Reviewing Market Abuse regime:
some indications from the ESME report

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1. Introduction: where we are with MAD regulatory framework[1]

The EU Market Abuse regulatory picture represents the first example (together with the prospectus framework) of the Lamfalussy process, which has been devised in order to reach a further level of harmonisation across EU Member States, whenever securities-related issues are involved in EU legislation. Actually, the proposal for the MAD was issued at the same time the Lamfalussy approach was being endorsed: in this way the proposal could not benefit from adequate consultation.

In accordance to such a procedure, the EU Market Abuse regulatory framework consists of the following acts:

Level 1 Directive 2003/6/EC of the European Parliament and of the Council (in the following also referred to as "MAD");

Level 2 Directive 2003/124/EC, implementing MAD as regards "the definition and public disclosure of inside information and the definition of market manipulation";

Level 2 Directive 2003/125/EC, implementing MAD as regards "the fair presentation of investment recommendations and the disclosure of conflicts of interest";

Level 2 Regulation (EC) No 2273/2003, implementing MAD as regards the "exemptions for buy-back programmes and stabilisation of financial instruments";

Level 2 Directive 2004/72/EC, implementing MAD as regards the "accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions";

Level 3 first set of CESR guidance and information on the common operation of the directive, addressing the accepted market practices, practices to be considered as market manipulation and the common format for reporting suspicious transactions (CESR/04-505b);

Level 3 second set of CESR guidance and information on the common operation of the directive, addressing the notion of inside information, the legitimate reason to delay the publication, when an information relating to a client's pending orders constitute inside information and insider lists in case of issuers subject to the jurisdiction of more than one EU or EEA Member State (CESR/06-562b).

The set of Level 3 provisions is not yet completed.

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[1] The author is member of the European Securities Markets Expert Group (ESME) and was the *rapporteur* of the subgroup which drafted the report "Market abuse EU legal framework and its implementation by Member States: a first evaluation" (http://ec.europa.eu/internal_market/securities/docs/esme/mad_070706_en.pdf), published by ESME on July 7, 2007. The subgroup was formed by Sebastian Albella Amigo, Margaret Chamberlain, Carmine Di Noia, Philippa Dodd, Henny Kapteyn, Andrew Procter and Maria Gracia Rubio de Casas.
This paper is a shorter and updated version of the ESME report on which it is heavily drawn but the opinions expressed here do not necessarily correspond to those of either the other members of the subgroup or of ESME or of Assonime. The author thanks Matteo Gargantini for his valuable assistance at the time of the drafting of the report and Paola Spatola for her help in drafting this paper.

Just after the publication of the ESME report, CESR identified further issues for work in the area of MAD (CESR/07-518) which have been included in consultation documents that CESR has been publishing for the last months. The first two documents will be finally published as third set of CESR guidance and information on the common operation of the directive. The first consultation document, published in May 2008, dealt with harmonisation of requirements for insider lists and suspicious transaction reporting (CESR/08-274). The second one, published in October 2008 and still in consultation, deals with stabilisation, buy back programmes and rumours (CESR/08-717).

CESR has also published various documents on the administrative measures and sanctions as well as the criminal sanctions available in Member States under the Market Abuse Directive (e.g. CESR/08-099).

Finally, CESR has been publishing the updated list of accepted market practices recognized by national competent authorities after thorough consultations including authorities of other Member States: they are five at the moment but some more are under consultation[2].

The implementation of the Market Abuse regime across Member States is completed[3].

Level 2 directives were all published very soon within the four years period following the entry into force of the Directive, set out in art. 17, (4), of MAD (April 12, 2007). The EU political bodies did not exploit the possibility to modify, by the same deadline, the Level 2 measures in force.

On November 5, 2008 the EU Commission has published its work plan for 2009, proposing a recast of the MAD[4]. In line with the Commission's Better Regulation approach, the review of the MAD will focus on areas where improvements could be achieved in terms of: (i) rationalising/reducing administrative burdens concerning, for example, the disclosure duties on company executives, and the duty to draw up and maintain insider lists, (ii) facilitating and strengthening supervision exercised at the level of Member States.

The announcement is very welcomed and it seems to tackle some of the problems described in the ESME report but not the major one: the notion of inside information. This is rather disappointing because the single notion of inside information has been recognized not only by ESME but also by CESR as the most important issue in the MAD framework. On the other hand, and quite ironically, CESR itself is not even trying to solve it because "this issue will be considered by the EU Commission as part of its review of the operation of MAD provisions. (…) CESR does not intend to produce any guidance on this issue, until after the EU Commission has produced feedback on its own review" (CESR/08-717, p. 8).

2. The analysis of ESME

The Market Abuse legislation represents an important achievement on the road to a further integration of EU financial markets: it has led to an increased level of harmonisation across

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[2] See http://www.cesr.eu/index.php?page=groups&mac=0&id=51.
[3] See http://ec.europa.eu/internal_market/securities/docs/transposition/table_en.pdf.
[4] See http://ec.europa.eu/atwork/programmes/docs/clwp2009_en.pdf.

Member States and is contributing to the creation of a common level playing field for all the involved stakeholders (retail and wholesale investors, financial analysts, intermediaries, issuers, journalists and others). Although some progresses have been made, further work is required to give effect to the policy objectives behind MAD and to ensure true harmonisation. Some flaws of the current regulation and of the way it has been implemented by Member States are observed in the ESME report.

The current financial crisis highlights some of the aspects (e.g. the disclosure obligation for listed financial companies receiving liquidity or other kind of similar assistance). Some sharp regulatory responses, like forbidding short selling, need to be carefully analysed in their advantages and disadvantages; a new ESME report addressing short-selling, is going to be published soon. The extension of MAD to the securities of issuers admitted to trading only on regulated market need to be carefully studied, too.

In the following, after reproducing the executive summary of the report, I will concentrate only on some selected topics of the report: disclosure obligations, insiders lists, directors' dealings and safe harbours.

2.1. Executive summary of the ESME report

ESME has analysed the effectiveness of the Market Abuse Directive and of its implementation.

