EUROPEAN SECURITIES MARKETS EXPERTS GROUP (ESME)

Report of 3rd meeting of ESME on 28 February 2007

1. Adoption of the agenda

The agenda was approved.

2. Private Placement

The Commission services presented a draft call for evidence on private placement in the EU. In its White Paper on Asset Management of November 2006 the Commission committed itself to prepare a report by autumn 2007 on whether a common private placement regime would be advisable and feasible. In preparation of this report the Commission is launching the following evidence gathering and fact-finding exercises: i) a questionnaire to CESR on, inter alia, the conditions and requirements for private placement and the eligibility of investors at national level and ii) a public call for expression of interest. In the meantime, the Commission will organise a hearing on the UCITS review where time will also be devoted to private placement.

One part of the draft call for evidence deals with more general questions on the economics of private placement and the shape of an "ideal" regime. The other part asks for an assessment of the existing laws, both at EU and national level. The aim of this second part is firstly to identify missing elements in and insufficiencies (if any) of the current framework and secondly to examine whether EU or national provisions could eventually serve as a basis for a common private placement regime.

The Group welcomed the initiative and expressed its interest in contributing to this exercise. It was proposed that the "legal read-across" sub-group would take up the task of preparing a reaction to the call for the next meeting in May 2007. The chair invited the group to comment on the draft call for evidence by email within the next 10 days and emphasized again the draft status of the document and asked the group not to distribute it. The Commission services will provide ESME with a copy of the abovementioned questionnaire.

3. Transparency/non-equities

The rapporteur for this sub-group introduced the following working documents:

- a preliminary report skeleton incorporating members' suggestions plus the Commission's specific mandate to ESME;
- a draft product matrix showing the characteristics of the various instrument types;
- a document headed 'transparency rating' prepared by a member of the sub-group;
- a summary paper surveying various items of applicable literature.

The Group discussed the issue of market failure which was referenced in the Commission's mandate. The Commission services clarified that there was no official definition of market failure for its purposes. In the call for evidence, applying the Commission's official impact assessment methodology, it sought evidence of 'problems', either in the form of anecdotal evidence of existing problems, or of research or data available tending to show, in a rigorous way, that present arrangements are suboptimal, in the sense that greater transparency would have significantly beneficial impacts in terms of any of the possible policy rationales identified above or in terms of wider policy goals such as those of the Community Lisbon programme. The Commission services also clarified there was no need for a separate cost benefit analysis at this stage.

There was some discussion of the 'transparency rating' proposal prepared by one of the Sub-group members. A number of members of the Group expressed support for the proposal, while others suggested that there was a need to focus on the issue of whether there were problems within the terms of the mandate before canvassing potential solutions. A number of legal and territorial questions were raised by members as to how the proposal would work.

One member stated that consumers wanted more transparency in order to enhance their participation in this market. Another asked whether there was any evidence of a decline in transparency causing a decline in retail participation. One member observed that the difficulty the sub-group was having with agreeing its product matrix showed the difficulty of the boundary issues that a legally mandated solution would bring.

It was agreed that members should provide written comments on the report skeleton to the Sub-Group by 7 March. The group will discuss a revised paper at the next ESME meeting before adoption at the end of June 2007.

4. Commodities

The rapporteur of this sub-group presented the broad framework of their current work, explaining that the subgroup would be preparing a response to the Commission's call for evidence but that this response would in no way attempt to duplicate the work of other bodies or trade associations. The sub-group considers inviting external experts to the work of the group as the subject is so vast and complex. At this stage, the subgroup's main task will revolve around fact finding. Another member underlined that the regulation of the commodities and commodity derivatives space is indeed an intellectual greenfield and will be a difficult exercise in exploring what would make a fair regulatory framework.

There was also a slight surprise expressed at the breath of the Commission's call for evidence. In particular, a member voiced a concern that the focus on spot markets could lead to unwarranted extension of financial services regulation. On the other hand, the fact that the call for evidence did also focus on market regulation was welcomed. It was underlined that COM should review all of the existing regulatory tools, pointing to the fact that licensing is not the only tool at lawmakers' disposal.

A number of members mentioned the need for a common EU solution that would address uneven regulation of the areas which are outside the scope of the financial services directives.

The Commission services gave an update on the timelines of the report, underlining the fact that they are different from the transparency report. Furthermore, the need for more market data, especially concerning the spot markets was emphasized. It was also explained that the

focus on the spot markets should not be seen as an intention to extend financial services regulation without reflection and reminded members that at this point the Commission is only in an evidence gathering stage. All policy options are on the table.

