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Comments of the Zentraler Kreditausschuss on the CESR Consultation Paper "Market Abuse Directive Level 3 - Third Set of CESR guidance and information on the common operation of the Directive to the market"

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As mentioned in our position paper of 23 September 2008, the German banking industry believes that the Market Abuse Directive has functioned successfully since its entry into force in 2004.

We warmly welcome the fact that the solutions proposed by CESR in its consultation document are practicable. The level of detail is also appropriate in our view, especially given that no major practical difficulties have emerged with regard to stabilisation and buy-back programmes or the definition of inside information. We do not believe that a few open questions justify completely overhauling the existing requirements, as has occasionally been suggested. Such a reorganisation would inevitably give rise to new questions, making it doubtful that greater legal certainty could really be achieved. This also applies to the issue currently under discussion as to whether it makes good sense to have a single definition of what constitutes an insider for the purposes of both the ban on insider dealing and ad-hoc disclosure. The possibility to delay the disclosure of inside information gives issuers an effective means of protecting a legitimate interest in confidentiality.

Our comments on the specific issues raised in the consultation paper are as follows:

I. Stabilisation and buy-back programmes

Safe harbour principle

We share CESR's view that stabilisation measures falling outside the safe harbour cannot automatically be regarded as abusive. There is a need, instead, to examine on a case-by-case basis whether a particular activity constitutes market abuse. We also agree with CESR that the safe harbour does not cover sell transactions. Here, too, each case must be examined individually to determine whether or not it should be deemed market abuse.

This interpretation of the functioning of the safe harbour can also be inferred from Recital 2 of Commission Regulation (EC) No. 2773/2003, which expressly states that trading in own shares in buy-back programmes and activities aimed at stabilising the price of a financial instrument should not in themselves be deemed to constitute market abuse even if they do not comply with the implementing measures for Article 8 of Directive 2003/6/EC.

One member state’s regime

The number of inconsistencies between the legal regimes of member states is likely to be fairly limited. Rules on stabilisation activities are set by an EU regulation, which as such applies directly in all member states and thus excludes inconsistencies arising from differing implementation in national law. It is nevertheless possible that the competent authorities in different member states may interpret the regulation differently. Further efforts by CESR to increase the level of harmonisation are therefore to be welcomed.

We cannot support the proposal that stabilisation activities should be governed by the legal regime in the member state in which the security is first admitted to trading on a regulated market. This approach is inconsistent with the home member state principle, which is the basis of other European legislation implementing the Financial Services Action Plan. What is more, it is at odds with the provisions of the Market Abuse Directive. As CESR correctly points out, Article 10 of Directive 2003/6/EC requires each member state to apply the prohibitions and requirements of the directive to

(a) actions carried out on its territory or abroad concerning financial instruments that are admitted to trading on a regulated market situated or operating within its territory or for which a request for admission to trading on such market has been made; and

(b) actions carried out on its territory concerning financial instruments that are admitted to trading on a regulated market in a member state or for which a request for admission to trading on such market has been made.

Since Regulation 2273/2003 applies in all member states, the proposal can only refer to the interpretation of the provisions. But this could result in different rules applying to the stabilisation of different financial instruments traded on the same market depending on whether or not the instrument in question was first admitted to trading in the member state in which the market is situated. This seems confusing. Multiple listings notwithstanding, the same rules should apply to all securities listed on one and the same market.

There are sometimes different approaches in different European countries to the interpretation of rules governing aspects of market abuse other than stabilisation. Coordination by CESR at Level 3 has been unable to eliminate these differences to date. There is, for instance, uncertainty about whether guidance issued by one competent authority on the scope of a particular type of market abuse is supported by other competent authorities. In May 2007, for example, the UK's FSA published extremely helpful guidance concerning block trades and the market abuse regime in issue no. 20 of Market Watch. This guidance reflects de facto practices in other member states. Nevertheless, it would be useful and establish greater legal certainty in all member states if CESR confirmed that it shared the views expressed by a particular national supervisor (in this case the FSA).

Sell side trading during stabilisation periods

CESR's views are well founded, in our view, and reflect the prevailing interpretation in Germany.

Refreshing the greenshoe

CESR's view on sales during a stabilisation phase reflects that of German market participants. This position is logical, in our opinion, since sales of securities are not covered by the safe harbour under Regulation 2273/2003.

This is not, however, to say that stabilising purchases following sales of securities during a temporary recovery in a volatile environment should no longer be exempt under Article 8 of the Market Abuse Directive. As long as stabilisation activities otherwise comply with the requirements of Regulation 2273/2003, there is no discernible reason why this regulation's exemption from the ban on market abuse should no longer apply after the first resale of securities purchased for stabilisation purposes.

The statement that transactions of this kind do not necessarily constitute market abuse does not really help matters. This is because it fails to clarify what requirements need to be met in order for behaviour to be deemed legally acceptable. Given the broad definition of market manipulation in Article 1(2) of the Market Abuse Directive (and Section 20a, paragraph 1 of the German Securities Trading Act), this situation is unsatisfactory. These stabilising purchases should therefore continue to be covered by the safe harbour under Regulation 2273/2003, particularly since the regulation itself gives no indication that its scope should be restricted in the manner which CESR proposes.

