



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 30.5.2001  
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2001/0118 (COD)

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**on insider dealing and market manipulation (market abuse)**

(presented by the Commission)

## EXPLANATORY MEMORANDUM

### **1. GENERAL COMMENTS**

The Lisbon European Council has made a strong commitment to integrate European financial markets by 2005 at the latest. The Stockholm European Council considered that every effort should be made by all parties concerned to achieve an integrated securities market by the end of 2003 by giving priority to securities markets legislation provided for in the plan, including those endorsed in the report by the Committee of Wise Men on the Regulation of European Securities Markets. The Stockholm European Council also called for the legislative process to be speeded up and to be more flexible in order to be able to respond to market developments whilst ensuring that the European Union can adapt to new market practices and regulatory standards, respecting the requirements of transparency and legal certainty.

There is a growing consensus that a single financial market will be a key factor in promoting the competitiveness of the European economy, lowering the cost of capital for large and small companies. But an integrated market, properly regulated and prudentially sound, will deliver major benefits to consumers, through higher pensions, lower mortgage costs and a wider range of financial products. And it will help to develop new economic and social cohesion throughout Europe. The vehicle to achieve this integrated market is the Financial Services Action Plan. One of the objectives of the Financial Services Action Plan is to “enhance market integrity by reducing the possibility for institutional investors and intermediaries to rig markets and to set common disciplines ... to enhance investor confidence”.

Markets in transferable securities are playing a more and more important role in the EU in financing companies and the economy as a whole. The valuation of securities plays a role in determining the expansion and contraction of credits and the appropriate collateralisation of bank loans. High growth enterprises depend on the efficiency and transparency of financial markets in order to raise capital. Indeed, the smooth functioning of financial markets and public confidence in them are prerequisites for sustained economic growth and wealth. Market abuse not only increases the cost for companies to finance themselves but also harms the integrity of financial markets and public confidence in securities and derivatives trading. Such practice dissuades new investors and can have severe consequences. Therefore, it undermines economic growth and European economic policy.

The aim of this Directive is to ensure the integrity of European financial markets, to establish and implement common standards against market abuse throughout Europe, and to enhance investor confidence in these markets.

#### **a) What is market abuse?**

Market abuse may arise in circumstances where investors have been unreasonably disadvantaged, directly or indirectly, by others who:

- have used information which is not publicly available to their own advantage or the advantage of others;
- distorted the price setting mechanism of financial instruments;
- disseminated false or misleading information.

This type of conduct can create a misleading appearance of trading in financial instruments and undermine the general principle that all investors must be placed on an equal footing:

- in terms of access to information. Insiders are in possession of confidential information. Trades based on such information lead to unjustified economic advantages to the expense of ‘outsiders’;

- in terms of knowledge of the price setting mechanism. Fair prices result from individual analysis by investors of all public information. Prices resulting from manipulation are set at another level, creating economic advantage solely for the manipulators, but damaging the interests of all other investors;

- in terms of knowledge of the basis or origin of public information. The dissemination of false or misleading information can lead investors to act on the basis of wrong information

## **b) The need for a European legal framework against market abuse**

The existing European legal framework to protect market integrity is incomplete :

- At European level, there are no common provisions against market manipulation. The Insider Dealing Directive (89/592/EEC) <sup>1</sup> limits itself to preventing the misuse of privileged information.

- At Member State level, there is a great variety of rules dealing with market abuse. Legal requirements differ according to the different jurisdictions. While all Member States have implemented the Insider Dealing Directive, in some there is no legislation addressing market manipulation. Furthermore, it is not always clear in the Member States who is responsible for dealing with these practices.

These differences lead to competitive distortions in the financial markets. They hinder the development of a single European financial market based on a level playing field. As a result investment firms and economic actors are often uncertain about the concepts, definitions and enforcement requirements in different Member States.

Moreover, new developments are adding to these difficulties. New products and technologies are being developed; the range of derivative products is growing; new and increasing numbers of participants are entering the markets; cross-border trading is increasing; interconnected markets are developing.

These developments are enhancing the incentives, means and opportunities for market manipulation. The key example of this is the way that the development of the Internet as a popular tool for the exchange of information is increasing the risk of dissemination of false or misleading information.

To ensure that integrated European financial markets will be well protected, a common legal framework is needed on the prevention, detection, investigation and punishment of market abuse. Such a framework needs to ensure certainty among market participants over concepts and enforcement, thereby setting a level playing field for all economic actors in all Member States.

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<sup>1</sup> OJ L 334, 18.11.89, p. 30 - 32

### **c) A single Directive against market abuse**

There are two main categories of market abuse: insider dealing and market manipulation.

The Insider Dealing Directive (89/592/EEC) was adopted more than a decade ago, well before the adoption of the Investment Services Directive. Given the changes in financial markets and in European legislation since its adoption, some people have questioned whether it is still up to date, and therefore whether it should be replaced or updated.

The objective of the existing Insider Dealing Directive and a new separate Directive addressing market manipulation would be the same: to ensure the integrity of European financial markets and to enhance investor confidence in those markets.

Any Directive addressing market manipulation must take account of new developments since the adoption of the Insider Dealing Directive. In particular it would need to establish higher standards for common implementation and enforcement in order to develop more integrated financial markets.

This would create potential inconsistency between the two Directives, leading to confusion and potential loopholes. To avoid this, and to bring it up to date, the Insider Dealing Directive would itself need to be updated to reflect these new standards.

In the view of the Commission, this all amounts to a compelling argument for a single Market Abuse Directive covering both insider dealing and market manipulation. This would ensure the same framework for allocation of responsibilities, enforcement and co-operation, avoiding any potential inconsistencies and confusion. It would be administratively simpler and reduce the number of different rules and standards across the European Union.

