

FSMA Market Abuse Regime: a review of the sunset clauses

Submission from the Association of Investment Companies

The Association of Investment Companies (AIC) welcomes the opportunity to comment on whether or not the existing 'super-equivalent' market abuse provisions included in the FSMA should be retained.

The AIC represents some 340 investment companies. The vast majority of these are listed, although some are AIM-traded. These companies invest in a range of shares, securities and other assets to provide a return for their shareholders. They are bound by the market abuse regime as issuers and investors. They have a strong interest in the maintenance of a fair market place which attracts liquidity and investor confidence. Effective market abuse provisions can help support these highly desirable market characteristics.

Response to consultation questions

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

Yes. The AIC believes that the UK's super-equivalent market abuse rules (covering: the nature of relevant information; types of abusive behaviour; the application of the rules to non-insiders; widening the instruments covered; and, applying them to a broader range of markets) are all useful. They focus on areas outside the scope of the MAD where there is potential for abusive behaviour to damage wider investor interests and confidence in the market.

Of course, having rules which address can capture potentially abusive activity is only one necessary condition for an effective market abuse regime. It is also important that effective monitoring, investigation and enforcement processes are put in place to achieve this outcome. However, the UK rules provide a good baseline to achieve a high-quality market place.

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

All aspects of the UK's super-equivalent rules are important. Their action – particularly in combination – provides value over and above any single rule in isolation. However, it could be argued that the most significant element of the super-equivalent rules is their application of market abuse requirements to individuals who are not 'insiders'.

One of the most significant obstacles to enforcement of the MAD rules is demonstrating that information arose from an 'inside' source. Extending the UK's regime to non-insiders increases the potential for effective enforcement in comparison with the European provisions. While the AIC would not welcome the relaxation of any of the super-equivalent provisions, this aspect arguably provides the most value.

Q3: Do you have any further evidence on the practical operation of the super equivalences since the introduction of MAD?

The AIC is not involved on a day-to-day basis in the market and so cannot comment directly on the efficacy of specific market abuse provisions in relation to its own activities. However, we are keenly aware of our members' concerns. Feedback from investment company boards indicates that where investors can follow existing rules and gain commercial advantage (but where their activity might be at the expense of other market participants) then they will do so.

A good example of this approach is the use and non-disclosure of CFDs. Under the current rules there are no obligations to disclose these interests and the use of CFDs without disclosing them is not of itself market abuse. However, the AIC believes that non-disclosure does undermine market quality so rules should be introduced to secure disclosure. If taken up, transparency for CFDs will be super-equivalent to the Transparency Directive but will help manage behaviour which can damage market quality and wider investor interests.

The case for CFD disclosure is analogous to that for a super-equivalent market abuse regime. The UK's provisions provide additional market quality. If they were to be relaxed some market participants would follow the letter of the rules (to secure their own commercial goals) but in some cases this would result in poorer outcomes for the rest of the market.

This likelihood that a lacuna in the rules will be abused at the expense of higher quality markets is fundamental to the AIC's support for the current rules. This perspective is particularly compelling in this case as the costs of compliance are low and the benefits are potentially significant.

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

Yes. The AIC would support extending the sunset clauses at least until the results of the EU review are known.

Depending upon the outcome of the EU review, there may be a case for altering UK provisions depending upon the outcome of that review. However, the AIC is strongly predisposed to the presumption that the UK's super-equivalent provisions should be maintained permanently (even if no changes to the EU regime are made).

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

The current provisions should be extended at least until 2010 to allow the outcome of the EU review to be assessed. This should allow sufficient time for this assessment to be made.

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

Our initial view is that the UK should be seeking to extend the EU rules to match those required under the UK's super-equivalent provisions.

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

The AIC has no views on this matter at this time.

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

The AIC believes that the costs of the market abuse regime are small in comparison with their potential to provide substantial ongoing benefits.

The CBA should fully recognise the benefits the market abuse rules can provide in relation to maintaining market integrity and stability (and their knock on effects in relation to enhanced liquidity, lower cost of capital etc). The market abuse rules support these outcomes, which will have benefits across the market. We recognise that qualifying these benefits in monetary terms is difficult, but are keen that they should be fully recognised when considering this matter.

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

The AIC has no further recommendations.

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

The AIC supports maintenance of the current super-equivalent rules. Its inclination is that these should be made permanent, but we also recognise the value in awaiting the outcome of the EU review before a final view is taken on this matter. The AIC therefore supports the proposed policy approach of extending the current super-equivalent regime until the outcome of the EU review can be assessed.

April 2008

To discuss the issues raised by this response please contact:

Guy Rainbird: Public Affairs Director, Association of Investment Companies.
020 7282 5553. guy.rainbird@theaic.co.uk