The major findings of the analysis are as follows:

- The Market Abuse legislation (directives, regulations and Level 3 guidelines) represents an important achievement on the road to a further integration of EU financial markets. However, in order for such legislation to develop all its potential, some corrections are needed.
- Supervisory practices across Member States still show a lack of harmonisation. This might be due to the fact that EU Level 2 legislation has made wide recourse to directives instead of regulations.
- Supervisory practices not perfectly aligned with EU legislation also exist. In many cases, the reasons for such divergences seem to depend on regulatory inconsistencies at EU level. In this respect, national habits may represent an answer to a legitimate demand for a coherent regulatory framework.
- Under the European Market Abuse legislation, a single definition of "inside information" is adopted. This represents a major change in comparison to the pre-existing European directives, where the "inside information" relevant for insider trading prevention was different from the "major new developments" to be disclosed to the market. The adoption of a single definition appears to be at the heart of widespread inconsistencies of behaviour and failures to comply with directive requirements.
- The single definition has sometimes proven to be too wide when it is used to determine when an issuer has a duty to disclose information to the public. Under certain circumstances, a legitimate need to avoid market volatility and uncertainty arise. The disclosure of events that are "likely to occur" might not fulfil this aim, while the possibility to delay – which has been devised as a remedy – is of limited value for issuers because of the conditions set by the directives. In order to settle these inconsistencies and to reach a

further level of harmonisation, it is suggested either to clarify the definition of "inside information" when disclosure obligations are involved (also taking into account differences between Level 1 and the relevant Level 2 directive) or to refine the regulation with regard to delay.

- A lack of harmonisation has also been observed with regard to responding to market rumours and in respect of meetings among issuers, investors and other stakeholders. There is a need for better-detailed European rules or for more effective CESR guidance.
- The duty to keep lists of insiders represents another major change in the EU legislation. The practice of preparing insider lists pre-dates the directive but served a different purpose. Insider lists have typically been used within companies in order to identify those who are in possession of confidential information, whether or not that information is in fact "inside information" under the general definition. Under the directive, the purpose of the lists has become more confused, while it is questionable if a list can provide guidance as to whether a particular person has in fact received particular information. Lists seldom appear to provide valuable information about the "true" insider traders. Level 2 and Level 3 interventions are suggested in order to refine the regulation of insider lists and to make them more effective.
- EU legislation dealing with the disclosure of transaction carried out by persons discharging managerial responsibilities (and by persons closely related to them) has sometimes proven to be unnecessarily burdensome. Given the main signalling function of such disclosure, some possible improvements are suggested.

2.2. The difficult harmonization process

Some inconsistencies in the current Market Abuse regime stem directly from the wording of the EU legislation while others are due to a lack of harmonisation across Member States,.

MAD is still a minimum harmonization directive. This is the main reason why, despite the Lamfalussy procedure, cross-border differences in the practical implementation of the new regulatory regime (Level 1 and Level 2) still persist. Facing these differences, market participants bear unjustified costs both when they are operating on a cross-border basis and when – despite operating in a national context – the rules they have to comply with impose burdens which are not required by the EU legislation and are therefore not borne by foreign competitors. In spite of the fact that each Member State should be motivated to avoid any discrimination against issuers, firms and other stakeholders under its jurisdiction, national Authorities often expand their powers whenever possible (a practice sometimes referred to as "super-equivalence"[5]).

In this way a minimum harmonisation approach may be inadequate to reach a common level playing field across the EU. Moreover, even when the European legal framework has reached a high level of integration, substantial drawbacks may be present when the EU rules do not appear to be *per se* fully efficient when tested in practice, i.e. when they impose costs which are not justified by increased benefits (see for example the threshold on directors' dealings).

[5] The UK currently has a wider definition of market abuse than that established in the MAD. According to FSMA, section 118, 2, market abuse refers to "information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investment of the kind should be effected. It is not clear if in practice the effect on issuers' disclosure obligation is wider or narrower.

The reasons for the flaws above are manifold.

Under the Lamfalussy procedure the preferential tools for Level 2 measures should be regulations. However regulations remain an exception: only one of the four Level 2 measures is a self-enforcing regulation. The other three measures are directives that allow for implicit and explicit choices by Member States, albeit often being very detailed. Level 2 regulations should be adopted as a preferential tool.

Sometimes, a lack of harmonisation in areas covered by the European securities legislation may be the answer to stakeholders' requests for remedies to some inconsistencies in the EU regulatory framework or to some unjustified compliance costs. The main reason for the above seems to be the lack of a thorough impact assessment before the adoption of the directive (see the different notions of inside information across Member States). An ex-post cost-benefit analysis should be performed by the EU Commission in reviewing MAD.

MAD makes as many regulators competent as possible (art. 10 MAD) in order to avoid cases where no authority could prosecute market abuse. This approach becomes problematic when applied to issuers and intermediaries, especially in a non-harmonised context, since market participants could be obliged to respect different (and maybe incompatible) rules (e.g. dissemination of inside information; lists of insiders; safe harbours for stabilisation and share buy-backs; competences shared between authorities and exchanges). Some of these inconsistencies are analysed in another ESME report on "Competent authority pertaining to issuers publication of regulated information"[6]. In order to avoid overlapping competences where issuers and intermediaries may find themselves subject to rules of more than one Member State, a single regulator should be identified to supervise issuers and, possibly, intermediaries.

3. Definition (or definitions) of inside information: scope of application

The directive 2003/6/EC adopts a single definition of "inside information", unlike the effective previous European framework.

Under the previous European framework, the ongoing obligation to disclose *price-sensitive* information was stated by the schedule C, par. 5 of directive 79/279 (consolidated in art. 68 of directive 2001/34/EC), under which "the company [had to] inform the public as soon as possible of any major new developments in its sphere of activity which [were] not public knowledge and which [might], by virtue of their effect on its assets and liabilities or financial position or on the general course of its business, lead to substantial movements in the prices of its shares". Art. 81 of the same directive stated a similar rule for issuers of debt securities. The definition of "inside information" for insider trading purposes was set in the art. 1 of directive 89/592/EEC ("information which has not been made public and of a precise nature relating to one or several issuers of transferable securities or to one or several transferable securities, which, if it were made public, would be likely to have a significant effect on the price of the transferable security or securities in question").

