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Dear Sirs

12 June 2009

Call for evidence on Market Abuse Directive (Directive 2003/6/EC)

THE CITY OF LONDON LAW SOCIETY

The City of London Law Society (**CLLS**) represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response to the **call for evidence in respect of the review of Directive 2003/6/EC on insider dealing and market manipulation (MAD)** has been prepared by the CLLS Regulatory Committee. Members of the CLLS Regulatory Committee (the **Committee**) advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

CONSULTATION QUESTIONS

Before commenting specifically on certain of the specific questions, we would like to comment on the following area of general concern which is not wholly captured by the questions.

There are cross-border differences which arise from the way in which the Market Abuse Directive has been implemented in practice across Member States. These differences can impose unnecessary burdens and costs on market players who operate on a cross-border basis, and in circumstances where the conduct falls within the remit of more than one competent authority, can leave them facing different and occasionally incompatible rules in respect of the same conduct.

We appreciate that the call for evidence is not intended to address the issue of supervisory and enforcement powers under the MAD (which is to be addressed on a horizontal basis initially, through various initiatives aimed at responding to market, regulatory and supervisory weaknesses identified in the financial crisis, with the results to be used in the review of the MAD). However, we believe that the lack of harmonisation within supervisory practices across Member States remains an obstacle to the creation of a level playing field across the EU[1] - while some of these discrepancies can be appropriately tackled through the work referred in the call for evidence, we also believe that the root causes of some of the issues lie within the wording of the MAD itself. Specifically, the Level 2 implementing measures have allowed Member States to adopt some differing approaches, particularly in relation to determining when information is sufficiently precise to be inside information,[2] and as to whether a delay in disclosure will automatically mislead the public.[3]

2.1 THE SCOPE OF THE MAD:

2.1.1 Only regulated markets? (Articles 1(3) and 9 of Directive 2003/6/EC) comparison with the MiFID? (Article 1(3) of Directive 2003/6/EC)

Do you consider that the scope of MAD should go beyond regulated markets? In particular, should it be extended to cover MTFs?

We do not consider that the case has been made for introduction of insider offences in relation to instruments traded on Multilateral Trading Facilities (**MTFs**). Extending the scope of MAD to all MTFs appears to us to be disproportionate, and likely to produce some unintended consequences and significant practical difficulties.

Trading of an instrument on an MTF does not carry with it disclosure obligations on the part of the issuer. This gives rise to a risk of a regulatory blockage on dealing in instruments traded on MTFs which are not also admitted to trading on a regulated market. Where a market participant has inside information about an issuer or security admitted to trading on a regulated market, it may take comfort from the fact that the issuer will be required to disclose that information to the public. By contrast, under the proposed extension of scope a market participant with inside information would be blocked from dealing with no confidence that the information he has will be disclosed to the market by the issuer – leaving him frozen out of the market.

For instruments for which there are no set ongoing disclosure standards, the effect of bringing them within scope could therefore damage the ability of market participants to deal in those instruments as there is no disclosure obligation on the issuer which would "cure" the holding of inside information. This is unlikely to be a significant issue for significant market participants (which typically have sophisticated Chinese walling arrangements), but could be

[1] Although it predated the implementation of the Market Abuse Directive, the MTS case provides an illustration of the different enforcement approaches of competent authorities across Europe in respect of the same conduct. It is noteworthy that whilst investigations were commenced in numerous Member States, including the UK, in respect of the conduct, the competent authority in one jurisdiction (Belgium's CBFA) took the view that it was prevented by Article 54 of the Schengen Convention (which endorses the principle of *non bis in idem)* from taking a decision since there was “identity between the material facts” examined in the context of the CBFA’s exercise of its competence in the matter of sanctions and those that were the subject of the UK FSA's decision to impose a sanction, which covered among other things the contested operations on the Belgian regulated market for government debt securities.

[2] e.g. in relation to ongoing negotiations where some regulators expect disclosure of intention and/or progress, and others do not.

