

CNMV ADVISORY COMMITTEE REPORT ON SECOND SET OF CESR GUIDANCE ON THE OPERATION OF THE MARKET ABUSE DIRECTIVE (CESR/06-562)

The document as a whole clearly merits approval. Firstly, we praise the efforts to clarify and to coordinate between supervisory authorities in the various Member States in such a delicate area as the prevention and pursuit of the misuse of inside information. Secondly, the document's technical content is of a high level, as is habitual with the CESR level three harmonisation work.

Nevertheless, we set out below a number of comments upon which there is consensus within the Advisory Committee:

1. The general trend in the document is to clarify doubtful concepts or rules by adopting a restrictive or less tolerant approach. Since the CESR is a body made up of regulators, that is understandable to a degree. However, it is worth considering whether it might not be better, as a rule, to adopt a more open approach that is oriented more towards giving certainty to market participants so as to benefit efficient and flexible market working; this would also enable regulators to focus more on preventing and pursuing actions which are truly harmful to investors and market integrity. The bulk of the comments that follow are inspired by this philosophy.

Section I

2. Section 1.5 states that, other than in exceptional circumstances or unless requested to comment by the competent regulator, issuers are under no obligation to respond to "market rumours which are without substance". It would appear to follow that CESR's position is that issuers must, in any case, respond to "rumours with substance", i.e. those which coincide with reality to a greater or lesser extent; that does not seem to be reasonable.

It should therefore be made clear that issuers should not be obliged to respond to rumours that are mere speculation without a significant impact on the market and which give no sign of being the result of a leak of inside information. In short, our proposal is that the CESR adopt the approach set out in article 83.bis of Spain's Securities Market Law (Ley del Mercado de Valores), which requires the issuance of a regulatory disclosure on the status of a transaction or with advance information only *"in the event that the volumes traded or the market prices perform in an abnormal fashion and that there are rational indications that this performance is due to a premature, partial or distorted disclosure of the transaction"*.

3. We note also that section 1.8 does not refer to the direction (upward or downward) of the possible effect on the market price.

The most natural reading of article 1 of Directive 2003/123/EC suggests that, in order to consider information to be specific, it is not enough to conclude that its publication would have an impact on market prices; rather, it is also necessary that a conclusion can be drawn as to which direction that impact would be. The examples offered in this section of the Document point in this direction (when the information is such as to allow a reasonable investor to take an investment decision without, or at very low, risk, or when the piece of information is such that it is likely to be exploited immediately on the market).

We believe the CESR Document should make clear and explicit reference to this aspect.

The clarification we propose is particularly pertinent if we analyse the concept of inside information from the standpoint of the prohibition to trade. The prohibition in the Directive refers to the use of the information (Article 2.1 of Directive 2003/6/EC) and not to the mere fact of trading while in possession of inside information. Only if the information is susceptible to being exploited and used (i.e. if it is possible to predict its possible impact on the market price) should it be classified as "inside information" for the purposes of prohibition.

4. Both Directive 2003/6/EC and Directive 2003/124/EC adopt an approach of "ex ante" observation and assessment as regards the requirements of specificity and likely significant impact on the market price, without reference at all to what actually happens when the information is made public.

We have no dispute with this "ex ante" approach. However, in those cases (the majority) where the information is eventually published, how the market price was actually affected should be taken into account, in some way, when the regulator establishes its priorities regarding oversight and punishment of this type of action and also when evaluating, "ex post", whether or not there was a breach of the prohibition. This is an objective datum that can be ascertained unambiguously; if the information did not have an significant impact on the market price, then there are no aggrieved parties (even though the need to protect the integrity of the overall market persists).

In any case, we believe the Document should address this relevant issue.

5. Section 1.15 of the Document is a specific manifestation of the general restrictive tendency mentioned above (beginning with the fact that, in the first line, only "non-exhaustive" is underlined, but not "purely indicative").

The items in the list of possible inside information in that section are excessively generic, in general. Some even refer to events or situations that would not normally fall under the heading of "inside information" in accordance with the Directives, which means information that is really relevant (i.e. capable of having a significant influence on the market price).

This is the case, for example, of items three and four (any change in the management or supervisory boards, and changes in any information relating to the auditors' activity) and others that are included in the list without any indication of their relevance.

The list itself is hard to reconcile with the note in the introductory paragraph that the fact that an event is included on the list does not mean that it automatically constitutes inside information. It should be stated, either generally in the introductory paragraph or specifically case by case, that the document refers only to significant cases. The latter approach (case by case) may be preferable since it would make it possible to quantify each case appropriately on the basis of its specific characteristics.

