

The meeting was chaired by Ms Maria Velentza, Head of the Securities Markets Unit of the European Commission.

1. Adoption of the agenda

The agenda was adopted.

2. Transparency Directive - Commission report on the operation of the Transparency Directive

The Commission services presented the objectives of the review of the operation of the Transparency Directive, the sources of data that has been used for the review, the timing of the review and the selected issues which they are currently reflecting on. The Commission services explained that the report on the operation of the Transparency Directive is due for the beginning of 2010, but that timing will depend on the agenda of the new Commission. As to the main issues under review, they concern the following topics:

- quarterly reports and short-termism,
- possible differentiation of obligations for smaller listed companies,
- non-financial disclosures,
- notifications of major holdings,
- storage and access to information,
- technical adjustment to some provisions of the Directive.

After the presentation, ESME members were asked to briefly comment on different subjects.

One member commented that in his view, there has been no real simplification of reporting requirements after the Transparency Directive entered into force, due to pressure exercised by investors and financial analysts. He also pleaded for a full harmonisation of notification of major holdings, especially with regard to the calculation of thresholds. He was supported by other members who agreed that there should be a full harmonisation and simplification of disclosure of major holdings at EU level for all types of financial instruments linked to listed shares.

Various members also agreed that better identification of shareholders by the issuer would favour the development of a deeper, longer-term relationship with investors. However, the problem of who bears the costs of such identification should be taken into account as well as where in the intermediaries chain the identification should stop.

As regards smaller listed companies, one member argued that too much burden on them may hamper entry of these companies on regulated markets. He suggested simplification

of the transparency regime for smaller listed companies and noted that if introduced should not have adverse consequence for investors because those investing in this type of companies have sufficient means to access information concerning them.

Another member pleaded for extension of publication deadline for financial reports for all issuers, not only for small listed companies. He argued that if there is a SME in a group, a parent company could be also affected because it would need to submit a consolidated report with a SME. In addition, he stressed that costs for financial reporting is considerably raised by a requirement existing in some Member States to publish information in the press.

Another member remarked that there have been no IPOs on regulated markets for two years because companies do not see benefits of being listed any more. Instead they are delisting or going for alternative unregulated markets. The danger is that this tendency may lead to regulated markets listing only blue chips. He saw an opportunity in creating a specific disclosures regime for SMEs by modifying a number of different directives (Prospectus Directive, Market Abuse Directive, Transparency Directive, IFRS regulation). He argued that the main problem for such a regime would be arriving at an appropriate definition of a SME for listing purposed. He suggested basing a definition of a SME for the listing purposed on relative thresholds per country, with a risk however, of regulatory arbitrage. Still, according to this member, regulatory arbitrage could be avoided by the home/host rule.

However, one member argued that if a SME decides to go public and attract investors, it needs to be transparent. He argued that the problem lies in the fact that SMEs are not always attracting financial analysts and therefore there are not enough reports analysing their situation. This member was of the opinion that the barrier to entry on a regulated market lies not in costs of reporting but in the inappropriate behaviour of market participants.

Another member added that another reason for the lack of financial analysis of SMEs may be also caused by a fixed year end when many annual reports are being published and annual reports of SMEs are not attracting attention.

As regards question whether quarterly reports contribute to short-termism, one member argued that this should not occur since managers of a listed company are capable of dealing with investors' pressure and they normally act with a long-term perspective and with the view of the best interest of the company. She was supported by another member who argued in favour of quarterly reporting by stating that there cannot be too much transparency. That member also noted that unreasonable use of information by investors is rather an issue of behaviour of investors and not an issue of too much information.

As regards non-financial disclosure and particularly disclosure concerning Corporate Social Responsibility (CSR), all members agreed that disclosure of this type of information may be a good thing if the company is really aware of its social and environmental responsibility and if the comparability of information is ensured. One member emphasised that in the light of Copenhagen conference, investors are more and more interested in the disclosure of information on corporate and social responsibility. However, it should be a condensed set of information easily readable and comparable. She referred in this respect to a recent project of the International Federation of Accountants on sustainability (social and environmental responsibility).

