

Mr Fabrice Demarigny
Secretary General
The Committee of European Securities Regulations
11-13 Avenue de Friedland
75008 Paris
France

Michael McKee
Executive Director

Direct Line: 020 7216 8858
Direct Fax: 020 7216 4358
E-mail: michael.mckee@bba.org.uk

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Dear Mr Demarigny

BBA Response to CESR's Consultation Paper on Additional Level 2 Implementing Measures for the Market Abuse Directive

The British Bankers Association is well known to CESR and has often made submissions to you in the past including our response to the Call for Evidence in relation to CESR's Second Mandate, a copy of which is attached.

This response to your Consultation Paper on the second mandate relating to market abuse implementing measures is structured as follows:

- ◆ Cover letter containing main points
- ◆ Drafting amendments proposed for the proposed level 2 advice (attachment 1)
- ◆ Answers to the questions asked by CESR in the CP (attachment 2)
- ◆ BBA response to Call for Evidence (attachment 3)

Overview of Key Issues

- The approach to accepted market practices is broadly acceptable but depends upon good co-ordination and further work on practices being done at Level 3.
- We consider that the approach to insider lists needs to be changed. It is too bureaucratic, too detailed and too complex. We consider that the Directive is really focused on the production of permanent insider lists, not on ad hoc lists for particular transactions or particular pieces of inside information. CESR should simply require lists for permanent insiders in issuers or those advisers who are permanent insiders of the issuer.

- If CESR does not accept this the approach to ad hoc lists needs to be modified. The focus should be on creating a list for a specific transaction, not for a specific piece of inside information. The people working on the transaction should be listed and this should be regularly updated but the list should only have to be provided to the competent authority on request – typically as part of a market abuse investigation.
- The approach to commodities derivatives is broadly acceptable.
- For disclosure of transactions the list of permanent insiders should be used to define which insiders must disclose their transactions.
- The lack of a safeharbour for reporting suspicious transactions is a serious defect in the Directive. Even if this cannot be fixed by CESR CESR should state the problem and ask the Commission, Parliament and Member States to seek to resolve this by creating a safeharbour akin to Art 8 of the 1997 Money Laundering Directive.
- Less detailed information should be required when reporting a suspicious transaction.

Accepted Market Practices

We agree that CESR should focus on advising on principles and process to be adopted in deciding what are “accepted market practices” (para. 20 of the CP). Indeed we would suggest that getting the right processes is particularly important. The process must be capable of taking into account how different markets work in different member states. As we said in our response to the Call for Evidence we consider that it would not be appropriate to attempt to make detailed rules at EU level on specific practices in different markets.

We agree that when considering the market manipulation defence the right approach is to focus on the impact of a practice on the price formation process rather than on consumer protection or conduct of business issues (para. 28 and 29 of the CP). It is the integrity of the price formation process which is critical in manipulation cases. Breaches of conduct of business rules are regulatory issues but, in themselves are not market abuse. While clean markets result in better protection for consumers the regulatory mischief in market abuse is abuse of the market as a whole rather than abuse of a customer or consumer. Abuses which harm investors are usually dealt with by other regulatory or legal rules such as civil claims, complaints processes, ombudsmen, criminal offences or conduct of business rules.

We agree that the focus of CESR’s approach should be to provide principles and processes to aid Competent Authorities to analyse a given market practice (para. 30 of the CP). It is correct, in our view, to focus on the Competent Authority as the primary user of the implementing measures. The implementing measures will have a secondary role of assisting market participants in forming a view of matters which the Competent Authority is likely to take into account in deciding whether or not a practice should be accepted.

Where a regulator has concerns about whether or not a market practice is acceptable consultation with market participants should be encouraged. Consequently we also support the bullet point requiring adequate consultation processes included in the technical advice at para. 36.

We consider that it is extremely important that CESR and Competent Authorities should generally assume that a market practice is acceptable unless there are strong grounds for thinking that it is abusive and should be slow to brand practices as unacceptable just because they have not been encountered before.

We also consider that the Competent Authority should be able, in the course of an investigation or enforcement action, to take a view that a particular practice which it has not previously encountered is, nonetheless acceptable. Often questions about the acceptability of a practice arise for the first time during an investigation and it makes sense to allow this to be the medium through which the Competent Authority can form a provisional view on a practice. In such cases, however, it might well be appropriate for the Competent Authority to consult about the practice in question so that its view on the acceptability (or not) of the practice can be tested against market participants' views. (We are assuming here that the matter has not been definitively decided by a judge.)

