imposed is limited to what is strictly necessary in relation to the seriousness of the offence concerned.[8]

Furthermore, the inherent criminal character of most administrative sanctions will require that the fundamental rights of defence and to be tried before an independent and publicly transparent court or tribunal with impartial judges are safeguarded within the institutional set-up of the NCA wielding the administrative powers and that each jurisdictions allow for a proper remedy against any decision to sanction. It may be true that to provide these safeguards may impair the speed and efficiency otherwise sought by the administrative system as an alternative to the traditional criminal system, but that is hardly an excuse not to.

Consequently, rather than simply exploring whether Member States should be obliged to implement a system of administrative sanctions acting in parallel with the criminal system, it is of fundamental importance to ensure that such an administrative system is implemented correctly in accordance with binding obligations of human rights law in all Member States where such a system is in place. It is a duty of the European Commission to ensure that all NCAs live up to these basic standards of European and International law and it is a task that ESMA is well suited to help achieving. This must form part of any harmonisation exercise and should be pursued as part of the ongoing MAR review even if the current regime in MAR allowing Member States to maintain as single criminal regime is continued.

Such a continuation would, by the way, be reasonable, because Member States may adapt their traditional criminal system to be more flexible and efficient even without sacrificing fundamental rights. One example is Denmark,

---

[6] European Court of Human Rights, *Grande Stevens et al v Italy*, Application Nos. 18640/10, 18647/10, 18663/10, 18668/10, and 18698/10.
[7] In decisions of 20 March 2018 in case C-524/15, *Menci*, and case C-537/16, *Garlsson Real Estate*.
[8] *Menci* decision (n. 7) para. 63.

which continues to apply a single criminal regime, but where the NCA is empowered to offer a criminal fine in a summary procedure in cases where the violation is not grave and stands undisputed. This is a simple and speedy procedure and if the violation is contended, the matter is transferred to the courts which guarantee a trial under full observance of all fundamental rights.

---oOo---

If you have any questions or comments, please feel free to contact me.

Yours sincerely,

[signed]
Jesper Lau Hansen
Professor, Dr. Jur.