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The Committee of European Securities Regulators
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Public consultation: second set of CESR guidance and information on the common operation of the Directive to the market

The Lamfalussy approach to harmonisation has proved highly successful and its centrepiece may be said to be the co-operation among European securities regulators that ensures a unified understanding and application of level 1 and 2 instruments. The public consultations play an important part in achieving the best possible guidance from CESR and I am happy to respond to the issues raised in the consultation paper (CESR/06-562).

As I agree with the understanding of inside information presented by CESR in Chapter I of the consultation paper on what constitutes ‘inside information’, I would like to draw attention to a related matter of some importance for Chapter II on when delaying publication of inside information may be legitimate.

It is, I believe, very important to distinguish between the regime on insider trading governed mainly by Article 2 of the Market Abuse Directive and the regime on mandatory disclosure that is governed by Article 6 of the Directive. Both are governed by the need to ensure the smooth functioning of securities markets and public confidence in markets that are mentioned as the purpose of the Market Abuse Directive in cons. 2 of its preamble and both regimes apply the notion of ‘inside information’. However, the two regimes are distinct and work independently of each other. It would be helpful if CESR would comment on the interaction of the insider trading regime and the related regime on mandatory disclosure.

I should be noted that in respect of mandatory disclosure the Commission in its Directive 2003/124/EC Article 2(2) states that:

2. 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.

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When addressing the definition of inside information in respect of the requirement that it should be of 'a precise nature', the Commission in Article 1(1) of said Directive rightly emphasises that:

*information shall be deemed to be of a precise nature if it indicates a set of circumstances which exists **or may reasonably be expected to come into existence** or an event which has occurred **or may reasonably be expected to do so** and if it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments.*

I have taken the liberty to highlight the difference between the definition of 'inside information' in Article 1(1) and the obligation to make a public disclosure in Article 2(2). The difference is, of course, that information may constitute 'inside information' at a point in time before the issuer is obliged to make the said information public. Because the obligation on the issuers to make inside information public only arises 'upon the coming into existence of a set of circumstances or the occurrence of an event', it is important to ensure that such inside information is not used for insider trading before that.

Consequently, it should be observed that information may qualify as 'inside information' at a time when the issuer is not yet obliged to make it public according to Article 2(2) of Commission Directive 2003/124/EC.

Furthermore, Article 6(2) of the Market Abuse Directive makes it plain that it refers to the situation when public disclosure should be made but is delayed by the issuer. Thus, this must be at a time *after* the duty to disclose has been reached according to Article 2(2) of Commission Directive 2003/124/EC since only at this point can there be any delay. Whether such delay is then justified is the subject for Chapter II of the consultation.

I think it would be useful if CESR were to comment on how the two regimes on insider trading and mandatory disclosure work at different stages. Basically, the following outline would appear to apply:

Time 1: The information is not of a precise nature. The information does not qualify as 'inside information'. No ban on using the information for trading applies. The issuer is not obliged to make the information public.

Time 2: The information is of a precise nature because it pertains to a set of circumstances which may reasonably be expected to come into existence. If the other requirements are fulfilled the information qualifies as 'inside information' and the information may not be used for trading according to Article 2(1) of the Market Abuse Directive. However, the issuer is not obliged to make the information public, because the set of circumstances has not yet come into existence according to Article 2(2) of the Commission Directive 2003/124/EC.

Time 3: The set of circumstances mentioned at time 2 has come into existence. The insider trading ban still applies. The issuer is now under an obligation to make the inside information public.

Time 4: The conditions at time 3 apply, however, the issuer decides to delay making the inside information public according to Article 6(2) of the Market Abuse Directive in order not to prejudice its legitimate interests.

Time 5: The conditions at time 4 apply, however, delay can no longer be justified in the issuer's legitimate interests and the issuer is obliged to make the inside information public.

Time 6: The information is made public by the issuer and thereby ceases to be 'inside information'. The ban on insider trading is no longer applicable.

Based on this understanding of the level 1 and 2 instruments, it is possible to provide examples of what may justify delay according to Article 6(2) of the Market Abuse Directive as requested in Chapter II of the consultation.

First of all, instances that are not yet final as required in Article 2(2) of the Commission Directive 2003/124/EC are not subject to disclosure according to Article 6(1) of the Market Abuse Directive and cannot therefore be subject to delay according to Article 6(2). This would cover, for example, proposals for decisions submitted to the board of the issuer for decision. Again, it should be noted that such information may qualify as 'inside information' because it may be of a precise nature, e.g. where there is a certain likelihood that the decision will be taken by the board, and as such it may constitute insider trading to use the information for trading purposes, but the proposal is not of such a final nature that it is subject to mandatory disclosure. The final decision made by the board may be subject to public disclosure, but the market would not expect the proposal to be disclosed before that. It may even confuse the market if proposals were disclosed only later to be retracted if they were turned down by the board.

On the other hand, decisions that are final may damage the company if they were disclosed to the public, for example decisions pertaining to business strategy such as how to penetrate new markets, when and how to launch new products, or which new research and development projects that should be initiated, and may for that reason be covered by Article 6(2) of the Market Abuse Directive. Again, this kind of information may constitute 'inside information', indeed it may often do so and as such is subject to the insider trading ban, but it is not normally considered subject to mandatory disclosure because it would be detrimental to the issuer vis-à-vis its competitors.

It should be noted that such sensitive inside information may be delayed for a considerable time, even indefinitely. For example, a plan comprising a particular business strategy may be adopted by the board of a publicly traded company

and although the plan itself constitutes 'inside information' and initiatives taken according to the plan, e.g. acquisitions and other transactions, are disclosed according to Article 6(1) of the Market Abuse Directive when they occur, the plan as such may never be publicly disclosed due to Article 6(2) of the Directive.

The same would be true in respect of trade secrets and know-how generated by a publicly traded company. Not all information of this kind is protected by intellectual property rights such as patents or copy right. Some information may be important but not important enough to merit protection by IPR law, while in other cases the company may refrain from seeking IPR protection in order to keep it confidential. Such information may constitute 'inside information' if its effect on the market price of the issuer's securities has not yet manifested itself. Here again, it may be justifiable to delay public disclosure of it according to Article 6(2) of the Directive for even very substantial periods of time as long as public disclosure of the information is deemed to be detrimental to the interests of the company.

I believe it would be helpful if CESR would comment on the interplay between the insider trading ban and the rules governing mandatory disclosure along these lines when issuing its final recommendations for level 3 guidance in this area.

Yours sincerely

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