Definition of “Inside Information” for Commodities Markets

We consider that the approach adopted by CESR is broadly along the right lines and, in particular, agree that the correct approach is to focus on information which is discloseable.

We consider, however, that it should be clarified that the focus should be on information which is discloseable in commodities markets. For example in equities markets many types of information are discloseable which are not discloseable on, for example, the London Metal Exchange. So, for example, it may be that a particular piece of information about a contract would be discloseable by an issuer on the London Stock Exchange but not on LME. In such circumstances it should not be treated as “inside information” for the purposes of trading on LME.

Insiders' Lists

The proposals in this part of the CP cause great concern to our members. They strongly support the need to have markets which investors have confidence in, and in which the disclosure of inside information is well managed and properly handled but they believe that the proposals are not the best way to achieve this, nor are they required by the Directive or the Commission's mandate.

The main proposals are:

- ◆ That the obligation to draw up a list should not just apply to an issuer but also to persons acting on their behalf (but without any clear definition of who is regarded as acting on behalf of an issuer).
- ◆ That a list should be begun as soon as a piece of inside information comes into existence.
- ◆ That a separate list should be created for each fresh piece of inside information.
- ◆ That each list should be continuously updated every time a new person is informed about the piece of inside information.

- ◆ That when someone ceases to have access to the information this should be recorded also.

CESR recognises, correctly in our view, that this will be an onerous obligation and that firms will have to dedicate additional resource to it.

Our members concern is that the approach proposed by CESR is not required by the Directive and yet, if implemented, is likely to create such a plethora of lists and internal tracking requirements that it will result in the production of lists which are unreliable, confusing, expensive to produce, and only a small proportion of which will, in the end, be required by a competent authority for the purposes of a market abuse investigation. Overall the proposals appear disproportionate and unnecessary to achieve the policy objectives of the Directive or the regulatory purposes of CESR and member state competent authorities.

In particular it should be remembered that it is not always possible to recognise that information is “inside information” at the outset. For example an initial meeting between senior executives of two companies may lead to discussions about a possible merger but it may be some time before it becomes clear that the discussions are sufficiently concrete to constitute inside information. As a result it is impractical to require firms to start lists immediately a piece of information becomes “inside information”. Similarly if there is an obligation to continuously update it is inevitable that the list creation and update will constantly run behind the flow of inside information. If it does not then the job of ensuring that the list is updated before information flows will inevitably significantly impede the normal and necessary flow of confidential information during a transaction, or during, for example, an issuer’s internal accounts preparation.

We consider that the key questions are:

- (1) What appear to be the legal requirements and the policy objectives of the Directive?
- (2) What is the most practical way of achieving them with minimum disruption to issuers and their advisers?

Below we set out our analysis of (1) and the approach for (2) which we consider is the right one in view of the analysis.

The Legal Requirements and the Policy Objectives of the Directive

The overall policy objective of the Directive is set out in Recital 12:

“to ensure the integrity of Community financial markets and to enhance investor confidence in those markets”.

Recital 24 applies to preventive measures relating to market abuse and recognises that a range of compliance measures can assist in preventing inside information from being abused. In particular it is said that:

“such measures could include, for instance, the creation of “grey lists” [and] the application of “window trading” to sensitive categories of personnel”.

Article 5 of the EU Treaty and Recital 41 of the Directive emphasise the obligation for measures to be proportionate.

Recital 43 requires the Commission, in making implementing measures, to respect a range of principles including:

- ♦ “the balance of costs and benefits to market participants on a long-term basis...in any implementing measures”
- ♦ “the need to foster the international competitiveness of EU financial markets...”

The substantive article in the Directive relating to lists is Article 6. The first point to bear in mind about Article 6 is that, in contrast to the preceding Articles which apply more generally to “any person” Article 6 paragraphs (1) (2) and (4) apply solely to issuers and paragraph (3) applies solely to “an issuer, or a person acting on his behalf or for his account”.

Consequently the focus of the provision is on inside information created within an issuer and what should be done in relation to its management. Moreover, it is evident from Recital 24 and from the context that a list is seen as a preventive measure, rather than an investigation tool for the competent authority. It is envisaged as being one list – the text of Art. 6(3) says “a list”, not “lists” and it does not envisage separate lists for separate pieces of inside information because it talks about “access to inside information” generically, rather than access to specific pieces of inside information.

The wording in Art. 6(10) relating to the conditions under which “a list” is to be drawn up is consistent with our interpretation above.