### **d) The approach of the Directive**

In order to ensure that the approach of a European market abuse regime remains relevant over the next decades in rapidly changing financial markets, the Directive provides for a general definition of what constitutes market abuse. This definition is flexible enough to ensure that new abusive practices which might emerge are adequately covered. At the same time it is sufficiently clear to provide adequate guidance for behaviour to market participants.

Market integrity can only be guaranteed with a general application of prohibitions of abusive behaviour. Given the potential developments on financial markets, the scope of the prohibition should not be limited to 'regulated markets' alone. This is to avoid other types of markets, Alternative Trading Systems and others being used for abusive purposes. However, the Directive recognises that in particular circumstances and for perfectly understandable economic reasons, exemptions (so called "safe harbours") will need to be allowed, where certain prohibitions would not apply.

If the European Union is to develop integrated financial markets, there needs to be convergence (rather than divergence) in the methods of implementation and enforcement in Member States. Different sets of responsibilities and powers of national administrative authorities hinder the establishment of a fully integrated market and add to market confusion. To address this, the Directive proposes that Member States designate a single regulatory and supervisory authority with a common minimum set of responsibilities.

Given the increasing number of cross-border activities, European legislation will need to ensure that regulatory and supervisory authorities work effectively together to prevent, detect,

investigate and prosecute market abuse. For this purpose they need to be able to rely on the assistance of each other and to receive relevant information from each other in good time.

In principle it is unacceptable in an integrated financial market for wrongful conduct to incur a heavy penalty in one country, a light one in another and no penalty in a third. However, a full harmonisation of penal sanctions is not foreseen in the EC Treaty. Nevertheless, it is both desirable and consistent with Community law for the Directive to set a general obligation for Member States to impose and determine sanctions to be imposed for infringement of measures pursuant to the Directive in a way that is sufficient to promote compliance with its requirements.

The new disciplinary framework set out by this Directive is not intended to replace the national provisions by directly applicable Community provisions, but contribute towards helping some convergence among the different national regimes through compliance with the requirements of the Directive. Since all Member States have signed and ratified the European Convention on Human Rights, they will be bound by its standards when implementing the framework of this Directive into their national law.

It is important to ensure that a process exists for new measures to be adopted, so that consumers willing to invest in new products are adequately protected and receive equal treatment in every Member State. To meet the challenge of regulating modern financial markets, new legislative techniques have to be introduced. On 17 July 2000, the Council set up the Committee of Wise Men on the Regulation of European Securities Markets. In its final report the Committee called for each Directive to be a split between framework principles and “non-essential” technical implementing measures to be adopted by a Regulatory Committee under the Union’s comitology procedures. In its Resolution on more effective securities markets regulation in the European Union, the Stockholm European Council welcomed the intention of the Commission to establish a Securities Committee. The Securities Committee, acting in its advisory capacity, should be consulted on policy issues, in particular, but not only, for the kind of measures the Commission might propose at the level of framework principles. According to this Resolution, the Council added that subject to specific legislative acts proposed by the Commission and adopted by the European Parliament and the Council, the Securities Committee should function as a regulatory committee in accordance with the 1999 Decision on comitology to assist the Commission when it takes decisions on implementing measures under Article 202 of the EC Treaty. This Directive follows the line drawn up by the Stockholm European Council.

This proposal indicates which are the non essential technical implementing details to be dealt with by the Commission through comitology procedure. For example, this will include adaptation and clarification of the definitions and exemptions in order to ensure uniform application and compatibility with technical developments on financial markets.

In view of the urgency of action in the area of market abuse, and in view of the extensive consultations on the issue already carried out with Member State governments, regulators and supervisors, financial industry (Forum Group meetings) and other interested parties, the Commission has decided to come forward with the proposal now rather than to delay it through recourse to a more formal consultative process. In line with the report of the Wise Men, the Commission will engage in consultations, as foreseen in the Stockholm European Council resolution, when it prepares the implementing measures in accordance with the relevant provisions of the proposed Directive.

## **2. DESCRIPTION OF ARTICLES**

## **Article 1 – Definitions**

### **‘Inside information’**

The definition of ‘Inside Information’ is based on the definition given in the existing Insider Dealing Directive, extended to cover primary markets as well. The scope has been also extended from ‘Transferable Securities’ to ‘Financial Instruments’, as defined in the Investment Services Directive, plus derivatives on commodities. The scope is set out in Section A of the attached Annex. The reason for this is to bring the scope up to date with the changes over the last decade. The scope of financial instruments significantly affected by privileged information is not limited to those of the issuer but enlarged to related derivative financial instruments (e.g. options on equity, futures and options on index).

## **‘Market Manipulation’**

The definition of ‘Market Manipulation’ relies on the behaviour of its authors, and not on their intention or aim. Two types of behaviour are listed which might be considered as manipulative :

- transactions and orders to trade in the orders book,
- the dissemination of information,

which mislead or try to mislead market participants.

This definition is both specific enough to encourage and guide the responsible behaviour of market actors and abstract enough to provide the necessary flexibility to adapt to new market developments when they arise.

## **‘Financial Instruments’**

The definition of ‘Financial Instruments’ covers the instruments listed in Annex B of the Investment Services Directive (93/22/EEC)<sup>2</sup> as well as commodity derivatives which are commonly considered as a category of derivative financial instruments, and should therefore also be covered.

## **‘Regulated market’**

The definition of ‘regulated market’ is the one given by Article 1 (13) of the Investment Services Directive. The aim of this provision is to create consistency between the Directives and to avoid confusion.