[6] See http://ec.europa.eu/internal_market/securities/docs/esme/05032008_ca_report_en.pdf.

The new MAD definition applies to both the prohibition of insider trading and the duty of publication by the issuer.

According to ESME, this seems a fundamental flaw of the directive.

The definition of "inside information" works well as a test for trading or tipping prohibition towards persons in possession of such information.

However, problems arise when the definition is also used to determine when an issuer has a duty to make information public. The intention to ensure that as soon as reasonably possible, investors have access to relevant information, is clear. The public good in investors obtaining information as soon as possible is preferred to any public good in allowing companies to delay disclosure, in all but the most limited circumstances. Nonetheless, companies anxious to avoid volatility and uncertainty concerning their share price have adopted a variety of strategies to delay the need for disclosure.

Legislators and regulators have also adopted inconsistent approaches to the matter, apparently in recognition of the fact that there is sometimes a greater public good to be served by some delay in disclosure and by the greater certainty that follows.

The result is, eventually, the widespread inconsistencies of behaviours and failures to comply with MAD rules referred to above.

Moreover, the use of a single definition of inside information may increase both market manipulation and insider trading.

In fact, whenever an issuer discloses inside information at an early stage in order to comply with MAD, it bears the risk of creating false market expectations and even manipulation in case the inside information does not develop in a real event.

On the other side, in order to avoid this consequence, issuers, accustomed to the old EU rules, might tend to believe that only more developed events should be regarded as inside information to be disclosed. Should this notion of inside information be generally adopted, the use of that piece of information at a less developed stage, for trading or tipping purposes, would not be perceived, in good faith, as an abuse of inside information.

ESME report showed some evidence like the following.

Some companies will delay bringing a matter to a relevant decision making body, apparently to avoid the need for disclosure and regulators take differing views of this practice. Other companies are expeditious in bringing matters to the attention of decision makers and announcements follow quickly.

The speed with which facts are considered as relevant and any necessary announcement is made varies from jurisdiction to jurisdiction; information is not always disclosed as soon as possible. The differences are particularly important in respect of the repealed art. 68 (1) of the consolidated directive 2001/34/EC, under which, as already described, the company had to "inform the public as soon as possible of any major new developments in its sphere of activity which [were] not public

knowledge and which [might], by virtue of their effect on its assets and liabilities or financial position or on the general course of its business, lead to substantial movements in the prices of its shares". The reference to the effects on assets and liability, the financial position and the general course of business, did not seem to require the disclosure of events or set of circumstances not yet occurred. Nowadays, in some jurisdictions acceptable delays are measured in hours; in others, in days. Many legislators and regulators are not, in practice, applying the test as written in MAD: they are not requiring disclosure as soon as possible[7].

This is the evidence that MAD requires some lifting

Similarly, regulators have taken divergent views on the meaning of "precise" information. This results in widespread practical differences among jurisdictions. The clearest example arises in the context of ongoing negotiations where some regulators do and others do not expect announcements of intention, or depending upon the facts and circumstances, announcements of progress. In some countries (e.g. Italy – Consob Issuers Regulation, art. 66) a duty to publish inside information is not deemed to arise for each of the stage of a complex procedure (e.g. in case of negotiations preceding the closing of a contract), but is referred only to the final outcome of the process. In order to achieve this result, a wise but "instrumental" use of art. 2(2), of Level 2 directive (2003/124/EC) is performed.

To some extent, the concept of inside information as it relates to abusive trading has come to be differentiated from inside information relevant for disclosure obligation. The "precise" nature of the disclosure obligations pertains only to "the coming into existence of a set of circumstances or the occurrence of an event". For abuses of inside information, the set of circumstances, which "may reasonably be expected to come into existence" or the events "which may reasonably be expected to occur" are additionally relevant. This differentiation is mostly based on the wording of art. 1(1), of the Level 2 directive 2003/124/EC in comparison with the MAD.

Finally, divergent behaviours can be noticed when inside information arises during non-business hours or days, especially when many retail investors are involved. Article 6(1) of the MAD states that "Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns the said issuers". The topic of whether to disclose the inside information on, for instance, Monday morning, prior to the opening of the markets, or to disclose it during the weekend does not seem to be addressed at EU level (and often by national regulators as well) and the question of whether the mechanism of the delay in disclosing inside information may be used is debatable.

These situations seem to be the result of the EU approach to the role of corporate information in preventing insider trading. If the issuer is obliged to publish any corporate information which directly concerns the issuer itself and which an insider could benefit from, the likelihood of the latter dealing with the benefit of informational asymmetry will be radically reduced: in practice, only a misfeasance or a legitimate delay by the issuer could make insider trading possible as far as corporate information is concerned. Apart from these exceptions, informational asymmetry would

[7] In Spain, for example, there is still a distinction between *información privilegiada*, relevant for insider trading, and *información relevante*, relevant for issuers disclosure obligation (see article 81 and 82, Ley 24/1998).

be possible only for market information. But in this way no listed company may keep any information confidential: companies may prefer to be listed not on a regulated market any more.

As a result of the situation above, each jurisdiction has devised its own solutions but different practical interpretation of the EU framework represent a cost in cross-border activities and an obstacle to the creation of a single financial market.

ESME report proposed two solutions, not necessarily alternative. The details as to when information should be disclosed should be changed, and/or the circumstances in which disclosure may properly be delayed should be reviewed and changed.

