

# **ESME Report**

## Market abuse EU legal framework and its implementation by Member States: a first evaluation

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## *Executive summary*

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.

- Safe harbours and accepted market practices (AMPs) also require some improvement. The legitimate purposes identified by EU legislation for buy-back programs appear too narrow. Stabilisation differs across Member States. AMPs, according to their nature, reflect national divergent practices, raising doubts on their effectiveness for cross-border investors.
- The definition of “inside information” adopted with respect to commodity derivatives does not appear to be aligned with the underlying market reality. Some suggestions are made in order to make it more precise.

## 1. Background and introduction

The Market Abuse regulation represents the first (partial<sup>1</sup>) example of the so-called “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.

The Lamfalussy process is based on a four-level approach. At Level 1 the European Parliament and the Council under the co-decision procedure adopt legal acts. This legislation contains the framework principles reflecting the basic political choices and defines the extent of the Commission's implementing powers. Level 2 covers the legislation adopted by the Commission with the assistance of so-called “Level 2 committees”<sup>2</sup> composed of representatives from the Member States. This level of legislation contains the technical implementing measures necessary to make the principles of Level 1 legislation operational. These technical measures are prepared on the basis of the work of so-called “Level 3 committees”<sup>3</sup> composed of high-level representatives from the national supervisory authorities. Level 3 committees also have the role of enhancing cooperation among and converging the supervisory practices of the competent national authorities. Finally, at Level 4 the Commission and the Member States act to strengthen the enforcement of Community law.

In accordance to such procedure, the EU Market Abuse legislation consists of the following acts:

- i) the Level 1 Directive 2003/6/EC of the European Parliament and of the Council (in the following also referred to as “MAD”);
- ii) the Level 2 Directive 2003/124/EC, implementing MAD as regards “the definition and public disclosure of inside information and the definition of market manipulation”;
- iii) the Level 2 Directive 2003/125/EC, implementing MAD as regards “the fair presentation of investment recommendations and the disclosure of conflicts of interest”;
- iv) the Level 2 Regulation (EC) No 2273/2003, implementing MAD as regards the “exemptions for buy-back programmes and stabilisation of financial instruments”;

<sup>1</sup> The proposal for the MAD has been issued at the same time the Lamfalussy approach was being endorsed: in this way the proposal could not benefit from adequate consultation.

<sup>2</sup> The committee procedure, originally established with the Council Decision n. 87/373/EEC, was extended to financial services by the Council Decision n. 1999/468/EC. Within the “Level 2” stage, two committees are involved: the *European Securities Committee* (ESC) – established by the Commission Decision n. 2001/528/CE and is composed of high-level Member States representatives – and the *Committee of European Securities Regulators* (CESR) – established by the Commission Decision n. 2001/527/EC and is composed of high-level representatives of Member State supervisory authorities. While ESC carries out regulatory functions within the European Treaty (art. 202 procedure), CESR has consultative powers regarding measures to be adopted in the Level 2 stage.

<sup>3</sup> Within Level 3, CESR should “contribute to the consistent and timely implementation of Community legislation in the Member States by securing more effective cooperation between national supervisory authorities, carrying out peer reviews and promoting best practice” (Commission Decision n. 2001/527/CE, “whereas” n. 9).

- v) the 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”;
- vi) the 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).

The set of EU-level provisions is not yet completed. On 17<sup>th</sup> October 2006, CESR held a public hearing in order for interested parties to express their evaluation of the supervisory functioning of the EU Market Abuse regime. In addition to the public hearing, on 2<sup>nd</sup> November 2006, CESR published a Level 3 consultation document (CESR/06-562) addressing the definition of inside information, the legitimate reasons to delay the publication of inside information, the client orders constituting inside information and the insider lists. A further set of guidelines is expected soon.

The implementation of the Market Abuse regime across Member States is almost completed. At the time of this report, Level 1 and 2 directives have been implemented by each of the Member States<sup>4</sup>. The Level 3 phase is still under way.

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 Member States and is contributing to create a common level playing field for all the involved stakeholders (retail and wholesale investors, financial analysts, intermediaries, issuers, journalists and others). Although progress has been made, further work is required to give effect to the policy objectives behind MAD and ensure true harmonisation. This draft report provides an initial evaluation of the EU Market Abuse regime: it identifies the flaws of the current regulation observed by the ESME Group members.

