



THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/02.089b

**CESR's Advice on  
possible Level 2 Implementing Measures  
for the proposed Market Abuse Directive**

**Consultation Paper**

**JULY 2002**



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## I. INTRODUCTION

1. CESR invites responses to this consultation paper on its proposed advice to the European Commission regarding technical implementing measures for the proposed directive on insider dealing and market manipulation (market abuse).
2. The deadline for submitting responses to the paper is 30 September 2002. Responses should be addressed to Mr. Fabrice Demarigny, Secretary General, CESR, by email at [secretariat@europefesco.org](mailto:secretariat@europefesco.org). Given the 31<sup>st</sup> December deadline set by the European Commission for receipt of CESR's advice, CESR cannot guarantee that due consideration will be given to responses received after 30<sup>th</sup> September 2002.
3. In order to facilitate the consultation process, CESR is planning to hold an open meeting on Friday 6<sup>th</sup> September. The venue has yet to be fixed. Please register your interest in participating with Mr Fabrice Demarigny at the above e-mail address.

### Background

4. On 30 May 2001, the European Commission published a *Proposal for a Directive of the European Parliament and of the Council on insider dealing and market manipulation (market abuse)* (the "Commission Proposal").
5. On 14 March 2002, the European Parliament adopted amendments to the Commission Proposal ("Parliament's Report").
6. On 7th May 2002, the ECOFIN Council adopted a political agreement on the articles of the text, as reflected in (the "Council Text").

### Annex A of this paper sets out the relevant extracts from the above texts

7. In accordance with the procedures outlined in the Lamfalussy Report, the Commission published its *Provisional Request for Technical Advice on Possible Implementing Measures on the future Directive on Insider Dealing and Market Manipulation (Market Abuse)* (the "Provisional Request") on 27 March 2002. The Commission asks CESR to deliver its technical advice by 31 December 2002.
8. CESR set up an Expert Group on Market Abuse, chaired by Pr. Stavros Thomadakis, Chairman of the Hellenic Capital Market Commission and supported by Mr Nigel Phipps of the CESR Secretariat. In addition, under the terms of CESR's Public Statement of



Consultation Practices (Ref: CESR/01-007c), CESR established a Consultative Working Group (the “CWG”) to advise the Expert Group.

9. On 27 March 2002, CESR published a Call for Evidence (Ref: CESR/02-047) inviting all interested parties to submit views by 26 April 2002 as to what CESR should consider in its advice to the Commission. CESR received around ten submissions. These were mainly from trade associations representing banks, issuers and investment firms. Submissions were also received from some individual organisations. The issues covered by these submissions were integrated into the work of the four drafting groups that were set up to deliver the preliminary drafts of this paper.
10. Depending on the outcome of this consultation, CESR may hold a second consultation and/or open meeting in November 2002.

## References

11. The Provisional Request asks that CESR’s advice take into account, among other things, certain principles, resolutions and statements as follows:
  - the Commission Proposal (for a directive on market abuse);
  - developments in the Council of the European Union and European Parliament regarding the Commission Proposal;
  - the principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001 (the “Stockholm Resolution”); and
  - the Parliament’s Resolution on the implementation of financial services legislation (5 February 2002) and the Commission’s formal declaration in response.
12. Papers published by CESR in this area are:
  - *A European Regime Against Market Abuse* – September 2000 (Ref. FESCO/00-061) (the “Market Abuse Paper”)
  - *Measures to Promote Market Integrity* – February 2002 (Ref. CESR/01-052h) (the “Market Integrity Paper”)
  - *Stabilisation and Allotment, a European Supervisory Approach* – April 2002 (Ref. CESR/02-020b) (the “Stabilisation Paper”)



13. In addition, the following papers published by CESR inform the discussion in the Paper:

- *Market Conduct Standards for Participants in an Offering* – December 1999(ref. 99-FESCO-B)
- *A European Regime of Investor Protection – The Harmonisation of Conduct of Business Rules* – April 2002 (Ref. CESR/01-014d)



## **II. Preliminary statement by Stavros Thomadakis**

14. Adoption and implementation of the Proposed Directive on market abuse is crucial to the development of an integrated, fair and efficient financial market in Europe. The Proposed Directive is the first of two proposed directives to employ the new, four-level legislative process recommended in the Lamfalussy Report. The process is designed to ensure that the legislative framework can keep pace with and facilitate developments in the EU's emerging single capital market.
15. This four-level legislative process consists of:
- Level 1: directives that confine themselves to framework principles;
  - Level 2: implementing measures developed by the Commission on the advice of a committee of independent regulators (CESR) and after the approval by a committee of high level representatives of member states (the European Securities Committee);
  - Level 3: joint recommendations, consistent guidelines and common standards issued by CESR regarding matters not specified by EU legislation to ensure uniform implementation and application of the legislative framework; and
  - Level 4: enforcement of Community law through Commission action.
16. This Paper is the first consultation paper published by CESR pursuant to a mandate from the Commission to provide technical advice on Level 2 implementing measures. It is important that readers of this paper recognise the scope of the proposed advice. This is particularly important as the EU legislation is still in a transition phase. The underlying level 1 directive has yet to be finally agreed by the EU institutions. Readers are advised to focus on the appropriate level 2 measures in the context of the current proposals before the European Parliament and the Council of Ministers. CESR has no formal participation in the negotiations at level 1 and will not therefore take into account comments that relate to level 1 issues.
17. CESR relies on the European Commission to inform it of relevant developments at level 1 in so far as they affect the Provisional Mandate. If during the course of this consultation, there are significant developments at level 1, CESR will, on the advice of the European Commission, seek to inform readers of this paper of such developments. In doing so, CESR will also identify any impact it believes that these developments have on the proposals contained in this Paper.



18. This Paper is therefore confined to issues relating to Level 2 implementing measures, as set out in the Provisional Mandate. CESR requests that responses to the Paper focus on the appropriate content of these Level 2 measures.
19. In arriving at its proposals for level 2 implementing measures, CESR has been conscious that it is working, in accordance with the Provisional Mandate, on the detailed aspects of EU law. The “Lamfalussy Report” recognised that there was also a level 3 to allow for regulatory standards to ensure uniform implementation of the EU legislative framework that consists of level 1 and 2 measures. Throughout the paper, references will be made to the border between level 2 and level 3. CESR would welcome comments on whether the Paper provides the correct balance between legislative measures at level 2 and regulatory standards at level 3.
20. The Paper covers five substantive areas as set out in the Provisional Mandate. These are:
  - The definition of inside information
  - The definition of market manipulation
  - The disclosure of inside information by issuers
  - The fair presentation of research
  - Safe harbours for share buy-backs and stabilisation
21. In the area of inside information, the existence of the Insider Dealing Directive of 1989 has ensured that there is already a fairly common approach to the issues in the EU. On stabilisation, CESR has already undertaken significant work to forge a common European approach. This approach has been adapted to meet the requirements of the Provisional Mandate. All the other areas are not only new areas for a more harmonised approach at the EU level, but also areas of considerable evolution in terms of regulatory approach.
22. CESR is convinced that an effective consultation that draws on the expertise of all market users and participants will result in better quality advice from CESR. Ultimately this should help deliver a legislative framework that better serves the needs of the EU’s emerging single capital market. For this result to be achieved, all respondents are invited to draw on their experience and provide concrete examples where possible of the impact of the proposals set out in this Paper and any counter proposals that they might be making. In doing so, they should recognise the objectives of the task in hand. While experience of the national markets around the EU will inform the process, the outcome of the level 2 measures will be a common EU approach for a single market.



23. Several questions have been included in this paper to focus discussion on areas where CESR especially welcomes your comments.

### **The Consultative Working Group**

24. In undertaking its work, CESR was assisted by a Consultative Working Group (CWG) of experts drawn from a broad range of market participants. The group operated under the terms of CESR's Public Statement of Consultation Practices (Ref: CESR/01-007c).
25. The CWG met with CESR twice and members of it were also asked to comment by e-mail on early draft documents, which have been developed into the current Consultation Paper. The CWG's first meeting with the Expert Group took place in London on 22 April 2002 within a month of the release of the Commission's provisional mandate. The CWG was asked to comment on a range of questions and options. The CWG was contacted in mid-May to give substantive comments by e-mail on a revised draft of the paper ahead of a meeting of the CESR Expert Group. A second meeting took place between the Expert Group and the CWG in Paris on 21 June 2002. The purpose of this meeting was to express views on the Consultation Paper as approved by the CESR Chairmen. As a result of the discussion a number of additional questions were added to the Consultation Paper with the aim of ensuring a more complete consultation process.
26. In a paper sent to CESR on the CWG process, the members of the CWG said: "The dialogue between the Expert Group and the CWG has been good and there has been an open exchange of views which has contributed to both Groups understanding each other better. We support the wider use by CESR of CWGs in preparing technical advice to the Commission and believe that they also would be of use in the development of work initiated by CESR itself. While CESR and the CWG have had some discussions about the content of the Consultation Paper it should not be assumed that CESR's views, as expressed in the Consultation Paper, are necessarily shared by the CWG."





### **III. ARTICLE I**

Section A deals with inside information, section B with market manipulation and section C with the definition of financial instrument.

#### **A. Inside Information**

##### **Extract from the Provisional Mandate**

3.1.(1) Implementing measures on the definition of ‘Inside information’:

- The possible draft implementing measures should take account of:
- factors which need to be taken into account in deciding whether and when a piece of information is of a precise nature;
- factors which need to be taken into account in deciding whether a piece of information relates to one or more issuers of financial instruments or to one or more financial instruments;
- factors which need to be taken into account in deciding whether and when a piece of information would be likely to have a significant effect on the price of those financial instruments;
- factors which need to be taken into account in deciding which related derivative financial instruments should be covered by the definition.

##### **Introduction**

27. The main issue concerning the definition of inside information is that it is the condition from which derive all the duties set out in the proposed Directive: the confidentiality duty, the disclosure duty placed upon the issuers and the prohibition to enter into transactions.

28. In some cases, although there is no obligation for the issuer to disclose information to the market (in fact, it might even be counterproductive), the information should be kept confidential and the prohibition to enter into transactions should also apply to everyone, who has had access to that information. This is the obvious case of matters in the course of negotiation.

29. These situations, which have enormous abusive potential, have to be classified as inside information, so that there is a legal basis, given the regime stated in the proposed

Directive, to impose a prohibition to enter into transactions and to require that confidentiality be maintained in these cases.

30. In the following paragraphs, CESR describes the factors which need to be taken into account in deciding whether a piece of information is to be considered as precise and price sensitive and this is done separately for each of the concepts involved. Nevertheless, for clarification purposes, the paper provides examples of situations that are typical examples of inside information.

**Factors, which need to be taken into account in deciding whether and when a piece of information is of a precise nature:**

**Explanatory text**

31. The precise nature of information is assessed on a case-by-case basis and depends on the information in question. CESR also acknowledges the fact that both conditions – precise and likely to have a significant effect on the price of the financial instrument – are very much linked to each other and that the characteristics of each condition may play an intensifying role on the occurrence of the other. However, CESR believes that it is possible to identify separately the factors, which should be taken into account in deciding whether we are in presence of precise information, on one hand, and of information that is likely to have a significant effect on prices, on the other hand.

**Level 2 advice**

32. In deciding whether a piece of information is precise, the following factors are to be taken into consideration:

*The event that the information refers to is true or could reasonably be expected to become true in the future;*

*The information is specific enough to allow a conclusion to be drawn about the direction of its impact on prices.*

**Question (1):**

Are these level 2 factors sufficient? Would the level 2 advice benefit from further development along the following lines:

“The notion of precision implies the existence of a project sufficiently defined between the parties to have a reasonable chance to come to fruition, even if there remain uncertainties, inherent to all transactions of that nature, conditioning the actual completion of that project.”

## Additional guidance

33. The following guidance could be developed to support the factors at level 2.

- An event is true when it is based on firm and objective evidence which can be communicated accurately (as opposed to rumours or speculation), i.e. if it can be proven to have happened or to exist. If the information derives from a stage process, every fact to do with the process, as well as the totality of the process itself, is inside information, unless it consists only of rumours or speculation;
- The referred event could become true in the future: contingencies relating to the actual occurrence of the referred event do not mitigate the precise nature of the information. For instance the fact that an expected merger does not occur at the end of a negotiation process, does not preclude the classification of such negotiations as precise information;
- A piece of information allows a conclusion to be drawn about the direction of its impact on prices, either when it would enable an informed investor to take an investment decision without (or at very low) risk or when it is likely to be exploited immediately on the market;
- A piece of information that comprehends more than one event and some of them are not precise, could be considered precise as far as it concerns precise events. For instance, a take over bid could constitute inside information even though the bidder has not yet decided the price of the bid;
- A piece of information could be considered precise even if it refers to events that could be alternatives. For instance, the event that concerns a take over bid on one out of two companies could be considered inside information. An investor could abuse of this information by trading in shares of the two companies.

### Question 2:

Is the guidance comprehensive? Would there be an advantage in having all or some of the guidance as Level 2 implementing measures?

