



ADVICE TO ESMA

SMSG Position Paper Regarding ESMA's Work on MAR Level 3-Measure

I. Executive summary

The Market Abuse Regulation (MAR) establishes a common regulatory framework on insider dealing, the unlawful disclosure of inside information and market manipulation to ensure the integrity of financial markets in the Union and to enhance investor protection and confidence in those markets. To achieve these goals, ESMA has been mandated to draft regulatory and implementing technical standards (level 2) and to issue guidelines (level 3). The SMSG has already responded to ESMA's work regarding the level 2-measures. It now provides high level advice on relevant future topics to be dealt with on level 3.

First, the SMSG wishes to highlight that an easy access for market participants to the new single rule-book on market abuse will be of outmost importance. To this end, ESMA should establish an interactive online tool on its website which provides a comprehensive compendium of the level 1 and level 2-regulations as well as the related ESMA guidelines and Q&A's.

Second, the MAR requires ESMA to issue three sets of guidelines. ESMA will soon launch a consultation on this work. The SMSG welcomes the opportunity to give advice beforehand.

- *One of the three guidelines will deal with the requirements for persons receiving market soundings (Art. 11 (11) MAR). Generally, ESMA's proposals appear to be reasonable. However, the SMSG wishes to ask ESMA to ensure that market soundings will not be discouraged by a too complex level 3-regime.*
- *As to the guidelines specifying the right to delay the disclosure of inside information (Art. 17 (11) MAR), the SMSG wishes to emphasize that the prerequisites for delay should not be interpreted narrowly. It therefore recommends CESR's list of examples of legitimate interests to be incorporated into ESMA's guidelines; however, making clear that this is a non-exhaustive list and other situations and circumstances could constitute legitimate interests as well. Furthermore, ESMA's guidelines should interpret the requirement "not misleading the public" in accordance with the former CESR guidance and specify that delay of disclosure is only misleading if an issuer actively sets signals that strongly contradict the inside information under delay.*

In order to ensure a uniform application of market abuse rules, it will be important to deal with certain interpretational questions by way of guidelines.

- *ESMA should further clarify some key aspects of insider trading law, such as price relevance of inside information. To this end, ESMA should aim to provide more analysis with respect to the divergent approaches taken by the NCAs in this specific area of insider trading law. In particular, ESMA should provide more guidance on the "reasonable investor test". Finally, ESMA's Guidelines should define which information directly concerns the issuer.*

- *The SMSG asks ESMA to clarify that issuers are under no obligation to respond to speculation or market rumours which are without substance.*

The SMSG considers some other topics to be relevant for further clarification by EMSA, such as the interplay between the Market Abuse Regulation and the Takeover Directive. However, to achieve a level playing field it might suffice to deal with these questions in a Q&A format.

II. Background

1. The Market Abuse Regulation (MAR) requires ESMA to draft implementing measures, such as Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) (level 2) and to issue guidelines (level 3). Furthermore, the European Commission (COM) has asked ESMA to provide technical advice on the possible content of the delegated acts required by the MAR.
2. On 14 November 2013, ESMA published its policy orientations on possible implementing measures under the MAR (“ESMA DP”) and sought views of interested parties. The SMSG responded to the ESMA DP on 21 April 2014 (SMSG/2014/SMSG/011).
3. On 15 July 2014, ESMA published consultation papers about its technical advice on draft RTS/ITS (“CP on draft RTS/ITS”) and its technical advice to the COM (“CP on technical advice”). The SMSG responded to ESMA’s CPs on 10 October 2014 (SMSG/2014/047).
4. On 3 February 2015, ESMA submitted its Final Report on technical advice on possible delegated acts to the COM. ESMA will soon provide the COM with its draft RTS/ITS under the MAR and then prepare a consultation paper on the proposed guidelines under the MAR.
5. ESMA has invited the SMSG to provide input on its work regarding level 3. Though the SMSG has already provided ESMA with its advice regarding guidelines about the disclosure of inside information, the Group welcomes the opportunity to provide additional advice in relation to these coming 3 sets of guidelines (*mandatory guidelines*). Moreover, the SMSG wishes to provide its view on whether ESMA should issue further guidelines which would ensure the common, uniform and consistent application of the MAR (*additional guidelines*).