[3] e.g. the FSA's guidance in DTR 2.5.2 G which states that delay will not always mislead the public; contrast the position taken by the Italian authorities.

of concern to smaller organisations (e.g. hedge fund managers) which do not have sufficient resources to operate Chinese walling arrangements.

There are also difficulties in establishing what the boundary of inside information should be for products which are not subject to mandatory disclosure obligations – a theme picked up by the consultation in relation to commodity derivatives. Any proposal would need to make clear what the threshold for inside information should be. As indicated above, that threshold would materially affect dealing.

There is currently no consolidated list of what instruments are traded on MTFs. In addition, because no consent is needed by an MTF to admit a product to its market, issuers and market participants would not necessarily be able to control (or even know) whether a product was traded on an MTF and therefore a public instrument. As a corollary of the addition of products traded on MTFs to the scope of the regime, a consolidated list of such instruments should be maintained and made public.

There is also a question of whether placing the burden of the market abuse prohibition on products traded on MTFs without the benefits associated with admission to trading on a regulated market is appropriate. Admission to trading to a regulated market carries with it a number of collateral benefits for issuers' securities. These include investability by regulated buy-side participants such as insurance companies and UCITS funds, favourable risk weighting in certain circumstances, and tax benefits. If the Commission seeks to level the playing field between MTFs and regulated markets, then these areas should also be considered.

2.1.2 What kind of financial instruments should be covered by the MAD, especially in comparison with the MiFID (Article 1(3) of Directive 2003/6/EC)

Do you agree with an alignment of the MAD definition of financial instrument to the definition for the same concept provided for in MiFID? Do you think it could be useful to explain in more detail in the MAD what is meant by a financial instrument "whose value depends on another financial instrument" or to list asset classes, such as CFDs and CDS, which belong to this category?

We agree that there is merit in aligning the MAD definition of financial instruments with the more modern and broader definition of financial instruments contained in MiFID. This would help clarify that the insider dealing regime covers all MiFID financial instruments whose value depends on financial instruments admitted to trading on a regulated market.

The MiFID definition of financial instruments notably includes:

- financial contracts for differences;
- derivative instruments for the transfer of credit risk; and
- options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned, which have the characteristics of other derivative financial instruments, having regard to whether,

inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls.

In particular, it appears to us that it would be helpful to clarify the position of contracts for differences (**CfDs**) under the MAD, given that in relation to such contracts, the investment's value is referenced to that of the underlying share or share index or basket. We note that the UK's FSA has taken enforcement action[4] with regard to a short position established through a CfD entered into on the basis of inside information.

We do not consider it helpful to compile a list of asset classes. We favour alignment of the definition of "financial instrument" under the MAD with the definition in MiFID, and also support the retention of the reference in the MAD to a financial instrument "whose value depends on another financial instrument".

The insider dealing prohibition is (and should remain) limited by Article 9, paragraph 2, of MAD so that it applies only to financial instruments not admitted to trading on a regulated market (e.g. OTC derivatives, unlisted structured notes) where their value depends on a financial instrument that is admitted to trading on a regulated market. We do not, however, consider that the market manipulation provisions should cover dissemination of information that gives false or misleading signals to such financial instruments (those not admitted to trading on a regulated market) simply because their value depends on financial instruments which are admitted to trading on a regulated market.

2.1.3 The specific case of commodity derivatives markets (Article 1(1) of Directive 2003/6/EC)

Question: Do you see a need for introduction of a market abuse framework for physical markets?

We have no response to this question.

2.2 INSIDE INFORMATION

2.2.1 Definition of inside information: the general definition (Article 1(1) of Directive 2003/6/EC and Article 1 of Directive 2003/124/EC) and the particular definition for commodity derivatives

Question: Do you share this view [that there does not seem to be a need to revise the concepts used to define inside information for MAD purposes] as far as insider dealing prohibition is concerned? (see also next point for disclosure of inside information). If not, which concepts would you advise to modify and how?

We agree with the ESME report that the definition of "inside information" works well as the test for whether someone in possession of such information should use that information as a basis for decisions on whether or not to trade (see below as to the concept of using inside information). However, we consider that the concepts used to define inside information for disclosure purposes have resulted in Member States adopting different approaches (see below).

