Opinion of the European Economic and Social Committee on the 'Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse)'

COM(2011) 651 final — 2011/0295 (COD)

and the 'Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation'

COM(2011) 654 final — 2011/0297 (COD)

(2012/C 181/12)

Rapporteur: **Mr METZLER**

On 25 November 2011 the Council, and on 15 November 2011 the European Parliament, decided to consult the European Economic and Social Committee, under Articles 114 and 304 of the Treaty on the Functioning of the European Union (TFEU), on the

Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse)

COM(2011) 651 final — 2011/0295 (COD).

On 2 December 2011 the Council decided to consult the European Economic and Social Committee, under Article 304 of the Treaty on the Functioning of the European Union (TFEU), on the

Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation

COM(2011) 654 final — 2011/0297 (COD).

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 7 March 2012.

At its 479th plenary session, held on 28 and 29 March 2012 (meeting of 28 March), the European Economic and Social Committee adopted the following opinion by 138 votes to 2 with 8 abstentions:

1. **Content and conclusions**

1.1 The EESC welcomes the fact that the Commission's proposal updates the framework created by the market abuse directive currently in force and thus protects confidence in the integrity of capital markets.

1.2 The EESC agrees in principle with the Commission's proposal. However, in relation to the specific structure of the Commission's proposal in the form of a regulation and a directive, the EESC has a number of concerns, some of which are fundamental ones.

1.3 In particular, the vague wording of many offences in the proposal for a directive on market abuse, and the delegation of further detail to ESMA and/or the Commission at Level 2, are likely to cause significant legal uncertainty. Bearing in mind that the principle of legal certainty in criminal law is key to the rule of law, this deserves criticism. The principle of legal certainty in criminal law is enshrined not only in the constitutions of the Member States, but also in the European Convention on Human Rights (ECHR). It would be in the interests neither of the Commission nor of the Member States nor of those applying the law for a European legislative act to give rise to such fundamental concerns as regards constitutional and criminal law. The EESC therefore calls for further clarification of offences at Level 1.

1.4 There are also grounds for criticism of Article 11 of the proposal for a Regulation, which requires anyone professionally arranging or executing transactions in financial instruments to put systems in place to detect market abuse. A heavier bureaucratic burden does not necessarily mean improved regulation. The EESC advocates efficient, balanced regulation. Not only does this rule give rise to the concern that large numbers of uninformed reports will be filed, which cannot be what the regulators intend; it also places a disproportionate burden on smaller credit institutions in particular and is thus likely to impair local economic activity, harming above all the interests of the population and of small and medium-sized enterprises in rural areas. The EESC calls on the Commission to take account of these concerns and to opt for a more tailored approach to regulation, as it is doing for example to make things easier for small and medium-sized issuers in a number of legislative proposals that are currently in the pipeline.

2. **Gist of the Commission document**

2.1 Directive 2003/6/EC on insider dealing and market manipulation was a first attempt to harmonise rules on market abuse at European level. On 20 October 2011 the European Commission published a proposal on revision of this directive in the form of a directive (MAD) and a regulation (MAR) on market abuse.

2.2 The Commission's intention is to update the current framework established by the market abuse directive and to ensure gradual harmonisation of European rules on insider dealing and market manipulation, in response to changing market conditions.

2.3 Whereas the market abuse directive only covers financial instruments traded on regulated markets, the proposal would extend the scope of European rules to financial instruments traded on new platforms and over the counter. At the same time, the proposal would step up the powers of regulators to investigate and sanction abuses, while cutting red tape for small and medium-sized issuers.

3. **General comments**

3.1 The EESC welcomes the fact that the Commission, with this proposal, is responding to changing market conditions and is seeking to update the framework created by the market abuse directive. Insider trading and market abuse damage confidence in the integrity of the markets, which is an essential prerequisite for a functional capital market.

3.2 It makes sense to extend the scope of the existing rules on market abuse to cover financial instruments traded outside regulated markets and the use of very sophisticated technology to implement trading strategies such as high-frequency trading. However, this will only help to underpin market integrity if the intended practical impact of extending the scope to include over-the-counter financial instruments and high-frequency trading is made clear.

