EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (MARKET ABUSE) REGULATIONS 2008

2008 No. 1439

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Description

These Regulations extend the sunset clauses in the Financial Services and Markets Act 2000 ("FSMA"), which would otherwise cease on 30 June 2008 so that subsections (4) and (8) of section 118 of the Act and related ancillary provisions will remain in force until 31 December 2009.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Background

These Regulations amend sections 118 and 118A of FSMA which were substituted, together with sections 118B and 118C, for the original section 118 by the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005, as from 1 July 2005. Such Regulations implemented, in part, Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation ("the Market Abuse Directive").

Subsections 118(4), 118(8), 118A(2) and 118A(3) of FSMA retain definitions of market abuse which are broader than those in Articles 1 to 5 of the Market Abuse Directive and were already in the original section 118. Section 118(9) provides that the provisions in section 118 will cease to have effect on 30 June 2008; section 118A(6) does the same for the related provisions in section 118A.

Regulations 3(2) and 3(3) amend sections 118(9) and 118A(6) of FSMA; they change the date on which the provisions affected by those sections will cease to have effect. The result of these amendments is that subsections (4) and (8) of section 118 of FSMA and related ancillary provisions will remain in force until 31 December 2009.

5. Territorial Extent and Application

The Regulations apply to all of the United Kingdom.

6. European Convention on Human Rights

The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

The Financial Services and Markets Act 2000 (Market Abuse) Regulations 2008 amend the Financial Services and Markets Act 2000. In my view, the provisions of this instrument are compatible with the Convention rights.

7. Policy background

The United Kingdom currently has a wider definition of market abuse than that established in the EU's 2003 Market Abuse Directive. When the Treasury transposed the Directive, the main challenge was to decide how much change was appropriate to the civil market abuse regime that had been put in place as part of FSMA in 2000. The FSMA regime and the Market Abuse Directive cover similar ground but adopt a slightly different approach to prohibiting abusive behaviour. The original FSMA regime defined market abuse in fairly broad terms and then qualified it by the requirement that behaviour is only abusive if it is likely to be regarded as such by a 'regular user' of the market. The Directive set out more specific descriptions of the type of behaviour that is to be prohibited.

On balance, it was decided to retain the scope of the existing market abuse prohibitions to the extent that these go beyond the prohibitions in the Directive (the new sections 118(4) and 118(8) of FSMA) but to make them subject to a sunset clause whereby the provisions would expire after a period of three years pending the outcome of a review by HM Treasury to assess whether they remain justified.

The Treasury held a three-month consultation between February and May 2008 to review whether the superequivalences remain justified and to seek views on whether the sunset clauses should be retained in the United Kingdom's civil market abuse regime. The consultation also noted that the EU is currently reviewing the Market Abuse Directive, which could result in revisions to it. In light of these factors it was proposed that we extend the sunset clauses for a short period until the outcome of the EU review is known to avoid two sets of changes in short order and to allow wider consideration of the benefits of the superequivalences.
16 responses were received to the consultation and the majority supported a short extension to the sunset clauses until the outcome of the EU review is known. Following feedback from respondents it was therefore decided to extend the sunset clauses until 31 December 2009. Details of the comments and the Treasury's response are summarised in the feedback statement on the consultation on HM Treasury's website (www.hm-treasury.gov.uk).

8. Impact

An Impact Assessment is attached to this memorandum.

9. Contact

Sarah Parkinson at HM Treasury: Tel: 020 7270 5912 or email: sarah.parkinson@hm-treasury.x.gsi.gov.uk can answer any queries regarding the Regulations.

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1.1 This feedback statement summarises responses received to our February 2008 consultation on the FSMA market abuse regime: a review of the sunset clauses. Since launching our consultation, market abuse and the ways in which it can be tackled has been the subject of increased debate. Maintaining investor confidence and the integrity of financial markets remain at the top of the UK's agenda.

1.2 Having an effective set of tools to tackle market abuse is crucial. This is a shared objective at the EU level and we are therefore keen that the EU review of the Market Abuse Directive should ultimately deliver an outcome that we consider fully satisfactory for combating market abuse. Pending this work we have decided to retain the areas in which we are superequivalent to the EU's Market Abuse Directive until December 2009 to enable a wider consideration of their benefits for addressing identified issues with the EU regime and to minimise transition costs for industry.

