The City of London Law Society

The Law Society

Commission proposals for a Regulation on insider dealing and market manipulation (market abuse) and for a Directive on criminal sanctions for insider dealing and market manipulation

Comments of the Law Society of England and Wales

and of the City of London Law Society Company Law Committee

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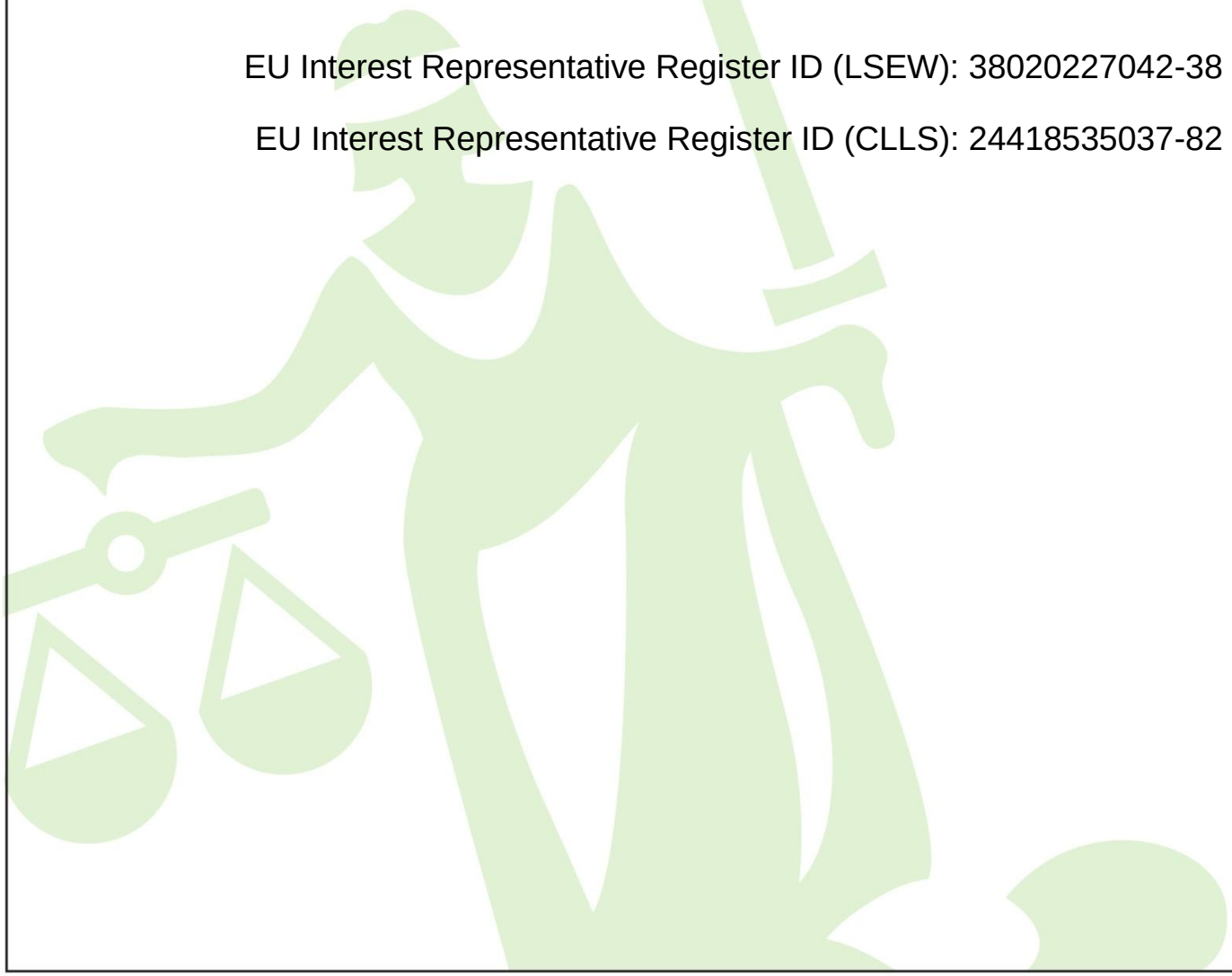

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Comments of the Law Society of England and Wales and the City of London Law Society Company Law Committee

Introduction

1. This response has been prepared on behalf of the Company Law Committee of the Law Society of England and Wales and the City of London Law Society Company Law Committee.

