UNICE
THE VOICE OF BUSINESS IN EUROPE

22.6/21/2 16 October 2001

PROPOSED DIRECTIVE ON INSIDER DEALING AND MARKET MANIPULATION

UNICE COMMENTS

1. GENERAL COMMENTS

UNICE has taken note of the proposed directive on insider dealing and market manipulation and would like to offer the following comments.

First of all, UNICE would like to welcome the laudable objective of establishing common standards against market abuse throughout the EU.

Before commenting on the content of the proposal, UNICE would like to stress that this directive together with the directive on the single prospectus will be the first instruments to be approved on the basis of the new fast-track "procedures" following recommendations in the Lamfalussy report. In this context, UNICE regrets that these proposals, which represent centrepieces of the financial services action plan, in the drive to create an integrated services market by 2003, do not follow the consultation recommendations contained in the above-mentioned Lamfalussy report.

One of the consequences of this lack of formal consultation before publication of the proposed instrument is that the proposed directive on insider dealing and market manipulation raises serious questions for corporate issuers and practitioners in capital markets. UNICE believes that, unless substantial amendments are made to the text of the directive, the result is likely to be a loss of necessary flexibility in regulation to take account of legitimate market practices, which have proved their worth, and added cost for issuers, especially SMEs. The result might also be that issuers from outside the EU will be deterred from using capital markets within EU Member States with consequent loss of business for the financial services sector. The directive, as proposed, is predicated upon the equity markets and, if applied to commodity markets, will lead towards more volatile asset markets, reduced security of supply, and reduce the relative competitiveness of the European single market.

UNICE has noted that the Commission has followed the Lamfalussy recommendations in later initiatives such as the transparency obligations of publicly traded companies. UNICE urges the Commission to ensure that this becomes the norm for both principle directives and practical implementation measures, and hopes that the Commission and other institutions will be responsive to UNICE's request for consultation and transparency before publication of any new proposal, in order to make sure that all proposals accommodate legitimate and well established market practices.

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UNICE would like to stress that the issue of where to draw the boundary between framework principles and technical implementing details to be decided by the European Securities Committee should be carefully considered. UNICE understands the Commission's objective of allowing flexibility of definitions to make it possible for new abusive practices which might emerge at a later stage to fall within the ambit of the directive. Nevertheless, UNICE is of the opinion that the directive still lacks precise definitions on key aspects of the proposal and opens the door to divergent interpretation at Member-State level. Even though UNICE agrees with the possibility of delegating technical implementing details to a technical Committee, it still believes that amendments to the basic definitions are necessary before adoption of this instrument.

Lastly, UNICE believes that the real difficulty with insider trading and market manipulation will be that of enforcement. It will be important to ensure that the regulators have a sufficient quantity of properly trained staff and technical tracking systems. Without these, the proposed directive will not achieve its aims.

2. SPECIFIC COMMENTS

ARTICLE 1 : DEFINITIONS

Article 1 (1) – inside information

UNICE believes that extending the scope of regulations on inside information to cover all financial instruments, including related derivative financial instruments, can close a loophole in the current system.

However, enlarging the scope of the ban on insider dealing to cover several regulated markets raises questions concerning money-market instruments and the role which the dissemination of political, statistical and other information from unidentified issuers would play in the event of criminal prosecution. This could make the circle of potential insiders too large to maintain an overall view.

The application of insider trading concepts to commodities trading is flawed. Whilst the notion and practice of 'insider trading' in equity and debt markets is both socially and legally understood and forbidden, there is no analogous concept within the commodity derivative markets. Accepting that "insider trading" is trading ahead of information that the market expects to receive, this simply does not occur within commodity markets - as there is no particular piece of information that market participants expect to receive - thus this concept cannot be merely "cut and pasted" from the equity markets on to the commodity derivative markets. Were this not the case, a coffee processor, for instance, who had previously purchased coffee to meet his customers' requirements, who then found that a major retailer had substantially reduced his requirements, would be unable to hedge his position by selling coffee futures before informing the market of his dealing intentions. This cannot be the intended consequence.

Attempting to apply this concept to commodity derivative markets will, in all likelihood, reduce market efficiencies, reduce market liquidity, increase transaction costs, increase market volatility, reduce the security of supply of the underlying commodities, and reduce the relative attraction of Europe's capital markets vis-à-vis other developed and developing markets. What commodity market participants require - in order to manage their commercial businesses – is the ability to use commodity derivatives to risk-manage their exposures and hedge specific events or transactions that they are aware of in their portion of the value chain. Without this ability market participants will become more risk-averse leading to the consequences described above.

It is right, however, that market manipulation provisions should apply to commodities trading. For example, a company may wish to hedge its purchase of oil and gas over the next year because of valid concerns as to likely fluctuations in the market. This would be a natural commercial decision as to the legitimate management of price risk and should not be caught by the insider dealing provisions. We would therefore suggest that all physical commodities should be excluded from the scope of this provision to avoid the possibility of such actions being caught.