## **‘Comitology procedure’**

The implementing measures are needed to take account in the application of this Directive new developments and to guarantee a uniform application of its rules in order to ensure a level playing field for economic actors.

## **Articles 2, 3 and 4 – Prohibition of behaviours related to Inside Information**

The prohibition of behaviours defined in Articles 2 to 4 is general :

- it is applicable to any person (natural or legal). In particular this means that a legal person may be considered to act as an insider, for instance by taking advantage of inside information for own profit.
- it is applicable in all the Member States, in order to establish a common standard throughout the European Union, contributing to fully integrated and efficient financial markets.

The content of the Articles is based on Articles 2, 3 and 4 of the existing Insider Dealing Directive, apart from the following:

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<sup>2</sup> OJ L 141, 11.06.93, p. 27 - 46

- the expression “*with full knowledge of the facts*” applied in the Insider Dealing Directive to the primary insiders is suppressed in Article 2 of the present Directive, as by nature these insiders may have access to inside information on a daily basis and are aware of the confidential nature of the information that they receive;

- “*transferable securities*” has been replaced by “*Financial Instruments*” in order to take into account the development of new products;

- the distinction between transactions effected through a “*professional intermediary*” or not has been deleted. This means that direct transactions between parties based on inside information would be covered by the Directive as soon as the financial instruments are admitted, or going to be admitted, to trading on a regulated market (see Article 9);

- the general exemption for sovereign States and other public bodies in Article 2 (4) of the Insider Dealing Directive is moved to Article 7;

-reference to “*markets*” is deleted. Article 9 deals with the scope of the Directive.

### **Article 5 – General prohibition of manipulative behaviour**

In the same way as for insider dealing, market manipulation as defined in Article 1 is prohibited. The prohibition applies both to natural and legal persons. Experience shows that, depending on the circumstances, both types of persons may manipulate the market, with similar negative effects on the financial market.

In order to establish a common standard throughout Europe, the general prohibition needs to be applied by all Member States.

To facilitate the understanding and the implementation of this prohibition, a non-exhaustive list of methods used for market manipulation is given in Section B of the Annex.

In order to take account of new methods of market abuse, the Commission should be able to amend or add to the indicative list using the Comitology procedure.

Member States may decide to introduce specific provisions to cover persons acting for journalistic purposes in the normal course of the exercise of their profession. By this the Directive separates clearly professional – journalistic – behaviour from personal behaviour for market abuse purposes.

### **Article 6 – Fair disclosure obligation and specific exemptions**

1. The rules laid down in Articles 2 to 4 forbid, on the one hand, to take advantage from a piece of inside information and, on the other hand, to disclose it to a third party. The general rule in Article 6 paragraph 1 provides for the disclosure of inside information to the public as soon as possible. This requirement should reduce the possibility to act on inside information.

2. This rule should ensure that whenever a selective disclosure of information to a third party is made in the normal course of business as described in Articles 2 and 3, that information is completely and effectively disclosed to the public. Public disclosure is to be carried out at the same time as the selective disclosure. If the selective disclosure is made unintentionally, public disclosure has to be carried out as soon as possible. Exemptions are proposed for



particular cases where persons receiving inside information are required to keep it confidential or are allowed to use it only for the specific purpose that it was disclosed to them. In order to promote compliance with the requirements of this Directive, a list of insiders must be established and updated by issuers and entities acting on their behalf.

3. In order to protect its legitimate interests and under certain conditions (not misleading omission for the public, ability to ensure the confidentiality of the inside information), an issuer may take the responsibility not to respect the disclosure requirement as laid down in paragraph 1. This could be the case for discussions on a potential take-over bid: if such discussions were disclosed before any agreement, they could result in erratic price movements making it difficult to determine the fair price of the take over bid.

4.– 5. There are specific clauses covering professionals (natural or legal persons) who are in charge of the production or dissemination of research or other information or who are professionally receiving orders which could reasonably constitute insider dealing or market manipulation. These clauses are necessary to involve market professionals in contributing to market integrity.

6. Specific implementing measures will be needed to provide greater clarity to economic actors on the provisions of paragraphs 1, 2 and 4. The Directive allows for such implementing measures to be adopted through comitology procedure (see Article 17).

### **Articles 7 and 8 – Transactions exempted from the prohibitions of insider dealing or market manipulation**

A first series of exemptions (Article 7) is established for Member States, the European System of Central Banks and national central banks conducting monetary, exchange-rate or public debt-management policies. The Article provides for Member States to extend this to their federated States.

A second series of exemptions (Article 8) is established, under limited conditions, for market participants. These exemptions are made for entities trading in their own shares in ‘buy back’ programmes or stabilising a financial instrument during an Initial or Secondary Public Offer, when trading is undertaken under agreed conditions. Trading in own shares and stabilisation however must be carried out transparently in order to avoid insider dealing or giving misleading signals to the markets. Trading in own shares could be used to strengthen the equity capital of issuers and so would be in investors’ interest. Stabilising securities for a limited period of time during an Initial or Secondary Public Offer is often necessary for perfectly valid economic reasons. Stabilisation can give confidence to investors and encourage small and medium sized companies to use capital markets.

The Directive proposes the Commission should be able to adopt the technical conditions of stabilisation and trading in own shares in accordance with the Comitology procedure.

### **Article 9 – Scope of means used**

The scope of the Directive is not strictly limited to regulated markets. The scope also includes:

- unregulated markets,
- trading platforms,

- devices for the continuous dissemination of price information,
- off-market transactions,
- or any other means or devices

as soon as they are used to manipulate a financial instrument admitted, or going to be admitted, to trading on a regulated market in at least one Member State, or as soon as they are used for insider dealing in such a financial instrument.

