

## **STUDY 1:**

# **Effects of possible changes to the Market Abuse Directive**

Impact on administrative burdens of  
enterprises in the EU

Paul Vroonhof  
John Boog

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# 1 Background of the study

## 1.1 Introduction

In the context of the Framework Contract FWC IA ENTR/2008/06 Lot 2, the consortium lead by Economisti has received a request to measure the consequences in terms of administrative burdens on enterprises of possible changes to the Market Abuse Directive.

This study was carried out by EIM Business and Policy Research, the Netherlands with help from The Evaluation Partnership (TEP) from the United Kingdom and the European Network for Social and Economic Research (ENSR) and particularly:

- Ikei Research & Consultancy
- Institut für Mittelstandsforschung (Germany)
- Regiopartner (Czech Republic).

The results of the study are presented in this report.

## 1.2 The Market Abuse Directive

The Market Abuse Directive (MAD) aims to set EU-wide standards for preventing, detecting and sanctioning market abuse on financial markets. To achieve this objective, organisations active on these markets are obliged to carry out certain activities which lead to administrative burdens<sup>1</sup> and other compliance costs. There are differences in the way Member States have included these obligations in national legislation.

The European Commission is currently reviewing MAD and in this context an impact assessment is being carried out on possible changes to the Directive. The study presented in this report assesses the costs of the policy options specified in the Terms of Reference that might have an impact on the administrative burdens of enterprises, specifically market operators in financial markets, banks, investment firms and issuers.

Since MAD provisions have not been included in studies in which the Standard Cost Model (SCM) has been applied, a partial baseline measurement was needed on the current administrative burdens.

The possible changes to MAD are foreseen to have an impact on the administrative burdens of:

- 1 Market Operators in financial markets (Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs));
- 2 Banks and investment firms
- 3 Issuers, especially SMEs.

<sup>1</sup> The definition of administrative burdens (AB) and other terminology are included in Annex I.

In addition to the MAD, there are the principles of the Markets in Financial Instruments Directive (MiFID) which aims to (1) protect investors and market integrity by harmonising regulations that govern the activities of licensed intermediaries; and (2) promote honest, transparent, efficient and integrated financial markets.

### 1.3 Purpose of the study

As stated in the Terms of Reference, the study should provide the following outputs:

- 1 Market operators of financial markets: the impact on surveillance cost for MTFs of extending the scope of MAD to financial instruments admitted to and traded on MTFs, including instruments not admitted to trading on RMs.
- 2 Banks and investment firms: the impact on the costs of reporting suspicious transactions for investment firms / banks of extending the scope of MAD to MTFs trading instruments not admitted to trading on RMs and to over-the-counter (OTC) derivatives.
- 3 Issuers (1): the impact on the administrative burdens on issuers of improving the legal clarity of some provisions on the delayed disclosure of inside information.
- 4 Issuers (2): the impact on the administrative burdens on issuers, especially SMEs, of possible changes to MAD with regards to inside information.
- 5 Issuers (3): the universe of SMEs listed on RMs or MTFs - the degree to which SMEs are listed on RMs and MTFs, their relative market capitalisation and the impact of changes of definition on the number of SMEs subject to obligations set by MAD.

### 1.4 Report contents

As the suggested changes and consequent impacts vary substantially for the three types of enterprises described, the results are presented per type. The impact on market operators in financial markets (RMs and MTFs) are dealt with in Chapter 2, the impact on banks and investment firms in Chapter 3, and the impact on issuers, especially SMEs in Chapter 4.

Each chapter is outlined as follows:

- 1 Obligations set by MAD;
- 2 Possible changes and the consequences;
- 3 Methodological specifications;
- 4 Population figures;
- 5 Cost estimates.

## 2 Market operators on financial markets

### 2.1 Introduction

The chapter sets out the impact on the administrative burdens of Multilateral Trading Facilities (MTFs) of extending the scope of MAD to financial instruments admitted to and traded on MTFs, which are not also admitted to trading on Regulated Markets (RMs).

Three types of MTFs are distinguished:

- MTFs only trading instruments admitted to trading on a RM (MTF1);
- MTFs admitting financial instruments to trading (including not permitted on RM) with extension of the provisions of MAD to these MTFs by the Member States (MTF2);
- MTFs admitting financial instruments to trading (including not permitted on a RM) and to which MAD does not currently apply (MTF3).

The cost estimates are presented in Section 2.6. The obligations set by MAD are presented in Section 2.2; the possible changes to these obligations in Section 2.3; methodological issues: the methodological specifications of the SCM application in Section 2.4; and estimates of the relevant number of market operators and groups in Section 2.5.

### 2.2 Obligations set by MAD

In describing the obligations set by MAD, the interaction between the MiFID<sup>1</sup> and MAD directives must be taken into account. MiFID governs trading of all types of financial instruments including RM, MTF and Over the counter (OTC), and measures that facilitate detection of market abuse. MAD is a specific legislative instrument aiming at preserving the integrity of the market and is narrower in scope of coverage of financial instruments (financial instruments admitted to trading on RMs<sup>2</sup>).

To ensure fair and orderly trading<sup>3</sup>, MiFID requires market operators, both RMs<sup>4</sup> and MTFs<sup>5</sup>, to monitor transactions undertaken in their trading system to identify conduct that may involve market abuse. Both types of market operators are required to report such instances to the Competent Authorities, and provide full assistance in investigating and prosecuting market abuse on or through their

<sup>1</sup> Markets in Financial Instruments Directive

<sup>2</sup> Article 4 para.1 subpara.14 of MiFID

<sup>3</sup> Article 14 para.1 and Article 39(d) of MiFID

<sup>4</sup> Article 26 of MiFID

<sup>5</sup> Article 43 of MiFID

systems. The cost for market operators of monitoring the trading on their markets are commonly defined as "surveillance costs".

As highlighted above, the current scope of MAD is narrower and largely determined by reference to RMs. The MAD insider dealing and market manipulation prohibitions apply to financial instruments admitted to trading on a RM. These prohibitions apply to transactions outside the Regulated Market, such as on a MTF and OTC. As a result, MAD covers transactions on MTFs of financial instruments that are also traded on a RM. However, MAD does not apply to financial instruments that are only traded on a MTF. Nevertheless for various reasons including national legislation, many MTFs comply with MAD (see also Section 2.5).

To prevent market abuse, MAD<sup>1</sup> requires market operators (RMs and MTFs) to adopt structural provisions aimed at preventing and detecting market manipulation practices. The MiFID provisions relating to market surveillance described above facilitate detection of market abuse.

### 2.3 Possible changes to MAD

The Commission is currently envisaging extending MAD provisions on insider dealing and market manipulation to financial instruments admitted to trading on a MTF. Although the MiFID provisions are largely similar for RMs and MTFs, RMs have expressed concerns that they are subject to more stringent requirements, notably surveillance costs<sup>2</sup>. The surveillance systems put in place by MTFs are not as sophisticated as those of RMs.

### 2.4 Methodological specifications

The Standard Cost Model (SCM) has been developed to determine the administrative burdens caused by legislation. In this study, the model was used to collect information on the administrative costs and to estimate the impact of possible changes to MAD.

The information required to standardise costs, a breakdown in activities and cost per cost parameter (time, frequency, tariff, outsourcing/expenditure) was collected in six interviews with RMs/MTFs. In one case, three separate markets were discussed and in another case two markets were discussed. In total, information was collected in nine RMs/MTFs. With the aim of covering the expected

<sup>1</sup> Article 6 para. 6 of Directive 2003/6/EC

<sup>2</sup> The requirements in terms of surveillance costs are further detailed in MiFID for RMs. Unlike for the MTFs, MiFID states that RMs must be adequately equipped to manage the risks to which they are exposed and to have sufficient financial resources to facilitate the orderly functioning of the markets. Article 39 of MiFID requires RMs:

- (i) to be adequately equipped to manage the risks to which it is exposed, to implement appropriate arrangements and systems to identify all significant risks to its operation, and to put in place effective measures to mitigate those risks;
- (ii) to have available, at the time of authorisation and on an ongoing basis, sufficient financial resources to facilitate its orderly functioning, having regard to the nature and extent of the transactions concluded on the market and the range and degree of the risks to which it is exposed.

variety in the additional administrative burdens, the respondents were distributed over:

- Financial markets (countries) of different sizes (seven organisations in large economies, and two in smaller economies);
- Geographical regions in the European Union (one organisation in Southern Europe, two in Eastern Europe and six in Central Europe);
- RMs and various types of MTFs (four RMs, two MTF1s, one MTF2 and two MTF3s)<sup>1</sup>;
- Large and small groups of RMs/MTFs (five RMs/MTFs in large conglomerates, four in small groups and stand alone markets).

Market operators were reluctant to participate in interviews. The surveillance systems is a highly sensitive topic, both in terms of competition and in informing on possible market abusers. Consequently, neither the respondents nor the countries they operate in are named in the report.

The willingness of RMs and MTFs to participate was also limited in terms of the details provided on the cost breakdowns. This hampered application of the SCM, and the extent to which it has influenced the results is unclear.