3.1. A Possible Change in the Definition of Inside Information

The more straightforward solution would be to distinguish between inside information as it determines the need for disclosure and inside information as it applies to the obligation to refrain from abusive trading or encouraging abusive trading in relevant financial instruments; in effect, to return to a position similar to that existing prior to MAD. A distinction between the "inside information" relevant for market abuses and the "inside information" to be disclosed to the public could be reached through an amendment to the MAD reflecting the previous 2001/34/EC directive. However, it should be acknowledged that any change affecting the Level 1 legislation is unlikely to be widely supported; at the same time, going through Level 3 guidelines would be a too weak exercise, not necessarily recognised as binding by courts in some jurisdictions.

The possible way forward should be to make a distinction between the two definitions of "inside information" by a focus upon when the information becomes a sufficiently "precise nature". This work could be done in the Level 2 directive 2003/124/EC through a distinction between what is precise for an insider and what is precise for the whole market. Art. 2 of the Level 2 directive already seems to recognise a distinction between the two definitions of inside information in that it states, "Member States shall ensure that issuers are deemed to have complied with the first subparagraph of Article 6(1) of Directive 2003/6/EC where, upon the *coming into existence* of a set of circumstances or the *occurrence* of an event, albeit not yet formalised, the issuers have promptly informed the public thereof" (emphasis added). This rule has been used by some Member States to limit the duty of disclosure only to events that have reached a high level of precision. Given the importance of the topic, the meaning of the quoted Level 2 rule might be usefully clarified stating that "issuers comply with the first subparagraph of Article 6(1) of Directive 2003/6/EC when they inform the public of the coming into existence of a set of circumstances or the occurrence of an event, albeit not yet formalised".

3.2. Delay in the disclosure of information

A further solution to the problems referred to before may be the delay in the disclosure of information. But this remedy, as it currently set out in the directive, has been devised in a way that makes it of limited value for issuers.

First, one of the pre-requisite to delay dissemination is that the "omission would not be likely to mislead the public". However, the definition of "inside information" implies *per se* that a reasonable investor would use it as a basis for her decisions: thus, any delay in the dissemination is almost by definition misleading and it is difficult to think of a circumstance in which delay would be permissible under this test. The directive seems to leave to the issuer any decision whether to delay on these grounds. Nonetheless, in some Member States, there is (still) the obligation on the issuer to request the authority to authorise the delay of the public disclosure of inside information (e.g. Spain, where, in exchange, the issuer is allowed, in general, not to disclose until a formal resolution has been adopted or an agreement has been executed – art. 82, Ley 24/1998). Furthermore, we know from Member States where communication with the competent authority is required that there have been very few cases of delay.

ESME recognised the public interest in the early dissemination of price sensitive information but believes the circumstances in which the public interest is better served by some delay are wider than those contemplated by the existing exception. The delay of transparency enables companies to take the necessary steps to complete the transaction. Granting a delay can contribute to a better functioning of the market and a well-functioning market is the best protection for existing and potential investors. Furthermore, investor protection is not violated by delayed transparency, unless the intention for delay is to mislead the public.

Moreover, the requirement of being capable of ensuring confidentiality constitutes an important safeguard with a view to preventing market abuse practices. ESME believes that its views are reflected in the actual practices of many issuers and by the approach taken by many regulators. In some jurisdictions (e.g. France), even if the general MAD rule on delay has been fully adopted (AMF General Regulation, art. 223-2), issuers are also allowed to delay the dissemination whenever confidentiality is needed to carry out a significant financial transaction and provided that confidentiality is maintained. Under this special rule, no reference is made to the delay of the publication being potentially misleading (AMF General Regulation, art. 223-6).

In the UK, an issuer is not obliged to disclose impending developments that could be jeopardised by premature disclosure. FSA specifies that "delaying disclosure of inside information will not always mislead the public, although a developing situation should be monitored so that if circumstances change an immediate disclosure can be made. Investors understand that some information must be kept confidential until developments are at a stage when an announcement can be made without prejudicing the legitimate interests of the issuer" (FSA Handbook, DTR 2.5.5)[8]. Actually it is not clear why the delay of an announcement should not be misleading for an investor because it prejudice the legitimate interest of an issuer. This investor may be a potential investor interested in trading, not the actual shareholder; if she bought a share, ignoring that a news publication is being delayed at that moment, he will easily find a court recognizing that he was mislead.

In general, regulation of delay could follow different patterns. A wide exemption might leave to the issuer any decision as to whether the test is met (the approach currently taken in the Directive); at

[8] At the same time, the UK FSA has recently closed a consultation on the possibility of delaying disclosure for a listed financial intermediary in case of liquidity support (http://www.fsa.gov.uk/pubs/cp/cp08_13.pdf). As stated also in the document, it is very unlikely that such support would not mislead the public.

the opposite extreme, a different path may require the approval of the regulator (the approach in fact adopted by some regulators even under MAD rules). Consideration could also be given to a model in which an issuer that has decided to delay must inform the regulator but does not need to seek consent.

As noted above, this solution envisages a change in the Level 1 Directive text. As a first step the Level 1 Directive should be amended by repealing the problematic and too narrow test: "provided that such omission would not be likely to mislead the public" (art. 6(2)).

Alternatively, since amending the Directive may prove to be impossible, the Level 2 directive 2003/124/EC could explain the meaning of the words "mislead the public". For instance, it could be made clear that a delay is likely to mislead the public only when the relevant information could run counter to a market consensus, i.e., only when the investment community (through market prices, analysts coverage or others) clearly shows expectations that are contradicted by the information directly regarding the issuer.

It is worth stressing that the suggested amendments to the regulation of delay would be less necessary if the distinction between the "inside information" relevant for market abuse and the "inside information" to be disclosed to the public were clearly drawn (see above). Uncertainties as to when a piece of inside information to be published arises will still affect to a certain extent issuers' behaviour. Under the current definition of inside information, indeed, it would be problematic to ascertain whether an internal procedure for delay has to be activated or not; as a result, the proposed amendment to the legislation on delay would solve the current uncertainties as to issuers' external behaviour, while leaving them unchanged whenever internal procedures are concerned.