The scope of the Directive is not limited to secondary markets but will include primary market and 'grey market' activities as well. This is to ensure that primary or grey market participants are unable to take unfair advantage of any particular position or privileged information they might have.

### **Article 10 – Territoriality**

The proposed Directive would require Member States to apply its provisions at the very least to actions undertaken within their territory. They would however, be allowed to expand the application to actions where only elements of the prohibited behaviour are done within their territory (e.g. where actions contrary to this Directive are undertaken by remote members of a domestic exchange, or inside information being passed in third countries but influencing financial instruments on a domestic regulated market). Member States would also be allowed to apply the provisions of the Directive if the financial instrument concerned is admitted, or going to be admitted, to trading in a Member State.

### **Article 11 – National Competent Authority**

At the moment, Member States have different regulatory structures for dealing with Market Manipulation. Some Member States have a single supervisory authority whereas others have several authorities. In some Member States there is no public supervisory authority at all, with the only supervision carried out by the exchanges themselves. In others there is a combination of both.

The designation of a single competent authority in each Member State to ensure that the provisions of this Directive are applied, answers to a need for efficiency and clarity, and to enhance co-operation between competent authorities (see Article 16).

The administrative nature of these single competent authorities is necessary to ensure their independence from the markets and to avoid conflict of interest.

### **Articles 12 and 13 – Enforcement and professional secrecy within competent authority**

The Directive sets out a minimum list of requirements for powers to be given to competent authorities for the detection and investigation of market abuse. These requirements will allow competent authorities to fulfil their duties and will lead to greater consistency and clarity in the application of the provisions of the Directive. Member States will however be free to stipulate that, in line with their national laws, traditions or constitutions, some of these powers may only be used by the competent authority in collaboration with other authorities in that Member State, in particular judicial authorities.

Only particular professions may be authorised to oppose, partly or completely, professional secrecy to competent authorities, according to national legislation (e.g. lawyers or journalists).

Within competent authorities, strict professional secrecy is needed to ensure that Agreements on the exchange of information will work and that particular rights of persons will be respected.

## **Article 14 – Sanctions**

In principle, it is unacceptable in an integrated financial market for a wrongdoing to incur a heavy sanction in one country, a light one in another and no sanction in a third. However, the harmonisation of sanctions is outside the scope of this Directive. Nevertheless, it is both desirable and consistent with Community law that the Directive sets out a general obligation for Member States to impose and determine sanctions to be applied for infringement of measures taken pursuant to this Directive.

Beside criminal sanctions, administrative sanctions become mandatory in the proposal - due in part because the proceedings are faster than criminal ones. The speed of administrative sanctions is particularly important to prevent persons from continuing any wrongful conduct during the period of proceedings. Administrative sanctions are also justified by the fact that competent authorities must co-operate closely with each other so as to guarantee a similar application of rules on sanctions. However, the rules themselves remain within the competence of Member States.

The sanctions must be effective, proportionate and dissuasive. However, each Member State may decide for itself the sanctions to be applied for infringement of these measures, or for failure to co-operate in an investigation subject to Article 12 of this Directive.

When determining the sanctions and organising a sanctioning procedure, Member States will have to comply with the principles of the Convention For The Protection Of Human Rights And Fundamental Freedoms.

The disclosure of sanctions is a very powerful deterrent. Moreover, in case of misbehaviour, it would be useful for the market to be informed of the sanctions in order to guarantee a high level of investor protection. Therefore, sanctions may be disclosed to the public by Competent Authorities, unless this would create potential risks for financial markets themselves or a disproportionate damage to the parties involved (these safe harbours are necessary to avoid wrongful conduct of a natural person leading to mistrust the entity).

## **Article 15 – Right to apply to the courts**

This disposition guarantees the principle of legal certainty and the right to a fair trial as required by the European Convention on Human Rights. It should ensure that decision-makers act in conformity with Convention rights when exercising their powers. Any person subject to a decision will have the right to full judicial review.

## **Article 16 – Co-operation between Competent Authorities**

Given the increasing number of cross-border activities, the Directive provides for a comprehensive framework of co-operation, in particular on questions of investigation and the allocation of responsibilities.

To this end, a competent authority will have to supply in good time, information required by another competent authority for that purpose. However, competent authorities will be able to refuse the supply of information in cases where judicial proceedings have already started or final judgements have already been delivered in connection with the same actions being investigated, or in those particular cases where important and legitimate interests of Member States are concerned (sovereignty, security or public policy).

The reply must be sent in as short a time as possible, to ensure the effectiveness of the investigation measures and to deter development of cross-border schemes for misbehaviour. Whenever a competent authority becomes convinced that market abuse is being, or has been, carried out outside the territorial scope of its activities but affecting other Member States, it would be required to notify it to the competent authorities of those other Member States. This is to reduce the potential for loopholes.

Cross-border investigations seem to be a complementary tool for improving the effectiveness of inquiries. Such investigations will have to be carried out on the responsibility of the Member State on whose territory they are taking place.

The Directive allows the Commission to provide the details on the procedure of exchange of information and cross-border inspections by using the comitology procedure.

#### **Article 17– Securities Committee and procedure related to it**

This Article makes reference to the European Securities Committee instituted by Commission Decision (2001/.../EC) and sets out the regulatory procedure in accordance with the comitology decision of July 1999 (1999/468/EC)<sup>3</sup>. The proposal is needed to take account in the application of this Directive new developments, to develop implementing measures in order to ensure a level playing field for economic actors and to enhance co-operation between competent authorities.

#### **Article 18– Adoption of national provisions**

This Article sets out the deadline for the implementation of this Directive in the Member States.