1.3 We would like to thank all respondents for their very detailed and helpful responses, and we will take them into account when preparing for the EU review. Domestic retention of the superequivalent provisions until 2009 does not imply that we will be arguing for the retention of all the provisions in the wider EU debate. The arguments for retaining some of the provisions are finely balanced, and we will reflect further on the detailed points submitted. We remain committed to ensuring firms are only subject to justified superequivalences.

1.4 There are very real challenges in prosecuting insider dealing and other market misconduct offences. We continue to pursue a range of work to improve the FSA's ability to tackle market abuse, including looking at ways to strengthen the FSA's formal powers. This is outside the scope of this paper, but we have noted the comments received on these broader questions and will continue to liaise with industry on these matters.

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SUMMARY OF RESPONSES

2.1 The aim of the February 2008 consultation paper was to seek views on the appropriate scope for the UK's civil market abuse regime. The UK currently has a wider definition of market abuse than that established in the EU's 2003 Market Abuse Directive (MAD or the Directive). The UK definition retained the then existing (and wider) scope of the UK market abuse regime that had been introduced in 2001. There were mixed views as to the merits of a 'superequivalent' regime and so HM Treasury committed to review the scope of the regime by May 2008 to assess whether the superequivalences remain justified. The consultation paper considered whether the wider scope remained desirable. HM Treasury received 16 responses to the consultation paper from a range of trade associations, law firms, exchanges and banks. This section summarises the responses received.

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

2.2 Eight responses considered that the superequivalences increased the effectiveness of our market abuse regime and have a positive effect on market integrity. They were felt to be important to the reputation of UK markets and in turn contribute to the success of London.

2.3 Respondents felt that the superequivalences increased the potential for effective enforcement, and the threat of enforcement in the UK markets in comparison with the European provisions. Furthermore, it was felt to be a matter of investor protection that these provisions are kept as a more robust market abuse regime helps to mitigate market volatility.

2.4 In contrast, several respondents agreed with the research quoted in the consultation that it is the enforcement of the market abuse regime that matters rather than the existence of the market abuse regime per se and that to date the superequivalences could not therefore be shown to have had an effect.

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

2.5 RINGA and the wider definition of insiders were cited as the most important superequivalences, although many respondents felt that all of the superequivalences were important. Various respondents pointed to the ESME work identifying problems with a common definition of inside information and noted that the current UK regime avoids this difficulty.

2.6 Respondents also cited the wider definitions of 'behaviour' and scope of instruments, in particular the questions about coverage of the CDS market, as beneficial. It was stated that the superequivalent 'catch all' covering instruments under FSMA keeps the legislation fresh with an ever-evolving market.

2.7 Some respondents however reiterated their view that all of the superequivalences should be left to expire this year as they felt that they neither increase the effectiveness of the UK market abuse regime nor have any significant effect on market integrity. However, amidst this sentiment, some respondents pointed out that the UK could bring new legislation or regulations to cover specific 'gaps'.

Q3 – Do you have any further evidence on the practical operation of the superequivalences since the introduction of MAD?

2.8 Most respondents did not have any further publishable evidence on the practical operation of the superequivalences. However, several argued that the superequivalences act as a deterrent, dissuading market participants from perpetrating market abuse. Respondents argued that the absence of practical examples therefore does not in itself constitute a proof that the rules are not important.

2.9 Some respondents have said that they have some reservations as to the demonstrable benefit of the practical examples of the superequivalences we gave in our consultation document; for example querying whether inaction would normally be a breach of other regulatory rules and so enforceable via other means and questioning how frequently the other examples would actually occur. Specific questions were also raised about the clarity of certain explanations. As regards the example given in paragraph 2.19 of the consultation; the example envisaged in the paper was one in which the analyst inappropriately obtained inside information and so differs to the existing FSA material on this matter.

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

2.10 Most respondents agreed with our proposal as firms did not want to be subject to two sets of changes in short succession. Additionally some respondents were keen to avoid introducing into the UK regime the problems associated with a common definition of inside information that ESME has highlighted. A few respondents went further to say that they supported the regime being extended indefinitely.