In SCM studies, the EC uses a standardised tariff structure to estimate internal costs (staff, hourly cost). In this study, the following were used:

- The tariff structure for cost category ‘professionals’ was used. This is the second highest category.
- An average was calculated using a rough weight based on the numbers of financial markets and credit institutions per Member State. The United Kingdom and Germany had the highest weights.
- A small correction was made for inflation – the EC standard was developed for 2008/2009.

This resulted in a standardised tariff of €45 per hour.

## 2.5 Population figures

### *Number of RMs, MTF1s, MTF2s and MTF3s*

According to <http://mifiddatabase.esma.europa.eu/>, there were 92 RMs and 127 MTFs in 2010. Based on the information included in the PWC report<sup>2</sup>, 10 MTFs were removed from the original list of 137 MTFs for the following reasons: the MTF was unknown to the holding company; the MTF was included twice on the list; and the MTF was established outside the EU.

The MTFs were classified into the three categories on the basis of information provided by the Competent Authorities in the United Kingdom<sup>3</sup>, France, Germany, Italy and Belgium. This information covered 65 MTFs. Next, information from the PWC report was used. MTFs in the categories ‘shares admitted to trading on a

<sup>1</sup> At the start of the study, this was considered the most relevant characteristic in terms of cost differences. However, other characteristics not included in this list proved to be more relevant.

<sup>2</sup> PWC-report on MTFs.

<sup>3</sup> Not all MTFs were included on the list provided by the Competent Authority.

regular market' and 'bonds admitted to trading on a regular market' were classified as MTF1s, unless otherwise classified by the Competent Authorities. In some cases, shares/bonds traded on these MTF1s were also admitted to trading on a regular market.

The other MTFs were classified as type 2 or 3 primarily on the basis of information provided by the Committee of European Securities Regulators (CESR). Some Member States have extended the scope of MAD in national legislation. In their report on MAD options and discretions<sup>1</sup>, CESR describes to extent to which Member States have extended the scope of MAD to MTFs. The extension takes different forms (all MTFs, specific MTFs, all parts, specific parts). Eight countries have not extended the legislation. In the Netherlands, Spain and Hungary, the extension applies to all types of instruments and all MTFs. The MTFs in these countries (7 MTFs in total) were already classified as either MTF1 (3 MTF1s) or MTF2 (4 MTF2s) in the first steps of the classification process.

Next, information from the Competent Authorities and the PWC report was used to classify the MTFs of types 2 and 3 in the other 24 Member States. If PWC considered the MAD provisions on suspicious transactions to be relevant to a specific MTF, this MTF was classified as MTF2. If these provisions were not considered relevant, PWC classified the MTF as MTF3. For the remaining MTFs in this group, the classification provided by the Competent Authorities was used where available. In total, 25 MTFs for which none of the information above was available were classified as MTF3.

Thus, some MTFs in Member States where other MAD provisions are relevant, such as provisions not concerning the monitoring system (e.g., insider trading rules), were classified as MTF3.

Number of MTFs per type:
– MTF1: 36
– MTF2: 44
– MTF3: 47

#### *MTF2s and MTF3s complying in full*

The current MAD does not apply to financial instruments that are only traded on MTF. As a result, EU legislation does not oblige MTF3s to comply. MTF2s are obliged to comply with regards to the instruments admitted to trading on a regular market. This implies that some form of surveillance system is available. RMs fully comply already, and MTF1s are assumed to do so as well.

A number of MTF2s use the available surveillance system for all their instruments, and not only the instruments admitted to trading on a regular market. As discussed, this is an obligation in the Netherlands, Spain and Hungary. In 16 other Member States, this is obligatory for part of the MTFs and/or part of the instruments. As previously described, the extent to which MTF2s are obliged to comply is based on the PWC analysis. When the 4 MTF2s in the Netherlands,

<sup>1</sup> CESR/09-1120, Review panel report – MAD Options and Discretions, 29 March 2010: [http://www.cesr.eu/index.php?page=document\\_details&id=6536&from\\_id=23](http://www.cesr.eu/index.php?page=document_details&id=6536&from_id=23)

Spain and Hungary are included 23 MTF2s are considered to be in full compliance.

149 markets are in full compliance with MAD provisions due to European and/or national legislation:

- RM: 92
- MTF1: 36
- MTF2: 23

Many RMs and MTFs are member of a group<sup>1</sup>. For example, NYSE/Euronext and London Stock Exchange own or participate in RMs and MTFs operating in various countries. Often, all members use the same system because this reduces cost considerably<sup>2</sup>. This implies that a number of MTF3s already have a full scale surveillance system (covering all instruments) as a result of being a group member. It seems likely this is mainly the case for MTFs in the group of MTFs and possibly RMs.

Thus assumptions need to be made regarding the extent surveillance systems are shared by market operators. The same system is used by RMs and/or MTFs operating under the same name<sup>3</sup> or referring to others in their name<sup>4</sup>.

Of the 219 RMs and MTFs, an estimated 129 are members of a group. In total, 29 groups were identified. 90 RMs and MTFs are not members of a group. These 90 stand alone markets or MTFs and the 29 groups give a total of 119 units. The 119 units form the population in the SCM calculations to reflect the assumption of costs shared by groups.

An overview of the differences between the market types with regard to group membership is presented in Figure 1. MTF1s and MTF3s tend to be members of a group.

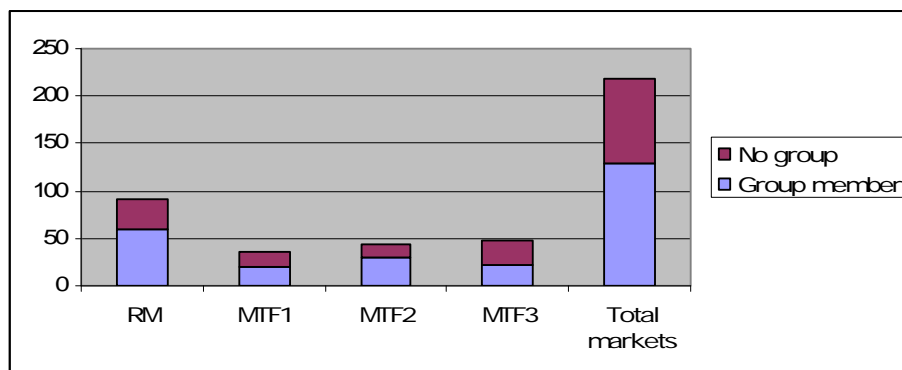
<sup>1</sup> The term 'group' is covering all types of co-operation between market operators, from co-operation between loose entities to full or partial ownership.

<sup>2</sup> This complicates the extrapolation of results. Even though it is feasible to identify all relationships between markets, the extent to which members of a group share surveillance systems would still be unclear. As an example, MTS is co-owned by NYSE and London Stock Exchange. It is unlikely these organisations would be willing to share their surveillance systems.

<sup>3</sup> For example, Boerse Berlin Regulierter Markt and Boerse Berlin Freiverkehr.

<sup>4</sup> For example, Eurolist by Euronext.

Figure 1 Group membership by type of financial market



Groups consisting only of MTF3s are not obliged to comply with MAD. Four such groups were identified, with 14 members in total. The other 25 groups include 17 MTF2 and 7 MTF3 members not yet determined in prior steps of the analysis to comply in full.

Of the MTF2s and MTF3s that are not a group member, the MTF2s are assumed to comply partly. The implication is that they would have to develop a new system if the proposed changes to legislation are approved. The MTF3s that are not group members are assumed not to comply at all.

This leaves 34 units currently not complying and of these, 4 units have more than one member. These non-complying units include:

- 4 MTF2s
- 40 MTF3s

These assumptions are made 'on the safe side'. Groups of market operators as defined are most likely to share surveillance systems, and there are probably more groups with members sharing a surveillance system.

## 2.6 Cost estimates

### 2.6.1 Activities performed by market operators in order to comply

MAD requires market operators to build a system to monitor the market, to maintain this system, to use it to monitor trade and to report results to the Competent Authorities.

Whether or not building a surveillance system should be considered as administrative costs or substantive costs<sup>1</sup> depends on whether the requirement to have such a system is a content obligation or required to enable compliance with in-

<sup>1</sup> Annex 10 Assessing Administrative Costs imposed by EU Legislation of Part III: Annexes to Impact Assessment Guidelines, Brussels, 15 January 2009.

formation obligations. In this case, the decision is debatable and can be considered from two perspectives:

- 1 An activity required to enable reporting to the Competent Authority
- 2 An activity required to prevent market abuse.

In discussion with EC experts on the EU SCM, it was decided that the second interpretation cost pertaining to building the system are substantive one-off costs.

The costs related to maintaining the system, monitoring trade and reporting the results to the Competent Authorities are considered to be administrative costs. These are recurring costs. The share not considered to be business-as-usual forms the administrative burdens.

#### *Surveillance software*

Most respondents report a surveillance system consisting of two tiers:

- 1 Surveillance software
- 2 Teams of experts.

Different systems have different parameters as for example:

- Large volumes of trade;
- Volatility of prices;
- Liquidity;
- Price movements around announcements/information relevant for prices;
- Cross-border elements.

In both tailor-made and off the rack systems, the system monitors and checks all transactions for instances of disorderly trading activity, possibly involving market abuse or insider trading on the market, and assesses them according to defined parameters. The basis is analysis of patterns and extremes.

