

## Report of ESME on Competent Authority pertaining to Issuers Publication of Regulated Information

Issuers' disclosure obligations to the market are addressed in many directives. However, there is no uniform approach on the determination of home country/host country for such issuers or for the designation of competent authority that goes across such directives. This paper analyses the implications for in particular issuers due to the current arrangements, and also where appropriate suggests a few alternatives on how to mitigate some of these concerns.

### 1. Introduction

The obligation imposed on issuers, whose financial instruments are admitted to trading on a Regulated Market within EEA, to publish information which reasonably is expected to assist investors in making informed investment decisions is addressed in numerous legal instruments adopted under the Financial Services Action Plan (FSAP). Thus, the IFRS-regulation sets out a common standard for listed companies in terms of financial reporting. Further, the Prospectus Directive (PD) requires initial disclosure of information on the issuer and the financial instruments before such instruments may be admitted to trading on a regulated market.<sup>1</sup> Once so admitted, the issuer will also be subject to the ad hoc disclosure requirements set out in the Market Abuse Directive (MAD), and the Transparency Directive (TD) sets common standards for periodic information, i.e. annual reports, half yearly reports and quarterly reports/quarterly management statements. TD also sets out the mechanisms for disclosure to the market such as publication channels, requirement to post information on the issuer's web site and storage of historically published information in an officially appointed mechanism (OAM).

Of particular importance is the concept of "Regulated Information", which is defined in TD as meaning

*"all information which the issuer, or any other person who has applied for the admission of securities to trading on a regulated market without the issuer's consent, is required to disclose under this directive, under Article 6 of Directive 2003/6/EC of the European Parliament and of the*

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<sup>1</sup> The prospectus requirements set out in PD also apply in case of public offering of non-exchange traded securities.

*Council of 28 January 2003 on insider dealing and market manipulation (market abuse), or under the laws, regulations or administrative provisions of a Member State adopted under Article 3(1) of this Directive”.*

Thus, Regulated information consists of three parts;

- (i) information to be published under MAD,
- (ii) information to be published under TD, and
- (iii) information to be published under national legislation, to the extent permitted in TD.

In respect of information under (iii), TD sets the limits in Article 3.1, by *inter alia* recognizing that a home member state may make an issuer subject to “requirements more stringent than those laid down in this directive”. However, such member state is not allowed to require more stringent disclosure standards than those referred to in (i) and (ii) in acting as a host member state for certain issuers.

One general observation to be made at the outset of this paper is that the regime above may result in that a particular issuer becomes subject to more than one set of rules and/or to supervision from more than one supervisory authority in respect of essentially one and the same disclosure obligation. It could of course be argued that – on the face of it – this is a suboptimal approach and that the regime should be simplified as a matter of principle. On the other hand, if the regime is found to have only limited regulatory impact repercussions or adverse consequences in terms of market efficiency, there might not be sufficient grounds to initiate changes to the current arrangements. In making this assessment, it should also be born in mind that different directives may have different objectives, which might justify differences in terms of supervision (bearing in mind, also, that the current state of play is to keep the model with domestic independent supervisory authorities rather than moving towards one single supervisory authority for all member states).

## **2. Designation of Competent Authority under MAD and TD**

MAD was formally adopted on 28 January 2003. The designation of Competent Authorities for the purposes of MAD is set out in Article 10, which reads:

*“Each Member State shall apply the prohibitions and requirements provided for in this Directive to:*

- (a) *actions carried out on its territory or abroad concerning financial instruments that are admitted to trading on a regulated market situated or operating within its territory or for which a request for admission to trading on such market has been made;*
- (b) *actions carried out on its territory concerning financial instruments that are admitted to trading on a regulated market in a member state or for which a request for admission to trading on such market has been made”.*

It should be recognized that MAD was one of the first directives to be adopted under FSAP. It may reasonably be assumed that – at the time – there were no firm understanding about the underlying principles behind the designation as a competent authority that were to come with directives of a later date. Even though directives such as the PD, TD and MiFID are not perfectly clear in all factual or potential circumstances, it could at least be said that there are some fundamental principles on which all these directives (and a few others) are based. Normally, under other directives than MAD, the competent authorities are designated as being the relevant authority in either (i) the member state in which the regulated entity has its domicile or registered office, or (ii) the member state chosen by the issuer, within certain limitations. Further, it is normally also assumed that only one authority should be competent in relation to an issuer for the purposes of a particular directive.<sup>2</sup>