2.11 Three respondents argued that we should let the superequivalences expire in June 2008. They felt that the concern that there may be changes to be made to UK law in two years time is not sufficient for their members to favour extending the sunset provisions. One of these respondents thought it key there should be a common pan-European market abuse regime and national divergence should not be encouraged other than in cases of the clear need, and stated that no such need has been found. This is echoed by another of the respondents who is of the opinion that the superequivalences do not present sufficient benefits to outweigh the disadvantages.

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

2.12 There was support for an extension until 2010 to allow for the outcome of the EU review to be assessed. One respondent thought there was merit in including a provision that leads to an automatic review of the clauses on the completion of the EU review, if it is sooner than 2010. Others noted concerns that the EU review could get delayed.

2.13 We acknowledge that the timing of the EU review is very difficult to predict with accuracy, but we are keen not to extend the superequivalences for longer than necessary. We are required to insert a specific date into the legislation – we could not simply extend the sunset clauses "until the outcome of the EU review became known". Therefore we propose extending the sunset clauses until 31 December 2009. This is a slight shortening to the proposal in the consultation paper.

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

2.14 Respondents in considering this question focussed primarily on whether the superequivalences should be a priority for the EU review. We continue to liaise separately with firms on the broader agenda for the EU review.

2.15 Several respondents said that the UK should be seeking to extend the EU rules to match those required under the UK superequivalent provisions – in particular to ensure the European adoption of a RINGA style regime. Respondents also supported the issues raised in the recent ESME report – notably the consideration of a two-fold notion of inside information, and the designation of a clear home competent authority for market abuse.

2.16 Again, a few respondents were not convinced that the superequivalent provisions should be incorporated into the Market Abuse Directive and indeed would prefer that we actively discourage such amendments.

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

2.17 Of those who responded to this question, there was support to update the 1993 Criminal Justice Act to reflect legislative changes brought on by FSMA and MAD.

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?

2.18 There was broad support for our analysis of the costs and benefits. Two respondents believed that the benefits of market confidence and stability that the superequivalences provided should be explicitly incorporated in the analysis, although it was acknowledged that these benefits were hard to quantify. The respondents believed that the costs of the superequivalent provisions of the market abuse regime were small in comparison to this substantial benefit. Our study was based on a 'worst case scenario' whereby we did not include these benefits.

2.19 One respondent argued that we should remove the costs of the EU review, as this is unavoidable. Our impact assessment includes varying costs of the EU review depending on its similarity to the UK regime and we therefore feel it is helpful to retain these costs. Another respondent did not believe that there were any additional corporate costs in maintaining the superequivalent regime and that our impact assessment overestimated the cost of retaining the superequivalences but their response did not provide details. Other respondents neither confirmed nor refuted our estimated costs.

2.20 On the other hand, another respondent pointed out that the non-harmonisation of the UK has a cost to pan-European firms and called for this to be included but did not provide any estimates. This factor is already included in the impact assessment as an additional unquantified factor.

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

2.21 One respondent thought there was merit in including a provision that leads to an automatic review of the sunset clauses on the completion of the EU review, if it is sooner than 2010. One respondent, whilst supporting the superequivalent standards, said that they found them difficult to comprehend and recommended that they be redrafted to improve their clarity. Another respondent said that, rather than retaining these provisions, it would be preferable to bring new UK legislation or regulation to cover any specific gaps.

2.22 The remaining respondents did not have any alternative proposals.

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

2.23 As already discussed under Question 4. Most respondents agreed with our proposal as firms did not want to be subject to two sets of changes in short succession and/or to be subject to problems that exist with the current EU regime. However some respondents disagreed – preferring either the immediate removal of the superequivalences or the permanent retention of them.

