

EALIC'S REPLY
to
CESR'S CALL FOR EVIDENCE
of 19 JUNE 2006
EVALUATION OF THE SUPERVISORY FUNCTIONING OF THE EU
MARKET ABUSE REGIME

31 OCTOBER 2006

EALIC welcomes CESR's Call for Evidence to evaluate the supervisory functioning of the EU Market Abuse regime after its first one and a half year of existence. We have listed hereinafter the comments we received from our members in this respect.

I. Lack of harmonisation and national differences

As a matter of principle, it is preferable that level 2 technical implementing measures for Directives under the FSAP take the form of Regulations which are directly applicable, rather than Directives which require implementing measures and therefore bear the risk of leading to differences among EU countries.

Even in areas covered by a Regulation, strongly embedded habits may sometimes lead national competent authorities to adopt different standards. This could possibly be avoided by indicating the envisaged level of harmonisation in a clear and unequivocal manner.

In general, it is advisable to give guidance to Member States on how to implement EU directives. However, this guidance must be carefully construed. Informal EU processes may influence the final legislative output: for instance, transposition meetings held at the Commission sometimes provide interpretations that are not necessarily in line with the text approved by the Council and the Parliament. This is an area where CESR and the Commission could liaise better than they have done so far.

Finally, it should be avoided that implementing measures give rise to diverging translations.¹ In such cases, where the Regulation is directly applicable in all Member States from the moment of its publication in the Official Journal of the European Union, the European Commission should be enabled to rapidly remove possible uncertainties resulting from diverging translations.

¹ For example, the English and French versions of Art. 5, § 1, of Regulation 2003/2273/EC concerning the trading conditions of buy-back programs are not in keeping with each other. Note that divergences do not only occur at the level of implementing measures: the Dutch version of Art. 6 of MAD uses the words "verlangen" meaning "desire" instead of "zullen vereisen" meaning "shall require".

In short, we recommend a further assessment of

- how local legislators cope with possible language difficulties during the implementation process of MAD
- the interpretational problems they encounter (e.g. definitions and their meaning, ...)
- the impact these factors have/had on the national legislation.

The problems identified hereinafter will illustrate what we said above.

II. The definition of inside information

The Market Abuse Directive 2003/6/EC, hereinafter “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 is “precise” enough for an insider to take an investment decision (stock prices of the target company will rise, stock prices of the bidder company will fall), but not precise enough to allow a non-insider to take a well informed decision: it is not possible to know when prices will have reached the “right” level, as long as the bidder’s offer for the target’s shares is unknown. As a consequence, the disclosure of information on such contemplated transactions may be detrimental (and somehow manipulative). Indeed, while preventing insider trading, dissemination will increase stock-prices volatility, because investors will speculate on the expected prices². As a result, 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 insider information that needs to be disclosed.

III. Who must disseminate inside information

In some Member States the publication of inside information regarding a given issuer may be carried out by the natural or legal person controlling that issuer. In dual-listed companies, this could create problems as far as jurisdictions with divergent provisions are concerned. The controlling entity that publishes information about the controlled company could in fact even be regarded as a manipulator by a foreign authority in case the inside information does not develop into a certain event. Enhanced coordination among Member States (especially in the Lamfalussy level 3 context) could avoid such

² Note that the explanatory memorandum to the proposal of MAD explains Art. 6 by pointing out that a “discussion on a potential take-over bid” could be considered as inside information to be disclosed to the public.

problems. Alternatively, these issues should be addressed with a higher level of harmonisation in the relevant Directives.

IV. Delaying the disclosure of information

In some circumstances the disclosure of inside information may be delayed. However this remedy has been devised in such a way that it has lost most of its interest for issuers. Indeed, one of the prerequisites for delaying dissemination is that the “*omission would not be likely to mislead the public*”. But the definition of “inside information” implies that a reasonable investor would rely on it for his decision. Thus, any delaying of dissemination may be misleading *per se*. The uncertainty thus created could lead to an increase of litigation.

Moreover, in a few Member States, legislation does not fully reflect the European rules. In at least one country, the law provides that the Financial Authority may identify the measures necessary to ensure that the public is correctly informed in case the dissemination is delayed. However, the relevant European directives do not provide a clear basis for this, the consequence being that the competences of the Authority in this case are much more far reaching than they should be in a fully harmonised context.

