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Review of EU Market Abuse Regulation – Main Issues from the Perspective of Listed Companies

29 November 2019

I. Background and key areas of concern after three years of being in force

According to Article 38 MAR the EU Commission has to report on several elements of the EU Market Abuse Regulation (MAR) which will supported by Technical Advice to be issued by ESMA. Notwithstanding the formal consultation process on this advice, this paper summarises listed companies' key issues of concern with both the definition of inside information in Article 7 MAR and the obligation to publish inside information according to Article 17 MAR.

It aims at drawing to the legislator's attention the experience that the MAR has created an environment where issuers are faced with a high level of uncertainty in the application of MAR. More specifically, it is the issuers' view that too much information is published too early. These problems are aggravated by the fact that the ECJ rulings in *Geltl* and *Lafonta* are interpreted in a way that tends to inappropriately widen the scope of inside information and thus makes it more difficult to define its limits.

Therefore, we are convinced that there is a need to improve legal certainty. More specifically, the term "inside information" should be clarified (and narrowed) and disclosures by issuers should be limited to cases where disclosure creates a clear benefit for the functioning of the markets.

This appears to us the key issue relevant to better balance MAR; a number of topics are closely connected and should also be resolved in a broader approach:

- **Uncertainty on the term "inside information":** Issuers face significant uncertainties on the term "inside information". The vagueness of the term makes it often close to impossible to determine with reasonable certainty if and at which point of time a piece of information will constitute inside information. In addition, neither the ECJ's rulings nor the supervisory practices have brought adequate clarity and/or appropriate guidance for market participants. Rather the opposite is true as they lead to inadequately broad interpretations. As a consequence, issuers are not only under the constant risk of being forced to premature disclosures. The broad interpretation also hampers issuers' ability to raise capital, to prepare and execute M&A transactions, causes difficulties with employee participation schemes and generally increases compliance duties to inappropriate levels.

- **Early stages of protracted processes should not be treated as inside information:** Legal uncertainty and the risk of an overly broad interpretation are in particularly relevant for protracted processes, i.e. in processes that occur in stages. Though the MAR 2014 tried to clarify the definition in this respect, issuers' experiences are negative. Early stages of protracted processes are now under the constant risk of falling under the definition of inside information from a purely legal perspective though from a market view this does not appear appropriate as it may lead to premature disclosure that may put the entire process at stake.

- **Protection of reasonable interests of issuers by the option to delay disclosure is undermined:** The option to delay the disclosure of inside information has been introduced in order to protect reasonable interests of issuers and to mitigate effects of the disclosure obligation. It also protects the market from being misled by premature information. Unfortunately, the requirement of "legitimate interests" is interpreted narrowly by regulators. Moreover, the newly introduced obligation to respond to market rumours undermines this option for issuers and puts at risk issuers' reasonable interests. The review should thus make delaying the publication safe(r) for issuers both in legal terms and in application in practice. This needs to be done irrespective of the need for more certainty on the definition of inside information.

Overall, the review of the MAR offers the unique opportunity to redraft certain elements of the MAR in order to better balance the issuers' interest in keeping sensitive information confidential and being able to comply with the MAR in practice against the investors' interest in fair market practices and transparency.

This is not only necessary having in mind that there is the risk of very significant sanctions if an issuer is mistaken in its legal judgment. It is also necessary to avoid negative economic impact for listed companies. For example, issuers frequently report that they are already now limited in their M&A activities compared to non-listed companies because MAR duties might lead to premature disclosures.

The remainder of this paper outlines the issues in more detail and offers solutions how the MAR should be amended in order to deliver more clarity and adequate solutions for the practice.

Concretely, the legislator should amend Article 7 and Article 17 MAR and improve the respective recitals so that

- the overly broad interpretations of inside information will be limited/reduced,
- protracted processes will be treated in a more appropriate manner (i.e. early stages of protracted processes are taken out of scope of the definition inside information) and
- the possibility to delay the disclosure of inside information will be protected better against abusive rumour spreading.

