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COMMISSION STAFF WORKING PAPER
EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

**Proposal for a
Regulation of the European Parliament and of the Council
on Insider Dealing and Market Manipulation (Market Abuse)**

and

**Proposal for a
Directive of the European Parliament and of the Council
on Criminal Sanctions for Insider Dealing and Market Manipulation**

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1. PROBLEM DEFINITION

The Market Abuse Directive (MAD) aims to increase investor confidence and market integrity by prohibiting those who possess inside information from trading in related financial instruments ("insider trading"), and by prohibiting the manipulation of markets through practices such as spreading false information or rumours and conducting trades which secure prices at abnormal levels ("market manipulation").

The MAD creates some tools to prevent and detect market abuses, like insiders' lists, suspicious transaction reports and the disclosure of managers' share transactions. It also obliges issuers of financial instruments traded on a regulated market to make public as soon as possible inside information that they possess, with limited possibilities to delay.

In order to promote enforcement, the Directive gives national competent authorities powers to investigate, take administrative measures and impose "effective, proportionate and dissuasive" sanctions.

The MAD has introduced a framework to harmonise core concepts and rules on market abuse and strengthen cooperation between regulators. However, a number of problems have been identified by the Commission services and these are examined further below.

1.1. Gaps in regulation of new markets, platforms and OTC instruments

If a financial instrument is admitted to trading on a regulated market then any trading in that instrument is covered by the MAD, whether the trading of that instrument occurs on a multilateral trading facility (MTF), broker electronic system ("crossing network") or over-the-counter (OTC). Further, for insider dealing (although not for market manipulation), the prohibition extends also to financial instruments not admitted to trading on a regulated market, but whose value depends on such a financial instrument.

However, this focus on instruments traded on regulated markets has been overtaken by market developments. Increased competition and use of technology has led to greater use of MTFs and other organised trading facilities (such as crossing networks) to trade instruments. There has also been a growth in OTC markets. If an instrument is not admitted to trading on a regulated market but is only traded on a MTF, another type of facility or OTC, it will not be covered by MAD.

Concerns have also been expressed that the increasing fragmentation of trading across different markets may inhibit effective enforcement, and different surveillance standards according to the nature of the venue may create an unlevel playing field. Finally, the increased trend towards automated and high frequency trading (HFT) has raised issues about how regulators monitor such trading and whether MAD adequately captures specific strategies that may be abusive practices.

1.2. Gaps in regulation of commodity and commodity derivatives markets

Market abuse may take place across markets and across borders, and this raises special concerns for commodity and related derivative markets, where market integrity and transparency rules apply to the derivatives markets but not to the underlying markets.

Currently, there is no obligation in the MAD for financial supervisors to take into account developments on physical commodity markets when monitoring financial markets for possible market abuse, or to cooperate and exchange information with regulators of physical markets in the EU or in third countries. This lack of cooperation between physical and financial market regulators could undermine the integrity of both physical and financial markets.

Commodity markets are not subject to the same market integrity and transparency rules for trading activity as financial markets. Derivatives trading which distorts the price of financial instruments is prohibited. However, derivatives trading which distorts the prices of underlying physical markets, and trading in physical markets which distorts the prices of financial instruments are not covered under the current definition of market manipulation. Regulators have expressed concern about the use of derivatives markets to manipulate underlying commodity markets.

In addition, there are no general rules that specify what information needs to be disclosed in commodity markets and there are concerns about a lack of transparency of fundamental commodity market information. This is a problem for investors in commodity derivatives markets, because the value of a derivative is largely determined by the underlying instrument or commodity. It is also a problem for supervisors, who cannot monitor transactions on these markets for possible abuse.

1.3. Regulators cannot effectively enforce

First, regulators lack some of the necessary powers to detect market abuse, such as to receive reports about suspicious transactions in OTC derivatives, even though these can be used for market abuse. Regulators in some Member States are unable to obtain existing telephone data records from telecom operators necessary to provide evidence for the investigation and sanctioning of market abuse, notably for insider dealing. As a result, specific market abuses subject to administrative sanctions may remain undetected and unsanctioned. Access to this data is considered an essential tool for the accomplishment of the investigatory and enforcement tasks of financial regulators. Some regulators lack the power to enter private premises and seize documents. In addition, regulators may be deprived from access to important primary information on suspicious transactions from "whistle blowers" as these sources of information lack incentives and may not be sufficiently protected. Moreover, regulators lack the tools to address "attempts at market manipulation", where a person tries but fails to manipulate the market.

Second, not all competent authorities have a full set of sanctioning powers at their disposal to ensure they can respond to all abuses with the appropriate sanction. For example, in 8 Member States, competent authorities do not have the possibility to withdraw licenses in case of violations. Furthermore, in some Member States the level of administrative fines can be considered low and insufficiently dissuasive. When the gains of a market abuse offence are higher than the expected sanctions, the deterrent effect of the sanctions is undermined. In addition, not all competent

authorities ensure that sanctions imposed are published, which is an important factor for effective enforcement. Finally, in some Member States criminal sanctions, which have an important deterrent effect, are not available for certain insider dealing and market manipulation offences. This divergence undermines the single market, leaves scope for regulatory arbitrage and complicates the cross-border cooperation of law enforcement authorities.

