

3

THE LEGISLATIVE IMPLEMENTATION OF THE DIRECTIVE

3.1 This chapter explains the draft legislative regulations which are contained in Annex A.

Introduction

3.2 In implementing the Market Abuse Directive, the Government's objectives are to create a regime which is:

- proportionate;
- comprehensible;
- effective; and
- consistent with our obligation to implement the directive.

3.3 In respect of the ground covered by the Market Abuse Directive, the UK has a pre existing civil legal framework, mainly in Parts 6 and 8 of the Financial Services and Markets Act 2000 (FSMA). Part of this pre-existing regime, that in Part 8 of FSMA, was new in FSMA and has been operational for only two and a half years.

3.4 The UK also has a criminal regime covering insider dealing and market manipulation¹. The directive is aiming at creating an effective administrative regime dealing with market abuse. The Government has therefore decided not to change the criminal regime as part of the implementation of this directive.

Implementation options

3.5 In the process of the drafting of the regulations, the Government has considered whether or not the UK's existing regime, in particular that covering market abuse, could be largely left alone given that it has a broad similarity to that contained in the directive. We do not consider that this is possible. Despite the broad similarity between the UK's existing regime and the provisions in the directive, there are important detailed differences. Some of these differences mean the UK's current regime falls below the minimum standards required by the directive. The Government believes therefore that certain substantive changes are needed to the UK's existing regime to ensure it is compliant with the directive.

3.6 In making these changes to the UK's existing regime, the Government faced a choice. This was whether also to change the UK's existing regime in areas where its scope was broader than that in the directive, or to maintain the existing scope in these areas.

3.7 The draft regulations are based on maintaining the scope of the UK's existing regime where it is broader than that in the directive. The existing regime was subject to extensive consultation and discussion before it was introduced relatively recently. The Government wishes to maintain the current scope of prohibited behaviours and the current coverage of markets to which the regime applies. These aspects of the regime are familiar to market participants and important to maintaining the integrity of the UK's financial markets.

¹ Part 5 of the Criminal Justice Act 1993 and s397 of FSMA

3.8 However, in practice, there is not a radical difference between the two options. If we had chosen to align the scope of the UK's regime to the scope of the directive regime, there would have been three main differences in the draft regulations:

- ⚡ Insider dealing. The new s118(4) of FSMA in the draft regulations which is a provision concerning behaviour in relation to relevant information not generally available, and not covered by the directive's prohibitions on insider dealing would not have been included.
- ⚡ Market manipulation. The new s118(8) of FSMA in the draft regulations which covers behaviour giving rise to false or misleading impressions or distorting markets which is not covered by the directive's definitions would not have been included.
- ⚡ Prescribed Markets and Qualifying Investments Order. The sections of this order making Ofex and markets operated by UK Recognised Investment Exchanges which are not EEA regulated markets would not have been included.

3.9 Elsewhere, where the draft regulations do not rely directly on copying out the words in the directive this does not reflect a choice by the Government to have obligations that differ from those in the directive. It reflects two things. First, an effort to try and ensure that effect is given to the directive's provisions in the most seamless way possible in the light of the UK's existing legislation. Second, an effort to add clarity to the prohibitions and obligations in the directive for the benefit of investors, financial intermediaries and issuers.

3.10 The other main significant policy choice the Government has made is in respect of the directive's provisions on research recommendations. The directive allows member states to choose the most appropriate form of regulation for producers and disseminators of research recommendations, including self-regulation. The Government has decided that self-regulation will apply where journalists are covered by appropriate self-regulatory mechanisms.

Question Q1 *Do you agree that we should retain the scope of the UK's existing market abuse regime where it is wider than the directive's regime?*

Market abuse

Part 8 of FSMA 3.11 The UK's existing civil definitions of and prohibitions of market abuse are contained in Part 8 of FSMA. Implementing articles 1 to 5 and 9 to 10 of the directive therefore requires modifications to Part 8 and the Prescribed Markets and Qualifying Investments Order made under a power granted in Part 8.

3.12 There are two main differences between the current provisions in Part 8 and the relevant provisions in the directive:

- ⚡ First, the Part 8 regime uses the general word "behaviour" when defining what constitutes market abuse. The directive is more specific using words such as "transactions or orders to trade". As a result the range of activities caught under Part 8 is potentially *wider* than that under the directive.

Second, the so-called “regular user test” in part defines market abuse in Part 6 ie behaviour is only market abuse if it falls within the definitions and is behaviour that a regular user believes falls below reasonably expected standards of behaviour. There is no equivalent catch all qualification to the offences in the directive, but instead a patchwork of different defences/qualifications in respect of different offences. The defences currently permitted under Part 8 may therefore differ from those permitted under the directive.

3.13 The Government wishes to retain the breadth of the current Part 8 regime. We believe that it is essential to have a comprehensive market abuse regime to enable the Financial Services Authority (FSA) to meet its regulatory objectives, in particular of maintaining confidence in the UK’s financial system and reducing financial crime.

3.14 However, the UK does need to adjust its existing regime to implement the directive. We cannot retain the breadth of the current “regular user test”. It may mean that behaviour prohibited by the directive would be exculpated currently in the UK. So for those offences which are included in the directive, we can only make available the defences that are included in the directive, this means that we will be reducing the current range of defences. To do otherwise would mean under implementation of the directive.

3.15 The approach to implementation taken in the regulations has been to recast the existing definitions of market abuse to take account of the offences in the directive. The new s118 of FSMA in the draft regulations splits market abuse between insider dealing and market manipulation. In each category are descriptions of behaviour which incorporate the specific offences and qualifications to those offences in the directive. The categories of insider dealing and market manipulation also retain offences based on existing provisions which incorporate the regular user test only for those offences.

Question Q2 *Do you think that the structure of the new s118 of FSMA provides a clear guide to what constitutes market abuse?*

Insider Dealing Prohibitions

3.16 In the new s118 of FSMA in the draft regulations, s118(2) to (4) set out the offence of insider dealing. Following articles 2 to 4 of the directive they prohibit dealing or attempting to deal on the basis of inside information and disclosing inside information. Recommending or inducing another person to deal on the basis of inside information is already captured by the existing s123(1)(b) of FSMA which is left unchanged by the draft regulations.

3.17 In respect of the prohibition in the new s118(2) of FSMA in the draft regulations on dealing or attempting to deal, the language used in the draft regulations differs from that in Article 2.1 of the directive. The formulation is closer to that currently used in Part 8 of behaviour which is “based on” inside information. We believe that this language is familiar in a UK context and also consistent with the prohibition in the directive.

3.18 The third insider dealing prohibition in the new s118(4) of FSMA in the draft regulations is based on the definition of market abuse in the existing s118(2)(a) of FSMA to the extent that the offence does not overlap with the insider dealing offences in the directive. The prohibition covers “other behaviour” not caught by the first two prohibitions. This includes behaviour described in the first two prohibitions when this occurs in relation to information which cannot be regarded as inside information (in

the way defined in the directive) but is relevant information that is not generally available.

3.19 This prohibition is important to ensuring that the UK has a flexible insider dealing regime. It enables action to be taken in relation to behaviour based on information which would be taken into account by investors but is not sufficiently precise to be inside information. It might include, for example, information about the state of negotiations over a major contract.

Inside information

3.20 In the new section s118C of FSMA in the draft regulations there is a definition of inside information giving effect to provisions in the directive². The directive refers, in relation to financial instruments other than commodity derivatives, to information “...likely to have a significant effect on prices”. The relevant implementing measure³ says that this means information which reasonable investors would be likely to use when making investment decisions. We believe that taking the two parts of the definition together, information that would be likely to be used by a reasonable investor when making investment decisions, is information which will lead to sufficient investment decisions being made for it to be likely to be a significant effect on the price of those instruments or related derivatives.

Question Q3 *Do you think that the new s118c of FSMA provides a clear definition of inside information?*

Insiders

3.21 The directive⁴ includes a list of insiders – those with access to inside information – which is given effect to in new s118B of FSMA in the draft regulations. There is an important distinction in the directive between the first three categories of insiders (management and shareholders, employees and advisers, and criminals) and the final category (people in receipt of information from the first three categories of insider). For those in the latter category to have engaged in insider dealing they must have known, or ought to have known, that the information was inside information. Accordingly, new s118B (e) of FSMA requires that such persons “..knew or could reasonably be expected to have known..” that the information was inside information. Different language is used here than in the directive for the purpose of clarification.

Market manipulation

3.22 New s118(5) to (8) of FSMA in the draft regulations sets out the market manipulation prohibitions. The first three are closely drawn from those in the directive⁵. The qualification relating to journalism in respect of giving a false or misleading impression through the dissemination of information is given effect to in new s118A (4) of FSMA in the draft regulations. The market manipulation offences in new s118 (5) of FSMA in the draft regulations are subject to the defence that the purpose behind the actions was legitimate and that they were in conformity with accepted market practices. Accepted market practices, unlike the regular user’s views, are determined by the Financial Services Authority (FSA). In exercising its powers in this area, the FSA has, as a result of the first definition in new s130A (3) of FSMA in the draft regulations, to have regard to consultation procedures and factors for identifying accepted market practices set out in an implementing measure⁶.

² Article 1 of Directive 2003/124/EC and Article 4 of Directive 2004/72/EC

³ Article 1 of Directive 2003/124/EC

⁴ Article 2 of Directive 2003/6/EC

⁵ Article 1.2 of Directive 2003/6/EC

⁶ Articles 2 and 3 of Directive 2004/72/EC

3.23 The final market manipulation prohibition in the new s118(8) of FSMA in the draft regulations is based on the existing definition of market abuse in s118(2)(b)&(c) of FSMA to the extent that it does not overlap with the directive offences. It catches “other behaviour” beyond that in the first three prohibitions that might distort a market, or create a false or misleading impression. Examples of the sorts of behaviours that will be captured include:

- ⚡ inaction which leads to a distortion of a market;
- ⚡ a course of conduct such as manipulation of commodity delivery mechanisms/grading facilities which can send false or misleading impressions, but may not be transactions or strictly speaking involve the dissemination of information.

