



Ref: CESR/07-402

## **Market Abuse Directive**

**Level 3 – second set of CESR guidance and  
information on the common operation of the  
Directive to the market**

### **FEEDBACK STATEMENT**

July 2007



## INDEX

- I Introduction.
- II What constitutes 'inside information' under the Market Abuse Directive.
- III When are there legitimate reasons to delay the publication of inside information.
- IV When does information relating to a client's pending orders constitute inside Information.
- V Insider Lists.

## I Introduction

1. On the 2<sup>nd</sup> of November 2006 CESR published a consultation paper entitled "Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the Market" (Ref CESR/06-562). Comments were invited by 2<sup>nd</sup> February 2007 and 35 responses were received from various trade associations representing sectors of the financial services industry as well as issuers' organisations, individual companies and other interested parties. Annex 1 contains a full list of respondents and the responses have been published on the CESR website. CESR is grateful to all those who commented on the draft guidance.
2. This feedback statement will set out the main points made by the respondents in the consultation process and explain the decisions CESR has taken in finalising the second set of guidance.
3. Before considering the detailed comments on the draft guidance we will deal with the more general points raised in the consultation exercise. Perhaps because the consultation followed CESR's Call for Evidence on the supervisory operation of the Market Abuse Directive (Ref. CESR/06-078), some respondents chose to include in their replies issues outside the scope of this particular consultation. In some cases these comments related to significant issues concerning interpretation of the Directive. CESR has decided that these wider matters are best considered in the context of the Call of Evidence and hence will not be addressed in this feedback statement.
4. In addition, a number of the responses which commented on the matters covered in the consultation paper raised issues which would have required further policy analysis and another round of consultation in order for CESR to produce proper guidance on these topics. Rather than delay finalising the second set of guidance these issues have again been left for consideration as part of the follow up to the Call for Evidence exercise. CESR wishes to make it clear that the second set of guidance is not necessarily the final word on the topics covered. It is possible that the Call for Evidence may result in a more fundamental review of any of these particular aspects of the Market Abuse Directive regime.
5. While most respondents to the consultation expressed the view the draft guidance CESR had produced was helpful, one group of trade associations commented that they were not convinced of the need for the further guidance CESR had produced and warned about the risk of over-regulation. They noted that it was important that the guidance should clearly explain its legal status as guidance.
6. Given that most respondents did welcome the guidance, CESR has decided to proceed to finalise and publish it. It is recognised that the guidance has no formal legal status. It is only intended to provide helpful clarifications as to be application of the provisions of the Level 1 and Level 2 measures not to extend their effect or in any way introduce further rules.
7. CESR's guidance, having been approved by CESR-Pol and the CESR Plenary, will be issued as "Market Abuse Directive: Level 3 – second set of guidance and information on the common operation of the Directive" and is being published simultaneously with this feedback statement.

## **II What constitutes 'inside information' under the Market Abuse Directive.**

8. The purpose of the guidance in this area is to clarify the operation of the various elements of the test under the Directive for when information constitutes inside information. The guidance also seeks to provide some purely illustrative examples of the type of information which may be inside information.
9. Although one respondent commented that they were not fully convinced that CESR's draft guidance was useful or added any real clarification, most respondents did consider it would be helpful. Many comments were made on the draft guidance. Some concerned points of detail on the drafting and CESR has reviewed the text to ensure the guidance is as clear as possible. The substantive issues raised on the guidance are discussed below.

### Information of a Precise Nature

10. Most respondents agreed with the view that, other than in exceptional circumstances, issuers are under no obligation to respond to rumours without substance. One respondent proposed that this should also be the case in respect of speculation (in the sense of conjecture without definite knowledge). This was considered to be a valid addition and the guidance has been amended accordingly.
11. It was also suggested that issuers should not have to respond to stories unless it was the issuer's own failure to ensure confidentiality of the information which has caused the rumour. However, CESR considers that, if a story does have substance, it would be taking too narrow an interpretation of the Directive to say that the issuer needs only to respond if it had caused the leak of information. In addition, the issuer may not know how the information has leaked. One respondent also asked for further guidance on what constitutes 'exceptional circumstances'. However, it was not considered possible to produce helpful elaboration on this term.
12. One respondent noted that issuers do have the right to delay announcing insider information in some circumstances and thought the examples of the scenarios given in this section of the guidance would fall into this category. It is the case that the examples given here are simply to illustrate the type of information which may be precise and do not imply that the information must always be announced immediately. The guidance has now clarified this point.
13. As regards whether information is specific enough to allow a conclusion to be drawn about its impact on prices, a number of respondents suggested the reference to allowing the reasonable investor to take an investment decision without (or at very low) risk should be clarified. The guidance here has therefore been expanded on this point.