#### **Article 19 – Repeal of Directive 89/592/EEC**

The Insider Dealing Directive is to be repealed at the same date as the implementation of this Directive will enter into force in the Member States. This simply reflects the fact that it will be replaced by this Directive.

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<sup>3</sup> OJ L 184, 17.07.99, p.23 - 26

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**on insider dealing and market manipulation (market abuse)**

**(Text with EEA relevance)**

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 95 thereof,

Having regard to the proposal from the Commission<sup>4</sup>,

Having regard to the opinion of the Economic and Social Committee<sup>5</sup>

Having regard to the opinion of the Committee of the Regions<sup>6</sup>,

Acting in accordance with the procedure laid down in Article 251.

Whereas:

- (1) A genuine Single Market for financial services is crucial for economic growth and job creation in the Community.
- (2) An integrated and efficient financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth. Market abuse harms the integrity of financial markets and public confidence in securities and derivatives.
- (3) The Communication of 11 May 1999 from the Commission “Implementing the framework for financial markets: action plan”<sup>7</sup> identifies a series of actions that are needed in order to complete the single market for financial services. Heads of State and Government, at the Lisbon Summit of April 2000, called for the implementation of that action plan by 2005. The action plan stresses the need to draw-up a Directive against market manipulation.
- (4) At its meeting on 17 July 2000, the Council set up the Committee of Wise Men on the Regulation of European Securities Markets. In its final report the Committee of Wise Men proposed the introduction of new legislative techniques based on a four level approach, namely framework principles, implementing measures, cooperation and

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<sup>4</sup> OJ C , , p. .

<sup>5</sup> OJ. C , , p.

<sup>6</sup> OJ C , , p. .

<sup>7</sup> COM/99/0232 final

enforcement. Level 1, the Directive, should confine itself to broad general “framework” principles while Level 2 should contain technical implementing measures to be adopted by the Commission with the assistance of a committee.

- (5) The Stockholm European Council Resolution endorsed the final report of the Committee of Wise Men and the proposed four level approach to make the regulatory process for Community securities legislation more efficient and transparent.
- (6) According to the Stockholm European Council Level 2 implementing measures should be used more frequently, to ensure that technical provisions can be kept up to date with market and supervisory developments and deadlines should be set for all stages of Level 2 work.
- (7) New financial and technical developments enhance the incentives, means and opportunities for market abuse: through new products, new technologies, increasing cross-border activities and the Internet;
- (8) The existing Community legal framework to protect market integrity is incomplete. Legal requirements vary between the jurisdictions of Member States, leaving economic actors often uncertain over concepts, definitions and enforcement. In some Member States there is no legislation addressing the issues of price manipulation and the dissemination of misleading information.
- (9) Market abuse consists of insider dealing and market manipulation. The objective of legislation against insider dealing is the same as legislation against market manipulation: to ensure the integrity of Community financial markets and to enhance investor confidence in those markets. It is therefore advisable to adopt combined rules to combat both insider dealing and market manipulation. A single Directive ensures throughout the Community the same framework for allocation of responsibilities, enforcement and co-operation.
- (10) Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing<sup>8</sup> was adopted more than a decade ago. Given the changes in financial markets and in Community legislation since its adoption, that Directive should now be replaced, to ensure consistency with legislation against market manipulation. A new Directive is also needed to avoid loopholes in Community legislation which could be used for wrongful conduct and which would undermine public confidence and therefore prejudice the smooth functioning of the markets.
- (11) Insider dealing and market manipulation prevent full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets.
- (12) Prompt and fair disclosure of information to the public enhances market integrity, whereas selective disclosure by issuers can lead to a loss of investor confidence in the integrity of financial markets. Professional economic actors must contribute to market integrity.

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<sup>8</sup> OJ L 334, 18.11.89, p. 30

- (13) Member States and the European System of Central Banks or national central banks should not be restricted in carrying out monetary, exchange-rate or public debt management policy.
- (14) Stabilisation or trading in own shares can be legitimate, in certain circumstances, for economic reasons and should not, therefore, in themselves be regarded as market abuse. Common standards should be developed to provide practical guidance.
- (15) The widening scope of financial markets, the rapid change and the range of new products and developments require a wide application of this Directive to financial instruments and techniques involved, in order to guarantee the integrity of Community financial markets.
- (16) Establishing a level playing field in Community financial markets requires wide geographical application of the provisions governed by this Directive.
- (17) A variety of competent authorities in Member States, having different responsibilities, creates unnecessary cost and confusion among economic actors. A single competent authority, of an administrative nature guaranteeing its autonomy from economic actors and avoiding conflicts of interest, should be designated in each Member State to deal with market abuse..
- (18) A common minimum set of strong tools and powers for the competent authorities will guarantee supervisory effectiveness.
- (19) In order to ensure that a Community framework against market abuse is sufficient, any infringement of the prohibitions or requirements laid down by this Directive will have to be promptly and effectively sanctioned.
- (20) Increasing cross-border activities require improved co-operation and a comprehensive set of provisions for the exchange of information between national competent authorities.
- (21) In accordance with the principle of proportionality as set out in Article 5 of the Treaty, the objectives of the proposed measures, namely to prevent market abuse in the form of insider dealing and market manipulation, cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and effects of the measures, be better achieved by the Community. This Directive confines itself to the minimum required in order to achieve those objectives and does not go beyond what is necessary for that purpose.
- (22) Technical guidance and modifications to the rules laid down in this Directive may from time to time be necessary to take account of new developments on financial markets; the Commission should accordingly be empowered to make such modifications as are necessary after consulting the European Securities Committee established by Commission Decision 2001/.../EC<sup>9</sup>.
- (23) Since the measures necessary for the implementation of this Directive are measures of general scope within the meaning of Article 2 of Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers

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<sup>9</sup> ...



conferred on the Commission<sup>10</sup>, they should be adopted by use of the regulatory procedure provided for in Article 5 of that Decision.