A

LIST OF RESPONDENTS

A.1 The following industry bodies and organisations submitted non-confidential written responses to the consultation:

- Association of British Insurers (ABI)
- Association of Corporate Treasurers (ACT)
- Association of Investment Companies (AIC)
- Aviva
- Britannia Building Society
- British Bankers Association (BBA)/International Capital Market Association (ICMA)
- Centre for Financial Market Integrity (CFA)
- CFA Society of the UK Response
- City of London Law Society
- Confederation of British Industries (CBI)
- Investment Management Association (IMA)
- Investor Relations Society
- London Investment Banking Association (LIBA)
- London Stock Exchange (LSE)
- Quoted Companies Alliance (QCA)

1 Final Impact Assessment

Summary: Intervention & Options

Department /Agency:	Title:	
HM Treasury	**Impact Assessment of the extension of the sunset clauses in the FSMA Market Abuse regime for a limited period**	
Stage: Implementation	**Version:** Final	**Date: 3 June 2008**
Related Publications: UK Implementation of the EU Market Abuse Directive (Directive 2003/6/EC) – a consultation document (June 2004).		

Available to view or download at:

http://www.www.hm-treasury.gov.uk

Contact for enquiries: Sarah Parkinson **Telephone:** 020 7270 5912

What is the problem under consideration? Why is government intervention necessary?

Sunset clauses in the UK's market abuse legislation are due to expire on 30 June 2008 unless new legislation is adopted which allows them to remain in force. These clauses contain provisions that are superequivalent to the EU's Market Abuse Directive.

The Government has reviewed this area and thinks that the sunset clauses should be extended until 31 December 2009. This Impact Assessment provides further

What are the policy objectives and the intended effects?

The Government's intention is to ensure high standards of market integrity and confidence balanced against commitment to the principles of better regulation.

What policy options have been considered? Please justify any preferred option.

Option 1: Retaining the current UK superequivalent offences for a further limited period.

Option 2: Allowing the current superequivalent offences to lapse.

Option 3: Making the current UK superequivalent offences permanent.

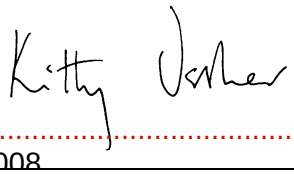
Option 1 is the Government's chosen option - to retain the current UK superequivalences for a further limited period until the outcome of the EU review is known. Extending the life of the sunset clauses will avoid unnecessary short-term changes to the regulatory framework and avoid possible pre-emptive UK legislation when change to the EU regime is expected.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? 2014.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:



..... Date: 05 June 2008

Summary: Analysis & Evidence

Policy Option: 1	Description: **Retaining the current UK superequivalent offences for a further limited period.**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off	**Yr**	
£ 10,600,000	1.5	Using the existing UK regime as the baseline, there would be no additional costs during 2008 as this option reflects the current situation. There would be a cost of implementing the outcome of the EU review. We have used a variety of ranges and probabilities to arrive at this £10.6 million best estimate, reflecting the cost of between 2-8 hours work depending on the magnitude of the review and its similarity to existing UK requirements.
Average Annual Cost (excluding one-off)		
£ 0		**Total Cost** (PV) **£ 10,241,720**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'.
One-off	**Yr**	
£ 4,800,000 *	1.5	Using the existing UK regime as the baseline, there would be no additional benefits during 2008 as this option reflects the current situation. The benefits of moving towards to a harmonised regime on completion of the EU review would be £4.8m (as we are only considering a limited time frame this appears here as a one-off benefit). This
Average Annual Benefit (excluding one-off)		
£ 0		**Total Benefit** (PV) **£ 4,637,760**

Other **key non-monetised benefits** by 'main affected groups'.

We have not included any benefits of implementing the EU Review, as the benefits will be the same in each of the three options. Only the costs will change.

Key Assumptions/Sensitivities/Risks
The annual costs of maintaining the superequivalences are not included as they are not additional to the status quo. The scale of the EU Review is as yet unclear – we have therefore had to estimate a wide range of possible costs of transitioning to that regime and the probability of the regime including something similar to parts of our current superequivalent regime. The benefits assume the EU review delivers a satisfactory outcome.

