



COMMITTEE OF EUROPEAN SECURITIES

Ref: CESR/02.089d

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

DECEMBER 2002



Index

Preliminary Remarks from the Chairman

Introduction Paragraph 1

Inside Information Paragraph 14

Market Manipulation Paragraph 37

Definition of Financial Instrument Paragraph 51

Appropriate public disclosure of
inside information by issuers Paragraph 52

Article 6 (5) Research Paragraph 73

Article 8 Safe Harbours - Share Buy-Backs Paragraph 106

Stabilisation Paragraph 127



I Preliminary remarks by Stavros Thomadakis, Chairman of the CESR Expert Group on Market Abuse

On 27 March 2002, the European Commission requested CESR to provide technical advice on possible implementing measures in connection with certain aspects of the Directive on Insider Dealing and Market Manipulation (Market Abuse). This was the first time the Commission had invoked the new Lamfalussy procedure, with its four-level legislative process designed to improve the development of securities legislation in the EU. For its part, CESR has been closely guided by the Lamfalussy level 2 concepts in taking this work forward.

CESR presents here its final advice to the European Commission in response to the mandates received. The efforts of all parties involved in this work have been exemplary. In particular, CESR Members who participated in the deliberations of the Expert Group have shown great commitment in forging consensus. Similarly, the contribution at each stage of the consultation process of market participants and other interested parties, has been valuable in reaching common solutions.

From a European perspective, this work represents a very good example of a level 2 framework against market abuse. Despite the fact that some regulatory differences may still persist in the various jurisdictions, CESR has sought in its advice to assemble all indispensable elements for an efficient European regulatory framework, and to achieve harmonization. In meeting precisely these objectives, I believe the final advice represents a finalized high quality outcome in response to the mandate received.

II INTRODUCTION

1. On 1st July 2002 CESR initiated a consultation process on its proposed advice to the European Commission regarding technical implementing measures for the draft directive on insider dealing and market manipulation (market abuse). Following a number of stages, the advice is now in its final form. This introductory section explains the process which CESR has followed in arriving at its final advice.

Background

2. On 27th March 2002, the Commission published its *Provisional Request for Technical Advice on Possible Implementing Measures on the future Directive on Insider Dealing and Market Manipulation*. The Commission asked CESR to deliver its technical advice by 31st December 2002.
3. CESR published a Call for Evidence on 27th March 2002, (Ref: CESR/02-047) inviting all interested parties to submit views by 26th April 2002 on what CESR should consider in its advice to the Commission. CESR received around ten submissions from trade associations representing banks, issuers and investment firms, as well as a number of submissions from individual organisations. The issues covered by these submissions were taken into account in the preparation of the consultation document.
4. CESR's 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, has been responsible for the drafting of the consultation paper and the development of the technical advice in response to consultation.
5. 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. The CESR Expert Group held three meetings with the CWG and also received written comments from CWG members during the preparation of the consultation paper and the final paper. 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".

6. Following publication of its consultation paper setting out its proposed advice, CESR gave market participants and other interested parties a deadline of 30th September to comment. To facilitate the process, CESR held an initial open meeting on 6 September in London for a preliminary exchange of views. In addition, a number of bilateral meetings were held between CESR and individual industry representatives to discuss specific aspects of the proposals. Two meetings between the Expert Group and representatives of the media were also held to discuss CESR's proposals on research. A number of jurisdictions also held national open hearings.
7. Over 100 responses were received in response to the consultation by the closing date. These came from both European and national federations, representing financial services providers, as well as individual banks, investment services firms, asset managers, regulated markets and exchanges, financial analysts and rating agencies. These groups accounted for well over half of all responses received, but there was also considerable input from issuers, investors' representative groups, academics, lawyers and the media. The number of responses varied per country, with some countries channelling the majority of their input through a small number of national federations, while others had a greater mix of federations and individual responses. Six responses were received from European federations. All responses which are public can be viewed on the CESR website.
8. The Expert Group carefully considered all comments received and, throughout October and early November, worked on redrafting the consultation paper. On 21 November, CESR held a further open meeting with market participants to discuss its proposed modifications to the original advice. For this purpose, CESR had previously circulated the draft working papers of its final advice. These redrafts took into account a significant number of comments received

by respondents, where these appeared to CESR to raise valid regulatory concerns. Points which were not accepted, as well as the rationale for those which were accepted, were discussed in a preliminary feedback statement.