Safe Harbours 3.24 The new s118A(5)(b) of FSMA in the draft regulations provides a safe harbour from the prohibitions on market abuse for behaviour in relation to share buy-backs and stabilisation activities by referring to the regulation⁷ which defines the boundaries of the safe harbour. Buy-back and stabilisation activities which fall outside the safe harbour, are not necessarily to be regarded as abusive. Such behaviour may be entered into for legitimate reasons and be an accepted market practice. Also, behaviour outside the safe harbour may not even fit the descriptions of market abuse in any case.

Scope 3.25 The directive requires changes to the scope of the instruments and markets covered by the UK’s market abuse regime. The two major changes this requires are:

- ⚡ **Markets** – At the moment the UK’s market abuse regime covers behaviour which occurs in relation to financial instruments trading on markets based in the UK. The directive⁸ requires this to be extended to cover behaviour which occurs in the UK in relation to financial instruments admitted to trading on a regulated market anywhere in the EEA.
- ⚡ **Instruments** – At the moment the UK’s market abuse regime only covers behaviour which occurs in relation to investments specified for the purposes of s22 of FSMA. The relevant instruments are set out in full in Part 8 of the Regulated Activities Order⁹, which covers a wide range of financial investments including equities, debt instruments and derivatives. The directive requires this to be extended to cover any instrument that is admitted to trading on a regulated market.

3.26 The scope of the UK’s proposed revised regime is set out in the new s118(1), 118A(1)-(3) & s130(1) of FSMA in the draft regulations. S118(1) sets the coverage of instruments as those which are admitted to trading on a prescribed market. The new s118A(1) of FSMA in the draft regulations sets the geographical scope of the regime. Behaviour is covered wherever it occurs if it is in relation to qualifying investments admitted to trading on prescribed markets operating in the UK. But behaviour in respect of qualifying investments trading on prescribed markets operating outside of the UK is only covered if the behaviour occurs in the UK.

⁷ Regulation 2273/2003

⁸ Article 10 of Directive 2003/6/EC

⁹ SI 2001/554

3.27 The Prescribed Markets and Qualifying Investments Order (PMQI)¹⁰ provides the definition of qualifying investments and prescribed markets. The draft regulations amend the PMQI so that the necessary extensions to the range of markets and instruments covered are made.

3.28 Prescribed markets operating in the UK are as follows: all markets set up by the UK's Recognised Investment Exchanges (the London Stock Exchange, OM London, Virt-X, EDX, the London International Financial Futures Exchange, the London Metal Exchange and the International Petroleum Exchange) together with the market known as Ofex. Prescribed markets operating outside the UK are all other EEA regulated markets¹¹.

3.29 This coverage of markets is wider than that required in the directive. It includes markets run by UK RIEs which are not EEA regulated markets (ie the London Stock Exchange's AIM market from 12 October 2004 and all markets trading commodity derivatives until the Markets in Financial Instruments Directive¹² is implemented) and Ofex (which is neither a market run by a Recognised Investment Exchange nor an EEA regulated market). This wider coverage reflects a desire to ensure that all economically significant markets in the UK are covered by a regime which deters and punishes market abuse.

3.30 Qualifying investments are as defined in the directive and set out in paragraph 2.14 above. The only major difference between this list and the UK's current regime is the catch-all category of "other instruments admitted to trading on a regulated market."

3.31 The full scope of the directive in respect of instruments and markets covered will not be applied to all the offences set out in the new s118 of FSMA in the draft regulations. As explained above, the new s118(4) and s118(8) of FSMA in the draft regulations are provisions which are not drawn from the directive but based on existing offences in FSMA. The coverage of these two provisions will differ from that in the rest of the regime in two respects:

- ⚡ they will only apply in relation to behaviour in respect of investments set out in Part 8 of the Regulated Activities Order rather than all instruments admitted to trading on regulated markets;
- ⚡ they will only apply in relation to behaviour in respect of investments admitted to traded on prescribed markets operating in the UK and not to behaviour occurring in the UK in respect of investments admitted to trading on prescribed markets operating outside of the UK.

3.32 The effect of this narrowing of the scope in relation to these two prohibitions is that UK standards of behaviour are only being applied to investments within the scope of UK regulation which are admitted to trading on prescribed markets in the UK. This will mean that the rules which apply to someone trading in, for example French equities on Euronext, will not differ depending on whether they are located in London or Paris.

Question 04 *Do you agree that the scope of the offences based on existing UK definitions of market abuse should be the same as the scope of the offences in the existing UK market abuse regime?*

¹⁰ SI 2001/996

¹¹ A list of the markets can be found at: http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_072/c_07220040323en00030007.pdf

¹² Directive 2004/39/EC

Disclosure of information

Disclosure obligations **3.33** The UK's existing regime dealing with the issues covered by the disclosure provisions in the directive is largely to be found in the Listing Rules, which the FSA makes under powers in Part 6 of FSMA. Many of the ongoing requirements in the listings rules are similar to those in Articles 6.1 to 6.4 of the Market Abuse Directive. However, the scope of the directive and the Listing Rules differ.

3.34 The Listing Rules only cover issuers whose securities are admitted to the official list. This is a narrower set of issuers than those covered in the directive. The latter applies to all issuers whose securities are admitted to trading (or for which a request for admission to trading has been made) on a regulated market in a member state. This applies whether or not those financial instruments have also been admitted to the official list.

3.35 The draft regulations therefore amend Part 6 of FSMA, in the new s73a, to give the competent authority for listing (currently the FSA) the power to make rules governing the disclosure of information in respect of instruments admitted to trading on regulated markets. Collectively rules made under this power and the existing power related to listed securities are to be known as 'Part 6 rules'.

3.36 The new s96A of FSMA in the draft regulations sets out what rules relating to instruments admitted to trading on a regulated market must cover. Giving effect to Articles 6.1 to 6.4 of the directive¹³ it requires that the rules must:

- ⊘ require an issuer to publish, and update as necessary, inside information;
- ⊘ allow an issuer to delay the publication of inside information in certain circumstances;
- ⊘ require an issuer who discloses information to a third party to publish that information without delay in certain circumstances;
- ⊘ require an issuer to draw up a list of those persons who have access to inside information relating directly to that issuer;
- ⊘ require those discharging managerial responsibilities within an issuer, and people connected to them, to disclose transactions conducted on their own account in shares of the issuer, or derivatives relating to those shares.

3.37 An expansion of the FSA's rule making powers also requires an extension of their ability to levy penalties when the rules are broken. The draft regulations revise s91 of FSMA to extend the range of entities and people who can be sanctioned for breaches of the rules. Giving effect to the directive, the draft regulations propose that the FSA should be able to sanction issuers with securities admitted to trading on regulated markets, and those discharging managerial responsibilities (plus those connected with such people) within such issuers.

3.38 The extension in scope of Part 6 of FSMA requires a definition of persons discharging managerial responsibilities in issuers and those connected with them. The directive definition appears in one of the implementing measures¹⁴. These definitions appear in the new s96B of FSMA in the draft regulations. The definition of someone

¹³ Directive 2003/6/EC

¹⁴ Article 1 of Directive 2004/72/EC

exercising managerial responsibilities is taken more or less directly from the directive. The definition of someone connected with such a person gives effect to the directive definition by referring to the definition of “connected persons” in s346 of the Companies Act 1985. This is to ensure that the definition uses familiar language to aid interpretation.

Questions 05 *Do you agree with the approach that has been taken to giving the FSA the scope to make rule-making powers in respect of the disclosure obligations of issuers whose financial instruments are admitted to trading on a regulated market?*

06 *Do you think it is appropriate to rely on the Companies Act definition of a connected person in the implementation of the directive?*

3.39 Part 6 of FSMA currently allows the competent authority to suspend from the official list, the securities of issuers who are not complying with their ongoing obligations under the listings rules. The directive requires that the competent authority has the power to enforce the suspension of trading in financial instruments on a regulated market. This is given effect to in the new s96C of FSMA. This enables the FSA to require suspension of the trading of a security in accordance with the Part 6 rules.

3.40 The Government considered also creating a power to allow the competent authority to request a suspension of trading by a prescribed market of a financial instrument. It considered that having two powers was unnecessary

Question 07 *Do you agree with the approach that has been taken to give effect to the requirement in the directive that the competent authority should have the power to suspend trading in a financial instrument?*

3.41 Part 6 of FSMA will need to be revised further in due course to take account of the Prospectus Directive and the Transparency Obligations Directive. The changes proposed in this consultation document have been discussed fully with those in the Treasury and FSA working on implementation of the Prospectus Directive to ensure consistency of approach.

Research 3.42 The directive¹⁵ requires regulation of those producing and disseminating research recommendations by way of business or as part of their progression. Such recommendations are information explicitly or implicitly making an investment recommendation in respect of a financial instrument or issuer of financial instruments. Article 53 of the Regulated Activities Order¹⁶ (RAO) requires that those who provide advice on the merits of buying and selling investments by way of carrying on a business are subject to authorisation by the FSA. Most producers of research recommendations in the UK therefore fall within the scope of regulation by the FSA.

3.43 The main part of the UK’s implementation of Article 6.5 and its associated implementing measure will therefore be through FSA rules. The FSA provides details in part 4 of this paper on how it will regulate authorised persons producing or disseminating research recommendations.

