German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

ESMA Consultation Paper: Draft guidelines on the Market Abuse Regulation

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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I. Preamble

Article 11(11) of Regulation (EU) No 596/2014 of the European Parliament and of the Council on market abuse (MAR) requires the European Securities and Markets Authority (ESMA) to issue guidelines addressed to persons receiving market soundings. Article 17(11) of MAR requires ESMA to issue guidelines on legitimate interests of issuers in delaying the disclosure of inside information and situations in which the delay in disclosure is likely to mislead the public. The German Banking Industry Committee (GBIC), which represents about 1,700 banks in Germany, welcomes the opportunity to comment on ESMA's draft guidelines of 28 January 2016.

Please find our comments on ESMA's proposals below.

II. Detailed comments

1. Guidelines for persons receiving market soundings

Market soundings play an important role in the preparation of transactions. The guidelines on market soundings which ESMA has drafted are addressed to persons who receive the information provided in a market sounding exercise (MSRs). The requirements MSRs are expected to meet should not be so far-reaching that such exercises become excessively complicated to the extent that investors may be unwilling to take part in market soundings at all.

Q1: Do you agree with this proposal regarding MSRs' assessment as to whether they are in possession of inside information as a result of the market sounding and as to when they cease to be in possession of inside information?

We basically agree with ESMA's proposals. Article 11(7) of MAR already obliges MSRs to carry out their own assessment of whether or not they are in possession of inside information as a result of a market sounding. We agree with ESMA that MSRs should take account of all the information available to them when making this assessment. We would like to stress that MSRs are under no obligation, in our view, to obtain information from sources other than the DMP. Such an obligation would impose a disproportionate burden on the MSR. MSRs cannot overcome the fundamental problem of information asymmetry between the DMP and MSR.

Q2: Do you agree with this proposal regarding discrepancies of opinion between DMP and MSR?

ESMA's proposed guidance on dealing with differences of opinion as to whether or not information constitutes insider information appears to strike a sound balance, in our view, between the interests of the parties involved. We therefore have no objections.

Q3: Do you agree with this proposal regarding internal procedures and staff training? Should the Guidelines be more detailed and specific about the internal procedures to prevent the circulation of inside information?

As mentioned above, we believe it makes good sense to establish ground rules for MSRs. A clear allocation of responsibilities will help to ensure the smooth functioning of market soundings and is therefore to be welcomed. The scale of requirements imposed on MSRs should not, however, be such that MSRs become unwilling to take on the burden associated with market soundings and DMPs experience difficulties preparing their transactions. This would have serious economic implications and be totally at odds with the overarching goals of creating a capital markets union. We are therefore firmly opposed to the idea of more extensive or more detailed guidance on this issue than that currently set out in proposed guideline 5.

Q4: Do you agree with this proposal regarding a list of MSRs' staff that are in possession of the information communicated in the course of the market sounding?

ESMA's proposals in this area are not covered by the mandate in Article 11(11) of MAR. They clearly exceed the scope to shape the guidelines conferred on ESMA. We would refer you to our reply to Q3 and would stress that we are firmly opposed to the requirement in proposed guideline 6 to draw up a list of staff who have received information in the course of a market sounding.

We would also like to point out in this context that we strongly disagree with the requirement in proposed guideline 9(e) to keep records of these lists.

Q5: Do you agree with the revised approach regarding the recording of the telephone calls?

Yes.

Q6: Do you agree with the proposal regarding MSRs' obligation to draw up their own version of the written minutes or notes in case of disagreement with the content of those drafted by the DMP?

Yes.

Q7: Can you provide possible elements of compliance cost with reference to the regime proposed in the guidelines for MSRs?

No.

2. Guidelines on legitimate interests of issuers to delay inside information and situations in which the delay of disclosure is likely to mislead the public

Q8: Do you agree with the proposal regarding legitimate interests of the issuer for delaying disclosure of inside information?

We warmly welcome the fact that ESMA is not proposing an exhaustive list of situations in which issuers will have a legitimate interest in delaying the disclosure of inside information. As ESMA correctly points out in para 70, decisions to delay disclosure will always be made on a case-by-case basis after weighing the particular circumstances involved. It is therefore important – and right – that the examples ESMA provides are indicative only and do not attempt to cover all possible scenarios.

Following recent case-law of the Court of Justice of the European Union (such as Geltl v. Daimler or Lafonta), intermediate stages in a protracted process may be deemed information of a precise nature within the meaning of inside information under Article 7(1) of MAR, thus making their disclosure necessary at a very early point in time. The ability to delay disclosure under Article 17(4) of MAR is consequently an extremely important instrument designed to protect the legitimate interests of the issuer. A narrow definition of what constitutes legitimate interests is therefore not appropriate, in our view. The complex process of corporate decision-making needs to be taken into account. Those in positions of responsibility must be given an opportunity to exercise the necessary care when making decisions. This is required by company law and due regard needs to be given in this context to the two-tier system of corporate governance existing in Germany and Austria. If a decision (taken by the management board, for instance) is made public too early, this may create expectations which are subsequently not be met as a result of a later decision (by the supervisory board). In this case, the public will have been misled. On top of that, we see a danger that a requirement to disclose information prematurely may restrict the ability of the issuer's decision-makers to properly conclude their decision-making processes.

