Deutsches Aktieninstitut

ESMA's Proposal on Legitimate Interests Would Erode the Right to Delay the Publication of Inside Information for Listed Companies

German issuers seriously concerned about the Draft Guidelines on the Market Abuse Regulation

Position Paper of Deutsches Aktieninstitut on ESMA's Consultation Paper on "Draft guidelines on the Market Abuse Regulation" (ESMA/2016/162), 31 March 2016

1 Comments on legitimate interests of the issuer (chapter 3.2.)

Q8: Do you agree with the proposal regarding legitimate interests of the issuer for delaying disclosure of inside information?

General remarks

German issuers represented by Deutsches Aktieninstitut[1] have closely followed the political debate on the revision of the Market Abuse Regulation (MAR). Our general concern has always been that either the level 1 text or measures on level 2 or level 3 could disregard accepted and well-proven market and supervisory practices or could lead to situations where issuers are forced to premature publicity that may be harmful for their own interests, make it difficult to implement their entrepreneurial strategy and that expose members of their decision making bodies to unnecessary liability risks as they can no longer take their decisions on a well-informed and advised basis as well as unaffected by public pressure. In addition, premature disclosure would be by no means of any interest for the investors or would lead to more market integrity.

In this context we also have already raised the general concern that level 3 Guidelines could factually eliminate or erode the right to delay the publication of inside information as it is granted in Art. 17(4) MAR. In that respect we are of the opinion that the proposed level 3 Guidelines are not in line with the level 1 regulation and, hence, are not covered by ESMA's mandate. According to the political will the right to delay the publication of an inside information is a pivotal balancing element of the MAR legislation which has been granted to protect the issuer in case a premature disclosure would negatively impact the issuer's interests and as long as the relevant information is kept confidential. In addition, the option to delay ensures that complex entrepreneurial decisions are taken with the required due care and on an informed basis. A delay of disclosure of ongoing protracted processes is also justified to avoid misleading signals to the market as a result of premature disclosure.

[1] Deutsches Aktieninstitut (EU transparency register: 38064081304-25) represents the entire German economy interested in the capital markets. The about 200 members of Deutsches Aktieninstitut are listed companies, banks, stock exchanges, investors and other important market participants. This position paper is based on discussions in the issuers working group which is the central forum of opinion building for listed companies in Germany on capital market issues.

We therefore doubt that ESMA is right in stating that the option to delay is the exception rather than the rule and should be interpreted narrowly (paragraph 69.). Rather, the opposite is true. The "history" of the MAR let us come to the conclusion that the legislator is well aware of the problems a premature publication could create for both the issuers and the investors, i.e. a) creating time pressure in decision processes and b) creating potentially misleading premature publication of information.

Against this background we are of the opinion that ESMA should generally not narrow down the issuers' possibilities to use the right to delay in practice. Moreover, such approach would also be contrary to the spirit of MAR (in particular its recital (50)).

Though we acknowledge that ESMA identifies a number of situations of practical relevance as being potentially a reason to delay, **we are deeply concerned that the wording of the ESMA's proposal as well as the explaining text will in fact narrow or even eliminate the right to delay if it is taken literally**. That holds particularly true in situations where a second body is involved in a decision process, but is not limited to these situations.

(1) Ongoing negotiations (chapter 3.2.1.)

We note that the wording of the ESMA Guidelines is stricter than recital (50) of the MAR. ESMA uses the term "jeopardizes" for both the general legitimate interest of protecting ongoing negotiations and the more specific situation of an issuer whose financial viability is in danger.

In contrast, recital (50) rightly acknowledges that the issuers have a general legitimate interest to protect ongoing negotiations by qualifying that "the normal pattern of those negotiations would likely be affected". "Affecting the normal pattern" is clearly a less strict criteria than "jeopardizing" that has to be met by the issuer in order to be allowed to delay the publication of inside information. Therefore, we ask ESMA to redraft the Guidelines to bring them back in line with the level 1 text.

Similarly, recital (50) qualifies that "the conclusion of … negotiations designed to ensure the long-term financial recovery of the issuer" could be "undermined" by the publication. From our point of view the term "undermining" is also less strict than the term "jeopardizing" which is used by ESMA. In this scenario, ESMA's interpretation may not only put efforts at risk to rescue a distressed company. It may result in detrimental knock-on effects on such company's stakeholders such as suppliers, customers, creditors and employees if an issuer's recovery fails as a result of premature disclosure. In our view recital (50) is clearly targeted at avoiding these risks that are also detrimental from an economic perspective. In this situation, overweighting the markets alleged interest in permanent and real time

transparency appears disproportionate and, hence, unjustified given the aforementioned other interests.