II. Clarification of the definition of inside information in Article 7 MAR

1) Legal uncertainty on the definition of inside information

a) Main issue

Though the term inside information is pivotal under MAR, it is vague and needs to be interpreted by market participants. To a certain degree, the vagueness is unavoidable. Thus, a certain degree of legal judgement and judgement from a market perspective will always be necessary.

However, issuers have made the experience that the current definition is too open for an extremely wide interpretation.

According to Article 7 MAR for a non-public information to qualify as inside information, it needs to be *specific enough* that a *reasonable investor would expect significant price effects* on the financial instrument(s) in question. However, practice has shown that this definition

cannot reliably serve its purposes (1) to narrow the definition to an extent that is practicable for issuers and (2) to enhance legal certainty (for this purpose see recital (18)) for the ex ante judgement of the issuer).

b) Proposed amendments

In our view, the term “inside information” should be clarified in two respects:

aa) Reasonable investors should be understood as rational investors that assess information generally with a view on the (long-term) fundamental value of a financial instrument. At least in the German market there has been an intensive discussion whether or not reasonable investors have to anticipate irrational market reactions or even if they themselves act (partly) in an irrational manner. If the reasonable investor test was interpreted that way, a meaningful ex ante judgement of market reactions/price effects of a piece of information would become impossible.

It should therefore be clarified that the issuer can assume investors acting rationally and adjusting to changes in the fundamental value of the issuer.

To achieve this, we believe it is sufficient to amend recital (14):

Recital (14): *Reasonable investors base their investment decisions on information already available to them, that is to say, on ex ante available information. Therefore, the question whether, in making an investment decision, a reasonable investor would be likely to take into account a particular piece of information should be appraised on the basis of the ex ante available information.* ***Reasonable investors are expected to act in a rational manner: As a rule investors assess information with the view to changes of the fundamental value of a financial instrument.*** *Such an assessment has to take into consideration the anticipated impact of the information in light of the totality of the related issuer’s activity, the reliability of the source of information and any other market variables likely to affect the financial instruments, the related spot commodity contracts, or the auctioned products based on the emission allowances in the given circumstances.*

bb) Clarification that issuers only have to evaluate effects on own financial instruments. Currently, it is not clear whether, when assessing their disclosure obligation under Article 17 MAR, issuers would also have to evaluate price effects an information might have on (derivative) instruments that are issued by third parties. Taken literally Article 7 MAR could be read as if even information that has no price effect on the (underlying) instrument of the issuer (i.e. share or bond) could qualify as inside information if it has only an effect “the prices of related derivative financial instruments” (see Article 7(1) MAR, last sentence). Indeed, there is already commentary in that direction picking up the ECJ’s ruling in the *Lafonta* case.

However, already for practical reasons issuers cannot include financial instruments issued by third parties in their ex ante judgement. Furthermore, the benchmark for evaluating information would become extremely vague and thus meaningless as the price impact of any information on a derivative will pretty much depend on its leverage – which is arbitrary and may be fully unrelated to the issuer.

To solve this problem Article 7(1) MAR could be amended and a new Article 7(4a) could be integrated as follows:

Art. 7(1): *For the purposes of this Regulation, inside information shall comprise the following types of information:*

(a) information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers 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 instrument.~~***

Art. 7(4a): ***For the purpose of Article 17 and Article 18*** *[if necessary add additional issuers' duties]* ***of this Regulation, the term inside information shall only comprise of inside information, that, if made public, would be likely to have a significant effect on the prices of financial instruments issued by that issuer.***

This clarification would not mean that derivative financial instruments are excluded from the scope of the prohibition of insider dealing. It would only mean, that issuers can limit their ex ante judgement for reasons of disclosure to their own financial instruments and that their compliance duties solely relate to their own financial instruments.

Excluding derivatives from the definition will not result in a limitation of investor protection since any financial instruments tradable on a trading venue are already captured by the "base case" definition that will remain unaffected of the proposed change.

2) Early stages of protracted processes should not be treated as inside information

a) Main issue

In many cases inside information develops over a period of time, i.e. it occurs in stages of a protracted process. Typical examples of such a protracted process are M&A activities or the issuance of a financial instrument. Having in mind the ECJ ruling re *Geltl./.Daimler*, MAR tried to clarify in recital (16) and Article 7(3) MAR that not any stage of a protracted process can and should be considered as inside information. However, the newly introduced definition and recitals around protracted processes leave it still unclear in which circumstances an intermediate step can by itself deemed to be inside information.