We are of the view that greater transparency across Member States in respect of the publication of the outcomes (and rationale) of enforcement actions would be of great

[4] John Shevlin, 1 July 2008 - http://www.fsa.gov.uk/pubs/final/john_shevlin.pdf

assistance in informing market participants of the way in which the concepts delimit "inside information".

We also note that there are significant differences in the way in which enforcement activity is publicised in Member States – whilst in some jurisdictions[5] competent authorities publish sufficient detail to enable market participants to understand how the administrative "jurisprudence" is developing, others publish little more than a brief description of the conduct and the sanction[6], and others publish only statistics of such cases[7]. It would be extremely helpful if CESR were to make available a market abuse equivalent of the EECS database of enforcement decisions.

Question: Do you support an alignment of the inside information definition for commodity derivatives with the general definition of the directive?

We acknowledge that there is some uncertainty surrounding the definition of inside information for commodity derivatives in article 1 of the MAD, and article 4 of Directive 2004/72/EC, because it is not clear under what circumstances market participants expect to receive inside information in accordance with accepted market practices on the relevant markets.

We are of the view that if commodity markets apply specific transparency and disclosure obligations, then the qualification in the definition of "inside information" in article 1(1) of the MAD regarding information that "users of markets expect to receive in accordance with accepted market practices on those markets" would operate more efficiently, in conjunction with article 4 of Directive 2004/72/EC which provides that users of commodity derivatives markets are deemed to expect to receive information relating to such derivatives, which must be disclosed in accordance with legal or regulatory provisions.

Question: Do you consider that any changes to the definition of inside information for disclosure purposes is necessary?

Subject to what follows, no. We consider that the issues identified by the Commission and in the ESME report can be dealt with through amendment or clarification of the proposed exemptions and the Level 2 implementing measures.

2.2.2 Dissemination of inside information and deferred disclosure mechanism (Article 6 of Directive 2003/6/EC)

2.2.2.1 General obligation of disclosure of inside information

Question: Do you agree that the described deficiencies of the deferred disclosure mechanism need to be addressed, possibly by way of amendments to the MAD framework? Do you consider that Level 3 guidance could be sufficient?

We acknowledge that the deficiencies in the disclosure mechanism described need to be addressed, and that in order to improve harmonisation, it would be appropriate to do so by way of amendment to the MAD framework. We do not think it is necessary to change the definition of "inside information" for disclosure obligations in the MAD, and acknowledge that the issues identified could be dealt with through amendment or clarification of the

[5] e.g. France and the UK
[6] e.g. Spain
[7] e.g. the Netherlands – although judicial proceedings are published.

proposed exemptions and the Level 2 implementing mesaures, particularly since we consider that it is these measures which have enabled Member States to adopt differing approaches. Equally, we do not believe that it would necessarily be sufficient to seek to deal with these issues through Level 3 guidance alone, since in some jurisdictions, including the UK, such guidance has no legislative support, and accordingly is not recognised by the courts as binding (although it would technically be open to the national regulator to adopt the guidance as its own).

Question: Do you agree that the issuer may be exempted from disclosing inside information in situations when that information concerns emergency measures being prepared in case the issuer's financial stability is endangered?

We agree that there should be a specific exemption from disclosing inside information where the financial viability of an issuer is at stake, and where it is necessary to delay the disclosure of the relevant facts to the markets in order not to put at risk the outcome of emergency measures being prepared or taken.

In the UK, provisions allowing delayed disclosure have been implemented through the UK FSA's Disclosure Rules and Transparency Rules (**DTRs**). These now specify that an issuer may have a legitimate interest to delay disclosing inside information concerning the provision of liquidity support by the Bank of England[8], but they only allow the issuer to delay disclosing the fact that liquidity support is (or may be) provided. Delay in disclosing the underlying circumstances that give rise to the need for support is not permitted. This means that an issuer must make a distinction between the fact that it is in financial difficulty (the event that gives rise to inside information which must be disclosed) and the steps being taken to mitigate those financial problems. We would advocate an exemption which was sufficiently widely drafted to catch the initial financial difficulties and the remedial measures being taken.