3.44 However, not all people producing or disseminating research recommendations fall within the scope of the RAO. There are exemptions to the RAO. The main one is that it does not cover journalism where the main purpose of the publication or the

¹⁵ Article 6.5 of Directive 2003/6/EC and Directive 2003/125/EC

¹⁶ SI 2001/554

broadcast in which the advice appears or is mentioned is not the giving of investment advice or leading or enabling people to buy or sell securities.

3.45 Under the directive the UK is required to regulate those not covered by the FSA's regulation but whose activity falls within the scope of the directive. One of the recitals to the directive¹⁷ makes clear that member states have discretion over the form of regulation that they believe to be appropriate. This was intended, in particular, to ensure that the directive did not cut across traditions of media self-regulation in member states.

3.46 The draft Investment Recommendation Regulations provide freestanding regulations covering those not captured by the RAO. We do not believe it is appropriate to amend the RAO to bring all making investment recommendations within the scope of regulation by the FSA. The draft regulations draw very heavily on the relevant implementing measure to give effect to the directive's provisions. The only significant elaboration is to define what constitutes a "significant financial interest" for the sake of clarity. For legal persons the definition draws on the relevant implementing directive¹⁸ to define it as a 5 per cent holding in the share capital of an issuer or a 5 per cent holding of a debt instrument. For individuals the definition draws on the threshold for the disclosure of directors dealings under the directive¹⁹.

3.47 Following the examples of the RAO and the Financial Promotions Order²⁰, the draft regulations provide an exemption from direct compliance with the obligations relating to those making or distributing research recommendations for two categories of journalist:

- ⌘ those subject to specified self-regulatory codes which include provisions dealing with conflicts of interest in financial journalism;
- ⌘ those subject to firm-specific codes which deal with conflicts of interest in producing or reporting investment recommendations.

3.48 There is one requirement for those subject to self-regulatory codes. This is that there is a reference to the self-regulatory codes in the publications in which the recommendations appear. The aim of this is to ensure that investors are able to be clear about the standards under which a recommendation is produced, which is consistent with the requirement for self-regulation to be "equivalent" to direct regulation.

3.49 Those who fall outside the specific exemptions will need to comply with the requirements in the draft regulations. It would be disproportionate to set up a statutory regulatory system to deal with those falling within this category. However, anyone who suffered loss as a result of a failure on the part of someone to comply with the obligations in the freestanding regulations would be able to bring a suit for damages.

Question 08 *Do you agree with the approach suggested to implementing the directive's provisions on research recommendations?*

¹⁷ Recital 22 to Directive 2003/6/EC

¹⁸ Article 6.1 of Directive 2003/125/EC

¹⁹ Article 6.2 of Directive 2004/72/EC

²⁰ SI 2001/1335

Enforcement

3.50 The draft regulations contain no proposals in respect of the FSA's enforcement powers. We believe that under FSMA, the FSA has virtually all the powers that it is required to have under the directive²¹. The one area where there is some room for doubt is in respect of telephone and data traffic records. During the consultation period we will continue to look at this issue and may bring forward additional proposals in this area.

Consolidated list of questions

Q1 Do you agree that we should retain the scope of the UK's existing market abuse regime where it is wider than the directive's regime?

Q2 Do you think that the structure of the new s118 of FSMA provides a clear guide to what constitutes market abuse?

Q3 Do you think that the new s118c of FSMA provides a clear definition of insider information?

Q4 Do you agree that the scope of the offences based on existing UK definitions of market abuse should be the same as the scope of the offences in the existing UK market abuse regime?

Q5 Do you agree with the approach that has been taken to giving the FSA the scope to make rule-making powers in respect of the disclosure obligations of issuers whose financial instruments are admitted to trading on a regulated market?

Q6 Do you think it is appropriate to rely on the Companies Act definition of a connected person in the implementation of the directive?

Q7 Do you agree with the approach that has been taken to give effect to the requirement in the directive that the competent authority should have the power to suspend trading in a financial instrument?

Q8 Do you agree with the approach suggested to implementing the directive's provisions on research recommendations?

²¹ Article 12 of Directive 2003/6/EC

A

DRAFT REGULATIONS

2004 No.

FINANCIAL SERVICES AND MARKETS

**Financial Services and Markets Act 2000 (Market Abuse)
Regulations 2004**

<i>Made</i> - - - -	<i>2004</i>
<i>Laid before Parliament</i>	<i>2004</i>
<i>Coming into force</i> - -	<i>[... ..]</i>

Whereas the Treasury are a government department designated(a) for the purposes of section 2(2) of the European Communities Act 1972(b) in relation to [insider dealing and market manipulation];

Now, therefore, the Treasury, in exercise of the powers conferred upon them by section 2(2) of that Act, hereby make the following Regulations:

Citation, commencement and interpretation

1.—(1) These Regulations may be cited as the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2004 and shall come into force on [].

(2) In these Regulations—

“the Act” means the Financial Services and Markets Act 2000(c);

“the 1994 Regulations” means the Traded Securities (Disclosure) Regulations 1994(d);

“the 2001 Order” means the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001(e)

“the 2001 Regulations” means the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001(f);

(a) S.I.

(b) 1972 c.68; by virtue of the amendment of section 1(2) made by section 1 of the European Economic Area Act 1993 (c.51) regulations may be made under section 2(2) to implement obligations of the United Kingdom created or arising under the Agreement on the European Economic Area signed at Oporto on 2nd May 1992 (Cm 2073) and the Protocol adjusting that Agreement signed at Brussels on 17th March 1993 (Cm 2183).

(c) 2000 c.8.

(d) S.I. 1994/188, as amended by S.I. 2001/3649.

(e) S.I. 2001/996.

(f) S.I. 2001/995.

Amendment of Part 6 of the Act

2. Schedule 1 (which contains amendments to Part 6 of the Act (official listing)) has effect.

Amendment of Part 8 of the Act

3. Schedule 2 (which contains amendments to Part 8 of the Act (market abuse)) has effect.

Revocation of the 1994 Regulations

4. The 1994 Regulations are revoked.

Amendment of the 2001 Order

5.—(1) In the 2001 Order, the following definition is inserted after the definition of a “UK recognised investment exchange” in article 3 —

“regulated market” has the meaning given in Article 1(13) of Council Directive 1993/22/EC of 10 May 1993 in investment services in the securities field(a);

(2) In the 2001 Order, for articles 4,4A and 5 substitute—

“Prescribed Markets

4.—(1) There are prescribed, as markets to which subsections (2), (3), (5), (6) and (7) of section 118 apply—

- (a) all markets which are established under the rules of a UK recognised investment exchange,
- (b) the market known as OFEX,
- (c) all other markets which are regulated markets.

(2) There are prescribed, as markets to which subsections (4) and (8) of section 118 apply—

- (a) all markets which are established under the rules of a UK recognised investment exchange, and
- (b) the market known as OFEX.

Qualifying Investments

5.—(1) There are prescribed, as qualifying investments in relation to the markets prescribed by article 4(1), all financial instruments within the meaning given in Article 1(3) of Directive 2003/6/EC of the European Parliament and the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)(b).

(2) There are prescribed, as qualifying investments in relation to the markets prescribed by article 4(2), all investments of a specified kind for the purposes of section 22 of the Act.”.

Amendment of the 2001 Regulations

6. In the Schedule to the 2001 Regulations, paragraph 5 is repealed.

(a) O.J. L141, 11.6.1993, p.27.

(b) O.J. L 96, 12.4.2003, p.16.

[Date]

Names
Two of the Lords Commissioners
of Her Majesty's Treasury

SCHEDULE 1

Regulation 2

AMENDMENTS TO PART 6 OF THE ACT

1.—(1) Subsection (1) of section 73 (general duty of the competent authority) is amended as follows.

(2) For paragraph (c), substitute—

“(c) the desirability of facilitating innovation in respect of listed securities and in respect of financial instruments which have otherwise been admitted to trading on a regulated market or for which a request for admission to trading on a such a market has been made;”.

(3) For paragraph (f), substitute—

“(f) the desirability of facilitating competition in relation to listed securities and in relation to financial instruments which have otherwise been admitted to trading on a regulated market or for which a request for admission to trading on a such a market has been made.”.

2. After section 73 insert—

“73A. Part 6 Rules

(1) The competent authority may make rules (“Part 6 rules”) for the purposes of this Part.

(2) “Part 6 rules” means—

- (a) rules relating to admission to the official list (“listing rules”);
- (b) rules governing disclosure of information in respect of financial instruments which have been admitted to trading on a regulated market or for which a request for admission to trading on a such a market has been made (“disclosure rules”).”.

3. In section 74 (the official list), subsection (4) is repealed.

4. For subsections (1) and (2) of section 91 (penalties for breach of listing rules), substitute—

“(1) If the competent authority considers that—

- (a) in relation to a listed security, an issuer or applicant for listing; or
- (b) in relation to a financial instrument—

- (i) an issuer, who has requested or approved the admission of the instrument to trading on a regulated market,
- (ii) a person discharging managerial responsibilities within such an issuer, or
- (iii) a person connected to such a person discharging managerial responsibilities,

has contravened any provision of the Part 6 rules, it may impose on him a penalty of such amount as it considers appropriate.

(2) If, in the case of a contravention by an applicant or an issuer referred to in subsection (1)(a) or (1)(b)(i), the competent authority considers that a person who was at the material time a director of that applicant or issuer, it may impose upon him a penalty of such amount as it considers appropriate.”.

5. In subsection (9) of section 95 (competition scrutiny), after paragraph (a) insert—

“(aa) disclosure rules,”.

6. After section 96 (obligations of issuers of listed securities), insert—

“96A. Disclosure of information requirements

(1) The competent authority must make disclosure rules which specify the disclosure of information requirements to be complied with by issuers who have requested or approved admission of their financial instruments to trading on a regulated market.

