Association française des marchés financiers
LES PROFESSIONNELS DE LA BOURSE ET DE LA FINANCE

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CALL FOR EVIDENCE OF THE EUROPEAN COMMISSION

Review of Directive 2003/6/EC on insider dealing and market manipulation (Market Abuse Directive)

Response of the AMAFI

1. AMAFI thanks the European Commission for providing it with the opportunity to discuss the review of the Directive 2003/6/EC on insider dealing and market manipulation (Market Abuse Directive).

AMAFI is always keen to provide its view on the application and implementation of the Market abuse directive, which it considers the cornerstone of sound and integrated European financial markets. The Association therefore examined with great interest the paper the European Commission put out for consultation 20 April 2009 and wishes to make the observations set out hereafter.

2. May it be said however that such a short consultation timeframe for substantial changes to the Directive seems inadequate if it is to result in thoughtful contributions, truly useful to the Commission's work. This is especially so since the revision of the Directive does not bear any high degree of urgency, as it does not constitute as such a response to the financial crisis. An extended timeframe would have allowed for a wider consultation of our members and a more detailed position.

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I. – SCOPE OF THE MARKET ABUSE DIRECTIVE

1 – Only regulated markets?

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

3. The primary objective of a market abuse framework is to protect investors by safeguarding market integrity. The need for such a framework is obvious: it creates confidence without which a large number of investors would not invest in financial instruments and, consequently, without which issuers would not be in a position to finance their development. But, in the same time, nobody can ensure that the market abuse framework, which imposes real constraints on issuers, investors and intermediaries, is the right response to every situation. Providing that some investors find advantages to it, some issuers may choose a less rigid framework offering less protection or even no protection at all.

Unilaterally extending the application of MAD to all MTFs may not therefore be appropriate, as it would reduce issuers' ability to find the right financing at the right price with the right constraints.

4. The European Commission seems to consider that ensuring a level playing field between MTFs is essential. In this respect, one should stress that all MTFs do not compete with each other and/or regulated markets. One should distinguish between MTFs providing an alternative trading venue for shares admitted to trading on a Regulated Market that do compete with it and between each other and other MTFs that offer <u>small and mid-size companies the opportunity to access capital markets without constraints that could prove too costly</u>. The securities traded on the former are already subject to MAD and the latter do not usually compete with the former, as they attract different industrial segments and target different types of investors. Hence, although the principle of a level playing field between markets that are competing against each other must be supported, it does not apply as such to all MTFs.

5. If MTFs are brought closer to regulated markets, there is a risk that the distinction between the two becomes blurred or even nil, whereas market forces should be able to choose the best option. Furthermore, in a post-MIFID era, no investor can be advised to trade on a market that does not offer the protection appropriate to its situation: suitability and appropriateness obligations apply and are enforceable by competent authorities. In this regulatory context, the existence of different market types, offering different levels of protection, is <u>not a source of increased risk for investors</u>.

6. <u>The extension of MAD to an MTF should therefore be optional</u>, the result of the will of both the MTF and the issuers of its admitted securities. Such MTFs should be granted a specific status by the competent authority in charge of enforcing the applicable regulatory provisions.

7. In addition, depending on the MTF, <u>this extension may not be fully fledged</u>, as some of the MAD provisions may not be applicable due to the business model and liquidity of the MTF concerned. For example, prescriptions related to buy-back programmes and stabilisation activities may not be adapted to some markets: for those, the market abuse framework could be circumscribed to insider dealing and a more limited set of market manipulations.

Consequently, the extension of MAD to MTFs should allow for two types of statuses: one which would correspond to the full set of the MAD provisions; another one, which would correspond to a more limited set. On the opposite "unregulated" MTFs should be able to operate outside of a market abuse framework.

8. Finally, needless to say that the current rule laying down that MAD applies to a transaction not executed on a regulated market but related to an instrument that is admitted to a regulated market would work symmetrically for an MTF to which a market abuse framework applies: transactions executed on other venues and related to instruments admitted to trading on these MTFs would be subject to MAD. Combined with the fact that MAD already applies to financial instruments admitted to trading on regulated markets (and therefore to transactions executed on MTFs where these instruments are traded) this proposal would significantly extend the scope of the MAD.