Another consequence of the regime set out in MAD is that more than one competent authority can claim supervisory powers over one and the same issuer and for one and the same obligation.<sup>3</sup> For example, if a listed company is registered in Member State A, and its shares are admitted to trading on a regulated market in Member State B, the competent authorities in both such member states may claim supervisory powers over the company’s disclosure obligations set out in MAD.<sup>4</sup> We have been told that, in certain member states, even issuers whose shares are only traded on a domestic regulated market in their home country may find themselves subject to certain requirements from a “host country supervisor” only based on the circumstance that they have a substantial portion of their investor base domiciled in such jurisdiction. As

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<sup>2</sup> This is without prejudice to the possibility for competent authorities to delegate supervisory and investigatory powers and to collaborate with other authorities in carrying out the supervision; see for example MAD, Article 12.1. The one example we have identified as deviating from this principle is to be found in Article 24.1, second paragraph, in the TD, which facilitates that the competent authority for supervision of financial reporting may be another than the competent authority for the remaining parts of that directive.

<sup>3</sup> A further assessment of MAD is presented in a previous report by ESME, for example the problem that the same definition of “inside information” apply both in respect of market abuse and in respect of ad hoc disclosure obligations.

recently recognized by CESR, this apply also for other obligations imposed on issuers under MAD, for example the obligation in Article 6.3 third paragraph to draw up a list of persons having access to inside information.<sup>5</sup>

While the allocation of responsibilities between competent authorities envisaged by Article 10 in MAD makes sense for the purposes of market abuse (i.e. insider trading and market manipulation), it is less evident that it is optimal in relation to supervision of issuers disclosure obligations. Rather, to facilitate dual supervisory powers enhances the legal uncertainty and complexity, as well as the regulatory costs for issuers that are subject to such parallel supervisory regimes. This potentially adverse consequence seems to be recognized by CESR in it's recently publish paper on the operations of MAD, where it seeks to find a pragmatic solution to the problem by agreeing on a common approach in the allocation of supervisory powers between competent authorities. CESR recommend in its guidance that relevant competent authorities recognise insider lists prepared according to the requirements of the member state where the issuer in question has its registered office.

The approach proposed by CESR is a satisfactory solution in the short run, but does not solve the basic issue in respect of the consequences of the regime set out in MAD compared with other directives. Another viable solution could be to reach agreement between member states on a common interpretation of Article 10 in MAD as such. Clearly, when drafting the directive, the key concern must have been to address the issue of market abuse. Again, as commented above, Article 10 in MAD works perfectly fine for the purposes of supervision in respect of market abuse. However, in relation to issuer's obligations under MAD, the text in that article is slightly ambiguous, which certainly is one of the reasons for why various member states have construed it in different ways.

Article 10 should be interpreted in the context of other relevant directives. As mentioned above, the bedrock of these directive, notably PD and TD, is that the competent authority is either the relevant authority in the member state where the issuer has its registered seat or, where the relevant directive so permit, the relevant authority in the jurisdiction at the choice of the issuer. The starting point for the assessment should be to align the understanding of MAD with these principles, in order to facilitate a coherent system for designating the competent authority for a particular issuer.

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<sup>4</sup> A list of practical examples of such inconsistencies identified by ESME is attached to this paper in **Exhibit A**.

<sup>5</sup> Section IV in the document "Market Abuse Directive; second set of CESR Guidance and information on the common operation of the Directive to the market", ref, CESR/06-562b, published by CESR in July 2007.

Article 10 limits the scope of its applicability to “*actions carried out.....concerning financial instruments...* ”. It is obvious that insider trading and market manipulation are to be viewed as an “action”. However, it is not obvious that issuers ad hoc disclosure obligations under MAD should be categorized as an “action”, and we suggest that the reference could be read as not applying in relation to the issuers obligations under MAD. However, it is obvious that a competent authority should be designated also for such purposes.