The aim of the analysis is to assess the legal framework dealt with by stakeholders on a practical day-by-day basis. Opinions expressed hereinafter deal both with the EU legislation itself and with the way it has been implemented by Member States. The evaluation therefore takes the national administrative and legislative rules as starting point, while the theoretical coherence of the EU legislation is taken into consideration as far as it is recognised that the final regulatory output could be improved through better EU legislation.

Paragraph 2 below provides a conceptual framework for the inconsistencies detailed in the subsequent part of the report. Paragraphs from 3 to 7 address the major inconsistencies providing an explanation of the gaps and suggesting possible solutions. Paragraph 8 contains technical topics.

## *2. Conceptual framework*

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

In spite of the fact that the Lamfalussy procedure has been followed, 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 which therefore foreign competitors do not face. In spite of the fact that each Member State should be motivated not

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<sup>4</sup> See: [http://ec.europa.eu/internal\\_market/securities/transposition/index\\_en.htm](http://ec.europa.eu/internal_market/securities/transposition/index_en.htm)

to discriminate against issues, firms and other stakeholders under its jurisdiction, national Authorities often expand their powers whenever possible (a practice sometimes referred to as “super-equivalence”). In this way a minimum harmonisation approach may be inadequate for reaching a common level playing field across the EU, unless a choice is given to market participants on the jurisdiction they prefer to be subject to.

Moreover, even when the European legal framework has reached a high level of integration, substantial drawbacks may be present when EU rules do not appear *per se* to be fully efficient when tested in practice, i.e. when they impose costs which are not justified by increased benefits.

The reasons for the flaws above are manifold:

- (a). 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 represented by a self-enforcing regulation. The other three are directives that allow for implicit and explicit choices by Member States, in spite of the fact that they are often very detailed.

***Examples: (i) legitimate interests for delaying public disclosure of information (ii) the procedure for delaying (see par. 3.2).***

Level 2 regulations should be adopted as a preferential tool.

- (b). Sometimes, a lack of harmonisation in areas covered by the European securities legislation may be the answer to stakeholders’ requests when facing inconsistencies in the EU regulatory framework or unjustified compliance costs. The main reason appears to be the lack of a thorough impact assessment before the adoption of the directive.

***Examples: different notions of inside information across Member States (see par. 3.1); lists of insiders (see par. 4).***

An ex-post cost-benefit analysis should be performed.

- (c). 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.

***Examples: dissemination of inside information (see par. 8.2); lists of insiders (see par. 4); safe harbours for stabilisation and share buy-backs (see par. 6.1 and 6.2).***

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, may be, intermediaries.

- (d). While the potential conflict of competences between regulators set out under Paragraph c. above could be described in terms of “horizontal conflicts”, there may as well in some jurisdictions arise also a “vertical conflict”, i.e. a conflict of competence between regulators and market participants of regulated markets (e.g. stock exchanges). In our experience, some jurisdictions read Art. 40.3 of MiFID, and in particular its reference to the obligation on market operators to “verify” issuers’ compliance with e.g. ad hoc disclosure obligations under Community law, in such way that market operators will be subject to an obligation to police issuers compliance with such law in substance. With such interpretation issuers’ would be subject to supervision from both the relevant competent authority under MAD as well as the market operator of the regulated market where the securities are admitted to trading.

***Example: Publication of ad hoc information.***

In order to make issuers subject to only one set of rules and only one single supervisor in respect of company disclosure obligations, it should be recognised that the only means to allocate such powers between the supervisor and the market operator would be to use the option to delegate set out in Art. 12.1 c. in MAD.

### 3. *Inside information*

#### 3.1. *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<sup>5</sup>. This definition applies to both the prohibition of insider trading and duty of publication by the issuer. This appears to be a fundamental flaw of the directive. ESME has not been able to carry out a detailed study but, based on personal experience and discussion among the group and with market participants, the members concluded that there are widespread inconsistencies in behaviour and failure to comply with directive requirements, which result from the use of a single definition.

The definition of “inside information” works well as a test for when a person in possession of such information should refrain from trading or encouraging trading in relevant financial instruments.