Price Base	Time Period	**Net Benefit Range** (NPV) **£**	**NET BENEFIT** (NPV Best estimate) **£ -£ 603,969**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			Continuing	
Which organisation(s) will enforce the policy?			FSA	
What is the total annual cost of enforcement for these			£0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			Yes	
What is the value of the proposed offsetting measure per			£ n/a	
What is the value of changes in greenhouse gas emissions?			£ n/a	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	Yes/No	Yes/No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)					(Increase -
Increase	£	Decreas	£	**Net**	**£**

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Summary: Analysis & Evidence

Policy Option: 2	Description: Allowing the sunset clauses to expire, thereby removing the superequivalences

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' This option involves two sets of transitional costs. Firstly, there would be a transitional cost of £4.8m estimated at two hours work in 2008 as firms adjusted their regimes to remove the superequivalences. Then, in 2009, there would be a further transitional cost of £13.35m estimated at between 2 and 8 hours work as firms changed their
One-off	**Yr**	
£18,150,000	1.5	
Average Annual Cost (excluding one-off)		
£ 0		**Total Cost** (PV) **£ 17,698,770**

Other **key non-monetised costs** by 'main affected groups'

Removal of the superequivalences could lead to lower standards of market integrity and consequently market confidence which may lead to economic costs through higher costs of capital. These costs are harder to quantify and indeed are disputed. We have therefore not sought to quantify them but they could be material. In 2005 an estimate of the benefit of a robust market abuse regime was as high as £150 million, based on using spread (the difference between the best bid and offer prices in the market place) as a measure of liquidity. A calculation on the weighted average spread for FTSE 100 shares at a point on 16 June was 19 basis points. Based on total turnover in UK equities in 2003 of £1,540 billion, the spread cost was £2.9 billion. A one basis point increase in the spread using these figures would increase costs to the market

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' The benefit, or cost saving is calculated as £4.8m per year. This is the amount saved largely on legal costs. As we would be adjusting the regime mid 2008 the benefits this year would be halved. Spread over 1.5 years, this
One-off	**Yr**	
£		
Average Annual Benefit		
£ 4,691,840	1.5	**Total Benefit** (PV) **£ 7,037,760**

Other **key non-monetised benefits** by 'main affected groups' The greater the degree of harmonisation in Europe in terms of market abuse rules, supervisory practice and enforcement, the closer we will be in creating a single European market for financial services.

Key Assumptions/Sensitivities/Risks. Key assumptions are the time taken to implement changes resulting from EU review.

Price Base	Time Period	**Net Benefit Range** (NPV) **£**	**NET BENEFIT** (NPV Best estimate) **£ 10,661,010**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			30 June 2008	
Which organisation(s) will enforce the policy?			FSA	
What is the total annual cost of enforcement for these			£0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per			£ n/a	
What is the value of changes in greenhouse gas emissions?			£ n/a	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	Yes/No	Yes/No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase -
Increase	£	Decreas	£	**Net**	**£**

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Summary: Analysis & Evidence

Policy Option: 3	Description: Making the current UK superequivalent offences permanent.

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off	**Yr**	
£ 10,600,000	1.5	Using the existing UK regime as the baseline, there would be no additional costs during 2008 as this option reflects the current situation. There would be a cost of implementing the outcome of the EU review. We have used a variety of ranges and probabilities to arrive at this £10.6 million best estimate, reflecting the cost of between 2-8 hours work depending on the magnitude of the review and its similarity to existing UK requirements.
Average Annual Cost (excluding one-off)		
£ 0		**Total Cost** (PV) **£ 10,241,720**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yr**	
£ 0		
Average Annual Benefit		
£ 0		**Total Benefit** (PV) **£ 0**

Other **key non-monetised benefits** by 'main affected groups'

We have not included any benefits of implementing the EU Review, as the benefits will be the same in each of the three options. Only the costs will change.

Key Assumptions/Sensitivities/Risks The scale of the EU review is as yet unclear – we have therefore had to estimate the possible costs of implementation.

Price Base	Time Period	**Net Benefit Range** (NPV) **£**	**NET BENEFIT** (NPV Best estimate) **£ 10,241,720**

What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	Continuing
Which organisation(s) will enforce the policy?	FSA
What is the total annual cost of enforcement for these	£0

Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			Yes	
What is the value of the proposed offsetting measure per			£ n/a	
What is the value of changes in greenhouse gas emissions?			£ n/a	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	Yes/No	Yes/No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)					(Increase -
Increase	£	Decreas	£	**Net**	**£**

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

EVIDENCE BASE: FOR SUMMARY SHEETS

Background

1.1 The purpose of this assessment is to review sections 118(4) and 118(8) contained in Part 8 of Financial Services and Markets Act 2000 (FSMA). These are legislative provisions, which prohibit a wider range of behaviours than the Market Abuse Directive. The aforementioned provisions are subject to a three-year sunset clause, which means that they will automatically lapse on 30th June 2008 unless new legislation is adopted to allow them to remain in force.