2 – Financial instruments that should be covered by the MAD

- ***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?***

9. In AMAFI's opinion, the application of the MAD should not depend on the type of financial instruments considered but rather on the market it (or its underlying) is traded on. Thus, insofar as a financial instrument is admitted to a market within the scope of the MAD, its derivative (including CDS and CFDs), wherever it is traded, should also be subject to the MAD regulation.

One advantage to the application of the MAD comprehended from a market perspective not from a financial instrument perspective is that control in financial institutions is easier to implement and much more effective and exhaustive.

In AMAFI's view there is therefore no need to explain in more detail what is meant by a financial instrument "whose value depends on another financial instrument" or to list asset classes, which would even be detrimental as it would certainly be soon outpaced by financial innovation.

3 – The specific case of commodity markets

- ***Do you see a need for introduction of a market abuse framework for physical markets?***

10. AMAFI is of the opinion that physical markets should indeed be submitted to a market abuse framework. However, this framework should be tailored to the specifics of these markets and should not be copied on the one applicable to financial markets, since they are of a different nature with their participants assuming different roles and information flows differing significantly.

As a consequence, we strongly recommend that commodity markets be submitted to a separate piece of legislation, not integrated to the MAD. Notably, the current work carried out by CESR and ERGEG with respect to energy spot markets should be continued towards this end. Once commodity markets are subject to transparency rules, the market abuse framework will be extendable to derivatives of these products.

In addition, the global nature of these markets calls for a global framework: an EU only initiative would fall short of preventing market abuses in these markets. Cooperation at a global level is necessary (e.g. IOSCO initiatives).

II. –INSIDE INFORMATION

1 – Definition of inside information

➢ ***Do you share this view as far as insider dealing prohibition is concerned? If not, which concepts would you advise to modify and how?***

11. In AMAFI's opinion, there is no need to revise the concepts used to define inside information. Well established case law and doctrine are now available on the concept of inside information, which provides a good degree of legal certainty to firms. In this respect, it could even be detrimental to modify this definition unless a thorough analysis is conducted beforehand that concludes that there are definite well identified advantages in modifying it.

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

12. The inside information definition for commodity derivatives should not be aligned with the general definition of the directive, because these derivatives pertain to markets that are very different as mentioned above. These markets do not benefit at the moment from similar transparency rules and they present structural asymmetrical information flows. In addition, they react to different types of information from the ones governing markets in financial instruments.

For these reasons, commodity derivatives should be regulated together with physical markets, i.e. under the same piece of legislation that CESR, ERGEG and IOSCO should help shape and the definition of inside information specific to commodities markets should also apply to commodity derivatives. In this respect and considering the variety of commodity markets involved, AMAFI suggests that regulators of these markets provide a suitable definition of inside information.

2 – Dissemination of inside information and deferred disclosure mechanism

2.1 – General obligation of disclosure of inside information

➢ ***Do you consider that any change to the definition of inside information for disclosure purposes is necessary?***

13. AMAFI does not deem necessary to change this definition.

- ***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?***

14. AMAFI agrees that changes should be made to the Directive to accommodate for exceptional market circumstances where systemic risk is high or market stability is at stake. Such circumstances could warrant a delay in the disclosure. In such events, firms should refer to the relevant competent authority, who would provide its approval or refusal to delay the publication of the inside information based on a more flexible appreciation of the three conditions currently set in the Directive. Let it be said however that the condition pertaining to maintaining the confidentiality of the information cannot be waived.

- ***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?***

15. Yes (cf. above comment § 9)

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

16. No comment.

2.2 – Disclosure duty in commodity derivatives markets

- ***Do you agree with this approach? Can you identify cases where a modification or deletion of the obligation may be undesirable for market integrity?***

17. AMAFI totally agrees with this analysis since the issuer of the commodity derivative is not the one who has knowledge of an inside information (and legally speaking, the term “issuer” may not even be applicable to derivatives, as is the case in France).

Transparency of the underlying assets is paramount as it should constitute the first pillar of the framework CESR and ERGEG are starting to shape: operators should have a duty to make available any information they possess that may affect the commodity concerned. The second pillar will then be built on these obligations to curb in market abuse.