1.4. Lack of clarity and legal certainty

The MAD includes certain options and discretions as well as provisions leaving room for interpretation in practical application. These divergences and ambiguities have resulted in differences in the rules applicable in the Member States. The De Larosière report has identified options and discretions as one reason for competitive distortions and regulatory arbitrage, thus as a hindrance for the efficient functioning of the single market. In particular this issue concerns the concept of accepted market practices (AMPs), the disclosure of inside information by issuers and the obligation on issuers' directors to report their dealings in financial instruments.

1.5. Disproportionate administrative burdens on issuers, especially SMEs

Concerns have been expressed that few SMEs seek to raise capital on securities markets in part because the initial and ongoing costs of listing outweigh the benefits, and that EU legislation represents a barrier to access financial markets which is too high for SMEs. If the MAD were to be extended to MTFs without any adaptation, SMEs which list on such markets would face higher costs than currently, as SME markets in several Member States have an adapted regime for SMEs to keep their costs down. Stakeholders have identified as particularly problematic in this regard the obligations to disclose price sensitive information, draw up insider lists and disclose managers' transactions. These are considered to create significant expense and administrative burdens for smaller quoted companies.

2. THE BASELINE SCENARIO AND SUBSIDIARITY

If no action is taken at EU level the problems defined above are likely to remain without a coordinated response and to occur again in the future. The result would be that certain markets and transactions would not be subject to market abuse rules, certain abuses would remain unsanctioned or be insufficiently sanctioned, and administrative burdens arising from differences in national law would persist. Although all the problems outlined above have important implications for each individual Member State, their overall impact can only be fully perceived in a cross-border context. This is because market abuse can be carried out wherever that instrument is listed, or over the counter, so there is a real risk of national responses to market abuse being circumvented or ineffective in the absence of EU level action. Further, a consistent approach is essential in order to avoid regulatory arbitrage. Against this background EU action appears appropriate in terms of the principle of subsidiarity.

The principle of proportionality requires that any intervention is targeted and does not go beyond what is necessary to achieve the objectives. At the identification of

alternative options, as well as throughout the analysis and comparison of options, this principle has been guiding the process.

3. OBJECTIVES

In light of the analysis of the problem above, the general objectives of the review of the Market Abuse Directive are to increase market integrity and investor protection, while ensuring a single rulebook and level playing field and increasing the attractiveness of securities markets for capital raising for SMEs.

Reaching these general objectives requires the realisation of the following more specific policy objectives:

- (1) Ensure regulation keeps pace with market developments
- (2) Ensure effective enforcement of market abuse rules
- (3) Enhance the effectiveness of the market abuse regime by ensuring greater clarity and legal certainty
- (4) Reduce administrative burdens where possible, especially for SMEs

4. POLICY OPTIONS

The policy options are grouped according to the operational objectives which flow from the above-mentioned specific objectives.

4.1. Prevent market abuse on organised markets, platforms & OTC transactions

- (1) Option 1 – no EU action.
- (2) Option 2 – extend rules on market abuse to Credit Default Swaps (CDS).
- (3) Option 3 – extend rules on market manipulation to OTC instruments.
- (4) Option 4 – extend market abuse rules to instruments only admitted to trading on MTFs.
- (5) Option 5 – extend market abuse rules to instruments only admitted to trading on other trading facilities (other than MTFs).
- (6) Option 6 – extend market abuse rules to instruments traded OTC (bilaterally).
- (7) Option 7 – improve supervision of HFT.
- (8) Option 8 – improve supervision of investment firms operating trading facilities such as MTFs.

4.2. Prevent market abuse on commodities and related derivatives markets

- (1) Option 1 - no EU action.

- (2) Option 2 - extend the definitions of inside information and market manipulation to include commodity spot contracts.
- (3) Option 3 - define inside information for commodity derivatives.
- (4) Option 4 - obligation for spot market traders to respond to information requests from competent authorities.
- (5) Option 5 - promote international cooperation among regulators of financial and physical markets.
- (6) Option 6 - require issuers of commodity derivatives to publish price sensitive information.
- (7) Option 7 - clarify market manipulation for commodity derivatives.

4.3. Ensure regulators have necessary information and powers to enforce effectively

- (1) Option 1 - no EU action.
- (2) Option 2 - introduce reporting of suspicious orders and OTC transactions.
- (3) Option 3 – prohibit attempts at market manipulation.
- (4) Option 4 - ensure access to data and telephone records of telecommunications operators to investigate and sanction market abuse, subject to a judicial warrant.
- (5) Option 5 - ensure access to private premises to seize documents to investigate and sanction market abuse, subject to a judicial warrant.
- (6) Option 6 - grant protection and incentives to whistleblowers.