- (24) This Directive respects the fundamental rights and observes the principles recognised in particular by the Charter of Fundamental Rights of the European Union;

HAVE ADOPTED THIS DIRECTIVE:

### *Article 1*

For the purposes of this Directive:

- (1) 'Inside information' shall mean information which has not been made public of a precise nature relating to one or more issuers of financial instruments or to one or more financial instruments, which, if it were made public, would be likely to have a significant effect on the price of those financial instruments or on the price of related derivative financial instruments.
- (2) 'Market manipulation' shall mean :
- (a) Transactions or orders to trade, which give, or are likely to give, false or misleading signals as to the supply, demand or price of financial instruments, or which secure, by one or more persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level, or which employ fictitious devices or any other form of deception or contrivance.
- (b) Dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply, demand or price of financial instruments, including the dissemination of rumours and false or misleading news.
- (3) 'Financial instrument' shall mean instruments listed in Section A of the Annex.
- (4) 'Regulated market' shall mean a market as defined by Article 1 (13) of Directive 93/22/EEC<sup>11</sup>.
- (5) The definitions referred to in this Article and Section A of the Annex shall in order to take account of technical developments on financial markets and to ensure uniform application in the Community of this Directive be clarified and adapted by the Commission in accordance with the procedure referred to in Article 17 (2).

### *Article 2*

1. Member States shall prohibit any natural or legal person who possesses inside information from taking advantage of that information by acquiring or disposing of

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<sup>10</sup> OJC L 184, 17.7.1999, p. 23

<sup>11</sup> OJC L 141, 11.6.1993, p. 27

for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates.

The first subparagraph shall apply regardless of whether such person has obtained that information:

- (a) by virtue of his membership of the administrative, management or supervisory bodies of the issuer, or
  - (b) by virtue of his holding in the capital of the issuer, or
  - (c) by virtue of his having access to the information through the exercise of his employment, profession or duties.
2. Where the person referred to in paragraph 1 is a company or other type of legal person, the prohibition laid down in that paragraph shall also apply to the natural persons who take part in the decision to carry out the transaction for the account of the legal person concerned.
  3. The prohibition laid down in paragraph 1 shall apply to any acquisition or disposal of financial instruments.

#### *Article 3*

Member States shall prohibit any person subject to the prohibition laid down in Article 2 who possesses inside information from:

- (a) disclosing that inside information to any third party unless such disclosure is made in the normal course of the exercise of his employment, profession or duties;
- (b) recommending or procuring a third party, on the basis of that inside information, to acquire or dispose of financial instruments to which that information relates.

#### *Article 4*

Member States shall also impose the prohibitions provided for in Articles 2 and 3 on any person other than those persons referred to in those Articles who with full knowledge of the facts possesses inside information.

#### *Article 5*

Member States shall prohibit any natural or legal person from engaging in market manipulation.

A non-exhaustive list of typical methods used for market manipulation is laid down in Section B of the Annex. The Commission shall adopt, in accordance with the procedure referred to in Article 17 (2), amendments of the examples of these methods.

Member States may decide to introduce specific provisions to cover persons acting for journalistic purposes in the normal course of the exercise of their profession.

## *Article 6*

1. Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information.
2. Member States shall require that whenever an issuer, or a person acting on its behalf, discloses any inside information to any third party in the normal exercise of his employment, profession or duties, as referred to in Article 3 (a), it must make complete and effective public disclosure of that information, simultaneously in the case of an intentional disclosure, promptly in the case of a non-intentional disclosure.

The provisions of the first sub-paragraph shall not apply:

- (a) if the person receiving the information owes a duty of trust or confidence to the issuer, or expressly agrees to maintain the disclosed information in confidence ; or
- (b) if the primary business of the entity receiving the information is the issuance of mandatory credit ratings, provided the information is solely for the purpose of developing a credit rating which will be publicly available.

Member States shall require that issuers, or entities acting on their behalf, establish a regularly updated list of those persons working for them and having access to inside information.

3. An issuer may at its own risk delay the public disclosure of particular information such as not to prejudice his legitimate interests provided that such omission would not be likely to mislead the public and that the issuer is able to ensure the confidentiality of this information.
4. Member States shall require that natural and/or legal persons being responsible for the production or dissemination of research or other relevant information to distribution channels or to the public take reasonable care to ensure that information is fairly presented and disclose their interests or indicate conflicts of interest in the financial instruments to which that information relates.
5. Member States shall require that a natural person, or an entity, professionally arranging transactions in financial instruments shall refrain from entering into transactions, and reject orders on behalf of its clients, if it reasonably suspects that a transaction would be based on inside information or would constitute market manipulation.
6. The Commission shall adopt, in accordance with the procedure referred to in Article 17 (2), implementing measures on
  - the technical modalities of appropriate public disclosure of inside information as referred to in paragraphs 1 and 2,
  - the technical modalities of fair presentation of research and other relevant information and the disclosure of particular interests or conflicts of interest as referred to in paragraph 4.

#### *Article 7*

This Directive shall not apply to transactions carried out in pursuit of monetary, exchange-rate or public debt-management policy by a Member State, by the European System of Central Banks, a national central bank or any other officially designated body, or by any person acting on their behalf. Member States may extend this exemption to their federated States in respect of the management of their public debt.