2. The Law Society of England and Wales is the representative body of over 140,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee. The committee is made up of senior and specialist corporate lawyers.

3. 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 and in this case the response has been prepared by the CLLS Company Law Committee.

4. This response comprises the views of the Joint Committee on the European Commission's proposal for a Regulation on insider dealing and market manipulation (commonly known as the Market Abuse Regulation, or the "**Regulation**") and a Directive for criminal sanctions on insider dealing and market manipulation (commonly known as the Market Abuse Directive II, or the "**Directive**"). Attached to this response is a schedule (the "**Schedule**"), which provides specific drafting comments on certain provisions of the Regulation and should be read together with this response.

Guidance for understanding key provisions

5. The Regulation, as currently drafted, lacks the level of detail and guidance on which market participants rely to understand the ambit of the current market abuse regime. A number of recitals in MAD (the present Market Abuse Directive 2003/6/EC, currently in force) provide important guidance for the understanding of its operative provisions and the scope of the insider dealing offence. These recitals are also relevant to the Regulation but have been omitted from it. The recitals referred to in page 1 of the Schedule should be included in the Regulation, as they contain examples of behaviour which is permitted under MAD and which should also be permitted under the Regulation. As the recitals provide defences to the insider dealing and market manipulation offences,

they should be included in the main provisions of the Regulation itself, as well as in the recitals.

6. In addition, the UK's Code of Market Conduct provides further guidance to market participants in the UK for determining whether or not behaviour amounts to market abuse, such as when information is improperly disclosed or misused. A number of provisions, as set out on page 2 of the Schedule, would provide useful further clarification on the scope of the market abuse offences in the Regulation. Such provisions could be included in the Regulation itself or by way of technical standards adopted by ESMA.

7. A number of concepts are used throughout the Regulation, but it is not clear whether ESMA will issue draft guidance to clarify how these concepts will be applied in practice. ESMA should be empowered to issue technical standards in the following areas or alternatively, further explanations should be included in the recitals or in the main provisions of the Regulation:

    a. Guidance under Article 7(7) as to when a legal person will be considered to have effective arrangements in place to ensure that no person in possession of inside information relevant to the transaction had any involvement in the decision or influencing behaviour;

    b. Guidance for issuers to enable them to comply with the obligation to disclose public information under Article 12, such as the circumstances in which delay is permitted, when omissions are likely to mislead the public or when information will be of systemic importance. Guidance should also be given to the meaning of “as soon as possible” and “an appropriate period”. The meaning of "legitimate interests", which is currently amplified in Implementing Directive 2003/124/EC and which sets out non-exhaustive circumstances of legitimate interests, should also be set out in Article 12(4).

Maximum harmonisation regime

8. Under Recital (5) of the Regulation, it is proposed that the new market abuse regime will be a maximum harmonisation regime (other than in relation to civil and criminal standards). It could, therefore be construed to mean that the detailed guidance in the UK's Code of Market Conduct on the UK's market abuse regime or the guidance included in the Disclosure and Transparency Rules as regards the disclosure and delay of inside information, may no longer be relied on. The Joint Committee's view is that such guidance is valued by market participants and we would therefore welcome confirmation that national competent authorities may still be able to issue guidance.