**Factors which need to be taken into account whether and when a piece of information would be likely to have a significant effect on the price of those financial instruments**

**Explanatory text**

34. Market participants have to be able to assess beforehand whether the information is price sensitive, in order to be able to act accordingly, regarding the duties of confidentiality, prompt disclosure and prohibition to enter into transactions.
35. This means that this assessment has to take into consideration the market impact, which would be foreseeable at the moment when the information has not yet been disclosed and the market impact is not yet measurable. Therefore *ex-ante* factors have to be found in order to guide market participants in their decisions. In order to perform this *ex-ante* analysis, any (relevant) information available at the time has to be taken into account. A piece of information could be considered as likely to have a significant effect on prices of financial instruments even though, when the piece of information is published, this doesn't actually produce any effect.
36. The *ex-ante* evaluation of the possibility of a price moving effect can be regarded as a question of determining the degree of probability with which at that point in time an effect on the price (due to the information) could reasonably have been expected. Assuming this, the mere possibility is not enough, as on the other hand a degree of probability close to certainty is not necessary either.
37. Regarding the various factors that can be taken into consideration, it becomes quite clear that fixed thresholds of price movements or quantitative criteria alone are not a suitable means of determining the significance of a price movement. Even differentiation according to markets, market segments or different groups of financial instruments (bonds, securities, derivatives) would not provide satisfactory results. Even within such groups there are too many differences and individualities as to justify a common rate of price movement for all cases. Moreover, the various markets and market segments in member states are not comparable and are often too different, making the set-up of EU-wide common thresholds impossible. In trying to meet the Directive's goal to create a common framework and to enhance conformity in all member states, the development of common rules or guidelines on the evaluation of the likelihood of a significant effect on prices seems to be preferable.
38. In considering whether the effect on the price of financial instruments, or on the price of related derivative financial instruments is likely to occur, all market variables that affect the financial instrument in question should be taken into account. These variables would include prices, returns, volatilities, liquidity, price relationships among financial instruments, volume, supply, demand, orders' book, timing of prices' and news' disclosure, rules governing the exchange and market microstructure, etc.
39. It should be pointed out again that the question of whether information is likely to have a significant influence on the price is to be determined by *ex-ante* objective criteria. The crucial factor here is the time at which the relevant action by the insider takes place. It is

therefore irrelevant whether or to what extent the price actually changes when the information eventually becomes publicly known.

### **Level 2 advice**

40. Regarding the information's likelihood to have a significant influence on prices, CESR suggest the following factors:

*A piece of information is likely to have a significant effect on the price of a financial instrument when it is information, which an investor could not omit to take into account or into consideration for his investment strategy. This assessment should be made ex-ante, in order to determine the possibility of a price moving effect and ought to take into consideration the following factors:*

- *The anticipated magnitude of the referred event in light of the totality of the company's activity;*
- *The relevance of the information regarding the main determinants of the company's share price;*
- *The credibility of the source;*
- *All market variables that affect the financial instrument in question.*

### **Additional guidance**

41. In determining whether, in the light of the factors stated above, the information is likely to have a significant effect on prices, there are some useful indicators that should be taken into consideration:

- The type of information is the same as information, which has, in the past, had a significant effect on prices;
- PrExisting analyst's research reports and opinions indicate that the type of information in question is price sensitive;
- The issuer itself has already treated similar events as inside information.

### **Question 3:**

Should the investor mentioned in the level 2 advice be qualified as reasonable/professional/informed?

**Question 4:**

Should the guidance be addressed at Level 2?

**Question 5:**

Are there any other relevant factors that should have been included?

**Factors which need to be taken into account in deciding whether a piece of information relates to one or more issuers of financial instruments or to one or more financial instruments**

**Explanatory text**

42. The purpose of the legislation against insider dealing is to ensure the integrity of European financial markets and to enhance investor confidence in those markets. Insider dealing is regarded as unfair, as an insider will have an advantage over the other market participants.
43. The abusive potential is not dependent on whether the information is related directly to the financial instrument/issuer, or if it affects the issuer more indirectly. Consequently price sensitive information should be regarded as inside information provided it is not a rumour or speculation.
44. The source of the “inside information” can be located inside the issuer’s sphere as well as outside the issuer’s sphere. Any kind of information, which is generally relevant to the market position of an issuer, can be regarded as relating to that issuer. This can be information on events that impact the issuer’s assets and liabilities, the financial position, general business operations or organisation and personnel matters as well as material market information about that industry or sector, caused by political, economic or even environmental events.
45. When the information concerns the issuer or the financial instrument indirectly and it is not yet publicly known, it should be treated as inside information, at least as far as the prohibition to enter into transactions and to communicate inside information is concerned. The main consequence of deciding whether the information concerns the issuer directly or indirectly is that the latter does not have to be disclosed by the issuer under article 6/1 of the proposed Directive.

**Level 2 advice**

There should be no level two measures in this area.

## **Additional guidance**

46. CESR is of the view that the list of facts that could be considered to be inside information as set out below is useful guidance for market participants. CESR proposes however, that this list should not be included in the level 2 technical development of the Directive. This is a non-exhaustive and indicative list of examples, which constitutes a starting point to the assessment of whether the information is inside information. However the evaluation, in concrete cases, of whether the threshold to «inside information» has been crossed depends considerably on the specific circumstances in each single case. For this reason, this list should not be envisaged as comprehensive and therefore it should not become a legal rule.

47. Information, which directly concerns the issuer:

- Changes in control and control agreements;
- Changes in management ;
- Changes in auditors or any other information related to the auditors activity;
- Operations involving the capital or the issue of debt securities or warrants to buy or subscribe securities;
- Decisions to increase or decrease the share capital
- Mergers, splits and spin-off;
- Purchase or disposal of equity interests or other major assets or branches of corporate activity;
- Restructurings or reorganizations that have an effect on the issuer's assets and liabilities, financial position or profits and losses;
- Decisions concerning buy-back programmes or transactions in other listed financial instruments;
- Changes in the class rights of the issuer's own listed shares;
- Filing of petitions in bankruptcy or the issuing of orders for bankruptcy proceedings;
- Significant legal disputes;
- Revocation or cancellation of credit lines by one or more banks;
- Dissolution or verification of a cause of dissolution;
- Relevant changes in the assets' value:
- Insolvency of relevant debtors;
- Reduction of real properties' values;

- Physical destruction of uninsured goods;
- New licences, patents, registered trade marks;
- Decrease or increase in value of financial instruments in portfolio;
- Decrease in value of patents or rights or intangible assets due to market innovation;
- Receiving acquisition's bids for relevant assets;
- Innovative products or processes;
- Serious product liability or environmental damages cases;
- Risk changes in expected losses and relevant changes in the expected income value;
- Relevant orders received from customers;
- Withdrawal from or entering into new core business areas;
- Relevant changes in the investment policy of the issuer;
- Ex-dividend date, dividend payment date and amount of the dividend; changes in dividends policy payments

48. Information, which indirectly concerns the issuer covers market information and information about transactions. It should be noted that, in the case of the following examples, the confidentiality duty and the prohibition to enter into transactions stated in articles 2 and 3 of the Directive's proposal apply. There is however no legal basis to require prompt disclosure under article 6/1, because this article only applies to issuers and to information that directly concerns them. Nevertheless the consequences resulting from events like the ones listed below may directly concern the issuer thereby leading to inside information in the sphere of the issuer (which again might fall under the disclosure requirement in article 6).

49. Market information:

- Data and statistics published by public institutions disseminating statistics;
- The coming publication of research, recommendations or suggestions concerning the value of listed financial instruments;
- Central bank decisions concerning interest rate;
- Government's decision concerning taxation, industry regulation, debt management, etc.
- Decisions concerning changes in the governance rules of market indices, and especially as regards their composition ;





- Regulated and unregulated markets' decisions concerning rules governing the markets;
- Competition and market authorities' decisions concerning listed companies;

50. Information about transactions:

- Relevant orders to trade financial instruments;
- A change in trading mode (e.g., information relating to knowledge that an issuer's financial instruments will be traded in another market segment: e.g. change from continuous trading to auction trading); a change of market maker or dealing conditions.

## **B. Article 1 - Market Manipulation**

### **Extract from the Provisional Mandate**

#### 3.1 (2) Implementing measures on the definition of 'Market manipulation':

The possible draft implementing measures should take account of:

- factors which need to be taken into account in deciding whether and when a transaction or an order to trade gives or is likely to give false or misleading signals as to the supply, demand or price of financial instruments;
- factors which need to be taken into account in deciding whether and when a transaction or an order to trade secures the price of one or several financial instruments at an abnormal or artificial level;
- factors which need to be taken into account in deciding whether and when a transaction or an order to trade employs fictitious devices or any other form of deception or contrivance.

### **Introduction**

51. This part of the CESR paper sets out indicative factors that identify manipulative behaviour involving either transactions or orders which give or are likely to give false or misleading signals as to the supply, demand or price of a financial instrument, or secure the price of a financial instrument at an abnormal or artificial level. Furthermore some indicative factors relating to the part of the definition concerning transactions or orders to trade which employ fictitious devices or other forms of deception or contrivance are also identified.
52. CESR believes that regulators must have the flexibility to adjust their methods of diagnosing, evaluating and sanctioning manipulative behaviours, in the context of varying market conditions. Consequently, the advice for implementing measures will include those factors that are common features or common preconditions of manipulative practices. The factors set out are by no means exhaustive.
53. Since the trading in own shares is the subject of technical advice in another part of this consultation paper, such transactions are not discussed here. However, CESR believes that there are times when trading in own shares, including as part of a buy-back program, could give false or misleading signals unless undertaken in accordance with the requirements of safe harbour provisions.

54. Furthermore CESR is aware that the indicators mentioned below do not always amount to market manipulation.
55. It is CESR's opinion that the three items on which advice is sought relate to a number of issues which can only be confronted at level 3 according to the Lamfalussy approach. These are:
- a. The specificities of market structure: the existence of continuous trading and/or auctions; the operation of market makers; the rules and systems for clearing and settlement.
  - b. The liquidity conditions: Accepted market practices in very liquid markets may become manipulative in low liquidity ones. Generally changes in liquidity may imply changes in regulatory scrutiny of market behaviour.

Examples:

- ? The ease of creating conditions for "market cornering" in low liquidity markets, i.e. markets in which a large portion of the supply is immobilized.
- ? The unwinding of a hedge in a low-liquidity situation, where liquidating a cash position will affect the price of the underlying asset.

56. Each of these groups of market characteristics, which may be permanent or changeable with market conditions, will influence both the frequency and the form of manipulative practices. Regulators must therefore have the flexibility to adjust their methods of diagnosing, evaluating and sanctioning manipulative behaviour, in the context of varying market situations.
57. Level 2 implementing legislation should therefore include those factors that are common preconditions or common features of manipulative practices.
58. This part of the consultation paper follows the approach of the Provisional Mandate which requests advice divided into three parts. It should be noted that due to the subject matter, there is a degree of overlap between these parts.

## PART 1

**Factors which need to be taken into account in deciding whether and when a transaction or an order to trade gives or is likely to give false or misleading signals as to the supply, demand or price of financial instruments;**

### Explanatory text

59. These factors will not be conclusive as to whether a particular conduct amounts to market abuse and the presence of one or more of the factors would not automatically mean that the transactions or orders to trade would constitute market manipulation. However CESR proposes “diagnostic flags” as well as factors that offer a strong indication of possible misleading signals.

### Level 2 advice

60. *Diagnostic flags are indications which should draw further scrutiny and are likely to be present individually or cumulatively as signals of manipulative behaviour:*

- *sudden and significant changes in the price of an instrument or volume of trades*
- *concentration of transactions in a small number of brokers*
- *concentration of transactions in a small number of clients*
- *concentration of transactions in a small time span within a trading session*
- *frequent introduction and cancellation of orders before execution*

61. *Factors offering a strong indication of possible false or misleading signals are necessary components of manipulative practice, and are likely to be present individually or cumulatively. Their cumulative presence increases the strength of the indication that false or misleading signals have been given.*

- *Orders given or transactions undertaken by persons acting in concert or collusion (including especially transactions among these persons) which represent a significant proportion of the daily volume of transactions in a financial instrument. The presence of a false or misleading signal is strongly supported if these activities lead to a significant change in the price of the financial instrument*

- *Orders given or transactions undertaken by persons with a significant position (long or short) in a financial instrument, whose orders or transactions lead to significant changes in the price of the financial instrument, or related derivative or underlying asset.*
- *Orders given or transactions undertaken by persons acting in concert or collusion which lead to no change in beneficial ownership of the financial instrument or which reallocate holdings among associated companies within a corporate holding.*
- *Orders given or transactions undertaken by a single person which include position reversals in a short period, and which represent a significant proportion of the daily volume, and/or are associated with significant changes in the price of a financial instrument.*
- *Orders given or transactions undertaken by a single person or persons acting in concert or collusion which are concentrated within a short time span in the trading session and which lead to a price change which is subsequently reversed.*
- *Orders given by a person which change the representation of best bid or offer prices in a financial instrument, or more generally the representation of the order book available to market participants, and which are removed before they are executed.*

**Question 6:**

Are the above diagnostic flags and factors appropriate for level 2 legislation?

**Question 7:**

Is the division between diagnostic flags and factors the right one? Are there any additional diagnostic flags or factors to be taken into account that you may want to suggest?

**PART 2**

**Factors which need to be taken into account in deciding whether and when a transaction or an order to trade secures the price of one or several financial instruments at an abnormal or artificial level**

**Explanatory text**

62. A number of different categories of factors seeking to identify manipulative behaviour could be set out. It should be noted that the different categories of factors including the category of persons gaining from artificial price levels, are not exhaustive.