(2) The disclosure rules made in accordance with subsection (1) must—

- (a) require an issuer to publish certain inside information;
- (b) require an issuer to publish any significant change concerning inside information it has already published;
- (c) allow an issuer to delay the publication of inside information in certain circumstances;
- (d) require an issuer (or a person acting on his behalf or for his account) who discloses inside information to a third party to publish that information without delay in certain circumstances;
- (e) require an issuer (or person acting on his behalf or for his account) to draw up a list of those persons working for him who have access to inside information relating directly or indirectly to that issuer; and
- (f) require persons discharging managerial responsibilities within such an issuer, and persons connected to such persons discharging managerial responsibilities, to disclose transactions conducted on their own account in shares of the issuer, or derivatives or any other financial instrument relating to those shares.

(3) Disclosure rules may make provision with respect to the action that may be taken by the competent authority in respect of non-compliance.

96B. Persons discharging managerial responsibilities and connected persons

(1) For the purposes of this Part, a “person discharging managerial responsibilities within an issuer” means—

- (a) a director of an issuer of shares admitted to trading on a regulated market; or
- (b) a senior executive of such an issuer, who
 - (i) has regular access to inside information relating, directly or indirectly, to the issuer, and
 - (ii) has power to make managerial decisions affecting the future development and business prospects of the issuer.

(2) A person “connected” with a person discharging managerial responsibilities within an issuer means—

- (a) a “connected person” within the meaning in section 346 of the Companies Act 1985, but that section shall apply as if any reference to a director of a company were a reference to a person discharging managerial responsibilities within an issuer;
- (b) a relative of a person discharging managerial responsibilities within an issuer, who, on the date of the transaction in question, has shared the same household as that person for at least 12 months;
- (c) a body corporate in which—
 - (i) a person discharging managerial responsibilities within an issuer, or
 - (ii) any person connected with him by virtue of subsection (a) or (b),

is a director or a senior executive who has the power to make management decisions affecting the future development and business prospects of that body corporate.

96C. Suspension of trading

(1) The competent authority may, in accordance with the disclosure rules, suspend trading in a financial instrument.

(2) If the competent authority suspends trading of any financial instrument, the issuer of that financial instrument may refer the matter to the Tribunal.

(3) The requirements relating to suspension of listing of securities in section 78 (discontinuance or suspension: procedure) shall apply to the suspension of trading in a financial instrument and the references to listing and securities shall be read as references to trading and financial instruments respectively for the purposes of this section.”.

7. In subsection (1) of section 97 (appointment by competent authority of persons to carry out investigations)—

- (a) in paragraph (a) for “listing rules” substitute “Part 6 rules”;
- (b) for paragraph (b) substitute—
 - “(b) a person who was at the material time a director of —
 - (i) an issuer of listed securities,
 - (ii) an issuer who has requested or approved the admission of a financial instrument to trading on a regulated market, or
 - (iii) a person applying for the admission of securities to the official list,and who has been knowingly concerned in a breach of Part 6 rules by that issuer or applicant for listing.”;
- (c) paragraph (c) is repealed.

8. After subsection (1) of section 99 (fees), insert—

“(1A) The disclosure rules may require the payment of fees to the competent authority in respect of the continued admission of financial instruments to trading on a regulated market.”.

9. At the end of subsection (2) of section 100 (penalties), insert—

“, or issuers who have requested or approved the admission of financial instruments to trading on a regulated market”.

10. In subsections (1) to (5) of section 101 (listing rules: general provisions), for “listing rules” each time it appears substitute “Part 6 rules”.

11. In section 103 (interpretation of Part 6)—

(a) the following definitions are inserted at the appropriate place in alphabetical order—

“ “disclosure rules” has the meaning given in section 73A;

“financial instrument” has the meaning given in Article 1(3) of Directive 2003/6/EC of the European Parliament and the Council of 28 January 2003 on insider dealing and market manipulation^(a);

“inside information” has the meaning given in section 118C;

“regulated market” has the meaning given in Article 1(13) of Council Directive 1993/22/EC of 10 May 1993 in investment services in the securities field^(b)”;

(b) for the definition of “issuer” substitute—

“issuer”, in relation to anything which is or may be admitted to the official list, has such meaning as may be prescribed by the Treasury, and in any other case means a person who issues financial instruments”;

(c) for the definition of “listing rules” substitute—

“listing rules” has the meaning given in section 73A”.

12. In subsection (4)(a) of section 150 (actions for damages), for “listing rules” substitute “Part 6 rules”.

(a) O.J. L 96, 12.4.2003, p.16.

(b) O.J. L141, 11.6.1993, p.27.

SCHEDULE 2

Regulation 3

AMENDMENTS TO PART 8 OF THE ACT

1. For section 118 (market abuse), substitute—

“118 Market abuse

(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) which—

(a) occurs in relation to qualifying investments traded or admitted to trading on prescribed market or in respect of which a request for admission to trading on such a market has been made, and

(b) falls within any one or more of the types of behaviour set out in subsections (2) to (8).

(2) The first type of behaviour is where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the qualifying investment.

(3) The second is where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties.

(4) The third is where the behaviour (not falling within subsection (2) or (3))—

(a) is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would be, or would be likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments or related investments should be effected, and

(b) is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.

(5) The fourth is where the behaviour consists of effecting, or participating in effecting, transactions or orders to trade (otherwise than for legitimate reasons in conformity with accepted market practices on the relevant market) which—

(a) give, or are likely to give a false or misleading impression as to the supply of, or demand for, or as to the price or value of, one or more qualifying investments or related investments, or

(b) secure the price of one or more such investments at an abnormal or artificial level.

(6) The fifth is where the behaviour consists of effecting, or participating in effecting, transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.

(7) The sixth is where the behaviour consists of disseminating, or causing the dissemination of, information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment or related investment by a person who knew or could reasonably be expected to have known that the information was false or misleading.

(8) The seventh is where the behaviour (not falling within subsection (5), (6) or (7))—

- (a) gives, or is likely to give, a regular user of the market a false or misleading impression as to the supply of, demand for or price or value of, qualifying or related investments, or
- (b) would be, or would be likely to be, regarded by a regular user of the market as behaviour that would distort, or would be likely to distort, the market in such an investment

and the behaviour is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.

118A Supplementary provision about certain behaviour

(1) Behaviour is to be taken into account for the purposes of this Part only if it occurs—

- (a) in the United Kingdom, or
- (b) in relation to qualifying investments or related investments—
 - (i) which are admitted to trading on a prescribed market situated in, or operating in, the United Kingdom, or
 - (ii) for which a request for admission to trading on such a prescribed market has been made.

(2) For the purposes of subsection (1), as it applies in relation to section 118(4) and (8), a prescribed market accessible electronically in the United Kingdom is to be treated as operating in the United Kingdom.

(3) For the purposes of section 118(4) and (8), the behaviour that is to be regarded as occurring in relation to qualifying investments includes behaviour which—

- (a) occurs in relation to anything that is the subject matter, or whose price is expressed by reference to the price of the qualifying investments, or
- (b) occurs in relation to investments (whether or not they are qualifying investments) whose subject matter is the qualifying investments.

(4) For the purposes of section 118(7), the dissemination of information by a journalist acting in his professional capacity is to be assessed taking into account the codes governing his profession unless he derives, directly or indirectly, any advantage or profits from the dissemination of the information.

(5) Behaviour does not amount to market abuse for the purposes of this Act if—

- (a) it conforms with a rule which includes a provision to the effect that behaviour conforming with the rule does not amount to market abuse,
- (b) it conforms with the relevant provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments, or
- (c) it is done by a person acting on behalf of a public authority in pursuit of monetary policies or policies with respect to exchange rates or the management of public debt or foreign exchange reserves.

118B Insiders

For the purposes of this Part an insider is any person who has inside information—

- (a) as a result of his membership of the administrative, management or supervisory bodies of an issuer of qualifying investments,
- (b) as a result of his holding in the capital of an issuer of prescribed investments,
- (c) as a result of having access to the information through the exercise of his employment, profession or duties,
- (d) as a result of his criminal activities, or
- (e) which he has obtained by other means and which he knows, or could reasonably be expected to know, is inside information.

118C Inside information

- (1) This section defines “inside information” for the purposes of this Part.
- (2) In relation to qualifying investments, or related investments, which are not commodity derivatives, inside information is information of a precise nature which—
 - (a) is not generally available,
 - (b) relates, directly or indirectly, to one or more issuers of the qualifying investments or to one or more of the qualifying investments, and
 - (c) would, if generally available, be likely to have a significant effect on the price of the qualifying investments or on the price of related investments.
- (3) In relation to investments which are commodity derivatives, inside information is information which—
 - (a) is not generally available,
 - (b) relates, directly or indirectly, to one or more such derivatives, and
 - (c) users of markets in which the derivatives are traded would expect to receive in accordance with accepted market practices on those markets.
- (4) In relation to a person charged with the execution of orders concerning any qualifying investments or related investments, inside information is information conveyed by a client and related to the client’s pending orders which—
 - (a) is of a precise nature,
 - (b) is not generally available,
 - (c) relates, directly or indirectly, to one or more issuers of qualifying investments or to one or more qualifying investments, and
 - (d) would, if generally available, be likely to have a significant effect on the price of those qualifying investments or the price of related investments.
- (5) Information is precise if it—
 - (a) indicates circumstances that exist or may reasonably be expected to come into existence or an event that has occurred or may reasonably be expected to occur, and
 - (b) is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of qualifying investments or related investments.
- (6) Information which a reasonable investor would be likely to use as part of the basis of his investment decisions is information which, if it were generally available, would be likely to have a significant effect on the price of qualifying investments or of related investments.
- (7) Users of markets on which investments in commodity derivatives are traded are to be treated as expecting to receive information relating directly or indirectly to one or more such derivatives, which is —
 - (a) routinely made available to the users of those markets, or

- (b) required to be disclosed in accordance with any statutory provision, market rules, or contracts or customs on the relevant underlying commodity market or commodity derivatives market.