3 – Prohibition of insider dealing

➢ ***Would you support this approach?***

18. AMAFI supports the second approach, according to which the use of inside information takes place only when a person trades, or attempt to trade, on the basis of inside information: an insider dealing case should be established only if it is proven that the underlying motive for the trade was the possession of inside information.

4 – Three new tools to help to detect suspicious transactions

4.1 – Insider lists

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

19. The duty to draw up lists of insiders definitely creates a heavy administrative burden, especially in terms of maintenance as it is often difficult to assess when an instrument (and the related staff) should not be listed anymore and staff turnover can be high (especially amongst external contractors). In this respect, a cost/benefit analysis would be extremely useful. More specifically, on the benefit side, one should assess how useful these lists are to competent authorities in helping them identify market abuse cases, for example by identifying how many cases have been raised based on the use of these lists since the implementation of the Directive. Competent Authorities should indeed value insider lists for what they are, a first instance tool in an investigation that can help detect market abuse cases, not a replacement for other methods of investigation.

20. In addition, because the scope of these lists is quite extensive, a number of people listed may not in actual fact be aware that they possess (or may not even possess) inside information. Lists may therefore include people who do not hold insider information, which paradoxically put them at risk from a regulatory perspective. More flexibility in establishing these lists would therefore be welcomed, especially so for financial institutions, which are already subject to stringent organisational requirements and rules of conduct.

4.2 – Transaction reporting by managers and closely associated persons and subsequent disclosure

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

21. The current threshold of 5,000 euros is so low that it is not relevant at all. If it were to be truly effective, this threshold should be raised significantly (at a minimum to EUR 50,000).

More importantly maybe, there should be the possibility for a manager to be exempted from reporting a transaction (or a set of transactions) when these do not provide a true signal to the market and may even mislead it. This is especially the case for sales solely motivated by personal circumstances (e.g. the need to raise cash when going through a divorce or financing a real estate purchase) for which the view of the manager on the prospect of their company is irrelevant. In such circumstances, competent authorities should be able to waive the obligation to report the transactions to the market.

4.3 – Reporting of suspicious transactions

- ***Do you agree that rules on suspicious transactions reporting do not require modifications?***

22. Yes, with respect of the matters discussed in the call for evidence.

23. On another point, article 11 of Directive 2004/72/EC states that "*competent authorities do not disclose to any person the identity of the person having notified these transactions, if disclosure would, or would be likely to harm the person having notified the transactions*". This provision is insufficient in AMAFI's view, as the protection of the notifying person's identity is ensured only under certain conditions.

In addition, the identity of the notifying person can be transmitted from the receiving authority to another one, whereas this information is not critical and not even useful to the investigation, as the receiving authority would have direct access to that person in case further information is required.

The identity of compliance officers who prepare and sign these reports should be absolutely safeguarded when the report is transmitted from one Member State to another one, i.e. it should be removed from the set of data transmitted. One should not ignore the risks inherent to reporting potentially criminal offences: the physical integrity of firm's staff in charge of the notifications should be protected by all means, and more specifically, through a legislative amendment.

5 – The competent authorities' right of access to telephone and existing data traffic records

- ***Do you consider that an amendment of the MAD is necessary?***

24. We are not aware of such issues but ensuring the two directives fit together properly seems the right approach.

III. –MARKET MANIPULATION

1 – Definition of market manipulation by transactions/orders to trade

- ***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?***

25. AMAFI does not see a need for change in this respect. The response made § 11 is also applicable here. In addition, any change that would imply organisational costs in the current period when the financial crisis takes its hit and some MIFiD provisions are still being implemented would be unwelcome.

2 – Accepted market practices (AMP)

- ***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?***

26. Accepted market practices work well in France and the rules governing their adoption should not be amended. The small number of market practices that have been accepted in the EU so far is not a consequence of stringent assessment criteria but rather the natural consequence of the harmonisation of the European markets (AMPs are a reminiscence of pre-MAD market practices).

However, when a market practice is accepted by several Member States, greater convergence would be much appreciated. This is the case in particular of the AMP related to liquidity contracts, which is in effect in four countries (five in the near future) but obeys to different provisions. A procedure should be developed to allow the extension of an AMP to other EU countries or all EU members.

