THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/08-717

Market Abuse Directive

Level 3 – Third set of CESR guidance and information on the common operation of the Directive to the market

Public Consultation

October 2008

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Introduction

1. CESR is continuing in its efforts to prepare ground for convergent implementation and application of the Market Abuse regime by ensuring that a common approach to the operation of the Directive takes place throughout the EU amongst supervisors. In July 2007, CESR confirmed that CESR-Pol will undertake another stream of Level 3 work on market abuse on the basis of the mandate given by CESR to CESR-Pol concerning Level 3 of the Market Abuse Directive (MAD) (Ref. CESR/04-10c) which should be read in conjunction with the Terms of Reference of CESR-Pol (Ref. CESR/06-114 replacing CESR/02-070b) and in the light of the responses to the Call for Evidence (Ref. CESR/06-664).

2. In its Work Program (Ref. CESR/07-416), CESR informed the market about the issues to be covered in its 3rd set of guidance regarding the common operation of the Market Abuse Directive (MAD). The first two issues (requirements for insider lists and suspicious transaction reports) have already been considered in the earlier consultation paper (Ref. CESR /08-274). As that consultation paper made clear, the guidance relating to stabilisation and buy-back programmes was to be consulted on later. Ultimately, all issues will be integrated into one final set of a 3rd set of Guidance. Thus, CESR intends to prepare one feedback statement for both its consultation papers.

3. Interested parties are invited to submit their comments on the draft guidance set out in this paper and send their responses via CESR's website (www.cesr.eu) under the sections "Consultations". The consultation closes on **9 January 2009**.

CESR

Draft Third set of guidance on the operation of the Market Abuse Directive

STABILISATION AND BUY BACK PROGRAMMES

Purpose:

4. Discussion of potential market questions regarding the harmonization of approach in relation to stabilisation as allowed under the Directive 2003/6/EC of the European Parliament and the Council on Insider Dealing and Market Manipulation (Market Abuse) (hereinafter referred to as "the Directive").

CESR Guidance

5. Various market participants have raised issues with CESR in response to the Call for Evidence (Ref. CESR/06-519) and with individual CESR members. The majority of these issues have been set out below and draft guidance on these issues provided.

Safe harbour principle

6. CESR members are aware that there is industry concern about the status of stabilisation outside of the exemption provided by Article 8 of the Market Abuse Directive 2003/6/EC. Recital 2 of the Buy-back programmes and Stabilisation Commission Regulations N°2273/2003 states that the activities of trading in own shares in buy-back programmes and of stabilisation which fall outside of the exemption provided by Article 8 should not of themselves be deemed to constitute market abuse. A number of competent authorities have made it clear that such activities outside of the safe harbour should not be regarded as abusive solely because they are outside of the safe harbour. The market has asked for confirmation that all CESR members have the same view.

7. CESR members share the understanding that stabilisation outside of the exemption provided by Article 8 should not be regarded as abusive solely because it occurs outside of the safe harbour. Whether activity outside of the exemption is abusive is determined in accordance with the criteria set out in the Market Abuse Directive 2003/6/EC.

Question to the market: Do you have any comments on CESR's view that stabilisation outside of the exemption in Article 8 should not be regarded as abusive solely because it occurs outside of the safe harbour?

One member state's regime

8. Cross-border stabilisation transactions can be caught by several Member States' regimes. There is an industry concern that in some cases the requirements are inconsistent and that this can add to the time and cost of transactions. Some representatives of industry have suggested that stabilisation activity should be governed by the Member State's regime where the security was first admitted to trading or issued.

9. Article 10 of the Market Abuse Directive 2003/6/EC outlines the application of the provisions of the Directive in each Member State. Whilst CESR is sympathetic to industry's concerns, it is anticipated, as part of the current work by CESR-Pol, that the level of inconsistencies between Member States will reduce. It is possible that some discrepancies will remain although it is expected that these will further reduce over time.

Question to the market: What do you regard as the most serious inconsistency that you have identified?

Sell side trading during stabilisation periods

10. Some market participants have suggested that sell transactions should be subject to the exemption provided by Article 8 of the Market Abuse Directive 2003/6/EC. The basis for this suggestion is their assertion that Recital 11 of the Buy-back Programmes and Stabilisation Regulations 2273/2003 can be interpreted to cover both buy and sell transactions.

11. CESR does not agree with this interpretation and does not support the view that sell transactions can be subject to the exemption provided by Article 8. The purpose of the exemption provided by Article 8 is to allow the price of the security to be supported and this is achieved by the purchase, rather than the sale, of securities. Nevertheless, this does not imply that sell transactions will necessarily be abusive and the criteria set out in the Market Abuse Directive 2003/6/EC should be applied to the particular circumstances.

Question to the market: Do you have any comments on CESR's views that sell transactions are not subject to the exemption provided by Article 8?