Practical Means of Achieving the Directive’s Policy Objective

In our view what the Directive envisages is a list of permanent insiders i.e. persons who by virtue of their position either as senior managers or their function in a particular department e.g. the finance department have regular access to price sensitive information. The value of such a list is that it can be used to manage such preventive measures as close periods and the pre-clearance measures associated with them. (See our answers to Questions 13 and 17 for more comment on this.)

Most member states already have established the principle that issuers must create this type of list – either through legislation or through regulatory rules. It appears to us to be likely, in consequence, that this is the sort of preventive measure the Council had in mind when considering the legislation since it is relatively unusual for the Council to agree to legal obligations which do not exist already in many member states.

CESR’s approach seems to us to misread the Directive. It requires the production by an issuer of “lists”, rather than “a list”. It requires differentiation between different types of inside information on different occasions whereas the Directive focuses on “access to inside information” generically. It appears to focus on the use of a list as a tool for investigation after the event, rather than as a preventive measure which, coupled with close periods and pre-approval procedures will assist the control of the use of inside information by permanent insiders.

It is entirely novel to require this as a legal obligation in the EU. To the best of our knowledge no regulator currently obliges the creation of lists of this type. (The Dutch banking regulator has some obligations to produce lists – but these are more in the nature of permanent insider lists.) It would seem strange that member states would have agreed to such a novel approach imposing significant additional burdens on regulators, issuers and the regulated community.

We strongly believe that the right way forward is to require each issuer to create a permanent insider list. If there is someone outside of the issuer who can properly be regarded as a permanent insider of the issuer then they should also be included in the list and should be subject to similar pre-approval procedures to insiders employed by the issuer. An example of this might be the audit partner of the accountants auditing a particular issuer.

This approach is manageable by issuers, is not unduly expensive and is in line with the legal text and the objectives of the Directive.

Insider Dealing Investigations and Lists

CESR's approach is, we believe, focused on assisting a competent authority in circumstances where it is investigating possible insider dealing as a result of information received.

In such circumstances the competent authority naturally wishes to know who knew the inside information and would no doubt like to have a list of which people had this information. We consider that it is reasonable that in such circumstances, after the event, the competent authority should be able to ask an issuer for this information (and any other parties who may have been privy to the information such as a potential acquirer or merger partner in a takeover and the advisors to them). However, we do not consider that this is what the Directive is aimed at in Art. 6(3). The Directive does not preclude Competent Authorities, during the course of an investigation, from asking for lists of people who knew about a particular transaction.

If CESR requires ad hoc lists to be produced

If CESR does not accept our analysis we consider that it is still essential for CESR to draw a clear distinction between a list for permanent insiders and ad hoc lists. It should be recognised that the two types of list perform different functions and are used by regulators and by firms in different ways.

Permanent lists are used to aid preventive measures such as quiet periods and identifying which people are subject to obligations to disclose share transactions. They are of use to issuers in controlling the actions of people who habitually have inside information but they are not of use in insider dealing investigations.

Ad hoc lists are not used to prevent anything but are of assistance after suspected market abuse has occurred as an aid to investigating insider dealing.

We believe that the approach to ad hoc lists needs to recognise this and to be modified. The focus should be on creating a list for a specific transaction, not for a specific piece of inside information. The people working on the transaction should be listed and this should be regularly updated but the list should only have to be provided to the competent authority on request – typically as part of a market abuse investigation.

Focus on Transactions not on Pieces of Information

In the course of the consultation a number of CESR regulators have suggested that ad hoc lists should be produced along the lines suggested by CESR “because firms are doing this already”.

It is important to recognise:

1. That issuers and their advisers do not produce lists based on the concept of “a piece of inside information coming into existence”. Insofar as any list is produced at present it is either a permanent insider list or, in corporate finance activity, a corporate adviser will often keep a list of the people within the adviser who are working on the transaction. It is not clear to us that the issuer will track the individuals within the issuer working on a particular transaction or that other advisers to the issuer (e.g. lawyers, accountants, PR advisers) keep such lists.
2. Such lists as are produced are not produced and transmitted to the competent authority as they are developed and updated. They are only ever provided to the competent authority when it requests them – and this will invariably in the context of a specific investigation. In many advisors (e.g. law firms and accountants) typically they are not drawn up in advance and on an ongoing basis but in retrospect as a result of a specific request from the regulator during an investigation.

We have already pointed out the difficulties of knowing when a piece of “inside information” comes into existence. There needs to be a clear and practical trigger for the creation of an ad hoc list. The obvious trigger for an adviser must be a request from the issuer to work on a specific transaction or project which is evidently going to result in inside information passing from the issuer to the adviser. Consequently we would propose that CESR should say that an obligation arises on an advisor at that point.