Consideration should also be given to excluding stock indices and possibly government bonds. The inside information provisions should also recognise that market intermediaries may legitimately buy an issuer's shares after a public offer to stabilise the price of the stock.

Article 1 (2) – Market Manipulation

UNICE is of the opinion that the definition of market manipulation as developed in this article is not clear enough on several of the key aspects explained below.

Basing the definition of market manipulation solely on the behaviour of the persons acting would include acts which by their nature fall outside the intended scope of the Directive. However, according to its current wording, such acts would fall into the category of market manipulation. Announcing a take-over bid or disclosing a planned joint venture may, for example, cause a company's share price to spiral to unusual or abnormal heights. In this context, UNICE is of the opinion that the definition proposed by the European Commission is too broad and should be carefully re-discussed. The notion of "rumours" in paragraph 1(1)b is too vague and should be deleted.

UNICE is of the opinion that it is insufficient to classify transactions or orders to trade, which give or may give false or misleading signals as to the supply, demand and price of financial instruments, as market manipulation. Such behaviour should be judged according to the motive for manipulation. The definition would otherwise remain too vague, failing to encourage responsibility among market players or provide them with a suitable legal framework against which to measure their behaviour. The current definition of market manipulation is not suitable for administrative proceedings or criminal sanctions. The definition should cover deliberate or reckless intent to manipulate the markets. The effect on the market should be secondary to intent.

The examples listed in Section B of the Annex to illustrate methods of market manipulation are not exhaustive and consequently leave room for interpretation. Only those actions with intention to mislead or create unfair advantages should be defined as market manipulation. To ensure uniform application of the law within the Member States, the intent to mislead or create unfair advantages should be explicitly included in the definition of market manipulation.

It should be made explicit that in order for an action to be qualified as market manipulation there must be an intent behind giving false or misleading signals and/or influencing the market value to abnormal or artificial rates etc., to achieve market manipulation.

UNICE strongly recommends that article 1.(2) be revisited in the light of the above comments.

ARTICLE 6 : FAIR DISCLOSURE OBLIGATIONS AND SPECIFIC EXEMPTIONS

Art. 6-1 and 3 – Regulation of disclosure

UNICE strongly objects against the obligation to disclose inside information. Price-sensitive information which is to be disclosed to the markets is a subset of inside information, i.e. information about facts that are so concrete and definite that such information must be disclosed promptly. Inside information as defined in article 1 is a much broader term.

Generally issuers and their representatives can be deemed to possess inside information much sooner than price-sensitive information (e.g. entering into initial merger negotiations is inside information requiring the relevant parties to abstain from dealing in securities; it only becomes price-sensitive if the negotiations lead to specific and concrete results). In most Member States there is only an obligation to disclose price-sensitive information, not inside information. The draft directive leaves an option of retention of inside information in art. 6.3, but the scope of this option is vague, leading to uncertainty and likely controversy in application.

Furthermore, the directive should set outside the principle very clearly that only price-sensitive information is to be disclosed promptly and not try to achieve this through an exemption under a much wider obligation to disclose. The current approach would create unacceptable uncertainty for practice and could lead to a company being obliged to disclose confidential information to its competitors.

Furthermore, the vaguely described time of disclosure ("as soon as possible") will surely lead to significant uncertainty in establishing the actual moment when disclosure becomes obligatory. To avoid this, exclusive reference should be made, as in the regulation in Art. 7 of the insider guideline, to the regulation of Scheme C, Point 5a of the Annex to Directive 79/279, coordinating requirements for the submission of securities for official quotation on a stock exchange. Reference to this directive is also important for the definition itself of the information that is to be disclosed.

Art. 6. 2 – Insider List

UNICE believes that additional thinking is needed concerning the obligation for issuers to maintain a list of persons with access to inside information as this could involve a disproportionate amount of work for the issuers affected. The number of persons with access to insider-relevant information can be very large, depending on the scale of preparations or plans for new developments or business projects, a number compounded by those with access to insider information relating to issuers (e.g. in the case of a pending order placement at a supplier's). Companies should therefore be given flexibility and should only be encouraged to develop rules to combat insider dealing.

Art. 6. 4 and 5 – Fair disclosure obligation

The circle of addressees of art. 6.4 is too general; it may also include universities, government organisations and research institutes, which have no specific commercial interest relating to the information provided. The provision of art. 6.4 should be limited to those persons who have a commercial interest.