Article 6: Inside information

9. Article 6(1)(e) introduces a new category of inside information (the "reasonable investor" test), which is not precise or price sensitive but is based on what a reasonable investor would regard as relevant when deciding the terms on which a relevant transaction should be effected. Article 6(1)(e) considerably broadens the range of information that could be regarded as inside information and is a significant departure from MAD. Whilst the reasonable investor test appears to be based on the regular user test in Section 118(4) of the UK Financial Services and Markets Act 2000, it would have a significantly different effect, as it does not include the objective test in the second limb of Section 118(4), which requires the behaviour to be regarded by a regular user of the market as a failure

to observe the standard of behaviour reasonably expected of a person in his position in relation to the market. The merit of this objective test is that it is based on the particular market concerned and could change as standards of conduct in relation to such markets develop over time.

10. If adopted in its current form, Article 6(1)(e) would make unlawful many activities that are currently accepted and are not regarded as abusive. Two important examples concern company insiders and normal investor relations activities. Company insiders (directors and employees of companies) will often have knowledge of non-public information which is not price sensitive and which a reasonable investor would regard as relevant. This "relevance" test, without any materiality qualification, will mean that those within the company with access to confidential information relating to the company are likely to conclude that the unpublished information they have is inside information. As a result, they will be insiders and may, therefore, be unable ever to find a time when they can deal in the company's securities. In their dealings with shareholders, companies regularly provide their key investors with information which has not been generally announced as part of their normal investor relations dialogue. This kind of dialogue is encouraged as part of the drive to improve the "stewardship" of institutional investors. Investors will generally not be willing to be given information that will make them insiders, for fear that they will be prevented from dealing. If companies only provide information that is not "relevant", the investors will soon see the meetings as serving little purpose.

11. For these reasons, the new category, as drafted, is unworkable. Article 6(1)(e) should either be deleted in its entirety or, if deletion is not acceptable, it could be redrafted as follows, so that inside information will only fall within Article 6(1)(e) if it is price-sensitive information); the effect of Article 6(1)(e) is to remove the requirement that the information be precise:

    "*information, not falling within paragraphs (a), (b), (c) or (d) which has not been made public and relates relating to one or more issuers of financial instruments or to one or more financial instruments, which is not generally available to the public, but which, if it were available to a reasonable investor, who regularly deals on the market and in the financial instrument or a related sport commodity contract concerned, would be regarded by that person as relevant when deciding the terms on which transactions in the financial instrument or a related spot commodity contract should be effected if made public, and which would be likely to have a significant effect on the prices of those financial instruments or on the price of the related spot commodity contract concerned*."

12. Article 6(3) tracks the definition given in Commission Directive 2003/124/EC but does not take into account the guidance given by the Committee of European Securities Regulator's in their Level 3 Guidance of July 2007 (CESR/06-536b). Paragraph 1.11 of CESR's Guidance provides that "*The "reasonable investor" test set out above assists in determining the type of information to be taken into account for the purposes of "significant price effect" criterion.*" This means that the reasonable investor test supplements the primary test as to whether information would be likely to have a significant effect on prices of financial instruments.

13. Without the CESR guidance the meaning of Article 6(3) is unclear as it could be interpreted as substituting the reasonable investor test for any assessment of the impact of the information on the price of the relevant securities or it could be interpreted as creating a two limb test for price sensitivity (that is to say that information must be likely to have a significant effect on the price of the affected financial instruments and must satisfy the reasonable investor test).

14. The sensible course is for the reasonable investor test to apply in assessing whether the information is price sensitive. To achieve this Article 6(3) could be amended as follows:

    a. *For the purposes of applying paragraph 1, information is price sensitive if it is information that, if it were made public, would be likely to have a significant effect on the prices of the financial instruments, the related spot commodity contracts, or the auctioned products based on the emission allowances and it is information a reasonable investor would be likely to use as part of the basis of his investment decisions.*

    OR

    b. *For the purposes of applying paragraph 1, information is price sensitive if it is information that, if it were made public, would be likely to have a significant effect on the prices of the financial instruments, the related spot commodity contracts, or the auctioned products based on the emission allowances and for the purposes of determining whether the information would be likely to have that effect, it is relevant to consider whether it is information a reasonable investor would be likely to use as part of the basis of his investment decisions.*

Article 7: Insider dealing and improper disclosure of inside information

15. Under Article 7(1), insider dealing arises where "a person possesses inside information and uses that information by acquiring or disposing of, for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates". Whilst Article 7(1) maintains the same prohibition which is contained in MAD, it does not deal with the Court of Justice of the European Union's decision in Case C-45/08 *Spector Photo Group NV* v *CBFA*, where the Court held that there is a presumption that an insider who deals while in possession of inside information intended to use that information for the purposes of dealing, and should therefore be held to commit an offence of insider dealing.