However, problems arise when the definition is also used to determine when an issuer has a duty to make information public. The intention is clear – to ensure that as soon as reasonably possible, investors have access to relevant information. 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. 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 the greater certainty that follows. The end result is the widespread inconsistency of behaviour and failure to comply referred to above.

The use of a single definition of inside information could 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 would not be perceived, in good faith, as an abuse of inside information.

In our experience, the following have been observed in the market:

- 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

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<sup>5</sup> 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), according to 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”).

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, par. 1 of the consolidated directive 2001/34/EC, according to 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”. The reference made 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, days. Many regulators are not, in practice, applying the test as written: they are not requiring disclosure as soon as possible.
- Similarly, regulators have taken differing views on the meaning of “precise” resulting in widespread differences in practice between jurisdictions. The clearest example arises in the context of ongoing negotiations where regulators in some jurisdictions 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, an “instrumental” use of art. 2, par. 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 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, par. 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 seems not to be addressed at EU level (and often by national regulators as well) and the question of whether the mechanism of delay of disclosure of 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 be possible only for market information. But in this way no listed company may keep any information confidential; no company would choose to be listed any more.

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

**Suggested solutions:** Two solutions suggest themselves. Either the details as to when information should be disclosed should be changed, or the circumstances in which disclosure may properly be delayed should be reviewed and changed. Either solution may require amendment to Directive text. The two alternatives are described in the following paragraphs.

### 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.

As a matter of fact, the different functions attached to the single definition of “inside information” determine that it tends to be interpreted in different ways. In certain jurisdictions, a higher level of precision will be implicitly required in order for information to be considered “inside information” to be disclosed, while an event not yet well defined will be regarded as a sufficient pre-requisite for insider trading purposes.

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.

A distinction between the two definitions of “inside information” may be achieved 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.

As a further alternative, a common position among regulators could be reached through Level 3 CESR guidance, although Level 3 convergence might not be recognised as binding by courts in some jurisdictions<sup>6</sup>.

Finally, a general problem linked to disclosure obligations and delay deals with the behaviour of competent authorities with respect to rumours. 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. 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. Further Level 3 guidance on which rumours should be worthy of comment might be useful.

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

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<sup>6</sup> For a similar problem, see par. 4, suggested solution and par. 8.2, suggested solution.

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 leak, 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.

### 3.1.2. *Delay in the disclosure of information*

An alternative solution to the problems referred to in par. 3.1 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” *per se* implies 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 it to the issuer to decide whether to delay on these grounds. Nonetheless, in some Member States, there is 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). Furthermore, we know from Member States where communication with the competent authority is required that there have been very few such cases.

The various failures described in par. 3.1 and the logical flaw inherent in the existing test suggest the need for a different test of when delay is acceptable. The sub-group recognises 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 to ensure confidentiality constitutes an important safeguard with a view to prevent market abuse practices. The sub-group also 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. 222-3), 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 potential mislead of the information (AMF General Regulation, art. 222-7).

In general, regulation of delay could follow different patterns. A wide exemption might leave it to the judgment of the issuer as to whether the test had been met (the approach currently taken in the Directive); at the extreme opposite, a different path may require the approval of the regulator (the approach in fact adopted by some regulators even under the current test). Consideration could also be given to a model in which an issuer that has decided to delay must inform the regulator but need not seek consent.

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

Alternatively, since amending the Directive may prove to be impossible, the Level 2 directive 2003/124/EC could explain the meaning of “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 clearly shows (through market prices, analysts coverage or others) expectations that are contradicted by the information directly regarding the issuer.

It is worth stressing that the suggested amendments to the regulation of delay, while probably being the more feasible, would represent a second best solution if compared with the distinction between the “inside information” relevant for market abuse and the “inside information” to be disclosed to the public (see par. 3.1.1. above). Uncertainties as to when a piece of inside information to be published arises will still affect to 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 as for internal procedures.

As a further observation, 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 this level. We would recommend leaving a decision to delay to the judgement of the issuer, but to ensure that confidentiality agreements are used in these circumstances and a compliance audit trail is kept of all meetings and considerations.

### *3.2. Definition (or definitions) of inside information: the reasonable investor test*

One of the conditions in order for a piece of information to be “inside” is that such piece of information is “likely to have a significant effect on the price”. Level 2 directive 2003/124/EC specifies that this condition is met whenever a reasonable investor would use the information as part of the basis of his investment decision.