### **Level 2 advice**

63. The diagnostic flags are:

- *Prices, volumes and volatilities which diverge from reasonable statistical norms and which subsequently retreat to normal levels*
- *Repetition of transactions among a small number of persons over a period of time (days or weeks)*
- *Concentration of transactions with one or a small number of brokers (excluding market makers) which persists over an interval of days or weeks*
- *Concentration of transactions with an issuer (excluding buy-back schemes), an issuer's "relevant persons" or investment firms with significant business with an issuer*
- *Concentration of transactions with one or more institutional investors affiliated with an issuer*

64. The persons most likely to obtain benefit from artificial price levels are:

- *Issuers and associated "relevant persons" in advance of a significant financial event, decision, contract, or contract completion (e.g. issue of new shares, bonds, warrants, merger or takeover, maturing of stock options, maturing of a conversion option).*
- *Investment firms with significant commercial or investment banking interests with an issuer, or seeking to acquire such interests, in advance of a significant contract, contract execution, contract evaluation*
- *Anyone with a significant position in a financial instrument who alters the valuation of that position by transactions in a derivative or underlying asset of the said financial instrument.*

65. The following methods, when used by persons most likely to obtain benefit from artificial price levels, are a strong indication of manipulative practices.

- *Repetitive reversal of transactions by the same person or by a group of persons, which represent a significant proportion of the volume of trades in a financial instrument. (By reversal here is meant the rapid succession of buying and selling activity in any order which generates volume without changing significantly beneficial ownership).*
- *The systematic purchase or sale of a financial instrument which affects the price, but which is simultaneously counteracted by transactions in other markets that have no equivalent impact on the price of the financial instrument.*
- *Transactions undertaken by a single person or persons acting in concert or collusion, which take place at or around a time when prices are calculated, when these transactions lead to price changes which have an effect on the said reference prices, settlement prices and valuations.*

**Question 8:**

Are the above diagnostic flags and methods appropriate for level 2 legislation?

**Question 9 :**

Are there any additional flags or methods to be taken into account?

**PART 3**

**Factors which need to be taken into account in deciding whether and when a transaction or an order to trade employs fictitious devices or any other form of deception or contrivance.**

**Explanatory text**

66. This category of manipulative practice is probably the most flexible one. It may overlap with the previous two categories in several respects. Furthermore, manipulators exhibit inventiveness and safeguarding the market against such inventiveness requires flexibility, adjustment and continuous learning on the part of regulators. Therefore, this category must remain an "omnibus clause" for the individual evaluation of possible infractions.

67. Indicative factors, which are by no means exhaustive and which relate to common experience can be pointed out. However, it should be noted that the following indicative factors overlap with the content of Article 1 paragraph 2 subparagraph (c) of the proposed

directive. The described indicative factors do not exhaust or exclude other forms and other agents of dissemination of false information through the media.

## Level 2 advice

68. The factors are:

- *False or misleading disclosure by issuers or other participants, preceded and / or followed by transactions by the same or associated persons.*
- *Analyst reports which are erroneous or biased and demonstrably influenced by material interests, as for instance in cases where analyst compensation depends on investment banking business, or when reports are preceded and / or followed by transactions by the same or associated persons.*
- *Misrepresentation by those who seek to either liquidate or acquire a significant position in a financial instrument that alters the cost or benefit of their planned action. For example, give out "good" (but misleading) signals before you sell and "bad" (but misleading) signals before you buy. The signals may include good or bad publicity about the issuer's business or its sector.*
- *Misrepresentation of the strategy of large market participants (e.g., institutional investors) with respect to a financial instrument or group of financial instruments, by issuers and their "relevant persons" or by investment firms and their relevant persons, when these investment firms have, or seek to obtain, a business connection with an issuer.*

**Question 10:** Are there any additional factors to be taken into account at level 2?





### **C. Article 1: Definition of Financial Instrument**

#### **Extract from the provisional mandate**

The possible draft implementing measures should specify which existing products would fall within the list of financial instruments.

#### **Level 2 advice**

*69. All financial instruments traded on a regulated market should be included within the list of financial instruments.*

<b>Question 11:</b> Do you agree with the above advice?
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#### IV ARTICLE 6 (1)

##### Appropriate public disclosure of inside information by issuers

##### Extract from the provisional mandate

3.2.(1) The possible draft implementing measures should take account of:

- the criteria for when information should be regarded as having been publicly disclosed;
- the appropriate channels for disclosure;
- the technical factors which need to be taken into account in determining whether a disclosure is complete, immediate or prompt and not misleading;
- factors to be taken into account in determining whether a disclosure of inside information has occurred as soon as possible;
- factors to be taken into account when delaying the publication of inside information.

##### **The criteria for when information should be regarded as having been publicly disclosed and the appropriate channels for disclosure.**

##### Explanatory text

70. When implementing this requirement, it is inevitable to take into consideration the definition of “inside information” in Art. 1 § 1 of the proposed Directive: *“information which has not been made public”*. The question arises if the appropriate channels have not been used and yet the information is, without a doubt, publicly known (e.g. due to other ways of publication, in newspapers, television, etc.).

71. CESR believes that the clarification of the criteria that should be taken into account to decide whether information has been made public should be done separately for article 6. The reason for this is that, although the information can already be publicly known for the purpose of article 1 of the Directive, there still would be a separate offence under article 6/1 if the dissemination of information by the issuer has not been done through the appropriate channel.

72. For the purpose of the fulfillment of the obligation stated on article 6, disclosure should be done through an officially appointed mechanism, as suggested in the CESR-Paper “Measures to promote market integrity” (CESR/01-052h).

## Level 2 advice

73. As far as article 6 is concerned, there would be an advantage in harmonizing the regime concerning the way to fulfill the disclosure duty and have, as a level 2 measure, the following requirements:

*Inside information can only be considered as having been publicly disclosed when it is disclosed through an officially appointed mechanism.*

*Such mechanisms should allow fast access both by issuers and by the public.*

*Issuers should not disseminate inside information through other channels before it is disclosed through an officially appointed mechanism.*

*Disclosure should be made in the jurisdictions of all regulated markets where an issuer has requested that its financial instrument be admitted to trading.*

### **Question 12:**

CESR would be interested in receiving views on the disclosure obligations when a financial instrument is traded in more than one EU jurisdiction. The objective is to ensure equal treatment of all investors. For instance should an issuer be able to rely on disclosure through an officially appointed mechanism in one jurisdiction even when the instrument is traded in other jurisdictions as well?

## Explanatory text

74. Requiring that the information is disclosed through an officially appointed mechanism has the advantage of certainty. The market is informed that all relevant information is disseminated through that channel. Such a mechanism should allow fast access both by the issuers (so that they can disclose the information quickly) and by the public (so that the information reaches the market as a whole as soon as possible).

75. In order to support this duty CESR proposes that issuers do not disseminate information through other channels before it is disclosed through an officially appointed mechanism.

76. The proposed level 2 measures could be further developed at level 3 to cover:

- The technical requirements of such officially appointed mechanisms: accuracy, timely information, level of security, input method, access by end users, etc.:
- Who is responsible for its management;

- How to ensure that the information disseminated through it is not mere publicity statements, etc.

**Question 13:**

CESR would welcome views on whether the EU needs a fully harmonised officially appointed mechanism. In putting forward any position respondents are asked to articulate the costs and benefits of any proposal.

**Technical factors which need to be taken into account in determining whether a disclosure is complete, immediate or prompt and not misleading.**

**Explanatory text**

77. Qualitative requirements on disclosure need to be set up to ensure an effective and sufficient flow of information to the public. In order to reach that goal it might be useful to give examples, while taking into account the different types of information to be published. Regarding annual reports, annual accounts, balance sheets and other forms of financial reports for example, besides the key figures, comparability to previously released reports is essential.

78. However, we believe that this should be done through regulatory guidance rather than through legal rules, since the legal rule is already quite comprehensive as far as abstract qualitative requirements are concerned.

**Level 2 advice**

79. There should be no level two implementing measures.

**Question 14:**

Should there be technical implementing measures at Level 2 further defining the qualitative requirements «complete», «prompt» and «not misleading»?

## **Factors to be taken into account in determining whether a disclosure of inside information has occurred as soon as possible**

### **Explanatory text**

80. It is important that the market receives as soon as possible information that is relevant for the pricing of financial instruments. Without this the market will not be able to fulfil its function, namely to price the securities correctly. Furthermore disclosure will prevent market abuse. However the issuer's obligation according to article 6.1 is limited to informing the public as soon as possible of inside information which directly concerns the issuer.
81. In meeting this objective, it is essential that the time lapse between the event to which the information refers is not longer than strictly necessary for the issuer to decide whether the event involves inside information that is subject to publication. However, this decision may not be delayed intentionally or negligently.
82. A useful indicator that disclosure did not occur as soon as possible would be the fact that the issuer disclosed it through a channel that is not one of the officially appointed mechanisms.
83. However, there still would have to be a positive requirement, in order to allow the issuer to decide when to disclose the information. Therefore, CESR suggests, as level 2 implementing measures, the two following time-related requirements:

### **Level 2 advice**

*Disclosure should take place as soon as the event occurs, regardless of whether it is already formalised;*

*Appropriate disclosure does not occur as soon as possible, when the issuer disseminates the information through other channels before it is disclosed through an officially appointed mechanism*

84. The first requirement is important when, for instance, the event is a contract. There is often a period of time between the agreement and finalising the contract, during which period there is a high risk of abuse of inside information.
85. CESR is aware of the fact that, in some cases, it is not in the company's best interest to disclose information at an early stage of, for instance, a negotiation process. However, CESR believes that these situations should be included under the exception provided by



article 6/2, because the company will then have to ensure confidentiality of the matters not disclosed.

### **The technical factors to be taken into account when delaying the publication of inside information**

#### **Explanatory text**

86. In advising the Commission on this particular point, there was the alternative that CESR provide a definition of legitimate interests. However, this possibility presents some problems:

- The definition would have to be extremely accurate, in order not to widen the scope of this article;
- Reality will probably be more creative than CESR can foresee and new cases will appear that will be on ‘the wrong side’ of the definition. Flexibility is important in this case.

87. Therefore, CESR believes that it would be more appropriate to give examples of situations that might justify delaying disclosure and suggest some measures to prevent the misuse of the information, which has not been immediately disclosed.

#### **Level 2 advice**

88. Examples of situations that would enable the issuer to delay disclosure:

*Matters in course of negotiation: it could be justified to delay disclosure when disclosure might affect the conclusion of a deal or the normal course of negotiations;*

*In the event that the existence of the issuer is endangered, information may be delayed where disclosure would seriously jeopardise the interest of shareholders by undermining the conclusion of specific negotiations designed to ensure the financial recovery of the issuer.*

#### **Additional comment**

89. It should be noted that in all the situations, a further evaluation should be done to decide whether the other conditions in article 6/2 apply. The examples stated above are, on one hand, a non-exhaustive list and, on the other hand, do not automatically allow the issuer to delay disclosure.

**Question 15**

Would a definition of legitimate interests be useful as a Level 2 implementing measure? If yes, what definition would you propose?

**Question 16**

Are there any other examples of situations that should be included in the list?

**Level 2 advice**

90. Measures to prevent the abuse of information, when disclosure is delayed:

*Issuers should ensure the confidentiality of information and control access to it. Members of the issuer's staff, other than those who require access to inside information in connection with the exercise of their functions within the issuer, should be prevented from having access to the information (e.g. through the implementation of Chinese walls);*

*Issuers should ensure that the persons that may have access to inside information are aware and acknowledge the legal and regulatory duties, as well as the penal, administrative and disciplinary sanctions that may be incurred through the misuse or undue circulation of such information;*

*Issuers should have in place measures, which allow immediate disclosure in the case of a breach of confidentiality.*



## V. ARTICLE 6 (4) RESEARCH

### Extract from the Provisional Mandate

Section 3.2.2. Fair presentation of research and other relevant information.

The possible draft implementing measures should take account of:

- factors on how research and other relevant information depending on the profession concerned are to be presented;
- factors on what would require the disclosure of particular interests or conflicts of interest.

### Introduction

91. The proposed directive provides for two types of objectives to be met: the relevant information must be “fairly presented” and the relevant persons must “disclose their interests and indicate their conflicts of interest”. The Provisional Mandate focuses on the content of the relevant information and disclosure thereby excluding the possibility of the level 2 measures including other means to meet the objectives. CESR will therefore limit itself to the scope of this Provisional Mandate.
92. By using the term “profession concerned” in the Provisional Mandate, CESR has understood this to mean that the professional capacity in which the information is produced or disseminated should remain an essential criterion for determining the scope of the implementing measures adopted pursuant to this provision. The level 2 advice therefore makes appropriate differentiation according to profession.
93. CESR considers that the measures set out in this part of the paper should apply to all natural or legal persons (“relevant persons”) producing or disseminating research concerning financial instruments or other information recommending or suggesting an investment decision where such information is intended to be distributed broadly (“relevant information”).
94. Because of its broad scope in terms of the persons subject to its provisions, article 6(4) of the Directive proposal requires Member States to “ensure that there is appropriate regulation in place” in order to meet the requirements that it sets, rather than requiring direct rule-making by the Member State or the competent authority. A recital adopted by the European Parliament on 14 March 2002 seeks to clarify this: “Member States should be able to choose the most appropriate way to regulate the different categories of persons concerned by the provisions of article 6(4), including appropriate mechanisms for self-





regulation, which should be notified to the Commission.” A Member State may therefore choose either direct regulation, or indirect regulation by a self-regulatory body.

### **Explanatory text**

95. The high-level principle should apply to all persons who produce and disseminate relevant information in the exercise of their profession or the conduct of their business. This would appear to include *inter alia* securities research reports produced by investment firms and credit institutions and credit reports produced by credit rating agencies, as well as securities research reports produced by independent research institutions and articles published in the press that correspond to the definition of “relevant information”.
96. CESR considers that recommendations issued by both a target company and a bidder in the context of a takeover may be subject to article 6(4). In CESR’s view, the high level principle below can be met through takeover rules which provide for fair presentation and disclosure within the meaning of this article.