5. Transparency Directive

The Commission services presented its current and future work in relation to the Transparency Directive ("Directive"), which entered into force on 20 January 2007. The current work includes:

– Storage of regulated information: the Commission services informed the Group of the upcoming publication of a consultation paper and asked ESME members to provide individual feedback, if interested;

– Standard form for the notification of major holdings: the Commission services explained that a standard form has been prepared and will be made available to market participants with the assistance of CESR;

– Monitoring of the transposition of the directive into national law: ESME members were asked to inform the Commission services of any difficulties in transposition they have come across;

– The implementation by Member States of recital 14 of the Directive on special disclosures extractive industry: The Commission is in the process of preparing a factual report on this issue, following the reply of Commissioner McCreevy to a written question from an MEP.

Concerning the future work, the Commission services informed ESME members of:

– The need to prepare, on a longer time perspective (for 2009/2010), various reports on the application of the Directive. Those reports are either requested by the directive itself or by the implementing measure. They cover: general issues, quarterly reports, accounting/auditing issues and dissemination of regulated information.

– Commission's intention to examine some specific issues related to the Directive that have given raise to interpretation problems, such as the obligation to notify major holdings of voting rights in the case of stock lending instruments. This issue is also likely to be discussed by CESR as a subject of interest for level 3 work. It is also of interest from the perspective of the "proportionality between capital and control" problem and the future recommendation on shareholders' rights that should accompany the upcoming Directive in this field;

Regarding the issue of notification of major holding of voting rights, several members stressed that it does not only raise problems in case of stock lending but also where other financial instruments are involved in which the voting right are separated from the share. However, it was also underlined that in most cases, borrowing of shares is done for short periods without any intention to exercise voting rights. Reference was made to a recent work done by UNICE with regard to stock lending. Some members also indicated that the general problem is that there is not enough harmonisation in the Directive as regards the notification of major holdings (notably as regards the information that should be included in the notification), which creates an significant costs for companies. They underlined that there is a need to ensure that companies are interested in remaining listed. On dissemination and

storage, a member indicated that we need a one-stop-shop, not just for investors, but also for issuers.

Upon proposal of the Commission services, it was agreed to create a subgroup on Transparency Directive issues.

6. Legal read across

The sub-group presented papers on the following topics:

1) The interaction between the residual regime for official listing and the more recent regulatory concept of admission to trading on a regulated market;

2) The use of the term 'durable medium' in the Distance Marketing Directive ('DMD') and the Markets in Financial Instruments Directive ('MiFID').

1. Official listing

The presentation outlined the history of the concept of admission to official listing, now contained in Directive 2001/34/EC (the Consolidated Listings Directive ('CLD')) and the subsequent shift of regulatory focus to the concept of admission to trading on a regulated market under the more recent securities directives adopted under the Financial Services Action Plan. Elements of the CLD remain in force, even though it has been partially superseded and repealed by the Prospectus Directive and the Transparency Directive, and the co-existence of the regulatory concepts of admission to official listing and admission to trading on a regulated market may give rise to confusion. The presentation made the following key points:

- the concept of official listing is interpreted and applied differently in different Member States. The standards attached to it vary, which raises concerns over investor protection and complicates harmonisation.
- Official Listing remains an important concept for some Member States which make a clear regulatory distinction between the obligations that apply in relation to securities that are admitted to, and traded on, regulated markets and the (more rigorous) obligations that apply in relation to listed securities. Indeed, a small number of Member States give such clear effect to the distinction as to permit official listing on a MTF. Other States do not make this regulatory distinction.
- Official listing on its own is not a mark of quality *per se,* since it is the super-equivalent national rules attached to the term in some Member States which provide the quality. In effect, official listing is important in a few Member States but has no 'added value' at EU level.
- However, abolishing the concept of official listing at Community level through repeal of the CLD would have important consequences which need to be carefully investigated and assessed.

The presentation called for more clarity in the terminology and set out three alternatives for action:

1. Repeal the CLD and abolish the concept of official listing entirely from Community law. However, this was not considered feasible in the light of its consequences for established regulatory systems and market practices in some Member States.

2. Repeal the CLD and bring the concept of official listing within the framework of MiFID. This would provide an opportunity to clarify its relationship with admission to trading on a regulated market. However, this would involve amending MiFID, which would interfere with the current transposition of that directive.

3. No legislative change, but recommend a clarification of the meaning and continuing regulatory significance of official listing, in order to ensure a consistent view across Member States.