The system scrutinises broker behaviour to ensure that brokers comply with pre- and post-trade transparency norms propounded by MiFID. This implies that the administrative burdens for the firms should be split between MAD and MiFID.

On a qualitative note: several respondents mentioned difficulties in designing systems suitable for non-liquid instruments.

One of the respondents (MTF2) stated:

A lot of development work concerned the correct calibration of alerts on illiquid securities especially in relation to sensitivity. This may reflect the very limited range of market supervision tools with a lot of development burden taken on by the market operator as opposed to the tool provider. We are held back more by the costs of data from data vendors as we need to access a wide range of data covering securities listed and trades across Europe in our surveillance activities. If we were able to access these data free of charge, it would be much easier for companies like ours to comply with the regulation. Moving forward, we envisage substantial time will need to be set aside for developing a market surveillance function.

The system used in add-on firms is much less complex. It is built by the unit itself using existing software and does not run continuously.

### *Teams of experts*

Teams of experts form the second tier. Teams work full-time on reacting to alerts from the surveillance software and in following trade patterns. However, most respondents stated that these experts have more tasks than surveillance. Monitoring trade is also relevant from a business perspective. The main difference between the typical firms (see Section 2.6.2) is the amount of time spent on it.

There are no other surveillance tools in place.

### *2.6.2 Typical firms*

The interviews indicated that there are substantial cost differences between market operators. The cost drivers are to a lesser extent the type of trading platform – RM or MTF – but mainly concern the type of instruments traded, the number of instruments traded, the volumes traded and their volatility, and cross-border trading.

The SCM prescribes a division into typical firms to allow for large differences in costs or cost structure. A typical firm can be seen as a model for categories of enterprises (in this study, market operator units) with comparable characteristics and roughly the same level of compliance costs.

Based on the respondents' descriptions of surveillance systems, compliance costs estimate, market size and unit size<sup>1</sup>, three typical firms can be distinguished:

- **Tailor-made systems.** Units using complex, tailor-made systems. Building the system is a lengthy process, using both internal and external expertise and done in close cooperation with the Competent Authorities. The system runs separately from other trade related software and tends to have the following characteristics<sup>2</sup>:
  - Used by organisations with much and varied trade;
  - Used for both market and legal purposes;
  - Used for many different types of instruments (including very liquid ones), traded on these markets;
  - International elements (cross-border trade, foreign instruments and traders) are relevant;
  - Surveillance systems of these groups are tailor-made;
  - MAD/MiFiD requirements play an important role in 'tailoring' the system and the Competent Authorities are closely involved in the designing process;
  - Used by substantial groups of markets and very large RMs.
- **Off the rack systems** are based on software and further developed to required specifications. These systems tend to have the following characteristics:
  - Used mainly by small RMs, medium-sized MTFs and small groups of RMs/MTFs;
  - Used for both market and legal purposes;

<sup>1</sup> See Section 2.4 for an explanation of 'unit'.

<sup>2</sup> There is no hard evidence for the characteristics of all three types.

- Used for either national trade or specialised activities;
  - Some involvement of the Competent Authorities.
- **Add-ons.** Surveillance systems of these units are 'add-ons' to the normal monitoring system used to monitor efficient working of the market. The main characteristics tend to be:
    - Used mainly by small MTFs (all types) and RMs trading a very limited number of instruments;
    - A limited number of instruments is traded;
    - Surveillance is limited;
    - MAD/MiFiD requirements play a limited role due to the characteristics of the instruments;
    - Little involvement of Competent Authorities in the designing process.

The nine enterprises represented in the interviews are divided into three typical firms as follows:

- Tailor made systems – four enterprises;
- Off the rack systems – three enterprises;
- Add-ons – two enterprises.

An exact total of enterprises per typical firm cannot be provided. Instead, a rough indication has been made on the basis of market size and, where relevant, the group to which the enterprise belongs. To that purpose, the grouping based on names was again used. Size is a combination of listed shares/bonds and trade per enterprise or group. As this information is not completely available, exact boundaries cannot be provided.

- Tailor made systems – between 5 and 10 units (enterprises or groups of enterprises using the same system). For the remaining calculations, 8<sup>1</sup> units were used. In the indicative division into RMs and MTFs, these 8 units cover 68 organisations. All 8 units currently comply with MAD.
- Off the rack systems – between 15 and 25 units (enterprises or groups of enterprises using the same system). For the remaining calculations, 21 units were used. In the indicative division of RMs and MTFs, a total of 57 organisations together form the 21 units. Of these 21 units, 3 are currently not complying.
- Add-ons – between 70 and 110 units (enterprises). For the remaining calculations, the study used 90 units, representing 94 markets. Of the 90 units, 31 do not as yet comply.

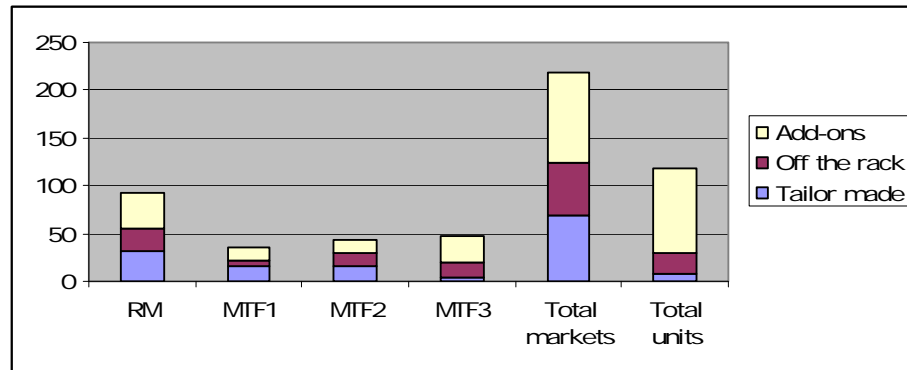
<sup>1</sup> Best estimate by EIM staff. The three figures (8, 21 and 103) sum up to 132, the estimated total of units.

To summarise, the following numbers were used in the calculations:

- Tailor made systems – 8 units currently complying, 0 units currently not complying
- Off the rack systems – 18 units currently complying, 3 units currently not complying
- Add-ons – 59 units currently complying, 31 units currently not complying

An overview of the division of RMs and MTFs into the three typical firms is presented in Figure 2. The tailor made systems are mostly used by units with more than one member, as can be deduced by comparing the ‘total markets’ and ‘total units’ in Figure 2.

Figure 2 Division of RMs and MTFs over typical firms



Source: EIM

### 2.6.3 One-off implementation cost

In many cases, the enterprises developed surveillance systems because this was a requirement of European or national legislation. If the changes of MAD are effectuated, all enterprises will have a surveillance system.

Rough estimates of the cost of developing a surveillance system are presented in Table 1. The cost parameters were standardised, which in this case meant a realistic average ('normal'). Investment and outsourcing cost pertain to expenditure on equipment and software and to payments to other enterprises to perform part of the required activities, for example ICT specialist and advisers.

Table 1 One-off cost of developing surveillance systems per unit per typical firm type

<i>Typical firm</i>	<i>Investment and outsourcing cost</i>	<i>Time spent (hours)</i>	<i>Number of employees involved</i>	<i>Tariff per hour (€)</i>	<i>Total substantive costs</i>
Tailor made systems	300,000	1,000	6	45	570,000
Off the rack systems	200,000	600	3	45	281,000
Add-ons	0	80	2	45	7,200

Source: EIM, 2010.

The estimated costs for the units using add-ons seem to be low (€7,200). Just gaining awareness of the practical implications of the provisions could very well have taken this much time already. However, the interviews did not provide grounds for upward correction.

The total substantive costs are presented in Table 2. All units together spend about 10 million euros on building surveillance systems.

Table 2 One-off substantive costs of developing surveillance systems per type of typical firm<sup>1</sup>

<i>Typical firm</i>	<i>Cost of building systems (substantive costs) per unit</i>	<i>Best estimate number of units</i>	<i>Total substantive costs</i>
Tailor made systems	570,000	8	4,560,000
Off the rack systems	281,000	18	5,058,000
Add-ons	7,200	59	424,800
Total		85	10,042,800

Source: EIM, 2010.

The respondents stated that roughly 50% of the cost could be seen as business as usual: cost for activities the enterprises would have undertaken even if not obligated to do so. The other 50% is due to obligations set by MAD/MiFID. A distribution between MAD and MiFID could not be made.

#### 2.6.4 Current cost of maintenance and monitoring

After the initial investment of setting up the system, there are annual system-related costs for maintenance (improvements) and licensing (provider). In addition, there are monitoring costs. As stated, these costs are considered to be administrative costs. To estimate the administrative burdens, a correction has to be made for costs considered to be 'business as usual'.

<sup>1</sup> As above, results are presented exactly to show how the costs were calculated. In terms of reliability, a less exact presentation would be preferable.

The differences in cost varied considerable between respondents. The elements determining the differences are similar to those related to the implementation costs. The number of transactions and the volatility of prices have a larger weight and directly affect the number of staff (full-time equivalents) involved in the surveillance system. Staff comprises of IT and surveillance staff. External cost include IT services (provider fee, advice), licenses and data storage.

The annual costs for tailor made systems is close to 0.5 million euro per unit, as presented in Table 3. The costs per unit using add-ons is just €14,000.