Even worse, issuers feel increased pressure to assume inside information in too early stages of protracted processes and, hence, may be forced to premature disclosure.

b) Proposed amendments

From our perspective, some minor amendments to recitals (16) and (17) and Article 7 MAR should sufficiently address that problem.

Recital (16): *Where inside information concerns a process which occurs in stages, each stage of the process as well as the overall process could constitute inside information. An intermediate step in a protracted process may in itself constitute a set of circumstances or an event which exists or where there is a realistic prospect that they will come into existence or occur, on the basis of an overall assessment of the factors existing at the relevant time. However, that notion should not be interpreted as meaning that the magnitude of the effect of that set of circumstances or that event on the prices of the financial instruments concerned must be taken into consideration.*

Intermediate steps usually have to be evaluated in conjunction with the potential final stage in a protracted process. If the final stage cannot be reasonably expected to occur, the intermediate step is typically not to be regarded as an inside information. Therefore, *an intermediate step should* ***only*** *be deemed to*

*constitute inside information if it, by itself, **i.e. [and] irrespective of a final stage, satisfies ~~meets~~** the criteria laid down in this Regulation for inside information.*

Recital (17): *Information which relates to an event or set of circumstances which is an intermediate step in a protracted process **which should be regarded in conjunction with the final stage** may relate, for example, to the state of contract negotiations, terms provisionally agreed in contract negotiations, the possibility of the placement of financial instruments, conditions under which financial instruments will be marketed, provisional terms for the placement of financial instruments, or the consideration of the inclusion of a financial instrument in a major index or the deletion of a financial instrument from such an index.*

These clarifications should also be reflected in Article 7(3) MAR:

Art. 7(3): *An intermediate step in a protracted process shall **only** be deemed to be inside information if it by itself, **i.e. irrespective of the final stage,** satisfies the criteria of inside information as referred to in this Article.*

The amendments to recital (16) and Article 7(3) MAR clarify that an intermediate step should *by itself* qualify as inside information in exceptional circumstances only. The amendment to recital (17) makes clearer that the examples mentioned here illustrate the standard situation where an intermediate step will not qualify as inside information by itself, i.e. irrespective of the final stage.

III. Public disclosure of insider information (Article 17 MAR)

1) Respect the specifics of the two-tier board system

a) Main issue

Furthermore, the MAR provisions should better reflect realities of the two-tier board system. Issuers frequently face the problem that it remains unclear that they can delay the disclosure of inside information on the grounds that a decision of the management board is not yet approved or even not yet discussed by the supervisory board. The MAR and even more the existing ESMA guidelines on legitimate interests set tighter restrictions than appropriate.

b) Proposed amendment

The problem can easily be addressed in clarifying in recital (50) that a delay should always be possible in a two-tier board system in order to protect the legitimate interest of the issuer to respect the typical (and legally defined) decision processes of a two-tier board system.

Recital (50): *For the purposes of applying the requirements relating to public disclosure of inside information and delaying such public disclosure, as provided for in this Regulation, legitimate interests may, in particular, relate to the following non-exhaustive circumstances: (a) […] (b) decisions taken or contracts made by the management body of an issuer which need the approval of another body of the issuer in order to become effective, where the organisation of such an issuer requires the separation between those bodies, **~~provided that public disclosure of the information before such approval, together with the simultaneous announcement that the approval remains pending, would jeopardise the correct assessment of the information by the public.~~***

2) Ease orderly periodic capital market communication

a) Main issue

There is a conflict between MAR and the regular financial reporting under the Transparency Directive that results in an information of investors at predictable points of time. Issuers might be forced to publish information relating to periodic financial reports under Article 17 MAR even though the scheduled time of publication of periodic financial reporting is close. Although issuers have in principle the possibility to delay that the disclosure of inside information it is however, unclear, whether the condition of Article 17(4) MAR can be applied to such situations. Furthermore, rumours will put at risk the delay and, thus, the orderly information of markets.

b) Proposed amendment

From our point of view, the legislator should in general give periodic and comprehensive information priority over immediate disclosure of single pieces of information relating to that periodic information.