We have contemplated whether the mechanisms set out in TD for the designation of competent authority potentially also could be used for the purposes of MAD. However, in our understanding, the provisions in TD for designation of competent authorities are not designed to facilitate such an extensive interpretation.

However, as set out in the outset of this paper, any initiative to remedy the current inconsistencies could only be motivated if the inconsistencies so identified would pose a real problem to issuers. During our deliberations, it has been argued that the adverse consequences of dual listings are well known to issuers, and that issuers *de facto* can choose to seek admission to trading only at one regulated market if they find that the regulatory costs and burdens from a dual listing would outweigh the advantages of such dual exposure to the market. Also, the improved possibilities in respect of remote access to regulated markets and other trading venues which is a result of *inter alia* regulatory innovations such as MiFID as well as improved technology has – or is reasonably expected to – enhance the competition between such market and diminish the need for issuers to seek dual listings in the future. This is obviously an accurate observation, but the problem still persist for such issuers that are domiciled in one member state, but considers to seek admission of their shares to trading at a regulated market based in another member state. The current well known home bias amongst, in particular, SME’s to seek admission to trading of their shares at a regulated market in the home country would certainly be promoted in practical terms, if the issuer would become subject to duplication in respect of regulation and supervision if it were to seek admission to trading at a competing regulated market operated from another member state.

In light of the above, we support the solution envisaged by CESR in its recently published guidelines. However, we are inclined to suggest that the mutual recognition regime proposed by CESR should be extended to cover not only supervision of insider lists, but also other obligations imposed on issuers under MAD. In the longer perspective, we recommend that

Article 10 in MAD be amended at an appropriate point in time to achieve consistency between MAD, PD and TD.

For the avoidance of doubt, the above is mainly a problem in respect of shares. We fully endorse the principle that an issuer may consider seeking admission of its shares to trading on a particular regulated market, but perhaps finds it more attractive to seek admission to listing or trading of other asset classes, such as fixed income instruments, at another market place in another jurisdiction. We would therefore not support an adjustment of the current regulation resulting in that an issuer should be subject to one single set of regulation or supervision for all of its asset classes that are eligible to investors.

### **3. Delegation of supervision**

Historically, it was recognized under EU securities markets law that certain supervisory functions could be delegated to national stock exchanges, or even other self-regulatory bodies. For example, supervision in respect of matters such as prospectuses, issuers' on-going disclosure obligations, take-over rules, and disclosure of major holdings in listed companies were in some jurisdictions commonly assigned to local exchanges, at the time having a monopoly as the primary trading venues on the local markets.

The endorsement of FSAP, and many directives and other legal instruments that followed suit, changed the position from EU quite dramatically. Clearly, the development resulting in a higher degree of competition between marketplaces, both across borders between traditional exchanges but also from the development of new forms of trading venues such as ATs, ECNs and MTFs, highlighted the potential conflict of interest of exchanges operating on a for-profit basis in a competitive environment compared with their traditional roles as watchdogs for market supervision.

Having said this, in our understanding there has never in history been a demonstrated market failure in the sense that exchanges have not been able to handle both their commercial interests as well as their regulatory functions in the best interest of the public. This could to a large extent be explained by the fact that the regulatory functions are part of the competitive edge for exchanges, and thus also consistent with their commercial interest. Frankly, an exchange that would start compromising with its regulatory functions would certainly have to face a reaction where the confidence for its marketplace would be questioned. In a competitive environment, not the least as is the situation post-MiFID, this could be detrimental to its business. Thus, any

concerns expressed in respect of “conflict of interest” is rather about mitigating the risk of investors – right or wrong – getting the perception that exchanges can not handle their dual functions properly, which could potentially initiate a run to other or alternative market places.

Bearing in mind the above, the potential perception of a conflict of interest for exchanges in their supervisory function of the markets is not addressed in a uniform manner in the relevant EU regulation. One thing that is common for all such regulation – primarily directives – is the notion of “delegation”. Essentially, the notion of delegation of tasks means that a public authority (normally the national Financial Supervisory Authority; or FSA) has the overall responsibility for monitoring compliance with EU-law, but subject to the possibility for national regulators to delegate such tasks to for example an exchange. Subject to such delegation, the national FSA will still be accountable to appropriate supervision of such delegated tasks, and thus be under an obligation to regularly assess and evaluate as to whether the supervision, as carried out by the relevant body, is efficient and appropriate.

