LEGISLATING WITHOUT CONSULTING

THE EU HAS NEGLECTED USERS' VIEWS IN PROPOSING NEW RULES FOR FINANCIAL MARKETS, WROTE **CHRIS BATES** RECENTLY IN THE *FINANCIAL TIMES*.

When Baron Lamfalussy's Committee of Wise Men launched its review of the regulation of European securities markets last year, one message came loud and clear from the industry: users must be fully consulted on any proposals to change the rules governing financial markets in the European Union. The committee recognised this priority, and called for the European Commission to consult in "an open, transparent and systematic way with market participants and end users" before making proposals for directives.

So there was dismay when, less than four months later, two new directives were rushed down the legislative slipway without anything approaching the kind of consultation called for in the Lamfalussy report. And these two directives need to be improved.

The first would replace the existing insider dealing directive with a new system prohibiting 'market abuse', covering both insider dealing and market manipulation. Member states could punish professionals who deal on the basis of any price-sensitive information and anyone at all whose conduct misleads or distorts markets, regardless of whether they knew or could have known the relevant facts and irrespective of whether they had a legitimate intention or purpose.

Even the UK's controversial new market abuse regime attempts to identify culpable conduct other than by looking simplistically at the effect on the market. In particular, the UK's Financial Services Authority can only fine market participants where the regular market user would regard the conduct as unacceptable - effectively introducing questions of intention or purpose by the back door.

The new EU regime would penalise a market-maker who traded on his own information about market dealings, even if he was not trading on behalf of customers.

It extends insider-dealing concepts, developed in the context of securities markets, to those trading commodities or interest rate derivatives, even though there is no 'issuer' whose inside information can be abused. It ignores even the most robust Chinese walls.

The proposal also invites member states to apply their own interpretation of the new rules on a broad, extraterritorial basis. This exposes market participants to multiple, differing and conflicting standards of conduct - hardly the recipe for a single market.

The second proposed directive aims to give European issuers a 'single passport' to raise capital freely across borders on the back of one prospectus. But this also needs significant work.

The passport regime would create significant additional complexities and new obstacles to capital-raising. For example, it shackles issuers to the regulator in their country of incorporation, regardless of where they want to list or offer their securities.

An issuer who listed in another country would have to deal with the listing regulator there as well, at the outset and on an ongoing basis. This would deter issuers from listing in other member states and restrict competition between trading platforms. Listing authorities would no longer be able to offer a one-stop shop. Indeed, corporate debt issuance programmes could face the impractical requirement of having to seek approval from several regulators where programmes involve issues by financing subsidiaries incorporated in different countries.

Another aim of the directive is to free up cross-border institutional and private placements. But again, the proposal would introduce new barriers to offers in many countries. For example, no prospectus would be required where the offer is to 'qualified investors'. None of Europe's largest and most sophisticated corporations would be treated as qualified to invest in these offerings – in contrast to the current position in many member states and the US rule 144A that has done so much to open up the US institutional market.

It is not too late to correct this. The directives are now before the Council and European parliament. Leading European finance houses want the legislative process to be put on hold and the Commission to initiate a full consultation. The Commission should then publish amended proposals with a statement dealing with the responses received. With redrafted directives, the EU should be able to deal quickly with the rest of the process on the accelerated timetable envisaged by the Lamfalussy report. Failing this, it would be up to the Council and the European parliament to ensure the proposals made sense. More haste could end up meaning less speed.

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