#### *Article 8*

1. The prohibitions of this Directive shall not apply to trading in own shares in 'buy back' programmes nor to the stabilisation of a financial instrument provided such trading is carried out under agreed conditions.
2. The Commission shall determine these technical conditions in accordance with the procedure referred to in Article 17 (2).

#### *Article 9*

The provisions of this Directive shall apply to any financial instrument admitted, or going to be admitted, to trading on a regulated market in at least one Member State, irrespective of whether the transaction itself actually takes place on that market or not.

#### *Article 10*

Every Member State shall apply the prohibitions and requirements provided for in this Directive at least to actions undertaken within its territory whenever the financial instruments concerned are admitted, or going to be admitted, to trading in a Member State.

#### *Article 11*

Every Member State shall designate a single administrative authority competent to ensure that the provisions of this Directive are applied.

#### *Article 12*

The competent authority shall be given all supervisory and investigatory powers that are necessary for the exercise of its functions. It shall exercise such powers either directly or, where appropriate, in collaboration with other authorities, including judicial authorities.

These powers shall include at least the right to:

- a) have access to any document and to receive a copy of it;
- b) demand information from any person, and if needed, to require the testimony of a person ;
- c) carry out on-site inspections;

- d) require telephone and data traffic records;
- e) request the freezing and/or the sequestration of assets;
- f) request temporary prohibition of professional activity.

The first and second paragraphs shall be without prejudice to national legal provisions on professional secrecy.

#### *Article 13*

Member States shall provide that all persons who work or who have worked for the competent authority, as well as auditors and experts instructed by the competent authority, shall be bound by the obligation of professional secrecy. Information covered by professional secrecy may not be divulged to any person or authority except by virtue of provisions laid down by law.

#### *Article 14*

1. Member States shall ensure that the appropriate measures be taken, including of administrative and criminal sanctions in conformity with their national law, against the natural or legal persons responsible where the provisions of this Directive have not been complied with. Member States shall ensure that these measures are effective, proportionate and dissuasive.
2. Member States shall determine the sanctions to be applied for failure to co-operate in an investigation subject to Article 12.
3. Member States shall provide that the competent authority may disclose to the public every sanction that will be imposed for infringement of the measures taken pursuant to this Directive, unless the disclosure would jeopardise the financial markets or cause disproportionate damage to the parties involved.

#### *Article 15*

Member States shall ensure that the decisions taken by the competent authority may be subject to the right to apply to the courts.

#### *Article 16*

1. Competent authorities of Member States shall co-operate with each other whenever necessary for the purpose of carrying out their duties, making use of their powers, whether set out in this Directive or in national law. Competent authorities shall render assistance to competent authorities of other Member States. In particular, they shall exchange information and co-operate in investigation activities.
2. Competent authorities shall, on request, immediately supply any information required for the purpose referred to in paragraph 1. Where necessary, the competent authorities being requested shall immediately take the necessary measures in order to gather the required information. If the requested competent authority is not able to

supply the required information immediately it shall notify the requesting Competent Authority of the reasons. Information thus supplied shall be covered by the obligation of professional secrecy to which the persons employed or formerly employed by the competent authorities receiving the information are subject.

The competent authorities may refuse to act on a request for information where communication might adversely affect the sovereignty, security or public policy of the State addressed, or where judicial proceedings have already been initiated in respect of the same actions and against the same persons before the authorities of the State addressed or where final judgement has already been passed on such persons for the same actions by the competent authorities of the State addressed.

Without prejudice to the obligations to which they are subject in judicial proceedings under criminal law, the authorities which receive information pursuant to paragraph 1 may use it only for the exercise of their functions within the scope of this Directive and in the context of administrative or judicial proceedings specifically related to the exercise of those functions. However, where the competent authority communicating information consents thereto, the authority receiving the information may use it for other purposes or forward it to other States' competent authorities.

3. Where a competent authority is convinced that activities contrary to the provisions of this Directive are being or have been carried out on the territory of another Member State, it shall notify this in as specific a manner as possible to the competent authority of the other Member State. The competent authority of the other Member State shall take appropriate action. It shall inform the notifying competent authority of the outcome and, to the extent possible, of significant interim developments.
4. A competent authority of one Member State may request that an investigation be carried out by the competent authority of another Member State, on the latter's territory.

It may further request that some of its own personnel be allowed to accompany the personnel of the competent authority of that other Member State during the course of the investigation.

The investigation shall, however, throughout be subject to the overall control of the Member State on whose territory it is conducted.

The competent authorities may refuse to act on a request for carrying out an investigation as provided for in the first subparagraph of this paragraph, or on a request for its personnel to be accompanied by another Member State competent authority personnel as provided for in the second subparagraph of this paragraph, where such an investigation might adversely affect the sovereignty, security or public policy of the State addressed, or where judicial proceedings have already been initiated in respect of the same actions and against the same persons before the authorities of the State addressed or where final judgement has already been passed on such persons for the same actions by the competent authorities of the State addressed.

5. The Commission shall adopt, in accordance with the procedure referred to in Article 17 (2), implementing measures on the procedures of exchange of information and cross-border inspections as referred to in this Article.

### *Article 17*

1. The Commission shall be assisted by the European Securities Committee instituted by Commission Decision (2001/.../EC)\*.
2. Where reference is made to this paragraph, the regulatory procedure laid down in Article 5 of Decision 1999/468/EC shall apply in compliance with Article 7 and Article 8 thereof.
3. The period provided for in Article 5 (6) of Decision 1999/468/EC shall be three months.

### *Article 18*

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive the [year, month, day: not later than one year after the entry into force of this Directive]. They shall forthwith inform the Commission thereof.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

### *Article 19*

Directive 89/592/EEC is repealed with effect from the date shown in Article 20.

### *Article 20*

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Communities*.