The framework for delegation of tasks is set out in the following way in some relevant EU-directives:

- *The Market Abuse Directive (MAD)*: Each member state shall designate one single administrative authority for the purposes of MAD (Art. 11). Such authority shall be given all supervisory and investigatory powers that are necessary for the exercise of its functions (Art.12). However, such powers may be exercised indirectly, under the responsibility of the designated administrative authority, by delegation to e.g. a “market undertaking”. The possibility to delegate such powers is not subject to any sun-set clause.
- *The Prospectus Directive (PD)*: Each member state shall designate a central competent administrative authority responsible for carrying out the supervisory obligations set out in PD (Art.21.1). Delegation is possible under Art. 21.2 in PD, however subject to a review not later than on 31 December 2008 and termination of the arrangements on 31 December 2011, at the latest. When considering whether or not delegation shall be made, the member states are required to consider potential adverse consequences, such as the risk of unfair treatment and potential effect on the competition.
- *The Transparency Directive (TD)*: Each member state shall designate a central authority, which should be the same as the designated competent authority under PD.

There is some possibility to designate another competent authority for the purposes of supervision of compliance with financial reporting standards Art. 24.1 Second paragraph). Delegation of tasks is a recognized feature also under TD, but such delegation shall be subject to review after five years from the entry into force of TD (which is on 21 January 2009) and shall be terminated within eight years from such date (which is on 21 January 2012) (Art. 24.2).

For issuers whose financial instruments are admitted to trading on a regulated market, the three directives above are closely connected since they all address the issue of furnishing the market with information material to investment decisions.<sup>6</sup> The current regime can easily be illustrated with an example.

A company that intends to bring its shares to trading on a regulated market would have to draw up and publish a prospectus. Unless one of the exemptions applies, a new prospectus or an update would have to be made every time the company considers requesting capital injections from shareholders or other investors by issuing new shares or other financial instruments. PD also requires such issuers to publish some regular information to the market, for example the annual lists of all information published during the most recent twelve months (Art. 10). Normally, information previously disclosed and put on such lists has been made public either as ad hoc information under MAD or as regular information under TD (both defined as Regulated Information under Art. 2.1(k) in TD). There is also a close interaction between the modalities of MAD and TD, since the procedures for publishing also ad hoc information are set out in TD, and thus subject to supervision under that directive.

It is possible, and in fact a reality in some jurisdictions that the entity carrying out supervision under the directives above would not necessarily always be one and the same. For example, in some member states, all tasks are done by a stock exchange based on the fact that the window for prospectus approvals under the sun set clause in PD is still open. One such example is Norway. In other, and certainly most, EU member states one single competent authority is responsible for supervision of all three directives. There are also jurisdictions where some tasks are assigned to a public body, whereas other are still carried out by an exchange. One such example is Sweden where prospectus approvals is a task for the Swedish FSA (*Finansinspektionen*), supervision of ad hoc disclosure under MAD is assigned to the exchange where the relevant financial instruments are admitted to trading and supervision of financial reporting is formally assigned to the FSA, but

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<sup>6</sup> There are also other EU regulations or directives of relevance such as the IFRS- regulation, the Take Over Directive and the Shareholders Rights Directive.

practically under the national stock exchange legislation a responsibility also of the relevant exchange.

We recognize that there are a lot of merits in assigning the responsibility for supervision of issuer's disclosure obligations to the exchange where the instruments are admitted to trading. There are reasons to believe that this would facilitate a more efficient supervision of the market, for example due to the close connection between timely information to the market and market abuse such as insider trading. So far, it has not been contested to transfer the front line responsibility for trading surveillance from the relevant trading venues to the FSAs (cf. Art. 43.2 in MiFID). However, if MiFID result in more fragmented trading, we also recognize that exchanges no longer will have the full picture of trading activities, as to a greater extent was the case prior to MiFID.

