

Minutes of the 4th ESME meeting on 23 May 2007

1. Adoption of the agenda

The agenda was approved.

2. Transparency Directive

The rapporteur of the ESME sub-group on the Transparency Directive presented a progress report on the work of the group. The sub-group's work focuses on three main topics: reporting and notification of major holdings in shares, stock lending and periodic information. Emphasis until now has been put on the first two themes.

On reporting and notification of major holdings in shares, the sub-group underlined the problem for institutional investors of having to face differences in thresholds across Member States. The recommendation in that respect would be to implement a uniform threshold across the EU (starting e.g. at 3%) above which the positions are publicly disclosed. The sub-group admitted that a delicate balance had to be found between on the one hand, imposing more reporting thresholds than those required by the TD (upward harmonisation) as the market could then be swamped by irrelevant information and on the other hand, supporting companies in their attempts to get better insight into their shareholder population. The sub-group considered that the issuing of guidance on "reporting triggers" (what should be reported? By when? And by whom) could be usefully addressed at Level 3 by CESR. A reference was made in this respect to the guidance provided in the UK by the UK Listing Authority (UKLA). The sub-group further recommended the harmonisation of reporting timelines across the EU as well as the use of the EU standard form. The Commission services recalled that a letter from Commissioner Charlie McCreevy had been addressed to the Chairman of CESR inviting CESR to promote the use of the EU standard form for reporting and notifying crossings of major shareholdings thresholds.

Regarding stock lending, the sub-group underlined the risk of empty voting (where the holder of voting rights has no economic interest and hence no economic risk and can behave as a free-rider). The ESME sub-group recommended self regulation and tighter control by institutional investors as the way forward.

The rapporteur indicated that the intention of the sub-group was to finalise its report on major shareholdings in September 2007.

The Commission services informed the group about the consultation papers on shareholders' rights recalling the deadlines for responses (27 July 2007 for the general consultation and 6 July for the specific one addressed to more targeted public due to the technicality of the information requested). These consultations address the issues of stock lending, disclosure of the ultimate investor, and the duties of the financial intermediaries. The responses to the consultations will provide input for the impact assessment that the Commission will carry out which could lead to the adoption of a Commission Recommendation as already announced at the time of the adoption of the proposal for a directive on shareholders' rights.

During the discussion regarding stock lending, it was noted that the existing codes of practise adopted by several market participants worked satisfactorily. Another member said that a

recent report published in the Netherlands showed that institutional investors seldom recall their lent stocks and do not exercise their votes. Whilst members acknowledged that empty voting was a concern, they also expressed concerns about any hasty formal regulatory responses which could have unintended effects on the good functioning of markets: what would happen if all shareholders were to recall their stock at the time of the general meeting? What would be the impact on short-selling positions and hence the effects on markets? One member was of the opinion that the positive role of activist investors for efficient capital market allocation should not be underestimated and that regulatory action might be detrimental to the functioning of the markets, underlining that such instruments as swaps and derivatives might be used as an alternative by some to hide their stakes in companies. That same member underlined that provisions on stock return were already included in "serious" contracts on stock lending. Another ESME member noted that some jurisdictions already have specific transparency requirements on harmonised disclosure on short-selling, adding that it would be of interest to explore how clearing houses work in this respect, whether they hold of registries of stock lent.

The Commission recalled that its intention was to proceed cautiously which explained why the Recommendation on shareholders' rights will be accompanied by an impact assessment, which the outcome of the current consultation was an important component of. In conclusion, the Commission services expressed their appreciation about the quality of the work produced by the sub-group. The Commission representative underlined the importance in the current phase of implementation of the Transparency Directive by Member States for the group to finalise its report as soon as possible, preferably by September 2007. The objective would be that this report is circulated to both the European Securities Committee and CESR so that the recommendations expressed by the ESME group can still be taken into account by Member States, to the maximum extent possible, either in the implementation phase of the Directive or for possible Level 3 measures.

In this respect, the CESR representative explained that CESR is starting working on Level 3 measures relating to the Transparency Directive and that a consultation to this end will be launched before the summer.