Contents of the Ad Hoc List

During the course of a transaction it is impossible to track precisely which bits of inside information a person has who is working on it. Some people will know almost everything, others will be brought in to advise on a particular part of a transaction but will not know other bits of it. In view of this the list should not say who knew what. Instead it should simply say who was given access to the transaction information at what point i.e. a name and a date. It is not practical to know when a person ceased to have information and so there should be no requirement to list when someone ceased to have information. Instead the list should say when the transaction information became public (e.g. because it was announced to the market) or, if the transaction was abandoned, the date when this happened so far as it can be ascertained (in some cases a transaction is not formally abandoned it simply gradually ceases to be pursued).

It is also important to bear in mind that there are substantial confidentiality risks in requiring lists to contain details of who knew what information when on a continuous, ongoing basis. Creating such a list produces a written record which is likely to be extremely commercially sensitive. This magnifies the risk that it will leak into the public domain during the course of a transaction with possible disastrous consequences for the transaction. A list of names and dates is still commercially sensitive – but to a lesser degree.

Transmission of List to Competent Authority

Art. 6.3 states “Issuers ...shall regularly update this list and transmit it to the competent authority whenever the latter requests it.”

A natural reading of this sentence indicates that there is no obligation to send the list to the competent authority once it has been begun, or even during its developing preparation. What appears to be envisaged, and makes sense, is the idea that there is no obligation to send the list to the competent authority at all – except on request.

We propose that that is the approach which CESR should adopt – to say that the list should only be transmitted to the competent authority when the competent authority requests it.

We would also propose that CESR should advise competent authorities that they should confine themselves to only requesting a list from an issuer or its adviser on a case by case basis. It would be counterproductive, in our view, for a competent authority to ask all issuers to provide their lists on a blanket basis once a month, say. This would simply lead to the competent authority receiving a flood of paper much of which it would never use.

Indeed, as we have said, there are dangers in seeking lists during the period when the transaction is confidential because if such a list accidentally entered the public domain this would itself be potentially very damaging for the transaction involved – consequently a list should only be sought while a transaction is in progress where there are reasons to investigate that transaction or other very serious regulatory concerns.

Disclosure of Transactions

We consider that the same list of permanent insiders resulting from Art. 6(3) can also be used as the list for disclosure of transactions. The permanent insiders are the “persons discharging managerial responsibilities with an issuer of financial instruments and, where applicable, persons closely associated with them.”

As a result the list acts as part of a preventative mechanism both for close periods and for pre-approval mechanisms and disclosure. See our answer to Q17 for more detail.

Suspicious Transactions

We have two important points about this part of the CP:

1. Need for protection of persons making suspicious transaction reports.

In our response to the call for evidence we pointed out that Art. 8 of the Second Money Laundering Directive (2001/97/EC) protects a person making a suspicious transaction report in good faith from any civil claim from the person in respect of which the report was made. No equivalent protection is included in the Directive. We consider that this was simply an oversight. There is no good reason in principle why one type of report should be protected and the other should not when the EU has decided that both types of report should be required in the public interest.

CESR has acknowledged the point in the CP but has said (paras. 83 and 84) that this issue falls outside the scope of the mandate which it has been given.

While we recognise that this is so we would strongly urge CESR to raise the issue with the Commission, and with national legislators who will implement the Directive, and urge them to remedy this disparity between the two Directives. We recognise that as the Directive has just been adopted it is likely to be impossible in the short term to amend the Directive itself – but the change could be achieved either by the Level 2 implementing measure which would apply in all member states or by each member state implementing the Directive by including the necessary protection in its national legislation.

2. The information to be provided in a suspicious transaction report

When someone finds a particular transaction suspicious they often do not have detailed information about it. Indeed in some cases a person may not even know that a particular transaction is suspicious – for example a trader may see activity in the market which, due to his experience of that market, is unusual.

In view of this in many cases a person will not have the information set out in paragraph 99 when he first becomes suspicious. In some cases he will never have all of this information. In view of this we consider that it is better to consider Para. 99 as a checklist for the regulator. The information in 99 will not all be required in every case and will often not all be available when the suspicion occurs. Consequently the word “shall” should be deleted and a different approach taken.

We would suggest that the approach should be that the person making the notification should provide the competent authority with such relevant information as it is able to at the time of the notification and that, thereafter, it shall provide such information in its possession that the competent authority requests.

The information listed in paragraph 99 should not be included in the Level 2 advice – but as part of Level 3 it would make sense if competent authorities agreed a checklist of information which is usually helpful to assist them in taking a common approach to these sorts of cases.