Regulators have shown divergence of opinion as to the level at which inside information would be used by a reasonable investor in his investment decision-taking. One approach appears to be that information that may affect any individual investor’s investment decision will be significant enough to require a regulatory release; this approach does not reflect the need for a “reasonableness” element in that decision. As a matter of fact, the reasonable investor test should be a criterion to distinguish between information that could be material for the market, that has to be disclosed, and non-material information that, if disclosed, could mislead the market. Therefore further guidance as to how to apply the “reasonable” investor test could be helpful to all market participants involved in making these determinations. The CESR level 3-draft guidance does not seem to properly address this issue in that it mostly relies upon historical precedents regarding the issuer.

***Suggested solution:*** Level 3 guidance should provide further indication on the “reasonableness” criterion. A professional investor test may be adopted as the relevant benchmark since it would provide a more suitable benchmark when assessing whether a piece of information would be appreciated by the market as a determinant of an investment decision.

### *3.3. Relationship among issuers, investors, and other stakeholders*

One-on-one meetings between issuers and investors (as well as between issuers and other stakeholders) should be managed so as not to communicate inside information. However, it is widely acknowledged, in particular by corporate governance codes, that a regular dialogue between

company's boards and its shareholders should take place in order to contribute to the quality of functioning of the financial markets. Shareholders provide large sums of money and a license to operate to the management of a company. A good relationship between shareholders and management of listed companies is therefore not only based on results, but also on trust and open-door informality.

Under the current regime, issuers and investors may not feel safe in participating in one on-one meetings because of a potential difference of views between the stakeholders involved and (one) of the supervisors. At least in some Member States the competent financial authorities do not appear to share a common understanding on how an effective dialogue between issuers and investors and/or other stakeholders could take place. The problem is the level of confidentiality that should be taken into consideration by both parties, especially if there is conflict of interest between the different stakeholders of the company. On the one hand there is a call for transparency and on the other hand confidentiality might result in a more prudent and consistent decision-making and implementation. Against this background, it is worth considering the desirability and necessity of issuing level 2-guidance regarding company contacts and possible consequences.

#### *3.4. Scope of the insider trading prohibition*

The intention to take advantage of inside information is an element in the application of the insider trading prohibition.

The implementation of this point across Member States has shown different approaches. For example, in Spain the approach has apparently been totally objective: whoever possesses privileged information is subject to an absolute prohibition to trade, applicable even in the case that the transaction does not move in the direction that the information might suggest. In other countries, prohibitions explicitly refer only to trading activities carried out using the inside information.

Another issue stems from the MAD recitals no. 29 and 30, whose scope of application is not clear: it is uncertain, for instance, if they cover purchases made prior to a tender offer by someone who has decided to launch that tender offer. The acquisition of a small stake in the target company often anticipates the launch of a bid: the practice of acquiring a toehold in advance of a tender offer should be expressly safeguarded under the MAD. The same holds true when a decision is taken by a consortium to launch a joint tender offer.

Greater clarity may be needed on the possibility of disclosing inside information to individuals or entities acting in the normal course of the exercise of their employment, profession or duties: in particular, it is not clear whether potential investors prior to an institutional private offering of shares are covered by this provision, nor which kind of relationship with institutional investors is allowed.

***Suggested solutions:*** Level 3 measures could properly address these problems although it is not clear to what extent a convergence among regulators would be taken into account by courts in certain jurisdictions. The topic of insider trading in relation to takeover bids deserves specific treatment: on the one hand, early disclosure to the public could hamper the feasibility of the transaction itself (see par. 3.1 above), on the other hand, harsh prohibition to trade before the bid could make the market for corporate control less efficient.

#### *4. 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, in some ESME members' opinion, 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 deal specific 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 a Regulator.

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 such a case, 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 centralised 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, par. 3, sub-par. 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, par. 3, sub-par. 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;
- (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);
- (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, par. 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 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.