### **Level 2 advice**

#### **High level principle**

97. *Reasonable care must be taken in the presentation of relevant information to ensure high standards of fairness, integrity and transparency. In particular, the relevant information must be accurate, clear and not misleading, any recommendation must have an adequate basis in fact, and the interests and conflicts of interest that may impair the objectivity of the information must be appropriately disclosed.*

#### **Additional guidance**

98. In reference to the above principle, CESR considers that:
- any broadly disseminated information containing an investment recommendation, explicitly or implicitly (a price target for example), concerning one or more financial instruments admitted to trading on a regulated market or for which such admission to trading has been requested, including any opinion as to the present or future value or price of such instruments, should be considered to be relevant information;
  - where the relevant persons know, or ought to know, that the information is likely to be distributed broadly, i.e. beyond a very small number of recipients, these persons should be considered as having intended this result and the information should be considered to be relevant information;

- macro-economic analysis, as well as general market commentary and research concerning broad markets, should be accurate, clear and not misleading and any recommendation contained therein should have an adequate basis in fact, but should not in principle be subject to requirements relating to disclosure of interests and conflicts of interest.

99. CESR notes that article 6(4) of the proposed Directive appears to apply to relevant information either in written (or electronically equivalent) form or other forms. The implementing measures should be adapted accordingly.

**Question 17:**

How should the proposed implementing measures, in particular regarding the disclosure of conflicts of interest, be adapted to relevant information that is distributed in another form, for example during a public appearance (radio, TV, “roadshows” and other meetings with potential investors, etc.)?

100. Similarly, article 6(4) refers broadly to “financial instruments and issuers of financial instruments” without distinction. As noted above, the proposed high-level principle would apply to securities research reports, credit reports and financial periodicals. The level 2 measures proposed below however (other than those that specifically address credit rating agencies), have been conceived with equity instruments, including convertible and exchangeable bonds, chiefly in mind.

**Question 18:**

CESR invites comments on how these measures, in particular those providing for disclosure of interests and conflicts of interest, should be adapted to research reports, articles in the press and other relevant information recommending bonds and other types of financial instruments (such as covered warrants).

**Fair presentation of relevant information depending on the profession concerned**

101. Persons who produce relevant information must be distinguished from persons who merely disseminate relevant information produced by another person.

**A) Producers of relevant information**

**Explanatory text**

102. CESR considers that persons who produce relevant information should be subject to the following rules in order to ensure that the information is fairly presented. The rules cover the identity of the producer, the methodology and content of relevant

information and the disclosure of interests or conflicts of interests. For each of these aspects of fair presentation, a basic rule is set out followed by more specific rules relating to certain professions.

## Level 2 advice

### 103. *Identity of the producer:*

- *The identity of the producer of the relevant information should be indicated clearly and prominently. The name of the individual preparer of the information, in addition to the name of the legal entity involved should be indicated.*
- *Where the entity producing the relevant information is an investment firm or credit institution, the identity of the regulator of the firm should also be indicated<sup>1</sup>.*
- *Where the person producing the relevant information is not an investment firm or credit institution, there may be another set of rules that apply such as self-regulatory standards or a code of conduct. These should be indicated.*

#### **Question 19:**

Do you think that investors would benefit from disclosure of the qualifications of the person producing the information?

## **Content of the relevant information: basic rule.**

### 104. *All producers of relevant information should take reasonable care to ensure:*

- *that all information is clear, accurate and as up-to-date as possible;*
- *that facts are clearly distinguished from interpretations, estimates, opinions and other types of non-factual information;*
- *that all sources are reliable;*

#### **Question 20:**

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<sup>1</sup> According to the CESR paper entitled “A European Regime of Investor Protection: The Harmonisation of Conduct of Business Rules” (CESR/01-014d), “relevant information” as defined in the present consultation paper constitutes a “marketing communication” and accordingly must be “fair, clear and not misleading” and must indicate “the identity of the investment firm, the financial group to which it belongs, its postal address, telephone number and the fact that the firm is authorised and the name of the competent authority that has authorised it” (§§29 and 32).

Where there is doubt about the reliability of a source, should this be indicated or should a relevant person refrain from publishing unreliable information?

- *that all projections, forecasts and price targets are clearly labeled as such and the assumptions used in making them are indicated;*
- *that any rating or recommendation to purchase or dispose of (or to continue to hold) a financial instrument can be substantiated as reasonable.*

**Content of the relevant information: investment firms, credit institutions and credit rating agencies**

105. *In addition to the above, where the relevant information is produced by an investment firm, credit institution or recognised credit rating agency, the relevant person should take reasonable care to ensure:*

- *that any methodology used to evaluate an issuer or financial instrument, to set a price target for a financial instrument, or to determine the credit rating of an issuer or financial instrument is adequately summarised;*
- *that the meaning of any rating or recommendation (e.g. “buy/overweight/outperform, hold/neutral, sell/underweight/underperform” or any credit rating) used, including the time horizon of the investment to which the rating or recommendation relates, is adequately explained;*
- *that reference is made to the planned frequency of updates of the relevant information or any changes in the coverage policy previously announced (e.g.a decision to stop coverage);*
- *that the date and time at which the relevant information was first released for distribution (to customers or to the public) is indicated clearly and prominently, as well as the relevant dates and times for any financial instrument prices mentioned (e.g. “closing prices on 3 May”);*
- *that any change in recommendation used or rating issued over the previous three years is indicated clearly and prominently;*
- *that all material sources are identified.*



## Disclosure of interests and conflicts of interests

### Explanatory text

106. CESR considers that certain of the disclosures mentioned below should be included in the relevant information distributed itself. Other disclosures (e.g. rules applying to personal investments and dealing by the analyst, factors determining the compensation of the analyst, policy regarding the release of relevant information and statistical information relating to the recommendations) may be posted on the website of the investment firm or credit institution provided the relevant information refers investors to this source. CESR also considers that it may be advisable to allow additional disclosures to be made in this way where the relevant information covers more than a small number of companies.

#### **Question 21:**

CESR would welcome comments on the form and place of disclosure.

### Level 2 advice

#### Basic rule

107. *Where the producer of the relevant information—the individual preparer of the information, the legal entity employing the individual or any affiliate of the legal entity—has a material financial interest in one or more of the financial instruments subject of the relevant information, or a material conflict of interest with respect to any of the issuers of such instruments, the nature of such interest or conflict should be indicated clearly and prominently so as to assist the reader in evaluating the objectivity and reliability of the information. Such disclosure should include all relationships and circumstances that may reasonably be expected to impair the objectivity of the relevant information.*
108. *In the case of relevant information produced by credit rating agencies or by the media, for instance, the agency or journalist should disclose in the report or article any control relationships with the subject company, and the individual preparer of the information should also disclose any material personal holdings of relevant financial instruments.*

## Disclosure of interests and conflicts of interests: investment firms and credit institutions

109. Where the relevant information is produced by an investment firm or credit institution (including any affiliate of such persons), the disclosures described below should be



made, clearly and prominently, regarding interests and conflicts of interest with respect to the company or companies subject of the relevant information (including any affiliate of such a company).

110. *Major shareholdings of the relevant person and subject company. The following should be disclosed:*

- *the number of shares in the subject company that are held by the relevant person provided that the shareholding exceeds 5% of the total issued share capital or carries more than 5% of the voting rights in a shareholders meeting;*
- *the number of shares in the relevant person that are held by the subject company provided that the shareholding exceeds 5% of the total issued share capital or carries more than 5% of the voting rights in a shareholders meeting.*

**Question 22:**

The threshold in EU law tends to be at 10% (e.g. directive 88/627). CESR considers that a 5% threshold may in many situations be “reasonably expected to impair the objectivity” of the research. CESR seeks comments on this proposed disclosure obligation as well as comments regarding the “timing” of the disclosure, exemptions from the disclosure obligation, and the desirability and feasibility of extending this disclosure to instruments other than shares (other equity instruments, and derivatives on the relevant instruments)<sup>2</sup>.

111. *Other significant relationships between the relevant person and the subject company. The following should be disclosed:*

- *whether the production and dissemination of the relevant information results from an agreement with the subject company<sup>3</sup>;*

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<sup>2</sup> On 10 May 2002, the U.S. SEC approved changes to NASD and NYSE rules relating to the conflicts of interest of research analysts and their employers. Inter alia, these rules will require, as of November 2002, disclosure in equity research reports and public appearances if the firm or its affiliates beneficially own 1% or more of the subject company’s common stock as of the end of the month immediately preceding the issuance of the report or the appearance, or as of the second most recent month end if the report is issued or the appearance occurs less than 10 calendar days after the most recent month end. As for the holdings of the preparer of the information, either the research report, or the analyst himself if he makes a public appearance, must disclose “if the research analyst or a member of the research analyst’s household has a financial interest in the securities of the subject company, and the nature of the financial interest” (rule 2711(h) of the NASD).

<sup>3</sup> By application of the basic rule stated above, this requirement would also apply to credit rating agencies where the issuer pays the agency to produce a rating.



- *whether the relevant person is a market-maker or liquidity provider in the securities of the subject company and if so, whether such a function results from an agreement with the company;*
- *whether the relevant person has been a lead manager or co-lead manager, over the previous three years, of any publicly announced offering of securities issued by the subject company<sup>4</sup>;*
- *whether, in addition to any participation in such an offering, the relevant person has supplied for compensation, over the previous three years, any other material investment banking services to the subject company;*
- *whether, in addition to the investment banking services, the relevant person has supplied for compensation, over the previous three years, any material commercial banking services or insurance services to the subject company;*
- *whether the relevant person expects to receive or intends to seek from the subject company over the coming twelve months, compensation for any material investment banking, commercial banking or insurance services*
- *whether any officer or director of the relevant person is, or has been over the previous three years, an officer or director of the subject company.*

**Question 23:**

CESR believes that disclosure of business relationships should be as meaningful and concrete as possible for the benefit of investors but without requiring the disclosure of any non-public provision of services. CESR would welcome comments on how this objective can be met, in particular as to the content and wording of the disclosure<sup>5</sup>.

**Question 24:** In particular CESR would welcome views on the time periods set out in the above requirements and elsewhere in the research section.

112. *Significant interests of the analyst. The following should be disclosed:*

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<sup>4</sup> This is meant to cover not only public offerings but also privately placed offerings that have been publicly announced, regardless of whether the offering was made by the issuer or a shareholder of the issuer.

<sup>5</sup> Cf. the terms of the disclosure that Merrill Lynch has agreed to put on its website (since 23 April 2002), and on its research reports (since 3 June 2002): “Merrill Lynch has received or is entitled to received compensation for services rendered in connection with equity underwritings and/or merger and acquisition transactions that were publicly announced in the past 12 months involving the companies listed below. Merrill Lynch also may have received or may receive compensation in connection with other business relationships with such companies. Given the nature of our business, investors should assume that Merrill Lynch is seeking or will seek investment banking or other business relationships with these companies.” Regarding future business, the new rules approved by the SEC require the member to disclose in research reports if the member or its affiliates “expect to receive or intend to seek compensation for investment banking services from the subject company in the next three months”.



- *any shares or related financial interest held by the individual(s) having prepared the relevant information, in the subject company or in any other company whose principal activity is the same as the principal activity of the subject company;*

**Question 25:**

CESR considers that this rule should be extended to cover the immediate family of the analyst. CESR is seeking views on how this might be done.

- *whether the individual preparer(s) of the relevant information are permitted to buy and sell the relevant securities, and if so, any conditions that must be respected in relation to such buying and selling;*
- *whether the individual preparer of the relevant information has been employed by the subject company over the previous three years;*
- *whether the compensation of such individual preparer is tied to investment banking transactions performed by the relevant person;*
- *whether the individual preparer has received compensation in cash or in kind, including gifts of more than nominal value, from the subject company.*

**Question 26:**

Is additional disclosure necessary where the analyst receives or purchases shares prior to an initial public offering of such shares, (i.e. the price at which he acquired the securities, the date of the acquisition and the number of shares involved)?

**Question 27:**

CESR seeks suggestions on how the disclosure of certain forms of compensation of the analyst can be clarified, in particular the extent to which compensation arrangements should be disclosed<sup>6</sup>.

113. *Policy of the relevant person regarding the review and dissemination of relevant information. The following should be disclosed:*

- *whether the relevant information was reviewed or approved, in whole or in part, by investment banking staff, and if so, for what purpose;*

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<sup>6</sup> The new U.S. rules provide that an investment firm may not “pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking transaction” and that research reports must disclose “if the research analyst principally responsible for preparation of the report received compensation that is based upon (among other factors) the [firm’s] investment banking revenues” (rule 2711(h) of the NASD).



- *whether the relevant information was communicated, in whole or in part, to the subject company prior to dissemination, and if so, which parts and for what purpose;*
- *whether the relevant information was communicated to any internal staff or department of the relevant person (trading, fund management or other) prior to release to customers or to the public;*
- *the policy of the relevant person regarding the release of the relevant information to customers, i.e. whether the information has been or may be disseminated to certain customers only, or has been or may be disseminated to certain customers before being disseminated to other customers.*
- *the policy and procedures within the relevant person regarding reporting responsibilities and avoidance and management of conflicts of interest with respect to relevant information.*

114. *Distribution of ratings and recommendations. The following should be disclosed:*

- *the proportion of all recommendations made by the relevant person, current as of the end of the most recent calendar quarter, that are “buy/ overweight /outperform”, “hold/neutral” and “sell/underweight/ underperform”.*
- *the proportion of subject companies corresponding to each of these three categories to which the relevant person has supplied material investment banking, commercial banking or insurance services over the previous three years.*

## **B) Dissemination of relevant information produced by a third party**

### **Explanatory text**

115. In order to ensure that the relevant information is fairly presented, CESR considers that persons who disseminate such information produced by a third party should be subject to the following rules.