III. ESMA’s way to building a single rulebook on market abuse

6. The creation of a single rulebook on market abuse raises technical issues regarding access to the new regime. The SMSG considers this of great importance and therefore asks ESMA to create an interactive online tool (para. 7-8). Moreover, fundamental questions arise as to how ESMA should carry out its role as coordinator between national competent authorities (NCAs) and ensure the consistent application of the rules. The market abuse regime will, to a great extent, be fully harmonized. As a consequence, ESMA will play a key role in avoiding potential regulatory arbitrage and enhancing legal certainty for market participants. The SMSG therefore provides views on how ESMA should carry out its work building a single rulebook on market abuse (para. 9-14).

1. Creation of an interactive online tool

7. The future single rulebook on market abuse will be a complex regime consisting of two levels of regulations. The MAR (level 1) will be accompanied by a number of additional regulations enacted

and endorsed by the COM. Furthermore, ESMA will issue guidelines and publish Q&A (level 3). It would be of great help for market participants to be able easily access the new provisions and the corresponding level 3 measures. To this end, the SMSG encourages ESMA to establish an interactive single rulebook on its website. The online tool should provide a comprehensive compendium of the level one text (MAR), COM's delegated acts and the corresponding RTS/ITS developed by ESMA and adopted by the COM, as well as the related ESMA Guidelines and Q&As. A very good example for an interactive online tool is EBA's documentation tool, which provides the level 1 text, technical standards, guidelines and Q&As relating to each article of the level 1 regulation.

8. However, ESMA should also make clear that the single rulebook on market abuse does not encompass sanctions provided by administrative and criminal law which continues to be subject to national laws. It is also important to note that the powers of the NCAs are laid down in national law and might accordingly differ between jurisdictions.

2. Relevance of the level 3 regime

9. The idea behind the MAR is to establish a uniform and strong regulatory framework that reduces and prevents divergences between national laws (recital 4 and 5 MAR). This explains why many aspects of this new framework will be regulated on level 2 by regulations (instead of directives) specifying the general rules provided by the MAR. Furthermore, the MAR requires ESMA to deal with certain interpretational questions by way of guidelines. This is designed to ensure a common understanding across the EU. However, this does not mean that all topics are exhaustively outlined. ESMA will need to provide further clarification on a range of issues. To this end, ESMA can take advantage of a variety of instruments. Aside from guidelines, ESMA can also deal with the topics in a Q&A format. The SMSG considers Q&A as an important convergence tool for the promotion of common supervisory practices and which will contribute to the single rulebook on market abuse. The proviso, however, is that only the European Court of Justice of the European Union (ECJ) has the competence to provide definitive interpretations of the MAR.
10. The former CESR has issued three sets of guidelines dealing with questions that commonly arise in Member States' daily practice. Many of them will be dealt with on level 1 (MAR) and level 2 (COM/ESMA regulations). However, this is not the case with respect to some select topics which still are essential for the uniform application of market abuse rules. The SMSG therefore asks ESMA to review the CESR guidance (see in more detail para. 31-37). It is recommended that ESMA consults with the SMSG and stakeholders prior to further elaborating on these topics and compiling the ESMA guidelines.
11. The SMSG observes that the NCAs have provided guidance to market participants about a wide range of issues relating to market abuse. For example, the French regulator AMF has issued the Recommendation No. 2010-07 of 3 November 2010 (Guide to preventing insider misconduct by executives of listed companies) and the Position-Recommendation No. 2003-01 (Transmission of inside information prior to the sale of significant shareholdings in companies listed on a regulated market – so-called “data room” procedures). In Germany, the BaFin has published the so-called Issuer Guideline explaining its administrative practice regarding a number of legal issues of market abuse, such as insider trading, market manipulation and ad hoc disclosure. The Dutch regulator AFM also elaborated on insider trading law (AFM, Insider Dealing, March 2012). In the UK, the FCA Handbook contains numerous interpretational details (sections marked with a “G”) thus helping market participants to understand how to best apply the rules. The Italian regulator Consob has also issued a communication dealing with different topics under the market abuse regime, such as

the interpretation of the price sensitive communication to be disclosed, delay of the communication, rumours, internal dealing and insiders list (Consob communication n. DME/6027054 of 28 March 2006).