3 – Exemption for buy-back programmes and stabilisation activities

- ***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?***

27. Cross-border stabilisation activities, which involve multi-listed bonds or shares for which several authorities are competent, require multiple reporting from the firm.

In AMAFI's opinion, a single regulator should be identified in respect of these activities. Jurisdictional disputes could be resolved by identifying as competent the authority with which the firm is registered. This supervisor would then communicate the necessary information to the other supervisors concerned.

28. As stated in AMAFI's answer to CESR's consultation on its third set of guidance on the Directive (*AMAFI/09-01* and *CESR/08-717*), the Association certainly considers that sales performed to refresh the greenshoe in the context of a stabilisation activity should be part of the safe harbour.

As an illustration, sales are particularly useful for replenishing stabilisation capacity as regards fixed income securities, given that greenshoe options are not widely used in this market. If there is no greenshoe option, the stabiliser's position is limited to 5% of the initial offer. But this is a level that can be exhausted very quickly, especially in the event of high volatility in the security – that is, in precisely those situations where stabilisation is most necessary. For this reason, the stabiliser must be able to sell to replenish its over allotment capacity, restore its initial position and successfully accomplish its stabilisation objective.

On this matter, there is inconsistency among competent authorities, some of them considering that refreshing the greenshoe falls within the safe harbour, whereas others do not. There would be merit in reaching a consensus on this matter.

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?***

29. It is essential that rules applicable to short selling be harmonised at EU level if they are to be effective. The current disharmony is very regrettable and indeed a very bad public display of EU's inability to offer a unified figure on such a highly visible subject raised by the financial crisis.

30. However, this harmonisation should be carried out via a piece of legislation different from MAD, because short selling per se does not constitute Market Abuse. Latest publications on the subject show that this practice is in effect beneficial to markets in various aspects and that it should not be equated to market abuse as long as it is not mis-used.

31. The safeguarding measures that should be part of this new framework would not pertain so much to reporting mechanism but rather to settlement/delivery rules and, in particular, buy-in mechanisms, which should be addressed as a priority because they are essential, and in AMAFI's view sufficient, in preventing market abuse via the use of short selling. AMAFI strongly believes that the settlement rules and, in particular, buy-in procedures should be harmonised in Europe

The new regime should also set a harmonised definition of short selling.

- ***Should short sellers be required to report positions to competent authorities? Under which conditions should naked short selling be allowed? 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?***

32. Reporting to regulators of sufficiently significant short positions could be useful to help them have a precise view of any short massive position on a security, however this is not as useful in avoiding market abuse via short selling, as ensuring that the short seller has an obligation to place itself in a position to deliver the securities on settlement date, which is properly enforced and results in a sanction if it is not observed.

33. After consultation of all financial industry stakeholders, competent authorities should be able to take emergency measures in exceptional circumstances that could restrain or even forbid short selling on some securities or in general.

- ***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?***

34. Enhancing risk management is not useful insofar as a proper settlement/delivery infrastructure is in place. When executing a short sale the seller commits to deliver the securities on settlement date. He is thus responsible for having in place the necessary arrangements to fulfil this commitment.

The competent authorities should monitor the proper settlement of securities contracts, which makes it easy for them to control the arrangements set up by a seller unable to deliver on time. In this respect, it could be useful to leverage the exiting applicable framework in France, which has shown its efficiency, as exemplified in a recent sanction by the AMF of a firm that sold short securities without making arrangements nor having the intention to deliver them on settlement date[1]. The regulator made a clear distinction between this situation and the one where the firm is unable to deliver the securities due to an unforeseen external event.

35. In addition, the buy-in mechanism of the clearing house should be such that a seller unable to deliver the securities would support a significant cost. Harmonisation of the buy-in mechanisms in Europe is a pre-requisite to any European regime on short selling. It should consider not only dates at which the buy-in occurs but also the price at which it is made, the maximum bid, the indemnification rules … LCH Clearnet SA ‘s buy-in model on ESES markets could serve as a model in this respect because it acts as a very efficient deterrent.

[1] Enforcement Committee decision concerning Avendis Capital SA, Accent Tonique BV and Accent Grave BV, 20 April 2009 (http://www.amf-france.org/documents/general/8869_1.pdf)