Conclusion

We hope that CESR will give careful consideration to the points we have raised, particularly our analysis of Article 6(3) and the approach to insider’s lists.

If you wish to discuss this letter further with the BBA please contact me on 00 44 20 7216 8858.

Yours sincerely

Michael McKee
Executive Director
Wholesale Banking and Financial Services

Attachment 1

BBA Comments on proposed technical advice

Para. 34 No comments. The principles appear to be on the right lines.

Para.35 Bullet four: We consider that there are considerable dangers in this bullet and that it should redrafted. Our concern is that in its present form it would leave a financial services institution exposed to considerable regulatory uncertainty when running a global book passing from Asia, to Europe and on to the US on a round the clock basis. The book would be dealing in the same product, say a fixed income security. When trading the book in Europe it is reasonable for a bank to take into account trading in Europe but it is unreasonable for the trader at the bank to have to take into account the likely impact of his trading on the Asian market which will be subject to many different considerations and regulatory rules.

We suggest the following redraft:

“The risks inherent in the practice for the integrity of similar markets in the financial instrument, including any market in the financial instrument which exists on an exchange (or another trading venue) and related markets in directly related financial instruments. The greater the risk to the integrity of a comparable market within the EU, the more unlikely it is to be accepted.”

Bullet five: We would suggest that the last sentence is redrafted to read:

“Similarly the extent to which a practice breaches any codes of conduct applicable in whole or in part to market abuse should also be considered...”

This is because it is necessary to tie the breach of a code to a connection with market abuse. There are many different codes of conduct and it should not be necessary to have to look at those which are not directed towards market abuse in deciding whether the Competent Authority’s assessment of a factor may result in a finding that a practice is unacceptable.

Bullet seven: The following clarification should be added: “The mere fact that a large position is held by a firm will not, of itself, be regarded as abusive.” This will ensure consistency with CESR’s technical advice in relation to the first set of implementing measures.

We also consider that the focus should be on actions which result in a structural failure in the market. The following should be added at the end of the bullet point: “Practices which result in serious structural failures in the market are more likely to be unacceptable.”

- Para. 36 We consider that the first bullet point – regarding consultation is particularly important. When considering the views of other Competent Authorities we would suggest that where the same product is traded on more than one market the views of the Competent Authority regulating the market with the most significant liquidity/volume in the product may be particularly relevant or persuasive as they are likely to have most experience of how the market for the product operates.
- Para. 46 It should be clarified that the focus should be on information which is discloseable in commodities markets. For example in equities markets many types of information are discloseable which are not discloseable on, for example, the London Metal Exchange. So, for example, it may be that a particular piece of information about a contract would be discloseable by an issuer on the London Stock Exchange but not on LME. In such circumstances it should not be treated as “inside information” for the purposes of trading on LME.
- Para. 47 No comment.
- Paras 58 to 63 We would redraft all of this technical advice. A suggested redraft might run as follows (using the numbering from the CP and seeking, broadly speaking to follow the issues covered in each of paras. 58 to 63 in the CP):
58. “An issuer shall establish a list of those persons working for it, under a contract of employment or otherwise, who have access to inside information on a regular basis. The list may be drawn up on behalf of the issuer by a person acting on behalf of the issuer or on its account, rather than by the issuer itself.”
59. “A list should indicate at least:
- the name of the person
 - the person’s functions and responsibilities
 - the date on which the person’s name was put on the list
 - when relevant the date on which the person ceased to have regular access to inside information
60. Persons in an issuer likely to have inside information on a regular basis include:
- Directors
 - Members of a supervisory board
 - The Chief Executive
 - Direct reports of the Chief Executive
 - Many staff in the Finance Department

