Asociación de Mercados Financieros (AMF)
Euribor ACI European Commission Working Group
Finnish Association of Securities Dealers (FASD)
Futures and Options Association (FOA)
Norwegian Securities Dealers Association (NSDA)
London Investment Banking Association (LIBA)
Swedish Securities Dealers Association (SSDA)

Response to CESR consultation on Market Abuse Directive, Level 3 – second set of CESR guidance and information on the common operation of the Directive to the Market (Ref: CESR/06-562)

General comments

1. This CESR guidance aims to complement the Directive (2003/6/EC) and in particular the Implementing Directives 2003/124/EC regarding the definition and public disclosure of inside information and the definition of market manipulation, and 2004/72/EC regarding accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions. It also aims to complement the previous CESR guidance (CESR/04-505b) concerning accepted market practices in relation to market manipulation and reporting of suspicious transactions.

2. Based on the existence of the implementing directives mentioned, the Joint Associations are not convinced of the need for further guidance proposed by CESR by means of this document. Although there are parts of the suggested guidance with which we do agree, there is always a risk of overregulation even if, as in this case, it only concerns regulation in the form of guidance. The Associations feel there is a risk that issuers might overdo their disclosure in order to be on the "safe side" the end result of which could be more confusion and information overload in the market.

3. It is important that the guidance clearly explains its legal status as guidance and what that concept implies from a legal perspective. We suggest that the guidance refer to the legal fact that finally the courts have the ultimate power to interpret EU directives and regulations.

4. The Joint Associations believe that the proposed guidance taken as such has been prepared in a thoughtful and thorough manner by CESR.

Comments on Specific Guidance Proposals *(following CESR's numbering)*

1.3 We are uncertain what is meant by the statement that the presence of precise information or of significant price effect may have an intensifying effect on the presence of the other. The paragraph goes on to say that CESR believes it is possible to identify these factors separately. Under the directive it is necessary to treat these factors separately. We suggest the reference to "intensify" be withdrawn. This reference could cause confusion.

1.5 We propose that the second key issue be stated as "the key issue is whether a reasonable person could draw this conclusion based on ex-ante information available at the time". It is important that there should be a clear and objective standard to obviate the possibility of arguing that there may be two reasonable views on this point. It must be clear that a reasonable man would conclude that a circumstance exist or an event has occurred - not merely that a man may reasonably conclude that a set of circumstances will come into existence.

We strongly agree that issuers are generally under no obligation to respond to market rumours which are without substance. We would propose that this statement be extended to include speculation.

1.7 This paragraph stretches the concept of precise information in a way which may lead to confusion. This paragraph should be withdrawn unless there is a more straightforward example to be given.

1.8 One example given refers to an investment decision which could be taken without risk, but it is not clear which "risk" is at issue. The risk of loss? The risk that the information is not accurate? The risk that the information will not significantly affect price?

The second example refers to information which is likely to be exploited immediately on the market. The meaning of "exploited" is not clear in this context. If the intent is to refer to information which will immediately lead to market activity, there should be a qualification that the activity will be by reasonable investors and is such as to lead to significant price change. However, this may be a truism i.e. information which leads to significant price movement is by definition precise information. These examples do not greatly illumine the issues and could be misconstrued.

1.11 It would be advisable to mention in this paragraph that the courts have the final authority to determine the meaning of directives and regulations.

1.12 This is an example where the guidance may provide less clarity. The word likely is generally understood as something more likely than unlikely to happen. CESR's guidance does not stress the important message which is the degree of

likelihood. This should mean clearly more than 50% probability, but CESR is merely talking about the low end and high end of the probability scale. We propose that this paragraph indicate that "likely" means "clearly probable".

1.14 The first bullet point should theoretically also refer to instances where the same type of information has led to insignificant effects on prices. Such history could also be relevant to the issue whether there is likely to be a significant price effect.

The second bullet point should theoretically also refer to previous research reports which have not treated similar information as price sensitive. Here the question arises as to whether issuers have an obligation to follow all or any research reports concerning their company. We do not believe that companies should be so burdened.