***Suggested solutions:*** 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 basis for the supervisor. However, costs and uncertainties around the day-by-day management of these registrations are high. We would support a common European approach with regard to insider-lists. It is acknowledged that the duty to draw up a list of insiders cannot be easily repealed since it involves Level 1 legislation. In any case, it should be stressed that national legislators and regulators must leave issuers the possibility to decide how to keep the register, provided that the aim of an effective identification of insiders is fulfilled. Moreover, a clarification of practical issues like the ones under the second set of problems above could reduce some concerns. For each of the highlighted topics, a further Level 3 convergence (e.g., through a CESR guidance) would increase market confidence. CESR has recently addressed some issues related to the list of insiders in its draft guidance “on the common operation of the Directive”<sup>7</sup>: in particular, the topic under (ix) above is dealt with in a consistent manner through a reference to a “mutual recognition” regime for lists prepared according to the “home country” regulation. Other similar initiatives might be helpful. However, the role of Level 3 measures remains uncertain in jurisdictions where the courts apply administrative regulations only to the extent these are referred to by the law through a clear enabling provision: thus, for topics referred to under (iii)-(ix) a Level 2 clarification, whenever feasible, could prove more effective.

## 5. Notification of transactions

### 5.1 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 were 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 prospects. If this is indeed the rationale behind the obligation, the reporting threshold should be much higher than 5,000 Euros. The directive is not clear. 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, competent authorities may receive all the info but disclosure may happen only when a certain threshold is reached.

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, par. 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” (i.e. a summary of the transactions). 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 clarify the correct interpretation of EU legislation; alternatively, Level 3 could enhance an appropriate supervisory practice in this respect.

Serious 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

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<sup>7</sup> CESR, (note 6), p. 14.

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, par. 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, par. 4, of directive 2003/6/EC. We would suggest not, but the definition art. 1 of the 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.

### *5.2. 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 is the one disclosing the transactions. It should be made clear that he 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 seems 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?

**Suggested solutions:** for issues addressed in par. 5.1, a solution could simply be to raise the 5,000 Euros threshold through an amendment of the Level 2 directive. If this were felt 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, par. 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.

For issues addressed in par. 5.1, 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 his turn should not be liable for unknown transactions held by the previous one.

A final problem might be the definition for these purposes of the concept "*person closely associated*", since the absence of a common definition might lead to distorted and unequal result in different Member States.

## 6. *Safe harbours and Accepted Market Practices*

### 6.1 *Buy-back programmes*

Article 8 of the 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 to be met by the buy-back programmes in order to benefit from the exemption. Article 3 of the Regulation states that the sole purpose of that buy-back programme must be:

- (i) to reduce the capital of an issuer (in value or in number of shares); or
- (ii) to meet obligations arising from debt financial instruments exchangeable into equity instruments; or
- (iii) 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 the Level 2 regulation from the prohibition of market abuse applies to trading in own shares in buy-back programmes for directors of the issuer. 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.

Some Member States appear not to have fully understood the meaning of a safe-harbour: it should be noted 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.

### 6.2. *Stabilisation of financial instruments*

The Level 2 regulation also creates a safe harbour for stabilisation.

Despite the fact that a regulation, instead of a directive, has been used, the interpretation of “permitted stabilisation” differs across the Member States. This reflects different historical experience with stabilisation in the domestic context and, in some cases, the non-existence of the activity in the domestic context. This divergence causes difficulties in the international context. For instance, some Member States oppose stabilisation of debt securities in principle. Other Member States appear not to fully appreciate the concept of a “safe harbour” and do not recognise that non-compliance with one or more of the requirements of the regulation does not automatically render the stabilising activity abusive (even though there is an express recital in the regulation to that effect).

Furthermore, the regulation requires the disclosure of some features of the stabilisation before it is actually carried out. It is not always clear how to notify this information. Each competent authority should have a designated e-mail address or other mechanism enabling the electronic filing of the disclosure. Similarly, it should be clear which methods of disclosure to the market are considered sufficient. In particular, a competent authority should recognise as acceptable the electronic disclosures common in international capital markets.

Other problems arise where a stabilisation affects more than one Member State. Because of the reasons explained above (par. 2.1(c)), stabilisation activity in a particular case may simultaneously be regulated by several Member States. Considering the different ways in which a stabilisation is treated across Member States (e.g., some of the Member States recognise 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 stabilisation activity affecting more than one Member State.

***Suggested solutions:*** As stressed above, regulations should represent the preferential level 2 tool. In order for a further harmonisation to be achieved, a certain degree of supervisory convergence is needed. In general, a further Level 3 convergence should stress that being outside the scope of a safe harbour does not by itself result in a presumption of market abuse.

