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RESPONSE

COMMISSION'S CALL FOR EVIDENCE – REVIEW OF THE MARKET ABUSE DIRECTIVE

I. INTRODUCTION:

The Federation of European Securities Exchanges (FESE) is a not-for-profit international association (AISBL) representing 42 Securities Exchanges (in equities, bonds, and derivatives) through 23 Full Members from all EU Member States and Iceland, Norway and Switzerland as well as 7 Corresponding Members from European emerging markets. FESE has a working group dedicated to the subject of market abuse composed of legal experts working in the areas of ad hoc and ongoing company disclosure and market surveillance. Thanks to the work of this group, FESE has contributed to the consultations concerning the Market Abuse Directive (MAD) since the beginning, including the process for the draft Level 3 sets of guidance during the last three years. We welcome the possibility to offer our expertise on the aspects of MAD legislation identified by the Commission.

As a general introduction, we would like to reiterate a long-standing issue of MAD, i.e. its Competent Authority (CA) regime. MAD foresees a regime based on the multi-competence of all involved authorities. As a result, the same level of consideration was not given to the principles of the designation of the CA as was given to the directives that followed. This approach might be seen as useful for avoiding any potential market abuse case to fall inside a vacuum of competence but it is problematic when applied to issuers and intermediaries. This is because domestic regimes differ from one another and in the European cross-border environment the lack of harmonisation obliges issuers and intermediaries to comply with diverging interpretations of EU rules. We agree with the assessment and the recommendation of the ESME Group[1] that a single regulator should be identified to supervise issuers and intermediaries. We believe that **the CA regime of MAD should be modified and the provisions of the Transparency Obligations Directive (TD) that the CA is the one of the Member State (MS) in which the issuer has its registered office apply.** This solution would allow more efficient supervision of market abuse, lower costs for issuers admitted to trading on RMs and enhance further harmonisation of regulation.

A second general aspect on which we would like to draw the attention of the Commission refers to the quality of trading surveillance on different execution venues. Since the introduction of MiFID, the same instruments can be traded on two types of execution venues[2] - Regulated Markets (RMs) and Multi-lateral Trading facilities (MTFs) - which are incorporated in several jurisdictions. **To avoid arbitrary effects and to ensure consistency of regulatory treatment, it is of the utmost importance that CAs require the same level of trading surveillance from all execution venues regardless of the legal status of the operator**. We will come back to this aspect in the next section, when responding to the Commission's question on the scope of the Directive.

II. RESPONSES TO THE COMMISSION'S QUESTIONS:

➢ THE SCOPE OF MAD

i. Only regulated markets?

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

[1] http://ec.europa.eu/internal_market/securities/docs/esme/mad_070706_en.pdf

[2] MiFID foresees a third category of execution venue i.e. Systematic Internalisers. In addition, competition in secondary market trading has led to a new unclassified and unregulated venue competing with the regulated ones: the intermediaries' in-house unclassified venues 'crossing networks' which currently account for 20-50% of total trading.

When discussing the possibility to extend MAD to MTFs it is important to distinguish between **two categories of MTFs i.e. Junior / Specialised Markets - operated by Market Operators - and pan-European equities MTFs – operated by Investment Firms or Market Operators**.

MAD applies to any financial instrument admitted to trading (or where a request for admission to trading has been made) on a RM in at least one MS and applies to all transactions concerning those instruments, whether those transactions are undertaken on RMs or elsewhere. This is to avoid markets which are not RMs from being used for abusive purposes concerning those financial instruments. The insider dealing provisions also apply to financial instruments not admitted to trading on a RM, but whose value depends on such a financial instrument. Generally, with a view to ensure market integrity and public confidence, it would seem appropriate for MAD to apply to all financial instrument admitted to trading on both RMs and MTFs. However, a differentiation between MTFs needs to be maintained.

Pan-European equities MTFs, such as Chi-x, Turquoise, NYSE Euronext ARCA or NASDAQ OMX Europe, operated by Investment Firms or Market Operators generally do not list firms but trade the financial instruments of issuers admitted to trading on a RM (generally blue-chips) on a pan-European basis. As pan-European equity MTFs trade instruments that are admitted to trading on a RM, MAD already apply to them. However, in order to enhance market integrity, strengthen investor protection and increase market confidence **the same level of trading surveillance should be required from all execution venues** i.e. RMs, pan-European equities MTFs, Systematic Internalisers and crossing networks.

As a solution, we suggest that Article 6(6) and Recital 27 of MAD L1 are extended to all entities and not only to Market Operators. This modification would reflect the market developments that took place since MAD was drafted and would be consistent with Article 25 and 26 of Directive 2004/39/EC (MiFID).

Junior / Specialised markets such as LSE Group AIM and AIM Italia, NYSE Euronext Alternext, Deutsche Börse Entry Standard or NASDAQ OMX First North operated by Market Operators, list and trade financial instruments issued by small and medium-sized firms. As MAD does not apply to MTFs as such but only to financial instruments admitted to trading on a RM, insider dealing and market manipulation rules do not automatically apply to these markets, although in many jurisdictions these rules have been extended to cover such Junior / Specialised markets. We suggest that, in order to ensure investor protection, **insider dealing and market manipulation provisions should apply to all markets**.