12. The NCAs' guidance relates to important questions which are still highly relevant under the MAR and which are, to a great extent, not dealt with by the new level 2-measures. It will therefore be important to assess whether the supervisory practices across the EU/EEA are consistent with the purposes of the new single rulebook on market abuse. Depending on the outcome of the evaluation, ESMA should decide whether it takes up an issue in guidelines or other instruments (again after conducting a public consultation process and seeking the advice of the SMSG).
13. Some regimes will be new on the European level. This is in particular true for provisions concerning market sounding and the closed period for manager transactions. Therefore, the question arises whether there is a need for further guidance on level 3. The SMSG acknowledges that the relevant provisions are already very detailed on level 1 and further specifications will be laid down in level 2-regulations. This does not however mean that all aspects are clarified. That said, the SMSG does not see the need for further action at this stage. This is also because ESMA has on previous occasions (CP on draft RTS/ITS and CP on Technical Advice) discussed important questions in depth. For example, ESMA has explained what kind of information might be disclosed under the provisions of market sounding. This opinion (and others) will give valuable guidance on how the rules are to be interpreted. In the long run, it might be advisable to come back to these topics in a Q&A format.
14. ECJ's jurisprudence plays a key role in interpreting the market abuse regime. The judgements "Spector/Photo Group", "Geltl/Daimler" and "AMF/Lafonta" concerning certain provisions of the Market Abuse Directive (2003/6/EC) will still be relevant for application of the provisions of the MAR. It is essential that ESMA draws the attention to this when dealing with insider trading law in guidelines or in a Q&A format. This would help market participants to better understand the law.

IV. Guidelines to be issued due to the MAR

1. Art. 7 (5) MAR

15. ESMA shall issue guidelines to establish a non-exhaustive indicative list of information which is reasonably expected or is required to be disclosed in accordance with legal or regulatory provisions in Union or national law on the relevant commodity derivatives markets or spot markets.
16. ESMA's DP does not deal with this topic. Thus, the SMSG has not provided any input on this topic to date. The Group considers this to be a very important topic and therefore wishes to provide some commentary on it. However, it will first await ESMA's consideration and then reply in the course of the official public consultation.

2. Art. 11 (11) MAR

17. ESMA shall issue guidelines addressed to persons receiving market soundings, regarding (a) the factors that such persons are to take into account when information is disclosed to them as part of a market sounding; (b) the steps that such persons are to take if inside information has been disclosed to them; and (c) the records that such persons are to maintain in order to demonstrate that they have complied with Art. 8 and 10 of the MAR.

18. ESMA's DP provides general ideas for dealing with the various aspects the buy side should consider in the course of a market sounding and has asked stakeholders about their views. The SMSG has not responded to the questions so far. But the Group has, as part of its earlier comments on ESMA's CP on draft RTS, made it clear that the new regime should above all be practical. In particular, market soundings should not be discouraged (SMSG/2014/047 para. 9). It is recommended that ESMA should take this into account when preparing the respective guidelines.
19. Furthermore, the SMSG again wishes to highlight that a disclosing market participant (DMP) only has to fulfil the obligations laid down in Art. 11 (5) – (8) MAR if the information constitutes inside information and the issuer delayed disclosure in accordance with Art. 17 (1) MAR.
20. The SMSG disagrees with ESMA's proposals regarding reporting requirements in cases where the buy-side suspects improper disclosure of inside information (ESMA DP para. 110-112). The MAR does not empower ESMA to require the buy-side to notify the relevant NCA of a potential violation of market abuse rules by the DMP/sell side.