1.2 The objective of the Review is to establish whether the expected benefits of having all or part of these superequivalent provisions has exceeded the cost. The Review should take into account the enforcement of the regime, market understanding, costs & competitive impact and foreign rules and implementation.

1.3 The EU Market Abuse Directive was implemented in the UK on 1 July 2005 through the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2005 and through changes in the FSA's rules. The aim of the Directive is to achieve greater confidence in the integrity of the financial markets in the EU by introducing a common administrative framework for deterring and punishing market abuse, and through providing a proper flow of information to the market. The Directive covers insider dealing, market manipulation and a framework for proper disclosure to the market. MAD is one of the key directives implemented as part of the Financial Services Action Plan (FSAP) that seeks to deliver an effective single market in financial services in the European Union.

1.4 During the consultations on implementing MAD there were mixed views as to the benefits of maintaining the superequivalent provisions. Those in favour of keeping the superequivalent provisions felt that the boundaries of the regime were familiar and were relevant in providing the UK with a more secure trading environment. Others argued that the UK should only prohibit behaviours defined by the Directive, as this was sufficient.

1.5 Given the range of views on which approach the UK should be taking, it was decided to maintain the original UK definitions of market abuse for a limited period. The underlying rationale for this was to gather more evidence and allow time to conduct a comprehensive review of these provisions.[1] The sunset clauses were inserted into the legislation so that the provisions would expire unless new legislation was introduced.

1.6 This policy and impact assessment is informed by dialogue between HM Treasury, FSA, relevant trade associations and industry.

Legislative proposals and options

1.7 The first option is to retain the current UK regime for a further limited period until the outcome of the EU review is known. The Commission are themselves reviewing the MAD in 2008 and we will take this opportunity to work for an outcome that delivers a satisfactory EU regime and to promote wider

[1] For further information on the rationale behind our policy please refer to the February 2005 HMT feedback statement http://www.hm-treasury.gov.uk/media/C/E/MAD_feedback240205.pdf

discussion of some of the elements of our superequivalences. Indeed one element of the superequivalences is already on the EU radar for possible changes to the MAD.

1.8 The European Commission are likely to be influenced by the European Securities Markets Experts group (ESME) report that identified practical difficulties that arise from having the same definition for market abuse and the disclosure obligation. In particular they think that the current requirements result in issuers having to disclose information too early and it would be preferable if the dates at which information becomes 'abusable' or 'disclosable' were separated. The UK already has such a distinction because of the superequivalences. The changes to MAD could result in new regulations from Europe that more closely resemble our rules.

1.9 Whatever the outcome of the EU review, allowing the superequivalent provisions to lapse in June 2008 and then implementing the EU's changes will subject the industry and FSA to two sets of changes in short succession. This would have cost implications and also a potentially negative impact on market understanding.

1.10 The second option is to align the UK regime with the EU Market Abuse Directive requirements now. Removing the superequivalences would simply require us to let the sunset clauses expire, as they would do as a matter of course, on 30 June 2008. No new legislation would be required. This will deliver some efficiency savings for financial firms and help maintain UK competitiveness by aligning our regime with that of our European counterparts. However, as noted above, it is possible that some legislation would have to be re-introduced following the outcome of the EU review and some of the superequivalent provisions would be re-established.

1.11 The third option is to make the superequivalences permanent. This would provide reassurance to the investing community that the widest range possible of market abuse offences were captured by the UK legislative framework but we would in any event have to consider possible changes arising from the EU's review.

BENEFITS

Option 1

1.12 Retaining the super-equivalent provisions for a limited period could maintain high standards of market integrity and consequently market confidence. These benefits are ongoing and hence not new. It would also allow wider discussion of the benefits of the superequivalences. Closer harmonisation with the revised EU regime would bring the benefits of European harmonisation, simplification for those firms operating on a pan-European basis and lower compliance costs.