On the other hand, we agree with the analysis of the Commission that primary market provisions e.g. disclosure rules, lists of insiders, transaction reporting by managers / would be less suitable for Junior / Specialised markets. We should bear in mind that these markets trade instruments issued by small- and medium-sized companies and the investors in these markets are typically non-retail investors. Moreover, specific primary market provisions are already included in the 'Rules for Companies' of our Members. **We would warn against the introduction of a 'one size fits all' approach**. An outright extension of the scope of MAD would most probably have a negative impact in terms of new listings. Small and medium-sized European firms would risk loosing an important avenue for raising capital if MAD were to be applied to them in an indiscriminate manner.

ii. What kind of financial instruments should be covered by the MAD, especially in comparison with the MiFID?

Questions: 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?

We support an alignment of the MAD definition of financial instrument being harmonised with the MiFID definition and we agree with the Commission that clarifying the treatment of CFDs and CDS under the MAD regime would prove beneficial. Moreover, consideration should be given to the possibility of reviewing Article 9 and include a reference to Article 5 in the second paragraph of Article 9. This modification would extend the market manipulation provisions of Article 5 to any financial instrument not admitted to trading on a RM but whose value depends on a financial

instrument admitted to trading on a RM. Finally, we agree that an explanation of what is meant by a financial instrument "whose value depends on another instrument", would be beneficial for the market and prepare the ground to future market innovation.

iii. The specific case of commodity derivatives markets

Question: Do you see a need for introduction of a market abuse framework for physical markets?

We agree with the CESR/ERGEG viewpoint that an extension of MAD to physical energy markets is not desirable. On the other hand, **we would strongly support legislative proposals for a tailor-made market abuse framework coupled with obligations on information disclosure for gas and electricity markets** provided that it consists of a separate piece of legislation and extensive consultations with the industry are carried out.

With regard to the specific case of commodity derivatives, other than gas and electricity markets, the same stance would not make sense where the underlyings are commodities produced and consumed throughout the world. To make an example, the table below summarises by producers and brands the metals deliverable into the London Metal Exchange (LME) non-ferrous metals derivatives contracts. Any EU measure to impose disclosure obligations will only apply to EU/EEA producers and, possibly, consumers - if all deliverables were EU/EEA produced and consumed then it might be useful, otherwise it would be more likely to be misleading.

Metal	Total Producers	of which EU/EEA producers	Total Brands	of which EU/EEA brands
Primary Aluminium	81	17	105	21
Aluminium Alloy	79	32	91	36
North American Aluminium Alloy	67	23	85	26
Lead	59	21	70	27
Copper	50	9	77	11
Zinc	39	9	50	9
Nickel	22	6	36	6
Tin	13	1	15	1

- INSIDE INFORMATION

i. Definition of inside information: the general definition

Question: Do you share this view as far as insider dealing prohibition is concerned? (see also next point for disclosure of inside information). If not which concepts would you advise to modify and how?

We agree with the view that a second definition is not needed and we would encourage CESR to carry out further work with regard to this subject. The focus should be on refining the treatment of delay i.e. it should be clearer at exactly what point in time a delay is allowed.

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

We would support maintenance of the status quo re the alignment of the definition of inside information relating to commodity derivatives in MAD, at least until the scope of any new obligations on public disclosure are introduced as a consequence of the Third Energy Package.

ii. Dissemination of inside information and deferred disclosure mechanism

Question: Do you consider that any changes to the definition of inside information for disclosure purposes is necessary?

We agree with the view that no changes in the definition of inside information for disclosure purposes would seem to be justified.

Question: 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?

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?

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

We see a potential danger in exempting an issuer from disclosing inside information because it would reduce the flow of information towards the market with a potential risk of information asymmetry and therefore we would not support amendments to the MAD framework in this regard. However, L3 guidance would probably be the best tool to clarify this kind of situations.

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

We strongly agree that operators of commodity derivative markets (particularly exchanges) should not be regarded as 'issuers' in the sense of being in possession of inside information to be disclosed. The assessment that other stakeholders (generally in the physical arena) or market participants may be better placed to disclose such information is correct, and links to the points made above.

iii. Prohibition of insider dealing

Question: Would you support this approach?