As for buy-backs, a wider set of purposes should be deemed as legitimate by the Level 2 regulation, and it should be clarified (whether in Level 2 regulation or in a Level 3 guidance) that all board members are included in the safe harbour.

As for stabilisation, Level 3 guidance should identify common technical standards to be followed, while a single supervisor should be identified as competent in cross-border operations (Level 2 or further Level 3 convergence).

### *6.3. Implementation of accepted market practices in different Member States*

Only in a very few cases have AMPs been implemented by Member States. 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; if we consider a dual listed issuer, he could behave according to a certain AMP recognised in one Member State but, at the same time, he would not be able to have the same behaviour in a different Member State where the same AMP has not been recognised. This would also imply disparity among the various 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 such a decision has not been made by the competent authorities, so that the market participants shall still bear the related regulatory uncertainty and the burden of proof that their market practices 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 an AMP: in particular, art. 1 of the MAD states that the market participant is exempted from punishment provided that his reasons for doing the transactions are legitimate. This means that the burden of proof is on the market participants and that the transactions are in principle deemed to be prohibited. Therefore, it needs to be reviewed whether this burden of proof and regulatory mechanism should be amended in a sense that the reasons for trading and the market practices are deemed to be legitimate and accepted unless the competent authority declares these as not being legitimate and not accepted.

***Suggested solutions:*** AMPs should be further harmonised through a Level 3 convergence.

The burden of proof on market participants (Level 1 directive) should be reconsidered since it strongly weakens the effectiveness of AMPs.

## *7. Commodity derivatives*

The scope of application of the insider trading prohibition of art. 2 and 3 of the MAD are decisively defined by the term “inside information”. The more specific definition of inside information in respect of commodity derivatives (see art. 1, par. 2 of the MAD) is of great practical significance and is expanded upon somewhat by article 4 of Directive 2004/72/EC, which sets the circumstances under which “users of markets on which commodity derivatives are traded are

deemed to expect to receive information relating to one or more such derivatives". These descriptions are too indefinite to create the necessary level of legal certainty for market participants. In particular, it is not clear under which circumstances market participants would expect to receive, in accordance with accepted market practices, the relevant inside information. This means that under these legal definitions of insider information it is not clear whether information referring to the production, the transport, the sale of commodities and prices of commodity derivatives are inside information or not. Specific CESR guidelines addressing these issues would be welcomed, but it is questionable if a Level 3 measure would be sufficient or if the Level 1/Level 2 text needs to be amended.

A stricter and more stringent definition of inside information in respect of commodity derivatives should be introduced and this definition should be harmonised with the general definition of insider information. This would mean that information should only be deemed to be inside information if all of the following conditions are fulfilled:

- the information refers to circumstances which are not publicly known (information of a precise nature which has not been made public); and
- the information relates directly or indirectly to one or more commodity derivative (financial instrument); and
- the information refers to circumstances which exist or may reasonably be expected to come into existence; and
- these circumstances have, or are likely to have, a significant effect on the prices of those commodity derivatives.

In this respect, a circumstance that has a "significant effect on the prices of a commodity derivative" shall mean refer to information which a reasonable investor would be likely to use in his investment decision. In this context the professional market participant, rather than the private retail customer, should be deemed to be the relevant reasonable investor.

As a final step it should be considered under which circumstances users of markets on which commodity derivatives are traded would expect to receive in accordance with accepted market practices on those markets the respective information: since it is quite difficult to decide under which circumstances an information is "routinely made available to users of those markets" (directive 2004/72/EC, art. 4), only the second subtests (disclosure in accordance with legal or regulatory provisions, market rules, contracts or customs on a relevant underlying commodity market or commodity derivatives market) should be maintained, even if the reference to the "customs" is quite indefinite.

Pursuant to article 6 of MAD, an issuer of commodity derivatives shall inform the public as soon as possible of inside information, which directly concerns that issuer. This obligation does not deliver any additional benefit with regard to the energy (commodity) wholesale market and relevant inside information.