### Make Public

14. As regards the means of making disclosures of inside information, one respondent suggested that it would be helpful if CESR could produce a list of the mechanisms recognised by CESR members. CESR will consider further the issue of producing a composite list of the mechanisms in each CESR member through which issuers should disclose inside information. Another respondent proposed that there should be a clear 'Home State' regime



as regards which disclosure mechanisms an issuer should use to disseminate information. CESR will consider this further but any solution must obviously be in accordance with other applicable Community legislation.

15. It was also suggested that the guidance should clarify that 'publicly available information' included information available on paid-for wire services such as Bloomberg, Reuters, etc. The guidance has been amended on this point: it is reasonable to include services which are available on payment of a subscription when considering the public availability of information.

### Significant Price Effect

16. In the context of the 'reasonable investor test' one respondent proposed that an issuer should consider the composition of its shareholder base when applying the test (for example, whether its shareholders included ethical investment funds). However, it was considered that this proposal would make the test too specific.
17. Two respondents commented on the question of the meaning of 'likely to have a significant effect on prices'. One thought that in this context 'likely' this should be interpreted to mean 'clearly probable'. The other suggested the test should be that it was beyond reasonable doubt there would be a significant price effect. However, in both cases these interpretations would involve a change to the meaning of the text of the Directive.
18. The draft guidance set out the view of CESR members that fixed thresholds of price movements or quantitative criteria were not suitable means of determining the significance of a price movement. One respondent considered that CESR should specify quantitative thresholds. However, CESR remains of the view that it is not possible to produce sensible quantitative thresholds which would apply in all circumstances: a given threshold for a 'blue-chip' security may be wholly inappropriate for a small, illiquid security.
19. As regards the indicators of whether information is likely to have a significant price effect, various respondents expressed concern that the factors listed in the draft guidance should not be treated as necessarily definitive in this respect. This was not the intention and the guidance has been redrafted to make this clearer. Another respondent questioned whether we should draw a distinction between different asset classes as regards what is likely to have a significant price effect. However, CESR remains of the view that it is a sensible distinction to draw.

### Examples of Possible Inside Information Concerning the Issuer.

20. The draft guidance included a list of examples of information which might constitute inside information. Various respondents commented that the guidance should make reference to the need to consider the materiality of the information in question. This is a valid point and the guidance has been amended.
21. There were also various suggestions for additions or amendments to the list. However, none of the suggestions put forward were considered to be clear cases for inclusion in to the list. In addition, it should be noted that the list is not intended to be comprehensive and should



only be considered an illustrative one. The examples have therefore been left largely unamended.

22. As regards inside information relating indirectly to issuers or financial instruments, some respondents argued that there should be no requirement on an issuer to have to disclose the consequences for them of an indirect piece of information which has been made public. It is recognised that issuers will not necessarily be aware of inside information which is in possession of other bodies and, even if they were, will not be in a position to announce it themselves. However, CESR considers that if an event once it has occurred produces significant consequences for an issuer, then the test for inside information could be met. The guidance has been redrafted to emphasise this point. In the illustrative list of examples of indirect information CESR has also taken into account the suggestion by one respondent to separate the reference to rating agencies' reports from that to more general research and recommendations.

#### Other issues

23. A number of respondents raised the question of inside information in relation to Special Purpose Vehicles admitted to trading on regulated markets and therefore brought within the scope of the provisions of the Market Abuse Directive. CESR wishes to consider the particular circumstances of these entities further before deciding whether to produce any specific guidance relating to them.