Many staff in the Compliance Department

61. Persons who are not employed by the issuer will not usually have inside information from the issuer on a regular basis. However, if a person who acts on behalf of, or for account of, the issuer does have access to inside information on a regular basis they should be included in the list (e.g. in some cases the audit partner of an accountant auditing an issuer).
62. A list should be updated regularly recording new individuals who have become regular recipients of inside information and the dates when those who were regular recipients of inside information ceased to be so. Lists should be kept for [the length of time required by the provision on record keeping in CESR's investor protection standards].
63. An issuer, and persons acting on their behalf or on their account, will also have persons employed by them who receive inside information in relation to specific transactions, but not on a regular basis. An issuer and persons acting on their behalf should have arrangements which will permit them to know which persons received information in relation to a specific transaction and should be able to provide this information to the competent authority on request within a reasonable time period.
64. Issuers, and persons acting on their behalf or for their account, should ensure that any persons that may have access to inside information are aware of, and acknowledge, their obligation to keep inside information confidential, and of the penal, administrative and disciplinary sanctions which may be incurred through the misuse or improper disclosure of such information.
69. Delete this as it is captured by the redrafted 62 above.
73. See our answer to Q.17 below. There is a strong connection between Art. 6(3) and 6(4) of the Directive. 6(3) is framed in terms of people having access to inside information 6(4) focuses on "persons discharging managerial responsibilities within an issuer...and persons closely associated with them. The link is that it is the access to inside information which is key – and in practice it is "persons discharging management responsibilities and those closely associated with them (e.g. internal accounting staff of the Financial Director) who have this access. We agree, therefore, that "access to inside information" is a key component of the definition in 73.

We would slightly redraft 73 to make this clearer. Our suggested redraft is:

"Persons discharging managerial responsibilities within an issuer and persons closely associated with them" are persons having regular access to inside information within the issuer. These are usually persons having decision making powers or working closely with decision makers. This is usually the case for: [text then the same as in CESR draft].

75. See our answer to Q.18
77. See our answer to Q.19
79. See our answer to Q.20
94. We suggest that the second sentence is reworded and move to the end of the paragraph. We would redraft as follows: “A person notifying a transaction need not have any documentary evidence to support the suspicion.”
96. As mentioned in our cover letter there should be scope for taking some time to make internal inquiries prior to notification, and for discovery of a suspicion some time after the transaction took place. We suggest the following redraft which makes it clear that the key point is when the suspicion is formed rather than when the transaction takes place:
- “In relation to a transaction or a group of transactions, notification without delay shall mean:
- so far as practicable immediately after the suspicion has been formed (but it is permitted where necessary, to take time to check information and carry out internal inquiries to substantiate the suspicion).”
- This redraft avoids the need for two bullet points in para. 96 since it applies regardless of whether the suspicion is formed before the transaction takes place, at the time of the transaction or some time after the transaction.
99. See our comments in the cover letter and in response to Q.23. We would redraft the first sentence as follows:
- “The person making the notification should provide the competent authority with such relevant information as it is able to at the time of the notification and, thereafter, shall provide such information in its possession that the competent authority requests. Among the information which the competent authority may request is the following: ...”
103. See our answer to Q.24.

Attachment 2

Answers to CESR Questions

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

A: In principle we consider the proposed approach to be broadly along the right lines subject to our comments in the cover letter. We consider that in assessing market practices the focus should be particularly on markets within the EU. Although the financial markets are global it can be very misleading at times to make assumptions about practices in markets in other continents which may be driven by different market dynamics and therefore are not necessarily relevant (e.g Asian markets and the US markets).

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?

A: See our comments on Paras. 34 to 36 of the CP in Attachment 1

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 kinds of regulated markets or MTFs (e.g. order driven or price driven)?

A: At the high level of generality proposed it is not necessary to distinguish between OTC and exchange trading. However, OTC markets are likely to have different characteristics than organised exchanges and therefore the application of the principles and factors is likely to have to be different in relation to OTC trading. The same is true of trading on MTFs rather than exchanges – where particular attention needs to be paid to the nature of the MTF and how it interacts with other parts of the market e.g. exchanges or the OTC market. Whether the MTF is order driven or price driven would be one aspect of this.

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?

A: Yes, indeed it is very important that this should be the case otherwise there is a serious risk that innovation in the marketplace will be stifled.

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

A: We do not consider that it is appropriate to specify market practices which are accepted in advance. We consider that the better approach is to assume that many practices are acceptable and that, therefore, it is not appropriate to require a practice to be accepted by the

regulator in advance before it is used.

What is acceptable is better worked out going forward based on concrete issues which arise. So, for example, an enforcement action may raise issues about whether a particular issue is acceptable or not. It should be possible during the course of the investigation or the enforcement action for the regulator, or ultimately a judge, to take a view on whether or not a particular practice is acceptable. Another situation might be that an innovative practice was developing but there was some uncertainty about the right regulatory approach and whether it might be considered to be abusive or not. This could be handled by a consultation by a Competent Authority or, if the practice was widespread across Europe, by a CESR consultation.

We consider this to be the better approach because markets often change quite rapidly and there needs to be flexibility to permit such evolution. The general assumption adopted by the Competent Authority should be that a practice is acceptable unless there are strong grounds for thinking that it is abusive.

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

A: We believe so.

7. Is there further information which is material, relevant and discloseable in relation to commodity derivatives markets?

