The Association of Corporate Treasurers

Comments in response to the consultation
FSMA market abuse regime: a review of the sunset clauses
HMTreasury, Feb 2008

May 2008

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

This document is on the record and may be freely quoted or reproduced with acknowledgement.

Background

Following the implementation of the Market Abuse Directive the Financial Services and Markets Act (FSMA) prohibits anyone in possession of inside information from dealing (or attempting to deal) in relevant securities or encouraging others to deal. The definition covers “information in relation to financial instruments or issuers that is precise, not in the public domain and which, if it were made public, would be likely to have a significant effect on the prices of those instruments or on the price of related derivative instruments. Information that would be likely to have a significant effect on prices is information a reasonable investor would be likely to use as part of the basis for his investment decision.” Note that the information must be “precise”.

Prior to this the UK had stricter controls restricting trading in securities by persons possessing relevant information not generally available (RINGA). This wider definition of information, possession of which would debar you from dealing, was preserved (subject to a "sunset clause" cancelling it on 30 June 2008) via the two super-equivalent provisions:

- Section 118(4) of FSMA concerning behaviour not covered by the Directive's prohibitions on insider dealing. This uses a different definition of information that can be abused, 'RINGA' – relevant information not generally available rather than 'inside information' used in the Directive provisions.

- Section 118(8) of FSMA covering behaviour giving rise to false or misleading impressions or distorting markets. This uses a broader range of behaviours than those in the Directive provisions.

The ACT position

The ACT's view, firmly held, is that super-equivalence is in general best avoided. However, this is a case where we feel that there are dangers for market participants in falling back from the current UK level of protections. We are particularly concerned that the UK's existing protection against misuse of information may be weakened in respect of trading by persons possessing information not generally available if the sunset clause operates. We therefore welcome the proposal to extend the sunset clause until 2010 and indeed would also support the continuation of these provisions after this date.

In para 2.14 of your consultation you say of the different definitions for disclosure and for prohibition on trading:

> "This distinction was seen as important by investor groups who feared that omission of this provision would allow people to trade to their advantage and to the disadvantage of others on the basis of information not generally available to investors, for example, information about the state of negotiations over a major contract."

It cannot be ethically right that an investor can trade when in possession of non public information that, for example, a company's directors were considering a major reorganisation or a change of strategy for the issuer, which under the MAD style definitions would probably be excluded from inside information as being insufficiently precise. To do so would be to put other investors at a disadvantage and be a distortion of fair market conditions.

Our members working in companies will often be responsible for accessing the capital markets, both debt and equity, and for optimising the cost of capital for their company. Insider trading will tend to distort the market and as you say has also been shown to increase market volatility. [1] More importantly investors feeling liable to lose out to others trading on RINGA will seek a higher return to compensate for that risk. This will all feed through to an increase in the cost of capital to the detriment of the issuer. An effective market abuse regime is therefore an essential part of a successful capital market.

The realistic possibility of enforcement is an important component of an effective market abuse regime. In your consultation para 2.22 and 2.24 you explain that:

> "It is a requirement under the Directive provisions of sections 118(2) and (3) that the individual be an insider either by virtue of how he obtained the

[1] Du, J., Wei, S-J., (2004). Does Insider Trading Raise Market Volatility*? Economic Journal 114*(498), 916-942

> inside information or because he knew or could reasonably be expected to know that the information in his possession was inside information."
>
> "The super-equivalent provision of s118 (4) helps to overcome this difficulty, as the provision requires no proof of how the information being abused was obtained. The FSA need only show that the information was RINGA, i.e. information not generally available that the regular user would be likely to regard it as relevant."

This additional feature of the super-equivalent provisions is ancillary benefit which supports the threat of prosecution and therefore the effectiveness of the anti-abuse provisions. We believe this is worth retaining.

The reputation of the UK markets for high standards of integrity and behaviour is one fact that contributes to its success. Issuers and investors need to be confident that the market will operate in an open and honest manner, free from manipulation or exploitation by privileged users. The FSMA sections 118 (4) and (8) make a significant contribution to these aims and should be retained.

The counter arguments

In para 2.13 of your consultation you explain that

> "In the Code of Market Conduct ('the Code') behaviour based on undisclosed information which is required to be disclosed or announced will be regarded as unacceptable by the regular user and therefore amount to market abuse ….. Judging the precise point at which a piece of information becomes 'disclosable' even under DTR is often difficult. The FSA therefore discusses explicitly in the Code that behaviour based on 'relevant information' which is likely to be disclosable in the future is unacceptable, even if it is less clear at that point in time that the information amounts to 'inside information' which is price sensitive and needs to be disclosed."

