

Recommendations by the Comisión Nacional del Mercado de Valores for securities issuers and financial intermediaries acting on their behalf in discretionary transactions with own shares

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The Executive Committee of the Comisión Nacional del Mercado de Valores (CNMV) has decided to publish the recommendations detailed below for discretionary transactions with own shares by securities issuers and financial intermediaries acting on their behalf.

In recent years, there has been an increase in Spain in transactions with own shares by securities issuers which buy and sell own shares in the market on an anonymous and discretionary basis via an intermediary. These transactions usually take place on official markets, specifically through orders entered by a financial intermediary in the central order book.

These discretionary transactions with own shares, consisting of buy orders at times of excess paper or when a security's price is deemed to be discordant with its fundamentals and of sell orders when there is surplus cash in a bull market, may, under certain circumstances, give rise to risks and conflicts of interest, ranging from distortions in the supply and demand of securities to the generation of erroneous signals with regard to a security's real liquidity or conflicts of interest on the part of a company's directors, since they are insiders par excellence and the primary source of inside information while also making decisions to buy and sell own shares.

Focusing on potentially misleading signals for the market, there are two main risks associated with discretionary transactions in own shares. The first refers to the generation of misleading signals as to volume, since such activity may give the appearance that the volume of a security's supply and demand exceeds that which would result from the free interplay of supply and demand. As a result, investors may be misled with respect to a security's liquidity due to the impossibility to determine the volume of supply and demand attributable to the issuer itself and that corresponding to market players.

The second risk refers to the possibility of producing misleading price information, which may lead to much more serious perturbations in the market. Trades in own shares by issuers or agents acting on their behalf may distort price discovery if they involve large volumes or are matched at prices which differ considerably from equilibrium.

Both types of misleading signals could be considered market manipulation in the terms of Act 24/1998, of 28 July, on the Securities Market and of European regulations, depending on their impact on volume and price.

Having consideration for the potential risks that improper discretionary transactions with own shares by listed companies pose to market integrity, and the growing importance of such integrity in the context of international competition between trading venues, the CNMV considers it appropriate to make a series of recommendations to securities issuers and financial intermediaries acting on their behalf in discretionary transactions with own shares.

These recommendations seek to contribute to proper price discovery while also enhancing market transparency and investor protection.

For these purposes, a discretionary transaction with own shares will be understood as the purchase or sale of own shares on official markets electronic trading platforms, multilateral trading systems or any other organised trading platform which is ordered by the issuer, directly or indirectly, except where such a transaction adheres to the stipulations under EC Regulation No 2273/2003 of 22 December, implementing Directive 2003/6/EC of the European Parliament and of the Council on exemptions for buy-back programmes and stabilisation of financial instruments, or to the provisions of CNMV Circular 3/2007, of 19 December, on liquidity contracts for the purposes of their acceptance as a market practice.

Transactions in shares of the issuer ordered by entities which are controlled by the issuer will also be considered as discretionary operations with own shares, as will block trades where the counterparty is unwinding a position established previously by means of trades in the market. However, block trades where the counterparty is not unwinding a position established previously by means of trades in the market will not be considered to be discretionary transactions with own shares.

These recommendations are primarily for issuers of listed securities; however, they should also be considered by Spanish investment firms and credit institutions, including subsidiaries of foreign institutions and branches of non-EU investment firms and credit institutions which perform transactions with own shares of issuers when considering the advisability of submitting to the CNMV a suspicious transactions report under the provisions of section 1 of article 83 quater of Act 24/1998, of 28 July, on the Securities Market.

The CNMV's recommendations to securities issuers and financial intermediaries acting on their behalf in discretionary transactions with own shares are as follows:

A) Recommendations related to the method by which a discretionary transaction in own shares is conducted:

- Volume:

The total daily volume of trades in own shares in the systems and markets where the transactions in own shares are performed, both purchases and sales, may not exceed 15% of the average daily volume of purchases executed in the 30 previous sessions in the order book facility (excluding the volume of the block and the special operations market) of the official secondary market in which the shares are listed. This limit may increase to 25% where the own shares acquired are going to be used as consideration for the acquisition of another company or in a swap as part of a merger.