A: We believe not.

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

A: See our cover letter and comments on para.46 of the CP.

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

A: See our cover letter and comments on para.46 of the CP.

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

A: No. The approach proposed by CESR is disproportionate, excessively bureaucratic, expensive and likely to be unreliable. We are not convinced that the text of the Directive requires such an approach. See our more detailed comments in the cover letter which suggest a number of possible approaches which we consider would strike a better balance between meeting public policy and regulatory concerns on the one hand and achieving a proportional impact on the other.

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

A: No. See our comments on Para. 60 of the technical advice in attachment 1.

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?

A: This is not necessary. It should be sufficient to be able to refer to CESR's Technical Advice to obtain a general indication of the sorts of persons who may hold inside information. The list will never be capable of being comprehensive and consequently should not be included in the text.

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?

A: See our cover letter. We consider that the Directive requires a list of permanent insiders of the issuer. Such a list is generally accompanied by a pre-clearance procedure which recognises the fact that there are circumstances when someone who has access to inside information may not, as a matter of fact, have that information at a particular point in time and, in consequence, may be permitted to deal. Dealing without such pre-clearance when it was required would usually constitute circumstantial evidence to suggest market abuse. We consider that Article 6(3) is actually intended to result in the creation of a permanent insider list for issuers and only a permanent insider list.

We consider that if CESR was to advise that a list of "permanent insiders" should be created this should apply to issuers only, it must be accompanied by a requirement that there should be pre-clearance procedures for persons on the permanent insider list and that it should be stated that if a person on a permanent insider list deals without pre-clearance then this constitutes circumstantial evidence suggesting market abuse.

See our answer to Q.17 for additional important comment on the concept of a list of "permanent insiders".

We do not think that Level 2 should identify jobs which typically provide access to inside information – because the list would never be capable of being comprehensive.

14. Would it be useful to further develop at Level 3 the "illustrative system" outlined?

A: No. We consider that the illustrative system is not particularly helpful.

15. Would it be useful to describe the meaning of the expression "working for them", for example, to give clarification regarding people who are not employees of the issuer?

A: More clarity is needed on this. In particular we would suggest that it can only apply to a person with a contractual relationship with the issuer which requires the person to contracted to act on behalf of the issuer in some respect, and that where the person is a legal person the person which it should list should only be the individuals working within a legal person acting for an issuer who are actually working on behalf of the issuer, not other staff of the legal person.

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

A: No for the reasons given in the cover letter and in other answers in attachment 2.

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?

A: If CESR recommends that an issuer has a list of “permanent insiders” we consider that the permanent insiders should be the individuals to whom this obligation applies. This would mean that only one permanent insider list would need to be kept but it would answer two requirements: (1) who must disclose transactions carried out by them (2) who is an insider for the purpose of close periods and similar restrictions associated with knowledge of inside information. It is conceivable that there may be some individuals acting for an issuer but not employed by it who would have such regular access to the issuer’s inside information that they would need to be included on the list (e.g. an audit partner as mentioned in the cover letter).

The approach outlined has the advantage of administrative simplicity while delivering targeted regulatory preventative measures.

When Articles 6(1) and 6(4) are read together it is evidence that these obligations are all focused on the issuer itself – and this supports the view that any permanent insider list for Article 6(3) and 6(10) purposes should apply only to the issuer, not its advisers.

Consequently we consider that the phrase “persons discharging managerial responsibilities within an issuer of financial instruments...” should be read to apply to persons who have access to inside information and who have decision making powers and are on a permanent insiders list. “Persons closely associated with them” should be those persons on a permanent insiders list who do not have decision making powers.

The definition, consequently, should be restricted to managers having access to inside information who are on the permanent insider list and those working closely with them who are also on the permanent insider list.

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

A: The description is sufficient. There are no other persons who should be included in this category. The key is to reach a definition which is clear and can be policed.

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

A: The description is sufficient. There should be no threshold.

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?

A: The description is sufficient. There are no other details which should be covered at Level 2.

21. Do you agree with the proposed approach?

A: See our comments in cover letter and Attachment 1

22. Do you think other possibilities should be taken into account?

A: Yes – time should be permitted to investigate in circumstances where you are not sure if you have grounds to make a report and are able to make internal checks to assist in making this decision. Allowance should be given for the situation where the suspicion arises some time after the transaction has taken place. In such circumstances the obligation should arise when the suspicion occurs.

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

A: No. We consider that Para. 99 is more of a checklist for the regulator. The information in 99 will not all be required in every case and will often not all be available when the suspicion occurs. Consequently the word “shall” should be deleted and a different approach taken. See our comments in the cover letter.