This priority could be ensured by clarifying that the two major conditions for a delay are assumed to apply close to the date of announced periodic information. Article 17(4a) MAR could be drafted as follows:

Art. 17(4a): ***It will be regarded as a legitimate interest of the issuer and as not misleading the public if the inside information is part of an interim financial report or a year-end report within the meaning of Article 19(11) or of any other periodic financial report that the issuer has announced, or is due, to publish within 30 calendar days.***

3) Delayed disclosure (Article 17(4) MAR)

a) Main issue

The option to delay the disclosure of inside information has been introduced in order to protect reasonable interests of issuers and to mitigate effects of the disclosure obligation. However, rather high hurdles are set for a delay of disclosure of inside information. In particular, in practice no issuer can guarantee that he *is able to ensure* the confidentiality of the information. He can only implement appropriate compliance structures to educate insiders on their duties and to keep confidentiality in his own area of responsibility.

b) Proposed amendments

Recital 49: *The public disclosure of inside information by an issuer is essential to avoid insider dealing and ensure that investors are not misled. Issuers should therefore be required to inform the public as soon as possible of inside information. However that obligation may, under special circumstances, prejudice the legitimate interests of the issuer. In such circumstances, delayed disclosure should be permitted provided that the delay would not be likely to mislead the public and the issuer is able to ensure the confidentiality of the information* ***within its area of responsibility****. The issuer is only under an obligation to disclose inside information if it has requested or approved admission of the financial instrument to trading.*

Art. 17(4): *4. An issuer or an emission allowance market participant, may, on its own responsibility, delay disclosure to the public of inside information provided that all of the following conditions are met:*

(a) immediate disclosure is likely to prejudice the legitimate interests of the issuer or emission allowance market participant;

(b) delay of disclosure is not likely to mislead the public;

(c) the issuer or emission allowance market participant is able to ensure the confidentiality of that information ***in its own area of responsibility****.*

[…]

4) Rumours (Article 17(7) MAR)

a) Main issues

According to Article 17(7) MAR issuers may have to react to rumours with immediate disclosure of inside information under delay, if that rumour indicates that confidentiality is no longer ensured. Unfortunately, the MAR sets out only low conditions for this kind of forced disclosure.

First, the leak of the rumour does not have to come from the sphere of the issuer, i.e. does not have to fall in his area of responsibility.

Second, and even worse, it is unclear when a rumour has to be regarded as precise enough to indicate a breach of confidentiality.

As a result, issuers always run the risk of immediate disclosure of legitimately delayed inside information when a rumour arises. The provision thus invites to unfair spreading of rumours, especially in sensitive situations.

In addition, the disclosure of an existentially important transaction for an issuer may have the consequence of undermining the transaction inappropriately. In this case, the interest of the issuer to ensure its financial viability or to prepare significant strategic changes should have primacy over transparency in any case. This is also in the interest of investors as otherwise issuers could suffer significant economic losses or even jeopardise their existence.

b) Proposed amendments

Overall, the existing MAR provisions on rumours may lead to abusive rumour spreading und thus thwart/devalue the possibility to delay disclosure. In order to better protect the legitimate interest of the issuer against unfair practices and misinformation it needs to be clarified when a rumour is precise enough to lead to immediate disclosure. This should be the case when it contains the most significant details of the delayed inside information and – at the same time – does not contain wrong or misleading information. In addition to that, an issuer should not be forced disclosure immediately as long as the rumour does not stem from his sphere. Furthermore, no comment policy should always be possible in cases where the publication of inside information would jeopardise the financial viability of the issuer.

Article 17(7) MAR should be amended accordingly. Additionally, a new recital (50a) should be introduced that explains the rationale of the amendments to Article 17(7) MAR.

Recital 50a: ***Issuers will have to publish inside information under delay, if a sufficiently accurate rumour relating to that information occurs. However, the Regulation sets out strict conditions for the accuracy in order to protect issuers' interests and in order to avoid abusive rumour spreading.***

Art. 17(7): *Where disclosure of inside information has been delayed in accordance with paragraph 4 or 5 and the confidentiality of that inside information is no longer ensured,*

the issuer or the emission allowance market participant shall disclose that inside information to the public as soon as possible.