Table 3 Administrative costs (maintenance and monitoring surveillance systems) per unit per typical firm type <sup>1</sup>

<i>Typical firm</i>	<i>Investment and outsourcing cost per enterprise</i>	<i>Time spent (hours) per enterprise</i>	<i>Number of employees involved per enterprise</i>	<i>Tariff per hour (€)</i>	<i>Total administrative costs per enterprise</i>
Tailor made systems	300,000	500	8	45	480,000
Off the rack systems	50,000	300	3	45	90,500
Add-ons	5,000	100	2	45	14,000

*Source: EIM, 2010.*

The share of administrative costs considered as 'business as usual' varies between the typical firms. These costs are estimated at about 50% by units using tailor made systems and at about 70% by units using other systems. The main reason for this difference is that the surveillance system used by enterprises in the tailor made system group is not integrated in other systems.

If these percentages are applied, the total administrative burdens has been estimated as presented in Table 4. Total administrative burdens is close to 2.7 million euros. Again, this is indicative. Part of these costs result from additional national legislation (provisions for MTF2s and MTF3s). Part of this are not administrative burdens because these activities are done voluntarily. Because of the groups, a further split was not possible.

<sup>1</sup> Results are presented exactly to show how the costs were calculated. In terms of reliability, a less exact presentation, for example € 100,000 instead of €90,500 would be preferable.

Table 4 Structural administrative burdens of current MAD provisions per type of typical firm<sup>1</sup>

<i>Typical firm</i>	<i>Cost of maintenance and monitoring (administrative costs) per enterprise</i>	<i>% business as usual</i>	<i>Administrative burdens per enterprise</i>	<i>Best estimate number of units</i>	<i>Total administrative burdens</i>
Tailor made systems	480,000	50	240,000	8	1,920,000
Off the rack systems	90,500	70	27,150	18	488,700
Add-ons	14,000	70	4,200	59	247,800
Total				85	2,656,500

Source: EIM, 2010.

#### 2.6.5 Future administrative costs resulting from extending MAD

It is estimated that 4 MTF2s and 40 MTF3s are currently not in full compliance (See Section 2.5). They form 34 units, 3 off the rack systems and 31 add-ons.

The current cost level for MTF3s not voluntarily complying could not be estimated from the interviews. None of the respondents was complying with the MAD surveillance regulations on a voluntary basis. Both MTF3s interviewed have surveillance software in place and was used in most of their trade activities.

The average substantive and administrative costs per unit presented above were used to estimate the cost of setting up and monitoring, reporting and maintaining a surveillance system for the 34 units. It was assumed that all belong to the add-ons systems group, except for 3 groups of MTF3s that are in the off the rack systems group. Current costs are assumed to be zero as these firms are currently not obliged to have a surveillance system in place. In reality, all MTFs are likely to have some costs for at least some monitoring for business purposes.

The results presented in Tables 5 and 6 are based on these assumptions. Because of these assumptions and the high level of uncertainty about the cost estimates, the results should be interpreted with caution.

<sup>1</sup> As above, results are presented exactly to show how the costs were calculated. In terms of reliability, a less exact presentation would be preferable.

Table 5 Additional one-off substantive costs of developing surveillance systems per type of typical firm <sup>1</sup>

<i>Typical firm</i>	<i>Cost of building systems (substantive costs) per unit</i>	<i>Best estimate number of units</i>	<i>Total substantive costs</i>
Tailor made systems	570,000	0	0
Off the rack systems	281,000	3	843,000
Add-ons	7,200	31	223,200
Total		34	1,066,200

Source: EIM, 2010.

The substantive costs related to building the system are presented in Table 5. For all units, this adds up to 1 million euros.

Table 6 Structural additional administrative burdens per typical firm<sup>2</sup>

<i>Typical firm</i>	<i>Cost of maintenance and monitoring (administrative costs) per enterprise</i>	<i>% business as usual</i>	<i>Administrative burdens per enterprise</i>	<i>Best estimate number of units</i>	<i>Total administrative burdens</i>
Tailor made systems	480,000	50	240,000	0	0
Off the rack systems	90,500	70	27,150	3	81,450
Add-ons	14,000	70	4,200	31	130,200
Total				34	211,650

Source: EIM, 2010.

The administrative burdens of maintaining the system, monitoring trade and reporting to the Competent Authorities are presented in Table 6. The annual costs total just over 200,000 euros.

<sup>1</sup> Results are presented exactly in order to use the same figures as is done in Tables 1 and 2.

<sup>2</sup> Results are presented exactly in order to use the same figures as above.

## 3 Banks and investment firms

### 3.1 Obligations set by MAD

Article 6(9) of Commission Directive 2004/72/EC of 29 April 2004 requires that any person professionally arranging transactions in financial instruments who reasonably suspects that a transaction might constitute insider dealing or market manipulation shall notify the Competent Authority without delay. As of today, investment firms have the obligation to report suspicious transactions on financial instruments admitted to trading on a Regulated Market in line with the current scope of MAD. To uphold the integrity of the markets, MIFID requires investment firms to report their transactions in any financial instrument admitted to trading on a RM to the Competent Authorities<sup>1</sup>.

### 3.2 Possible changes to MAD and the consequences

As described in Chapter 2, the European Commission is currently assessing extension of MAD prohibitions to financial instruments admitted to trading on MTFs only.

In addition, the Commission is assessing the extension with OTC derivatives whose value is linked to the prices of a financial instrument traded on a regulated market or an MTF (as is the case for trading OTC derivatives when in possession of inside information). This might imply an extension of the scope of Suspicious Transaction Reporting (STR). The Commission is also analysing the possibility of making reporting of suspicious orders (whether executed or not) mandatory.

As market manipulation can involve orders as well as transactions, the Commission is also considering extending the scope of suspicious transactions reports to orders on financial instruments admitted to trading on a RM or a MTF.

As a consequence of these policy options, reporting of suspicious transactions would be extended to instruments admitted to trading on MTFs, to OTC derivatives, and to suspicious orders.

The effect of these policy options on the administrative burdens for banks and investment firms is discussed in this chapter.

### 3.3 Methodological specifications

The impact on the costs of persons professionally arranging transactions of reporting suspicious transactions for investment firms/banks of extending the scope of MAD to MTFs trading instruments not admitted to trading on RMs and to OTC derivatives have been estimated

<sup>1</sup> Article 25 of MIFID

The target groups in this case are banks and investment firms. An investment firm is a business engaged in investment or investment services as their core business. Banks also engage in these activities but often this is not their core business. To collect the information needed, interviews were held with 3 investment firms and 7 banks.

The Standard Cost Model methodology was used to estimate the administrative burdens. Based on the interviews, a number of “typical firms” were defined. Typical firms are groups of firms with some comparable characteristics, and comply with the obligations reasonably efficiently. Information from various sources was then used to extrapolate the results.

Investment firms and banks were reluctant to participate in the interviews. Surveillance systems are a highly sensitive topic for banks and investment firms, both in terms of competition and exposure to market abusers. Due to very strict confidentiality agreements, this report does not contain the names of respondents.

For more information on the methodology, see Section 2.4.

### 3.4 Population figures

Suspicious transactions reporting will extend to orders in all types of financial instruments covered or not covered by MAD. No information is available on the number of orders and also not in relation to OTC derivatives. The same is the case for the number of banks and investment firms trading in relevant instruments. The most relevant number available is the total number of monetary financial institutions excluding money market funds and central banks. On 1 January 2010, there were 6,458 of these type of credit institutions.

The respondents indicated that a voluminous number of transactions subject to the MAD provisions: between 500 million and 1 billion in the EU per year. On the basis of Federation of European Securities Exchanges (FESE), the number of trades per 1 January 2010 is closer to 1 billion in the EU. The percentage of suspicious transactions is estimated to be about 1% (approximately 10 million in the EU per year), and the number that received follow up was estimated at about 5% (500,000 transactions per year).

### 3.5 Cost estimates

#### 3.5.1 *Typical firms*

The interviews did not provide a rationale for the determination of typical firms. In line with the SCM methodology, general standardised estimates were used for the costs.

#### 3.5.2 *Identification tools / measures*

##### *Cost of identifying suspicious transactions*

MAD requires banks and investment firms to build a system to monitor trade, to maintain this system, to use it to monitor trade and to report results to the

Competent Authorities. Through the system, suspicious transactions can be identified, followed and reported to the Competent Authorities. Queries with detailed information can be developed and specific data of suspicious transactions can be archived.

As with the market operators, whether or not building the system should be considered to be administrative costs or substantive costs is debatable. The same decision was made. The costs of building the system were considered to be substantive costs of a one-off nature. The recurring costs related to maintaining the system, monitoring trade and reporting the results to the Competent Authorities were considered to be administrative costs. The proportion not considered to be business as usual forms the administrative burdens.

The cost calculation is presented in Table 7. Based on the 10 interviews, the estimated one-off costs per investment firm/bank are approximately € 88,000, of which € 60,000 is investment cost and € 28,000 is manpower cost. The total costs for the EU are about € 569 million (number of credit institutions is 6,458). The estimated investment costs are approximately € 387 million and the manpower cost € 182 million.

The ongoing costs per investment firm/bank are approximately € 129,000. The costs for the EU in total are about € 831 million (number of credit institutions is 6,458).