Finally, regarding technical adjustments, one member emphasised that divergent definitions in Member States of "concerted action" is an important issue. He also pointed out to differences in implementation, especially with regard to the calculation of deadlines for publication of reports.

Another member raised the issue of enforcement and of differences in sanctions levied by Member States with regard to infringements of transparency requirements.

The Commission services responded that they are reflecting on the issue of SMEs but one should bear in mind that the existing directives were drafted with the primary objective of establishing a single EU capital market. At that time there was insufficient calibration of the provisions towards SMEs. However, taking into account the present experience the issue of SMEs needs to be addressed. With regard to defining SMEs, one should avoid adopting an approach which would be inconsistent with the single market and will differentiate between big and small Member States.

To conclude the discussion, the Commission services invited ESME members to send their written comments on different aspects of the operation of the Transparency Directive at their earliest convenience.

2. MiFID

Consolidated tape

The Commission services presented the issue of the possible introduction in the EU of a US style consolidated tape system. The reason for the Commission services to analyse consolidation of post trade data is twofold: on the one hand, Article 65 of MiFID provides for a mandatory review and a report by the Commission on the state of removal of obstacles which may prevent the consolidation of information trading venues are required to publish; on the other hand, the Commission services have been receiving a number of users complaints that commercial providers have not been able to adequately consolidate and provide post trade data. The reasons for this seem varied. For example, there is a lack of granularity in MiFID about the format and content of post trade reporting which leads to inconsistencies. There are mistakes and double counting by firms in reports. Also, commercial interests amongst market users and trading venues are not aligned (e.g. some venues derive a significant amount of their revenue from selling this data).

Apart from resolving problems related to the quality of the raw data itself, there was an increased call from some parts of the market for the introduction of a US style consolidated tape.

The Commission services inquired if members have experience of using the US consolidated tape as well as what in their views are pros and cons of consolidated tape.

One member noted that post-trade data was fragmented and therefore its availability was not satisfactory. In addition, sale of market data may account for a large share of revenues for some stock exchanges (up to 20-30%). According to that member the solution would be to have providers of consolidated tape to be localised outside stock exchanges.

Another member responded that stock exchanges have different business models and not all of them derive such substantial part of revenues from selling post-trade data. He

remarked that, on the other hand, the data has to come from somewhere and it naturally comes from stock exchanges and MTFs. He also stressed that if we look at overall costs of consolidated data, fees for data are only a tiny portion of what investors are paying for consolidation.

Some members expressed their surprise about complaints concerning the cost and quality of consolidated data. They would understand if complaints concerned pre-trade data (needed for the best execution), which reveal market efficiency, but did not see the problem with the post-trade data.

The Commission services noted that it has received comments from a variety of buy side organisations from different Member States complaining about the quality of consolidated post trade data (rather than pre-trade data). The buy side organisations argue that good quality post trade data is essential to monitor if they are in fact receiving best execution. So this was the reason for this issue being on the agenda.

Others remarked that there may be problem of quality of data that is fed into consolidation. One member suggested that as to the quality of data, a possible solution could be driven by the industry.

Consolidation of pre-trade transparency

The Commission services thanked those ESME members that contributed to the informal fact-finding exercise related to the availability of consolidated pre-trade transparency for less sophisticated investors. They highlighted the relevance of the work, as previous work streams within ESME had indicated that some issue might exist around access on a non-discriminatory basis. The fact finding aimed at mapping the specific circumstances and conditions under which pre-trade transparency is distributed. ESME members had provided short descriptions of a variety of data providers.

The rapporteur (Mats Beckman) presented the findings. According to these, the cost of data only represents a fraction of the overall costs imposed on market participants. The cost of market data can be split between the fee from the initial data provider, and other costs such as a fee to a data vendor to consolidate data. Data vendors typically charge between 5% and 15% on top of the fee of the market data source. A range of different products exist, some of which are also aimed at less sophisticated investors. The fact-finding exercise did not indicate any particular issues in relation to the availability of pre-trade transparency data.