What are other deficiencies in this area that raise major interpretation / application difficulties? What is the best way to address them?

We are not persuaded that the disclosure obligations in article 6(1) and 6(3) of MAD should apply to exchange traded derivatives contracts. It seems to us inappropriate to treat the exchange or clearing house as the issuer of the derivative. With regard to derivatives relating to securities, the duty of disclosure should fall on the issuer of the underlying security. As to commodity derivatives, see below.

As indicated in our introduction, a number of differing approaches have been adopted by Member States, particularly in relation to determining when information is sufficiently precise to be inside information, and as to whether delay in disclosure will automatically mislead the public.

Different interpretations given by regulators to the meaning of "precise" has meant that practices differ significantly between jurisdictions. To some extent this has been fostered by the Level 2 directive (2003/124/EC), which implies that information will be precise (for the purpose of insider trading) when the circumstances may reasonably be expected to come into existence or the events may reasonably be expected to occur, whereas for disclosure purposes, the obligation is deemed satisfied provided disclosure is made promptly on the

[8] DTR 2.2.5A

coming into existence of the circumstances or the occurrence of the event. It would be helpful to clarify the practical implications of the distinction.

The requirement that dissemination be delayed if (inter alia) the omission would not be likely to mislead the public has also created difficulties for firms operating on markets which straddle several jurisdictions. In Italy, we understand, the regulatory position is that because the definition of inside information imports the notion that a reasonable investor would use such information as a basis for a decision to trade, the presumption is that any delay in publication will inevitably mislead the investor. Yet in many cases the public interest is better served by some delay, provided that confidentiality can be maintained, in order to complete a transaction, or to verify information (we are aware of at least one instance where premature disclosure of an potential issue, without appropriate verification, could itself have misled the public). We agree with the ESME that investor protection is not necessarily damaged by delayed transparency, provided that the intention in delaying is not to mislead the public. On balance we would favour clarification within the Level 2 implementing measures.

2.2.2. Disclosure duty in commodity derivatives markets

Question: Do you agree with this approach [that consideration should be given to reviewing the obligation to disseminate inside information for commodity derivatives issuers (e.g. electricity and gas derivatives)]? Can you identify cases where a modification or deletion of the obligation may be undesirable for market integrity?

The disclosure obligations in relation to commodity derivatives are difficult to understand and to apply. The requirement that the issuer of commodity derivatives should inform the public of inside information that directly concerns the ‘technical’ issuer does not necessarily deliver relevant information in relation to the commodity market.

Whilst we accept that markets should be as fully and equivalently informed as possible, we do not support the suggestion that the duty should be moved to market participants. In particular, it seems to us that obligations should not be imposed on commodity producers who have no interest in (whether or not they have knowledge of) derivative contracts entered into without reference to them. There is no merit in imposing potentially unenforceable disclosure obligations.

Many energy producers/suppliers have listed entities within their groups, and will be making disclosures in respect of inside information in that capacity.

We do, however, support the proposals for mandatory and minimum standards across the EU which encompass the disclosure and publication of fundamental data.

2.2.3 Prohibition of insider dealing (Articles 2, 3 and 4 of Directive 2003/6/EC)

Question: Would you support this approach [namely that there is merit in considering the ECJ preliminary ruling before the services of the European Commission envisage measures that would seek to clarify apparent divergences in relation to the interpretation of the concept of "using" inside information]?

We are aware of the case of *Spector Photo Group NV and Chris Van Raemdonck v Commissie voor het Bank-*, *Financie- en Assurantiewezen*, which has been referred to the European Court of Justice (**ECJ**) by a Belgian court. The case raises a number of issues – of which, the interpretation of the concept of "using" inside information is the most significant - which may have important implications for the Commission's review. Whilst we endorse the Commission's proposal that it should await and consider the ECJ's preliminary ruling before taking any measures in respect of this issue, we also note that this is a matter of critical importance for the markets, and one which should be resolved as soon as practically possible.