Table 7 Administrative and substantive costs of identifying suspicious transactions

	<i>Num- ber of credit institu- tions</i>	<i>Invest- ment and out- sourcing cost per institu- tion</i>	<i>Time spent (hours) per insti- tution</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per institution</i>	<i>Cost per institution</i>	<i>Total sub- stantive costs</i>	<i>Total admin- istrative costs</i>
One-off costs	6,458	60,000	625	45	28,125	88,125	569,111,250	
Ongoing costs	6,458	50,000	1,750	45	78,750	128,750		831,467,500

Source: EIM, 2010.

Of the administrative costs (ongoing costs), respondents indicated that 25% are business as usual and 75% is considered as administrative burdens (based on 8 interviews). The ongoing administrative burdens is € 624 million (see Table 8).

Table 8 Administrative burdens of identifying suspicious transactions

	<i>Number of credit in- stitutions</i>	<i>Administrative costs per in- stitution</i>	<i>% busi- ness as usual</i>	<i>Administrative burdens per institution</i>	<i>Total administra- tive burdens</i>
Ongoing costs	6,458	128,750	25	96,563	623,600,625

Source: EIM, 2010.

*Cost of follow up on suspicious transactions*

The costs to follow up on suspicious transactions are also based on the interviews. The one-off costs consist of the costs of development of an investigation methodology<sup>1</sup>. Ongoing costs include the costs of investigation and when relevant of reporting. The costs per investment firm /bank are estimated at € 11,250 per year. The one-off costs for the EU in total are about € 73 million. The ongoing costs are € 8,460 per investment firm/bank. The ongoing costs for the EU in total are about € 54 million (see Table 9).

Table 9 Administrative costs of follow up on suspicious transactions

	<i>Num- ber of credit institu- tions</i>	<i>Invest- ment and out- sourcing cost per institu- tion</i>	<i>Time spent (hours) per insti- tution</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per institution</i>	<i>Cost per institution</i>	<i>Total ad- ministrative costs</i>
One-off costs	6,458	0	250	45	11,250	11,250	72,652,500
Ongoing costs	6,458	0	188	45	8,460	8,460	54,634,680

Source: EIM, 2010.

The respondents indicated that 25% of these administrative costs are business as usual and 75% is considered as administrative burdens (based on 8 respondents). The one-off administrative burdens are € 54 million. The ongoing administrative burdens are € 41 million (see Table 10).

Table 10 Administrative burdens of follow up on suspicious transactions

	<i>Number of credit in- stitutions</i>	<i>Administrative costs per in- stitution</i>	<i>% busi- ness as usual</i>	<i>Administrative burdens per institution</i>	<i>Total administra- tive burdens</i>
One-off costs	6,458	11,250	25	8,437.5	54,489,375
Ongoing costs	6,458	8,460	25	6,345	40,976,010

Source: EIM, 2010.

*Overview total administrative burdens suspicious transaction reporting*

The total administrative burdens of suspicious transaction reporting are presented in Table 11.

<sup>1</sup> Considered instrumental to reporting to the Competent Authorities. As such, the costs are seen as administrative rather than substantive.

Table 11 Administrative burdens related to suspicious transaction reporting

	<i>Number of credit institutions</i>	<i>Administrative costs per institution</i>	<i>% business as usual</i>	<i>Administrative burdens per institution</i>	<i>Total administrative burdens</i>
One-off costs	6,458	99,375	25	74,531	481,322,813
Ongoing costs	6,458	137,210	25	102,908	664,576,635

Source: EIM, 2010.

### 3.5.3 Cost of extension of suspicious transaction reporting

#### *Instruments admitted to trading on a MTF*

The one-off (development) costs and ongoing (monitoring) costs that would be generated by extension of suspicious transaction reporting to instruments trading on a MTF are € 16,875 and € 16,875 respectively (see Table 12). These estimates are based on results of 4 respondents, since only 4 out of the 10 respondents trade on a MTF. One-off costs and ongoing costs are equal and are about € 44 million (multiplication of the above mentioned costs and 40% (4 out of 10) of 6,458 credit institutions)

The costs result from changing the system<sup>1</sup>, training and extra time spent by compliance officers. Business as usual is zero.

Table 12 Administrative burdens of extension of suspicious transaction reporting instruments admitted to trading on a MTF

	<i>Number of credit institutions</i>	<i>Investment and outsourcing cost per institution</i>	<i>Time spent (hours) per institution</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per institution</i>	<i>Total cost per institution</i>	<i>% business as usual</i>	<i>Total administrative burdens per institution</i>	<i>Total administrative burdens</i>
One off costs	2,583	0	375	45	16,875	16,875	0	16,875	43,588,125
Ongoing costs	2,583	0	375	45	16,875	16,875	0	16,875	43,588,125

Source: EIM, 2010.

#### *OTC derivatives*

The one-off (development) costs and ongoing (monitoring) costs generated by extension of suspicious transaction reporting to OTC derivatives are about € 11,250 and € 11,250 respectively. These costs are based on 4 respondents, since 4 of the 10 respondents trade in OTC derivatives. One-off costs and ongoing

<sup>1</sup> The costs of such a change are considered to be administrative costs.

costs are equal and are about € 29 million (multiplication of the above mentioned costs and 40% (4 out of 10) of 6,458 credit institutions). See Table 13. The costs result from changing the system<sup>1</sup>, training and extra time spent by compliance officials. The business as usual costs are zero.

Table 13 Administrative burdens of extension of suspicious transaction reporting OTC derivatives

	<i>Number of credit institutions</i>	<i>Investment and out-sourcing cost per institution</i>	<i>Time spent (hours) per institution</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per institution</i>	<i>Total cost per institution</i>	<i>% business as usual</i>	<i>Total administrative burdens per institution</i>	<i>Total administrative burdens</i>
One off costs	2,583	0	250	45	11,250	11,250	0	11,250	29,058,750
Ongoing costs	2,583	0	250	45	11,250	11,250	0	11,250	29,058,750

Source: EIM, 2010.

#### Orders

The one-off (development) costs and ongoing (monitoring) costs related to extension of suspicious transaction reporting to orders are about € 56,000 and € 28,000 respectively (see Table 14). This estimate is based on 4 respondents. One respondent stated that they already comply with orders. The remaining 5 respondents were not able to give an estimate. The one-off costs for the EU in total are about € 291 million and the ongoing costs € 145 million (multiplication of the above mentioned costs) and 80% (20% complies) of 6458 credit institutions). The costs result from changing the system<sup>2</sup>, training and extra time spent by compliance officials. The business as usual costs are zero.

<sup>1</sup> The costs of such a change are considered to be administrative costs.

<sup>2</sup> The costs of such a change are considered to be administrative costs.

Table 14 Administrative burdens of extension of suspicious transaction reporting orders

	<i>Number of credit institutions</i>	<i>Investment and outsourcing cost per institution</i>	<i>Time spent (hours) per institution</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per institution</i>	<i>Total cost per institution</i>	<i>% business as usual</i>	<i>Total administrative burdens per institution</i>	<i>Total administrative burdens</i>
One off costs	5,166	0	1250	45	56,250	56,250	0	56,250	290,587,500
Ongoing costs	5,166	0	625	45	28,125	28,125	0	28,125	145,293,750

Source: EIM, 2010.



## 4 Issuers

### 4.1 Obligations set by MAD

As indicated in the TOR, the Commission foresees that the proposed changes to MAD will have an impact following three obligations on issuers:

- Disclosure of inside information;
- Insider lists;
- Manager transaction reports.

#### *Disclosure of inside information*

According to Article 6.1 of Directive 2003/6/EC, issuers of financial instruments are obliged to inform the public immediately of any inside information which directly concerns those issuers. The objective of this requirement is to ensure that inside information available to the issuers is not unjustifiably withheld from the markets, but is disclosed and may be priced as soon as possible.

However, this provision is complemented by the deferred disclosure mechanism set out in Article 6.2,<sup>1</sup> which allows issuers under specific conditions to delay public disclosure. These conditions are that:

- 1 there is a legitimate interest for the issuer;
- 2 such an omission would not be likely to mislead the public;
- 3 the issuer is able to ensure the confidentiality of the information.

Article 6.2 also gives Member States the option to require an issuer to inform without delay the Competent Authority of the decision to delay the public disclosure of inside information. In their report on MAD options and discretions<sup>2</sup>, CESR identified the Member States that have applied this option.

In the EC public consultation of stakeholders, some issuers indicated difficulties in interpreting and following the specific conditions under which disclosure of inside information can be delayed. In particular, this concerns the second (not misleading the public) and third condition (preservation of confidentiality).

Some respondents stated that they never delay disclosure. The main reason is their perception that the Competent Authorities never agree with the reasons for doing so.

<sup>1</sup> "An issuer may under his own responsibility delay the public disclosure of inside information (...) such as not to prejudice his legitimate interests provided that such omission would not be likely to mislead the public and provided that the issuer is able to ensure the confidentiality of that information".

<sup>2</sup> CESR/09-1120, Review panel report – MAD Options and Discretions, 29 March 2010: [http://www.cesr.eu/index.php?page=document\\_details&id=6536&from\\_id=23](http://www.cesr.eu/index.php?page=document_details&id=6536&from_id=23).