- Price:

Buy orders should not be made at a price greater than the highest price between the last price traded in the market between independent parties and the price of the highest buy order in the market order book. In contrast, sell orders may not be executed at a price lower than the lowest price between the last price traded in the market between independent parties and the price of the lowest sell order in the market order book. In addition, the buy and sell prices should not create trends in the security's price.

- Time:

a) The issuer or intermediary acting on its behalf should not enter buy or sell orders during the opening or closing auctions, except where:

- i) The transaction carried out in those periods is exceptional and is duly justified, in which case extreme caution should be exercised to avoid having a decisive influence on the auction price. The cumulative volume of buy and sell orders may not exceed 10% of the theoretical volume resulting from the auction at the time those orders are entered. Additionally, except where warranted by exceptional circumstances, neither market nor limit orders should be entered in those periods.
 - ii) The issuer's shares are traded under the fixing system. In such case, the orders should be introduced sufficiently in advance of the auction outcome to enable other market participants to react to the orders entered. Additionally, except where warranted by exceptional circumstances, neither market nor at best orders should be entered in those periods.
- b) The issuer, or the intermediary acting on its behalf, may not trade in own shares during the period between the time that the issuer, in accordance with article 82.4 of Act 24/1988, of 28 July, on the Securities Market, decides to delay the disclosure of price-sensitive information, under its own responsibility, and the date on which that information is finally disclosed.
- c) Where trading is suspended, during the auction period prior to resumption of trading, the issuer or the intermediary acting on its behalf should not enter orders until trades in the share have been matched. Orders which have not been executed should be withdrawn.
- d) The issuer or intermediary acting on its behalf may not trade in own shares during the 15 calendar days prior to the publication of the financial information regulated under Royal Decree 1362/2007, of 19 October, which implements Act 24/1988, of 28 July, on the Securities Market, regarding transparency requirements in relation to information on issuers whose securities are listed on an official secondary market or on another regulated market in the European Union.

- Internal organisation and oversight:

- a) The issuer should ensure that the area of the company which manages trading in own shares is hermetically separated from the company's other activities. Also, a person should be appointed to manage transactions in own shares and such appointment should be disclosed to the CNMV.
- b) The person responsible for managing the issuer's transactions with own shares should submit a monthly disclosure on such transactions to the Audit Committee.

B) Recommendations in connection with disclosures on discretionary transactions with own shares to be provided to the supervisor and the market:

Issuers are recommended to disclose to the CNMV the identity of any investment firm or credit institution acting on their behalf in discretionary transactions with own shares and to submit the contracts signed with such intermediaries for the management of own shares.

Where the issuers have disclosed relevant information to the CNMV on the acquisition of, or merger with, another company and that transaction is going to be paid for partially or wholly with own shares, it is recommended that issuers observe the following disclosure guidelines:

- a) Prior to acquiring own shares, the issuer should submit the corresponding price sensitive information to the CNMV with the following information: the purpose of the purchases, the number of own shares to be acquired, and the time frame for completing such purchases.
- b) The issuer should make public, by means of a disclosure of a price sensitive information to the CNMV, the details of any transactions made with own shares by the end of the seventh trading day following the date of execution.

c) Where the acquisition of, or merger with, another company justifying the purchase of own shares is not completed, the issuer should make this public by submitting a price sensitive information to the CNMV and disclosing what it has done or plans to do with the own shares acquired.

It is recommended that issuers which are going to acquire own shares for use as consideration in the acquisition of another company or in a swap as part of a merger and has not submitted the corresponding price sensitive information should nonetheless submit the information under a), b) and c) above to the CNMV.