Against this background, the ability to postpone the immediate disclosure of inside information should be regarded as a necessary corrective designed to protect the legitimate interests of the issuer. A narrow interpretation would fail to offer the issuer an adequate level of protection. What is more, proposed guideline 1(c) and ESMA's comments in paras 76 ff. do not take adequate account of the two-tier system of corporate governance composed of a management board and a supervisory body.

We would like to raise the following specific points in this regard:

"Ongoing negotiations" are seen at level 1 (cf. recital 50 of MAR) as a possible legitimate reason for delaying the public disclosure of inside information. In para 72 of the consultation paper and proposed guideline 1(a), ESMA diverges from the requirements of level 1: where MAR rightly merely requires that the outcome of negotiations would "be likely to be affected" by immediate disclosure, ESMA requires that they would "likely be jeopardised".

The same goes for negotiations in the event that the financial viability of the issuer is in danger. While recital 50 of MAR talks about immediate disclosure "undermining" the conclusion of such negotiations, ESMA uses "jeopardising" in para 74 and proposed guideline 1(b) – a significantly stronger term and far more suggestive of failure.

We believe the guidelines should reflect the language of the level 1 text and would ask ESMA to reword these passages accordingly. The wording chosen by ESMA does not just formally exceed the framework set by MAR, moreover. It is also inappropriate from a substantive perspective. In the interests of the issuer's capacity to act and as a corrective to the broad understanding of what constitutes inside information, MAR consciously provided for delayed disclosure in order to accommodate issuers' needs in the context of negotiations on corporate actions or funding. The simultaneous ban on insider trading, which also applies during the delay, provides outside market participants with sufficient protection, so there is no need to require the premature disclosure of information about ongoing negotiations to the detriment of the issuer.

ESMA takes the view that all the conditions in para 78 and proposed guideline 1(c) need to be met (cf. also para 80). This is another excessive restriction on the right to delay disclosure. The requirement in para 78(c) is tantamount to acting in a legislative capacity since there is no legal requirement at present to obtain a decision from the second body on the same day. Nor is this normal practice. Given that the composition of the two boards is different, it is hardly even feasible to convene a meeting of the second body on the same day at short notice. What is more, the second body needs to be given enough time to come to a decision if it is to effectively carry out its supervisory function.

The expectation referred to in para 78(d) concerning the decision of the second body is not a suitable criterion. A responsible management body will never pass a decision that it itself assumes will fail to meet with the approval of the supervisory body. The supervisory body's past behaviour – referred to in para 80 – is not a suitable criterion either. The behaviour of the supervisory body is essentially determined by its composition at a given time and by the specific context surrounding the decision to be taken. Past behaviour, even in a similar set of circumstances, is no predictor of future behaviour and to assume otherwise is pure speculation. Decisions of this kind depend wholly on the individual circumstances of the particular case in question and these circumstances have to be considered and analysed at the time of the relevant decision-making. The idea that decisions by the second body (such as the supervisory board of a German *Aktiengesellschaft*) are nothing more than a rubber-stamping exercise is totally wrong and fails, in particular, to take account of the increased due diligence requirements following recent case-law and the associated personal liability risks facing board members.

If all four conditions had to be met, it would be virtually impossible to delay disclosure and the two-tier corporate governance system would be seriously undermined. In Germany, the decision of the supervisory board is by no means a pure formality, so we believe the issuer has a legitimate interest in delaying the disclosure of inside information until a final decision has

been taken. This is also the view of the German Federal Financial Supervisory Authority (BaFin) – see section IV.3.1 of BaFin's Issuer Guideline. ESMA should therefore delete the qualifying conditions (i) to (iv) in proposed guideline 1(c) or should at least establish them as purely indicative.

In para 83 and proposed guideline 1(d) on protecting the issuer's intellectual property rights, ESMA once again uses the verb "jeopardise". As explained above, we believe this term goes beyond the existing standard. Up to now, CESR's level 3 guidance has considered it sufficient to justify delaying disclosure if the issuer "needs to protect its rights" (CESR/06-562b, section 2.8). This wording should be retained in the new guidelines.

In para 86, ESMA proposes that a legitimate interest in delaying disclosure should exist if immediate disclosure would make the transaction "very likely to fail". It is extremely difficult, from a practical perspective, to predict this level of likelihood of failure. We consider it sufficient, moreover, if the early disclosure of information would increase the risk of the outcome or pattern of ongoing negotiations being adversely affected. Unlike ESMA's proposal, our view would also be consistent with MAR, since one of the examples of possible legitimate reasons for the issuer to delay disclosure mentioned in recital 50 is "ongoing negotiations, or related elements, where the outcome or normal pattern of those negotiations **would be likely to be affected** by public disclosure."

Q9: Do you agree with the proposal regarding situations where the delayed disclosure is likely to mislead the public?

We basically agree with ESMA's proposals and welcome ESMA's recognition in para 99(c) of the need for the issuer to have actively sent out signals. We would nevertheless welcome it if the guidelines made it clear that these "signals" do not include any implicit signals. On the contrary, clear, explicit signals are meant which are closely linked to the inside information in terms of both content and timing. The issuer should continue to be able to respond with a "no comment" to market expectations based on speculation outside the issuer's official communications to the capital market provided that these rumours are not due to a breach of confidentiality within the issuer's sphere of control. The delayed disclosure will not, in such cases, mislead the public.

Q10: Do you see other elements to be considered for assessing the market's expectations?

We welcome the view expressed in para 101 that the assessment of market expectations may also take account of the "consensus among financial analysts".