1.13 The costs of the superequivalences were estimated at around £ 3 million in 2004 or an average of around 2 hours per firm. This cost has been updated to around £5 million. This reflects an increase in the number of firms and of staff costs. When the market abuse regime was introduced in 1999 it was estimated that there was a cost of £500 an hour for firms in seeking advice on the regime (made

up of internal costs and the costs of external legal advice). In our 2004 consultation, we updated this to £610 an hour on the basis of increases in average earnings of those working on financial intermediation. We update this cost again to £690 per hour, stressing that this is the result of the combined cost of internal project work and the cost of seeking internal and external legal advice.

Option 2

1.14 The main benefits associated with immediately removing the superequivalences would be the earlier harmonisation of our rules with MAD. A greater degree of harmonisation would be beneficial for a variety of reasons. For example, it would remove complexities for those firms operating on a pan-European basis. This is likely to mean lower compliance costs for firms (through alignment of training and control processes and reduced numbers of suspicious transaction reports). These cost savings are not likely to be large. There are also likely to be lower ongoing legal costs for firms. As discussed above, these were estimated as around £3 million in 2004 and we have updated this to savings of £4.8million in 2009 with a saving of £2.4 million during 2008, as the new regime would start midway through the year.

1.15 There is no evidence to suggest that any welfare-creating business might be possible if the superequivalent provisions were allowed to lapse and so there are probably no benefits in terms of business creation from this option.

Option 3

1.16 Making the superequivalences permanent could lead to higher standards of market integrity and consequently market confidence, which may lead to economic benefits through lower costs of capital. These benefits, to the extent that they arise, would be ongoing and hence are not additional.

1.17 Whether benefits arise in practice depends on whether the superequivalent provisions actually deter abuse. In turn, deterrence will depend on the expectation of market participants that the provisions will result in successful enforcement. Since the implementation of MAD in 2005 no action based on the superequivalent provisions has been taken, suggesting at first glance no additional incremental benefits. However, if there is increased enforcement of these superequivalent provisions in the future there should be incremental economic benefits.

COSTS

Option 1

1.18 The costs of temporarily retaining the superequivalences are the additional legal costs and compliance costs resulting from the more complex UK regime, as against a regime aligned with the Directive. These costs would be ongoing and are not new. The cost of implementing the EU review is estimated at £10.6 million. We have used a variety of ranges and probabilities to arrive at this £10.6 million best estimate, reflecting the cost of between 2-8 hours work

depending on the magnitude of the review and its similarity to existing UK requirements.

Option 2

1.19 Removing the superequivalences will involve costs. The one-off costs of adjustment will vary from firm to firm but we have estimated an average two hours at a consolidated cost of £690 an hour. This means a one-off cost of £4.8 million to remove the sunset clauses. The costs to the industry would largely be related to changing training programmes as well as adjusting procedures and manuals.

1.20 Removing the superequivalences would also entail costs to the FSA arising from changes to the handbook training materials and some retraining of staff. There may also be additional queries to the FSA arising from change to the regime. These costs are not believed to be significant.

1.21 There is potential for costs to arise to the extent that removal of the super-equivalent provisions leads to lower market confidence and to the extent that this manifests itself in a higher cost of capital for firms.

1.22 There would be further costs under this option resulting from implementing the European review of MAD. This cost will depend on the amount of changes to the regime. Therefore under this option firms would bear the costs of changing their processes now and further costs in the future if the Directive requirements are further altered. Firms may of course opt not to update their internal systems pending the outcome of the EU review. This could lead to considerable confusion in the market. We have assumed that firms would remove the superequivalences given the uncertainty about the precise timing and outcome of the EU review.

Option 3

1.23 The costs of permanently retaining the superequivalences are the additional legal costs and compliance costs resulting from the more complex UK regime, as against a regime aligned with the Directive. These costs would be ongoing and are not new. Firms would also face the costs of implementing the outcome of the European Commission's review.

COMPETITION ASSESSMENT

1.24 There is no evidence to suggest that any of these proposals has an impact on competition.

SMALL FIRMS IMPACT TEST

1.25 All firms authorised to conduct investment management and securities business in the UK currently have to work within the market abuse regime. Removing the superequivalences may impose additional burdens on smaller firms as they may be less well placed to cope with two sets of regulatory change in short order.

Specific Impact Tests: Checklist

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No