This paragraph includes situations where a rumour explicitly relates to inside information the disclosure of which has been delayed in accordance with paragraph 4 or 5, where that rumour is sufficiently accurate to indicate that the confidentiality of that information is no longer ensured ***and the issuer has strong indications that the breach of confidentiality stems from his own sphere of influence. A rumour may only be regarded as sufficiently accurate, if it reveals all of the most significant details of the inside information and does not contain [additional] wrong or misleading information. Issuers do not have to respond to a rumour that does not meet these criteria. In cases where the publication of inside information carries the risk that the issuer would suffer significant economic losses, a disclosure based solely on a rumour is not required.***

IV. Summary

The paper addresses the main problems that issuers have identified in the application of the MAR, i.e.

- uncertainty on legal terms,
- wide interpretation of inside information in particular in protracted processes and
- the limited protection of legitimate interests and the constant risk of being forced to premature disclosures under Article 17 MAR.

Though some of the problems might also be resolved through legal interpretation and/or guidance from supervisory authorities, we believe that the best way forward would be to tackle the problems by amendments to MAR itself.

Our proposals above would keep the two-fold notion of inside information of the MAR, i.e. the same definition of inside information is used for both the prohibition of insider trading and the disclosure obligation. However, it will be ensured that more appropriate results are delivered by this concept.

This is however not to say that there cannot be other solutions for the problem. As an alternative to the changes to the Regulation laid down in the main part of the paper, it could also be conceivable to work towards an amendment to the Regulation that retains the current, rather broad concept of inside information for the prohibition of insider dealing, while limiting issuers' disclosure obligations. The advantage of this proposal is that it would leave the definition of inside information untouched and only make disclosure obligations under Article 17(1) MAR subject to additional conditions (for a concrete preliminary proposal, see Annex 1)

Annex 1

A new Article 17(1) MAR revised on this basis could read as follows (changes to the existing highlighted):

Art. 17(1): *Public disclosure of inside information*

An issuer shall inform the public as soon as possible of inside information which directly concerns that issuer ***provided that all of the following conditions are met:***

(a) The inside information has a reasonable degree of finality.

(b) The inside information would have a significant effect on the prices of financial instruments issued by the issuer.

(c) The inside information is not part of an interim financial report or a year-end report within the meaning of Article 19 (11) or of any other periodic financial report that the issuer has announced, or is due to, publish within 30 calendar days*.*

[…]

Condition (a) reflects the need to avoid disclosures that happen to early, and it gives issuers some flexibility to not disclose, without having to comply with the rather restrictive requirements for delay under Article 17(4) MAR. Condition (b) limits monitoring obligations for issuers to financial instruments that they have issued themselves by excluding from disclosure information with price effects on derivatives issued by third parties. Condition (c) reflects the fact that, as regards financial reporting, the market and the principle of information equality is best served by delivering financial information at a moment that is known in advance to all market participants.

Issuers would remain free to disclose inside information before being required to do so under the redrafted Article 17(1) MAR, provided they comply with the requirements under Article 17(8) MAR. This proposal is really not much more than (i) complementing the delay provisions with a solution that is more workable in practice (conditions a and c), and (ii) a correction of the regulatory practice after *Lafonta* (condition b). The provisions for delay would only be needed in cases where there is a reasonable degree of finality, but there continue to be overriding interest in maintaining confidentiality (e.g., participation of an issuer in a leniency programme that requires confidentiality).

For example, employees of an issuer working on a large M&A deal would be covered by the ban on insider trading from the outset – but the issuer would only be obliged to publish the information when it is “ready for publication”, i.e., in normal cases, where an SPA has been signed. Similarly, the prohibition of insider dealing may have a broad field of application in the course of preparing financial reporting, which is also reflected in the trading prohibitions under Article 19(11) MAR that apply independently of the existence of inside information. For the question of disclosure obligations, however, the regular financial reporting is usually sufficient as the market will be aware of the release dates/financial calendars of the issuer.

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