

EALIC'S REPLY

To

CESR 2ND SET OF DRAFT GUIDANCE ON THE OPERATION OF THE MARKET ABUSE
DIRECTIVE FOR PUBLIC CONSULTATION OF 2 NOVEMBER 2006

7 February 2007

EALIC welcomes CESR's consultation on the second set of Level 3 guidance on the common operation of the Market Abuse Directive 2003/6/EC (hereinafter "MAD") of November 2006. This consultation follows the CESR's Call for Evidence of 19 June 2006 (Evaluation of the supervisory functioning of the EU Market Abuse regime). EALIC replied to the Call for Evidence with a letter submitted on 31 October 2006; some topics raised by the November 2006 consultation were also addressed in that reply. For the sake of completeness, the comments hereinafter should be read in conjunction with these earlier comments.

A detailed set of guidance will provide listed companies with a useful tool in their day-by-day activity and will increase the level of coherence across the EU. However, despite the aim of the Lamfalussy procedure, the implementation of the directives across the EU still shows a lack of coherence. Regulatory practices among Member States widely vary in that they often reflect the traditions of different jurisdictions. For instance, as far as the duty of disclosure is concerned, it seems that in some countries issuers are not required to disclose information until they have clear confidence in it. In other countries, the competent authority widely allows delaying the disclosure. Issuers are allowed not to communicate a financial transaction that is being prepared if they are able to ensure confidentiality and if such confidentiality is temporarily necessary to carry out the transaction. Finally, the interpretation of the concept of "inside information" may vary depending on whether it is seen in the context of a possible insider trading or in the context of disclosure obligations. As this seems to be the situation across the EU, it might be advisable to further reflect on the topic of issuers' duty to disclose.

I. WHAT CONSTITUTES INSIDE INFORMATION

Information of a Precise Nature

In principle, as correctly recognised by CESR in paragraph 1.5, issuers are required to disseminate information only on events (or sets of circumstances) that either have occurred or are expected to occur on a reasonable ground. Coherently, CESR states that *"in general, other than in exceptional circumstances or unless requested to comment by the competent regulator pursuant to Art. 6(7) of Directive 2003/6/EC, issuers are under no obligation to respond to market rumours which are without substance"*. EALIC shares this approach. A general obligation to disclose information in response to rumours could jeopardize operations planned by the issuer: listed companies should be generally required to disclose information only if the rumours provide "evidence" of a "breach of

confidentiality” under Article 6.3 of MAD. In order to reach a further level of confidence on this issue across the EU, it could be useful to receive further guidance on what is meant by “exceptional circumstances” as well as by “rumours without substance”.

MAD adopts a single definition of “inside information”. This definition is used for two purposes, namely insider trading repression and issuers’ disclosure duties. The difficulty is to assess when information can be considered to be “of a precise nature” against this dual background.

The disclosure of corporate information is meant to i) prevent market abuse and ii) allow investors to take well-informed investment decisions on the assumption that market information works efficiently. Preventing insider trading and allowing investors to take decisions may, in some circumstances, result in a trade-off. E.g., consider the case of a planned take-over where the due diligence process has been completed to the satisfaction of all parties, so that insiders know it will lead to an offer, although the price of the offer still has to be decided. Such information may be “precise” enough for an insider to take an investment decision (stock prices of the target company could rise, stock prices of the bidder company could fall), but may not be precise enough to allow a non-insider to take a well informed decision, and therefore may not be precise enough to be publicly disclosed. As a consequence, the disclosure of information on such contemplated transactions may be detrimental (and somehow manipulative). Indeed, while preventing insider trading, dissemination could increase stock-prices volatility, because investors would speculate on the expected prices. As a result, it appears that in some countries an inside information will not be published, even in the absence of a formal procedure for delay under Art. 6, § 2, of MAD, until the competent body has formally identified it as inside information that needs to be disclosed.