There should be precise rules on the procedure that must be followed in view of delaying the disclosure of inside information.

V. Managers' transactions

A. Threshold below which no notification is required

According to Art. 6, § 2, of Directive 2004/72/EC, Member States may decide that no notification is required or that it may be delayed until the total amount of transactions has reached 5.000 euros. This threshold is too low. In order to provide the market only with information on significant transactions operated by managers, it would be advisable to raise this threshold to for instance 10.000 to 25.000 euros a year.

In addition, according to the said Directive, the threshold has to be calculated on the basis of the transactions conducted by both the person discharging managerial responsibilities and the person closely associated to him. Such a rule seems likely to create difficulties when assessing the responsibilities of people involved in the relevant transactions: what if one of them does not know of the transactions conducted by the other?

B. Definition of persons closely associated with a person discharging managerial responsibilities within an issuer of financial instruments

The definition laid down in Art. 1, § 2d, of the Commission's implementing Directive 2004/72/EC is way too broad. Indeed, it extends the notification duty to legal persons (or similar)

- i) that are managed by a director (or similar) of the listed company, or

- ii) that are managed by a spouse, child or parent by that director, or
- iii) that are directly or indirectly controlled by the persons in i) or ii), or
- iv) that have been set up for the benefit of the persons in i) or ii), or
- v) whose economic interests are substantially the same as the interests of the persons in i) or ii),

This would mean that for instance a legal person (thus in practice the director of that legal person) that conducts banking activities and is managed by a director of a listed company, or by his spouse, child, etc., will be obliged to notify the transactions that the bank conducts in shares of that listed company.

It is necessary to restrict this definition, for instance by clarifying that only transactions for the bank's own account are concerned, or to restrict it to legal persons set up for the benefit of the director. At least, it should be clarified at level 3 how this provision must be interpreted.

VI. Lists of insiders

A. "Acting on behalf" and "for their account"

The expressions "*acting on behalf*" and "*for their account*" (of issuers) used in Art. 6, § 3, 3, should be clarified and the distinction between them explained in terms of legal meaning.

B. Timing of registration

An important element that causes uncertainty concerns the question when to register the relevant person in the list: when access to inside information is possible or has become a fact?

C. Identity

There should be harmonisation of what is understood by the "identity" of any person having access to inside information (Art. 5, § 2a, of Directive 2004/72/EC) in order to allow companies operating in different Member States to use harmonised procedures when they draw up and up-date permanent or occasional insiders' lists.

The components of the identity could be:

- for natural persons: name, first name, professional address, name of the relevant issuer, professional telephone and e-mail address;
- for legal persons: corporate name, type of company, activity, professional and e-mail address, contact person, telephone number.

Moreover, Art. 6, § 3, of MAD obliges issuers, or persons acting on their behalf or for their account, to draw up a list of those persons working for them, under a contract of employment or otherwise, who have access to inside information, and to regularly update

this list. It should be clarified at European level that the issuer is obliged to include only the corporate name of this third party (in most cases indeed the latter is a legal person) and not the names of all the natural persons possibly having access to the insider information within this third party.

D. Data integrity measures

It is also advisable to provide for European harmonisation on the necessity (or not) to protect the integrity of the data in insiders' lists.

E. Storage

According to Art. 5, § 4, of Directive 2004/72/EC, Member States shall ensure that insider lists be kept for at least five years after being drawn up or updated. The length of the storage period is particularly burdensome. Indeed, any update of the list triggers the start of another five year storage period, leading to multiple and often voluminous lists being stored at the same time.

A possible solution would be to align the length of storage with prescription periods in the different Member States.

VII. Safe harbour

The scope of the safe harbour provided for in Article 8 of MAD needs clarified. Art 3 (b) of the Commission Regulation 2273/2003 allows *inter alia* buy-back programs that are necessary to meet obligations in employee share option programs or other allocations of shares to employees of the issuer or of an associate company. However, most companies propose to grant share options not only to employees, but also to directors of the company or of an associate company. As a consequence, it is not clear whether the safe harbour also applies to options granted to directors who don't qualify as employees.
