The City of London Law Society

The Law Society

Draft ECON Report and New Presidency Compromise texts on the proposal for a regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse)

Comments of the Law Society of England and Wales

and of the City of London Law Society

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Draft ECON Report dated 20 March 2012 on the proposal for a regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) (COM(2011)0651 – C7-0360/2011 – 2011/0295(COD))

New Presidency Compromise on the above regulation dated 22 May 2012 and 11 June 2012 (Interinstitutional File 2011/0295 (COD)

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

1. These comments have 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. These comments comprise the views of the Joint Committee on (i) the draft ECON Report dated 20 March 2012 on the proposal for a regulation (the "**Regulation**") of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) (COM(2011)0651 – C7-0360/2011 – 2011/0295(COD)) (the "**Report**") and (ii) the Presidency compromise text for the proposal dated 22 May 2012 as amended by the revised Presidency compromise text dated 11 June 2012 (the "**Presidency Text**").

Recital 8 - Amendment 1 ECON Report

5. The Committee notes in the Explanatory Statement to the Report that all references to Organised Trading Facility (OTF) have been removed on the basis that Asian markets are not as fragmented as those in the EU and as a result supervision and insider manipulation surveillance is less complex for authorities to perform. It is not clear if this provision has been deleted because an OTF is considered to be a less fragmented market similar to an Asian market or whether there are other specific reasons. The Committee would welcome further clarification on this point.

RECITAL 8 – PRESIDENCY TEXT

6. The latest text provides for ESMA to publish a list of the financial instruments which are admitted to trading or are traded on trading venues which they supervise. It is not clear if

it is intended that this should be a list of specific securities or types of security – if it is the latter, the list will be bound to be very generalised and we wonder how helpful this will be.

Recital 14 - Amendments 2 to 4 ECON Report

7. The Committee welcomes the inclusion of original recitals 29, 30 and 31 from Directive 2003/6/EC on insider dealing and market manipulation ("**MAD**"). Recitals 18 (requirement to consider what a normal and reasonable person would know or should have known in the circumstances) and 20 (legitimate reasons for transactions and conformity with accepted practices) of MAD should also be included as new recitals, as these provide important guidance on the understanding of the operative provisions of the Regulation.

Recital 14 (a) - Presidency Text

8. We welcome the proposed inclusion of recital 14a to make it clear that the Regulation is not intended to prohibit discussions between shareholders and management concerning an issuer. We do not think it is necessary or appropriate to include the word "reasonable" or "illicit" before the word "discussions".

Recital 27 - Amendment 5 ECON Report

9. The Committee notes that the exemption for issuers on SME growth markets to produce insider lists has been deleted, and that all market participants should apply the same rules. The Committee believes that whilst insider lists are a useful tool for competent authorities' initial investigation of suspected market abuse, the use of such lists is not generally critical for competent authorities to establish whether a particular individual has committed market abuse. Whilst on the one hand it may not be a large burden for SMEs to produce insider lists once the rules relating to the production of those lists are established, the Committee's view is that, before deleting the exemption, it should be established to what extent SMEs would find it a burden to produce insider lists and how beneficial it would actually be in terms of law enforcement for the exemption to be deleted.

Recital 28 - Amendment 6 ECON Report

10. The Committee welcomes the deletion of a uniform threshold below which transactions need not be notified by a manager. The UK does not operate such a threshold and the reporting system is easier to operate without such a threshold in place.

Recital 35a - Amendment 11 ECON Report

11. The Committee welcomes proposed new Recital 31(a), as it will give Member States discretion to impose criminal sanctions and/or civil sanctions, depending on the facts of the case. This is currently the practice in the UK, where criminal penalties are only sought for the most serious offences.

Article 6 (1) (e) - Amendment 18 ECON Report

12. The Committee notes that the inclusion of the proposed wording "*and where any type of conduct upon such information is likely to be regarded by a reasonable investor who regularly deals on the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in such position in relation to that market*" is an attempt to build the new inside information limb in Article 6(1)(e) around the UK's RINGA (relevant information not generally available) test in section 118(4) of the Financial Services and Markets Act 2000. The proposed wording,

however, confuses the issue as to what constitutes inside information and the separate test as to whether dealing on the basis of such information is market abuse. We do not see how the additional wording could work in terms of enabling an issuer to determine whether it has inside information which needs to be announced – we tend to the view that basing a test round whether conduct upon such information is likely to be regarded as a failure to maintain an appropriate standard of behaviour does not make sense. The Committee prefers the approach suggested by it in paragraphs 9 to 14 of the attached response paper to the Regulation dated March 2012 (the "**Response Paper**").

Article 6 (1) (e) - Presidency text

13. We welcome the deletion of Article 6.1(e) and the proposed amendments to Article 6.3 to make it clear that the question whether a reasonable investor would be likely to use information as part of the basis of his investment decision is only a factor to be taken into account in deciding if information would be likely to have a significant effect on the prices of financial instruments (and is not determinative). We would therefore support Amendments 169 to 172 (which delete Article 6.1(e)).