The Commission services suggested that based on this fact finding, as well as earlier work undertaken by ESME, it appeared reasonable to conclude that:

- 1) The existence of smart order routing as well as wide distribution of pre-trade transparency data indicates that it is technically feasible to consolidate the pre-trade transparency data.
- 2) The additional cost of consolidating data (5 – 15%) is modest, in particular compared with overall costs faced by market participants.
- 3) A range of products exist – and the needs of less sophisticated investors in this regard appear to be satisfied, based on the currently available information.

In the following discussion no opposition to these conclusions was expressed.

High frequency trading

The Commission services presented briefly the issues surrounding high frequency trading. They referred to the fact that the issue of High Frequency Trading (HFT) has been subject to increased attention recently. Diverging views about the possible impact of HFT on equity markets have been expressed. CESR members are currently considering whether preparatory work on this topic should be undertaken to support the 2010 MiFID review.

They also raised a concern whether a clear line distinguishing HFT from algorithmic trading exists. He stressed that high frequency trading should be distinguished from "flash trading" which is a separate issue.

The Commission services posed a question what benefits high frequency trading provides to the market (e.g. more liquidity, reduce spreads, reduce market volatility). He also posed the question whether high frequency trading may have adverse effects on market efficiency.

One ESME member gave the example of problems that occurred in leveraging transactions in Italy because the server was located in Frankfurt and the 1.5 seconds it took to get to Milan was just too long. He brought to the attention that the buy side which was not interested in velocity was finding it difficult to gain fair access to the market due to HFT.

Another member saw fragmentation as being for most buyers a bigger issue regarding fair access to the market than HFT.

Another member commented on the natural tendency in the market to welcome whatever possibility of increasing turnover and liquidity.

Another member stated that there was a huge difference between algorithmically steered trading and HFT. HFT mostly looked for arbitrage and the question was how much of that a market could take. HFT needed a "normal order" on the other side. In this respect it resembled market making. As a result, HFT is bringing liquidity to the market but the question is whether that is the right type of liquidity. Another member questioned whether a distinction between different 'right' and 'wrong' liquidity was meaningful.

The Chairwoman asked whether HFT could facilitate market abuse. One member was of the opinion that since market relied on infrastructure every time the infrastructure was improved there was a possibility of manipulation. Another member disagreed by stating that HFT was not manipulating market prices and did not involve market abuse issues.

Another member remarked that HF-traders were a small group of traders who had invested in technology. There were probably no more than 50 HF-traders worldwide, these included some investment banks, market makers plus firms who came more from a specialist technology background (rather than traditional financial services).

4. Packaged Retail Investment Products (PRIPs)

The Commission services gave an overview on the state of play of the work concerning Packaged Retail Investment Products (PRIPs). They also reported on the outcome of the workshop on PRIPs organised in October 2009. (It should be noted, that the EU commission had asked ESME members to provide views on certain aspects of the PRIPs concept which had been the basis for the discussion). They then presented specific issues to be discussed at the meeting, namely:

- Pre-contractual product disclosures - common elements and tailoring.
- Selling practices: Refining the consumer protections needed for sales of PRIPs.

Some members inquired about possibility to broaden the scope of PRIPs to include pension schemes and informed about tendencies in pensions funds to split up their asset management part. Members argued that involvement of social and purely national regulatory frameworks should not be a sufficient reason, in the perspective of investor protection, to take pension schemes out of the PRIPs scope, especially in the case of pillar III pensions.

One member voiced concerns about the adoption of a definition of PRIPs focused only on certain economic characteristics. He considered such an approach to be difficult. The same member also voiced concerns that this workstream could lead to new licensing requirements.

Another member argued for introduction of a wide definition of PRIPs, including derivatives. She considered this workstream to be very important and most welcome and informed about a number of cases before national courts, which proved that neither investors nor banks selling packaged products understood those products.

As to the entity that should be responsible for producing the information about PRIPs – the product manufacturer, the distributor or both - members were divided. Some emphasised the better knowledge of products by product manufacturers. Others underlined that there are some aspects of the cost disclosure information which cannot be disclosed beforehand by product manufacturers. It was also noted that a know-your-product requirement for distributors is as important as a know-your-customer approach. The importance of a joint effort from manufacturer and distributors was also recalled.

