

FSMA Market Abuse Regime:

summary of responses to the consultation on the sunset clauses

June 2008



HM TREASURY



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INTRODUCTION

1.1 This feedback statement summarises responses received to our February 2008 consultation on the FSMA market abuse regime: a review of the sunset clauses. Since launching our consultation, market abuse and the ways in which it can be tackled has been the subject of increased debate. Maintaining investor confidence and the integrity of financial markets remain at the top of the UK's agenda.

1.2 Having an effective set of tools to tackle market abuse is crucial. This is a shared objective at the EU level and we are therefore keen that the EU review of the Market Abuse Directive should ultimately deliver an outcome that we consider fully satisfactory for combating market abuse. Pending this work we have decided to retain the areas in which we are superequivalent to the EU's Market Abuse Directive until December 2009 to enable a wider consideration of their benefits for addressing identified issues with the EU regime and to minimise transition costs for industry.

1.3 We would like to thank all respondents for their very detailed and helpful responses, and we will take them into account when preparing for the EU review. Domestic retention of the superequivalent provisions until 2009 does not imply that we will be arguing for the retention of all the provisions in the wider EU debate. The arguments for retaining some of the provisions are finely balanced, and we will reflect further on the detailed points submitted. We remain committed to ensuring firms are only subject to justified superequivalences.

1.4 There are very real challenges in prosecuting insider dealing and other market misconduct offences. We continue to pursue a range of work to improve the FSA's ability to tackle market abuse, including looking at ways to strengthen the FSA's formal powers. This is outside the scope of this paper, but we have noted the comments received on these broader questions and will continue to liaise with industry on these matters.

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SUMMARY OF RESPONSES

2.1 The aim of the February 2008 consultation paper was to seek views on the appropriate scope for the UK's civil market abuse regime. The UK currently has a wider definition of market abuse than that established in the EU's 2003 Market Abuse Directive (MAD or the Directive). The UK definition retained the then existing (and wider) scope of the UK market abuse regime that had been introduced in 2001. There were mixed views as to the merits of a 'superequivalent' regime and so HM Treasury committed to review the scope of the regime by May 2008 to assess whether the superequivalences remain justified. The consultation paper considered whether the wider scope remained desirable. HM Treasury received 16 responses to the consultation paper from a range of trade associations, law firms, exchanges and banks. This section summarises the responses received.

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

2.2 Eight responses considered that the superequivalences increased the effectiveness of our market abuse regime and have a positive effect on market integrity. They were felt to be important to the reputation of UK markets and in turn contribute to the success of London.

2.3 Respondents felt that the superequivalences increased the potential for effective enforcement, and the threat of enforcement in the UK markets in comparison with the European provisions. Furthermore, it was felt to be a matter of investor protection that these provisions are kept as a more robust market abuse regime helps to mitigate market volatility.

2.4 In contrast, several respondents agreed with the research quoted in the consultation that it is the enforcement of the market abuse regime that matters rather than the existence of the market abuse regime per se and that to date the superequivalences could not therefore be shown to have had an effect.

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

2.5 RINGA and the wider definition of insiders were cited as the most important superequivalences, although many respondents felt that all of the superequivalences were important. Various respondents pointed to the ESME work identifying problems with a common definition of inside information and noted that the current UK regime avoids this difficulty.

2.6 Respondents also cited the wider definitions of 'behaviour' and scope of instruments, in particular the questions about coverage of the CDS market, as beneficial. It was stated that the superequivalent 'catch all' covering instruments under FSMA keeps the legislation fresh with an ever-evolving market.

2.7 Some respondents however reiterated their view that all of the superequivalences should be left to expire this year as they felt that they neither increase the effectiveness of the UK market abuse regime nor have any significant effect

on market integrity. However, amidst this sentiment, some respondents pointed out that the UK could bring new legislation or regulations to cover specific 'gaps'.

Q3 – Do you have any further evidence on the practical operation of the superequivalences since the introduction of MAD?

2.8 Most respondents did not have any further publishable evidence on the practical operation of the superequivalences. However, several argued that the superequivalences act as a deterrent, dissuading market participants from perpetrating market abuse. Respondents argued that the absence of practical examples therefore does not in itself constitute a proof that the rules are not important.

2.9 Some respondents have said that they have some reservations as to the demonstrable benefit of the practical examples of the superequivalences we gave in our consultation document; for example querying whether inaction would normally be a breach of other regulatory rules and so enforceable via other means and questioning how frequently the other examples would actually occur. Specific questions were also raised about the clarity of certain explanations. As regards the example given in paragraph 2.19 of the consultation; the example envisaged in the paper was one in which the analyst inappropriately obtained inside information and so differs to the existing FSA material on this matter.