9. Following this meeting, a number of further written contributions were submitted by those attending and final modifications were made to the revised advice. A final feedback statement will be published to supplement the original statement and explain any further changes which have occurred.

Next Steps

10. CESR has now completed its consideration of comments received in the course of the second wave of consultation and its proposed final advice is set out in the remainder of this paper. It covers the five substantive areas as set out in the Provisional Mandate:

- 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

References

11. In taking this work forward, CESR has had regard to a number of factors. Firstly, 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 23rd March 2001 (the "Stockholm Resolution"); and
- The Parliament's Resolution on the implementation of financial services legislation (5th February 2002) and the Commission's formal declaration in response.

12. Secondly, a number of relevant papers in this area previously published by CESR have been taken into account in the development of the advice. These are as follows:

- *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. Finally, 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)

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

14. 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.
15. 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.
16. 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.

17. 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

18. 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

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

The underlying matter or event to which the information refers 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 its impact on prices.

Additional guidance

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

- A matter or an event is true when it is based on firm and objective evidence, which can be communicated accurately (as opposed to rumours), 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 precise information and therefore could be inside information, unless it consists only of rumours;
- The referred matter or event could become true in the future: contingencies relating to the actual occurrence of the referred matter or 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 its impact on prices, either when it would enable a reasonable 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 matter or event and some of them are not precise, could be considered precise as far as it concerns precise matters or events. For instance, a take over bid can be considered as precise information and 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 matters or events that could be alternatives. For instance, the matter or event that concerns a take over bid on one out of two companies can be considered precise information and therefore could be inside information. An investor could abuse of this information by trading in shares of the two companies.

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

21. 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.
22. 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.
23. 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.
24. 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.

25. 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.
26. 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. In this context, it is therefore irrelevant whether or to what extent the price actually changes when the information eventually becomes publicly known. This does not preclude the fact that the actual impact on prices might be relevant as an indicator for the investigation of a possible infraction.

Level 2 advice

27. 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 a reasonable investor¹ in the given circumstances would be likely to take into account for his investment decision. This assessment should be made ex-ante, in order to determine the likelihood of a price moving effect and ought to take into consideration the following factors:

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

Additional guidance

28. 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:

¹ A reasonable investor is a person that thinks and behaves in a rational way.

- The type of information is the same as information, which has, in the past, had a significant effect on prices;
- Pre-existing 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.

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

29. 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.
30. 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.
31. 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.
32. 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

33. There should be no level two measures in this area.

Additional guidance

34. 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.

35. Information, which directly concerns the issuer:

- Changes in control and control agreements;
- Changes in management and supervisory boards ;
- 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;
- Changes in expected earnings or losses;
- Relevant orders received from customers, their cancellation or important changes;
- 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

36. The following list comprehends examples, which would usually only concern the issuer **indirectly**. These examples are also an indicative and non-exhaustive list, to which the test described in point 46 should also be applied, in order to determine whether they might constitute inside information. It should be noted that, in the case of these examples being inside information, 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 disclosure requirement in article 6 applies to the disclosure of the consequences, which directly concern the issuer, resulting from the examples like the ones listed below provided these consequences constitute inside information.

- Data and statistics published by public institutions disseminating statistics;
- The coming publication of rating agencies' reports, 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;



- Relevant orders by government bodies, regional or local authorities or other public organizations;
- 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