6. In fact, Section 1.16 of the Document refers to two different types of situation or event:
 - (i) Information relating to macroeconomic or industry-wide situations. In this connection, it is appropriate to cite the reasoning in the introductory paragraph: since this is not information relating directly to the issuer, there are no legal grounds for requiring immediate disclosure or publication of the data, only of the consequences arising for the issuer from such measures or situations insofar as such consequences constitute inside information.
 - (ii) Information relating directly to the issuer, even if it comes from a source external to the issuer. This information would, in principle, fall fully under the Directive's definition of inside information (e.g. items seven and eight: competition authorities' decisions concerning listed companies and relevant orders by government bodies).

Section II

7. Section II of the document refers to issuers' ability to delay the disclosure of inside information where legitimate interests are at stake. This section commences by noting (section 2.4) that the examples set out in Directive 2003/126/EC are not an exhaustive list and that issuers may delay publication of inside information in other circumstances provided that the conditions of article 6.2 of Directive 2002/6/EC are met (i.e. that such omission would not be

likely to mislead the public and that the issuer is able to ensure the confidentiality of the information). Nevertheless, the document reinforces the restrictive approach apparently adopted in article 3.1 of Directive 2003/124/EC since it includes the aforementioned examples, which are exceptional and limited.

Firstly, CESR justifies its non-inclusion of a long list of cases by stating that the right to delay disclosure of inside information is a derogation or exception to the general rule. It then sets out a number of situations (only four) in which the restrictive approach is clearly predominant once again. In practically all the cases that are considered, the entire deal or development would have to be in danger in order to justify non-disclosure. One is left with the impression that mere interest in bringing all issues of the negotiation to a satisfactory conclusion or the understandable approach of not making a contract public until it has been signed would not suffice, even if the issuer is capable of ensuring the total confidentiality of the negotiations.

We believe that such a restrictive approach clashes with reality, with the way things are done in practice, and is unjustifiably unnatural. The CESR Document should be more generous to issuers on this point, subject evidently to the condition that they are capable of maintaining confidentiality.

Specifically, we believe that a reference should be included by which issuers, under their own responsibility, may delay publication in all cases of negotiation of contracts or agreements where it is reasonable to maintain a climate of confidentiality to ensure that the negotiations take place satisfactorily for the issuer or where such confidentiality is in the interests of, or required by, the counterparty, without prejudice to full insistence on the condition that the issuer be capable of maintaining confidentiality and on its duty to disclose the information (the status of negotiations) in the event of leaks or distortions in the market for the securities.

It would also have been advisable to take advantage of this document to specify and clarify the meaning of the requirement that the delay in disclosure not be likely to mislead the public. This requirement cannot be given a literal or absolute reading since, otherwise, it would apply whenever an issuer delayed disclosure: after all, delaying disclosure involves keeping a reality secret, hidden from the public eye. It appears more appropriate to interpret this requirement as referring to cases where the market has, or is at risk of gaining, the impression or conviction that events are the opposite to the reality whose disclosure is being delayed by the issuer. Therefore, one should not

interpret that delayed disclosure misleads simply because the market is not informed.

Section III

8. This committee considers the content of Section III, relating to pending orders, is appropriate, but it has two comments to make relating not so much to the question of when a pending order constitutes inside information as to the prohibition to trade set out in article 2 of the Directive.

Firstly, we would have welcomed a reference to the situation in which an intermediary finds itself when, either before or after the reception of an order constituting inside information, it received or receives orders from other clients relating to the same security. Should the intermediary execute such orders in that case? How? Can the intermediary recommend that orders be withdrawn without revealing information about the significant pending order?

Secondly, the question arises as to the position of the client who gave the order with respect to the prohibition to trade that is set out in article 3.2.a) of Directive 2003/6/EC. The strategy of action in the market clearly should not constitute inside information for the party that designs and implements it. But this should be set out expressly. In this connection, consider that Directive 2003/6/EC contains a recital (no. 30) which excludes from the prohibition only the transaction in question, stating that the carrying out of the acquisition or disposal should not be deemed in itself to constitute the use of inside information for the party that performs it.

Section IV

- 9 The key part of Section IV of the CESR document, relating to insider lists of issuers with securities listed in several Member States, is section 4.5, which confines itself to recommending that the competent authorities of the various Member States recognise the insider lists prepared in accordance with the law of the issuer's home state. Perhaps this approach is too timid. Surely the CESR, by analogy with the solution given expressly by the securities market directives in other cases, could establish that approach as mandatory rather than merely recommended?

Moreover, section 4.6 of the Document appears to require that issuers draw up as many insider lists as Member States where their securities are listed. That does not appear to be logical. One list should be enough, provided that it is at the disposal of the regulators in all the countries involved.