In its consultation document, CESR (par. 1.7) states, “*an approach to a target company about a takeover bid can be considered as precise information even though the bidder had not yet decided the price*”. It also states, “*a piece of information could be considered as precise even if it refers to matters or events that could be alternatives*”. This is a very wide concept of “inside information”. While this approach reflects the need to prevent insider-trading practices on the market, it does not take into account the above commented situation. Indeed, information may be precise enough under certain circumstances, while not precise enough under others. As a consequence, it is important to underline that CESR guidelines are to be used as mere guidelines, meaning that they need to be confronted with the concrete circumstances of a given situation. Moreover, the CESR statement does not appear to be aligned with the level 2 provision according to which “*Member States shall ensure that issuers are deemed to have complied with the first subparagraph of Article 6(1) of Directive 2003/6/EC where, upon the coming into existence of a set of circumstances or the occurrence of an event, albeit not yet formalised, the issuers have promptly informed the public thereof*”. (dir. 2003/124/EC;). Under this provision, issuers are required to disseminate an inside information if, and only if, the relevant event or the set of circumstances has become more certain and concrete.

Significant Price Effect

The “reasonable investor test” provides a flexible criterion to assess the price-sensitivity of the information. CESR guidelines provide a very useful framework for such evaluation. EALIC suggests that CESR clarify whether an issuer, when considering the need to disseminate information, also has to consider the composition of its stockholding, provided such is known: ethical funds could deem a (quantitatively) insignificant operation as a valid reason to disinvest because it does not meet their investment criteria. However, although more precise guidelines are useful to assess certain situations, they should at the same time leave room for flexibility for the issuer.

Examples of Possible inside information directly or indirectly concerning the Issuer

As a preliminary remark, it would be interesting for issuers to be able to consult on CESR’s website the most “interesting” (read problematic) examples of inside information. The local competent authorities have direct knowledge of these issues and can easily provide them to CESR. In this manner, issuers can learn from the experience of others and find solutions suitable to their situation.

According to Article 6.1 of the MAD, an issuer has to disclose inside information “*which directly concerns the same issuer*”. Under this rule, the inside information to be disclosed by the issuer “differs” from the inside information relevant for insider trading practices under two aspects: information matters only if it refers to the issuer (and not to financial instruments) and such connection has to be direct.

The first list of events does not appear to fully reflect the former aspect. Some of the indicated events seem to concern financial instruments rather than the issuer, albeit stemming from an issuer decision. For instance, the ex-dividend date depends on the length of the settlement cycle and is not directly fixed by the issuer. Thus, an issuer should not be deemed to breach the Art. 6.1 of MAD if it does not communicate the ex-dividend date to the public, provided that the payment date is published.

As regards the need for the information to be “directly” connected to the issuer, it should be clarified if (or under which conditions) an event brought into being outside the issuer can be regarded as directly referring to it. Moreover, we suggest CESR to clearly state that an event produced outside the scope of the issuer’s activity – e.g. a judicial sentence – but “directly” concerning the issuer, must be disseminated only when the issuer itself has knowledge of it according to the relevant corporate governance rules.

In addition, for the sake of clarity and legibility, the non-exhaustive and purely indicative list could be structured according to different themes, such as financial information (e.g. relevant changes in the assets’ value; insolvency of relevant creditors), operational events (e.g. mergers, splits and spin-offs; restructurings) or structural events (e.g. changes in management and supervisory boards).

It should be stated that among the criteria typically leading to the classification of an event as inside information are the exceptional and unexpected character of the event as opposed to events that occur in the ordinary course of business.

For example, a change in the statutory auditor may be considered inside information if it is the consequence of an adversarial relationship between the issuer and the auditor, by contrast to the mandatory rotation of key auditor partners as imposed by the 8th Company Law Directive on Statutory Audit.

Likewise, changes in the management or supervisory board will not be considered inside information if this change is due to the expiry of the director's term of office. The same applies to operations involving the capital or the issue of debt securities or warrants to buy or subscribe securities if this is done in the course of a financial institution's daily activities.

As far as the second list of events is concerned (events indirectly related to the issuer), CESR states, *"Nevertheless, the disclosure requirement in Article 6 applies to the disclosure of the consequences, which directly concern the issuer (...), provided that these consequences constitute inside information".....* EALIC appreciates the attempt to confine the duty of disclosure only to events that entail relevant consequences for the issuer. In order to avoid a general duty to comment macroeconomic events, it should be stressed that the consequences stemming from indirect events are considered to "directly concern the issuer" when they are specific to the given issuer and not likely to affect all issuers in the same category. Only information which, even indirect, has a substantial impact on issuer's stock prices should be considered in this respect.

The guidance gives examples of information relating indirectly to issuers or financial instruments and which may require disclosure if the consequences resulting from these examples constitute inside information.