37. 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.
38. 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. For that reason this paper sets out in part 1 factors offering an indication of possible false or misleading signals or supporting the price to an abnormal or artificial level. These factors are components which 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 just as the orders and transactions which the factors refer to can be given and undertaken by a single person or persons acting in concert or collusion.
39. All factors give stronger indications when the entities or the persons involved are the most likely to obtain benefits from market manipulation, for instance issuers and associated persons in advance of a significant event, decision, contract or contract completion, investment firms with significant commercial or investment banking interest with the issuer or anyone with a significant position in the concerned financial instrument.
40. 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: Usual and 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.
41. 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.
 42. Prior to the regulator's possible scrutiny of cases of market abuse indicators of manipulative behaviour often occur. Such indicators could be characterized as 'diagnostic flags' in the sense that they indicate behaviour that could lead to the regulator's further scrutiny. CESR believes that regulatory guidance is important in this field but also that it should be left to level 3 for regulators to issue guidance and rules concerning 'diagnostic flags'.
 43. 'Diagnostic flags' could be sudden and unusual significant changes in the price of a financial instrument or unusual concentration of transactions in a small number of brokers or clients; unusual concentration of transactions with one or more institutional investors affiliated with an issuer; unusual repetition of transactions among a small number of persons over a period of time (days or weeks).
 44. While these 'diagnostic flags' often will occur after a transaction has been executed and are likely to lead to regulatory scrutiny the factors set out in the level 2 advice below are factors which need to be taken into account by market participants in advance of entering into transactions to determine whether orders given or transactions undertaken are likely to give rise to false or misleading signals, or secure the prices at abnormal or artificial levels.
 45. This part of the consultation paper does not entirely follow the approach of the Provisional Mandate which requests advice divided into three parts as it has been considered more appropriate to give advice to the two first requests jointly due to their close relationship. However, there might be a degree of overlap between the pieces of advice given in the two parts due to the subject matter.

PART 1

Factors which need to be taken into account in deciding a) 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; b) 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

46. CESR is aware of the fact that the proposed directive lays down a 'defence' in the part of the definition on market manipulation regarding the transactions or orders to trade discussed in part 1 of this part of the paper. The defence implies that the transactions or orders to trade in question will not be regarded as manipulative behaviour if "...the person who entered into the transactions or issued the orders to trade establishes that his reasons for so doing are legitimate and that these transactions or orders to trade conform to accepted market practices on the regulated market concerned."

Level 2 advice

47. *The factors set out are by no means exhaustive and will not be conclusive as to whether particular conduct amounts to market abuse. In addition the presence of one or more of the factors would not automatically mean that the transactions or orders to trade would constitute market manipulation.*

The factors are:

- *The extent to which orders given or transactions undertaken represent a significant proportion of the daily volume of transactions in a financial instrument, in particular when these activities lead to a significant change in the price of the financial instrument.*
- *The extent to which orders given or transactions undertaken by persons with a significant position (long or short) in a financial instrument lead to significant changes in the price of the financial instrument or related derivative or underlying asset.*
- *Whether orders given or transactions undertaken lead to no change in beneficial ownership of the financial instrument or which reallocate holdings among associated companies within a corporate holding.*
- *The extent to which orders given or transactions undertaken include position reversals in a short period and represent a significant proportion of the daily volume, and/or are associated with significant changes in the price of a financial instrument.*
- *The extent to which orders given or transactions undertaken are concentrated within a short time span in the trading session and lead to a price change which is subsequently reversed.*
- *The extent to which orders given 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 are removed before they are executed.*

- *Whether the systematic purchase or sale of a financial instrument affects the price, but is simultaneously counteracted by transactions in other markets that have no equivalent impact on the price of the financial instrument.*
- *The extent to which transactions when undertaken at or around a time when prices are calculated lead to price changes which have an effect on the said reference prices, settlement prices and valuations.*

PART 2

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

48. 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 including the Internet. Therefore, this category must remain open to the individual evaluation of possible infractions.
49. It should be stressed that the proposed directive does not lay down any 'defense' regarding transactions or orders to trade treated in this part of the paper.

Level 2 advice

50. *The factors are:*

- *Whether false or misleading disclosure by issuers or other participants is preceded and/or followed by transactions by the same or associated persons.*
- *Whether trading is undertaken by persons, and associated persons, who produce research reports which are erroneous or biased and demonstrably influenced by material interest.*
- *Whether misrepresentation by market participants about an issuer's business or its sector occurs at the time of or prior to the same participants dealing in the issuer's financial instrument. For example giving out "good" (but misleading) signals before selling and "bad" (but misleading) signals before buying.*
- *Whether there has been misrepresentation of the strategy of large market participants (e.g. institutional investors) with respect to a financial instrument or group of financial instruments.*



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

51. *All financial instruments admitted to trading on a Regulated Market or for which a request for admission to trading on such market has been made should be included within the list of financial instruments.*

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

52. 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.).
53. 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.
54. For the purpose of the fulfilment 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).
55. 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).
56. 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.