3.3 Greater harmonisation of insider dealing and market abuse rules is welcome. However, the form of the Commission's proposal, envisaging a regulation and directive on market abuse, could give rise to a plethora of legal problems, particularly in view of the general penal and constitutional principles involved here. For this reason, it deserves criticism.

4. **Specific remarks**

4.1 The EESC welcomes the extension of the scope to include over-the-counter financial instruments. However, it remains unclear as to how these are to be covered by the proposal. There is often no market at all for over-the-counter financial instruments, as they are only traded bilaterally. It would therefore help those applying the law if the text were made more specific; to achieve this, the Commission or the ESMA (European Securities and Markets Authority) could add some examples of specific cases.

4.2 The EESC also broadly welcomes the inclusion of highly sophisticated technology for implementing trading strategies within the scope of the rules on market abuse. However, it should be remembered that algorithm-based trading is not *per se* a bad thing, but is also used by credit institutions to process day-to-day orders from private clients. Those applying the law therefore need further clarification as to what is legally permissible. Here, too, a set of examples drafted by the Commission or the ESMA would be helpful.

4.3 When legislating in the field of penal law, the European Union must comply with the subsidiarity principle. Under current legislation, rules are set out in the form of a directive, an approach which we endorse. It is difficult to understand why the Commission has not stuck to this approach. The proposal sets out rules on penalties in the form of a directive (MAD). The cases where these penalties are to be applied are, however, set out in a regulation (MAR), to be directly applied in the Member States.

4.4 Putting the rules in the form of an EU regulation is a questionable approach, as applying the proposed rules could lead to numerous legal problems. The Member States cannot obstruct their application as they could in the case of a directive. However, steps should be taken to steer clear of such difficulties, if the objectives of the Commission's proposals are to be achieved.

4.5 Legal problems of this type could arise due to the lack of precision in the wording and the use of imprecise legal concepts. The legal uncertainty arising from penalty provisions has implications for general constitutional principles and for criminal law. This includes the principle of certainty in criminal law (*nulla poena sine lege certa*) – e.g. Article 103(2) of the German constitution (*Grundgesetz*); Article 25(2) of the Italian constitution). In keeping with this principle, a standard must clearly define the cases where penalties may be applied. This general principle of the rule of law is also enshrined in Article 7 ECHR. The EESC doubts whether this principle has been adequately complied with in the case of most of the rules in the proposal for a regulation. Even the existing regulatory regime on insider dealing is, at least in the German legal literature, perceived as creating too much legal uncertainty and is therefore criticised.

4.6 Legal uncertainty also arises from the provisions empowering the Commission or the ESMA to specify Level-2 criteria for cases where penalties apply, as is the case in Article 8(5) of the proposed MAR. True, Article 8 itself has

no legal implications, as it only concerns the definition of market manipulation. However, there is no point in quibbling about Article 8 having no direct punitive effect, as this measure provides for an authoritative definition of the offence of market abuse and is thus is an integral part of the provision relating to penalties. Moreover, Annex I to MAR contains a catalogue of indicators in relation to individual parts of Article 8. It is therefore questionable to flesh this out in an additional step at Level 2. The EESC does understand the Commission's concerns that probably underlie this way of proceeding, namely to make it possible to continuously adapt to market developments and thus leaving it to the Commission or ESMA to clarify individual elements or aspects. New market developments may also change the demands placed on supervision. However, given that criminal law is involved, this approach raises legal questions. Moreover, the combination of Article 8, the annex and any further implementing measures means that it is not exactly clear what behaviour is to be punished.

4.7 Moreover, the ESMA would be required to specify Level-2 indicators not only under the proposed rules on market abuse, but also in parallel under the proposals on recasting Directive 2004/39/EC (MiFID); this could place an excessive burden on the ESMA. As a result, it is feared that there might be delays and continuing uncertainty.

4.8 The requirement set out in MAR Article 11(2) for any person professionally arranging or executing transactions in financial instruments to have systems in place to prevent and detect market abuse is questionable from the point of view of those concerned by the proposals.