The third bullet point should make clear that, where a company has previously treated the event as price sensitive, it is also relevant whether the event proved to have a significant effect on price. If it did not, a different conclusion could be drawn. Also, this bullet point should equally refer to previous treatment where the event was considered as insignificant, perhaps by the addition of the words 'or not' at the end of the point.

Ultimately what actually matters is not previous treatment by the company or a research analyst. What matters is whether there was a significant effect or insignificant effect on price arising from the similar event previously. We would very much prefer that the bullet points be withdrawn because they may lead to confusion and misinterpretation.

1.15 There are at least one very important event missing out from the list of circumstances and that is "profit warnings" which may encompass events like "Operating business performance".

More generally the list is imprecise in the sense that it sometimes qualifies the degree of the issue sometimes does not, e.g. "Operating business performance;" is unqualified but "Serious product liability or environmental damages cases;" has a qualified degree. The qualifier "material" would fit in some cases.

We turn now to the list of information that directly concerns the issuer. It is stated that a change in auditors could be inside information. The Associations agree with CESR on this. But CESR goes on to add "…or any other information related to the auditors' activity;" We believe this is too vague as well as too onerous a criterion to be included because it could encompass almost anything related to the auditors' activity which would be hard to assess by the issuer. Routine work and investigatory work should not be considered as price sensitive unless there is a finding of a material problem or the probability of a material problem. We suggest that this language be withdrawn.

"Operations involving the capital" is vague. It should be withdrawn or clarified.

"Decisions concerning buyback programmes or transactions in other listed financial instruments" should be clarified to refer to the company's own securities.

"Significant legal disputes" and "serious product liability or environmental damages cases" should be combined and be qualified with a requirement that the cases involve material damages or regulatory sanction (fine, withdrawal of license).

"Revocation or cancellation of credit lines …" should be qualified by reference to the reason for cancellation and to a standard of "material effect on financing".

"Relevant changes in assets' value" should be restated as "material changes …"

"Insolvency of relevant debtors" should be qualified to include only debts of material importance to the company.

"Reduction of real properties' values" should refer to "material reductions …"

"Physical destruction of uninsured goods" should be stated with a "material value" qualifier.

1.16 As regards information which relates indirectly to issuers there is an important difference from information directly related to the issuer. In the latter case it is only the issuer that initially has access to that information whereas in the case of indirect information that will be known by the entire market once it becomes disclosed. We believe CESR is going too far in saying that the definition of inside information in the directive encompasses indirect information. This is true only in certain circumstances. The main Directive 2003/6/EC says

> 1. 'Inside information' shall mean 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.

This wording implies that only if the information that is … indirectly related to one or more issuers has not been made public, it will be defined as inside information. This means that any such indirect information once published by the relevant third party does no longer constitute inside information. It does not follow from the provisions of the Directive that the issuer has to disclose any

consequences in connection with such disclosed indirect information. The rational for this would be that market participants may assess the effects of a certain piece of information indirectly related to the issuer/s affected by that information. This is also supported by the wording in the implementing directive 2003/124/EC where we believe 'information' should be read as 'any information, i.e. directly or indirectly, related to the issuer':

> 2. For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC, 'information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative financial instruments' shall mean information a reasonable investor would be likely to use as part of the basis of his investment decisions.

Thus we believe that it would be unnecessary and burdensome for the issuer to disclose the consequences when information indirectly related to the issuer is already disclosed to the market.

On the other hand, if the piece of information is still undisclosed and thus constitutes inside information there is no obligation imposed on the issuer to disclose it – provided that the issuer has any knowledge of the information which his highly unlikely. The problem is that on the one hand the issuer is not obliged and has no right to disclose indirect inside information and on the other hand the issuer will be obliged - according to CESR's proposal - to disclose the consequences of such inside information which would also imply a disclosure of the indirect information.