Furthermore, the differences in how the current test for delay is administered should be removed. The requirement for consent from the regulator, which appears not to be allowed by the directive, should be removed in those jurisdictions in which it has been introduced; the information flow between issuers and the competent authority should be harmonised at an EU level. The ESME report recommends leaving any decision to delay to the issuers' judgement while ensuring that confidentiality agreements are used in these circumstances and a compliance audit trail is kept of all meetings and considerations.

3.3. Harmonisation problems for issuers

Other concerns arise from territoriality issues when the directive has been implemented in a stricter way (super-equivalence). According to some EU legislation (e.g. Italy) publication of inside information may be carried out by the natural or legal person *controlling* the issuer and may be related to inside information of companies *controlled* by the listed issuer. In the case of dual-listed companies, this could create some problems as far as other jurisdictions not providing for this extension are concerned. The controlling entity publishing information on behalf of the issuer about its controlled company could in fact be regarded as a manipulator by a foreign authority in case the inside information does not develop into an event.

As already stated in the ESME answer to the Commission's consultation about "gold-plating", these rules introduce additional requirements adversely affecting issuers having that country (in this case Italy) as Home Member State because it extend the MAD requirements in two ways: the information of the subsidiaries (the content of the information) and the controlling company (reporting entity). Furthermore, these provisions are difficult to be enforced by the listed company itself because they presume a flow of information from the subsidiary to the controlling listed entity; this may violate the principle of the equality of treatment among shareholders (one shareholder would receive information before others) or on board responsibility (a member of the board is acting in the interest of the company she belongs to and cannot deliver information to external shareholders even if they elected him).

3.4. The treatment of rumours

Finally, a general problem linked to disclosure obligations and delay arises from the behaviour of competent authorities when rumours are concerned. A general obligation to disclose information in response to rumours could jeopardize the feasibility of planned operations. Listed companies should be generally required to disclose information only if the rumours provide "evidence" of a "breach of confidentiality" under Article 6.3 of MAD.

Some countries have in place a discipline on the disclosure of intentions, either in the area of MAD or in the takeover regulations: the risk is to threaten the freedom of capital movement in order to favour national champions. In France, for example, according to the AMF General Regulation, AMF may require any person to publicly disclose her "intentions" in the event of preparation for takeover bid[9]; the required disclosure, in this case, is detrimental for the planning of the operation. A very interesting document recently published by AMF discuss possible modification of the issue[10] in order to make existing rules more effective (evasive statements of intentions should be deemed inadequate for fulfilling the duty to disclose).

In order to reach a further level of confidence on this issue across the EU, it would be advisable to clarify under which circumstances an obligation to disclose arises. Other than in exceptional circumstances, or unless requested to comment by the competent regulator, issuers should be under no obligation to respond to market rumours which are without substance, as already stated by CESR[11]. Further Level 3 guidance on which rumours should be worth of comment might be useful: the recent CESR document, still under consultation, is thus welcomed but may be still shy. It should be better to clarify that a comment on rumours should arise only if "it relates explicitly to a piece of information that is inside information within the issuer" and anomalous price movements arise (anomaly should be checked against market trends). In other cases (i.e. when one or both the two conditions are not met) a "no comment" statement should be allowed.

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[9] See articles 223-32 and following of AMF General Regulation and the *Tables de correspondence, déclarations d'intention en cas de rumeurs*, p. 3.

[10] *Rapport du groupe de travail de l'AMF sur les déclarations de franchissement de seuil de participation et les déclarations d'intention (Octobre 2008)* (http://www.amf-france.org/documents/general/8479_1.pdf).

[11] See CESR/06-562b, p. 5.

When market rumours having some substance are circulating and market prices are affected, issuers should be required to provide comments only to the extent that a piece of inside information exists. Moreover, issuers should be allowed to delay the dissemination of inside information whenever the general conditions for delaying are met. The existence of rumours will, without doubt, be taken into account when assessing if a delay is likely to mislead the public and if confidentiality has been effectively broken. If the rumours are widespread, are having an impact on price or the volume of trade and there are indications that they have been caused by a leakage, it will be difficult to argue that those requirements have not been met, and the issuer should normally provide comment to clarify the issue.

As regards the contents of the communication made in presence of rumours, homogeneous behaviour among competent authorities regarding the use of a "no comment" statement by a listed company in case of rumours could be useful[12].

3.5. Lists of insiders

While the effectiveness of insider lists in preventing market abuse practices remains uncertain, the obligation to draw up such a list has created significant administrative burdens, for larger companies in particular. The reasons for this are manifold: on the one hand, the obligation to maintain and to update these lists is often perceived as unnecessarily burdensome in itself; on the other, the way this obligation has been devised by the relevant directive creates some uncertainties about the practical handling of lists.

The practice of preparing insider lists, of course, pre-dates the directive but served a different purpose. Within investment banks, insider lists typically record members of a "deal team" those who are in possession of confidential information about a particular transaction - whether or not that information is in fact "inside information" as defined. The lists have the further purpose of helping to manage conflicts.

Under the directive the purpose of the lists has become confused and confusing. It may assist in distinguishing between a specific deal and a general course of business situation.

In a deal-specific case, if the list is being maintained by an issuer then, logically, those on the list should be those who possess information in the brief window between the information rising to the level of inside information and its disclosure to the market under the requirement to do so as soon as possible. That is not what happens in practice. In fact, people are added to the list because they possess confidential information and are part of the "deal team". The obligations under the directive add nothing to market practice and provide no additional information of value to Regulators.

[12] In Germany, for example, if an issuer has no reason to believe that there is a confidentiality loophole in its sphere of influence it is exempted from any requirement to comment. Otherwise, a disclosure will be required. If it continues to rely on the exemptions, it must not give signals that would be misleading in the light of (correct) rumors and must adhere to a "no comment" policy. Spreading unfounded rumors can be prosecuted as market abuse (see Issuer Guideline, IV.3.3.).

The problems are even more obvious in respect of those who are placed on lists because they may have occasional access to inside information. In practice, long lists of names appear which provide no real guidance as to whether a particular person has in fact received particular information. The current approach would clearly fail a cost/benefit analysis. In the event that a regulator needs to know with precision who possessed what information and when, the lists will be of little practical use. Nor can the need to compile the lists be justified on the basis that they support other controls around the management of inside information.