Notwithstanding the above, we are inclined to support the view reflected under FSAP and the relevant directives, i.e. that all supervisory tasks pertaining to issuers disclosure obligations should be carried out by one and the same entity. However, our observation is that this approach is not well promoted because of the inconsistency across MAD, PD and TD. One could reasonably assume that the sun set clauses set out in PD and TD in a few years time will result in a coherent regime for those directives. However, MAD facilitates delegation for an indefinite period of time, and we have reasons to believe that some jurisdictions are hesitant to transfer the responsibility for MAD-supervision from the local exchange to the relevant public authority. We would therefore suggest that the approaches taken in the directives mentioned above be aligned so that one single regime for delegation applies across all directives.

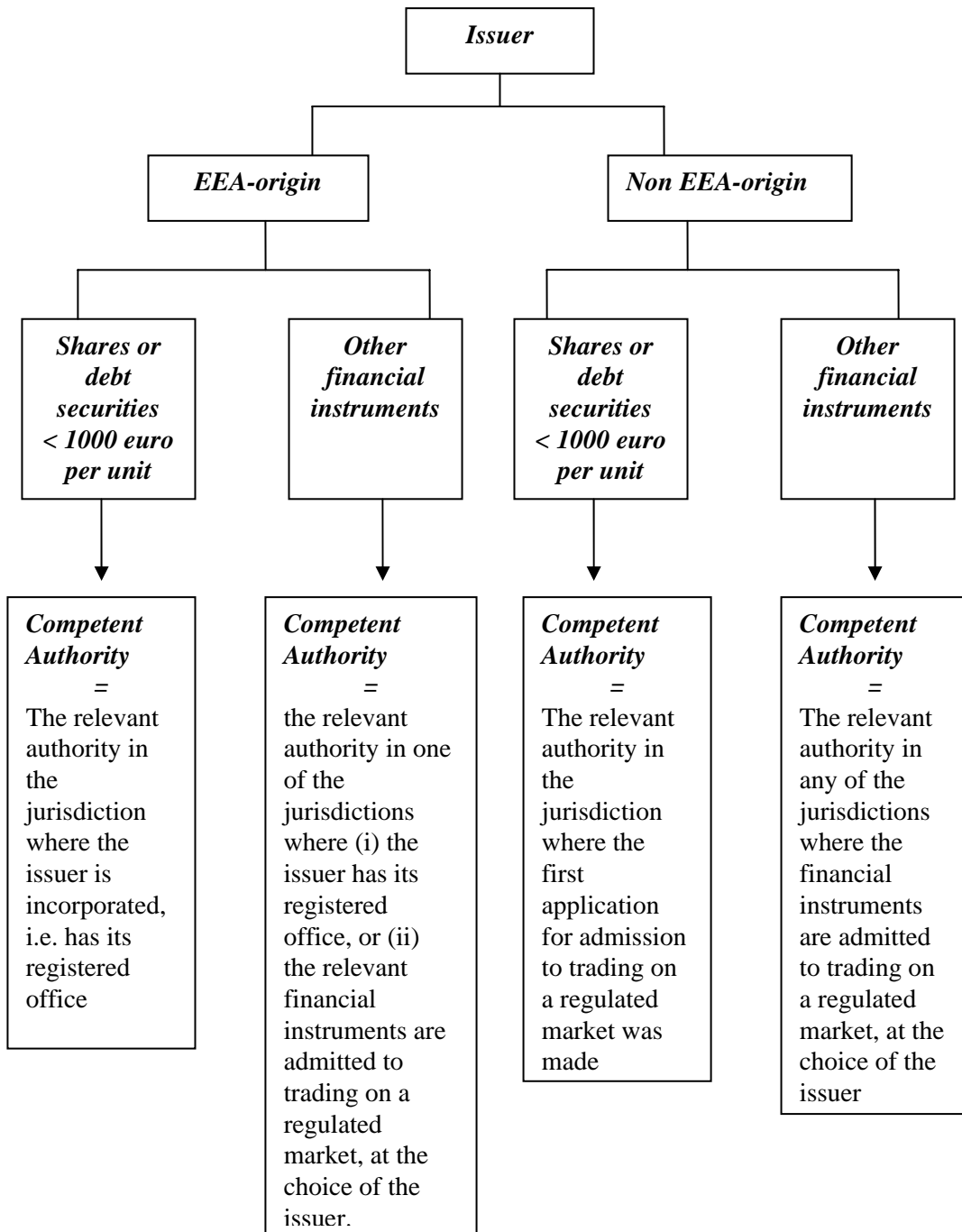
We also conclude that a recognition of exchanges as competent authorities under EU law may give cause to unwarranted consequences in terms of pass porting. For example, while it might make sense for an exchange to assess and approve the prospectus in connection with admitting financial instruments to its own market, this is not necessarily the case if the issuer seeks a secondary listing/admission to trading on another foreign exchange. Such situations are not uncommon in practice. In such circumstances, it would not only be inappropriate for the primary exchange to approve the prospectus and then passport it, but in our experience – when it happens – it normally makes the relevant exchange feel uncomfortable about the scope of its responsibility.