### *Insider lists*

MAD includes an obligation on issuers or persons acting on their behalf or for their account to draw up and update insider lists. These lists have to include the persons working for the issuer who have access to inside information. The aim of these lists is twofold:

- 1 to assist Competent Authorities in executing their investigatory powers;
- 2 to act as a deterrent to potential insider dealing practices.

There are administrative burdens associated with this obligation. A contributing factor is the divergent requirements introduced by Member States on the type of information to be provided in drawing up insider lists. These divergent requirements oblige multi-listed companies to draw up and maintain insider lists for each jurisdiction under which they trade financial instruments. The CESR report contains a description of the various requirements set by the Member States.

### *Manager transaction reports*

Issuers are obliged to report manager transactions to Competent Authorities<sup>1</sup>.

This obligation has two major purposes:

- 1 to deter insider trading by managers;
- 2 to provide information to the public that may be useful in indicating manager views on the share prices of companies they manage.

Member States are obliged to ensure that public access to information on such transactions, on at least an individual basis, is readily available as soon as possible<sup>2</sup>.

In the EC consultation of stakeholders, some market participants complained about the administrative burdens associated with this obligation. In the Directive 2004/72/EC, the threshold for transactions to be reported is set at 5,000 euros. This amount is considered to be far too low by these participants.

Also, the provisions of the directive are deemed to be unclear on the relationship between the obligation to notify the Competent Authorities about manager transactions and the obligation to ensure public access to information on such transactions.

## 4.2 Possible changes to MAD and the consequences

The EC is considering adapting some of the obligations described above. These possible changes mainly focus on helping small and medium sized enterprises (SMEs) who are considered to be disproportionately burdened by the obligations.

In the EC consultation, some stakeholders proved to be in favour of introducing an EU definition of a small and medium-sized issuer listed in Europe<sup>1</sup>. Criteria to

<sup>1</sup> Article 6 para. 4 of Directive 2003/6/EC: The measure imposes an obligation on "persons discharging managerial responsibilities within an issuer (...) and, where applicable, persons closely associated with them" to "notify to the competent authority the existence of transactions conducted on their own account relating to shares of the said issuer, or to derivatives (...).

<sup>2</sup> Article 6 para. 4 of Directive 2003/6/EC: Member States shall ensure that public access to information concerning such transactions (...) is readily available as soon as possible".

be included are, for example, the transaction value at the time of the initial public offering and/or the market capitalisation. Understanding the characteristics of smaller issuers listed on RMs and MTFs will enable the Commission to assess whether the official EU definition of SMEs is appropriate for financial markets legislation.

#### *Clarifying when issuers can delay disclosure of inside information*

One of the issues considered by the EC is to clarify for issuers of financial instruments when they are authorised to delay disclosure of inside information to reduce the risks of issuers of being non compliant and to better protect investors. In such a situation, identifying whether the issuer is authorised or not will take less time and thus reduce the administrative burdens. The options to further clarify the legislation on this point are:

- to abolish the condition that delaying disclosure would "not be likely to mislead the public";
- to amend the condition so that delay would not "significantly" mislead the public;
- to define in more detail in implementing measures, the types of cases where delayed disclosure would be likely to mislead the public.

In addition, the Commission is analysing the possibility of removing the option that enables Member States to require issuers to inform the Competent Authority. The issuer would have to inform the Competent Authority of a prior decision to delay disclosure immediately after the information is disclosed to the public (an *ex post* control by the Competent Authority to check whether the conditions for delay were fulfilled). Currently, 16 Member States have used the option that the Competent Authority has to be informed without delay<sup>2</sup>.

#### *Insider lists: impact on the administrative burdens of issuers, especially SMEs*

The obligation of issuers (and persons acting on their behalf or for their account) to establish insider lists will be revised in order to find a better balance between the administrative burdens related to this obligation and the interest of the public.

The range of policy options includes:

- harmonisation of the type of information to be included;
- reduction in the number of persons included on insider lists by abolishing the obligation to include occasional insiders.

With respect to SMEs, the envisaged policy options range from excluding these enterprises from this requirement to introducing simplified requirements ("proportionate" regime).

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<sup>1</sup> An EU-listing Small Business Act, Establishing a proportionate regulatory and financial environment for Small and Medium-sized Issuers Listed in Europe (SMILEs), March 2010, report by Fabrice Demarigny.

<sup>2</sup> CESR/09-1120, Review panel report – MAD Options and Discretions, 29 March 2010: [http://www.cesr.eu/index.php?page=document\\_details&id=6536&from\\_id=23](http://www.cesr.eu/index.php?page=document_details&id=6536&from_id=23).

### *Manager transaction reports*

The obligation to report manager transactions will be reviewed to limit the obligations on managers of public issuers to disclose their transactions without diminishing the protection of investors. Possible policy options include:

- increasing the threshold for manager transaction reporting;
- excluding elements of the transaction reporting requirements such as excluding reporting by managers of transactions made by portfolio managers managing their portfolio in a blind trust.

With respect to SMEs, one option would be to create a specific regime for managers of SMEs.

In addition, this might clarify the requirements for making manager transactions publicly available. The information reported to the public could be harmonised, or be different and simpler to that reported to Competent Authorities for supervisory purposes.

## 4.3 Methodological specifications

The main objective of this study is to estimate the impact on the administrative burdens:

- for issuers of improving the legal clarity of cases where disclosure of inside information can be delayed;
- for issuers, especially SMEs, of the legal requirement to prepare insider lists;
- for issuers, especially SMEs, of the legal requirement to prepare Manager transaction reports.

In total, seven interviews were carried out with issuers. The contacts were obtained with the assistance of Business Associations.

It was also difficult to find issuers willing to participate because of the sensitivity of the topic. However, the main reason was that many issuers did not perceive this legislation to be problematic or costly for them.

The Standard Cost Model methodology was used to estimate the administrative burdens. Because of the limited number of interviews, the results are indicative.

To cover the variety of the additional administrative burdens expected, the study aimed for a spread of respondents over relevant characteristics but the number of successful interviews was too low for this. The seven respondents had the following characteristics:

- Financial markets (countries) of different sizes (three issuers in large economies, four in smaller economies);
- Geographical coverage (three issuers in Southern Europe, three in Eastern Europe and one in Central Europe);
- Size of the enterprises (four large enterprises and three SMEs).

On the basis of the CESR, information was available on the Member States that apply the option to oblige issuers to inform the Competent Authority.

In addition, information from various sources was used to extrapolate the results. Information on issuers, mainly market capitalisation, was collected from

the websites of three junior markets and extrapolated to estimate the changes in the number of SMEs having to comply with legislation if thresholds are included in the MAD provisions.

For more information on the methodology, see Section 2.4.

#### 4.4 Population figures

##### *Issuers*

The possible changes have an impact on all public issuers. However, as the changes are aimed primarily at SMEs, more information was needed on the relative importance of SMEs in EU securities markets. This information includes numbers, market capitalisation and according to a possible new threshold of SME-issuers listed on RMs and MTFs.

The EU definition of SMEs encompass enterprises of limited size (with fewer than 250 employees and either an annual turnover not exceeding 50 million euros, or a balance sheet not exceeding 43 million euros<sup>1</sup>). This definition does not take into account any listing criteria.

In 2009, the European Central Bank (ECB) presented information on the role of SMEs in EU securities markets<sup>2</sup>. The distribution over Member States is not available. According to the ECB, 1% of the listed enterprises are SMEs. Based on Eurostat data, this means 207,000 SMEs, listed and not listed, and includes employee-owned enterprises. This total appears to be much higher than the number of listed SMEs when compared with the number of issuers listed on large RMs and MTFs.

Based on the expert interviews, a large proportion of the SMEs is listed on junior markets and many enterprises listed on junior markets are SMEs. Data on the listed enterprises from three junior markets (AIM (UK only), Alternext and Newconnect) was used to provide an indication of the market capitalisation of SMEs and the number of SMEs listed on markets. In total, 1,047 enterprises are listed on these three markets. The distribution of listed enterprises over market capitalisation classes is presented in Table 15.

<sup>1</sup> ([http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm)).

<sup>2</sup> ECB, Survey on the access to finance of small and medium-sized enterprises in the euro area, 2009 (p.10).

Table 15 Market capitalisation of enterprises listed on junior markets

<i>Market capitalisation (in € 1 million)</i>	<i>Proportion of listed enterprises (in %)</i>	<i>Proportion of listed enterprises after removing the 200+ categories and weighing for other junior markets (in %)</i>
0 – 24	69.6	70.7
25 – 49	14.2	14.5
50 – 74	6.6	6.7
75 – 99	3.1	3.1
100 – 124	1.6	1.6
125 - 149	1.6	1.6
150 – 199	1.5	1.6
200 – 499	1.0	0
500+	0.6	0
Total number	1,047	1,454

*Source: EIM based on listings information markets*

The two highest categories are likely to be large enterprises. When they are excluded, the other percentages need to be multiplied by 1.016 to obtain an indication of the distribution of SMEs (100%) over the other size classes. This reduces the total number of enterprises by 23 to 1,024.