3. Art. 17 (11) MAR

21. ESMA shall issue guidelines to establish a non-exhaustive indicative list of (i) the legitimate interests of issuers for delaying disclosure of inside information and (ii) the situations where the omitted disclosure is likely to mislead the public.

3.1 Indicative list of legitimate interests

22. ESMA's DP explains that CESR has already specified a non-exhaustive indicative list of examples of legitimate interests (CESR/06-562b), such as "negotiations in course" and "complex decision-making processes in the issuer's organization" (para. 296-304). ESMA considers that CESR's list of illustrative examples should be included in the Guidelines to be issued in accordance with Art. 17 (11) MAR. It further believes that it should not provide a long list of additional circumstances.
23. The SMSG agreed in its response to ESMA'S DP with the approach followed by ESMA. The Group however wished to clarify that also additional situations and circumstances could constitute legitimate interests as well.
24. This point was also made by other stakeholders in the public consultation. In fact, the possibility to delay disclosure of inside information has become quite important for issuers due to the ECJ's interpretation of the term "inside information" in the cases *Geltl/Daimler* and *AMF/Lafonta*. As a consequence of the jurisprudence (which will still be valid under the MAR), a piece of information can qualify as inside information at an early stage in a protracted process. This can be assessed positively from the perspective of insider trading law. The imposition of share trading restrictions is of no insignificant consequences for directors and other insiders once an intermediate step is considered to constitute inside information. However, disclosure of such information may jeopardize impending M&A-transactions and negotiations. Therefore, the importance of the possibility of delay cannot be emphasized enough.
25. The SMSG therefore wishes to emphasize that the right to delay should not be interpreted narrowly. An issuer should be allowed to keep the information secret if disclosure of the information may be detrimental to him. A mere probability that such detriment may occur should suffice for the right to delay disclosure to become applicable.

26. Finally, when drawing up a list of legitimate interests it can be helpful to closer look at the guidance provided by the NCAs. The following example seems appropriate for inclusion in ESMA's list:
- If an issuer is faced with an unexpected and significant event, a short delay may be acceptable if it is necessary to clarify the situation (FCA Handbook DTR 2.2.9).

3.2 Situations where the omitted disclosure likely misleads the public

27. ESMA's DP deals with the requirement that delay of disclosure must not mislead the public. In the opinion of ESMA, disclosure will always be required where the undisclosed inside information contradicts the market's current expectations (para. 307). Furthermore, according to ESMA's DP disclosure will always be required where the undisclosed inside information contradicts any previous public announcement of the issuer (para. 308).
28. The SMSG has already voiced its concerns regarding this interpretation and argued that a delay of publication would only be misleading if an issuer actively sets signals that strongly contradict the insider information under delay (ESMA/2014/SMSG/011). Furthermore, all stakeholders who responded to ESMA's question in the consultation process raised concerns about ESMA's interpretation and asked for a different approach, some of them asking ESMA to clarify that only in very few situations a disclosure is necessary because the delay is likely to mislead the public.
29. The SMSG again strongly recommends to interpret the requirement "not misleading the public" in accordance with former CESR guidance (Level 3 – second set of CESR guidance, CESR/06-562b) and current guidance by NCAs (e.g. BaFin, Issuer Guideline). The "argument that any delay in disclosing information would be misleading" was not shared by CESR because "then clearly there would have been no purpose in including a provision [...] which allowed for delay since the criteria for doing so could never be met" (cf. CESR, 2.12). In fact, it is in the nature of a delay that an imbalance of information exists. Misleading the public is therefore only assumed if an issuer "provides any indications that are in contradiction to the undisclosed inside information" (BaFin, IV.3.2.). This interpretation is in accordance with the purpose of the right to delay disclosure of inside information and should be adopted by ESMA. A short list of situations where omitted disclosure is likely to mislead the public would suffice.

V. Additional Guidelines

30. ESMA has the power to issue guidelines in order to establish consistent, efficient and effective supervisory practices within the ESFS, and to ensure the common, uniform and consistent application of Union law (Art. 16 ESMA-Regulation).