In our view, the concept of "using" inside information necessarily implies something more than mere possession coupled with the fact of a trade. Recital 30 of the MAD indicates that what is significant is the decision to trade, not the carrying out of the trading. There must be some taking advantage of the possession of the information – the information must be the reason for, or a material influence on, the decision to trade.

Any alternative interpretation would significantly impair market efficiency. It is for this reason, we submit, that Recital 18 advocates that the pursuit of legitimate market-making business and the lawful execution of orders (while in possession of inside information) should not in itself be deemed to constitute use of such inside information. We also note the carve out in Recital 29 which provides that the use of inside information relating to another company and using it in the context of a public take-over bid for the purpose of gaining control of that company or proposing a merger with that company should not in itself be deemed to constitute insider dealing.

In our view, the fact that there is no presumption of use of inside information through mere possession, without more, does not prevent a competent authority from seeking to draw inferences from the evidence available. Such evidence may be circumstantial, but nevertheless compelling, based on patterns, frequency and timing of trading, for example, and occasionally on transfers of funds. (This of course presumes that the competent authority is not required to establish that the circumstances are susceptible to no other interpretation, but rather that this is, on the balance of probabilities, the likely interpretation). Although the making of decisions to trade are relatively rarely captured in evidential form (tape recording of conversations, written notes, emails, etc), in circumstances when the trading pattern is unusual and the timing 'fortuitous', it seems to us that there could be evidence which it would be a challenge to undermine.

2.2.4 Three New tools to help detect suspicious transactions

2.2.4.1 Insider lists (Article 6(3) of Directive 2003/6/EC and Article 5 of Directive 2004/72/EC)

Question: Do you consider that the obligations to draw up lists of insiders are proportionate?

The requirements to draw up insider lists have not been applied consistently across jurisdictions, and this has created significant administrative burdens on authorised firms undertaking cross-border business (as well as on their advisers, and others acting on their behalf).

CESR members have acknowledged that insider lists are used by the competent authorities as a first instance tool in a market abuse enquiry or investigation, without prejudice for the authority to require additional information from the issuer, as is usually done, when a case is investigated. We note that some competent authorities require insider lists to contain first and family names, date and place of birth, and private and business addresses for insiders. In some cases competent authorities have also asked for private telephone numbers, including mobile numbers, to be provided.

It is not immediately apparent that a blanket requirement for information about the date and place of birth and private addresses would greatly enhance the effectiveness of this "first instance" tool. In addition, there are data protection issues in this area which are highlighted where more "invasive" personal data (such as mobile phone numbers) are requested. We consider that the requirements should be proportionate - the public interest in the provision of any personal data needs to be balanced against the individuals' rights to privacy – and applied more consistently.

Currently, individuals who appear on insider lists in different jurisdictions in respect of the same information may find that that they are not treated consistently, and that different levels of personal data may need to be supplied. In this regard we welcome CESR’s recommendation in its second set of Guidance to the effect that that the relevant competent authorities should recognise insider lists prepared according to the requirements of the Member State where the issuer in question has its registered office where issuers are subject to the jurisdiction of more than one Member State.

We also note the issue of the ambiguities which are raised in the ESME report, and the suggestion in footnote 36 in the Call for Evidence that the MAD requirement to draw up, update and transmit insider lists should be amended to impose this requirement directly on persons acting on behalf or for account of issuers. There are uncertainties about whether "acting on account" should include activities carried out on the issuer's request as well as operations which have a legal effect in the issuer's interests which would need to be clarified if the proposal in footnote 36 were to be adopted.

2.2.4.2 Transaction reporting by managers and closely associated persons and subsequent disclosure (Article 6(4) of Directive 2003/6/EC and Article 6 of Directive 2004/72/EC)

Question: Do you see a need for a regulatory action in the above areas? Would you suggest further improvements?

We believe this is a matter for industry to comment on.