3. Operation of the Market Abuse Directive

The rapporteur of the sub-group briefly introduced the main elements of the final report regarding the i) the definition of inside information, ii) insider lists, iii) notification of transactions and iv) the safe harbour regulation.

As regards inside information and one-on-one meetings between issuers and investors, reference was made to the clarifying statements made by the Dutch competent authority. In the context of a discussion on the burden of proof for market abuse, one member commented on the confusing reasonable investor test for insider trading. The issue of liability for (non)disclosure of information was also raised and one member made the point that providing general information to securities supervisors on markets they are not familiar with (e.g. commodities) contributes to the quality of enforcement of information disclosure requirements.

Following calls from some members for more harmonisation of sanctions on market abuse and their publication, the Commission services elaborated upon their intention to publish, with the help of CESR, a list of all administrative sanctions and measures that can be imposed

for violation of the MAD. The CESR representative also explained that it is setting up an internal database for market abuse sanctions taken by CESR members.

The Commission services welcomed the high quality paper of the sub-group and encouraged all members to provide final comments within the following two weeks, before the paper is adopted through written procedure.

4. Operation the Prospectus Directive

Members of the sub-group briefly introduced the revised draft of their paper formally presented to ESME at the last meeting. The paper consists of a detailed narrative and a table in the Annex which lists issues relating to individual provisions in the PD and ranking them by priority.

The subgroup invited all ESME members to comment on the paper with the aim of adopting the paper at the next ESME meeting in September. A timetable was suggested, inviting written comments by June 8, followed by a conference call including all interested members of ESME before June 30. This would enable members to finalise the draft paper before the summer break for formal adoption at the next meeting on 5th September.

One member commented that the paper contained items that needed further discussion and that a number of assertions and opinions expressed in the paper were not supported by sufficient evidence. In some cases the findings of the paper could be inconsistent with those of other papers from ESME: in particular, conclusions drawn in connection with the alleged lack of access for retail investors to the bond market might be inconsistent with the work on non-equity transparency. Another member observed that problems with the PD resulted more from the implementation in Member States than from the Directive itself.

The Commission services welcomed the paper as a very useful document and commented that the ranking of all issues listed in the Annex as high, medium or low priority was particularly valuable for their assessment of the Directive. The paper should be adopted as soon as possible and that comments should be submitted to the subgroup with a view to readying the paper for adoption at the September ESME meeting.

5. Legal Read Across

The sub-group presented the following papers:

- 1) a new paper from one Member – not yet discussed formally by the sub-group – responding to the Commission's call for evidence on an EU private placements regime;
- 2) a re-drafted version of the paper on the difference between listing and admission to trading that had been discussed at the previous meeting in February; and
- 3) a final version of the paper on the concept of durable medium in the Distance Marketing Directive ('DMD') and MiFID

1) the author of the [paper on private placements](#) presented its principal themes, making the following points:

- As regards some of the questions in the call for evidence it is not exactly clear how to respond to the questions regarding market failure. Moreover, there was no definition of private placements or an indication of the kinds of securities to be covered by the regime.

- Any consideration of this issue should start by establishing whether there is a market failure in relation to the distribution of particular classes of financial instruments. Whilst different countries had different regimes entailing costs for legal advice and compliance procedure, this in itself did not amount to a market failure. Similarly the fact that some countries did not formally allow private placements was potentially a national failure but not a market failure at EU level.

- In the absence of evidence of a market failure, a regulatory response would not be appropriate, according to the author of the paper. The placing of financial instruments with institutions was already possible in many jurisdictions, and the market would not want any EU regime (the need for which was not proven) to jeopardise existing domestic regimes. Any initiative should therefore do no more than establish a minimum common standard, without affecting the ability of Member States to retain or adopt less onerous regimes.

- The Commission's paper on private placements appeared to be driven by concerns about access to private equity and the non-UCITS fund market (including hedge funds, real estate funds, and funds managed offshore). Because of the amounts involved these funds were not consumer products, and most retail involvement was indirect, e.g. through pension funds and life products. Promoters and distributors of such funds do face difficulties, but this is not necessarily evidence of a market failure.