(8) For the purposes of this Part, information which is “generally available” in relation to qualifying investments, commodity derivatives or other related investments means information which is generally available to users of the relevant market on which those qualifying investments, commodity derivatives or other related investments are traded.

(9) Information which can be obtained by research or analysis conducted by, or on behalf of, users of a market is to be regarded, for the purposes of this Part, as being generally available to them.”.

2. (1) Section 119 (the code) is amended as follows.

(2) In subsection (2), after paragraph (c), insert—

- “(d) descriptions of behaviour that are accepted market practices in relation to one or more identified markets; and
- (e) descriptions of behaviour that are not accepted market practices in relation to one or more identified markets.”.

(3) After subsection (2), insert—

“(2A) In determining, for the purposes of subsections (2)(d) and (2)(e), what are and what are not accepted market practices, the Authority must have regard to the factors and procedures laid down in Articles 2 and 3 respectively of Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council (a).”

3. After section 130 (guidance), insert—

“130A Interpretation and supplementary provision

(1) The Treasury may by order specify (whether by name or description)—

- (a) the markets which are prescribed markets for the purposes of provisions of this Part, and
- (b) the investments that are qualifying investments in relation to the prescribed markets.

(2) An order may prescribe different investments or descriptions of investment in relation to different markets or descriptions of market.

(3) In this Part—

“accepted market practices” means practices that are reasonably expected in the financial market or markets in question and are accepted by the Authority or, in the case of a market situated in another EEA State, the competent authority of that EEA State within the meaning of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse),

“behaviour” includes action or inaction,

“dealing”, in relation to an investment, means acquiring or disposing of the investment whether as principal or agent or, directly or indirectly, and includes agreeing to acquire or dispose of the investment, and entering into and bringing to an end a contract creating it,

(a) OJ L162, 30.4.2004, p.70.

“investment” is to be read with section 22 and Schedule 2,

“price”, in relation to qualifying investments and related investments, includes value,

“regular user”, in relation to a particular market, means a reasonable person who regularly deals on that market in investments of the kind in question,

“related investment”, in relation to a qualifying investment, means an investment whose price depends on the price of the qualifying investment.

(4) Any reference in this Act to a person engaged in market abuse is to a person engaged in market abuse either alone or with one or more other persons.”.

EXPLANATORY NOTE

(This note is not part of the Order)

2004 No.

FINANCIAL SERVICES

Investment Recommendation Regulations 2004

<i>Made</i> - - - -	2004
<i>Laid before Parliament</i>	[...]
<i>Coming into force</i> - -	[...]

The Treasury, are a government department designated(a) for the purposes of section 2(2) of the European Communities Act 1972(b) in relation to [insider dealing and market manipulation]

In exercise of the powers conferred upon them by section 2(2) of that Act, the Treasury hereby make the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Investment Recommendation Regulations 2004 and come into force on [].

Interpretation

2.—(1) In these Regulations—

“financial instrument” has the meaning given in Article 1(3) of Directive 2003/6/EC of the European Parliament and the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)(c);

“investment recommendation” means information which is made publicly available (or intended to be made publicly available) that directly recommends a particular investment decision in respect of a financial instrument admitted to trading on a regulated market;

“publicly available”, in relation to information, means information made available to a wide section of the public;

(a) S.I. [].

(b) 1972 c. 68; by virtue of the amendment of section 1(2) made by section 1 of the European Economic Area Act 1993 (c.51) regulations may be made under section 2(2) to implement obligations of the United Kingdom created or arising under the Agreement on the European Economic Area signed at Oporto on 2nd May 1992 (Cm 2073) and the Protocol adjusting that Agreement signed at Brussels on 17th March 1993 (Cm 2183).

(c) O.J. L 96, 12.4.2003, p.16.

“regulated market” has the meaning given in Article 1(13) of Council Directive 93/22/EC of 10 May 1993 on investment services in the securities field^(a)

“related financial instrument” in relation to shares or a debt instrument, means a financial instrument whose price or value depends on the price or value of those shares or that debt instrument

“undertaking” means a body corporate, partnership or unincorporated association.

(2) In these regulations, a “related undertaking” in relation to a person (‘A’), means any undertaking that is—

- (a) a parent undertaking of A
- (b) A subsidiary undertaking of A
- (c) A subsidiary undertaking of the parent undertaking of A
- (d) A parent undertaking of a subsidiary undertaking of A, or
- (e) An undertaking in which A or an undertaking mentioned in paragraph (a), (b), (c) or (d) has a participating interest.

(3) “Participating interest” has the same meaning as in Part 7 of the Companies Act 1985^(b) (or Part 8 of the Companies (Northern Ireland) Order 1986)^(c); but also includes an interest held by an individual which would be a participating interest for the purposes of these provisions if he were taken to be an undertaking.

(4) “Parent undertaking” has the same meaning as in Part 7 of the Companies Act (or Part 8 of the Companies (Northern Ireland) Order 1986); but also includes an individual who would be a parent undertaking for the purposes of those provisions if he were an undertaking (and “subsidiary undertaking” is to be read accordingly).

(5) “Subsidiary undertaking” has the same meaning as in Part 7 of the Companies Act (or Part 8 of the Companies (Northern Ireland) Order 1986); but also includes, in relation to a body incorporated in or formed under the law of any EEA State other than the United Kingdom, an undertaking which is a subsidiary undertaking within the meaning of any rule of law in that State for the purposes of the Seventh Company Law Directive (and “parent undertaking is to be read accordingly).

(6) The “Seventh Company Law Directive” means Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts^(d).

Persons producing investment recommendations

3.—(1) A person who produces an investment recommendation must ensure that the recommendation indicates clearly and prominently—

- (a) the name and job title of the individual who prepared the investment recommendation, and
- (b) the name of the undertaking responsible for its production.

(2) A person who produces an investment recommendation must take reasonable care to ensure that—

- (a) facts are clearly distinguished from interpretations, estimates, opinions and other types of non-factual information;
- (b) all sources are reliable or, where there is any doubt as to whether a source is reliable, this is clearly indicated; and

^(a) O.J. L141, 11.6.1993, p.27.

^(b) c.3.

^(c) S.I.

^(d) O.J. L193, 18.7.83, p.1.

- (c) all projections, forecasts and price targets are clearly labelled as such and that any material assumptions made in producing or using them are indicated.
- (3) A person whose main business is to produce investment recommendations must also take reasonable care to ensure that—
- (a) all substantially material sources are indicated, as appropriate, including details of the relevant issuer, together with details of whether the investment recommendation has been disclosed to that issuer and amended following this disclosure before it is made publicly available;
 - (b) any basis of valuation or methodology used to evaluate a financial instrument or an issuer, or to set a price target for a financial instrument, is adequately summarised;
 - (c) the meaning of any recommendation made, for instance a recommendation to buy, sell or hold a particular financial instrument, which may include the time horizon of the financial instrument to which the investment recommendation relates, is adequately explained and any appropriate risk warning, including a sensitivity analysis of the relevant assumptions, indicated;
 - (d) reference is made to the planned frequency, if any, of updates of the investment recommendation and to any major changes in the coverage policy previously announced;
 - (e) the date at which the investment recommendation was first released for distribution is indicated clearly and prominently, as well as the relevant date and time for any price mentioned in relation to a financial instrument;
 - (f) if an investment recommendation differs from an investment recommendation concerning the same financial instrument or relevant issuer issued during the 12-month period immediately preceding its release, this change and the date of the earlier investment recommendation are indicated clearly and prominently.

(4) But where the disclosure of information required under paragraph (3) would be disproportionate in relation to the length of the investment recommendation, it shall suffice to make clear and prominent reference in the recommendation itself to the place (such as a direct Internet link) where such information can be directly and easily accessed by the public.

(5) For the purpose of this regulation a “relevant issuer” means an issuer of a financial instrument who himself, or whose financial instrument is the subject of the investment recommendation in question.

Disclosure of interests and conflicts of interest

4.—(1) Subject to paragraph (5), a person who produces an investment recommendation must disclose in that recommendation all relationships and circumstances that may reasonably be expected to impair the objectivity of the investment recommendation and in particular must disclose—

- (a) any significant financial interest in one or more of the financial instruments which are the subject of the investment recommendation, and
- (b) any significant conflict of interest with respect to an issuer to which the investment recommendation relates.

(2) In so far as the requirements in paragraph (1) apply to an undertaking, they shall also apply to—

- (a) any individual working for it under a contract of employment or otherwise, and
 - (b) any person providing a service to it,
- who was involved in preparing an investment recommendation.

(3) For the purposes of paragraph (1)(a), a “significant financial interest” includes—

- (a) in relation to an undertaking, a holding exceeding 5% in the shares or debt instrument in question, or an interest in a related financial instrument with an equivalent nominal value, and

(b) in relation to an individual, a holding or interest exceeding £3000 in the shares or debt instrument in question or in any related financial instrument.

(4) Where the person responsible for the production of the investment recommendation is an undertaking, the information to be disclosed in accordance with paragraph (1) shall include at least the following—

- (a) any interest or conflict of interest of that undertaking or any related undertaking that is accessible or reasonably expected to be accessible to the persons involved in the preparation of the investment recommendation,
- (b) any interest or conflict of interest of that undertaking or any related undertaking that is known to persons who, although not involved in the preparation of the investment recommendation, had or could reasonably be expected to have access to the investment recommendation prior to it being made publicly available.

(5) Where the disclosure of information required under paragraph (1), (3) or (4) would be disproportionate in relation to the length of the investment recommendation, it shall suffice to make clear and prominent reference in the recommendation itself to the place (such as a direct Internet link) where such information can be directly and easily accessed by the public.