### III When is it legitimate to delay the disclosure of inside information

24. This section of the guidance deals with the provision of Article 6 (2) of the Directive concerning the circumstances in which issuers could delay disclosing inside information in order not to prejudice their legitimate interests. Respondents generally were content with the proposed guidance as far as it went, although there were a lot of suggestions for additional topics to cover. In particular, a number of respondents thought CESR should clarify what was meant by 'not misleading the public'. CESR will consider this issue as part of its future work rather than trying to cover in this current exercise as the provision of guidance on this subject would require a further round of consultation. However, CESR does think it worthwhile making clear that it does not agree with the argument that any delay in disclosing inside information must be likely to mislead the public and hence be incompatible with the requirements of the Directive.
25. A further proposal on the scope of the guidance in this area was that we should clarify what was meant by being able to ensure the confidentiality of inside information. CESR considers this requirement is self-explanatory and does not believe that further guidance can be usefully provided here. Finally, there were proposals that the guidance should provide additional examples of circumstances where it would be legitimate to delay the disclosure of inside information. However, CESR did not consider there were grounds for changing its position that it should not produce an extensive and wide list of the circumstances in which delaying disclosure was permissible should not be widened.
26. Other comments made on the draft guidance and CESR's responses are as follows:
- CESR should harmonise the approaches that regulators take on the issue of legitimate reasons to delay the disclosure of inside information so that there is a consistent approach in Europe. CESR considers that the production of the second set of guidance will help converge practice in this respect.
  - Issuers should document the reasons for delaying the disclosure of inside information. CESR does not consider that issuers should be under any obligation to do this but the guidance does now note the benefits of doing so.
  - One respondent questioned the proposition in the draft guidance that disclosure obligations should have priority over confidentiality agreements. However, CESR considers this is what the Directive requires: if the tests for delaying a disclosure are not met, then an issuer must disclose regardless of whether there are confidentiality agreements.
  - CESR should state that an issuer's decision to delay the disclosure of inside information was the only information to be transmitted to the competent authority. This comment relates to the question of what information an issuer should provide to its competent authority when delaying the disclosure of inside information. As such, it goes beyond the subject matter of the draft guidance and will fall to be considered in the Call for Evidence. CESR also notes that this is a requirement in some Member States but not all as a result of the option given to Member States in the MAD.
  - There were also calls that CESR should comment on the interaction between the insider trading regime and the regime governing mandatory disclosure of inside information by



issuers. This is a very significant subject which goes beyond the scope of the guidance consulted on and again would best be followed up as part of the Call for Evidence exercise.

- The existence of multiple hierarchical layers could justify a delay in announcing insider information when a decision-making process involved the controlling companies of the listed issuer. CESR does not support this: the relevant provision within the Directive confines itself to the situation within an issuer and CESR does not consider this should be extended.

- There was a call that it should be clarified that buy-back programmes should not be treated as insider dealing. Again this matter goes wider than the scope of the present consultation and will fall to be considered in the context of the Call for Evidence exercise.

- It was suggested that CESR should provide guidance on how issuers should behave during the period between the insider information arising and the issuer disclosing it. The guidance has been amplified to give some basic considerations to take into account on this point.

- The question was raised of what happens when issuers get inside information during non-business days. This point relates to what is meant by making disclosures as soon as possible and, as such, is better considered in a separate exercise.

#### **IV When does information relating to a client's pending orders constitute inside information?**

27. This section of the guidance was devoted to offering clarification on the circumstances when information conveyed by a client and related to the client's pending orders would constitute inside information (paragraph 3 of Article 1 (1) of the MAD). The consultation exercise revealed that there was general support for the guidance put forward by CESR.
28. The main dissenting voice came from one group of associations which disputed that pending client orders were inside information according to the Directive. They argued that since the Directive distinguished between a client's pending order and the information conveyed by a client which is related to that client's pending order, only the latter should be treated as inside information. The order itself would not be. This is an ingenious argument but CESR disagrees that a distinction can be drawn between what this group of associations described as 'true order data' and other information related to a client order. CESR considers that the Directive was intended to cover both. However, the guidance has been redrafted to follow more closely the wording used in the Directive itself.
29. Another respondent commented that there might be confusion between the concepts of a client's pending order and front running and asked CESR to be clearer about the distinction. CESR does not consider this point should be included in the guidance itself. However, in CESR's view, all dealing ahead of a client's order with the intention of exploiting its anticipated effect on the market to the disadvantage of the client would be front running. But not all client orders will be significant enough to meet the test for inside information. So an investment firm could front run its client without necessarily be committing insider dealing. On the other hand, all insider dealing by an investment firm ahead of executing its client's order on the basis of knowledge of that order would also be front running.
30. There were a number of comments that we should clarify what was meant by the term 'pending client order'. CESR agrees this would be useful and has expanded the guidance to cover this. In this context CESR has also taken account of a comment by another group of associations that merely polling for a price should not constitute an order.
31. Another proposal was that CESR should clarify that only suspicious pending client orders should be treated as inside information. CESR considers that this would result in far too narrow a test of what information relating to a client's pending order would constitute inside information and hence do not agree with the proposal. It is perfectly possible for a legitimate client order to be of such a size or type that it would be likely to have a significant effect on the price of the financial instrument in respect of which it was to be executed.
32. Another respondent raised concerns about what should happen if a firm got orders from other clients for the same security after it had received a significant order from another client. CESR considers that it is relevant to draw attention to Recital 18 of the Directive in this context. Hence the fact that a firm receives a big order to execute does not mean that it has to cease executing other orders it may receive until the big order is completed.
33. There were also some specific comments about the factors put forward in the guidance:



- One group of associations noted that orders displayed according to the rules of the market are made public and that information about them cannot be considered to be inside information. CESR did not agree with this comment. For example, the display of an iceberg order would not reveal the full extent of the order the firm had received and hence the full size of the order could not be considered to be public knowledge.
- As regards the factors which might be likely to make an order have a significant price effect, a comment was made that the identity of the investor was irrelevant as to whether the order was price sensitive. CESR disagrees: the identity of the investor can be a factor which moves markets.

## **V Insider lists**

34. This section of the guidance was intended to clarify the application of the requirement to keep insider lists when issuers were admitted to trading on regulated market in more than one member state and therefore potentially subject to different rules in this area. Again the draft guidance CESR tabled was generally welcomed, although there were plenty of suggestions for additions or variants to the proposal.
35. One respondent did, however, comment that the proposed approach was duplicative and did not follow the approach taken in the Prospectus and Transparency Directives – i.e. that the issuer would follow the rules of its home authority regardless of how many jurisdictions its shares were listed in. Other respondents also supported following the approach taken in the concept defined in the applicable Level 1 Transparency Directive. CESR notes that the Level 3 guidance it produces cannot go outside the framework set by the Level 1 and 2 Directives and that moving to the 'home authority' approach taken in other Directives would entail doing so. Hence the more fundamental change called for by various respondents will be considered as part of the follow-up to the Call for Evidence.
36. A number of respondents thought we should propose a standard harmonised format for insider lists, specifying the level of information required. CESR again considers that such suggestions are best taken as part of the Call for Evidence exercise. Another suggestion was that CESR should make mutual recognition of insider lists mandatory rather than just a recommendation – the purpose of this would be to give industry more certainty. However, CESR notes that it cannot mandate a course of action on its members and hence the mutual recognition of insider lists remains a recommendation rather than a requirement.
37. A number of respondents also thought that the mutual recognition approach should be applied to insider lists kept by advisers to issuers – so that an adviser followed its home country rules rather than those of the issuer for whom it was working. That way advisers working for issuers in a number of jurisdictions would not have to follow different insider list policies but could apply a standard approach. Again this suggestion would need to be taken forward in the Call for Evidence rather than the finalisation of the current guidance since it implies a change to the Directive.
38. There were some more detailed points raised. One respondent raised the question of when staff should be put on insider lists. However, this question is outside the scope of this guidance and would probably need to be the subject of a separate consultation exercise. Another respondent asked whether the competent authority needed to be informed of updates to insider lists on an ongoing basis or only on request. In this context CESR notes that the Directive contains no requirement to supply an insider list to a competent authority unless the authority requests it. The guidance has been expanded to clarify this point.

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ANNEX I: Respondents to the Consultation

Sector	Name
Banking	ABN AMRO Bank
Banking	Association of Foreign Banks in Germany
Banking	BBA and ICMA
Banking	European Banking Federation
Banking	European Savings Banks Group
Banking	Fédération bancaire française
Banking	Spanish Banking Association
Banking	Zentraler Kreditausschuss
Credit Rating Agencies	Moody's Investors Service
Individuals	Università L. Bocconi Milano
Insurance, pension & asset management	Assogestioni
Insurance, pension & asset management	Hermes Investment Management Ltd
Insurance, pension & asset management	Investment Management Association
Investment services	AFEI
Investment services	ANASF
Investment services	APCIMS
Investment services	ASSOSIM
Investment services	EFFAS
Investment services	ISDA
Investor relations	CLIFF
Investor relations	Test-Achats
Issuers	Association of Stock Exchange Issuers
Issuers	Assonime
Issuers	EALIC
Issuers	MEDEF
Issuers	Quoted Companies Alliance
Issuers	Royal Dutch Shell plc
Others	ADVISORY COMMITTEE OF THE SPANISH SECURITIES REGULATOR
Others	AMF, Euribor, FASD, FOA, NSDA, LIBA, SSDA
Others	Association Française des Entreprises Privées (AFEP)
Others	Eumedion
Others	University of Copenhagen
Regulated markets, exchanges & trading systems	Borsa Italiana
Regulated markets, exchanges & trading systems	Euronext
Regulated markets, exchanges & trading systems	Federation of European Securities Exchanges (FESE)

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