We believe that one single approach to the concept of 'using inside information' is a precondition for the fair and orderly functioning of European financial markets. The Commission should continue working on possible measures to be taken in order to achieve a harmonised solution across Europe. The ECJ ruling may prove to be valuable in clarifying the matter and should be taken into account before ultimately deciding on what measures may be needed, but we strongly encourage the Commission to already start preparatory work given the importance of the matter.

iv. Insider lists

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

Drawing up and maintaining of insider lists implies administrative and organisational burden for issuers and therefore any suggestion to simplify the current environment is welcome. We think that replacing the minimum requirements for the content of insider lists in Article 5 of Directive 2004/72/EC by an exhaustive set of requirements would be a good initiative. It is regrettable that multi-listed companies are obliged to establish an insider list - according to different requirements - for each of the jurisdictions in which their financial instruments are traded. This issue is linked to the current CA regime of MAD and, as stated in the introductory part of this response, we believe that should a single CA be identified to supervise issuers and intermediaries this kind of obstacles would be overcome.

v. **Transaction reporting by managers**

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

We agree with the Commission that this reporting duty is an important element of MAD. The threshold currently set at 5 thousand euros for transactions that have to be reported may need to be revised, but, from a general perspective, we should focus on harmonising rules across Member States without loosing the effectiveness that this tool has for the Competent Authorities. In any case, we would not oppose a double regime for reporting, as imagined by the Commission.

vi. **Reporting of suspicious transaction**

Question: Do you agree that rules on suspicious transactions reporting do not require modifications?

We believe that the current framework for reporting suspicious transactions is proving very effective for detecting market abuse and it should therefore not be modified. Clarification with regard to what is meant by whistle-blowing would be welcome, however, to better understand the plans of the Commission and study the effects that the introduction of such a measure would have.

vii. **The competent authorities' right of access to telephone and existing data traffic records**

Question: Do you consider that an amendment of the MAD is necessary?

We agree with the Commission that it may be necessary to amend MAD and/or the e-privacy Directive to remove any uncertainties on the rights of the competent authorities to require telephone data records.

- **MARKET MANIPULATION**

i. **Definition of market manipulation by transactions/orders to trade**

Question: 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?

We have no comments to make in this regard.

ii. **Accepted market practices (AMP)**

Question: 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?

We agree with the view that there is room for greater convergence among competent authorities in this area and we therefore support further L3 work.

iii. **Exemption for buy-back programmes and stabilisation activities**

Question: 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?

We agree that greater convergence is desirable in the application of the Regulation 2273/2003. We would like to draw the attention of the Commission to the fact that CONSOB, the Italian Regulator, following other EU Member States (France, Austria, Greece and Portugal) adopted a rule that considers buy-back activity for M&A transactions as Accepted Market Practice.

iv. 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?

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?

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?

We would strongly discourage the Commission to include measures concerning short-selling in the Market Abuse Directive. In order to be effective, it is important that any solutions that might be considered are discussed at the international level and endorsed by the relevant stakeholders. Proportionate measures that truly address the policy concerns should be well justified, taking into account the beneficial effects of short-selling (e.g. on market liquidity, and price discovery) and applying it in a non-discriminatory way to all venues and instruments concerned. We would welcome CESR's Level 3 guidance on short selling.

The need to base any future rules on a common international understanding of basic principles and technicalities is also highlighted by March 2009 Report[3] by the European Securities Markets Expert Group (ESME), which, at the end of the year 2008, was asked by the European Commission to evaluate certain aspects of short-selling. We would like to commend the thoroughness of the work undertaken by ESME and express full support in particular for the following three conclusions[4] it has reached:

- *A measure* (e.g. 'Level 3' Guidance) *concerning the disclosure of short-selling activity, to be achieved on an aggregated and anonymous basis, could provide useful information to both the competent authorities and market participants*. In addition, FESE believes that it would be necessary to discuss whether this measure should be permanent, the scope - in terms of instruments (e.g. the treatment of derivatives) and venues – to which disclosure rules would apply, the threshold for any disclosure requirements, the recipient of the information and the frequency of the reporting requirements. Enhanced and meaningful reporting of short-selling (e.g. volumes and open positions) could be beneficial if transparency measures are well thought through and proportionate. As a general approach, we believe that there should be a distinction between reporting to authorities and reporting to the market; moreover, authorities should be very clear with regard to which objectives a specific measure aims to achieve. In any case, to allow for a consistent application across the EU, a detailed cost-benefit analysis should be undertaken with clear objectives in mind.

- *Any alternative measures should be considered on a cost-benefit basis*; we agree that **rules that might be appropriate for the needs of some markets (e.g. uptick rules, circuit breakers) could be too costly and difficult to implement in other jurisdictions**. Moreover, *their effectiveness has not been proved from a cost-benefit perspective*.

Finally, a robust discipline for settlement of short sales is central to an effective short selling regulatory regime. We support strict regulation for failed trades, as well as a short settlement cycle (T+3) provided it applies to all

[3] http://ec.europa.eu/internal_market/securities/docs/esme/report_20090319_en.pdf

[4] ESME original wording is in *italic*.

comparable types of execution venues (including systematic internalisers and broker dealer operated crossing systems). Procedures for addressing late settlements would increase the efficiency of our markets and address potential settlement drawbacks. As a matter of fact, stock exchanges and clearing houses have limited possibility to prevent settlement risk; as short-selling is a service provided by investment firms to their clients, the firms should implement proper internal regulations to ensure sufficient risk management.

In any case, short-selling as such should never be banned or limited, no matter what the market conditions might be.

III. CONCLUSION:

We thank DG Markt for the opportunity to offer our views and remain ready to provide any further input required.