Additional disclosure obligations

5.—(1) A person whose main business it is to produce investment recommendations must also disclose clearly and prominently in the investment recommendation itself—

- (a) any major shareholding which between him (or any related undertaking) and the issuer;
- (b) any other significant financial interest held by him (or any related undertaking) in relation to the issuer;
- (c) if applicable, a statement that he (or any related undertaking) is a market maker or liquidity provider in the financial instrument of the issuer;
- (d) if applicable, a statement that he (or any related undertaking) has been lead manager or co-lead manager over the previous 12 months of any publicly disclosed offer of a financial instrument of the relevant issuer or in any related financial instrument;
- (e) if applicable, a statement that he (or any related undertaking) is party to any other agreement with the relevant issuer relating to the provision of investment banking services, provided that—
 - (i) this would not entail the disclosure of any confidential commercial information; and
 - (ii) the agreement has been in effect over the previous 12 months or has given rise during the same period to a payment or to the promise of payment; and
- (f) if applicable, a statement that he (or any related undertaking) is party to an agreement with the relevant issuer relating to the production of the investment recommendation.

(2) But where the disclosure of information required under paragraph (1) would be disproportionate in relation to the length of the investment recommendation, it shall suffice to make clear and prominent reference in the recommendation itself to the place (such as a direct Internet link) where such information can be directly and easily accessed by the public.

(3) For the purposes of paragraph (1), a “major shareholding” includes—

- (a) a shareholding held by the person whose main business it is to produce investment recommendations or any related undertaking exceeding 5% of the total issued share capital in the issuer; and
- (b) a shareholding held by the issuer exceeding 5% of the total issued share capital in the person whose main business it is to produce investment recommendations or in any related undertaking.

Persons disseminating investment recommendations

6.—(1) A person who disseminates an investment recommendation produced by a third party must ensure that the disseminated investment recommendation indicates clearly and prominently the identity of the person responsible for its dissemination.

(2) Where a person disseminates an investment recommendation in a form that is substantially altered from the basis on which it was originally produced, he must explain the nature of that alteration.

(3) To the extent that a substantial alteration changes the direction of the investment recommendation (such as changing a ‘buy’ recommendation to a ‘hold’ or ‘sell’ recommendation or vice versa), the person disseminating the information must comply with the requirements of regulations 3 and 4.

(4) Where a person summarises an investment recommendation, he must—

- (a) ensure that the summary is clear and not misleading,
- (b) mention the document in which the investment recommendation appears, and
- (c) provided that it is publicly available, state where the information regarding the interests or conflicts of interest of the producer of the investment recommendation can be accessed.

(5) Any body corporate, partnership or unincorporated association which is responsible for the dissemination of investment recommendations produced by a third party must have in place a written policy enabling recipients of such recommendations to be directed to where they can have access to the identity of the producer of the investment recommendation, the investment recommendation itself and, provided they are publicly available, the disclosure of the producer’s interests and conflicts of interest.

Non-written investment recommendations

7.—(1) In the case of the production of non-written investment recommendations, the requirements of regulations 3, 4 and 5 are deemed to be complied with where the broadcast or transmission in which the investment recommendation is made includes a reference to a place where the information required to be disclosed in accordance with those regulations can be directly and easily accessed by the public.

(2) A place where such information can be directly and easily accessed may include an Internet site.

(3) For the purpose of this regulation a “non-written investment recommendation” is an investment recommendation which is—

- (a) broadcast or transmitted in the form of a television or radio programme, or
- (b) displayed on a web site (or similar system for the electronic display of information).

Exemptions

8.—(1) Regulations 3, 4, 5 and 6 do not apply to investment recommendations produced or disseminated by—

- (a) a person who is an authorised person within the meaning of section 31(2) of the Financial Services and Markets Act 2000^(a),
- (b) a person working for such an authorised person, whether under a contract of employment or otherwise, who is acting in the proper course of his employment or duties,
- (c) any other person acting otherwise than in the course of his profession or the conduct of his business, or
- (d) a journalist, provided the conditions in paragraph (2) are met.

^(a) 2000 c. 8.

- (2) The conditions are that—
- (a) the investment recommendation appeared in a publication or a television or radio programme which falls within the remit of—
 - (i) the Code of Practice issued by the Press Complaints Commission;
 - (ii) the Programme Code of the Radio Authority;
 - (iii) the Producers’ Guidelines issued by the British Broadcasting Corporation; or
 - (iv) the Programme Code of the Independent Television Commission; and
 - (b) in the case of an investment recommendation in a written publication, a reference to the relevant standards or code referred to in paragraph (a) has been disclosed in that publication.

Actions for damages

9. A contravention of regulation 3, 4, 5 or 6 is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

Signatory text

Address
Date

Name
Two of the Lords Commissioners
of Her Majesty’s Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

TITLE OF PROPOSAL

B.1 The Market Abuse Directive Regulations 2004 and the Investment Research Regulations 2004.

PURPOSE AND INTENDED EFFECT OF MEASURE

Objective B.2 The purpose is to implement the EU Market Abuse Directive,¹ which came into force on 12 April 2003, in the most cost effective and proportionate way. The aim of the directive is to achieve greater confidence in the integrity of the financial markets in the EU by introducing a common administrative framework for deterring and punishing market abuse, and through providing a proper flow of information to the market.

B.3 In the main, the regulations make changes to the scope of existing offences and obligations rather than introducing new offences and obligations. Those most directly affected by the existing market abuse regime, and therefore by these regulations, are investors, financial intermediaries and the management of issuers whose securities are traded on exchanges.

Background B.4 The directive builds on existing rules and regulations. It was required because the European legal framework was incomplete (there were no common provisions against market manipulation) and needed updating (the Insider Dealer Directive was passed in 1989). The directive covers both insider dealing and market manipulation and ensures that the same framework will be applied to both categories of market abuse. It also provides a framework for the proper disclosure of information to the market.

B.5 The directive is one of the centre pieces of the Financial Services Action Plan and aims to reduce potential inconsistencies, confusion and loopholes by establishing a basic framework for the allocation of responsibilities, enforcement and co-operation within the Community.

B.6 The directive affects investors because its prohibitions on market abuse potentially cover behaviour by investors. For example, an investor who becomes aware of inside information is prohibited from trading on the basis of that information.

B.7 The directive affects financial intermediaries because they are the people involved in trading financial instruments. As with investors, their behaviour must conform with the prohibitions in the directive. This includes refraining from trading on the basis of information conveyed by an investor's pending orders. They are also required to report any suspicious transactions they see to the relevant competent authority, and to comply with provisions relating to the production of research recommendations

B.8 The directive affects the management of issuers of financial instruments traded on exchanges because they are required to ensure certain information reaches the market. They must ensure that the firms they work for disclose inside information promptly, keep lists of those with access to inside information and reveal their dealings in the shares of the companies they work for.

¹ Directive 2003/6/EC (OJ L 96, 12.4.2003, p.16)

B.9 The directive will also affect those working in advisers to issuers and those who for professional reasons have access to inside information. They are required to keep inside information confidential and not to trade on the basis of the information. This group will include people working for public authorities such as the Office for Fair Trading and the Competition Commission.

B.10 The directive also touches, in places, upon others. These include:

- ⚡ operators of exchanges who must run systems to detect and prevent market abuse;
- ⚡ advisers to companies who must keep lists of their own employees who have access to inside information about the companies they work for;
- ⚡ people not working in financial intermediaries who produce research recommendations as part of their business or profession (probably mainly journalists).

B.11 The UK has a civil regime dealing with market abuse and market integrity, mainly in Parts 6 and 8 of the Financial Services and Markets Act, 2000 (FSMA). The UK's existing regime, as with that in the directive, provides a framework for deterring and punishing market abuse, (both insider dealing and market manipulation), and ensures a proper flow of information to the market from issuers whose securities trade on exchanges. The civil regime stands alongside a criminal regime dealing with insider dealing and market manipulation in Part 5 of the Criminal Justice Act 1993 and s397 of FSMA.

B.12 The UK's existing regime for market abuse and market integrity is not identical to that in the directive. Implementation of the directive in the UK requires that changes are made to the UK's existing regime to give effect to the directive's provisions. But because there is significant overlap between the UK's existing regime and that in the directive, the changes involve mainly alterations in scope rather than the introduction of wholly new offences and obligations.

B.13 Examples of the main changes of scope required are as follows:

- ⚡ **Boundaries of market abuse.** Under the existing regime behaviour is only market abuse, inter alia, if a regular user of the market regards the behaviour "...as a failure on the part of the person ... concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market". The directive does not include a 'regular user test' in its definitions of market abuse. Instead there are a series of specific defences and qualifications in respect of different offences, although most are likely to be considerations that a regular user would take into account in the existing UK regime.
- ⚡ **Geographical.** The current UK market abuse regime does not prohibit market abuse which takes place in the UK in relation to instruments admitted to trading on markets based outside of the UK. The directive requires that such behaviour is prohibited.
- ⚡ **Management of issuers.** The current UK regime requires directors of companies and those closely associated with them to disclose dealings in shares of the companies for which the directors work. The directive has a similar obligation but it covers senior management rather than just

directors, and has a more expansive definition of those closely associated with the directors. For example, it includes relatives other than spouses and dependent children sharing the same house as a member of senior management.

B.14 There are a few areas where the directive introduces new obligations. The main ones are as follows:

- ⚡ **Insider lists.** The directive requires issuers of securities, and persons acting for them, to draw up a list of those persons working for them who have access to inside information. The UK does not have a direct requirement like this currently, although the keeping of insider lists is something many issuers already do as a matter of best practice.
- ⚡ **Investment recommendations.** The directive requires regulation of those producing investment recommendations. Currently the UK does not regulate this as a freestanding activity. However, most of those producing investment recommendations work in FSA authorised firms subject to a framework of principles and rules dealing with issues such as conflicts of interest. And many journalists producing investment recommendations are subject to self-regulation.
- ⚡ **Reporting suspicious transactions.** The directive requires financial intermediaries to have an obligation to notify the competent authority of suspicious transactions. The UK regime does not currently have a direct obligation along these lines but financial intermediaries operate under FSA principles and rules that seek to promote integrity and there are similar sorts of obligations arising out of the Proceeds of Crime Act.