Maintaining one central list has proved burdensome mainly because of problems relating to the identification of inside information and the extent to which those employees who have "occasional" access to inside information are to be placed on the list:

(i) *identification of inside information*: scheduled events that constitute inside information, such as the financial results, are easily identified and all persons involved with scheduled events can be placed on the insider list. However it is not possible to predict when unscheduled events will constitute inside information. These unscheduled events range from acquisitions or disposals under consideration and negotiations regarding issues or problems taking their course, to totally unexpected issues such as accidents. When an issue or project reaches the stage where it constitutes inside information collecting names and inputting them on a centralized database at that time typically may not be feasible from a purely practical perspective. Therefore, an analysis must be made prior to such time, where possible, and names inputted centrally at an earlier stage, leading to a long list of "insiders". Moreover, many planned acquisitions or disposals, after having reached the quality of "inside information" lose their status not because they are abandoned, but just because they become less likely to occur: this sort of "oblivion" may last for years, while the treatment of registration for people having access to this information proves to be difficult;

(ii) *employees with occasional access to inside information*: this issue surrounds not what constitutes inside information, but what "occasional" access to inside information is. Since there is no limit on what "occasional" access is, significant numbers of persons become "insiders" simply because they may at some time have access to inside information. However, these persons may not be involved in a project or activity that constitutes inside information for a long period of time, if at all. For example, an employee on an acquisition team may not be involved in a transaction for many years that proceeds past preliminary stages or is of a significant size to constitute inside information for the issuer. However, he might be placed on the list on the basis that one of the significant proposed acquisitions may proceed and therefore constitute inside information.

Uncertainties also stem from the way the obligation to keep insiders list has been devised by the relevant directives:

(iii) under the Level 1 and 2 directives, it is unclear if the list of insiders relevant for the issuers may be kept under the responsibility of persons acting on their behalf or for their account (see the word "or" in MAD, art. 6(3)(3), first sentence) or if the rule requires *both* issuers *and* persons acting on their behalf or for their account to keep registers (see the word "or" in MAD, art. 6(3)(3), second sentence);

(iv) it is also unclear if, for the purpose of the duty to maintain a list of insider, the "access" to inside information has to be actual or (also only) potential. The possibility to permanently register a person seems to indicate that the access could be potential, but if the potentiality

were intended as merely hypothetical the function of the list would be weakened. Linking the insider list to those persons who are aware of inside information or have "regular"' access to inside information through additional guidance would provide clarity; CESR' s clarification Level 3 work, stated that to be registered in insiders' list is the result of activities or duties. This is opposed to obtaining access by other means, such as by accident, of which the issuer is not aware. CESR's clarification would be appreciated[13].

(v) other doubts stem from the expression "acting on behalf or for account" of issuers. It is unclear if "acting for account" encompasses only operations having a legal effect in the issuers' interests (e.g. a mandate) or also other activities simply carried out on issuers' request (e.g. the assignment of a rating on request). With respect to the persons acting on behalf of for the account of the issuer, CESR clarified that the rules that have to be followed must be the ones applicable to the issuer[14].

(vi) the moment when the relevant person should be registered in the list is not completely clear: if the inside information must be disclosed to the public "as soon as possible" (MAD, art. 6(1)), it is unclear when the relevant information may be at disposal of persons working for the issuer while not to the public. Does the list of insiders cover only the very short time period between the moment when an information has reached the status of "inside information" to be disclosed and the moment of actual dissemination? Or does the rule on insider's lists refer only to a delay in the disclosure? The answer to these questions seems to depend on the definition of "inside information" referred to in par. 3.1: should there be a distinction between the inside information relevant for insider trading and the inside information to be published, the obligation to keep a list of insiders could be referred to the former;

(vii) the threat of being considered as "not compliant" could push issuers to adopt restrictive parameters when assessing the need to register people having (potential) access to inside information, thus leading to a huge number of persons being considered as "insiders". For example, a major multinational oil company has over 1,000 employees on the insider list, and this is typical for the larger companies. However, it is unclear to what extent the registration of a person on the list of insiders affects the possibility for that person to deal in the shares of the company or to exercise stock options. It should be clarified that the registration does not result in a legal presumption of being an insider: the registration should rather be regarded as a clue for investigations run by the competent authorities;

(viii) the question also arises of the timing and possible frequency of the information to be given to persons that have access to inside information: it is unclear at what time the information should be given and whether the information should be sent once and for all or should be refreshed when the reasons why a person is considered as "insider" has changed (e.g., because a new transaction is undertaken);

(ix) finally, national companies listed abroad as well as dual listed companies might be subject to different jurisdictions imposing different (and maybe contrasting) duties. CESR clarified in Level 3 work that for issuers subject to the jurisdiction of more than one EU or EEA Member State only the requirements of the Member State where the issuer has its registered office are applicable[15].

Awareness of compliance requirements at all levels within an organization is crucial. Insider lists and transaction reporting could contribute to a proper internal compliance function, serving as a

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[13] See CESR/08-274, p. 5.

[14] See CESR/06-562-b. par. 4.7

[15] See CESR/06-562b, p. 15.

basis for the supervisor. However, costs and uncertainties around the day-by-day management of these registrations are high.

The approach taken by the EU Commission—which in the work plan for 2009, just published, decided to tackle the problem and to strengthen the common European approach with regard to insider-lists—is therefore very welcome. The duty to draw up a list of insiders should not be repealed in Level 1 legislation but should be more cost-effective.

3.6. Notification of transactions

The first observation in the ESME report deals with notification by persons discharging managerial responsibilities.

According to the Level 2 directive 2004/72/EC, all transactions made by managers have to be notified, but the notification may be delayed if their total amount does not exceed 5,000 Euros. Such threshold reflects the idea according to which duties of notification prevent insider trading: but, if this was the case, a notification would result in an unlikely self-accusation.