Level 2 advice

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

For the purpose of article 6/1 of the Directive, 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.

Issuers should not use the officially appointed mechanisms for marketing purposes.

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

58. 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, how to ensure disclosure as synchronised as possible in all of the jurisdictions of all regulated markets where an issuer has requested that its financial instrument be admitted to trading, etc.
- Who is responsible for its management;
- How to ensure that the information disseminated through it is not mere publicity statements, etc.

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

Explanatory text

59. 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.

60. However, CESR believes 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

61. There should be no level two implementing measures.

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

Explanatory text

62. 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.
63. 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.
64. 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.
65. 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 matter or event occurs, regardless of whether it is already formalized. In any case, disclosure should allow complete and correct assessment of the information.

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.

Disclosure should be up-dated through the same mechanism, as soon as any relevant changes in the disclosed inside information occur.

66. 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.

67. 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

68. In advising the Commission on this particular point, there was the alternative that CESR provides 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.

69. 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

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

- 1) *Matters in course of negotiation: it could be justified to delay disclosure when disclosure would be likely to affect the conclusion of a deal or the normal course of negotiations;*
- 2) *In the event that the existence of the issuer is endangered, although not within the scope of the applicable insolvency law, information may be delayed where disclosure would seriously jeopardise the interest of existing or potential shareholders by undermining the conclusion of specific negotiations designed to ensure the financial recovery of the issuer;*
- 3) *Where, in a two-tier company organization system, a decision or contract made by the Management Board needs approval or requires the consent of the Supervisory Board in order to become effective, disclosure may be delayed until the approval has been given by the Supervisory Board, when disclosure before the approval would jeopardise the correct assessment of information by the public;*

Additional comment

71. It should be noted, on one hand, that the examples stated above do not automatically allow the issuer to delay disclosure: in all the situations, a further evaluation should be done to decide

whether the other conditions in article 6/2 apply. On the other hand, these examples constitute a non-exhaustive list, which means that the issuer can delay the disclosure of information in other situations, provided the conditions in article 6/2 of the Directive apply.

Level 2 advice

72. 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 (5) 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

73. 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”.
74. Because of its broad scope in terms of the persons subject to its provisions, article 6(5) of the Directive 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(5), 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.
75. Furthermore, the role that self-regulatory rules can play in satisfying the directive’s requirements for journalists who produce or disseminate research or other information recommending investment strategy is particularly emphasised in Article 6 (10).
76. It is for the Member State to be satisfied that the level 2 measures established by the Commission, following receipt of CESR’s advice, are implemented in the most appropriate way. In establishing its advice, CESR has sought input from a wide range of professions to ensure that its advice on level 2 is compatible with Member States’ freedom to choose mechanisms of self-regulation to ensure appropriate implementation. During this process, CESR has identified that within the EU, there are many different standards of fair presentation and disclosure that apply. CESR understands that Article 6 (5) has as an objective a more common approach within the EU.

Explanatory text

77. CESR's consultation on Article 6(5) has identified many issues relating to the scope of the Article. CESR has therefore concluded that it needs to be more explicit on the issue of scope to avoid misunderstanding of the advice it proposes. To this end, CESR sets out its understanding of the different terms used in Article 6 (5). It is on the basis of this understanding, that CESR proposes its advice to the Commission.

- **Research and other information recommending or suggesting an investment strategy:** information produced by independent analysts or by an investment firm/credit institution/rating agency or an individual employed by them that expresses (e.g. "buy" or "hold" or "sell" or equivalent) or implies (e.g. by reference to a price target for example) an investment recommendation in respect of a financial instrument or an issuer, as well as, information produced by others apart from investment firms/credit institutions/rating agencies or individual(s) employed by them that expressly recommend that a person should buy, sell or hold a financial instrument.
- **Distribution channel:** A channel through which information is, or is likely to become, publicly available. Where the information is distributed to a large number of persons, it should be presumed to be likely to become publicly available.