To enable extrapolation to all junior markets, an estimate was made of the total number of listed SMEs. This was based on the relative size of the three junior markets referred to above compared to all other junior markets and the remaining part of AIM. For this purpose, the number of trades from the PWC report was used. The three junior markets had 55% of the total number of trades on these markets. On the assumption that the other 45% of trade is related to 45% of all SMEs listed on the junior markets, a total number of 1,900 SMEs listed on the junior markets was estimated. FESE members reported a total of almost 8,800 listed enterprises on regular markets in October 2010<sup>1</sup>. Their members reported a total of 600 listed SMEs. Compared to these figures, an estimated total of 1,900 listed SMEs would appear to be reasonable.

The number of listed enterprises on RMs used in this study is 12,500. This was the total of listed enterprises on FESE members in 2009, and is likely to be an underestimate but to what extent is not clear.

Using both figures, the total number of issuers used in the calculation was  $12,500 + 1,900 = 14,400$ . Again, this is likely to be an underestimation.

<sup>1</sup> Note: London Stock Exchange and Borsa Italiana are no longer FESE members. They were in 2009; at the time the corresponding figure was 12,500.

#### *Disclosure of inside information*

The respondents indicated on average 3 delays of disclosure per year. The large enterprises interviewed indicated 5 delays on average per year. None of the SMEs interviewed had experience with the obligation. Based on this information, an average of 0.5 delays per SME was used in the estimates.

#### *Insider lists*

All public issuers are obliged to prepare insider lists and as explained previously, the estimated number of 14,400 has been used.

#### *Manager transaction reports*

The respondents reported that on average 13 manager transaction reports per year have to be prepared. The answers varied from 0 (four times) to 60. For SMEs the average was 2, and for large enterprises, 20. The latter is very uncertain. As already mentioned, most of the respondents have never reported manager transactions. The CESR<sup>1</sup> report presents a total of 67,000 reports per year in 22 MS. Five MS did not report the number. Based on this information, on average 2 reports for SME issuers and 6 reports for large issuers would seem reasonable. This leads to 78,800 transaction reports in total in the EU. In most MS, a threshold of €5,000 is set<sup>2</sup>.

## 4.5 Cost estimates

### *4.5.1 Typical firms*

Two types of typical firms have been defined - small and medium-sized enterprises (SMEs) and large enterprises (LEs). The selection of enterprises was based on these characteristics, and the results made the distinction a logical step.

### *4.5.2 Current cost for issuers*

#### *Disclosure of inside information*

The three obligations for issuers distinguished are:

- 1 To identify what is inside information;
- 2 To analyse on a case by case basis whether or not the criteria are met to justify delay of disclosure;
- 3 To report the decision to delay disclosure of information to the Competent Authorities without delay (relevant in 16 MS);

Due to the limited number of interviews, only indications of the current costs for issuers can be provided.

Listed enterprises are obliged to disclose inside information, and thus have to identify whether information is considered **inside information**. Most respondents stated that this is not a complex step. In SMEs, on average 1 to 2 persons

<sup>1</sup> CESR-Pol, responses by CESR-Pol Members to questionnaire on managers transactions reports, 2010.

<sup>2</sup> In four MS no threshold exists. All manager transactions must be reported.

are involved and the work takes about 30 hours per year. The total cost per SME is €1,440.

Based on the interviews, the cost estimates for the large enterprises were wide ranging. The lowest was €2,000 per year and refers to an issuer that never delayed the publication of information. The highest was close to €400,000 per year and pertains to an investment firm. In addition to the range of activities, the number of subsidiaries was shown to be a major cost factor, with head office and subsidiary staff involved. Based on the information provided, on average 6 persons per enterprise are involved in activities and the work takes on average 80 working days per year per person. The external cost (mainly legal advice) is €10,000 on average.

Based on these figures, the total cost per large enterprise is about €175,000. This cost figure seems most likely to be too high.

All respondents attributed at least 50% of the cost to be business as usual: the cost for activities that would be carried out even if not obliged to do so. The average percentage given was 80%. These costs cannot be considered as administrative burdens.

The administrative burdens for SMEs and LEs are presented in Table 16. In total, there are 1,900 smaller issuers (SMEs) and the average administrative costs is € 1,440. The total administrative costs for SMEs is approximately € 2.7 million, of which about € 550,000 (20%) can be considered as administrative burdens due to MAD provisions.

The average administrative costs for large issuers (LEs) is € 175,600. This means that the total costs for 12,500 LEs is € 2.2 billion, of which about € 439 million (20%) is considered to be administrative burdens due to MAD provisions.

Table 16 Administrative costs related to identification of inside information

	<i>Number of issuers</i>	<i>Investment and outsourcing cost per issuer</i>	<i>Time spent (hours) per issuer</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per issuer</i>	<i>Total administrative costs per issuer</i>	<i>% business as usual</i>	<i>Total administrative burdens per issuer</i>	<i>Total administrative burdens</i>
SME	1,900	0	32	45	1,440	1,440	80	288	547,200
LE	12,500	10,000	3680	45	165,600	175,600	80	35,120	439,000,000
Total	14,400								439,547,200

Source: EIM, 2010.

The enterprises interviewed indicate that the costs of **analysing on a case by case basis whether or not the criteria are met to justify the delay of disclosure** are on average € 1,800 per case. All of these costs are related to staff costs. and also include the cost of work on cases for which it was decided NOT to delay disclosure.

The administrative burdens of analysing case-by-case are presented in Table 17. Based on the assumption of an average of 0.5 case<sup>1</sup> per SME, the cost for an SMEs is on average € 900 per year. The total cost for 1,900 SMEs is about € 1.7 million.

The number of cases per large enterprise is assumed to be on average 5 per year, and results in an average annual cost per LE of € 9,000. The total cost (12,500 LE) is about € 112.5 million.

All of these costs are the result of legislation and therefore can be considered to be administrative burdens.

Table 17 Administrative costs related to analysing on a case by case basis whether criteria are met to justify the delay of disclosure

	<i>Number of issuers</i>	<i>Investment and outsourcing cost per issuer</i>	<i>Time spent (hours) per issuer</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per issuer</i>	<i>Total cost per issuer</i>	<i>% business as usual</i>	<i>Total administrative burdens per issuer</i>	<i>Total administrative burdens</i>
SME	1,900	0	20	45	900	900	0	900	1,710,000
LE	12,500	0	200	45	9,000	9,000	0	9,000	112,500,000
Total	14,400								114,210,000

Source: EIM, 2010.

As mentioned previously, 16 MS have applied the option of **reporting the decision to delay disclosure of information to the Competent Authorities without delay**. About 45% of all SMEs and 42% of all LEs are in one of these MS.

The administrative costs per case are € 3,510 and the work is almost entirely carried out by staff. In an enterprise, on average 3 persons are involved for on average 26 hours per person per year.

Based on the average number of cases for SMEs and LEs and the total number of SMEs and LEs, the costs are estimated as follows:

- For SMEs, the annual average cost is € 1,755, with the total annual cost for the 855 SMEs in the 16 MSs of about € 1.5 million euros.
- For LEs, the annual average cost is €17,550, with the total annual cost for the 5,250 LEs in the 16 MSs of € 92 million.

All of these costs are the result of legislation and can, therefore, be considered to be administrative burdens. See Table 18.

<sup>1</sup> This is an assumption – none of the SME respondents reported doing this.

Table 18 Administrative burdens related to reporting decisions to delay disclosure (16 MS)

	<i>Number of issuers</i>	<i>Investment and outsourcing cost per issuer</i>	<i>Time spent (hours) per issuer</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per issuer</i>	<i>Total administrative costs per issuer</i>	<i>% business as usual</i>	<i>Total administrative burdens per issuer</i>	<i>Total administrative burdens</i>
SME	855	0	39	45	1,755	1,755	0	1,755	1,500,525
LE	5,250	0	390	45	17,550	17,550	0	17,550	92,137,500
Total	6,105								93,638,025

Source: EIM, 2010.

The total compliance cost for all obligations related to delaying the disclosure of inside information is presented in Table 19.

Table 19 Administrative burdens of obligations related to delaying disclosure of inside information

	<i>Number of issuers</i>	<i>Total administrative burdens</i>
Identify inside information <sup>1</sup>	14,400	439,547,200
Analyse whether criteria are met	14,400	114,210,000
Report decision to delay disclosure	6,105	93,638,025

#### *Insider lists*

The annual cost of implementing, maintaining and/or updating the insider list is estimated at € 945 for SMEs and at almost € 2,025 for large enterprises. In a large enterprise, on average 2 persons are involved for on average 22.5 hours per person per year. In SMEs, this work is assumed to be done by on average one person taking on average about 21 hours. All of these costs are to be considered administrative burdens. As presented in Table 20, the administrative burdens for SMEs is estimated to total € 1,8 million and for LEs to total € 25.5 million.

<sup>1</sup> Identifying inside information is an activity also relevant for the IO disclosure of information.

Table 20 Administrative burdens related to insider lists

	<i>Number of issuers</i>	<i>Investment and outsourcing cost per issuer</i>	<i>Time spent (hours) per issuer</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per issuer</i>	<i>Total administrative costs per issuer</i>	<i>% business as usual</i>	<i>Total administrative burdens per issuer</i>	<i>Total administrative burdens</i>
SME	1,900	0	21	45	945	945	0	945	1,795,500
LE	12,500	0	45	45	2,025	2,025	0	2,025	25,312,500
Total	14,400								27,108,000

Source: EIM, 2010.