### **Level 2 advice**

116. *The identity of the disseminator should be indicated clearly and prominently.*

117. *Persons who disseminate information produced by a third party in unaltered form (other than adding any required disclosures as indicated below) should take reasonable care, in the context of the role they assume with respect to the relevant information, to ensure that the rules relating to the identity of the producer and the content of the relevant information basic rule above have been met. It will generally*

*suffice to verify that a reputable person produced the information and that it does not appear to have been altered.*

118. *Where disseminators alter the information in a substantial manner by adding to it (e.g. by including the disseminator's comments), they should clearly and conspicuously indicate such alterations in the relevant information that they disseminate. Furthermore, they should comply with the rules applicable to producers of such information to the extent of such alterations.*
119. *Persons who summarise information produced by a third party and then disseminate it should ensure that the summary is clear and not misleading. Where the disseminator either summarises the relevant information or disseminates only part of it (e.g. the conclusion or recommendation), the required disclosures of interests and conflicts of interest should also be summarised. The disseminator should also indicate how the source document can be obtained or accessed.*
120. *In addition, where the disseminator of unaltered information is an investment firm or credit institution:*
- *the information must indicate the name of the relevant regulator;*
  - *the disseminator should take reasonable care, in the context of the role it assumes with respect to the relevant information, to ensure that the requirements relating to the content of the information produced by a regulated entity are met;*
  - *in the event that the relevant information has not been broadly distributed before, the information must include, where applicable, all of the disclosure requirements for a regulated producer of relevant information;*

**Question 28:**

Are the above rules for disseminators of relevant information appropriate?

## **VI. Article 8 SAFE HARBOURS**

### **Extract from Provisional Mandate**

3.3 Technical conditions under which trading in own shares in ‘buy back’ programmes and stabilisation will be allowed during an initial or secondary public offer (Article 8 of the proposed Directive).

DG Internal Market requests CESR to provide technical advice on possible draft technical conditions on:

#### Standards for trading in own shares in ‘buy back’ programmes

The draft standards should take account of:

- developing criteria on how ‘buy back’ activities should be undertaken;
- different types of markets (eg depending on the market, different limits for maximum market volume share accepted for buying shares through ‘buy back’ programmes );
- the maximum proportion of share capital accepted for trading in own shares in ‘buy back’ programmes;
- disclosure requirements (disclosure to the public and to competent authorities);
- trade restrictions (eg prohibited limited periods before public disclosure of annual reports or of inside information).

#### Standards for stabilising a financial instrument in an initial or secondary public offer:

The draft standards should take account of:

- the need to identify the conditions under which stabilisation is allowed, taking into account the different types of markets, in particular the time period during which stabilisation should be allowed, and the price limits for stabilisation activity;
- disclosure requirements (disclosure to the public and to competent authorities)”

### **Introduction**

121. At level 1, the directive establishes a safe harbour for trading in own shares under “buy back” programmes and stabilisation. If these activities are undertaken in accordance with the level 2 implementing measures, then the prohibitions in the Market Abuse Directive will not apply. In this section, CESR sets out its advice to the European Commission as to what these implementing measures should be.

122. In making recommendations on the appropriate measures, CESR recognises that the safe harbour has been created to provide legal certainty to companies and to balance the economic benefits of these activities against the very real risks that these activities pose to the integrity of financial markets in the EU. In tackling the task set by the Commission, CESR has identified a set of ex-ante conditions for the use of the safe harbour. Once in the safe harbour, CESR has identified a set of free standing ex-post measures, which should be complied with by people who rely on the safe harbour.
123. Following advice from the European Commission, the scope of article 8 and the mandate given to CESR by the Commission does not permit the establishment of measures other than conditions for benefiting from the safe harbour. Therefore CESR sets out in this paper the level 2 ex-ante conditions that it advises the Commission to establish.
124. The paper also provides readers with a clear indication of the ex-post level 3 measures deemed necessary for reasons of regulatory effectiveness. Subject to the outcome of this consultation, these measures would be recommended by CESR members to the relevant authorities within their own jurisdictions for implementation at the time of implementing the proposed directive. CESR believes it is important to expose these additional ex-post measures during this consultation in order to allow all readers to get a better view of the balance CESR has sought to strike between the economic benefits of the safe harbour and regulatory effectiveness.

**Question 29.**

CESR would welcome views on the approach set out above. In particular, CESR is seeking views on whether the indicated level 3 measures should preferably be harmonised at level 2. Are there other approaches that CESR should consider?

**Trading in own shares under a “buy-back” programme**

125. Under the Second Company Law Directive (77/01/EEC), member states have discretion as to whether a company may buy-back its own shares. If a member state permits this activity, then the conditions are set out in that directive (Articles 19-24 as set out in annex B). Any buy-back that benefits from the safe harbour must therefore be undertaken in accordance with that directive.
126. The conditions in the Second Company Law Directive were not however established with a view to the company benefiting from a safe harbour to market abuse. CESR believes that satisfaction of the conditions in the Second Company Law Directive is

necessary but not sufficient in order to benefit from the safe harbour for share buy-backs. Accordingly, CESR is proposing additional conditions that must be met if share buy-backs are to benefit from the safe harbour set out in the level 1 directive.

127. The proposed directive states that it is a safe harbour for **trading in own shares in “buy-back” programmes**. The scope is therefore limited to shares. It is also limited to buy-back programmes. The implication of this wording must be that while companies might have many reasons for trading in own shares, it is only a subset of those reasons that will benefit from the safe harbour. In particular, CESR would not expect the following activities to benefit from the safe harbour:
- Transactions in redeemable shares (as defined in article 39 of directive 77/91/EEC). These shares should be redeemed in accordance with the redemption terms set out in the original offer document. The exercise of any discretion allowed by the terms of the redeemable shares will be subject to the Market Abuse Directive.
  - Trading in own shares by authorised entities when undertaken in the normal course of business (e.g. for hedging or other risk management purposes).
  - The execution and performance of liquidity agreements entered into by companies with investment firms.
128. In establishing the implementing measures, CESR is of the view that the implementing measures must be particularly rigorous to mitigate risks from the abuse of inside information. As companies are a key source of inside information, the risk to market integrity in this area is particularly acute. CESR is therefore proposing certain trading restrictions to mitigate this risk. These are set out below and include trading restrictions ahead of the release of inside information and programme suspension on the receipt of a merger or take-over offer. These restrictions are not applicable if a company has provided for the programme to be managed by an independent investment firm.
129. CESR in particular is considering the following measure: “a company may not trade preceding the announcement of inside information via an officially appointed mechanism.” In addition, CESR is considering whether companies should not trade when they have decided to delay the public disclosure of inside information.

<b>Question 30</b>
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Are these measures appropriate to mitigate the insider dealing risks?
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130. CESR is also of the view that the sale of own shares is not covered by the safe harbour. However, it is possible that during the life of a programme, a company might

well need to sell own shares as well. On balance, CESR is of the view that a buy-back programme should be outside the safe harbour if the company wanted to undertake sales of own shares during the period of the programme, unless the programme was managed by an independent investment firm. CESR recognises that this measure removes flexibility and would welcome suggestions of how to introduce some flexibility. It is important that any proposed measure will allow sales of own shares under certain objective conditions.

**Question 31**

Does this achieve an appropriate balance with regard to the EU's regulatory objectives (particularly as between the objectives of market integrity and efficient allocation of capital)? How could CESR introduce more flexibility in this area?

131. CESR has also considered the length of time during which a buy-back programme runs following authorisation by the shareholders. The Second Company Law Directive imposes a limit of 18 months. CESR believes that this limit should be reduced to 12 months. Some members of CESR have suggested 6 months. The question of length is related to the fact that disclosure is an important element of the conditions for the safe harbour. The longer the period the less effective is disclosure in protecting market integrity. However, the shorter the period the greater the cost to companies and the less flexibility the companies have to execute the programme in a manner that is appropriate for the prevailing market conditions.
132. To mitigate these costs, CESR has considered the possibility of removing or reducing the restrictions on volumes, prices and volatility for short-term programmes that last for a maximum of two/three months.

**Question 32:**

Should CESR introduce a time limit of less than 18 months?

**Question 33**

Should special consideration be given to short term programmes? And what conditions should be attached to them?

133. CESR is of the view that trading restrictions should be placed on the price, volume and volatility at which trades executed under the terms of a buy-back programme can be undertaken.
134. With regard to price, restrictions that have been considered include obligations to trade on a regulated market, at a price at or below yesterday's close, at a price at or below the last trade. On balance, CESR would propose that where trades are executed on a regulated market these should be done according to the rules of that market.



Where trades are executed off-market, these should be done at a price below yesterday's closing price and be subject to a strict reporting requirement.

**Question 34**

Should off-market transactions be disallowed for the purposes of the safe harbour?

135. With regard to volumes, companies should be restricted from buying more than a certain percentage of the average daily volume. CESR has opted for 25%.
136. On volatility, companies should take due care and avoid increasing the volatility of the share price when executing trades under the programme.

**Question 35:**

Views are sought on the above restrictions particularly with regard to the specific detail that should be included at level 2.

137. CESR is still considering whether the Competent Authority should be given the power through an implementing measure to suspend a programme where it believes that execution of the programme is particularly damaging to market integrity.

**Question 36:**

Should the Competent Authority be given such a power?

**Level 2 advice**

138. The following measures give an indication of CESR's current thinking but they should be read in conjunction with the questions set out in the introduction above.
139. **Measures that must be met before the activity is undertaken in order to benefit, ex-ante, from the safe harbour.**
- i *Share buy-backs must be undertaken in accordance with the second Company Law Directive (77/01/EEC).*
  - ii *The programme must have been approved in a general meeting of the holders of the shares.*
  - iii *Prior to the start of trading, full details of the programme must be published through an officially appointed mechanism. These details must include the purpose of the programme, the maximum price at which purchases are to be made, the number of shares to be bought and the duration of the programme*

*which cannot exceed [12] months. All subsequent changes to the programme must be published through the same officially appointed mechanism.*

- iv A programme must be announced outside the closed periods at the time of quarterly, half yearly and annual reports. The closed period must be at least [15] days long.*
- v The company must have in place the mechanisms necessary to ensure that it is able to fulfil its trade reporting obligations to the competent authority and/or to the market.*
- vi A programme involving more than 10% of the subscribed capital cannot benefit from the safe harbour.*
- vii When executing trades under the programme a company;
  - a) may not purchase shares at a price that exceeds the previous days closing price unless the purchase is undertaken on a regulated market where the company should not have orders placed at a price that is higher than the last trade;*
  - b) may not purchase more than [25%] of the average daily volume of the shares in any one day. The average daily volume figure should be established at the time the programme is announced and should be based on the average daily volume traded in the [15] days preceding the announcement of the programme;*
  - c) may not increase the volatility of the share price when executing trades under the programme.**

*NB: CESR is considering whether the above restrictions should be either lifted or modified for short term programmes of less than [3] months.*

- viii Any trade forming part of the programme that is not undertaken on a regulated market must be disclosed to the market within [5] minutes of the trade being executed.*
- ix Unless the programme is being lead managed on behalf of a company via an independent investment firm, the company:
  - a) may not sell any own shares during the life of the programme;*
  - b) may not trade during the closed periods as set out in (iv) above;**





*c) may not continue with the programme when it has received either a merger or take-over offer from a third party;*

**Question 37**

Is the above restriction appropriate for a programme that meets all the other conditions set out above?

*d) may not trade preceding the announcement of inside information via an officially appointed mechanism.*

*x Undertake all trading in accordance with the announced programme.*

**Ex-post level 3 measures applying during the programme**

140. CESR is of a view that the above measures are a proportionate response to the objectives underlying the safe harbour. However, as set out in the introductory paragraphs, CESR is of the view that the following measures need to be introduced to ensure the regulatory effectiveness of the safe harbour. While any breaches would not result in a company losing the protections of the safe harbour, CESR would stress that these measures are a significant part of the protection of market integrity. However, as breaches will have an impact on market integrity, they should be sanctionable in proportion to the seriousness of the impact. These measures are an essential element in making the safe harbour effective. CESR would therefore advise the establishment of the following measures within the jurisdictions of CESR members:

- a daily reporting:** all trades under a buy-back programme should be disclosed to the market at the latest before the market opens on the day after the trade.
- b materiality:** daily reporting should not apply to trades under a buy-back programme that in any one day account for the lower of either [0.1%] of the issued share capital or [5%] of the average daily volume measured on the same basis as vii(b) above. All these trades will need to be reported to the competent authority on a weekly basis and to the market on a monthly basis. The trades can be consolidated as long as the high, low and average price is disclosed.
- c reduced disclosure:** daily reporting may be waived providing that disclosure is made on the same basis as in (b materiality) above and that the company adheres to one of the following trading restrictions;

- i either all the orders to trade on a particular day are channelled through a single investment firm;
- ii or, the programme is lead-managed on behalf of the issuer by a single investment firm.