- If anything were to be done in that area, the focus should be on who should be eligible to receive promotions of this type of investment. Any such regime should be predicated on the assumption that 'professional' investors are able to make their own decisions, and any concept of mandatory disclosure rules would not be appropriate given the nature of such investors. The MiFID concept of professional investors is helpful, but has its limitations. Any regime must avoid any inclusion of product registration in an approval procedure. One possibility would be mutual recognition of national regimes.

The author confirmed the status of the paper as provisional and produced in response to the request for a submission on the topic. Members were invited to submit comments and the paper would be re-drafted for further consideration by the full group.

One member expressed broad support for the paper. Another commented that to the extent there was a problem it had two aspects. First, one should consider the utility of the 'private placement' regime already provided by the Prospectus Directive. This regime, based on a class of qualified investors with whom issuers could place securities with no prior product registration, was adequate, and the inter-relation between that PD regime and the regulation of 'placers' under MiFID was reasonable. The second aspect related to unregulated funds, where there was no harmonised private placement regime equivalent to that under the PD. A relatively simple but effective solution, therefore, would be to establish a private placement regime parallel to that in the PD for unregulated funds. Another member observed that there was a potential mismatch between the class of qualified investors under the PD and the concept of professional investors under MiFID, and further exploration was needed as to whether the two categories should be aligned.

The Commission Services informed ESME that an open hearing on the issue of a private placement regime had taken place at the end of April and that Member States represented in the European Securities Committee had expressed an interest in the issue. ESME was encouraged to consider the type of regime that industry would like to see since responses to the call for evidence did not reveal a clear consensus as to the usefulness of the PD regime and invited ESME members to provide comments on the draft paper by 8 June. ESME's response to the Commission's call for evidence should be submitted before the end of June.

2) the paper on official listing was briefly introduced by a member of the subgroup, who explained that the redrafted paper included an in-depth analysis of the issue and the practice in different Member States with respect to official listing and admission to trading. One member welcomed the sensible approach taken.

The Commission Services asked for comments on the paper to be submitted in writing with a view to adopting the document at the next ESME meeting, following which it would be published as an ESME document providing advice to the Commission Services.

3) the paper on durable medium was adopted by the group, with the Commission services agreeing to clarifying some outstanding issues.

Rome I

The Commission Services gave a presentation on the proposed 'Rome I' Regulation on the law applicable to contractual obligations, highlighting the areas of concern for financial markets and asking ESME members for comments on the amendments that had been proposed by DG Markt services. Those amendments carve certain financial market contracts out of the general provision that contracts with consumers should in all cases be governed by the law of the consumer's country of residence. They also outlined the stage of the negotiations in Council on the proposal and stressed the need for feedback from ESME in the light of the potentially huge implications of certain provisions of the draft Regulation for the internal market in general and financial service providers in particular.

In the discussion that followed, members expressed varying degrees of disbelief at the content of the proposals in the Rome I Regulation and the process being followed in its adoption (and the lack of an impact assessment in particular).

One member expressly thanked the Commission services for raising the issue and said that the large amount of legislation in the financial services area in recent times explained industry's failure to recognise the potential implications of Rome I at an earlier stage. ESME members made the following comments.

- The process adopted raised significant concerns: in the same timeframe the Commission had been proceeding both with MiFID and with provisions in Rome I that would have the opposite effect on the single market to that intended by MiFID.
- There was no evidence that the rules under the existing Rome Convention were causing problems for consumers. The Rome Convention represents a fair balance between the interests of consumers and of business. It is relatively simple for firms to establish the mandatory rules of a particular jurisdiction; but if (as required by Rome I) they have to determine whether the terms of their contracts have a different meaning in one country than in another they will need to consider a huge range of issues. This will be conceptually difficult and costly.