Consequences of the facts described in the examples should be in relation to the company's performance as measured by its profit and loss account and not as measured by the market price of a financial instrument. A board is responsible for the profit results of the company. It is not responsible for managing or measuring perceptions in the financial markets or volatility in the markets.

Some of the examples given would be outside the competence of the boards of most companies to consider. This would be the case with respect to decisions changing the governance rules of market indices, decisions regarding changes in markets' rules, changes in trading mode, and changes in market maker or dealing conditions. These examples may be confusing and may lead to unfair regulation. We would recommend these examples be withdrawn.

To conclude we propose that this paragraph make clear firstly, that the prohibition to enter into transactions refers to those situations where an issuer has knowledge of the facts, that are indirectly related to it as described in the listed examples, before they are publicly announced. Secondly, after the publication of the facts described, there should be no obligation on a company to disclose the consequences resulting from such disclosed facts as listed - even if these

consequences constitute inside information about the issuer. Such consequences may be discernable from the already disclosed facts by a reasonable investor or by an analyst. Such an obligation on the issuer to disclose the consequences would be burdensome, unnecessary and in many cases already obsolete information.

3.1 Conceptually, it is possible to distinguish between a client's order and information conveyed by a client which is related to that client's pending order as stated in the Level 1 Directive. It is possible to say that the failure to specify that a client's order itself is covered by the definition of inside information is an indication that such was not intended. The language could be viewed as catching other non-public information concerning the issuer which may be among the reasons the investor has decided to give the order.

Such an interpretation of the Directive would relieve market makers from the constraining concern that handling any pending customer order to buy or sell any security prevents it from trading the security for its own account in a moving market. Instead the market-marker would be governed by the requirements of MIFID to give best execution to clients on whose behalf they act as agent.

3.5 This paragraph is based on a view that pending orders are inside information. If broadly utilized, this interpretation may impede the liquidity of a security needlessly given the protections otherwise afforded to clients of intermediaries acting as agent.

3.6 – 3.7
CESR is citing the main Directive and the Implementing Directive that is all about information that relates directly or indirectly to one ore more issuers of financial instruments or to one or more financial instruments but not to order. The question is whether the directives encompass the true order data i.e. the name of instrument, order volume, price, timing etc. or whether they concern only additional information related to the pending order conveyed by the client e.g. "this order is related to a pending public offer". If the directives refer only to such additional information, CESR is the proposed guidance under 3.8 – 3.16 would be incorrect.

3.8 CESR is here talking about when a client's pending order is inside information whereas the directives do not refer to the pending order as such but to any information related to the pending order. This means that it is not the true order data - which in fact constitutes the order - that is targeted by the directive, but rather additional inside information that the client conveys to the intermediary. Our interpretation of the directives implies that CESR is wrong in its inclusion of the pending order as such in the concept of inside information.

3.10 Orders displayed according to the rules of the market are 'made public' within the meaning of the Directive. Information about them cannot therefore be 'inside'

information. It should not be necessary to take a view about the nature of information relating to a partially displayed order.

3.13 (g) The identity of a client is listed as a factor which may be price sensitive. However, this is not generally a factor to be considered by a reasonable investor who is unaware of the investment basis of the identified client. For example, to know that Warren Buffett is selling X is not a rational basis to sell a position or to go short. Mr Buffett could have a variety of reasons for selling which do not apply to most or any other investors. Our point here is that considering what speculators may do with some piece of information should not be part of the analytical process for determining whether information is inside information.

3.13 (h) This merely states a conclusion without any rationale.

4.5 MAD does not itself establish whether the governing law for the insider list would be the home state or the host state, where a company has its shares admitted to trading only in one host state. Paragraph 4.3 describes the problem which has occurred where a security is admitted to trading in more than one host state. Paragraph 4.5 could be read to say that, where there is only one host state and the company's securities are not admitted to trading in its home state (where the registered office is), the law of the home state would govern. On the other hand it could be read to say that the law of the only host state would govern unless there are other host states. Perhaps it would be simpler to agree that the home state law governs in all cases whether or not a company's securities are admitted to trading in its home state.

2 February 2007