Disclosure of price sensitive information to the market is addressed also in MiFID. We would just like to point at the fact that Art. 40.3 in MiFID have been subject to different interpretations in the member states. In particular, the reference to an obligation for regulated market to “verify” issuers' obligations under Community law has been interpreted inconsistently. Some member states have

construed this reference as meaning an obligation to carry out a minimum due diligence to investigate that sufficient facilities are in place for the issuer from a formal point of view, for example that relevant prospectuses have been approved and published, that the issuer has sufficient procedures and arrangements in place for disclosing price sensitive information etc. However, other member states have understood the reference to “verify” as meaning an obligation equivalent to the obligation that applies for competent authorities under e.g. MAD, PD and TD. Such dual supervision would seem inappropriate and inefficient not only for the issuers’ perspective, but also from the perspective of the wider economy as such. We therefore urge the Commission to give guidance to member states as to the adequate interpretation of the term “verify” as well as to monitor that the term is applied consistently either by way of level 3 measures or – if necessary – as part of level 4 enforcement.

**Exhibit A**

**Determination of Competent Authority under Article. 2.1. (i) in the Transparency Directive**



## Exhibit B

### List of practical examples in respect of duplicated regulation or supervision under the Market Abuse Directive

The below examples are based on experience from ESME-members in respect of some – but not necessarily all – member states on an anonymous basis. They are intended just to give a flavor of how different understanding of the relevant directives by individual member states may cause issuers to be subject to excessive red-tape which presumably was not anticipated when the relevant directives were adopted.

<i>Relevant MAD-obligation</i>	<i>Example</i>
<b>Disclosure of Ad-hoc information, Art. 6.1</b>	<ul style="list-style-type: none"><li>○ <b>An issuer domiciled in ms A, whose shares are admitted to trading on a regulated market in its home country as well as on a regulated market in ms B;</b> the issuer is subject to the statutory disclosure requirements in ms A and ms B, as well as to the disclosure rules of both regulated markets. First line supervision is carried out in parallel by the market surveillance function of both regulated markets, and second line supervision by the competent authorities in both member states.</li><li>○ <b>An issuer is domiciled in ms A, but its shares are admitted to trading on a regulated market in ms B only;</b> the issuer is subject to the same regulatory requirements and supervision described above, though supervision by the regulated market is only carried out by the regulated market in the host country. .</li></ul>
<b>Insider Lists, Art. 6.3, third paragraph</b>	<b>Same situation as under both bullet points above;</b> the issuer is subject to the insider list obligations of MAD as transposed into the legislation in both ms A and ms B, and under supervision by both competent authorities in this regard.

<p>Notification of personal transactions, Art. 6.4</p>	<p><b>Same situation as under the two bullet points in the first box above;</b> the issuer is subject to the MAD notification requirements as transposed into the legislation in both member states. In ms A, reporting is made to the competent authority within five business days from the date of the transaction, and all reported transactions are disseminated by the competent authority. In ms B, reporting shall be made to the relevant regulated market – in principle on a real time basis – and is instantly disseminated through the systems of such regulated market</p>
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