Ministerstvo financí České republiky
Ministry of Finance of the Czech Republic

Prague, 10th June 2009

Dear colleagues,

we are thankful for having the opportunity to comment on the Call for evidence on the review of Directive 2003/6/EC on insider trading and market manipulation (Market Abuse Directive) and its implementing measures. Please find bellow both our general and specific comments regarding the proposals included in the review paper. These comments are only an indication of the possible approach by the Ministry of Finance of the Czech Republic and they are not meant as our final official policy position.

THE SCOPE OF MAD

Only regulated markets?

Do you consider that the scope of the MAD should go beyond regulated markets? In particular, should it be extended to cover MTFs?

We support the preliminary assessment outlined in the document to widen the scope of the MAD to cover MTFs too. Furthermore, we would propose to analyze widening of application of the MAD also to systematic internalizers acting in their capacity. We agree that covering only some of the trading/execution venues would not be systematic and might not provide full protection against various forms of market manipulation to the whole financial market. But, we are also convinced that possible changes or waivers should be considered depending on business model and role of MTFs and other platforms.

What kind of financial instruments should be covered by the MAD, especially in comparison with MiFID?

Do you agree with an alignment of the MAD definition of financial instrument to the definition for the same concept provided for in MiFID? Do you think it could be useful to explain in more detail in the MAD what is meant by a financial instrument "whose value depends on another financial instrument" or to list asset classes, such as CFDs and CDS, which belong to this category?

We support the idea of aligning both the MAD and the MiFID definitions of "financial instrument", preferably by taking the concept provided for in MiFID.
We do not think it is necessary to explain in the MAD in more detail what a financial instrument "whose value depends on another financial instrument" means, or to list in the MAD asset classes, which belong to this category. New types of derivatives come to existence unceasingly and, thus, any specific definition could not be sufficiently wide. On the other hand, it could be useful to include some examples of derivatives in a Recital.

The specific case of commodity derivatives markets

Do you see a need for introduction of market abuse framework for physical markets?

We agree that it is desirable to introduce a market abuse framework for some commodity markets. However, we think that any commodities covered should be explicitly listed in the Directive in order to avoid any doubt what is covered by its scope.
Anyway, such an amendment represents a major shift in the current legislation and requires a further cost-benefit analysis.

INSIDE INFORMATION

Definition of inside information: the general definition and the particular definition for commodity derivatives

Do you share this view (i.e. no need to change insider information definition) as far as insider-dealing prohibition is concerned? If not, which concepts would you modify and how?

We agree that there is no need to amend substantially the definition of inside information at this time in terms of clarifying concepts. Coherent interpretation of terminology should be left to competent authorities or CESR and civil courts.
We would only suggest considering to remove some redundant concepts and to simplify the definition (Art. 1 (1) of the MAD).
First, we have doubts regarding the criterion of "*a precise nature".* We think that it is vague and redundant. Inside information can be defined only by a criterion of *a presumable (or a probable) significant effect on the price*. It is obvious that only information of a sufficiently *precise* nature (or in better words, *specific* or *concrete* information) is likely to have a significant effect on the prices of financial instruments.
Second, the words "*relating, directly and indirectly, to one or more issuers…"* should be reconsidered too. The real difference between these two categories is whether the information arises from the issuer's undertaking or not. For instance, some items in CESR's 2nd Set Of Guidance correctly labeled as "Information, which indirectly concerns the issuer" may be still regarded as directly *related* to the issuer, such as statistics by public institutions demonstrating an improvement in issuer's market position.
Third, the criterion of materiality "*significant effect on the price"* defines the quality of inside information and, thus, allows an objective assessment of its

materiality. An additional clarification within the Community or national law (see Art. 1 (2) of the Directive 2003/124/EC) is not necessary. We believe the interpretation should be left to courts and law experts.
Fourth, a specific definition of inside information "*for persons charged with the execution of orders*" is not needed. It just repeats the general definition for this particular type of information. Moreover, it implies that orders represent inside information only for persons charged with their execution, while other insiders may misuse it as well. We suggest dropping this provision.

Do you support an alignment of the inside information definition for commodity derivatives with the general definition of the directive?