The likely economic rationale behind a duty on managerial staff to notify own account transactions is market signalling; by providing the market with this notification, managers show to investors their real perception of the issuers' future perspectives. This being the more sensible rationale behind the obligation, the reporting threshold should be much higher than 5,000 Euros. The effect in some countries has been to flood the market with not relevant information[16]: the threshold should be raised; furthermore, after exceeding the threshold, not all transactions (even of one euro) should be notified *uti singuli* but only when reaching again at least half of the threshold.

There is another very important point were the directive is not clear, at least to many European legislators and regulators. Quite all Member States have interpreted the obligation to disclose to the competent authority as the identical obligation to disclose the same information to the market. On the contrary, according to ESME, competent authorities may receive all the info but disclosure may happen only when a certain threshold is reached, as it appears to be in the Portuguese regulation.

In fact, under Article 6 of directive 2004/72/EC, not every transaction to be disclosed to the authority has to be disseminated. A duty to disseminate exists only under Article 6(4) of MAD. The article does not impose the access by the public to all the transactions notified to the competent authority, but only to (some) "information concerning such transactions" (a summary of the transactions should therefore satisfy the requirement). The public has only the right to know the information "on an individual basis" (i.e. the summary of the information must refer to a single relevant person). It can be easily argued that information to be disclosed to the competent authority and information to be disclosed to the public may diverge. A Level 2 amendment could properly

[16] In Italy, before MAD, managers transactions were regulated by the Italian Stock exchange. Immediate disclosure was required for relevant transaction (250,000 euro) and every three months (50,000 euro, cumulated every 12 months): the number of notifications from April 1, 2005 to March 31, 2006, were 1600. After the entry into force of MAD in Italy the number of notifications jumped to 3785 from April 1st, 2006 to March 31, 2007, and to 4888 from April 1st, 2007 to March 31, 2008. The attention of media on the topic has obviously declined.

clarify the correct interpretation of EU legislation; alternatively, Level 3 could enhance an appropriate supervisory practice in this respect.

Some concerns also stem from the way relevant persons have been identified in the mentioned directive 2004/72/EC. For instance, a listed company's director also discharging managerial responsibility in a separate bank or investment firm (and even if he had to be qualified as an independent director) would be required to publish the ordinary trading of such bank or investment firm: the huge costs of the dissemination and the uselessness of the subsequent flood of information are obvious (art. 1(2), Level 2 directive 2004/72).

Moreover, even if the firm buying or selling shares was controlled by the person discharging managerial powers in the issuer, what if such a trading is made through funds managed by the firm itself in its clients' interest? Should this be considered as a transaction "conducted on [firm's] own account" in accordance with art. 6(4), of directive 2003/6/EC? I would suggest not, but the definition art. 1, Level 2 directive is not clear.

Finally, some Member States (e.g. Italy) have extended the list of persons required to notify transactions (e.g. encompassing the relevant shareholders of the issuer): this results in a lack of harmonisation and, possibly, in a relevant increase of costs.

The second main observation by ESME deals with the notification by persons closely associated with a person discharging managerial responsibilities.

In principle, the responsibility for the notification seems to be directly on the "persons closely associated". However, the threshold relevant for disclosure has to be calculated considering transactions carried out both by managers and persons associated to them. This mechanism implies a previous notification to the person discharging managerial responsibilities, which in some jurisdiction discloses the transactions. It should be made clear that the latter is obviously not responsible if he does not receive the notification.

Besides, according to the directive 2004/72/EC, the 5,000 Euros threshold has to be calculated on the basis of the transactions run both by the person discharging managerial responsibilities and by the person closely associated to him. Such a rule is likely to create difficulties in assessing the responsibilities of people involved in the relevant transactions: what if one of the mentioned persons does not know the transactions of the other?

For the first issue, a solution could simply be to raise the 5,000 Euros threshold through an amendment of the Level 2 directive. If this was deemed to prejudice the fight against insider trading practices, than the distinction between (i) the notification to the authority and (ii) the disclosure to the public should be clearly made. The difference is not made clear by the directives (art. 6(4), MAD and art. 6, directive 2004/72/EC), but could be clarified through a Level 3 regulatory convergence. In order not to flood the market with information of negligible or no value, the disclosure to the public of the transactions up to a certain threshold should be allowed on a consolidated basis (e.g. 50,000 Euros calculating aggregate transactions).

As for persons subject to the obligation to notify, it should be clarified in the Level 2 directive that the transactions of the legal person closely associated to a relevant person matters, for the purpose notification, only when conducted in his direct own account.

It should be clarified in the Level 2 directive that the person closely associated must communicate his transactions to the relevant person discharging a managerial function, who on her turn should not be liable for unknown transactions held by the previous one.

3.7. Safe harbours and Accepted Market Practices

Article 8 of MAD provides that the prohibition of insider trading and market manipulation practices does not apply to "trading in own shares in buy-back programmes [...] provided such trading is carried out in accordance" with the implementing measures adopted in accordance with the procedure laid down in Article 17(2). Chapter II of the Level 2 Regulation (EC) No 2273/2003 sets out the conditions the buy-back programmes must meet in order to benefit of the exemption. Article 3 of the Regulation states that the sole purpose of that buy-back programme must be either to reduce the capital of an issuer (in value or in number of shares), or to meet obligations arising from debt financial instruments exchangeable into equity instruments, or to meet obligations arising from employee share option programmes or other allocation of shares to employees of the issuer or of an associate company.

In general, the objectives which buy-back programmes have to meet in order for the exemption to apply significantly restrict the practical application of this safe harbour: a wider set of purposes should be considered.

Moreover, the scope of these purposes is often uncertain in practice: for example, it is not clear whether the exemption applies to buy-backs of shares that shall be granted to the issuer's directors under a share option program. The main issue is whether directors, and in particular non-executive directors, can be regarded as employees in the light of these specific provisions of the MAD and the Regulation.