In addition, UNICE would like to draw attention to the "Chinese wall" arrangements which require or enable information held by a person in the course of carrying on one part of its business to be withheld from, or not to be used for, persons with or for whom the person acts in the

course of carrying on another part of its business. The specific obligations to take reasonable care to ensure that information is fairly presented and that interests or conflicts of interests in the financial instruments to which information relates be disclosed, goes against the need for intermediaries to establish "Chinese walls". Accepted market practices such as "Chinese walls" should be granted a safe harbour within the directive.

We suggest that Articles 6.4 and 5 be amended to ensure that such arrangements are recognised as a defence by the directive.

The obligation imposed in art. 6.5 on professionals arranging transactions to reject orders if they reasonably suspect that they are based on inside information or would constitute market manipulation is too vaguely defined and must be substantiated. This could be done by adding the following words: "…, *on the basis of objective information,…*" after the words, "*if it reasonably suspects*".

ART. 8 – EXEMPTIONS FOR TRADING IN OWN SHARES AND STABILISATION

The issue of where to draw the boundary between framework principles and technical implementing details to be decided by the European Securities Committee should be further considered. UNICE understands the Commission objective of allowing flexibility of definitions to make it possible for new abusive practices which might emerge at a later stage to fall within the ambit of the directive. Nevertheless, UNICE is of the opinion that the drafting of article 8 is too vague and needs further work.

For instance, the limitation of legitimate measures to support purchases, such as stabilising acquisitions or buying back shares, should - just as the definition of market manipulation – be explicitly established in the Directive itself.

ARTICLE 9 : SCOPE OF MEANS USED

UNICE is concerned about the wide scope of this directive. Its provisions would be applicable not only to financial instruments admitted to trading on a regulated market but also to financial instruments "to be admitted". Once again, UNICE believes that this formulation is too broad and should be complemented by specific time criteria in order not to impose unduly burdensome obligations on issuers.

ARTICLE 12 : INVESTIGATORY POWERS

Here again, UNICE is concerned about the broad scope of powers to be conferred on competent authorities. They are too general and should be restricted to obtaining information or data relevant to the investigation.

ARTICLE 14 : SANCTIONS

The wording of article 14 seems to allow the possibility of having both administrative and criminal sanctions. This is against the "non bis in idem" principle and also against the European Convention on Human Rights. In this context article 14 should read "*administrative **or** criminal sanctions*".

ARTICLE 16 : COOPERATION BETWEEN COMPETENT AUTHORITIES

Article 16.2 allows the authorities which receive information to use it *for other purposes* or forward it to other states' competent authorities. UNICE is totally opposed to this provision which does not adequately guarantee the rights of the parties. Information gathered on the basis of the provisions of this directive must only be used for the purposes directly related to market abuse.

More generally Articles 10 to 15 would seem to enable any supervisory authority to impose different rules on companies. This goes against the announced objective of harmonisation. Traders would have to know 15 sets of rules, which would not assist in the development of the single market. UNICE hopes that attention will be given to this important concern.

3. CONCLUSION

In the light of the above assessment, UNICE believes that the scope of market manipulation is too loosely defined in the proposed directive and would lead to considerable legal uncertainty for issuers. UNICE is of the opinion that the main definitions are insufficiently developed and should be further looked at. In particular, it is essential to reconsider the need for a definition of intent and the need to prove intent, as well as to provide for proper defences such as Chinese walls.

The proposed directive relies too heavily upon the equity markets for its provisions; more attention needs to be given to the normal practices within the debt and commodities markets. It is therefore important to consider whether it is appropriate for both insider trading and market manipulation provisions to apply in all cases; as, for example, with commodities, where UNICE believes only the market manipulation provisions should apply.

From the analysis of the proposed directive, problems arise with respect to the use of the notion of inside information both for market abuse purposes and for disclosure obligations. It is worth considering whether it would be more practical to adopt a comprehensive approach to the question of issuers' obligations to disclose information in the directive which should follow the consultation on issuers' transparency obligations, issued by the Commission last July.

Accordingly, UNICE wonders whether a solution could not be to remove from the directive the rules on issuers' disclosure obligations (Article 6.1-3). Alternatively, issuers' disclosure obligations should refer only to "important information", as just defined in Directive 2001/34, i.e. only information concerning "*major new developments*" in an issuer's sphere of activity which are not public knowledge and which may, by virtue of their effect on its assets and liabilities or financial position or on the general course of its business, lead to substantial movements in the prices of its shares. Similar rules, adjusted for the risk of the instrument, should be adopted for the issuer of financial instruments other than shares, admitted to trading on a regulated market.

Greater clarity would also be desirable in Article 9 with reference to the time at which the directive's obligations (including those regarding disclosure) start to apply in the case of financial instruments that "are going to be admitted to trading".

Lastly, there would appear to be a need for a more detailed specification of the powers of the supervisory authorities responsible for matters concerning market abuse and issuers' disclosure obligations, with special reference to their investigatory powers and the exchange of information.

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