4.4. Ensure consistent, effective and dissuasive sanctions

- (1) Option 1 – no EU action.
- (2) Option 2 – common minimum rules for administrative measures and sanctions.
- (3) Option 3 - uniform administrative measures and sanctions.
- (4) Option 4 - requirement for criminal sanctions.
- (5) Option 5 - common minimum rules for criminal sanctions.
- (6) Option 6 - improved enforcement of sanctions.

4.5. Reduce or eliminate options and discretions

- (1) Option 1 - no EU action.
- (2) Option 2 - harmonise accepted market practices.

- (3) Option 3 - remove accepted market practices and phase-out existing practices.

4.6. Clarify certain key concepts

- (1) Option 1 – no EU action.
- (2) Option 2 - clarify conditions of delayed disclosure of inside information.
- (3) Option 3 - reporting of delayed disclosure of inside information.
- (4) Option 4 - determine conditions of delayed disclosure in case of systemic importance.
- (5) Option 5 - clarify disclosure of managers' transactions.

4.7. Reducing administrative burdens, especially on SMEs

- (1) Option 1 – no EU action.
- (2) Option 2 - SME regime for disclosure of inside information.
- (3) Option 3 - SME exemption for disclosure of inside information.
- (4) Option 4 - harmonise insiders' lists.
- (5) Option 5 - SME exemption for insiders' lists.
- (6) Option 6 - abolish managers' transactions reporting.
- (7) Option 7 - harmonise managers' transactions reporting requirements with an increased threshold for all issuers, including SMEs.
- (8) Option 8 - SME regime for managers' transaction reporting.

5. ASSESSMENT OF THE IMPACTS OF THE PREFERRED OPTIONS

The different policy options were tested against the criteria of their effectiveness and efficiency in achieving the related objectives. The comparison of policy options lead to the following conclusions:

- *Organised markets, platforms & OTC transactions*: the preferred option is a combination of options 2, 3, 4, 5, 7 and 8. Combining options 4, 5 and 8 would ensure a level playing field and a high level of investor protection and market integrity for financial instruments, irrespective of the trading venue they are admitted to trading on. Combining options 2 and 3 would ensure that market manipulation of underlying instruments through OTC derivatives such as CDS would also be clearly prohibited. Option 7 would make it easier for regulators to detect and sanction manipulative practices through high frequency trading.
- *Commodity derivatives*: the preferred option is a combination of options 3, 4, 5, and 7. Combined, these options will clarify existing definitions and prohibitions, ensuring that all cross-instrument manipulative strategies are fully in scope, and

offering a level playing field to investors. In terms of costs, hedging may become more expensive for producers, and supervisors will need to invest in additional data processing and monitoring tools. In terms of benefits, it will be clear to investors which information they may expect to receive, and how they are to conduct themselves in the derivatives markets.

- *Regulators' powers*: the preferred option is a combination of options 2, 3, 4, 5 and 6. Combining these options will ensure that regulators have the appropriate powers to detect market abuse, notably by facilitating detection of suspicious OTC transactions and orders and sanctioning attempts at market manipulation. The package will ensure that when there are reasonable grounds to suspect market abuse, competent authorities have powers to access telephone data records from telecom operators and to enter private premises based on safeguards, in line with the e-privacy directive and charter of fundamental rights. Finally, the package will improve detection by providing for protection from retaliation and incentives for whistle blowers.
- *Sanctions*: the preferred option is a combination of options 2, 4 and 6. These options, which reinforce each other, will ensure effective, proportionate and deterrent sanctions within the market abuse framework. In accordance with article 83.2 of the Treaty (TFEU), the introduction of a requirement for criminal sanctions for insider dealing and market manipulation offences, as defined at Union level, is considered essential and proportionate for the functioning of the internal market.
- *Options and discretions*: the preferred option is option 3. Implementing this option would reduce a source of legal uncertainty, clarify the legal framework applicable and would be a step towards the creation of a single rulebook in the EU.
- *Key concepts*: the preferred option is a combination of options 3, 4 and 5. A combination of these options would ensure greater legal certainty in respect of delayed disclosure and managers transactions while eliminating an option in the Directive.
- *SMEs/administrative burden*: the preferred option is a combination of options 2, 4, 5 and 7. These four options would comprehensively reduce the administrative burdens related to the issuer-related requirements of the market abuse framework, and would establish a specific market abuse regime for SMEs with a reduced administrative burden on them.

6. MONITORING AND EVALUATION

The Commission will monitor how Member States are applying the changes proposed in the legislative initiative on market abuse. The evaluation of the consequences of the application of the legislative measure could take place three years after the entry into force of the legislative measure, in the context of a report to the Council and the Parliament. This could be based on data from national competent authorities on sanctions for market abuse and a report by ESMA on the experience gained by regulators.