2.2.4.3 Reporting of suspicious transactions (Article 6(9) of Directive 2003/6/EC and Article 7(11) of Directive 2004/72/EC)

Question: Do you agree that rules on suspicious transactions reporting do not require modifications?

It is not entirely clear what the Commission has in mind when it suggests that there may be a case for making the reporting requirement approximate to a whistle-blowing measure, particularly since the Commission accepts that as a rule, investment firms have properly assumed their obligations to report suspicious transactions.

Confirmation that the reporting of a suspicious transaction to the competent authority for MAD would satisfy the obligation to report under anti-moneylaundering Directives would be welcomed by industry and resolve a potential overlap in relation to which there is some legal uncertainty.

We also consider that, in order to guard against unnecessary defensive reporting, that it would be helpful to clarify that only failures to report which, viewed objectively and without the benefit of hindsight, were deliberate or negligent should be subject to sanction.

2.2.5 The competent authorities' right of access to telephone and existing data traffic records (Article 12 of Directive 2003/6/EC)

Question: Do you consider that an amendment of the MAD is necessary?

From a UK perspective, we do not consider that it is necessary to amend the MAD to remove uncertainties on the rights of competent authorities to require traffic data. We note that the Data Retention Directive (2006/24/EC) requires communications services providers to retain traffic data for the purposes of the investigation, detection and prevention of serious crime.

2.3 MARKET MANIPULATION

2.3.1 Definition of market manipulation by transactions/orders to trade (Article 1(2) of Directive 2003/6/EC)

Question: Do you think that the definition of market manipulation should be amended? If this is the case, what elements of the definition should be reconsidered?

We do not consider that a case to amend the definition of market manipulation has been made out.

2.3.2 Accepted market practices (AMP) (Articles 1(2)(a) and 1(5) of Directive 2003/6/EC)

Question: Do you consider that the rules on accepted market practices should be amended in the MAD? Do you think there is room for greater convergence among competent authorities in this area?

We agree that ideally it would be helpful if there were greater convergence in the area of AMPs. There would potentially be merit in consulting on the process for deciding on, and putting into place, AMPs, in order to ensure that there is consistency across member states and certainty for cross-border transactions.

2.3.3 Exemption for buy-back programmes and stabilisation activities (Article 8 of Directive 2003/6/EC and Commission Regulation 2273/2003)

Question: Do you consider that the safe harbours for buy-back programmes and stabilisation activities should be revisited? Do you think that greater convergence is desirable in the application of the Regulation 2273/2003? What would be the most appropriate way forward in this respect?

We endorse the view that trading that is not within the safe harbour is not automatically market abuse, which we consider to be consistent with Recital 2 of Regulation EC 2273/2003 and welcome CESR's recent guidance to this effect. We do not consider that there is a need for the safe harbours should be revisited, but we believe that it would be desirable to achieve greater convergence regarding the application of the Stabilisation Regulation by Member States. It would also be helpful to provide some confirmation of the application of the safe harbour to conduct complying with stabilisation rules operative outside the EU (for example, where securities stabilised in a third country in accordance with local third country rules have been (or are to be) admitted to trading on a regulated market).

2.3.4 Short selling

Do you see a need for a comprehensive framework for short selling? If so, should it be addressed in the Market Abuse Directive? What issues should such a regime cover?

The implementation of temporary measures at short notice put considerable strain on systems and resources, and most particularly on the many market participants operating across multiple jurisdictions, who were forced during the rapidly evolving events of last September to negotiate a panoply of different regulatory measures and regimes in those jurisdictions, in order to achieve compliance across their businesses. From a legal point of view, the initial iterations of the temporary measures in various jurisdictions lacked clarity, and there was considerable uncertainty about the scope and effect of the regimes, which was gradually dealt with through guidance in the form of evolving FAQs, though many regulators were slower in formulating this guidance than the FSA. We believe that a consistent set of short selling measures across European and other significant global markets is a priority, and that achieving this should be a key objective.

However, we consider it inappropriate to seek to regulate short selling through the market abuse regime, both in respect of emergency interventions in times of market fragility, and also to any permanent disclosure regime (see below). We consider that manipulative conduct associated with short selling is amply covered by the existing regime.