We question the usefulness of these examples for the following reasons:

- The effects these examples may produce can constitute inside information only if these effects are known by issuer before the public (e.g. the withdrawal of a broadcast license).
- According to minimum disclosure requirements for the debt and derivatives securities registration document, issuers have to prominently disclose risk factors that may affect the issuer's ability to fulfil its obligations under the securities to investors. These risks include legal, industrial, environmental, liquidity and market risks, such as interest rates and exchange rates.

The indicative and non-exhaustive examples, which are listed by CESR, refer precisely to such data. EALIC considers that it would be extremely burdensome for issuers to permanently evaluate possible consequences of such public information, which they have already clearly classified as risk factor in their registration document, and would require them to set up proper monitoring services especially to this effect.

- If in certain cases, such publicly available information were to produce price sensitive effects, it should be left to the issuer to appreciate case by case whether such publicly available data relating indirectly to him constitutes inside information.

In conclusion, we believe that we can distinguish between two kinds of information:

(i) information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments. Such information could become public information, if in a certain time, it becomes precise and certain enough to be disclosed.

(ii) information of a precise nature relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments which knowledge is relevant for investors to accurately evaluate such issuer or such financial instruments, and consequently, make an informed investment decision.

II. WHEN ARE THERE LEGITIMATE REASONS TO DELAY THE PUBLICATION OF INSIDE INFORMATION

Legitimate Interests and Illustrative Examples of Legitimate Interests for Delay

A possible solution to some of the problems above (see: Information of a Precise Nature) may be the delay in the disclosure of information whenever the event (or the set of circumstances) has not reached a sufficient degree of completion. However, the way this remedy has been devised in the MAD creates some uncertainties.

One of the conditions to delay a dissemination is that the “omission would not be likely to mislead the public” (see par. 2.10 of the consultation document). However, the definition of “inside information” *per se* implies that a reasonable investor would use it as a basis for his decisions: thus, any delay in the dissemination is, by literal definition, misleading. This is the more relevant since a disciplinary consequence could be attached to the delay in information, which might give rise to difficult questions since there is a wide field open to interpretation (whether the omission is likely or not to mislead the public) by the issuer. We suggest CESR to provide guidance on the criteria to determine if a delay in information is “likely to mislead the public”, for instance by clarifying that a delay has to be regarded as lawful whenever the undisclosed information is not likely to go against market expectations.

Moreover, it is not clear, in case the competent authorities chose to be informed of the “decision to delay”, which kind of information should be transmitted by the issuer: the mere decision to delay, the inside information delayed or also the motivations for the delay could fall into the scope of the provision. A further coherent approach under this respect would benefit the market. We suggest CESR to state that the decision to delay is the only information to be transmitted to the competent supervisor.

III. INSIDER LISTS

CESR draft guidelines provide a clear solution to the problems stemming from overlapping requirements of different jurisdictions. We hope this position will be taken into account by courts in case criminal sanctions are involved: a more precise allocation of powers among competent authorities in the directives would be helpful in this respect.

CESR's proposal for a mutual recognition system as set out in paragraph 4.5 is particularly useful. Indeed, the recommendation that relevant competent authorities should recognise insider lists prepared by an issuer that has its registered office in another EU or EEA Member State, according to this Member State's requirement, would contribute to solve the problems resulting from diverging requirements in different jurisdictions.

Issuers whose securities are admitted to trading on regulated markets in different European jurisdictions need to be able to refer to coherent procedures when they establish and up-date permanent or occasional insiders' lists. There should be mutual recognition for insiders' lists, so that if they comply with their home market standards, they would not be required to comply with the requirements applicable in each one of those jurisdictions. As CESR pointed out this is a "burdensome" requirement for issuers. We agree with CESR's suggestion that the relevant competent authorities recognise insiders lists prepared by an issuer that has a registered office in another EU or EEA Member State, according to this Member State's requirements.

Finally a topic which should be addressed in CESR guidelines is that of the moment when a person has to be registered in the insider list. It is not clear if a potential access to inside information may be a condition for a person to be registered, even if that person has not actual access to any piece of inside information. For instance, in case a new project is planned but not worked out in detail - so that the information is not yet "precise" – the question arises if the personnel that is likely to be involved in the future development of the project should already be registered in the insider list.