Moreover, some Member States appear not to have fully understood the meaning of a safe-harbour: it should be stressed that if a buy-back programme does not fulfil the requirements of the Regulation, that, in itself, does not mean that the trading in question should be deemed to constitute market abuse. It only means that the particular trading will be examined, as any other behaviour, under the general provisions of the MAD. Recent CESR clarification on the fact that a stabilisation run outside of the safe-harbour provided by art. 8 should not be regarded as abusive is appreciable; anyhow, it would have been appropriate to remark that both buy-back programmes and stabilisation outside the conditions set forth by Regulation (CE) n. 2273/2003 are not deemed to be abusive[17].

The Level 2 regulation also creates a safe-harbour for stabilisation. Cross-border stabilisation activities may be simultaneously regulated by several Member States. Considering the different ways in which a stabilisation is treated across Member States (e.g. some Member States recognise

[17] See CESR/08-717, p.4.

the possibility of exceeding the 5% over-allotment limit, but others do not), a single regulator should be identified as responsible for the supervision of cross-border stabilisation activities.

CESR recognised the importance of enlarging the strict objectives and limits set forth by the Regulation (CE) n. 2273/2003, which now represents the new goals to achieve by Level 3 work[18].

3.8. Implementation of accepted market practices in different Member States

Only in a very few cases (5) AMPs have been implemented by Member States[19]. The macro problem deals with the differences among them: does the market need harmonization? If so, should AMPs be regarded as new safe harbours? Are the actual AMP already approved the model for the new ones?

At this stage the recognition of AMPs is a matter of national discretion. This could raise some problems. A dual listed issuer could behave according to a certain AMP recognised in one Member State but, at the same time, he could not keep the same behaviour in a different Member State where the same AMP has not been recognised. This would also imply a disparity among markets in terms of liquidity and efficiency. The factors to be taken into account by supervisors when assessing accepted market practices (directive 2004/72/EC, art. 2) are quite indefinite and do not offer regulatory certainty and comfort to the market participants. In this context, the admission procedure of market practices by the national supervisory authorities (pursuant to art. 3 of Directive 2004/72/EC) is important to provide regulatory certainty.

However, in many Member States competent authorities have not yet made such a decision, so that the market participants shall still bear the related regulatory uncertainty and the burden of proof that the market practices they adhere to are acceptable. In addition, there is a regulatory risk that the national supervisory authorities will declare a behaviour as forbidden even if it complies with another Member State's AMP: in particular, art. 1 of MAD states that the market participant is not punishable if her reasons for doing the transactions are legitimate. This means that the burden of proof is on the market participant and that the transactions are in principle prohibited. Therefore, it should be considered whether this burden of proof and this regulatory mechanism need amendments in order to state that the reasons for trading and the market practices shall be deemed legitimate and accepted unless the competent authority declares the opposite. As an alternative, Level 3 guidance on presumptions of legitimate reasons should be soon developed.

As clearly stated by CESR in its overview on the sanctions under MAD, it is necessary to accommodate concerns about the diversity of measures and sanctions applied in the Member States. According to the applicable regime in some Member States, the accepted market practice and the existence of a legitimate reason exempt from the application of administrative sanctions but not from the application of the criminal ones (e.g. Italy). In the above mentioned context it would be important to ascertain if the same happens in other Member States because it is clear that the

[18] See press release CESR/07-416 and CESR/08-717.
[19] See http://www.cesr.eu/index.php?page=groups&mac=0&id=51.

difference of behaviours in this field can create unjustified disparities and hamper the creation of a level playing field.

In some Member States some accepted market practices have been recognised: purchases and sells of securities for fostering the liquidity, subject to some determined conditions of disclosure, are recognised as accepted market practices (liquidity providing). These accepted market practices foresee the mandatory use of an intermediary with whom the issuer must have an agreement. According to MIFID, the possibility to access the regulated market is now granted also to subjects different from investment firms and credit institutions[20]. This should imply for issuers who have in place appropriate Chinese walls the possibility to foster the liquidity of their securities, trading directly on the market and without the obligation to use the services of an intermediary.

4. Conclusions

The market abuse regulatory framework is a milestone in the regulation of financial market in the EU. Some important issues are still unclear, even more after the financial crisis, and the implementation and the different behaviours of the Member States and their competent authorities hamper the creation of a level playing field.

The review of the directive gives a chance of amending some important provisions: the announcement of the Commission's working plan of the is very welcomed.

Keeping strict rules and enforcement and at the same time simplifying unnecessary burdens in insiders list and managers transaction is a good start. Enforcement is the key, more than the sanctions.

The revision of the directive (level 1 or 2) should not forget the most important problem: the notion of inside information. The divergent implementations of the Member States clearly show the failure of the twofold notion of inside information used in the directive. Either the details as to when information should de disclosed should be changed or the circumstances in which disclosure may properly be delayed should be reviewed and changed. Either solution may be simply solved with an amendment to the Level 2 directive 2003/124/EC. The amendment to the notion of inside information would at the same time solve the problem of the moment when the relevant person should be registered in the insiders' list. EU Commission and CESR reciprocally want the other to act. Coordination is necessary but at least some Level 2 are needed, which is out of the domain of CESR.

Other issues that should be solved by the amendment of the directive are those concerning the notification of transactions: an amendment of the Level 2 directive could simply raise the 5,000 Euros threshold. If this was felt to prejudice the fight against insider trading practices, than the distinction between the notification to the authority and the disclosure to the public should be clearly made. The difference is not crystal clear in directives (art. 6, par. 4, MAD and art. 6, directive 2004/72/EC), but could be clarified through a Level 3 regulatory convergence: in order not

[20] See art. 42, par. 3.

to flood the market with information of negligible or no value, the disclosure to the public of the transactions up to a certain threshold should be allowed on a consolidated basis (e.g., 50,000 Euros calculating aggregate transactions).

Finally, a stronger effort on Level 3 is needed: competent authorities should formally take into account the guidelines, which should be binding for them. It would be important not to defend the status quo but to evolve to a harmonized framework to the whole market's advantage.