Article 6.2 – Presidency Text

14. We think that it would be clearer to word the final sentence of this Article as follows:

    In this respect in the case of a process which occurs in stages, every intermediate stage of the process shall be considered as a separate event to determine whether it is of a precise nature, irrespective of whether the remainder of the process can be reasonably expected to occur.

Article 6 .4 - Presidency text

15. We are concerned by Article 6.4 proposed in the Presidency compromise text, which proposes that ESMA should issue guidelines to issuers to determine at what point inside information occurs where a process occurs in stages. We think that it will be very difficult for ESMA to produce useful guidelines and will run the risk of issuers having to make an announcement too early, damaging their commercial interests, or too late, damaging investors. We think the proposed additional wording in Article 6.2 (which provides that where a process occurs in stages every intermediate stage can constitute an event which has occurred irrespective of whether the end stage can be reasonably expected to occur) is sufficient and appropriate to deal with processes that occur in stages.

16. The reason why we do not think ESMA guidelines on this would be appropriate or helpful is as follows. For information to be inside information, it must:

    a. be precise

    b. not have been made public

    c. relate to one or more issuers of financial instruments; and

    d. if made public, be likely to have a significant effect on the price of the relevant financial instruments or related derivatives.

17. Where a process occurs in stages, such as a merger, change in manager, bond issue or contract negotiation, each stage in the process can be of a precise nature – e.g. the initial approach by a purchaser to a target company, a director indicating that he may wish to leave a company, an issuer discussing a possible bond issue with advisers or parties to a possible contract meeting to discuss heads of terms. However, in each case

the question of whether inside information has occurred at any particular stage will normally depend to a large extent on whether the information relevant to the particular stage would be likely to have a significant effect on the price of the party's financial instruments (or related derivatives). This, in turn, will depend on the market's view of the particular company and what is likely to be price sensitive in relation to that company. As the facts will be specific to each company it is likely to be very difficult, if not impossible, to create guidelines that would apply appropriately to all companies. For some companies, the fact that a company has commenced negotiations with a particular third party could be price sensitive, whilst for other companies this might not be. Similarly, in some cases there may be such uncertainty about negotiations at a particular stage that they would not be price sensitive, whereas in other cases negotiations at that stage may be price sensitive. The importance of the particular merger, or contract, the identity of the director or the size of a bond issue could all be relevant factors.

18. We therefore suggest that Article 6.4 should be deleted.

Article 7 - Presidency text

19. The latest Presidency compromise text has changed one of the ingredients for the insider dealing offence to a person obtaining the information through being involved in **unlawful** activities whereas in the draft regulation and the previous compromise text the test was being involved in **criminal** activities (this is already wider than the test in the current Directive). We think that the latter test is the appropriate one here. Certainty in the law is of paramount importance and the wide-ranging and uncertain meaning of "unlawful" may in a number of situations make it difficult for someone to know if the article applies to him. This also applies to Article 7b.2(e).

Article 7a – Presidency text

20. The latest Presidency compromise text has added wording in Article 7(a) (1) so that the defence to insider dealing in the context of a public takeover bid only applies where the information is used "for the purposes of determining the offer price of the shares to which the information relates or to propose a merger with" the other company involved. This is considerably narrower than the wording in Recital (29) of the current directive, which provides: "Having access to inside information relating to another company and using it in the context of a public takeover 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."

21. We think that the existing wording is more appropriate. We therefore suggest that Article 7a should read "Insider dealing does not arise where the person possessing insider information uses that information in the context of a public takeover bid for the purpose of gaining control of another company or proposing or effecting a merger with that company to which the information relates."

22. We assume that this provision is foreshadowed by Recital (16e) and the wording of that section should be made consistent.

Article 8 (1) (a) – Presidency text

23. We do not see the need for the words in square brackets at the end of this Article as we consider that the legitimacy test should be the relevant one. Conformity with accepted market practice will be relevant to the determination of whether or not transactions are legitimate but this need not be the sole criterion.

Article 8 (1) (b) - Amendment 19 ECON Report

24. It is not clear what it meant by the words "or the normal functioning" in relation to financial instruments or spot commodity contracts. The term "normal functioning" is more often associated with the operation of markets as opposed to instruments or contracts. This should be clarified.

Article 8(3) (a) - Amendment 20 ECON Report

25. The inclusion of the words "or otherwise" is extremely wide and should be deleted.

Article 12(1) - Amendment 24 ECON Report

26. This amendment suggests that an issuer of a financial instrument must make a separate notification to the public as soon as it has reported the inside information to the relevant competent authority. In the UK, an issuer must notify a Regulatory Information Service (RIS) as soon as possible of any inside information which directly concerns the issuer. Aside from an obligation on the issuer to publish inside information announced via a RIS on its website, there is no additional requirement for an issuer to notify the public of that inside information after it has made the appropriate notification to the RIS. This amendment should be clarified so that, as an alternative, an issuer of a financial instrument should be able to discharge the obligation to inform the public simply by making an announcement to the competent authority or an RIS (in addition to the requirement to publish inside information announced via an RIS on its website).