78. In order to clarify the proposed level 2 measures, CESR is working with the following definitions:

- **Relevant Information:** Research or other information suggesting or recommending an investment strategy that is intended for distribution channels or for the public.
- **Relevant Persons:** All natural or legal persons producing or disseminating Relevant Information in the exercise of their profession or the conduct of their business.
- **Relevant Issuer:** Any issuer that is the subject of Relevant Information.

79. CESR advises the Commission to differentiate between the producers of Relevant Information and disseminators of Relevant Information. However, the core standard below should apply to all Relevant Persons. Furthermore, to take into account the mandate's requirement to have regard to the profession concerned, CESR advises establishment of basic rules applicable to all followed by more specific rules relating to certain professions.

80. CESR considers that Article 6 (5) applies to Relevant Information either in written (or electronically equivalent) form or other forms, (e.g. information provided during a public appearance radio, television, "roadshows" and other meetings with potential investors). The level 2 implementing measures should be appropriately adapted to such circumstances and to the medium of communication used.

81. CESR considers that the level 2 implementing measures should be appropriately adapted to Relevant Information on all types of financial instruments.

82. CESR further considers that, without prejudice to the provisions of Article 1(2) third indent, Article 6(5) should not apply to brief, short-term investment recommendations originating from the sales or trading staff of an investment firm or credit institution provided that such recommendations are unlikely to become publicly available.

Level 2 advice

Core standard

83. *Reasonable care must be taken in the presentation of Relevant Information to ensure high standards of fairness, integrity and transparency. In particular, reasonable care must be taken to ensure that the Relevant Information is accurate, clear and not misleading and that any recommendation can be substantiated as reasonable. The interests and conflicts of interest that may impair the objectivity of the Relevant Information must be appropriately disclosed.*

A) Producers of Relevant Information

Level 2 advice

Identity of the producer:

Basic rule

84. *The identity of the producer of the Relevant Information should be indicated clearly and prominently. The name(s) and job title(s) of the individual preparer(s) of the information, in addition to the name of the legal entity involved, should be indicated.*

Specific rules

85. *Where the Relevant Person is an investment firm or credit institution, the identity of their regulator should also be indicated.*
86. *Where the Relevant Person 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.*

Presentation of the Relevant Information

Basic Rule

87. *All Relevant Persons, other than those financial journalists who are subject to an appropriate and equivalent self-regulatory regime, should take reasonable care to ensure that:*

- *facts are clearly distinguished from interpretations, estimates, opinions and other types of non-factual information;*
- *all sources are reliable or that, where a source is not considered reliable, this is indicated if the information is nevertheless included;*
- *all projections, forecasts and price targets are clearly labeled as such and the material assumptions made in using them are indicated.*

Specific Rules

Presentation of Relevant Information: investment firms, credit institutions and credit rating agencies

88. *In addition to the above, the Relevant Persons should take reasonable care to ensure:*

- *that all substantially material sources are indicated, where appropriate;*
- *that any basis of valuation or 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 category assigned (e.g.Aaa etc) or recommendation (e.g. “buy/hold/sell) made, including the time horizon of the investment to which the rating or recommendation relates, is adequately explained and any appropriate risk warning (including sensitivity analysis of the relevant assumptions) indicated;*
- *that reference is made to the planned frequency, if any, of updates of the Relevant Information and to any major changes in the coverage policy previously announced (e.g. a decision to stop coverage);*
- *that the date at which the Relevant Information was first released for distribution is indicated clearly and prominently, as well as the relevant date and time for any financial instrument price mentioned;*
- *that the most recent change in recommendation or rating issued, if such change occurred over the previous twelve months, is indicated clearly and prominently;*

89. *Where the inclusion of the first three items above would be disproportionate in relation to the length of the Relevant Information distributed, it will suffice to post them on an appropriate website of the Relevant Person provided that the Relevant Information clearly and prominently refers investors to this source and that there has been no change in the methodology or basis of valuation used.*

Disclosure of interests and conflicts of interests

Level 2 advice

Basic rule

90. *Where the Relevant Person - 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 other material conflict of interest with respect to a Relevant Issuer, the nature of such interest or conflict or*

control relationship with respect to the Relevant Issuer should be appropriately disclosed so as to ensure an evaluation of 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. In all cases, those producing Relevant Information should disclose publicly significant holdings in the financial instrument subject of the Relevant Information.