B.15 Given the draft regulations have a similar coverage to the UK's existing market abuse regime, they should not lead to much of a change in the rate of enforcement activity against market abuse. Under the new market abuse powers in FSMA there has been one successful enforcement action taken which resulted in a £15,000 fine for insider dealing. The FSA also fined one firm in 2003 for abusive trading activity which took place before the new regime came into force. Action was taken for a breach of general business principles governing authorised firms. Since 2000, four successful enforcement actions have been taken for breaches of issuers' disclosure obligations under the Listing Rules (which are akin to aspects of the market integrity provisions of the directive). In the year from 1 April 2003, the FSA opened 30 enforcement investigations in respect of market abuse and 2 in respect of breaches of the Listing Rules. At 31 March 2004 there were 25 market abuse enforcement investigations still open and 6 Listing Rules enforcement investigations still open. These figures include some investigations opened in earlier years.

B.16 The directive - like the current UK regime - is aimed at reducing market abuse and ensuring that markets are properly informed. The risk of failing to deal with this issue is that there will be a loss of confidence in securities markets. This would adversely affect both savers and companies. Savers could face higher transactions costs, be left to choose from a narrower range of investment products and enjoy less attractive returns. Around 11 million individuals in the UK hold shares directly, and individuals have around £800 billion invested indirectly in securities through various forms of collective investment products. Companies could face a higher cost of capital if abuse reduces liquidity in financial markets. At the end of March 2004 there were 1,530 UK companies admitted to trading on the London Stock Exchange's main market.

OPTIONS

Option 1 B.17 Do nothing. Taking no action to implement the directive would still mean that the UK would have a legislative regime aimed at deterring and punishing market abuse and promoting market integrity and there would be no additional costs for industry. But it will not allow us to meet the objective of fulfilling our obligations under the directive. The UK's existing regime falls short of the regime in the directive in some areas. For example, the scope of the current regime is narrower than that in the directive in the areas set out in paragraph 2.12.

B.18 The risk of this option is that the UK would be infracted by the Commission for failure to implement the directive correctly. We judge that if such proceedings started they would have a reasonable chance of succeeding. The UK would then be forced to revise our market abuse regime to make it consistent with that in the directive.

Option 2 B.19 Implement the draft regulations. The draft regulations seek to meet our objectives by incorporating the directive's provisions into the UK's existing market abuse regime. Where the scope of the UK's existing regime is broader than that in the directive, the current scope is retained. This enables the UK to comply with its obligations to implement the directive, ensuring that the UK retains an adequate breadth of regime, and provides greatest continuity for those affected by the UK's existing regime.

B.20 The main risk to our objectives from this option is that this regime is more costly as a result of being broader than that in the directive itself.

Option 3 B.21 Adapt the UK's existing regime to align its scope with that in the directive. This would give certainty that the UK had complied with its implementation obligations. It would also provide the UK with a regime for deterring and punishing market abuse broadly consistent with that in other member states.

B.22 Relying on the scope of regime in the directive would represent a bigger change to existing arrangements than the second option. Relative to adapting the existing regime, there are three changes that would be needed to the draft regulations to implement this option (there are other areas in which the language in the regulations departs from that in the directive but this is to provide clarity rather than to change the regime). All three changes would narrow the scope of the UK's market abuse regime.

B.23 The three provisions that would be removed from the draft regulations under this option are as follows:

⚡ **Insider dealing.** The provision in the regulations (the proposed new s118(4) of FSMA) drawn from the existing regime which would prohibit behaviour (not covered by the offences drawn from the directive) in relation to relevant information not generally available, subject to the 'regular user test'.

Omission of this provision would no longer explicitly prohibit people from trading to their advantage and to the disadvantage of others on the basis of information not generally available to investors.

⚡ **Market manipulation.** The provisions in the draft regulations (the proposed new s118(7) of FSMA) drawn from the existing regime which would prohibit behaviour (not covered by the offences drawn from the directive) which gave a false or misleading impression or distorted markets.

Omission of this provision would, for example, no longer explicitly prohibit someone from giving a false and misleading impression affecting trading in commodity derivatives by the movement of physical commodity stocks.

Scope. The provisions in the draft regulations (the amendments to the Prescribed Markets and Qualifying Investments Order), which would prohibit market abuse in relation to financial instruments traded on Ofex and the London Stock Exchange's AIM market (and before the Markets in Financial Instruments Directive is implemented in mid-2006, the London Metal Exchange, the International Petroleum Exchange and OM London).

Omission of this provision would mean that markets aimed at providing a platform for new and growing companies would no longer provide the same level of protection to investors from market abuse as they enjoy in respect of the securities of larger more established firms trading on the London Stock Exchange's main market. It would also be disruptive to the UK's commodity derivatives exchanges who would be outside of the regime for about eighteen months. The markets affected have indicated that they wish to remain inside the scope of the civil market abuse regime.

B.24 The main risk to our objectives from this option is that the narrowing of the market abuse regime undermines confidence in the UK's financial markets.

BENEFITS AND COSTS

B.25 The sections below on benefits and cost do not take into account any environmental or social impacts arising out of the options considered. The operation of financial markets may have significant implications for sustainable development, but the directive does not directly impact on the environment or our natural resources. Likewise the operation of financial markets may have significant implications for the distribution of wealth and income, but the directive does not directly impact on the distribution of wealth and income. The focus of the analysis is therefore on the economic costs and benefits.

B.26 The main effects of potential changes to the market abuse regime will be felt by investors, financial intermediaries trading securities and by companies whose securities are admitted to trading on an exchange. The benefits and costs set out below are based on the impact on 2,839 companies authorised by the FSA at the end of March 2003 to conduct investment management and securities and futures business and the 1,530 UK companies whose securities were admitted to trading on the main market of the London Stock Exchange at the end of March 2004.

B.27 When the market abuse regime was introduced in 1999 it was estimated that there was a cost of £500 an hour for firms in seeking advice on the regime (made up of internal costs and the costs of external legal advice). The calculations below have updated this to £610 an hour on the basis of increases in average earnings of those working on financial intermediation.

B.28 All the options involve the UK continuing to have a significant civil market abuse regime alongside a criminal regime. What they offer are variations on the boundaries of the civil regime. There are good grounds for believing that having an effective market abuse regime bring significant benefits; but it is less easy to determine the point at which the marginal benefits of a wider scope equal the marginal costs to investors and the industry of complying with the regime.

B.29 Market integrity matters for investors, intermediaries and companies. This is because it potentially impinges on liquidity of markets, which, crudely put, is the ability of markets to absorb fluctuations in trading activity without huge movements in prices. The lower is liquidity, the higher are the risks and costs for investors and intermediaries and the more expensive raising capital is for issuers.

B.30 One crude measure of liquidity is spread – the difference between the best bid and offer prices in the market place. A calculation of the weighted average spread for FTSE 100 shares at a point on 16 June was 19 basis points (ie about a fifth of a percentage point). Based on total turnover in UK equities in 2003 of £1,540 billion, the spread cost was £2.9 billion. A 1 basis point increase in the spread using these figures would increase costs to the market of trading by £150 million. As one of the factors affecting liquidity and spreads, a market abuse regime has the potential to bring significant benefits.

B.31 Less interest in trading securities in the UK would also have direct affects on economic activity in a sector of the UK economy. Figures collated by International Financial Services London show that securities dealing in the UK accounts for 0.05 per cent of GDP and employs about 58,000 individuals

B.32 The fact that all of the options involve the UK having a significant civil market abuse regime alongside a criminal regime limits the extent to which any of the options will change the compliance costs currently faced by industry. The one-off costs of change are likely to significantly outweigh any overall addition, if any, to annual compliance costs.

BENEFITS

Option 1 B.33 The main benefit of this option is that it would involve no change to the existing regime. Everyone could continue to work with a regime they are familiar with. However, because the UK's existing regime does not give effect to all of the provisions in the directive (paragraph B13 above outlines the main differences), it is probable that the UK would be successfully infringed by the Commission for failure to implement the directive properly. At that stage the UK would have to change its regime, choosing either of the second or third options.

Option 2 B.34 Implementation of the draft regulations would minimise the changes to the UK's market abuse regime. For those involved in the markets, the regime should be more familiar. It should also eliminate the risk of infraction proceedings by the Commission.

B.35 The main benefit of this option is that it would maintain the breadth of the current regime market abuse regime. The FSA would be able to take enforcement action against behaviour which the directive doesn't prohibit but which the Government regards as falling short of an acceptable level of conduct in financial markets. Examples of the kinds of behaviour were given in paragraph B23 above. The existing regime was widely consulted on and discussed before its introduction.

B.36 Perhaps the most significant benefit of retaining the existing scope is that it ensures that the Ofex and AIM markets fall within the scope of the regime. These are the two most successful junior equity markets in Europe (in terms of the number of companies traded on the markets), and many companies have graduated from them to the London Stock Exchange's main market. Both markets wish to remain within the scope of the regime. They see it as being an important component of encouraging

investor interest in the companies traded on their markets, by providing reassurance that abusive behaviour in relation to the markets will be punished. Such protection benefits the markets, investors and the companies whose securities trade on these markets. Over 700 UK companies have securities trading on AIM and over 150 UK companies have securities trading on Ofex. It would also avoid disruption in respect of commodity derivatives markets run by OM London, the International Petroleum Exchange and the London Metal Exchange. They are caught in the scope of the UK's existing regime but outside the scope of the directive until the Markets in Financial Instruments Directive is implemented by the end of April 2006.