Refreshing the greenshoe

12. CESR members are aware of industry concerns that there is a lack of clarity about the meaning of "refreshing the greenshoe" and the application of Article 8 of the Market Abuse Directive 2003/6/EC to such activity.

13. "Stabilisation" is often perceived as being an activity of buying and selling of a security in order to maintain its price around what is considered as an equilibrium price. However, in Regulation 2273/2003 (art. 2(7)), stabilisation is defined as a temporary price support activity through purchases (or orders to purchase), undertaken due to the selling pressure on the concerned security. CESR's view is that selling securities that have been acquired through stabilising purchases, including selling them to facilitate subsequent stabilising activity, is not behaviour that can be categorised as being for the purpose of price support, which is the objective of stabilisation as defined in the Stabilisation Regulation 2273/2003.

14. For this reason, CESR's view is that such sales of securities are not covered by Article 8 of the Market Abuse Directive 2003/6/EC, neither would be further acquisitions conducted after such sales. Refreshing the greenshoe falls outside the scope of the safe harbour and is not covered by the exemption provided by Article 8 of the Market Abuse Directive 2003/6/EC. As set out above, this does not imply that these transactions will necessarily be abusive and the criteria set out in the Market Abuse Directive 2003/6/EC should be applied to the particular circumstances.

15. Although such sales will not be regarded as abusive solely because they fall outside the scope of the safe harbour, they should nevertheless be carried out in a way that minimises market impact and with regard to the prevailing market conditions. For example, it may be harder to demonstrate a legitimate purpose for sales which cause a drop in price to below the offer price or purport to create "capacity" when the price has been largely stable in the days before these sales, more especially in the last few days before the end of the stabilisation period. In the latter case, the entity undertaking the stabilisation should also carefully consider, before undertaking such sales, how far from the "greenshoe option" volume limit its stands, when applicable.

16. Finally, sales by the entity undertaking the stabilisation followed shortly by the exercise of the greenshoe option (when applicable) may be perceived as not being in line with the objective of the mechanisms of overallotment facility and greenshoe option, which are "closely related to stabilisation, by providing resources and hedging for stabilisation activity" (Recital 19 of Commission Regulation N°2273/2003).

Question to the market: Do you have any comments on CESR's clarification that selling securities that have been acquired through stabilising purchases, including selling them to facilitate subsequent stabilising activity, is not behaviour that is covered by Article 8?

Third country stabilisation regimes

17. Industry has concerns at the level of inconsistencies between the EU stabilisation regime and those of third country jurisdictions, such as the U.S. and Japan.

18. CESR recognises the desirability of consistent regimes and is sympathetic to this concern. It is hopeful that clarification that stabilisation outside of the exemption provided by Article 8 should not be regarded as abusive solely because it is outside of the safe harbour may contribute to a resolution of this concern. However it is likely that certain inconsistencies will remain. It may be possible to achieve further convergence as part of the ongoing dialogue between the EU and US authorities.

Question to the market: What would you regard as the difference in approach that gives rise to the most significant practical problem?

Reporting mechanisms

19. CESR members are aware that there is industry concern that in some Member States it is unclear how reports of stabilisation and buy-back programmes transactions should be submitted to competent authorities of the relevant markets. This lack of clarity can result in delays and increased costs for the entities involved in the stabilisation and buy-back programmes.

20. CESR recommends that all competent authorities should publish the mechanism(s) by which such reports should be submitted. Where possible, unless adequate arrangements already exist, this should be a dedicated email address.

Question to the market: Do you support the proposal that all competent authorities should publish the mechanism by which reports of stabilisation and buy-back programmes transactions should be submitted and that ideally this should be a dedicated email address?

Mechanism for public disclosure

21. Article 9 of Regulation 2273/2003, specifies information that must be "adequately publicly disclosed" by issuers, offerors or entities undertaking stabilisation. "Adequate public disclosure" is a defined term and refers to the procedure laid down in Articles 102(1) and 103 of Directive 2001/34/EC.These provisions of 2001/34/EC have been subsequently repealed by the Transparency Directive. The Transparency Directive (TD) deals with both dissemination and storage of regulated information (a term defined in that directive) and so the correct application of the definition set out in Regulation 2273/2003 has been a question of debate.

22. Similar notification obligations apply in relation to share buy-back programmes in accordance to article 4.4. of the Regulation 2273/2003. However there are some differences. In particular, whereas full details of the programme must be "adequately publicly disclosed", the details of the actual transactions must be just "publicly disclosed" (rather than be "adequately publicly disclosed"). There is an argument to say that there could be sufficient justification on investor interest grounds for the details of buy-back programmes to be stored under the TD mechanism and so continue to be available. However, details of the actual transactions have a more limited time-significance and so simply making them public is sufficient.