## **Stabilisation**

### **Technical conditions under which stabilisation will be allowed during an initial or secondary public offer (Article 8 of the proposed Directive)**

#### **Introduction**

- 141. Stabilisation transactions mainly have the effect of providing support for the price of a new issue if it comes under selling pressure, thus alleviating sales pressure generated by short-term investors. In this way, stabilisation contributes to greater confidence of investors and issuers in the capital markets as financing and investing venues. Stabilisation may also contribute to a lower cost of funding for issuers.
- 142. Stabilisation also poses some risks to the market. Generally, there is a risk that Stabilisation activity could conceal the true market demand by sustaining a price for too long a time at a potentially artificial level. Stabilisation must therefore be conducted according to specific rules if it is to have the benefit of the safe harbour under appropriate national rules.
- 143. The advice set out in this paper draws heavily on the recently finalised CESR Paper “Stabilisation and Allotment – a European supervisory Approach”. CESR undertook extensive consultation on this paper before reaching an agreed approach. While the approach was not developed under the terms of a mandate from the Commission, the paper recognised the need for a safe harbour. In CESR’s view, the approach set out in that paper is the appropriate way forward in responding to the request.
- 144. To access the safe harbour, CESR identified in its earlier paper two sets of conditions relating to time and price limits. On time limits, the principle is that stabilisation can be undertaken for 30 days from the announcement of the final price providing it is disclosed to the market in advance. On price, stabilisation can only be undertaken for the purpose of price support.
- 145. These requirements do much to mitigate the potential risks associated with stabilisation while still making the safe harbour accessible. However, the safe harbour



relies on good quality disclosure and an effective stabilisation manager. To this end CESR recommends that each jurisdiction establish an additional set of measures within the safe harbour to ensure the regulatory effectiveness of the safe harbour. These additional measures deal with disclosure in the prospectus, public disclosure of stabilisation activity, disclosure to the regulator and the appointment of a stabilisation manager.

**Question 38:**

Do respondents agree with the position taken by CESR?

**Definitions**

146. **Stabilisation** - any purchase or offer to purchase Relevant Securities or any transaction in Associated Securities equivalent thereto which is undertaken in the context of a Significant Distribution of Relevant Securities for the purpose of securing a market price for such Securities that would not otherwise prevail. All other definitions are set out at the end of this section.

147. **Level 2 advice**

148. *Stabilisation shall be under a safe harbour provided that it is undertaken by Investment Services Firms in the context of a Significant Distribution of Relevant Securities in order to support the price of such Relevant Securities for a limited period of time.*

149. **I Stabilisation Period**

*Stabilisation shall be undertaken only during a defined period that has been disclosed to the market in advance:*

*(a) for equity securities*

- *in the case of a secondary offering beginning with the public announcement of the final price of the Relevant Securities and ending no later than 30 days after Allotment; or*
- *in the case of an IPO, beginning with the commencement of trading of the Relevant Securities on a Regulated Market and ending no later than 30 days thereafter and*

- *where in an IPO, there is trading prior to the commencement of trading on a Regulated Market (i.e. when issued trading where it exists), beginning with the public announcement of the final price of the Relevant Securities and ending no later than 30 days thereafter provided that any such trading fulfils the following conditions:*
  - *it is undertaken subject to/under the rules of a Regulated Market,*
  - *it is subject to trade reporting requirements, and*
  - *it is undertaken subject to an appropriate level of regulatory supervision and monitoring.*

*(b) for debt securities*

- *commencing with the public announcement of the offer of the Relevant Securities; and*
- *ending no later than 30 days after the closing date/the date on which the issuer of the securities received the proceeds of the issue, or if earlier than that, ending no later than 60 days after the date of Allotment*

*(c) for debt securities convertible or exchangeable into equity securities*

- *commencing with the public announcement of the final terms of the Relevant Securities; and*
- *ending no later than 30 days after the closing date/the date on which the issuer of the securities received the proceeds of the issue, or if earlier than that, ending no later than 60 days after the date of Allotment*

150. **II**     **Stabilisation Price**

*(a)     Equity Securities*

*Stabilisation may only be undertaken to support the market price of the Relevant Securities having due regard to prevailing market conditions and in any event may not be executed above the offering price.*



- (b) *Debt Securities including debt securities convertible or exchangeable into equity securities*  
*Stabilisation may only be undertaken for the purpose of price support.*

### **Additional comment**

151. Without prejudice to the ongoing work on the prospectus directive, prospectus disclosure of stabilisation should provide a full, clear and coherent picture of planned stabilisation activity. In particular, the prospectus must contain adequate disclosure on the following items in one clearly identified section:
- the fact that stabilisation may be undertaken, that there is no assurance that it will be undertaken and that it may be stopped at any time;
  - the beginning and end of the period during which stabilisation may occur,
  - the identity of the stabilisation manager for each relevant jurisdiction unless this is not known at the time of publication in which case it must be published before any stabilisation activity begins;
  - the fact that stabilisation transactions may result in a market price that is higher than would otherwise prevail;
  - other aspects of stabilisation which could be material to an investor's decision to subscribe for or purchase the Relevant Securities.
152. **Explanation:** Prospectus disclosure is the basis of the investment decision of investors. Prospectus disclosure is delimited by the principle of materiality, which requires that everything material for an investor's investment decision, and nothing not material to such decision, is included in the Prospectus. The after market performance of the security is of course of vital interest to any investor. Stabilisation could impact on after market performance. Prospectus disclosure of stabilisation should therefore provide a full, clear and coherent picture of planned stabilisation activity including ancillary devices.

### **Additional level 3 measures**

153. CESR is of a view that the above measures are a proportionate response to the objectives underlying the safe harbour. However, as set out in the introductory paragraphs, CESR is of the view that the following measures need to be introduced to



ensure the regulatory effectiveness of the safe harbour. While any breaches would not result in a company losing the protections of the safe harbour, CESR would stress that these measures are a significant part of the protection of market integrity. However, as breaches will have an impact on market integrity, they should be sanctionable in proportion to the seriousness of the impact. These measures are an essential element in making the safe harbour effective. CESR would therefore advise the establishment of the following measures within the jurisdictions of CESR members:

#### **A Public disclosure of stabilisation activity**

154. Within one week after the end of the stabilisation period, the stabilisation undertaken must be adequately disclosed to the public. This disclosure has to contain the following information:
- the date at which the stabilisation period ended;
  - whether or not stabilisation was undertaken;
  - the price range between which stabilisation was undertaken;
  - the date at which stabilisation last occurred.
155. **Explanation:** Public disclosure of stabilisation activity after it has been undertaken is important to allow the investing community to judge the fate of the offer in terms of stabilisation activity undertaken. However, as Stabilisation is not an absolute indicator,<sup>7</sup> the information should be presented such as to avoid confusion. Furthermore, the amount of information presented needs to strike a balance between

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<sup>7</sup> In very weak general market conditions, for example, the stabilisation manager may decide not to stabilise at all, because any support that could be provided would not counteract prevailing general market sentiment. Whereas one could think that the fact that no stabilisation was undertaken indicated that the issue was trading above the offer price, thus making stabilisation both unnecessary and impossible, this would be misleading in this concrete case.



the information needs of retail investors and the need to avoid providing other, less peacefully inclined investors with information they could use to attack the issue.

## **B Reporting to the regulator**

156. All Stabilisation orders and transactions must be recorded separately. The information to be recorded shall include for each order and transaction, at least the information set forth in Article 20 para (1) of the Investment Services Directive (93/22/EEC). This information must be at the disposal of the competent authority at all times.
157. **Explanation:** Reporting to the regulator should be structured to allow the regulator to gain a full picture of the stabilisation activity that was undertaken. The information should be in a format already used for transaction reporting. However, to allow a quick review, information on stabilisation should be recorded separately. The availability of such information to the regulator should take account of the fact that a review of stabilisation activity will not be undertaken for every issue, but rather only where indicators for possible rule breaches are present.

## **D The Stabilisation Manager**

158. One Investment Services Firm within the consortium must be accountable vis à vis each relevant competent national authority, in order to act as central point of inquiry for any regulatory intervention. There must be adequate co-ordination between all Investment Services Firms undertaking stabilisation.

### **Question 39:**

CESR would welcome views on the approach set out above. In particular, CESR is seeking views on whether the indicated level 3 measures should preferably be harmonised at level 2. Are there other approaches that CESR should consider?

## **Definitions**

**Associated Securities** – Associated Securities shall mean the following financial instruments which are admitted to trading on a Regulated Market or for which a request for admission to trading on such market has been made

- (1) contracts or rights to subscribe for, acquire or dispose of Relevant Securities,
- (2) financial derivatives on Relevant Securities, and
- (3) where the Relevant Securities are convertible or exchangeable debt securities, the securities into which such convertible or exchangeable debt securities may be converted or exchanged.



**Investment Services Firms** - investment firms and credits institutions as defined in Article 1 Nos. 2 and 3 of the Investment Services Directive (Directive 93/22/EEC).

**Offeror** - the person(s) who were prior holders of or the entity issuing the Relevant Securities.

**Prospectus** - the prospectus or listing particulars as referred to in Directives 89/298/EEC and 2001/34/EC respectively or, where no prospectus exists, comparable offering, listing or other documentation.

**Relevant Securities** - shares, as well as securities equivalent to shares (such as depository receipts) and debt securities including convertible and exchangeable debt securities as well as securities equivalent thereto (such as depository receipts) which are the subject of a Significant Distribution and which are admitted to trading on a Regulated Market or for which a request for admission to trading on such market has been made, as well as, where the context so requires securities identical thereto which are already admitted to trading on a Regulated Market.

**Regulated Market** - the markets as defined in Article 1 No. 13 of the Investment Services Directive (Directive 93/22/EEC).

**Significant Distribution** - an offering of Relevant Securities publicly announced no later than at the beginning of the offering that is distinct from ordinary trading both in terms of the amount of securities offered and the selling methods employed. This would encompass initial public offerings as well as secondary offerings of Relevant Securities. Block trades would, however, not be comprised in the definition as they are strictly private transactions.





## ANNEX A: RELEVANT PROVISIONS IN THE PROPOSALS

This annex contains extracts from the following proposals:

1. On 30 May 2001, the European Commission published a *Proposal for a Directive of the European Parliament and of the Council on insider dealing and market manipulation (market abuse)* (the “Commission Proposal”).
2. On 14 March 2002, the European Parliament resolved to propose amendments to the Commission Proposal (“Parliament’s Report”).
3. On 7<sup>th</sup> May 2002, the ECOFIN Council adopted a political agreement on the articles of the text, as reflected in (the “Council Text”).

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## ADVICE ON CERTAIN DEFINITIONS IN ARTICLE 1

Implementing measures on the definition of “inside information”

### **The Commission Proposal**

Recital (11) of the Commission Proposal states:

Insider dealing and market manipulation prevent full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets.

Article 1(1) of the Commission Proposal states:

‘Inside information’ shall mean information which has not been made public of a precise nature relating to one or more issuers of financial instruments or to one or more financial instruments, which, if it were made public, would be likely to have a significant effect on the price of those financial instruments or on the price of related derivative financial instruments.

### **The Parliament’s Report**

The first paragraph in proposed recital (11) in Parliament’s Report is identical to proposed recital (11) of the Commission’s Proposal. The first, second, third and fifth paragraphs in proposed recital (11), as well as proposed recitals (13a) and (13b), in Parliament’s Report may be relevant to CESR’s proposed technical advice to the Commission:

Inside information is any information which directly or indirectly relates to one or more issuers of financial instruments or to one or more financial instruments. Information which could have a significant effect on the evolution and forming of the prices of a regulated market as such could be considered as information which indirectly relates to one or more issuers of financial instruments or to one or more financial instruments.

As regards to insiders, account should be taken of the cases where the source of inside information is not a profession or function but the criminal activities carried out, preparation or execution of which could have a significant effect on the prices of one

or more financial instruments or on the forming of the prices of the regulated market as such.

Use of inside information can consist in acquiring or disposing of financial instruments while the party concerned knows or ought to have known that the information possessed is inside information. In this respect, the competent authorities should consider what a normal and reasonable person would know or should have known under the given circumstances. Moreover, the mere fact that market-makers, bodies authorised to act as *contrepartie*, or stockbrokers with inside information confine themselves, in the first two cases, to pursuing their legitimate business of buying or selling financial instruments or, in the last case, to carrying out an order dutifully, should not in itself be deemed to constitute use of such inside information.

The competent authority may issue guidance on matters covered by the Directive, e.g. what is inside information in relation to derivatives on commodities, and what are acceptable practices relating to the definition of market manipulation. This guidance shall be in conformity with the provisions of the Directive and the implementing measures adopted in accordance with the comitology procedure as referred to in Article 17(2).

(13a) Since the acquisition or disposal of financial instruments necessarily involves a prior decision to acquire or dispose taken by the person who undertakes one or other of these operations, the carrying out of this acquisition or disposal does not constitute in itself the use of inside information.

(13b) Research and estimates developed from publicly available data cannot be regarded as inside information and, therefore, any transaction carried out on the basis of such research or estimates does not constitute insider dealing within the meaning of this Directive.

Proposed Article 1(1) in Parliament's Report states that:

'inside information' shall mean:

information which has not been made public of a precise nature relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments which, if it were made public, would be likely to have a significant effect on the price of those financial instruments or on the price of related derivative financial instruments. In respect of derivatives on commodities, 'inside information' shall mean information which has not been made public of a precise nature relating directly or indirectly to one or more such derivatives, and which users of markets on which such derivatives are traded would expect to receive in conformity with

acceptable practices. For persons changed with the execution of orders on such markets, inside information shall also mean information conveyed by a client and related to the client's pending orders.

'Information of a precise nature' shall mean any tangible factor or event having a significant probability of occurring in future.