- The potential impact of Rome I on the single market and on Europe's position in global markets was huge. The proposal limited the ability of EU firms to do business globally on a single set of terms, and would have an adverse impact on all internet-based services.
- The amendments proposed by DG Markt were only 'sticking plaster' and fail to deal with the basic problem that the provision relating to consumer contracts would erect huge barriers to the provision of services from the EU. Service providers that wish to avoid their contracts being governed by numerous laws depending on the location of the consumer would be likely to relocate and provide services such as private banking from e.g. Switzerland or New York.
- The proposal was in total contravention of the Better Regulation agenda (no impact assessment) and should not be allowed to go forward in its current form;

On the specific question asked by the Commission services about the need for a default provision specifying the governing law for contracts concluded in a multilateral trading system, one member confirmed that it was necessary. A choice of law cannot be implied in (the increasingly common) cases where a transaction carried out on an exchange governed by the law of one jurisdiction is cleared and settled through systems located in different jurisdictions. Moreover, two members pointed out that uncertainty might arise in cases of execution-only dealing where a consumer was contracting through a broker acting in an undisclosed agency capacity. However, another member took the view that such a default rule was probably not necessary since all multilateral trading facilities provide for a governing law that will be impliedly 'chosen' by participants.

6. Transparency/non-equities

The rapporteur of the sub-group reported that while the sub-group had not seen evidence of a market failure in the wholesale bond markets, there were some signs in the retail bond markets with regards to access to pricing information. Some members of the group felt that this sub-optimality represented a possible market failure.

The rapporteur also stated that the sub-group was not supportive of mandatory pre- or post-trade transparency in order to address such issues, but felt strongly that self-regulatory solutions were more desirable. The ICMA, in particular, is exploring with its membership a number of options for self-regulatory change, and the sub-group felt that these were potentially valuable.

ESME members discussed the draft report and expressed general support for the direction the report was taking. One member said she struggled to understand how more transparency would limit the wholesale market. She also said there was clearly a problem on the retail side; why was there a retail market in Germany, Italy and Belgium and not elsewhere? The demand is out there for retail on the issuer side, the funding is 6 to 8 basis points cheaper. Another member added that an analysis was needed of the differences between those jurisdictions where retail involvement was bigger. Another member said that the rules were the same but the different participation levels of retail investment reflected historical differences amongst the Member States.

One member said that the Bank of Italy's report on Parmalat had just been published and distinguished the effects of the default of Parmalat and of the transfer of bonds to retail

investors. Due to a lack of price transparency the spread offered to retail was very detrimental. He also presented a graph illustrating the narrowing and tightening of spreads in Eastern European government bonds after fully transparent (exchange) trading started on NewEuro MTS.

Another member said that the discussion of prospectus issues in the Prospectus paper and in this paper needed to be made consistent.

One member voiced reservations about drawing any conclusions for the EU from the experience in one Member State. He explained the history of principal intermediation in bond markets in terms of lower liquidity. Principal traders have committed significant capital to gain information associated with order flow. If information is disseminated for free that incentive will be lost and principal trading will disappear. We should not lose sight of indirect retail investment. Nor should there be any subsidy of retail investment by wholesale. Very complex issues can arise.

One observer noted its experiences with self-regulatory solutions and stated that they can be very difficult to put into practice. The representative of CESR presented the CESR Consultation Paper on bond market transparency. Like the ESME Sub-group, this was more focused on retail access and participation but was not limited to possible self-regulatory moves nor to post-trade transparency only.

It was agreed the Expert Group would provide written comments on the draft report by 1st June, to be incorporated in a redraft by 13th June, which would be discussed at a sub-group conference call on 20th June, in time for submission of the report to the Commission by 30th June.

7. Commodities

The Commission services gave an overview of the answers received to the call for evidence and informed ESME members about the following steps in the process, in particular the fact that the feedback statement will be finalised by September 2007.

The rapporteur of the commodities sub-group explained what they had been doing with respect to the call for evidence and briefly presented the draft paper that was distributed to the group. The sub-group will collect further data in line with the information on oil products trading and continue discussions on the Commission's call for evidence.

8. A.O.B.

The next meeting will take place in Brussels on 5 September 2007.