We support the consolidation of definitions. We are convinced that there is no reason for commodity derivatives to be treated differently from the rest of financial instruments. Therefore, the general definition of inside information should apply also to them.

Dissemination of inside information and deferred disclosure mechanism

Do you consider that any changes to the definition of inside information for disclosure purposes is necessary?

We consider the definition of inside information for disclosure purposes to be proportionate at this moment. We do not think there is any need to change the definition.

Do you agree that the described deficiencies of the deferred disclosure mechanism need to be addressed, possibly by way of amendments to the MAD framework? Do you consider that Level 3 guidance could be sufficient?

Do you agree that the issuer may be exempted from disclosing inside information in situations when that information concerns emergency measures being prepared in case the issuer's financial stability is endangered?

What are other deficiencies in this area that raise major interpretation / application difficulties? What is the best way to address them?

The aim of the MAD is to protect shareholders and the market against manipulation with prices of financial instruments. Suggested exemption from disclosure requirement does not address the protection of the market, but that of an issuer of financial instruments. We understand that there might be a need to protect some financial institutions – especially banks – from adverse effects, such as "bank runs". But, to tackle such an issue by means of amending the MAD is inappropriate. Informed investors have the possibility to make their opinion on viability of business and this capacity should not be lifted away from them by widening the legality of deferring important information.

Disclosure duty in commodity derivatives markets

Do you agree with this approach? Can you identify cases where a modification or deletion of the obligation may be undesirable?

We support the idea of making certain participants of commodity markets subject to the obligation to disclose inside information. In fact, we find reasonable that any market participant who possesses inside information should inform the public as soon as possible of inside information which directly concerns the said commodity (or ask for delaying the disclosure of it), and therefore fall under the scope of MAD.

Prohibition of insider dealing

Would you support this approach?

We support the first mentioned approach, i.e. to forbid any trading with a financial instrument after an inside information has been acquired. Some exceptions, like those mentioned in the paper, would guarantee proper application of this ban. These exemptions include the case when decision to trade was taken before acquiring the inside information and the case of carrying out a duty from a contract concluded before the inside information had been acquired.
As to the second approach ("on the basis of inside information"), we consider it to be inadequate and outdated; since it is highly difficult for competent authorities to prove the use of inside information (i.e. the course of thoughts). This makes the provision very difficult to apply in practice.

Insider lists

Do you agree that the obligations to draw up lists of insiders are proportionate?

We have not identified any problems with the obligation to draw up the lists of insiders. We believe that such list represents a useful regulatory tool for competent authority . Once the authority has any suspicion of insider dealing, it can ask for the list of insiders. If the list as such does not prove the possession of inside information, it has a significant role for the first phase of investigation.
Therefore, we think this obligation to be proportionate, provided that it is interpreted in a way that for each inside information a specific (ad hoc) insider list shall be drawn up.

Transaction reporting by managers and closely associated persons and subsequent disclosure

Do you see a need for a regulatory action in the above areas? Would you suggest further improvements?

We do not think that the threshold of 5,000 EUR should be raised. We would welcome more precise guidance regarding the calculation of the EUR 5,000 limit. It is not clear whether it covers only the last transaction that exceeds the above stated limit be notified or all transactions?

We welcome the clarification of the issue concerning obligation to notify the transaction executed in favour of the manager by the investment firm (portfolio manager) operating under a discretionary management contract without client interference. It seems that many Member States require notification also in case of portfolio management, whilst many do not, arguing that client does not initiate transactions or neither gives orders. It would be very useful to clarify the purpose of this provision.

Reporting of suspicious transactions

Do you agree that the rules on suspicious transactions do not require modification?

We would welcome further improvement. We are also convinced that the reporting requirement could be enhanced by making it approximate to a whistle blowing measure.

The competent authorities' right of access to telephone and existing data traffic records

Do you consider that an amendment of the MAD is necessary?

An amendment of the MAD is not necessary, as the MAD represents *lex specialis* to the e-Privacy Directive. However, we welcome the effort to remove any uncertainty in the interpretation of application of the MAD, and therefore we would generally support such an amendment.