(2) Approval of another body (chapter 3.2.2.)

Another serious concern relates to paragraphs 78ff. respectively Art. 1.c. of the Draft ESMA Guidelines, according to which ESMA specifies under which conditions an issuer will be allowed to delay the publication of inside information if a certain decision requires the approval of another body of the issuer than the management board. This issue is particularly virulent in all two-tier-board systems where the supervisory board is separated from the management body and material corporate decisions require its approval.

The legislator was fully aware of the issue in two-tier-systems. Recital (50) of the MAR therefore explicitly mentions a pending approval of second body as one "legitimate interest" of a non-exhaustive list (see paragraph 60b of the ESMA proposal) as a general rule in order to avoid both organizational difficulties on the side of issuers and potentially confusing market information.

ESMA formulates four conditions which all have to be met before the issuers will be allowed to delay the disclosure of inside information in situations where another body is involved or has to approve a management decision. In addition, in paragraph 82 the general rule is laid down that the issuer has to publish an inside information still awaiting approval, but has to qualify the publication by making clear that the approval is still pending. This ESMA guidance is the exact opposite of how the right to delay of inside information is currently handled e.g. in the German market for good reasons.

Currently and according to the well-proven guidance of the German supervisory authority BaFin the issuer is generally allowed to delay the publication of inside information as long as the approval is still pending and the other preconditions for a delay are met (in particular confidentiality). This general rule has been developed because it is the legitimate interest of an issuer not to prejudice the supervisory body in the two tier system, to respect the rights and duties laid down in the corporate law and to avoid potentially misleading communication in cases an approval is still pending.

The ESMA proposal will de facto disregard the existing and well-proven practice and thus will factually eliminate the right to delay the publication of inside information in companies in a two-tier corporate governance structure. It is worth noting that this will not only negatively affect German companies, but also companies in a number of European countries. More specifically:

- **Condition a)** is an unnecessary condition because such an announcement would always bear the risk that the information is not correctly assessed by the market.

- **Condition b)** is an unnecessary condition because such an announcement would always jeopardize the freedom of decision of the supervisory body.

- The next-day-approval of **condition c)** will not be possible in practice. Every meeting of a supervisory board has to be prepared by the issuer in order to comply with legal or internal documentation obligations. Corporate laws in two tier systems therefore generally regard an invitation period of 2 weeks for the supervisory board as sufficient. Though this period may be shortened in urgent matters (if the charter of the body or the company allows for it), it will be impossible to schedule a meeting within 1 day generally as ESMA proposes. Nor will it be possible for the supervisory board to thoroughly evaluate the merits of the decision to be taken with the necessary care. **ESMA should therefore lay down a more flexible requirement such as "as soon as reasonably possible".** This would better take into account existing traditions of corporate governance across Europe, such as the German employee participation in the supervisory board.

- According to **condition d)** a delay will only be possible if the issuer expects the approval of the supervisory board not to be in line with the management decision. If taken literally, this would lead to the following:

  If the management board is confident that the approval is granted, **a cautious issuer will always be forced to make public the inside information** in order to avoid the sanctions of the MAR – with severe consequences for the issuer. The same is even true if the management is just uncertain whether the approval is granted or not.

  As a consequence, the – independent – supervisory board will be regularly prejudiced and the **pressure to approve** the matter in question in order to avoid the disclosure of any disagreement between the two corporate bodies will significantly increase. In essence, the position of the supervisory board will be weakened which is in clear contrast to the political efforts to strengthen the corporate governance of listed companies. Even worse, would the supervisory board not approve a decision already made public, another publication (correcting the previous publication) would be necessary which would clearly confuse the market and negatively impact the issuer's reputation.

  In addition to that the following is to consider: As a matter of course, the management will only present (and should only present) a decision to the supervisory body for approval if it sees a chance that the supervisory body actually approves it. Normally, a delay will therefore be considered when the approval of the second body – albeit uncertain – appears to be possible or likely. In contrast, if the management board expects that the

supervisory body will not approve a certain decision the decision will normally not be presented to the second body. **Condition d) is therefore effectively eliminating the possibility to delay the publication of inside information as it can only be complied with in situations where the management body will not present the decision to the supervisory board**, but not in the normal day-to-day situations of protracted decision making processes.

Against this background we are strongly of the opinion that ESMA's proposal is neither in line with the intention of the legislator and the level 1 regulation nor is it in the interest of the market. Even worse, the ESMA proposal would de facto eliminate the possibility of a delay for a number of situations that currently constitute "a legitimate interest" in two tier board system.