Article 12.1- Presidency text

27. The proposed Presidency compromise text provides in (1) “An issuer of a financial instrument shall inform the public as soon as possible of inside information when the inside information is likely to occur even if not yet formalised , which directly concerns the issuer or the financial instrument issued by the issuer..”

28. This wording seems to be intended to require an issuer to announce inside information at an early stage and we do not think that this is appropriate or practical. The current directive (Article 6) provides that “Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns the issuers.” We think this approach is better because it requires issuers to announce inside information (subject to the ability to delay) as soon as possible when it becomes inside information – i.e. as soon as the four tests set out in our comments on Article 6.4 above are satisfied. It is therefore not necessary (and it is confusing) to include wording about the timing of the announcement in Article 12.1. Timing will be one of the factors an issuer will need to consider in deciding if information meets the definition of inside information and hence if an obligation to make an announcement has arisen. We suggest that the sentence is redrafted to read “*An issuer of a financial instrument shall inform the public as soon as possible of inside information which directly concerns the issuer.*”

29. If there is a concern that issuers need to understand that information can be precise or can be likely to have a significant effect on price before a decision has been formalised or when an event may reasonably be expected to occur, that could be dealt with separately in guidance on the meaning of “precise” or how the definition of “inside information” is to be considered by issuers.

Article 13.1 – Presidency text

30. We are glad to see that the latest changes to the Presidency Text recognise that insider lists may be kept by those acting on behalf of an issuer or on their account, as this was not clear in the previous wording. However the word "or" should be substituted for "and" in the second line of the Article in order to give effect to this.

31. We think that the first indent is unclear and should read: "draw up a list of all person working for them who have access to inside information, whether under a contract of employment or otherwise , who have access to inside information and of those acting as advisers, accountants, credit rating agencies or otherwise performing tasks through which they get access to inside information".

32. We also think that it would be clearer if the words " or on behalf of" be inserted (i) after "shall be drawn up by" in Article 13.2 and (ii) after the words " should be kept by" in Article 13.4.

33. We note that Article 13.1 (d) requires an acknowledgment of the insider's duties and sanctions to be in writing. Whilst we believe that many issuers will seek written acknowledgments we would question whether the law needs to require these to be in writing – the current Directive does not require this.

Article 13(3) - Amendment 27 ECON Report

34. It is not clear why this amendment has been deleted. The Commission's proposed text in Article 13(3) of the Regulation would cover, for example, depositary receipts of financial instruments which may not have been admitted to trading. In those circumstances, Article 13 should not apply and Article 13(3) should be reinstated.

Article 14(4) - Amendment 30 ECON Report

35. The Committee agrees that a person discharging managerial responsibilities within an issuer of a financial instrument should not be able to conduct any transactions on his or her own account relating to the shares of that issuer or derivatives or other financial instruments linked to them within a certain close period. However, the use of the terminology "within a trading window" is confusing, as it implies that trading within a certain period is permitted. As trading is to be prohibited during the relevant period, the words "within a close period" would be more appropriate.

Article 14(6) – Presidency Text

36. There is an exemption from the requirement for the announcement of transactions in shares or securities by persons discharging managerial responsibilities for transactions totalling under EUR[15,000] over a period of [1 year]. It is not clear what this means. Will issuers (or PDMRs) have to keep a rolling list of what they have done and calculate the 12 calendar months on a rolling basis? If so, it would seem preferable to use a calendar year starting 1 January as this should make the calculation easier for PDMRs to track.

Article 29 – presidency text

37. We agree with the deletion of paragraph 1b of the first draft of the Presidency Compromise which would have required issuers to put an internal compliance system in place to allow for reporting by employees of possible breaches. Our view is that such a requirement is not appropriate for issuers generally. We suggest it is made clearer that the mechanisms that have to be put in place do not apply to all employers but only to those engaging in activities that are regulated for financial services purposes.

Further comments

38. The Response Paper sets out further suggested amendments to the Regulation, which have not been adopted and the Committee recommends that the following be taken into consideration:

    a. paragraphs 6 and 7 (Guidance for understanding key provisions);

    b. paragraph 8 (Maximum harmonisation regime);

    c. paragraphs 15 to 18 (Article 7: Insider dealing and improper disclosure of inside information);

    d. paragraph 19 (Managers' Transactions); and

    e. paragraphs 22 and 23 (The Criminal Sanctions Directive).

39. The Committees would be happy to discuss the above points and to assist with any drafting concerning these matters.

Further information

40. For more information or to speak to one of our interested practitioners, please contact:

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