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

2.10 Most respondents agreed with our proposal as firms did not want to be subject to two sets of changes in short succession. Additionally some respondents were keen to avoid introducing into the UK regime the problems associated with a common definition of inside information that ESME has highlighted. A few respondents went further to say that they supported the regime being extended indefinitely.

2.11 Three respondents argued that we should let the superequivalences expire in June 2008. They felt that the concern that there may be changes to be made to UK law in two years time is not sufficient for their members to favour extending the sunset provisions. One of these respondents thought it key there should be a common pan-European market abuse regime and national divergence should not be encouraged other than in cases of the clear need, and stated that no such need has been found. This is echoed by another of the respondents who is of the opinion that the superequivalences do not present sufficient benefits to outweigh the disadvantages.

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

2.12 There was support for an extension until 2010 to allow for the outcome of the EU review to be assessed. One respondent thought there was merit in including a provision that leads to an automatic review of the clauses on the completion of the EU review, if it is sooner than 2010. Others noted concerns that the EU review could get delayed.

2.13 We acknowledge that the timing of the EU review is very difficult to predict with accuracy, but we are keen not to extend the superequivalences for longer than necessary. We are required to insert a specific date into the legislation – we could not simply extend the sunset clauses “until the outcome of the EU review became known”. Therefore we propose extending the sunset clauses until 31 December 2009. This is a slight shortening to the proposal in the consultation paper.

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

2.14 Respondents in considering this question focussed primarily on whether the superequivalences should be a priority for the EU review. We continue to liaise separately with firms on the broader agenda for the EU review.

2.15 Several respondents said that the UK should be seeking to extend the EU rules to match those required under the UK superequivalent provisions – in particular to ensure the European adoption of a RINGA style regime. Respondents also supported the issues raised in the recent ESME report – notably the consideration of a two-fold notion of inside information, and the designation of a clear home competent authority for market abuse.

2.16 Again, a few respondents were not convinced that the superequivalent provisions should be incorporated into the Market Abuse Directive and indeed would prefer that we actively discourage such amendments.

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

2.17 Of those who responded to this question, there was support to update the 1993 Criminal Justice Act to reflect legislative changes brought on by FSMA and MAD.

Q8- Do you agree with the analysis of the costs and benefits for the different implementation options, including the impact on competition and small firms?

2.18 There was broad support for our analysis of the costs and benefits. Two respondents believed that the benefits of market confidence and stability that the superequivalences provided should be explicitly incorporated in the analysis, although it was acknowledged that these benefits were hard to quantify. The respondents believed that the costs of the superequivalent provisions of the market abuse regime were small in comparison to this substantial benefit. Our study was based on a ‘worst case scenario’ whereby we did not include these benefits.

2.19 One respondent argued that we should remove the costs of the EU review, as this is unavoidable. Our impact assessment includes varying costs of the EU review depending on its similarity to the UK regime and we therefore feel it is helpful to retain these costs. Another respondent did not believe that there were any additional corporate costs in maintaining the superequivalent regime and that our impact assessment overestimated the cost of retaining the superequivalences but their response did not provide details. Other respondents neither confirmed nor refuted our estimated costs.

2.20 On the other hand, another respondent pointed out that the non-harmonisation of the UK has a cost to pan-European firms and called for this to be included but did not provide any estimates. This factor is already included in the impact assessment as an additional unquantified factor.

Q9 – Are there any alternative options, or combinations of the proposed options, that should be considered?

2.21 One respondent thought there was merit in including a provision that leads to an automatic review of the sunset clauses on the completion of the EU review, if it is sooner than 2010. One respondent, whilst supporting the superequivalent standards, said that they found them difficult to comprehend and recommended that they be redrafted to improve their clarity. Another respondent said that, rather than retaining these provisions, it would be preferable to bring new UK legislation or regulation to cover any specific gaps.

2.22 The remaining respondents did not have any alternative proposals.

Q10 – Do you agree with our policy proposal? If not, please specify your reasons.

2.23 As already discussed under Question 4. Most respondents agreed with our proposal as firms did not want to be subject to two sets of changes in short succession and/or to be subject to problems that exist with the current EU regime. However some respondents disagreed – preferring either the immediate removal of the superequivalences or the permanent retention of them.

A

LIST OF RESPONDENTS

A.1 The following industry bodies and organisations submitted non-confidential written responses to the consultation:

- Association of British Insurers (ABI)
- Association of Corporate Treasurers (ACT)
- Association of Investment Companies (AIC)
- Aviva
- Britannia Building Society
- British Bankers Association (BBA)/International Capital Market Association (ICMA)
- Centre for Financial Market Integrity (CFA)
- CFA Society of the UK Response
- City of London Law Society
- Confederation of British Industries (CBI)
- Investment Management Association (IMA)
- Investor Relations Society
- London Investment Banking Association (LIBA)
- London Stock Exchange (LSE)
- Quoted Companies Alliance (QCA)

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