During the discussion that followed, several members said that abolishing the concept of official listing from Community law could have very damaging effects, and the full consequences of such a move were hard to foresee. Members referred by way of the example to the Eurobond market that could move out of the EU if established concepts were changed or abolished. The continued existence of official listing had permitted the establishment of several multilateral trading facilities for officially listed 'professional securities' such as Eurobonds. As MTFs rather than regulated markets, these were outside the scope of the Prospectus and Transparency Directives. Official listing had therefore played an effective role as a 'safety valve' in preserving those EU markets from the threats posed by those Directives. One member also warned that there could be an impact on investment restrictions that refer to officially listed securities (for example in private contracts). Because the concept of listing was used differently in the various Member States any change in the status quo would have to be preceded by careful analysis of the consequences in each Member State.

Another member pointed out that the additional requirements imposed by some Member States under the CLD were generally related to corporate governance, and were therefore of a different nature to the disclosure requirements that were wholly or partly harmonised under the Prospectus and Transparency Directives. Such corporate governance rules are important for market integrity, and the same protection is unlikely to be achieved by replacing them with single, harmonised standards, which are likely to be pegged at the lowest common denominator.

The Group also discussed the ultimate purpose of the debate. One member argued that it was aimed at creating a level playing field between trading venues. Other members disagreed with this and argued in favour of competition between regulators in the interest of quality of service to investors. One member said that bringing about a level playing field was too big a task for ESME and that the purpose of the paper should be to shed light on the issue and give guidance. Another said that no big changes, but clarification was needed on what constitutes listing on a regulated market and admission to trading on a regulated market.

The Commission services agreed that more research was needed as to why official listing is important in some jurisdictions and the effects of any change in Community law in this area. They recognised the very strong interest in some States for retaining official listing as a distinct regulatory category, and did not discern an appetite for further change in the regulatory framework. However, legal clarity was important, and if there is real uncertainty about the regulatory status of official listing under Community law and the interaction of the CLD with the more recent concept of 'admission to trading on a regulated market', then guidance might be needed. ESME could play a useful role in the development of such guidance.

2. Durable Medium

A member of the subgroup summarised the detailed paper submitted to ESME that discusses and seeks, as far as possible, to reconcile differences in the provisions on durable medium in the DMD and MiFID. This topic is very important both for firms and for investors.

The presentation made the following points:

- the term 'durable medium' is used in the two directives, which overlap in their application. However, the term is not used identically, and there are differences in the scope of application of the relevant provisions: in the DMD the relevant provisions apply to consumers only, whereas in MiFID they apply to all clients.
- Article 3(1) of Directive 2006/73/EC (implementing MiFID), which specifies where information may be provided in a durable medium other than paper, is potentially ambiguous. In particular, it is unclear from the drafting whether that provision requires investment firms to be offered the choice between receiving information on paper or in another durable medium in every case. However, it is clear under the DMD that the firm is not always required to give the consumer the choice of receiving information on paper. For reasons of consistency, given the overlap between the two regimes, Article 3(1) of Directive 2006/73/EC should be interpreted in the same way.
- Both directives recognise that websites can - but will not always - constitute a durable medium, but do not specify the conditions that make it a durable medium. More certainty is therefore needed as to how a website can qualify.
- The test for a durable medium could be met in two ways. Either the website should be means of delivering the information to the consumer or client in a durable medium (because it allows the information to be printed off or emailed to a recipient); or the website could itself be a durable medium, because it has its own information storage facilities.
- However, a mismatch between the two regimes will remain, because the DMD requires some information always to be provided in a durable medium, while the MiFID allows it to be provided by means of a website that is not a durable medium for the purposes of MiFID. Areas will therefore remain where it will not be sufficient for firms to comply only with the MiFID. They will also have to be aware of the specific requirements under the DMD. The paper can only highlight such areas rather than remove them.

The paper was welcomed by the Group and the Commission Services. It was agreed that the paper would be finalised and published.

7. Operation of Prospectus Directive

Members of the sub-group summarised the findings in their detailed paper submitted to ESME. It was acknowledged that the most recent CESR Q&A may be relevant with regard to some of the issues identified and would have to be considered in any further update. Further, there was a likely overlap with the Commission Services' draft paper on the risk-based assessment of transposition, which had been forwarded to ESME for comments.

The presentation focussed on the following issues:

1) Macro-issues

- Divergent interpretations of the scope of definitions, e.g. 'transferable securities', and of exemptions, e.g. the exemption in Article 3(2)(b) for offers to fewer than 100 persons other than qualified investors "per Member State".
- Prospectuses not user-friendly for retail investors due to length and complexity.
- the right of withdrawal under Article 16 gives investors a free 'put option' that is not limited by any materiality test for inaccuracies.