[According to the laws and regulations for the admission and issuance of products to regulated markets the issuers of commodity derivatives, which are admitted to regulated markets, are only the operators of such regulated markets and not the market participants. This may imply that the operator of the market would have to publish inside information that directly concerns the issuer, i.e. the operator itself (the exchange). Such an obligation is not meaningful and does not provide any benefit.

General inside information in the sense of article 1 subparagraph 1 of the MAD, which does not specifically relate to commodity derivatives, is often published by the relevant market players, insofar as it relates to the shares issued by these firms. The relevant information, which relates to energy (commodity) and energy (commodity) derivatives, will and should be preferably covered by the more appropriate and specialised energy market regulation and not by financial market regulation. Furthermore, the Commission's Energy and Transport DG works on future regulations for the publication of the relevant energy / production / network data.

**Suggested solution:** The definition of “inside information” with respect to commodity derivatives should be amended as suggested above. Moreover, legislation on commodity derivatives should take into account the misalignment between the traditional concept of “issuer” and the role of issuers in commodity derivatives.

## 8. Technical issues

### 8.1. Dissemination of inside information

Other concerns arise from the competence of different authorities as may apply to the same issuer. 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 controller 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.

**Suggested solutions:** conflicts of jurisdictions should be addressed both with further harmonisation and with the identification of only one regulator for each issuer; such regulator should be identified on a “home country” basis. Although a Level 1 or Level 2 amendment could plainly resolve the problems above, Level 3 convergence may be also effective.

### 8.2. Financial analysts. Conflicts of interests

Art. 6 of the MAD and Directive 2003/125/EC introduce a regulatory regime for the production and dissemination of financial analysis. The European regulatory regime for financial analysis is restricted to financial analysis intended for distribution channels or for the public.

The definition of a “recommendation” gives rise to some uncertainties: since the drafting of a more detailed rule might prove to be difficult in practice, a common understanding of what does *not* constitute a recommendation would increase market confidence: by this, operators could benefit from a sort of safe-harbour. Furthermore, the distinction between a direct and an indirect recommendation for an investment strategy may be unclear in practice: for example, it is questionable whether the information that a share or a financial instrument is “over or under-valued” could be regarded as an indirect recommendation. In this context it is very important to draw a clear line between general information and investment information. Otherwise, the scope of the regulatory regime for financial analysis would be too wide, thus hampering the exchange of information and financial markets’ transparency. All the more so when commodity derivatives are involved: any forecast regarding the underlying commodity could be considered an implicit recommendation about the derivatives related to that commodity.

Other issues stem from the conflict of interests regime. According to directive 2003/125/EC (art. 6), Member States “shall require that any recommendation produced by an independent analyst, an investment firm, a credit institution [...] discloses clearly and prominently the following information on their interests and conflicts of interests:

- (a). major shareholdings that exist between the relevant person or any related legal person on the one hand and the issuer on the other hand. These major shareholdings include at least the following instances:
  - when shareholdings exceeding 5% of the total issued share capital in the issuer are held by the relevant person or any related legal person, or
  - when shareholdings exceeding 5% of the total issued share capital of the relevant person or any related legal person are held by the issuer.

Member States may provide for lower thresholds than the 5% threshold as provided for in these two instances.”

The possibility for Member States to provide for lower thresholds has resulted in an uneven transposition of the directive in this area. Although some competent authorities have announced that it is acceptable for an analyst to comply with the MAD rules of another Member State regarding disclosure of conflicts of interests in order to facilitate cross border distribution of research, others have not. The possibility that some Member States may lower the threshold, whilst others do not, could create concerns for analysts operating in different Member States.

Moreover, nothing is said about the case where the significant shareholding is held by an individual who is related to the relevant person (e.g. the controlling shareholder or a board member): a clarification on the scope of the obligation of disclosure in this regard would be welcome, since it appears that a relevant person in such a situation could clearly have a conflict of interest under the spirit of the regulation, but not be covered by the wording of the rule as currently stated.

***Suggested solutions:*** concrete examples of what does *not* represent a “recommendation” would help market participants; furthermore, it would be very helpful to have some European level guidance of what does represent an indirect recommendation for an investment strategy. Level 3 convergence seems to be the most appropriate tool in this respect.

The possibility for Member States to lower the 5% threshold for conflicts of interests should be rethought, while it should be made clear if the ownership of this percentage of shares by an individual related to the relevant person has to be regarded as relevant or not. Level 2 directives should be amended in this respect.