23. CESR is therefore inclined to the view that adequate public disclosure would entail the use of the information dissemination and storage mechanism(s) set up in the member state as part

of their implementation of the TD. Hence details of the buy-back and stabilisation programmes would be made available and stored for later examination as desired. Whereas, although it would be possible to make public disclosure of buy back transactions through the dissemination mechanism set up to implement the TD, it could also be done in other ways. It would be possible to meet the public disclosure requirement by using a news-wire service for example. In any event, the obligation to trade report / notify to the competent authority remains.

Question to the market: Do you support the proposal that adequate public disclosure is made through the mechanism used to implement the TD and gives rise to the obligation for this information to also be stored under the TD provisions? Do you agree that only public disclosure of buy-back transactions is required?

24. CESR has sought to deal with the majority of the substantive issues that have been raised by market participants relating to the issue of share buy-backs and stabilisation.

Question to the market: Are there any other substantive issues that you consider should be dealt with by CESR relating to these issues? If so, what are these issues and why do you consider them to be important?

THE TWO-FOLD NOTION OF INSIDE INFORMATION

25. In July 2007, CESR published a Level 3 document – the 2nd set of guidance and information on the common operation of MAD (Ref: CESR/06-562b) – which dealt with several issues related to inside information. In particular, the document provided guidance on the definition of inside information (for example, what is meant by terms such as "precise nature", "made public" and "significant price effect"), and gave detailed examples of possible inside information directly and indirectly concerning issuers. It also highlighted examples of legitimate reasons for delaying the disclosure of inside information, and gave guidance on when information relating to a client's pending orders constitute inside information.

26. The industry has provided CESR with a number of comments concerning the notion of inside information. In particular, CESR received comments from: 1) the Call for Evidence on the evaluation of the supervisory functioning of the EU market abuse regime (Ref: CESR/06-078), 2) the consultation on the 2nd set of Level 3 guidance (Ref: CESR/06-078), and 3) the ESME report.

27. Most of the comments CESR received were related to the so called "two-fold notion" of inside information.

28. CESR-Pol Level 3 work programme published on the CESR web-site on 26 July 2007 included the intention to provide further guidance on the two-fold notion of inside information. This is clearly a complex issue and raises a number of issues that are of importance to market participants. Although there have been discussions and work has been undertaken by CESR-Pol on this issue, it has become clear that at the moment CESR is not in the position to present new guidance, bearing particularly in mind that this issue will be considered by the EU Commission as part of its review of the operation of MAD provisions.

29. As the EU Commission will be producing some findings and conclusions on this issue in its review it seems unnecessary and duplicative for CESR to do comparable work at the moment. It would also risk producing guidance on something that could potentially be changing. For those reasons CESR does not intend to produce any guidance on this issue, until after the EU Commission has produced feedback on its own review.

30. There was however one issue related to the disclosure obligation of issuers under MAD that was thought to be unlikely to be changed as part of the EU Commission's review and on which useful guidance could be produced; that was on the treatment of rumours.

Rumours:

31. CESR members consider that the 2nd set of Guidance[1] could be usefully completed by additional guidance on rumours.

32. In Paragraph 1.5 of the 2nd set of Guidance, CESR members specified in the section dedicated to the precise nature of an inside information that "in general, other than in exceptional circumstances or unless requested to comment by the competent regulator pursuant to Art 6.7 of MAD, issuers are under no obligation to respond to speculation or market rumours which are without substance." Issuers are also under no obligation to respond to false rumours.

33. CESR considers that this should also apply to publications, e.g. articles published in the press or internet postings, which are not resulting from the issuer's initiative in relation to its disclosure obligations.

34. As a matter of principle, it is not because such a publication has been published or because there is a rumour in the market about an issuer that this issuer should, by this mere

[1] Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market; July 2007 (Ref: CESR/06-562b)

publication or the existence of that rumour, be prompted to react and respond by denying, in part or in whole, the content of the relevant publication or rumour.

35. However, it should be recalled that an issuer is obliged to publicly disclose as soon as possible any inside information unless it has decided to delay the publication provided that it fulfils the conditions of article 6(2) of the Directive: protection of its legitimate interests, omission not likely to mislead the public and confidentiality is ensured. It should also be recalled that the dissemination of false or misleading information, including through the dissemination of rumour or false or misleading news is prohibited under the market abuse regime.

36. Therefore, if and when the relevant publication or the rumour relates explicitly to a piece of information or information that is inside information within the issuer, the latter is expected to react and respond to the relevant publication or rumour as that piece of information or that information is sufficiently precise to indicate that a leak of information has occurred and, thus, that the confidentiality of this inside information is no longer ensured. In such circumstances, which should be the exception rather than the rule, a policy of "no comment" by the issuer would not be acceptable. The issuer's reaction or response should be made publicly available in the same conditions and using the same mechanisms that those used for the communication of inside information, so that an ad hoc announcement has to be published without undue delay.

Question to the market: Do you have any comments in relation to this draft guidance on the issue of rumours?

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