Specific rules

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

91. *Where the Relevant Information is produced by an investment firm or credit institution (including any affiliate of such persons), the disclosures described in the following paragraphs regarding interests and conflicts of interests with respect to the Relevant Issuer (including any affiliate of the Relevant Issuer) should be made clearly and prominently.*
92. *Major shareholdings that exist between the investment firm/credit institution and the Relevant Issuer should be publicly disclosed. At the very least it should be disclosed where:*
 - *shareholdings exceeding 5% of the total issued share capital in the Relevant Issuer are held by the investment firm/credit institution*
 - *shareholdings exceeding 5% of the total issued share capital in the investment firm/credit institution are held by the Relevant Issuer.*
93. *Other significant financial interests held by the investment firm/credit institution in relation to the Relevant Issuer should be publicly disclosed.*
94. *The following other significant relationships between the investment firm/credit institution and the Relevant Issuer should be publicly disclosed :*
 - *Where the investment firm/credit institution is a market-maker or liquidity provider in the financial instruments of the Relevant Issuer;*
 - *Where the investment firm/credit institution has been lead manager or co-lead manager over the previous twelve months of any publicly announced offering of financial instruments of the Relevant Issuer;*
 - *Where the investment firm/credit institution is party to any other agreement with the Relevant Issuer relating to the provision of material investment banking services, provided however that this would not entail the disclosure of any confidential information and the agreement was in effect over the previous twelve months or gave rise to compensation received over the same period;*
 - *where the investment firm/credit institution is party to an agreement with the Relevant Issuer relating to the production of the Relevant Information.*

95. *The disclosures required in the above three paragraphs should be included in the Relevant Information itself. Where the inclusion of these items would be disproportionate in relation to the length of the Relevant Information distributed, it will suffice to post them on an appropriate website of the Relevant Person provided that the Relevant Information clearly and prominently refers investors to this source.*
96. *The general nature of the policies and procedures within the investment firm or the credit institution regarding reporting structures and avoidance and management of conflicts of interests, including information barriers (Chinese walls), with respect to Relevant Information, should be disclosed.*
97. *Significant interests held in the Relevant Issuer or in the financial instruments subject of the Relevant Information by the individual(s) having prepared the Relevant Information as well as material conflicts of interest if they exist, should be publicly disclosed. This would include, in particular, the fact that the remuneration of such individual(s) is tied to investment banking transactions performed by the investment firm/credit institution. In addition, where this individual receives or purchases the shares of the Relevant Issuer prior to an initial public offering of such shares, the required disclosure must also include the price at which the shares were acquired and the date of acquisition.*
98. *The investment firm/credit institution should disclose the proportion of all recommendations that are “buy”, “hold”, “sell”, etc, as well as the proportion of Relevant Issuers corresponding to each of these categories to which the investment firm/credit institution has supplied material investment banking services over the previous 12 months. These figures should be current as of the previous end of quarter.*
99. *The disclosures required in the last three paragraphs should be publicly disclosed on an appropriate website of the investment firm/credit institution provided that the Relevant Information clearly and prominently refers investors to this source.*

B) Dissemination of Relevant Information produced by a third party

Level 2 advice

Basic rules

100. *The identity of the Relevant Person disseminating Relevant Information produced by a third party should be indicated clearly and prominently.*
101. *Relevant Persons who disseminate Relevant Information produced by a third party in unaltered form, regardless of whether such Relevant Information has been distributed previously, should take reasonable care, in the context of the role they assume with respect to this information, to ensure that the rules relating to the identity of the producer and the presentation of this information (basic rules 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.*