#### *Manager transaction reports*

Most of the respondents had no experience with preparing manager transactions reports. The respondents with experience stated that this was a simple process in almost all cases. For SMEs, the annual average cost is estimated to be about € 135 (2 reports) and for large enterprises about € 405 (6 reports). All of these costs are administrative burdens. See Table 21.

Table 21 Administrative burdens related to reporting managers' transaction

	<i>Number of issuers</i>	<i>Investment and outsourcing cost per issuer</i>	<i>Time spent (hours) per issuer</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per issuer</i>	<i>Total administrative costs per issuer</i>	<i>% business as usual</i>	<i>Total administrative burdens per issuer</i>	<i>Total administrative burdens</i>
SME	1,900	0	3	45	135	135	0	135	256,500
LE	12,500	0	9	45	405	405	0	405	5,062,500
Total	14,400								5,319,000

Source: EIM, 2010.

#### *4.5.3 Impact of possible changes on costs for issuers*

##### *Disclosure: clarifying of conditions delay in disclosure*

Based on the available information on the changes foreseen by the EC (see Section 4.2), respondents that had experience with delaying disclosure were asked to estimate the cost reductions for analysis on a case to case basis and for reporting to the Competent Authorities. The answers are wide ranging and the information provided was not sufficient to obtain an clear insight into the consequences.

For the calculations, the following cost reductions were assumed:

- 30% cost reduction for analysis on a case to case basis;
- 40% cost reduction for reporting to the Competent Authorities.

The administrative burdens of the reduction resulting from clarifying conditions are presented in Table 22.

Table 22 **Reduction** in administrative burdens resulting from clarifying conditions (indicative)

	<i>Number of issuers</i>	<i>Total administrative burdens reduction</i>
Identify inside information	0	0
Analyse whether criteria are met	14,400	34,263,000
Report decision to delay disclosure	6,105	37,455,210

*Disclosure: eliminate requirement to inform the Competent Authority*

As already stated, the alternative to the option for Member States to require issuers to inform the Competent Authority of the decision to delay disclosure without delay is that the issuer inform the Competent Authority of its prior decision to delay disclosure immediately after disclosure to the public. This enables an *ex post* control by the regulator to check whether the conditions for delay have been fulfilled.

For issuers in the MS currently applying this requirement, only a small cost reduction is expected because of the reduced time pressure and consequently improved efficiency. No other changes will occur. For this group, the administrative burdens are assumed to be unchanged. For issuers in the 11 MS where reporting is not required, the cost will rise to the same level as for the issuers in the 16 MS that have the disclosure requirement because these issuers were previously not obliged to do this (neither prior to nor after delay). The effects are presented in Table 23.

The increase in administrative burdens related to reporting the decision to delay disclosure is presented in Table 23.

Table 23 **Increase** in administrative burdens related to reporting decision to delay disclosure

	<i>Number of issuers</i>	<i>Investment and outsourcing cost per issuer</i>	<i>Time spent (hours) per issuer</i>	<i>Tariff per hour (€)</i>	<i>Manpower costs per issuer</i>	<i>Total administrative costs per issuer</i>	<i>% business as usual</i>	<i>Total administrative burdens per issuer</i>	<i>Total administrative burdens</i>
SME	1,045	0	39	45	1,755	1,755	0	1,755	1,833,975
LE	7,250	0	390	45	17,550	17,550	0	17,550	127,237,500
Total	8,295								129,071,475

Source: EIM, 2010.

*Insider lists: harmonisation of information to be included*

The respondents foresaw a 5% cost reduction with the harmonisation of information to be included in the insider list over the MS. This is an annual reduction of € 94 per enterprise and is considered to have little impact. The amount is based on estimates provided by four respondents only whose expectations varied between 0% and 10%.

The reduction in administrative burdens due to harmonisation of requirements on insider lists is presented in Table 24.

Table 24 **Reduction** in administrative burdens due to harmonisation requirements insider lists

	<i>Number of issuers</i>	<i>Total administrative burdens reduction</i>
Report decision to delay	14,400	1,355,400

*Insider lists: eliminating the obligation to include occasional insiders*

The respondents foresaw a 5% cost reduction with the removal of the obligation to include occasional insiders. This would mean an annual reduction of € 94 per enterprise with little impact on cost reduction. This is based on estimates provide by 4 respondents, with expectations varying between 0% and 15%.

The reduction in administrative burdens due to eliminating reporting on occasional insiders is presented in Table 25.

Table 25 **Reduction** in administrative burdens due to deleting inclusion of occasional insiders

	<i>Number of issuers</i>	<i>Total administrative burdens reduction</i>
Report decision to delay	14,400	1,355,400

*Manager transaction reports: increasing the threshold*

As already mentioned, most respondents had no experience with the preparation of manager transaction reports, including all SME respondents. The latter is highly relevant in terms of the possible introduction. According to the three respondents with experience, raising the threshold to € 20,000 would have no impact.

According to CESR<sup>1</sup>, 41% of manager transaction reports concern transactions below € 20,000. Based on the estimated 78,800 reports, this would reduce the number of reports to be prepared by about 32,000. This implies a reduction in administrative burdens of 41%, or € 2.2 million, of which about €100,000 for SMEs.

This is probably an underestimation mainly because in the UK (12,700 reports) there is currently no threshold. Therefore, the reduction will probably be higher than 41% as reports will still be prepared for transactions of less than €5,000.

The reduction in administrative burdens for a € 200,000 threshold for reporting manager transactions is presented in Table 26.

Table 26 **Reduction** in administrative burdens with a €20,000 threshold for reporting manager transactions

	<i>Number of issuers</i>	<i>Investment and out-sourcing cost per issuer</i>	<i>Reduction of time spent (hours) per issuer</i>	<i>Tariff per hour (€)</i>	<i>Reduction of manpower costs per issuer</i>	<i>Total administrative costs reduction per issuer</i>	<i>% business as usual</i>	<i>Total administrative burdens reduction per issuer</i>	<i>Total administrative burdens reduction</i>
SME	1,900	0	1.23	45	55.35	55.35	0	55.35	105,165
LE	12,500	0	3.69	45	166.05	166.05	0	166.05	2,075,625
Total	14,400								2,180,790

Source: EIM, 2010.

*Manager transaction reports: excluding reporting in a blind trust*

None of the respondents had experience with trading in a blind trust and no other information on the topic was available.

<sup>1</sup> CESR-Pol, responses by CESR-Pol Members to questionnaire on manager transactions reports, 2010.

## ANNEX I Terminology

**SCM: Standard Cost Model.** The Standard Cost Model is designed to measure the administrative consequences of legislation for businesses. The SCM has been developed to provide a simplified, consistent method to estimate the administrative costs imposed on business by central governments. The SCM method is a way of breaking down regulation into a range of manageable components that can be measured. The SCM does not focus on the policy objectives of each regulation. As such, the measurement only focuses on the administrative activities that must be undertaken to comply with regulation and not on whether the regulation itself is reasonable or not.

**IO: Information Obligation.** Information obligations are obligations arising from regulation to provide information and data to the public sector or third parties. IOs are the unit of analysis of the present report. A piece of legislation may include one or more IOs. A single IO may refer to a single provision, a single article, or to a group of related articles. The EU Standard Cost Model guidelines provide 12 categories to classify an IO.

**DR: Data Requirement.** Each information obligation consists of one or more data requirements. A data requirement is each element of information that must be provided when complying with an IO. Our analysis usually does not focus on DRs, but only on single IOs. DRs can be used to assess the impact of a new legislative provision changing only part of an existing IOs (for instance, a new proposal on food labelling may impose 5 DRs instead of 6).

**AC: Administrative costs.** Administrative costs are defined as the costs incurred by a normally efficient enterprise in meeting legal obligations to provide information on its action or production, either to public authorities or to private parties. Information is to be construed in a broad sense, *i.e.* including labeling, reporting, registration, monitoring and assessment needed to provide the information. In some cases, information has to be transferred to public authorities or private parties. In others, it only has to be available for inspection or supply on request. Recurring administrative costs and, where significant, one-off administrative costs must be taken into account. Administrative costs are measured over a one-year period.

**BAU: Business-As-Usual.** BAU costs (or BAU factor, in percentage terms) correspond to the costs resulting from collecting and processing information which would be collected or processed by an undertaking even in the absence of the legislation. For instance, firms would keep annual accounts even if they were not required by law.

**AB: Administrative Burdens.** Administrative burdens are the part of the administrative costs resulting from collecting and processing information which would not be collected or processed by an undertaking in the absence of legislation. Formally:

ACs = BAU costs + ABs.

Finding that a legislative provision generates many burdens does not imply any

judgment on its usefulness and benefits. Our analysis is not a net analysis of costs and benefits created by an act, but only a partial analysis of part of its costs. For instance, highly beneficial acts may be burdensome, and burdens may arise also from provisions whose content has been agreed on by the industry.

**P: Price; Q: Quantity.** Price and quantity are the key variables of the “core” equation of the Standard Cost Model. Price of an IO is its cost per occurrence, calculated multiplying the time spent on complying with an IO by the appropriate tariff. A price of an IO may also include external and one-off costs. Quantity of an IO is calculated multiplying the number of entities concerned by the frequency of the IO. Administrative costs are calculated through the following formula:

$$\sum P \times Q$$