From our point of view **the ESMA should rather generally allow the delay of publication of inside information if there is a second body involved that needs to approve a decision of the management board**.

More concretely **condition b) und d) should be deleted** and **condition c) should be redrafted as laid down above**. In addition, **paragraph 82 should also be deleted or it should be redrafted so that it is generally allowed to delay the publication of an inside information as long as an approval of a second body is still pending** and the other precondition for a delay are met (in particular confidentiality).

(3) M&A projects (chapter 3.2.4.)

We are also concerned about **paragraph 86** of the draft Guidelines **which appears to raise the hurdle** for a delay in M&A situations. In that paragraph ESMA states that a delay will only be possible if the transaction "is very likely to fail" which appears to specify the Art. 1.a. of the proposed Guidelines.

Since the MAD has come into force in 2003 it has broadly been accepted that it is as a legitimate interest of an issuer that M&A projects can be negotiated without informing the public as long as confidentiality is ensured. This legitimate interest does not only relate to a complete failure of a negotiation as ESMA proposes but also to central elements of the M&A project, such as the purchase price or pivotal contractual elements (e.g. certain reps and warranties, liability clause etc.).

Moreover, important M&A projects typically require the approval of the supervisory board in two tier-systems, which would rise even further the hurdle for a delay having in mind what ESMA proposes for the option to delay as general requirements if another body is involved.

We therefore urge ESMA to redraft the condition from "very likely to fail" to a less demanding term, such as "it is reasonably likely, that the negotiations on the transactions will be significantly influenced to the disadvantage of the issuer."

From our point of view this is exactly what recital (50) of the MAR strives for as it reads that a legitimate interest may be a circumstance where the “outcome or normal pattern of those negotiations would be likely to be affected by the disclosure”.

There is clear difference between the term “being affected” of the level 1 text and term “very likely to fail” of the proposed Guidelines so that paragraph 86 needs to be redrafted in order not to create legal uncertainty in the market.

2 Comments on situations where a delay in the disclosure is likely to mislead the public (chapter 3.3.)

Q9: Do you agree with the proposal regarding situations where the delayed disclosure is likely to mislead the public?

We appreciate that ESMA regards a delay of the publication of inside information as misleading only if the market expectations are based on signals that the issuers has previously set. From our perspective this clarification is important because otherwise one could argue that any delayed publication of inside information will mislead the public. We therefore appreciate that ESMA has changed its view since the publication of the Discussion Paper.

However, the wording of paragraph 99.c) as well as **Art. 2.c. of the Guidelines appear to be too far reaching** as it does not qualify further the term "previously set signals". This could create legal uncertainties as to what constitutes a signal in the sense of the Guidelines. We therefore suggest that ESMA at least specifies in Art. 2.c. as well as in para. 99.c) that the signals have to stem from the official capital markets communication of the issuer and have to be clear, actively brought in the market and closely related to the inside information. Alternatively and preferably, Art. 2.c) could be deleted because Art. 2.a. und Art. 2.b. already cover the relevant situations. Otherwise, we are concerned that even if the issuer does not communicate or has not actively communicated on a specific matter the inside information relates to, the "no comment" will maybe be misinterpreted as a "passive" signal.

Q10: Do you see other elements to be considered for assessing market's expectations?

See Q9.

From our point of view it should be made clearer that signals may only be regarded as misleading if they are part of the official capital market communication of the issuer. It has to be avoided that also implicit "communication" by an issuer (e.g. by not commenting on a certain issue) may be regarded as misleading because this would create massive legal uncertainties and may erode the possibility to delay.

Furthermore, we reiterate our concerns regarding rumors. In the Final Report ESMA responded to the concerns raised in the consultation process regarding the duty to publish inside information in reaction of rumors being spread in the market (Art. 17(7) MAR).

Deutsches Aktieninstitut is among those concerned, because rumors may be spread on purpose either to influence ongoing negotiations at the expense of the issuer (e.g. in M&A transactions to publicly create pressure) or to simply "fish" confidential information. Though both practices would be clearly abusive, this fact would not help the issuer in a concrete situation, even if the issuer had taken all required measures to keep the information in question confidential and he can rule out any kind of leakage from his end.

In the light of the foregoing, we still regard it as justified if an issuer in such an event is still allowed to follow a "no comment" policy unless the rumor is "sufficiently accurate" in the sense that very detailed aspects of the inside information become public that can only be known to a very small number of persons within the sphere of responsibility of the issuer.

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