'Information made public' shall mean any information disseminated through traditional or electronic media.

### **The Council Text**

Proposed recital (11) of the Council Proposal is identical to proposed recital (11) of the Commission Proposal and the first paragraph of proposed recital (11) in Parliament's Report.

Proposed recitals (12), (12a), (14), the second paragraph of proposed recital (15d) and proposed recitals (15e) and (15f) of the Council Proposal also may be relevant to CESR's proposed technical advice to the Commission:

Inside information is any information which has not been made public of a precise nature relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments. An information which could have a significant effect on the evolution and forming of the prices of a regulated market as such could be considered as an information which indirectly relates to one or more issuers of financial instruments or to one or more related derivative financial instruments.

As regards to insider dealing, account should be taken of the cases where the source of inside information is not a profession or function but the criminal activities carried out, preparation or execution of which could have a significant effect on the prices of one or more financial instruments or on the forming of the prices of the regulated market as such.

Use of inside information can consist in acquiring or disposing of financial instruments while the party concerned knows or ought to have known that the information possessed is inside information. In this respect, the competent authorities should consider what a normal and reasonable person would know or should have known under the given circumstances. Moreover, the mere fact that market-makers, bodies authorised to act as counterparty, or stockbrokers with inside information confine themselves, in the first two cases, to pursuing their legitimate business of buying or selling financial instruments or, in the last case, to carrying out an order dutifully, should not in itself be deemed to constitute use of such inside information.

(12a) Member States must tackle the practice known as 'front-running', including 'front running' in commodities derivatives, where it constitutes market abuse under the definitions contained in this Directive.

The competent authority may issue guidance on matters covered by the directive, e.g. definition of inside information in relation to derivatives on commodities; implementation of the definition of accepted market practices relating to the definition of market manipulation. This guidance shall be in conformity with the provisions of the directive and the implementing measures adopted in accordance with the comitology procedure as referred to in Article 17(2).

(15d) ...

Having access to insider information of another company and using it in the context of a public take-over bid for the purpose of gaining control of this company or proposing a merger with this company should not in itself be deemed to constitute insider dealing.

(15e) Since the acquisition or disposal of financial instruments necessarily involves a prior decision to acquire or dispose taken by the person who undertakes one or other of these operations, the carrying out of this acquisition or disposal should not be deemed in itself to constitute the use of inside information.

(15f) Research and estimates developed from publicly available data should not be regarded as inside information and, therefore, any transaction carried out on the basis of such research or estimates should not be deemed in itself to constitute insider dealing within the meaning of this Directive.

Proposed article 1(1) of the Council Text states:

‘Inside information’ shall mean information which has not been made public of a precise nature relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments, which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

In relation to derivatives on commodities, ‘inside information’ shall mean information which has not been made public, of a precise nature relating directly or indirectly to one or more such derivatives, and which users of markets on which such derivatives are traded would expect to receive in conformity with accepted market practices on those markets.



## **Implementing Measures on the Definition of “Market Manipulation”**

### **The Commission’s Proposal**

Article 1(2) of the Commission Proposal states:

‘Market manipulation’ shall mean:

Transactions or orders to trade, which give, or are likely to give, false or misleading signals as to the supply, demand or price of financial instruments, or which secure, by one or more persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level, or which employ fictitious devices or any other form of deception or contrivance.

Dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply, demand or price of financial instruments, including the dissemination of rumours or false or misleading news.

### **The Parliament’s Report**

The fifth paragraph of proposed recital (11), and paragraph (12a) of Parliament’s Report also may be relevant to CESR’s proposed technical advice to the Commission:

The person who enters into transactions or orders to trade which constitute market manipulation could establish that his reasons to enter into such transactions or orders to trade were legitimate and that these transactions and orders to trade are in conformity with acceptable practices on the regulated market concerned. A sanction could still be imposed if the competent authority establishes that there is another, illegitimate, reason behind these transactions or orders to trade.

(12b) Modern communication methods make it possible for financial market professionals and private investors to have more equal access to financial information, but also increase the risk of the spread of false or misleading information. *[Note to Draft: Or should this recital be listed under fair presentation of research?]*

Proposed article 1(2) of Parliament’s Report states that “market manipulation” shall mean:

Transactions or orders to trade, which give, or are likely to give, false or misleading signals as to the price or volume traded, or the supply or demand of one or several financial instruments, or which employ fictitious devices or any other form of deception or contrivance.

In particular, the following paragraphs are derived from the core definition expressed above:

Conduct by one or more persons acting in collaboration to secure for themselves a dominant position over the supply and demand for a financial instrument having the effect of fixing, directly or indirectly, purchase or sale prices or other unfair trading conditions.

(ab) Buying or selling financial instruments at the close of the market with the effect of misleading investors acting on the basis of closing prices.

(ac) Taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument (or indirectly about its issuer) while having previously taken positions on that financial instrument and profiting subsequently from the impact of the opinions voiced on the price of that instrument, without having simultaneously disclosed that conflict of interests to the public.

Dissemination of false or misleading information as to material facts, or dissemination of information which gives, or is likely to give, false or misleading signals as to the supply, demand or price of financial instruments, whether through traditional or electronic media or by any other means likely to have a significant impact on the price of one or several financial instruments with the effect that the dissemination of such information or the persons informed of the manipulation derive, directly or indirectly, an advantage or profits therefrom, whereas the person having disseminated such information knew or could without reasonable doubt be considered to have known that the information was false or misleading.

The provisions of points (aa) and (ab) shall not apply to the conduct of any person insofar as such conduct is for legitimate reasons and accepted methods of operation on the regulated market are adhered to. The Commission shall draw up, pursuant to the procedure laid down in Article 17(2), guidelines for market participants specifying in particular what shall be meant by legitimate reasons and accepted methods of operation that may be invoked.

The definitions of market manipulation shall be adapted so as to ensure that new patterns of activity that constitute market manipulation in practice can be included.



Proposed article 6(4b) in Parliament's Report also may be relevant to CESR's proposed technical advice to the Commission [*Note to Draft: Should we include this as we don't go anywhere near this topic?*]:

(6b) Member States shall ensure that market operators adopt structural provisions aimed at preventing and detecting market manipulation more difficult. Such provisions shall in particular include maintaining a minimum level of liquidity for each financial instrument, transparency of transactions concluded, total disclosure of price-regularisation agreements, a fair system of order pairing, introduction of an effective atypical-order detection scheme, sufficiently robust financial instrument reference price-fixing schemes and clarity of rules on the suspension of transactions.

### **The Council Text**

Proposed recital (13) of the Council Proposal also may be relevant to CESR's proposed technical advice to the Commission:

The person who enters into transactions or orders to trade which are constitutive of market manipulation could establish that his reasons to enter into such transactions or orders to trade were legitimate and that these transactions and orders to trade are in conformity with accepted practices on the regulated market concerned. A sanction could still be taken if the competent authority establishes that there is another, illegitimate, reason behind these transactions or orders to trade.

Proposed recital (15a) of the Council Text is identical to proposed recital (12a) in Parliament's Report.

Proposed recital (15c) of the Council Text addresses some of the same concepts addressed in proposed Article 6(4b) in Parliament's Report

(15c) Market operators should contribute to the prevention of market abuse and adopt structural provisions aimed at preventing and detecting market manipulation practices. Such provisions may include transparency of transactions concluded, total disclosure of price-regularisation agreements, a fair system of order pairing, introduction of an effective atypical-order detection scheme, sufficiently robust financial instrument reference price-fixing schemes and clarity of rules on the suspension of transactions.

Proposed article 1(2) of the Council Proposal states that

market manipulation" shall mean:



Transactions or orders to trade:

which give, or are likely to give, false or misleading signals as to the supply, demand or price of financial instruments, or

which secure, by one or more persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level,

unless the person who entered into the transactions or orders to trade establishes that his reasons to enter into such transactions or orders are legitimate and that these transactions or orders to trade are in conformity with accepted market practices on the regulated market concerned.

Transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.

Dissemination of information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumours or false or misleading news, where the person who made the dissemination knew or ought to have known that the information was false or misleading. In respect of journalists when they act in their professional capacity such dissemination of information is to be assessed, without prejudice to Article 11, taking into account the rules governing their profession, unless those persons derive, directly or indirectly, an advantage or profits from the dissemination of the information in question.

In particular, the following instances are derived from the core definition expressed in (a), (b) and (c) above:

Conduct by one or more persons acting in collaboration to secure for themselves a dominant position over the supply and demand for a financial instrument having the effect of fixing, directly or indirectly, purchase or sale prices or other unfair trading conditions;

Buying or selling financial instruments at the close of the market with the effect of misleading investors acting on the basis of closing prices;

Taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument (or indirectly about its issuer) while having previously taken positions on that financial instrument and profiting subsequently from the impact of the opinions voiced on the price of that instrument, without having simultaneously disclosed that conflict of interests to the public in a proper and effective way.



The definitions of market manipulation shall be adapted so as to ensure that new patterns of activity that constitute market manipulation in practice can be included.



## **Implementing Measures on the Definition of “Financial Instrument”**

### **The Commission’s Proposal**

Article 1(3) of the Commission Proposal states that the term “financial instrument” shall mean instruments listed in Section A of the Annex. Section A of the Annex states that:

‘Financial Instrument’ shall mean:

Transferable securities as defined in Directive 93/22/EEC

Units in collective investment undertakings

Money-market instruments

Financial-futures contracts, including equivalent cash-settled instruments

Forward interest-rate agreements

Interest-rate, currency and equity swaps

Options to acquire or dispose of any instrument falling in these categories, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates.

Derivatives on commodities.

### **The Parliament’s Report**

The definition of “financial instrument” in proposed Article 1(3) of Parliament’s Report is substantially identical to the definition in the Commission Proposal, except that: (1) Annex A is deleted, so that the definition of “financial instrument” is moved directly into Article 1(3); and (2) the following item is added to the list of financial instruments:

any other instrument admitted to trading on a regulated market in a Member State or for which a request for admission to trading on such a market has been made.



## **The Council Text**

The definition of “financial instrument” in proposed Article 1(3) of the Council Proposal is identical to the proposed definition in Parliament’s Report.

## **APPROPRIATE PUBLIC DISCLOSURE OF INSIDE INFORMATION**

### **The Commission’s Proposal**

Proposed recital (12) in the Commission’s Proposal may be relevant to CESR’s proposed technical advice to the Commission::

Prompt and fair disclosure of information to the public enhances market integrity, whereas selective disclosure by issuers can lead to a loss of investor confidence in the integrity of financial markets. Professional economic actors must contribute to market integrity.

Proposed Article 6 of the Commission’s Proposal states, in relevant part, that:

Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information.

Member States shall require that whenever an issuer, or a person acting on its behalf, discloses any inside information to any third party in the normal exercise of his employment, profession or duties, as referred to in Article 3 (a), it must make complete and effective public disclosure of that information, simultaneously in the case of an intentional disclosure, promptly in the case of a non-intentional disclosure.

The provisions of the first sub-paragraph shall not apply:

if the person receiving the information owes a duty of trust or confidence to the issuer, or expressly agrees to maintain the disclosed information in confidence; or

if the primary business of the entity receiving the information is the issuance of mandatory credit ratings, provided the information is solely for the purpose of developing a credit rating which will be publicly available.

Member States shall require that issuers, or entities acting on their behalf, establish a regularly updated list of those persons working for them and having access to inside information.



An issuer may at its own risk delay the public disclosure of particular information such as not to prejudice his legitimate interests provided that such omission would not be likely to mislead the public and that the issuer is able to ensure the confidentiality of this information.

### **The Parliament's Report**

Proposed recitals (12) and (12b) in Parliament's Report may be relevant to CESR's technical advice to the Commission:

Prompt and fair disclosure of information to the public enhances market integrity, whereas selective disclosure by issuers can lead to a loss of investor confidence in the integrity of financial markets. Professional economic actors must contribute to market integrity by various means. Such measures include for instance the creation of 'grey lists', the application of 'window trading' to sensitive categories of personnel, the application of internal codes of conduct and the establishment of 'Chinese walls'. Obviously, such preventive measures may contribute to combating market abuse only if they are enforced with determination and dutifully controlled. Adequate enforcement control would imply for instance the designation of compliance officers within the bodies concerned and periodic checks conducted by independent auditors."

(12b) Greater transparency vis-à-vis the public of transactions conducted by persons discharging managerial responsibilities within issuing institutions and, where applicable, persons closely associated with them, constitutes a preventive measure as a counterpart to sanctions. This can also be a highly valuable source of information to investors.

The relevant paragraphs in proposed Article 6 in Parliament's Report state:

Member States shall ensure that issuers of financial instruments inform the public within the meaning of Article 1(1) as soon as possible of inside information which directly concerns said issuers.

1a. Without prejudice to any measures taken to comply with the provisions of the first subparagraph, Member States shall ensure that issuers, for an appropriate period, post on their internet sites all inside information that they are required to disclose.

Member States shall require that whenever an issuer, or a person acting on its behalf or for its account, discloses any inside information to any third party in the normal exercise of his employment, profession or duties, as referred to in Article 3(a), it must make complete and effective public disclosure of that information, simultaneously in



the case of an intentional disclosure, promptly in the case of a non-intentional disclosure.

The provisions of the first sub-paragraph shall not apply if the person receiving the information owes a duty of trust or confidence, regardless of whether such duty is based on a law, on regulations, on articles of association or a contract.

In order to take account of technical developments on financial markets and to ensure uniform application in the Community of this Directive, the Commission shall, in accordance with the procedure referred to in paragraph 17(2), adopt implementing measures concerning the conditions under which issuers, or entities acting on their behalf, shall draw up a list of those persons working for them and having access to inside information, together with the conditions under which such lists shall be updated.