16. The CJEU stated that, when determining whether information is inside information, it was not necessary to show intention (i.e. that the inside information influenced a person's decision to deal on such information), but that, where the constituent elements are proven (and the use of the inside information is unfair or contrary to the objectives of MAD) a relevant mental element can be inferred and it will then be for the accused to rebut this. *Spector* has, therefore, created uncertainties, as it is not clear whether an offence can be committed purely on the basis of "dealing while in possession of inside information" or whether it has to be "on the basis of inside information" (the latter being the basis on which many Member States, including the UK, implemented MAD). In our view, Article 7(1) should be amended so that:

    a. a person is permitted to deal in financial instruments while in possession of inside information where that information does not have a material influence on his decision to deal in such instruments; and

    b. as mentioned in paragraph 5 above, specific defences to the offences of insider dealing and improper disclosure of information should be included, in addition to the Chinese walls defence in Article 7(7).

17. The offence of attempted insider dealing in Article 7(2) is wider than the offence of committing insider dealing, as the latter requires the use of inside information, whereas

the attempt offence only requires possession of inside information in attempting to acquire or dispose of financial instruments to which that information relates. The concept of “using” information should apply to the offence of attempting as well as to the actual dealing offence. Furthermore, attempts at market manipulation should require intention, which will align the offence with that contained in REMIT (the Regulation on Market Integrity and Transparency).

18. The exception to the offence of improper disclosure of inside information in Article 7(4) and 7(5)(c) should be amended to conform to Article 3(a) of MAD, as it allows disclosure where there is a duty that arises other than from employment or a profession (for example, a regulatory or fiduciary duty). A similar amendment should also be made to Article 12(6).

Article 14: Managers' Transactions

19. The current notification system in the UK involves notification to the issuer which makes the information public. This practice should be allowed to continue and Article 14(1) should be amended accordingly.

20. It is not clear under the Regulation how the EUR 20,000 threshold under Article 14(3) for managers' transactions will apply, namely whether, if that threshold is exceeded, there will be a requirement to disclose all transactions (including those under the threshold) or only those transactions over the threshold and whether the threshold applies per PDMR or to all PDMRs collectively within an issuer. Alternative drafting suggestions are given on page 56 of the Schedule. ESMA should be required to develop draft technical standards to determine how and when the value of transactions is to be calculated, including how and when purchases and sales are to be aggregated and how pledges are to be dealt with.

The Directive

21. Whilst the Committee welcomes proposals which will harmonise the criminal market abuse regime in Member States, it should be clarified whether the criminal regime will run alongside the civil regime, so that (as is the case in the UK) national competent authorities may use criminal proceedings for the most serious offences or whether, in the case of the criminal offences set out in the Directive, only a criminal sanction will be available so that it will not be possible to bring a civil claim.

22. Under the Directive, insider dealing and market manipulation will only be criminal offences if they are committed with "intent", which is not defined. The Directive should make clear what "intent" means in this context.

23. Article 7 of the Directive provides that a legal person can commit criminal offences under the Directive where such offences have been committed for its benefit by “any person who has a leading position within the legal person, acting either individually or as part of an organ of the legal person". This wording is unclear and the circumstances in which a person will be considered to fall within the scope of this provision should be defined. Furthermore, “lack of supervision or control” is not an appropriate basis on which to impose criminal liability, as it is not clear what an individual is expected to do to supervise or control the person who commits the offence and, therefore, what the failure is which gives rise to the liability. The Committee would be happy to contribute technical drafting suggestions on these issues.

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