Finally it was noted that there are self-directed and advised investors. It was also noted that self-directed investors tend to buy less complex products.

Differences in tax treatment in the different Member States were recalled as an important factor to be taken into account.

5. Whistleblowing

The Commission services introduced the notion of whistleblowing and gave an overview of the legislative framework concerning whistleblowing in the US (the Sarbanes-Oxley Act, the Securities Exchange Act, a proposal for the Investor Protection Act) and in the UK (the Public Interest Disclosure Act). They underlined that whistleblowing may have a bad reputation because of cultural reception. They posed a question if whistleblowing were to be introduced at EU level, could it be narrowed to cover a few areas, like insider dealing and market manipulation, or should it rather encompass all financial services activities.

One member remarked that the UK system focuses on protecting the employee and that it distinguishes between internal and external whistle-blowing. Regarding external whistleblowing additional requirement has to be met to make outside disclosure reasonable. The UK law urges firms to set up procedures for whistleblowing. If there are internal procedures for whistleblowing, it is more difficult to blow the whistle externally. He mentioned also that the requirement to set up anonymous hot-lines in order to comply with the Sarbanes-Oxley Act (concerning US-listed companies) had been controversial in

some member states. However, according to the experience of another member, in order to fulfil obligations imposed by the Sarbanes-Oxley Act, it was enough to set up internal procedures that would assure management of anonymous complaints.

As regards introduction of whistleblowing in relation to insider trading or market manipulation it was stressed that rules on whistleblowing would not bring much of added value for institutions that already have a segregated compliance function. Introducing whistleblowing could make sense only for those listed companies that do not have a compliance officer. In addition, existing provisions on suspicious transaction reporting are already requiring brokers to report if a transaction may constitute insider dealing or market manipulation.

It was also stressed that whistleblowing works well for reporting fraud against company but a few members have not seen any reasons for introducing whistleblowing for insider dealing or market manipulation since the EU legislation already provides for a number of instruments requiring reporting of these behaviours: suspicious transaction reporting or manager's transaction reporting.

Another member noticed that whistleblowing is closely linked to ethics and its successful implementation depends on building awareness among employees. The issue of empty of false accusation in case of anonymous complaints was also raised.

It was underlined that in some Member States whistleblowing is culturally difficult to accept because of the unwritten rule that one does not sneak on his/her colleagues.

Another member remarked that whistle-blowing was more in place in systems based on checks and balances and less so in more hierarchical societies.

It was also mentioned that whistleblowing should be distinguished from leniency programmes in the area of competition. The idea of whistleblowing is to report on wrongdoing which does not affect the reporting person, whereas in case of leniency programmes it is a participant in a cartel who discloses information on a cartel.

6. General discussion on priorities for 2010-2015

The Chairwoman invited members to present their recommendations on priorities for the policy actions in the area of securities markets for years 2010-2015.

She acknowledged that one area has already been mentioned: a specific cross-sectoral regime for SMEs.

ESME members raised the following issues:

- new tailored-made transparency and market integrity regimes for commodities and commodity derivatives;
- monitoring of the competitiveness of the EU single market;
- global dialogs and international convergence;
- mutual recognition in securities;
- division of supervision competencies between home and host Member States;

- consistent interpretation of the EU provisions at level 3;
- harmonisation of company law;
- coherent implementation of directives;
- going for maximum harmonisation in order to avoid conflicts between national provisions;
- continuation of the work on removing barriers within the civil law (Legal Certainty Group)
- pension systems - no level playing field, no transparency;
- clarification of the application of VAT to UCITS, especially in relation to the custodian services;
- financial advisors – regulating the profession of financial advisors;
- investment advice –further clarification under MiFID;
- custodian liability and asset management liability, in connection with the system of clearing and settlement;
- legislation which fits to the economic needs of retail investors

7. AOB.

The Chairwoman thanked all the members for their contributions and hard work since the creation of the ESME. She informed that depending on the decision of the new Commissioner a similar group may be created in 2010. She closed the last meeting of the group.