1. Topics dealt with by former CESR-guidelines

31. The SMSG observes that all topics dealt with by CESR's first set of guidance and information on the common operation of the Directive (CESR/04-505b) will in the future be regulated on level 1 and 2.
32. As to CESR's second set of guidance and information (CESR/06-562b), some aspects are yet not completely clarified on level 1 and level 2. Of particular importance is the guidance provided under para. 1.1 -1.16 („What constitutes inside information under the Market Abuse Directive?"). Whilst some questions have been answered by the ECJ, others such as the "price relevance of inside information" are not. It will be extremely important to have a common understanding of this requirement.

33. According to Art. 7 (4) MAR, information would be likely to have a significant effect on the prices of financial instruments, if a reasonable investor would be likely to use the information as part of the basis of his or her investment decisions. This concept of a reasonable investor is further defined in recital 14 of the MAR stating that “reasonable investors base their investment on ... *ex ante* available information.” The SMSG strongly recommends that ESMA further specifies this by reviewing the respective CESR guidance (1.11-1.13) and the guidance provided by NCAs on this topic (BaFin, Issuer Guideline, III.2.1.4; FCA, Handbook, DTR 2.25 and 2.26; AFM, Insider Dealing, p. 6 ff.).
34. ESMA should make clear “that a reasonable investor will make investment decisions relating to the relevant financial instrument to maximise his economic self-interest” (FCA Handbook DTR 2.2.5). However, this principle will not suffice to ensure a consistent application of insider trading law in the future. Experiences over the past years show that courts and NCAs tend to adopt different understandings of the “reasonable investor test”. Some argue that a reasonable investor would take into account herd behavior. A further important question is whether a reasonable investor has short-term interests. ESMA should ensure that the same standards will be applied across the EU! The SMSG considers a consistent application here to be crucial for the successful operation of the new regulatory framework.
35. Furthermore, ESMA should revert back to the requirement for an issuer to be directly concerned by the inside information (cf. Art. 17 I) MAR). It will be extremely important to prepare a non-exhaustive indicative list of information which directly and indirectly concern the issuer. CESR’s second set of guidance and information (CESR/06-562b para. 1.15-1.16) can serve as a model.
36. Finally, CESR’s third set of CESR guidance and information (CESR/09-219) deals with topics which now mainly have been clarified on level 1 and level 2; the exception, however, being CESR’s guidance on the treatment of rumours (cf. para 64-69). Art. 17 (7) MAR requires disclosure of rumours, provided that disclosure of inside information has been delayed and the confidentiality of the information is no longer ensured. But other topics discussed by CESR are not covered by the MAR and the future level 2 regime.
37. The SMSG therefore asks ESMA to clarify that issuers are under no obligation to respond to speculation or market rumours which are without substance (cf. CESR/09-219 para. 65). Moreover, ESMA should provide input on how to differentiate inside information from rumours.

2. Further topics

38. It is difficult to assess whether further topics of the MAR and corresponding level 2 regulations should be harmonized across the EU through guidelines. The SMSG encourages ESMA to review national guidance and assess whether the supervisory practices differ greatly. This will be a strong reason for coordination.
39. In addition to the above, the SMSG considers the following topics to be relevant for further discussion and clarification on level 3 (guidelines or Q&A):
 - In M&A transactions, the question arises whether alongside purchases (face-to-face transactions) are subject to the prohibition to use inside information when acquiring or disposing of financial instruments.
 - The interplay between the Takeover Directive (TOD) and the MAR needs to be further explored. According to the TOD, the decision to make a bid has to be made public without

delay. However, the TOD does not define when a decision to make a bid has actually been made. Thus the questions arises whether this issue should be clarified in light of the MAR and the obligation to disclose inside information.

- A further topic relates to a stake-building. According to Art. 9 (4) MAR, the rules about legitimate behavior do not apply in this case. But this does not necessarily mean that an investor will generally rely on inside information (his decision to acquire further shares) when he gradually builds a relevant stake.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

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