MARKET MANIPULATION

Definition of market manipulation by transactions/orders to trade

Do you think that the definition of market manipulation should be amended? If this is the case, what elements should be reconsidered?

We consider the current definition of market manipulation to be appropriate. It is sufficiently broad to prevent (and cover) all the forms of market manipulation, even those that could develop in future.

What we would suggest in addition is to introduce a non-exhaustive list of the most frequent market manipulation practices (such as wash sales, painting the tape, improper matched orders, advancing the bid, cornering, abusive squeeze, scalping, spreading of rumours, marking the close, pump and dump or trash and cash) and to include it in the MAD. This would help day-to-day application of MAD.

Accepted market practices

Do you consider that the rules on accepted market practices should be amended in the MAD? Do you think there is room for greater convergence among competent authorities in this area?

We definitely think that there is a room for improvement of the concept of accepted market practices. Currently, the market practices that benefit from the exemption provided for in Article 1(2)(a) and 8 of the MAD are covered by both regulation (Regulation 2273/2003) and the directive laying down the process for the acceptance of a particular market practice.
We consider this status quo complex and we think that it still leads to different interpretations of what is accepted and what is not throughout the Community. In the end, all accepted market practices should be interpreted in the same way in all Member States. Only directly applicable Regulation can assure such a result.
We would suggest the process to be in place as follows: The competent authorities would find a consensus in the Committee of European Securities Regulators on which practices should be accepted on the financial market in the EU. With regard to their decisions about such acceptance, Commission would release a Regulation covering those agreed accepted market practice. The abolishment of the existing discrepancies between market practices in Member States and improvement of the legal certainty of issuers and traders will lead to further convergence.

Definition of offer of securities to the public

Do you consider that the safe harbours for buy-back programs and stabilization activities should be revisited? Do you think that greater convergence is desirable in the application of the Regulation 2273/2003? What would be the most appropriate way forward in this respect?

We think that *de lege ferenda* the Regulation should cover also accepted market practices other than buy-back programs and stabilization activities. There is no reason for drawing distinction line between these two concepts and therefore they should be formally unified. (See our previous comment.)

As for current wording of the Regulation we have not encountered cases of justified buy-back programs that would not be covered by the Regulation. We had, however, difficulties applying several terms used in the Regulation such as "the trading venues where the purchase is carried out" or „independent trade" when shares are being bought back through an investment firm.

Short selling

Do you see a need for a comprehensive framework for short selling? If so, should it be addressed in the Market Abuse Directive? What issues should such a regime cover?

Should short sellers be required to report positions to competent authorities? Under which conditions should naked short selling be allowed? Should competent authorities be able to take emergency measures (e.g. temporary bans on short selling or on naked short selling) within prescribed limits when they need to address specific market risks and disruptions?

Is there a need to enhance risk management by financial intermediaries and banks? Should investment firms and banks be required to have necessary

arrangements in place to ensure timely delivery of financial instruments traded on own account or in the context of execution of clients' orders?

We are reluctant as to the further regulation of short-selling and/or naked short selling. These practices largely contribute to efficiency of markets, and as such are also widely used by market makers, where short selling represents a legitimate trading technique. We suggest maintaining current approach – either the specific short-selling transaction conforms to definition of market manipulation, thus it is illegal, or it does not, hence it is legal.
Any precipitous requirement to disclose trading could impede a smooth functioning of the market and lead to larger use of substitutive techniques, such as derivatives, which fulfill more or less the same role.
In terms of supervision, the competent authorities already have powers to gather information in order to assess the volumes of short selling, like stock lending data (for short-selling) or data about settlement failures (for naked short-selling).
If any, the power to prohibit a (naked) short selling should be fully left on the market operator. The market operator is already today empowered to set out rules for or bans of short selling on its market. If the competent authority has concerns about falling prices of financial instrument, it also has the power to require suspension of trading in this financial instrument.
On the other hand, we think that there is a room to enhance risk management by financial intermediaries by way of having additional necessary arrangement in place. Such a proposal, however, is outside the scope of this review and should be treated in a different consultative manner.

Once more we would like to thank you for an opportunity to express our opinions and to comment on the document.