2) Micro-issues

- Divergent interpretation by regulators of the scope of information that can be included in "final terms" (rather than a supplementary prospectus).
- Use of base prospectus (one per security).
- Validity period of tri-partite prospectuses.
- Uncertainty for issuers with regard to liability: which national regime applies in the case of passported issues (risk of 'liability arbitrage'); should there be different standards for prospectus contents and liability depending on the type of investor (as under MiFID); diverging certification requirements from regulators (e.g. by auditors, issuers).
- To what extent, if any, is an issuer exposed to liability in a host Member State in respect of the omission of information from a prospectus that has been authorised by the competent authority of its home Member State? Does such authorised omission bind the host CA?
- Uncertainty about the type of situations which trigger the requirement for a supplement to the prospectus, and the law (home/host) applicable to the right of withdrawal.

Members were asked to provide written comment on the draft paper before 31 March 2007 in order to finalise the paper for adoption after a final discussion at the next ESME meeting on 23 May 2007.

3) Transposition Issues

The subgroup also identified additional requirements and divergent practices among regulators with regard to the timelines for approval of prospectuses, conditions for approval and fees. Further problems for issuers were caused by national publication requirements (e.g. press notices that go beyond the requirements in the PD), additional reporting obligations in some Member States, the inflexibility of the language regime and a lack of legal certainty about the status of translated prospectuses.

With regard to issues identified, the Commission services said that a distinction had to be drawn between incorrect application of the PD and divergent practices which did not fall within the ambit of the legislation (e.g. with regard to different levels of fees charged by regulators). They also stressed the need for factual evidence in support of the issues raised, for example on the impact of the Prospectus Directive on the retail bond market. However, one member said that evidence was difficult or impossible to provide in cases where regulators insisted on certain practices by exerted informal pressure on issuers.

In the discussion that followed, one member said that the length and complexity of prospectuses was the result of investor demands for more information and that issuers, having adapted to the PD requirements, would not welcome changes to the disclosure regime at this stage. An impact assessment would be needed if any changes are to be considered.

The same member gave a detailed account of the problems that arise from the uncertain application of the PD to the selling and distribution of securities by 'retail cascade'. The wording of the PD is incompatible with the way that retail offerings are actually made. This is particularly so in the case of debt, but retail offerings of equity are increasingly being made in similar ways. Since the last meeting of ESME in December, when this issue was first discussed in detail, a number of very large companies have stopped or are in the process of stopping all issues of retail bonds. The issuers in question probably accounted for the majority of bonds that are available for retail investors in Europe, so the suspension of such issues had consequences not only for issuers but also for the availability of investment opportunities for investors. The regulators that are most directly involved have been unwilling to accommodate issuers through interpretation of the PD and Prospectus Regulation without guidance from either CESR or the Commission. Therefore such guidance was urgently required. The member also noted that since implementation of the PD issuers' costs had increased significantly, and promised to provide figures.

One member raised the issue of divergent opinions on interpretation included in the CESR Q&A and said these were unhelpful for issuers. CESR should strive to achieve a common view. In response, the observer from CESR commented that where no unanimity was reached among regulators, CESR had no powers to impose a unique position to all its members; he also reminded that transparency of these divergent views would give rise to pressure by market participants to achieve further convergence. One member said that publication might make it more difficult for regulators to review their position and may therefore entrench divergent views.

8. Operation of Market Abuse Directive

The rapporteur of the sub-group gave an overview of the subjects in the draft report on the operation of the Market Abuse Directive (MAD). The main subjects in the draft report include: i) inside information; ii) insider lists, iii) transaction reporting; iv) safe harbour Regulation and Accepted Market Practices (AMPs); v) commodity derivatives and vi) some additional technical issues. The rapporteur highlighted the fact that the application of one definition on inside information to insider trading and to public disclosure requirements poses difficulties in practice. Likewise, the effectiveness of the current insider list requirements was questioned. Finally, the rapporteur raised the issue of the diversity of criminal and administrative enforcement regimes across Member States. In response to this last point, the Commission services announced the publication by the end of this year of a list of administrative measures and sanctions in all Member States in case of violation of the market abuse provisions. Members were asked to provide written comment on the draft paper before 31 March 2007 in order to finalise the paper for adoption after a final discussion at the next ESME meeting on 23 May 2007.

Regarding the delay of disclosure of inside information and Article 4(b) of Directive 2004/72/EC, one member noted that immediate disclosure of specific inside information in the energy sector (e.g. outage of power plant) would have adverse consequences for the energy supplier. Furthermore, the issue of the scope of recitals 29 and 30 of Directive 2003/6/EC was raised in relation to corporate financial transactions where potential investors have access to inside information at the same time. Finally, several members suggested including in the paper a call for more transparent enforcement of the MAD legal framework across the EU.

9. A.O.B.