4.9 Those people professionally involved in trading financial instruments are already required to report suspicious transactions (cf. Article 6 (9), directive on market abuse). Indeed, according to German regulator BaFin (cf. report in BaFin Journal, July 2011, p. 6 ff.) such reporting of suspicious transactions provides useful information, and the number of transactions reported is constantly on the increase.

4.10 The introduction of detection systems could lead to a proliferation of reports of allegedly suspicious transactions; large numbers of unsubstantiated reports are certainly not in the interest of regulators. In practice, the problem with infringements of the rules designed to prevent market abuse seems to be not so much a failure to detect abuse, but rather the fact that an overwhelming majority of cases are either not prosecuted or are dropped in exchange for payment of a fine. It is possible that public prosecutors' offices in Member States lack specialist departments in this area.

4.11 It is also doubtful whether those who professionally arrange or execute transactions in financial instruments are at all the best parties to require to set up such systems for preventing and detecting market abuse.

4.12 In any case, the stock exchange trading surveillance offices should have a comprehensive overview of domestic trading. As market abuse can take place across borders, the EESC would welcome it if such authorities were empowered to develop their international cooperation.

4.13 In particular, it is also doubtful whether small and medium-sized credit institutions should be required to put in place systems to prevent and detect market abuse. Setting up special mechanisms could well overload them. Such small and medium-sized credit institutions are often found in rural areas and play a key role in providing services to local residents and small and medium-sized enterprises. In doing so, they help to put local economies on a stronger footing and promote local employment. Good examples of this are credit unions such as the *Cajas Rurales* in Spain or the *Volksbanken* and *Raiffeisenbanken* in Germany. Credit institutions cannot be expected to take on regulatory tasks. Detecting and above all evaluating cases of market abuse is a task for regulators.

4.14 Moreover, placing additional burdens on small and medium-sized credit institutions runs counter to the intention of these proposals to cut red tape for small and medium-sized issuers. The Commission had this aim, amongst others, not only with its proposed legislation on market abuse, but also with that on revising the transparency directive (2004/109/EC). Spectacular cases of market manipulation that have come to light in connection with individual banks were set in train by individual traders in investment banking, for example the Frenchman Jérôme Kerviel in 2008. Prominent cases of insider dealing show that credit institutions are rarely implicated in such offences. Small and medium-sized credit institutions are not, therefore, suitable parties to require to set up systems for preventing and detecting market abuse. In failing to make any distinction, the approach set out in Article 11 of the draft MAR does not take sufficient account of such differences.

4.15 Against this background, consideration should be given to putting in place a market abuse surveillance structure for those professionally arranging or executing transactions in financial instruments, along the lines of the self-regulation under regulatory supervision that exists in the liberal professions. Such a surveillance structure would bring on board the expertise and knowledge of the sector that is necessary for effective professional supervision that ensures quality and trust. If financial market operators are given a self-regulatory task under statutory state supervision, this will above all benefit the consumer and not the interests of market operators, who will be keeping each other in check. Self-regulation breaks down established privileges and creates transparency.

4.16 The exemption clause from the draft MAD for the United Kingdom, Ireland and Denmark (recitals 20-22 of MAD) is at odds with the objective of harmonising rules. Adding to or amending the relevant parts of the draft would thus be in line with the objectives. The United Kingdom has already declared that it will be exercising its right to opt out and – at least initially – will not be taking part in the adoption and

application of the directive. Its main argument is that the draft MAD depends on the results of the proposals on MAR and MiFID currently under discussion and that the impact of these is not clear at present. On the one hand, we consider that this position confirms the concerns outlined above in relation to the legal uncertainty that is likely to arise from the use of imprecise legal concepts and the clause allowing subsequent clarifications. On the other, this approach is questionable given that the objective is to harmonise rules and that London, the biggest financial centre in the EU, is located in the United Kingdom.

Brussels, 28 March 2012.

The President
of the European Economic and Social Committee
Staffan NILSSON