On this view the argument is that the super-equivalent provisions are redundant. From the issuer point of view we would counter this and maintain that for the avoidance of doubt it is preferable to be absolutely clear as to the sorts of information that give rise to a prohibition on trading and therefore the current FSMA provisions should be retained.

The well organised trade bodies for the financial services industry have previously opposed the RINGA provisions saying that the use of a wider restriction in the UK means they have to teach staff to observe two levels of control. We would hope that this is nonetheless perfectly possible to do, or alternatively institutions could teach a single boundary using RINGA and that will then encompass the MAD definition of "inside information".

One could argue that capital markets exist to provide capital and that doing this in the most efficient and effective way should be a market objective. The self interest or convenience of the market intermediaries should not be the driving factors, subject to a sufficient number of them making a satisfactory return so as to stay in the market.

The second argument deployed is that prosecutions in this area are rare and very difficult to bring. In fact, this argument applies just as much to "inside information" as

to RINGA. Of course, potentially, more actions are caught by RINGA – but the mischief which the law seeks to control is surely more nearly defined by RINGA than by "inside information". RINGA is not qualitatively different as regards investigation and enforcement. Past failures of enforcement do not necessarily imply impossibility of enforcement.

Further European regulation

We note that the European Commission will be undertaking a review of the Market Abuse Directive and its implementation during 2008. This may well result in changes to the European market abuse regime. We fully agree that the short extension to the current super-equivalences until the outcome of the EU review is known would be beneficial and a pragmatic step to avoid repeated changes to the regime. During the course of that review the ACT will be pressing for a RINGA style regime to be extended throughout the EU rather than abandoning it in the UK. The ACT has held this stance for some time as has the French National Treasury Association the Association Française des Trésoriers d'Entreprises (AFTE).[2]

In any event we do not consider the failure of other EU Member States to adopt a more investor-friendly rule should weaken the UK's resolve.

Specific questions

The preceding paragraphs explain the thinking of the ACT, and to a large extent answer your specific questions. However for ease of reference we can summarise our specific responses.

Q1: Do you consider that the super-equivalences increase the effectiveness of our regime and have an effect on market integrity?

A1: The ACT is firmly of the view that the super-equivalences of RINGA are beneficial for the UK markets

Q2: Which of the identified differences do you see as most important and why?

A2: We believe that the generally wider scope as to information and behaviours is the major difference. With regard to your list of 5 differences in para 2.10 we would highlight as most important point 1 that the definition of RINGA is not as narrow as 'inside information' and secondly point 3 that S118(4)does not require proof of how the RINGA information being abused was obtained so that it makes it easier for the FSA to take enforcement actions without having to demonstrate that there was an 'insider'.

Q3: Do you have any further evidence on the practical operation of the super-equivalences since the introduction of MAD?

[2] See joint ACT / AFTE response to CESR's technical advice to the European Commission on possible measures concerning credit rating agencies at http://www.treasurers.org/purchase/customcf/download.cfm?resid=1928 page 13: "The ACT and AFTE take the view that the definition of inside information used regarding restrictions on trading in securities by persons with special knowledge of an issuer's circumstances required by MAD do not go far enough."

A3: Nothing to report

Q4: Do you agree that we should extend the sunset clauses for a limited period of time until the results of the EU review are known?

A4: For the reasons explained the ACT considers that you should extend the sunset clauses.

Q5: Do you agree that an extension until 2010 would allow sufficient time to access the outcome of the EU review?

A5: We suspect that the FSA is in in a better position to judge whether this is sufficient time to allow the EU deliberations to become clearer.

Q6: Do you have any initial views on the EU Review and what the UK priorities for change should be?

A6: Ideally we would like to see the EU come closer to the super-equivalent provisions in force in the UK.

Q7: Do you have any views on the need to update the 1993 Criminal Justice Act?

A7: No comment.

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at http://www.treasurers.org/technical/resources/manifestoMay2007.pdf .

Contacts: John Grout, Policy and Technical Director (020 7847 2575; jgrout@treasurers.org) Martin O'Donovan, Assistant Director, Policy and Technical (020 7847 2577; modonovan@treasurers.org) Peter Matza, Policy and Technical Officer (020 7847 2576; pmatza@treasurers.org)	The Association of Corporate Treasurers 51 Moorgate London EC2R 6BH, UK Telephone: 020 7847 2540 Fax: 020 7374 8744 Website: http://www.treasurers.org