B.37 Implementing the directive in the UK and elsewhere will narrow the differences between market abuse regimes in EEA countries. This should reduce compliance costs for those trading in more than one member state. These benefits will, however, be reduced to the extent that the UK retains additional provisions to those contained in the directive.

Option 3 B.38 Replacing the UK's existing regime with that in the directive would eliminate any risk of proceedings by the Commission for failure to implement properly. It would also leave the UK with a regime dealing with the main aspects of market abuse and market integrity.

COSTS

Option 1 B.39 There would be no new costs for investors, intermediaries or companies in the short term. But potentially the government would have to bear the costs of infractions proceedings and investors, intermediaries and companies would then need to bear the costs of either of options 2 or 3 depending on which was chosen to bring the UK's regime into compliance with that in the directive.

B.40 Infractions proceedings would involve policy and legal input within government and use of external legal resources. The internal input might require 200 hours of policy input and 200 hours of legal input. At an average cost of £30 an hour this would cost £12,000. About 50 hours of external legal advice might be required. At an average cost of £250 an hour this would cost £12,500.

Option 2 B.41 Adapting to a new regime will involve costs. The one-off compliance costs for intermediaries will vary from firm to firm depending upon their involvement in the market. At the time of the introduction of the market abuse regime in FSMA it was estimated that intermediaries would require, on average, ten hours of time to prepare for the new regime.

B.42 There is no reason to believe that the introduction of the directive should be any more costly than the introduction of the regime in FSMA. It represents a change to an existing regime rather than the introduction of a wholly new regime. Across the firms involved in securities trading this produces a one-off implementation cost of approximately £17 million.

B.43 There should be little incremental addition to the ongoing compliance costs of financial intermediaries relative to the position before the implementation of the draft regulations. They will be dealing with a regime very similar to the existing market abuse regime. The FSA have estimated that approximately £104,000 will be spent on making 200 suspicious transaction reports a year by intermediaries. This represents one man day per report for a compliance officer earning £65,000 (on the assumption of a 100 per cent overhead rate and a 250 day working year).

B.44 Companies with securities admitted to trading on regulated markets would also need to adapt to the provisions arising out of the requirements to keep lists of those with access to inside information and the widened obligation to make public managers transactions in the shares of their own companies. The compliance costs arising out of the requirements on insider lists should not be significant. Whilst there is currently no formal legal requirement in this area, issuers already maintain insider lists as a matter of good practice. The widening of the obligation to report managers' transactions is likely to add to costs. The FSA estimates one-off legal and training costs of £21 to £36 million. And additional annual compliance costs of £260,000 for extra announcements to the market.

Option 3 B.45 Those dealing on UK markets would be subject to a wider market abuse regime than those dealing on non-UK markets. Implementation of the directive across the EU will actually serve to narrow the existing differences between the UK and other EU countries. We are not aware of any evidence that the current breadth of the UK's regime has led to any trading activity moving to other financial centres with narrower regimes. Implicitly any additional costs are lower than the benefits of continuing to trade in whose securities trade on these markets. Over 700 UK companies have securities trading on AIM and over 150 UK companies have securities trading on Ofex.

B.46 This option will involve one-off costs of adjustment. The costs for issuers would be identical to those under the previous option (£21 to £34 million) as the obligations would be identical. The costs for intermediaries are also likely to be very similar to the previous option (£17 million). Whilst the regime would be less broad than under the previous option, it would represent a bigger change to the status quo.

B.47 Again the ongoing additional costs for issuers relative to their existing costs will be identical to the previous option (£260,000 a year). Ongoing compliance costs for intermediaries might be lower than currently for two reasons: this option narrows the differences between the UK's regime and those in other countries making life easier for those doing business in other countries as well as the UK; and it has a narrower scope relative to the existing regime. If on average companies trading in securities save 2 hours of compliance/legal advice a year, there would be an annual cost saving of £3 million a year. As in the previous option there will be an annual addition to intermediaries costs from making suspicious transaction reports of £104,000.

CONSULTATION WITH SMALL BUSINESS

B.48 This is the first consultation being conducted on the Market Abuse Directive Regulations 2004 and small businesses will be consulted as part of this formal public consultation process. However, informal consultations have already been held with a variety of industry associations including some representing smaller companies. The main association representing smaller companies made no direct suggestions regarding the proposals in the process of informal consultation.

COMPETITION ASSESSMENT

B.49 Given that the draft regulations would introduce largely incremental change to an existing regime, they should not have a significant effect on competition.

B.50 Two main markets are likely to be affected by the implementation of the Market Abuse Directive. The market for the provision of exchange services, and the market for the provision of intermediary services linked to securities dealing.

B.51 Because of the network externalities associated with liquidity, the market for exchange services is dominated by a small number of companies. However, the market is contestable. For example, there is currently three-way competition between exchanges in the trading of Dutch equities. Exchanges have two main assets: their brand and their trading technology. An important part of their brand is a reputation for probity. Requirements under the directive for exchanges to have structures to prevent and detect market abuse (which already exist in UK legislation) do not constitute a barrier to entry but an essential component for any exchange wanting to attract liquidity.

B.52 There are 2839 firms in the UK authorised by the FSA to manage investments and to deal in securities and futures. In addition there are branches of firms authorised elsewhere in the EEA doing the same business in the UK. Together these firms include major international investment banks as well as a large number of smaller firms. All face the same market abuse regime and all need to understand it. The regime should not, however, bear disproportionately on smaller firms. It is no more difficult for a small firm to act with integrity towards the market than for a large firm. The day to day obligations directly imposed on those trading securities by the directive are limited (the main obligation is to report suspicious transactions). For the same reason, the draft regulations should not constitute a barrier to entry to the securities trading industry.

ENFORCEMENT AND SANCTIONS

B.53 The Government via the Financial Services and Markets Act 2000 (FSMA) delegated the power of enforcement of the market abuse regime to the Financial Services Authority (FSA). The FSA has already taken enforcement under this regime. There is no reason to believe that the regime under any of the options would not be enforced.

Sanctions B.54 Article 14 of the directive requires administrative sanctions as a minimum standard. There is nothing in the directive that alters the range of sanctions currently available in the UK to deal with market abuse, as opposed to the scope and nature of the offences covered.

MONITORING AND REVIEW

B.55 The EU has no specific current formal plans to review the effectiveness of the Market Abuse Directive. However, under the Lamfalussy process for financial services legislation in the EU, the Commission has a role in ensuring that legislation is enforced properly in Member States. In part in doing this job it relies on the private sector to point out specific problems.

B.56 The UK government has no specific current formal plans to review the effectiveness of legislation introduced as part of the implementation of the EU's Financial Services Action Plan in the UK, and no specific current formal plans to review the effectiveness of the primary legislation in FSMA (although aspects of the impact of FSMA overall are being considered as part of an exercise looking at FSMA two years on from when it came into force).

B.57 The sorts of criteria that the effectiveness of a market abuse regime needs to be judged against might include its impact on the following:

- ⌘ the incidence of market abuse;
- ⌘ the ability to successfully prosecute incidences of market abuse;
- ⌘ the confidence of investors in the probity of the UK's financial markets;
- ⌘ the costs of trading for investors;
- ⌘ the costs of capital for issuers;
- ⌘ the costs to financial intermediaries and issuers of complying with the regime.

CONSULTATION

B.58 This is the first formal public consultation on the draft Market Abuse Directive Regulations 2004. However, informal consultations have already been held with industry associations, exchanges and investment banks. These consultations have helped to shape the proposals that have emerged in the draft regulations. In particular, they have influenced:

- ⌘ Architecture. The broad architecture of the new s118 of Part 8 of FSMA in the draft regulations emerged out of a discussion of possible approaches at a roundtable and a subsequent worked-up suggestion from industry. The shape of the part of the draft regulations dealing with investment recommendations was also influenced by a discussion of broad options with representatives of media organisations including working journalists.
- ⌘ Scope. The limiting of the geographical scope of the prohibitions drawn from the existing regime responds to suggestions from industry.

B.59 The informal consultation has indicated that market participants and market operators are broadly content with the existing scope of the UK's market abuse regime. They regard it as familiar and not excessively burdensome. Both Ofex and AIM have indicated that they wish to remain inside the scope of the regime.

SUMMARY AND RECOMMENDATION

B.60 Option 2 is recommended. This will enable the UK to comply with its obligations to implement the directive whilst at the same time retaining a market abuse regime which is sufficiently broad to maintain confidence in the integrity of the UK's financial markets. (See costs on next page)

Option	Total cost per annum	Total benefit per annum
1. Do nothing	<p>No incremental change in costs.</p> <p>£12,500 costs of infractions proceedings.</p> <p>Regime is not legally sustainable.</p>	No incremental change in benefits.
2. Implement draft regulations	<p>£17 million one-off implementation costs for intermediaries.</p> <p>£21 million to £34 million one-off implementation costs for issuers.</p> <p>£260,000 addition to annual compliance costs for issuers.</p> <p>£104,000 annual cost of suspicious transactions reports</p>	No incremental change in benefits.
3. Implement scope of directive regime	<p>£17 million one-off implementation costs for intermediaries.</p> <p>£21 to £34 million one-off implementation costs for issuers.</p> <p>£260,000 addition to annual compliance costs for issuers.</p> <p>£3 million annual reduction in annual compliance costs for intermediaries.</p> <p>£104,000 annual costs of suspicious transactions reports</p> <p>Reduction in the coverage of UK market abuse regime to the potential detriment of investors and issuers.</p>	Unquantifiable incremental reduction in the benefits of the existing regime through a narrowing of the market abuse regime.