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

A: We consider that the advice in para. 103 is appropriate subject to adding the phrase “or any other reasonable form of communication” so as to include, for example, meeting face to face with the competent authority.

Attachment 3
BBA Text to CESR on 28 February 2003

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Fabrice Demarigny
Secretary-General
CESR
11-13 Avenue de Friedland
75008 PARIS

Michael McKee
Director

Direct Line: 020 7216 8858
Direct Fax: 020 7216 4358
E-mail: michael.mckee@bba.org.uk

28 February 2003

Dear Fabrice,

Second Commission Mandate on Market Abuse

The British Bankers Association is well known to CESR and has often made submissions to you in the past.

We are writing to you with brief comments on the new mandate given to CESR by the European Commission.

We would comment on the five different aspects of the mandate as follows:

Accepted Market Practices

We would encourage CESR to adopt a fairly high level approach to this part of the mandate and focus on the general factors to be taken into account in deciding whether a practice is accepted or not. We consider that it would not be appropriate to attempt to make detailed rules at EU level on specific practices in different markets.

Our own experience, in the UK regime, has been that it has often been easier to obtain a sense of what is acceptable by giving clear guidance about what is not acceptable.

We agree with the Commission that the focus should be on factors – and it may be that some of the indicative factors relevant to market manipulation identified in CESR's first technical advice on market abuse may be relevant here. These factors should be clearly identified as indicative factors to which the competent authority in each member state should have regard in determining what is accepted market practice, rather than market participants (as is the case with the market manipulation factors).

Application to Commodity Derivatives

It seems to us to be premature to do much work on commodity derivatives since these financial instruments will not be covered by the EU Market Abuse regime until the new ISD is implemented. We would suggest that any work in this area should be high level.

We would encourage CESR to take into account the fact that there are no “issuers” of commodity derivatives and consequently no one on which to impose obligations to produce regular financial information and other announcements in relation to these instruments (in contrast to equity markets). Consequently only certain types of information which are either required under a legal or regulatory disclosure requirement or are regularly announced to the market (or expected to be announced) are price sensitive. Typically these announcements are either information which the exchange itself collects and announces or government statistics or information relevant to a particular commodity. We would suggest that CESR should ensure that the definition of “inside information” in the commodity markets should be tied to the fact that such announcements are made. In the UK it is by linking relevant information to the concept of “announceable” information that the UK market abuse regime was made to work for commodity markets.

The UK is, to the best of our knowledge, the only European jurisdiction which has had to apply a market abuse regime to the commodity markets and we would suggest that its precedent and experience should be carefully considered by CESR in formulating its advice.

List of Insiders

The focus of this work should be on issuers rather than on their advisers and the responsibility of maintaining such lists should lie with the issuer.

It should be borne in mind that the sort of information which becomes “inside information” can vary considerably. Some of this information can be easily predicted (e.g. unpublished results information) and the people holding it can be easily identified in advance. Other types of information become “inside information” on a more ad hoc, or occasional, basis e.g. a decision to take over a company results in a range of people becoming insiders who would not necessarily be involved in the production of the routine financial results.

Careful thought needs to be given to the balance between creating insider lists and not imposing too burdensome an obligation on issuers.

Persons subject to a duty to disclose own dealing

Financial services firms in Europe and elsewhere are generally used to imposing personal account dealing obligations on certain of their employees who may have access to inside information. We would suggest that insofar as the requirements will also apply to issuers they should not be under any lower obligation than financial services firms.

We understand that the rules are intended to apply to the personal account dealing of private individuals. This should be made clear.

Suspicious Trades

The regulatory emphasis should be to encourage individuals to report suspicious trades. The more burdensome is the procedure for reporting suspicions the less likely that a good flow of reporting will take place.

We do not consider that the approach taken for money laundering reporting is the best model to follow. It has proved to be expensive and paper heavy and there is little evidence that it has led to significant improvement in the number and quality of criminal prosecutions.

We would encourage CESR to seek for solutions which are straightforward to implement and not document heavy.

We also are concerned that no protection has been included in the Directive for those who may in good faith report a suspicious trade which subsequently proves to be legitimate. As matters stand there must be significant risks of civil liability to our members and their staff in making such reports. In order to encourage reporting Level 2 measures should include a rule that reports of suspicious trades made in good faith are protected from civil claims.

If you wish to discuss this letter further with the BBA please contact me on 7216 8858.

Yours Sincerely

Michael McKee
Director
Wholesale & Regulation