It would consequently be desirable for CESR to clarify that the resale of securities purchased for stabilisation purposes does not prevent the complete exercise of the greenshoe option during the stabilisation phase and that, after the shoe has thus been refreshed, this exercise of the option continues to be exempt from the ban on market abuse provided that the safe harbour criteria under Regulation 2273/2003 are met. This is also the unanimous view of legal literature in Germany.

We are unable to see the contradiction which CESR evidently perceives between this view and Recital 19 of Regulation 2273/2003. Recital 19 states that

> "Overallotment facilities and 'greenshoe options' are closely related to stabilisation, by providing resources and hedging for stabilisation activity."

Even if sales are made to "refresh" the greenshoe, they do nothing to change the original overallotment or its purpose, namely to achieve stabilisation while avoiding unnecessary financial risk. Furthermore, sales aimed at "refreshing" the greenshoe do not constitute overallotment. They are outside the scope of Article 11(a) of Regulation 2273/2003 since they are undertaken after the end of the allotment period. The fact that the exercise of the greenshoe option – should it be granted by the issuer – increases the proceeds of the issue is also no reason to consider the exercise of the option abusive. The objective is not to influence the market price and so there is no justification to restrict the use of the greenshoe option or the application of Regulation 2273/2003 to the option.

Finally, we also reject CESR's proposal to restrict the exercise of the greenshoe option when sales of the security are undertaken "shortly" before the option is exercised. It is totally unclear how long a period the term "shortly" is meant to signify. It is, moreover, open to question whether CESR is in a position to exclude transactions from application of the safe harbour rules of Regulation 2273/2003 when these transactions are clearly covered by the regulation's wording.

Third country stabilisation regimes

Greater consistency between stabilisation regimes in jurisdictions outside and inside the EU would most certainly be desirable, in our view.

It would also make good sense for CESR to specify which regimes in jurisdictions outside the EU are substantially consistent with the rules inside Europe so that it would be clear that compliance with such regimes will not constitute market abuse. A system of this kind is already in place in the UK, for example, where Chapter MAR 2.5 of the FSA Handbook confirms the equivalence of stabilisation rules in the US, Japan and Hong Kong.

Reporting mechanisms

We would welcome the proposed clarification of this information by the competent authorities (as well as the publication by CESR of a consolidated list of communication channels recognised by individual national competent authorities).

Mechanism for public disclosure

Question 1:
Since the enactment of the Transparency Directive there has been uncertainty among German market practitioners about what constitutes "adequate public disclosure" pursuant to Article 2(5) of Regulation 2273/2003. This is because of the unclear legal position arising from a complex web of references to various items of European legislation. We would be happy to provide more detailed information about this point on request. Guidance by CESR would therefore be extremely helpful since the reference to Article 2(5) of Regulation 2273/20 is no longer clear now that the Transparency Directive has been transposed into national law.

Alternatively, it would be worth considering whether the disclosure methods under Article 14(2) of Directive 2003/71/EC (Prospectus Directive) should be deemed sufficient to constitute "adequate public disclosure". An argument in favour of this approach is that, under Article 9(1) of Regulation 2273/2003, the adequacy criterion is satisfied by the publication in a prospectus of the information to be disclosed before the start of a significant subscription offer. The publication of the prospectus is governed, in turn, by Article 14(2) of Directive 2003/71/EC.

Question 2:
Given that different terms are used in Regulation 2273/2003, the distinction indicated by CESR is essential, in our view.

It would nevertheless be useful if supervisors issued a non-exhaustive list of acceptable mechanisms for disclosing information under Article 4(4) of Regulation 2273/2003. These could, for example – along the lines of Article 14(2) of Directive 2003/71/EC (Prospectus Directive) – include publication on the issuer's website or in an official stock exchange gazette.

II. The two-fold notion of inside information

As mentioned in our introductory remarks, we see no need at this stage to abandon the single definition of insider for the purposes of both the ban on insider dealing and the disclosure of inside information by issuers. In our view, the possibility for an issuer to delay the disclosure of inside information to protect a legitimate interest in its confidentiality is sufficiently practicable.

III. Rumours

We consider it appropriate that CESR does not generally deem issuers to be under an obligation to respond to rumours. We also consider it correct to make an exception to this principle if the rumour contains an element of truth which itself constitutes inside information. In these cases, the emergence in the market of a rumour may indicate that the issuer has been unable to keep inside information confidential. We share CESR’s view that the issuer is then obliged to disclose the relevant information. CESR’s final document could, however, underline more clearly the exceptional nature of such an obligation and illustrate it with examples. The criteria for exemption from the “no comment” policy which were discussed at the CESR hearing on 26 November 2008 should be reflected in the final document, i.e. the rumour

- should refer to an actual item of *inside information*,
- be sufficiently precise to indicate a *leak of information*, and
- be based on a *breach of confidentiality* within the issuer.