### 8.3. *Sanctions*

The enforcement of the directives will be crucial to their success, and in order to retain confidence in the markets, regulators must be robust in their application of the directives against those engaging in abusive practices.

The prosecution of market abuse conduct in practice has shown great disparity of treatment among Member States. In some Member States the same conduct may be punished through both an administrative and a criminal sanction, while in others a more precise distinction is drawn. When both courts and supervisors are involved in a prosecution, the relationship between them may be unclear: in theory, the administrative arm might be expected to provide for an expedited procedure and (perhaps) a less severe sanction, while the courts might be expected to be slower but more accurate. In practice, this is not the case all over Europe.

Moreover, a settlement between the supervisor and the defendant is allowed only in some jurisdictions, in spite of the fact that settlement mechanisms can be a quick and effective solution for financial markets.

Further, in some jurisdictions, such as the UK, decisions by the regulator are required to be published; however this is not the case in all Member States. Although CESR announced on 2 August 2006 a new operational structure for CESR-Pol to “(...) ensure the consistent and effective application of EU key directives, particularly the Market Abuse Directive”, it would also be useful for market participants to be able to access information about cases brought and sanctions under the regime applied in each of the Member States. This would assist in the ongoing application of the requirements of the regime and its continuing improvement. In addition, where cases are settled, information about that settlement should be made available, whilst protecting the identity of the individuals and/or companies concerned. There is a concern that without the Market Abuse directives being seen to be implemented, abusive practices are continuing. There is little incentive for compliance among general market users where there appears to be a low risk of being caught, which is partly a result of settlements that are not published, and where sanctions are light

Although the criminal law has traditionally been left to the Member State discretion according to the EU Treaties, a further level of harmonisation could be reached when national supervisors are involved, and in particular in the field of administrative procedures.

**Suggested solutions:** procedural aspects of administrative prosecution should be coordinated through a Level 3 convergence. Sanctions and settlements should be published in a manner that is available on a pan-EU basis.

#### 8.4. *Suspicious transactions*

Article 7 of directive 2004/72/EC requires a firm to make a decision as to whether there are “reasonable grounds” for suspecting market abuse. Many regulators have stated that they will take action against firms making “defensive” reports without sufficient grounds; however a firm failing to make a report where a regulator deems (with hindsight) that sufficient grounds existed is also subject to potential penalty. It would therefore seem appropriate for further clarification on what is expected.

Furthermore, it must be ensured that, where a firm has judged it appropriate to make a report, it is provided with a clear safe harbour from any breach of confidentiality actions by its counterpart. In addition, firms should not be subject to a penalty for failing to report a transaction which turns out to have been suspicious purely on the basis of a regulatory hindsight. Rather, they should only be subject to possible penalties if their failure to report was either deliberate or negligent.

Finally, it is questionable whether the application of the market manipulation prohibitions of art. 1 of the MAD (and the relevant provisions of art. 4 and 5 of the Directive 2003/124/EC) to commodity derivative markets would lead to appropriate regulatory results if such a market is immature and illiquid. There is not “a” commodity derivative market as such, but rather various different commodity derivative markets with very different degrees of liquidity and maturity. However, these market manipulation provisions have been created for mature and liquid markets e.g. in shares, money-market instruments and interest-rate, currency and equity swaps. In the event that a commodity market is illiquid and immature, market manipulation as defined could easily be committed by the market participants without having the intention to manipulate the regulated exchange or market price of financial instruments. This is in particular true for market participants who have to perform transactions for the proper risk management of their power plant assets and/or supply obligations. These firms often have to perform large volumes of transactions for risk management/hedging purposes during a short period of time and such transactions could have and often do have an effect on the regulated exchange or market price of financial instruments (commodity derivatives) if the market is relatively illiquid. The appropriate risk management or hedging of such commercial positions could therefore be unintentionally drawn into alleged market manipulation. This could also be the case for relatively liquid commodity derivative markets, such as the power sector, because traded volumes by the underlying commodity providers are regularly large. Clearly this is not a desirable effect for an emerging market and the liberalisation of the European energy market. Again in this context it is advisable that an accepted market practice for commodity derivative trading should in general be introduced: this would give more comfort to commodity trading market participants.