### *Article 21*

This Directive is addressed to the Member States.

Done at Brussels,

*For the Parliament*

*For the Council*

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\* Commission Decision establishing the European Securities Committee, not yet adopted.

## **ANNEX**

### **SECTION A**

#### **Financial Instruments**

'Financial Instrument' shall mean :

- Transferable securities as defined in Directive 93/22/EEC
- Units in collective investment undertakings
- Money-market instruments
- Financial-futures contracts, including equivalent cash-settled instruments
- Forward interest-rate agreements
- Interest-rate, currency and equity swaps
- Options to acquire or dispose of any instrument falling in these categories, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates
- Derivatives on commodities.

### **SECTION B**

**The following illustrative examples of methods being used for market manipulation are not exhaustive, but shall serve the interpretation of the general definition provided by Article 1 (2):**

- Trade-based actions intended to create a false impression of activity:
  - - Transactions in which there is no genuine change in actual ownership of the financial instruments (“Wash sales”);
  - - Transactions where both buy and sell orders are entered at the same time, with the same price and quantity by different, but colluding parties (“improper Matched orders”);
  - - Engaging in a series of transactions that are reported on a public display facility to give the impression of activity or price movement in a financial instrument ( “Painting the tape”);
  - Engaging in an activity designed by a person or persons acting in collaboration to push the price of a financial instrument to an artificially high level (pumping the financial instruments on the market) and then to sell its or their own financial instruments massively (“Pumping and dumping”);
  - Increasing the bid for a financial instrument to increase its price (creating the impression of strength or the illusion that stock activity was causing the increase). “Advancing the bid”);
- Trade-based actions intended to create a shortage:



- Securing such a control of the bid or demand-side of the derivative and/or the underlying asset that the manipulator has a dominant position which can be exploited to manipulate the price of the derivative and/or the underlying asset (“Cornering”);
  - Like “cornering” taking advantage of a shortage in an asset by controlling the demand-side and exploiting market congestion during such shortages in such a way as to create artificial prices. Having significant influence over supply or delivery, having the right to require delivery and using that to dictate arbitrary and abnormal prices (“Abusive squeezes”);
  - Time-specific trade-based actions:
    - Buying or selling financial instruments at the close of the market in an effort to alter the closing price of the financial instrument and therefore misleading those acting on the basis of closing prices (“Marking the close”);
    - Trading specifically to interfere with the spot or settlement price of derivative contracts;
    - Trading to influence the particular spot price for a financial instrument that had been agreed as determining the value of a transaction;
  - Information-related actions:
    - Purchasing a financial instrument for one’s own account before recommending it to others and then selling it at a profit on the rise in the price following the recommendation (“Scalping”)
    - Spreading false rumours to induce buying or selling by others;
    - Making untrue statements of material facts;
- Non-disclosure of material facts or material interests.

## **IMPACT ON BUSINESS WITH SPECIAL REFERENCE TO SMALL AND MEDIUM-SIZED ENTERPRISES( SMEs)**

### **TITLE OF PROPOSAL**

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

### **DOCUMENT REFERENCE NUMBER**

### **THE PROPOSAL**

1. Taking account of the principle of subsidiarity, why is Community legislation necessary in this area and what are its main aims?
- In accordance with the principles of subsidiarity and proportionality as set out in Article 5 of the Treaty, the objectives of the proposed measures, namely to prevent market abuse in the form of insider dealing and market manipulation, cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and effects of the measures, be better achieved by the Community. This Directive confines itself to the minimum required in order to achieve those objectives and does not go beyond what is necessary for that purpose.

### **THE IMPACT ON BUSINESS**

2. Who will be affected by the proposal?
  - Which sectors of business? All financial market participants working in relation with financial instruments traded on regulated markets.
  - Which sizes of business (What is the concentration of small and medium-sized firms)? All market participants, of whatever size they are, are affected by the proposal. The concentration of small and medium-sized firms varies according to the Member States.
  - Are there particular geographical areas of the Community where these businesses are found? No.
3. What will business have to do to comply with the proposal (does it mean : with financial consequences?) ?
  - Fulfilment of deontological standards. - (For persons or entities arranging transactions in Financial Instruments) Refraining from entering into transactions, and reject orders on behalf of their clients, if they can reasonably expect that the transactions would be based on inside information or constitute market manipulation. Such refraining may have negative consequences on short term brokerage revenues; but in the mid term, general investor confidence thus created will benefit to the industry.

- Delivery of copies of documents, if asked by the competent authority.
  - Telephone and data traffic recording.
4. What economic effects is the proposal likely to have?
- On employment? The smooth functioning of financial markets and public confidence in them are prerequisites for sustained economic growth and health, with positive effects on employment.
  - On investment and the creation of new businesses? By lowering costs for raising capital, efficient financial markets have a positive effect on company investments in general. Moreover, the development of new types of participants (like “e-brokers”) or means of trading (like electronic platforms), which create employment, relies on investor confidence depending on the transparency of the markets.
  - On the competitiveness of businesses? Prohibition and enforcement against insider trading reinforce the level playing field between market participants in access to issuer information, and so increase the fair competitiveness between these participants. Similarly, prohibition and enforcement against market manipulation reinforce the level playing field between market participants through transparency in market participant behaviours, thus contributing to the fair competitiveness between the participants.
5. Does the proposal contain measures to take account of the specific situation of small and medium-sized firms (reduced or different requirements etc)? No.

#### CONSULTATION

6. List the organisations which have been consulted about the proposal and outline their main views :

The Forum of European Securities Commissions (FESCO), composed by national Securities Supervisors, contributed to the work of the Commission during the elaboration of the draft Directive.