2a. Persons discharging managerial responsibilities within an issuer of financial instruments and, where applicable, persons closely associated with them, shall, at least, (...) notify to the competent authority the existence of transaction conducted on their own account relating to shares issued by the institution of which they are members, or to derivatives or other financial instruments linked to them. Member States shall ensure that public access to such information, either on an individual or an aggregate basis, is readily available without delay.

An issuer may at his own risk delay the public disclosure of inside information, as referred to in paragraph 1, such as not to prejudice his legitimate interests provided that such omission would not be likely to mislead the public and that the issuer is able to ensure the confidentiality of this information. Member States shall require that an issuer notify without delay its competent authority of the decision to delay the public disclosure of inside information. Each national competent authority shall handle such notifications according to its own procedures.

4a With a view to ensuring compliance with paragraphs 1 to 4, the competent authority may take all necessary measures to ensure that the public is correctly informed.

### **The Council Text**

Recital (15) in the Council Text is substantially identical to proposed recital (12) in Parliament's Report, except that: (1) the word "could" is inserted after "Such measures" and before "include"; and (2) the word "are" is inserted after "determination and" and before "dutifully controlled".

Proposed recitals (14a) and (14b) of the Council Text also may be relevant to CESR's technical advice to the Commission:

(14b) Posting of inside information on internet sites as mentioned in Article 6(1) shall be in accordance with the rules on transfer of personal data to third countries as laid down in Directive 95/46/EC of the European Parliament and the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and of the movement of such data.

The relevant paragraphs in proposed Article 6 of the Council Text state:

Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns said issuers.

Without prejudice to any measures taken to comply with the provisions of the first subparagraph, Member States shall ensure that issuers, for an appropriate period, post on their internet sites all inside information that they are required to disclose.

An issuer may at his own risk delay the public disclosure of inside information, as referred to in paragraph 1, such as not to prejudice his legitimate interests provided that such omission would not be likely to mislead the public and that the issuer is able to ensure the confidentiality of this information. Member States may require that an issuer shall without delay inform the competent authority of the decision to delay the public disclosure of inside information.

Member States shall require that whenever an issuer, or a person acting on its behalf or for its account, discloses any inside information to any third party in the normal exercise of his employment, profession or duties, as referred to in Article 3(a), it must make complete and effective public disclosure of that information, simultaneously in the case of an intentional disclosure, promptly in the case of a non-intentional disclosure.

The provisions of the first sub-paragraph shall not apply if the person receiving the information owes a duty of trust or confidence, regardless of whether such duty is based on a law, on regulations, on articles of association or on a contract.

Member States shall require that issuers, or persons acting on their behalf or for their account, establish a list of those persons working for them, whether under a working contract or otherwise, and having access to inside information. Issuers and persons acting on their behalf or for their account shall regularly update this list and transmit it to the competent authority each time the latter requests it.



3a. Persons discharging managerial responsibilities within an issuer of financial instruments and, where applicable, persons closely associated with them, shall, at least, (...) notify to the competent authority the existence of transactions conducted on their own account relating to shares issued by the institution of which they are members, or to derivatives or other financial instruments linked to them. Member States shall ensure that public access to such information, either on an individual or an aggregate basis, is readily available as soon as possible.

With a view to ensuring compliance with paragraphs 1 to 4 of this Article, the competent authority may take all necessary measures to ensure that the public is correctly informed.

## **FAIR PRESENTATION OF RESEARCH AND OTHER RELEVANT INFORMATION**

### **The Commission's Proposal**

Paragraph 4 of Article 6 of the Commission's Proposal states:

Member States shall require that natural and/or legal persons being responsible for the production or dissemination of research or other relevant information to distribution channels or to the public take reasonable care to ensure that information is fairly presented and disclose their interests or indicate conflicts of interest in the financial instruments to which that information relates.

### **The Parliament's Report**

Proposed recital (12a) in Parliament's Report states:

(12a) Modern communication methods make it possible for financial market professionals and private investors to have more equal access to financial information, but also increase the risk of the spread of false or misleading information.

Proposed paragraph 4 of article 6 in Parliament's Report states:

Member States shall ensure that there is appropriate regulation in place to ensure that persons producing or disseminating research concerning financial instruments or issuers of financial instruments or producing or disseminating other information recommending or suggesting investment strategy, intended for distribution channels or the public, take reasonable care to ensure that information is fairly presented and disclose their interests or indicate conflicts of interest in the financial instruments to which that information relates. Such regulation shall be notified to the Commission.





## **The Council Text**

Proposed recital (14a) of the Council Text may be relevant to CESR's technical advice to the Commission:

(14a) Member States may be able to choose the most appropriate way to regulate the different categories of persons concerned by the provisions of Article 6(4), including appropriate mechanisms for self-regulation, which shall be notified to the Commission.

Proposed paragraph 4 of article 6 of the Council Text states:

Member States shall ensure that there is appropriate regulation in place to ensure that persons producing or disseminating research concerning financial instruments or issuers of financial instruments or producing or disseminating other information recommending or suggesting investment strategy, intended for distribution channels or for the public, take reasonable care to ensure that information is fairly presented and disclose their interests or indicate conflicts of interest in the financial instruments to which that information relates. Such regulation shall be notified to the Commission.

## **SAFE HARBOURS**

### **The Commission's Proposal**

Recital (14) states:

Stabilisation or trading in own shares can be legitimate, in certain circumstances, for economic reasons and should not, therefore, in themselves be regarded as market abuse. Common standard should be developed to provide practical guidance.

Article 8 of the Commission's Proposal states:

The prohibitions of this Directive shall not apply to trading in own shares in 'buy back' programmes nor to the stabilisation of a financial instrument provided such trading is carried out under agreed conditions.

The Commission shall determine these technical conditions in accordance with the procedure referred to in Article 17(2).

### **The Parliament's Report**



Parliament's Report does not propose any amendment to recital (14) of the Commission's Proposal.

Proposed article 8(1) of Parliament's Report is identical to Article 8(1) of the Commission's Proposal. Article 8(2) of the Parliament's Report states:

In order to take account of technical developments on financial markets and to ensure uniform application in the Community of this Directive, the Commission shall, in accordance with the procedure referred to in Article 17(2), adopt implementing measures concerning these conditions.

### **The Council Text**

Proposed recital (17) of the Council Text states:

Stabilisation of financial instruments or trading in own shares in buy back programmes can be legitimate, in certain circumstances, for economic reasons and should not, therefore, in themselves be regarded as market abuse. Common standards should be developed to provide practical guidance.

Article 8 of the Council Text states:

The prohibitions of this Directive shall not apply to trading in own shares in 'buy back' programmes nor to the stabilisation of a financial instrument provided such trading is carried out in accordance with implementing measures adopted pursuant to the procedure referred to in Article 17(2).

## ANNEX B

### **Extract from directive 77/91/EEC – second company law directive**

Articles 19 to 24 and article 39

#### Article 19

1. Where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall make such acquisitions subject to at least the following conditions: (a) authorization shall be given by the general meeting, which shall determine the terms and conditions of such acquisitions, and in particular the maximum number of shares to be acquired, the duration of the period for which the authorization is given and which may not exceed 18 months, and, in the case of acquisition for value, the maximum and minimum consideration. Members of the administrative or management body shall be required to satisfy themselves that at the time when each authorized acquisition is effected the conditions referred to in subparagraphs (b), (c) and (d) are respected;
  - (b) the nominal value or, in the absence thereof, the accountable par of the acquired shares, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, may not exceed 10 % of the subscribed capital;
  - (c) the acquisitions may not have the effect of reducing the net assets below the amount mentioned in Article 15 (1) (a);
  - (d) only fully paid-up shares may be included in the transaction.
2. The laws of a Member State may provide for derogations from the first sentence of paragraph 1 (a) where the acquisition of a company's own shares is necessary to prevent serious and imminent harm to the company. In such a case, the next general meeting must be informed by the administrative or management body of the reasons for and nature of the acquisitions effected, of the number and nominal value or, in the absence of a nominal value,

the accountable par, of the shares acquired, of the proportion of the subscribed capital which they represent, and of the consideration for these shares.

3. Member States may decide not to apply the first sentence of paragraph 1 (a) to shares acquired by either the company itself or by a person acting in his own name but on the company's behalf, for distribution to that company's employees or to the employees of an associate company. Such shares must be distributed within 12 months of their acquisition.

#### Article 20

1. Member States may decide not to apply Article 19 to: (a) shares acquired in carrying out a decision to reduce capital, or in the circumstances referred to in Article 39;

(b) shares acquired as a result of a universal transfer of assets;

(c) fully paid-up shares acquired free of charge or by banks and other financial institutions as purchasing commission;

(d) shares acquired by virtue of a legal obligation or resulting from a court ruling for the protection of minority shareholders in the event, particularly, of a merger, a change in the company's object or form, transfer abroad of the registered office, or the introduction of restrictions on the transfer of shares;

(e) shares acquired from a shareholder in the event of failure to pay them up;

(f) shares acquired in order to indemnify minority shareholders in associated companies;

(g) fully paid-up shares acquired under a sale enforced by a court order for the payment of a debt owed to the company by the owner of the shares;

(h) fully paid-up shares issued by an investment company with fixed capital, as defined in the second subparagraph of Article 15 (4), and acquired at the investor's request by that company or by an associate company. Article 15 (4) (a) shall apply. These acquisitions may not have the effect of reducing the net assets below the amount of the subscribed capital plus any reserves the distribution of which is forbidden by law.

2. Shares acquired in the cases listed in paragraph 1 (b) to (g) above must, however, be disposed of within not more than three years of their acquisition unless the nominal value or,

in the absence of a nominal value, the accountable par of the shares acquired, including shares which the company may have acquired through a person acting in his own name but on the company's behalf, does not exceed 10 % of the subscribed capital.

3. If the shares are not disposed of within the period laid down in paragraph 2, they must be cancelled. The laws of a Member State may make this cancellation subject to a corresponding reduction in the subscribed capital. Such a reduction must be prescribed where the acquisition of shares to be cancelled results in the net assets having fallen below the amount specified in Article 15 (1) (a).

#### Article 21

Shares acquired in contravention of Articles 19 and 20 shall be disposed of within one year of their acquisition. Should they not be disposed of within that period, Article 20 (3) shall apply.

#### Article 22

1. Where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall make the holding of these shares at all times subject to at least the following conditions: (a) among the rights attaching to the shares, the right to vote attaching to the company's own shares shall in any event be suspended;

(b) if the shares are included among the assets shown in the balance sheet, a reserve of the same amount, unavailable for distribution, shall be included among the liabilities.

2. Where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall require the annual report to state at least: (a) the reasons for acquisitions made during the financial year;

(b) the number and nominal value or, in the absence of a nominal value, the accountable par of the shares acquired and disposed of during the financial year and the proportion of the subscribed capital which they represent;



- (c) in the case of acquisition or disposal for a value, the consideration for the shares;
- (d) the number and nominal value or, in the absence of a nominal value, the accountable par of all the shares acquired and held by the company and the proportion of the subscribed capital which they represent.

#### Article 23

1. A company may not advance funds, nor make loans, nor provide security, with a view to the acquisition of its shares by a third party.
2. Paragraph 1 shall not apply to transactions concluded by banks and other financial institutions in the normal course of business, nor to transactions effected with a view to the acquisition of shares by or for the company's employees or the employees of an associate company. However, these transactions may not have the effect of reducing the net assets below the amount specified in Article 15 (1) (a).
3. Paragraph 1 shall not apply to transactions effected with a view to acquisition of shares as described in Article 20 (1) (h).

#### Article 24

1. The acceptance of the company's own shares as security, either by the company itself or through a person acting in his own name but on the company's behalf, shall be treated as an acquisition for the purposes of Articles 19, 20 (1), 22 and 23.
2. The Member States may decide not to apply paragraph 1 to transactions concluded by banks and other financial institutions in the normal course of business.

#### Article 39

Where the laws of a Member State authorize companies to issue redeemable shares, they shall require that the following conditions, at least, are complied with for the redemption of such shares: (a) redemption must be authorized by the company's statutes or instrument of incorporation before the redeemable shares are subscribed for;

- (b) the shares must be fully paid up;
- (c) the terms and the manner of redemption must be laid down in the company's statutes or

instrument of incorporation;

(d) redemption can be only effected by using sums available for distribution in accordance with Article 15 (1) or the proceeds of a new issue made with a view to effecting such redemption;

(e) an amount equal to the nominal value or, in the absence thereof, to the accountable par of all the redeemed shares must be included in a reserve which cannot be distributed to the shareholders, except in the event of a reduction in the subscribed capital ; it may be used only for the purpose of increasing the subscribed capital by the capitalization of reserves;

(f) subparagraph (e) shall not apply to redemption using the proceeds of a new issue made with a view to effecting such redemption;

(g) where provision is made for the payment of a premium to shareholders in consequence of a redemption, the premium may be paid only from sums available for distribution in accordance with Article 15 (1), or from a reserve other than that referred to in (e) which may not be distributed to shareholders except in the event of a reduction in the subscribed capital ; this reserve may be used only for the purposes of increasing the subscribed capital by the capitalization of reserves or for covering the costs referred to in Article 3 (j) or the cost of issuing shares or debentures or for the payment of a premium to holders of redeemable shares or debentures;

(h) notification of redemption shall be published in the manner laid down by the laws of each Member State in accordance with Article 3 of Directive 68/151/EEC.