Should short sellers be required to report positions to competent authorities?

As indicated above, we consider it inappropriate to regulate short selling on the basis of a blanket assumption that an undisclosed net short position above a particular size is market abuse (the approach adopted in the UK). The market abuse regime was not intended or designed to operate as a regime for the disclosure of positions in securities, and we note that a number of European regulators[9] have created standalone requirements outside the market abuse provisions. We believe that this is the preferable approach if a requirement to report positions to competent authorities is to be imposed.

We are not, however, aware of any published research on the impact in the UK of the disclosure regime which compares trading before and during the period of the emergency ban with trading since the ban was lifted in January 2009. We consider that such an analysis would be of vital importance to inform the debate as to the costs of transparency. We are not convinced that there can be any useful read across from data relating to the disclosure of trades by corporate insiders or major shareholder notifications.

The costs of managing a permanent regime will also vary enormously depending on whether participants are seeking to manage different obligations in different jurisdictions, and it is therefore too early to reach a final conclusion. We consider that there is more work to be done on the cost benefit analysis, particularly since this will also be heavily dependent on the method of disclosure selected. Overall, we do not feel that the case for public disclosure by market participants has as yet been compellingly made out. However, we are also mindful of the fact that it will be important to aim for as high a degree of international consensus as is reasonably achievable.

Under which conditions should naked short selling be allowed?

Although we understand that in some jurisdictions outside the EU, notably the US, there was a problem with failed trades in relation to naked short selling, we do not believe this was a

[9] E.g. AFM in the Netherlands, AMF in France.

significant problem in the UK or the EEA. As such we do not consider that additional and distinct measures are necessary to deal with naked short selling. We believe that additional restrictions on naked short selling would not significantly alter the impact of short selling behaviour in the market (see also below).

Should competent authorities be able to take emergency measures (e.g. temporary bans on short selling or on naked short selling) within prescribed limits when they need to address specific market risks and disruptions?

The available research strongly suggests that the emergency short selling restrictions in the UK relating to financial sector stocks led to a reduction in market quality (defined as price volatility and liquidity) in the affected stocks in the period following the ban, and an increase in bid-offer spreads. We refer in particular to research by Capital Markets CRC Limited commissioned by the London Stock Exchange, and to the comments in the Turner Review. In the US context, we note comments by SEC Commissioners Troy A. Paredes and Kathleen Casey regarding the effect of the ban, and research by SunGard Astec Analytics which confirmed that the expiration of the US ban did not prompt a new wave of short sales in those stocks. Accordingly, we believe that emergency powers should be exercised with the utmost caution, and only in the most extreme circumstances, balancing the public interest in the restriction of financial markets to restore stability against the loss in efficiency that such intervention entails.

In designing any long-term emergency powers to enable regulatory intervention in times of extreme market fragility, where the competent authorities reasonably consider that short selling has the potential to exacerbate declines in share price to an unacceptable level, we believe that it is important that the framework should be fully transparent, and (within appropriate limits) accountable, in order to ensure market confidence, given that such interventions can have particularly severe impacts on the market. We also believe that it is vital to ensure that any emergency powers be placed on a proper statutory footing, so that emergency measures cannot be subject to challenge on the grounds that they are ultra vires.

Is there a need to enhance risk management by financial intermediaries and banks? Should investment firms and banks be required to have necessary arrangements in place to ensure timely delivery of financial instruments traded on own account or in the context of execution of clients' orders?

We are of the view that the existing requirements with regard to delivery, and for settlement of failed trades, are fit for purpose and that there is no need for additional measures to deal with naked short selling. We also note that both the UK's FSA and France's AMF have in the past taken successful enforcement action under the market abuse regime in respect of short selling in circumstances where there were no appropriate plans for settlement of the resulting positions (*Evolution Beeson Gregory, 2004; Banque d'Orsay; MM. Eric Duhamel, Gwenael le Carvennec et Philippe Andrieu, 2008*).

Yours faithfully

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