102. *Where disseminators alter the Relevant Information in a substantial manner they should clearly and conspicuously indicate such alteration in the Relevant Information that they disseminate. Furthermore, they should comply with the basic rules applicable to producers of such information to the extent of such alteration.*
103. *Where disseminators summarise or make substantive reference to Relevant Information produced by a third party, they should ensure that the summary or this reference is clear and not misleading. They should also indicate how the source document and disclosure of interests or conflicts of interests of the third party can be obtained or accessed provided that such information is publicly available.*

Specific rules

104. *Where the disseminator is an investment firm or credit institution that alters the Relevant Information in a substantial manner such persons should in addition comply with the specific rules applicable to producers of such information to the extent of such alteration.*
105. *Where the disseminator of unaltered information is an investment firm or credit institution:*
- the Relevant Information must indicate the name of the disseminator's regulator;*
 - in the event that the Relevant Information has not been broadly distributed before, all of the disclosure requirements for a producer of Relevant Information apply to the disseminator as well.*

VI. Article 8 SAFE HARBOURS – Share Buy-backs

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).

Introduction

106. At level 1, the directive establishes a safe harbour for trading in own shares under “buy back” programmes. If this trading is undertaken in accordance with the level 2 implementing measures, then the prohibitions in the Market Abuse Directive will not apply.

107. 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.

108. 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.

109. CESR is particularly mindful that the safe harbour is only available for the purpose of trading in own shares under a buy back programme that meets the conditions set out below. Therefore behaviour undertaken for other purposes will have to be undertaken in a manner that does not contravene the prohibitions of the directive.

110. Under the Second Company Law Directive (77/91/EEC), member states have discretion as to whether a company may buy-back its own shares. If a member state permits this activity, then certain conditions are set out in that directive. Any buy-back that benefits from the safe harbour must therefore be undertaken in accordance with that directive.
111. 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.
112. 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. CESR has received representation that debt buy-backs should be brought within the scope of article 8. CESR does not have the power to extend the safe harbour in such a fashion. Debt buy-backs will therefore have to be undertaken in a manner that does not contravene the prohibitions of this directive.
113. The scope 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:
- Buy backs of 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).
 - Buy back programmes involving more than 10% of the subscribed capital.
 - The execution and performance of liquidity agreements entered into by an issuer with investment firms.
 - Other activities involving the sale of own shares.
114. While the activities mentioned above are outside the scope of article 8, there is no presumption that such activities are abusive. These activities will however have to be undertaken in a manner that is consistent with the rest of the directive.
115. CESR has in particular received many representations seeking the inclusion of sales of own shares within the scope of the safe harbour. CESR’s understanding of the scope of the article precludes such a possibility as it only refers to buy-back programmes. Furthermore, CESR would endorse such a narrow scope as it does not seem appropriate to offer issuers a safe harbour under article 8 when the issuer itself is both a buyer and a seller of its own shares. While such activity is common practice in many European jurisdictions, the activity generally

does not benefit from such a safe harbour and, in the event of market abuse occurring, Competent Authorities have the power to investigate and sanction abusive behaviour. In other words, in jurisdictions where sales are permitted, there is no presumption that such activity is abusive.

116. CESR is therefore 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. CESR is of the view that if sales were to occur, purchases under the buy-back programme would no longer benefit from the safe harbour. CESR recognises however that the loss of flexibility to manage their capital needs resulting from this decision has a cost for issuers. CESR is therefore proposing that the benefits of the safe harbour can be maintained in certain circumstances.

117. CESR believes that regulated market transactions, and non regulated market transactions where permitted, should be allowed for the purchase of shares under a programme. This will allow for better management of the purchase programme. However, CESR recognises that there are risks in terms of creating false markets and obstructing transparency. Consequently CESR is proposing price and volume restrictions coupled with disclosure requirements to be applied to all buy back transactions within the safe harbour.

Level 2 advice

118. *The safe harbour covers:*

(1) the buying back of shares for the purposes of reducing the capital of an issuer;

(2) the buying back of shares to meet obligations arising from debt financial instruments exchangeable into equity instruments;

(3) fulfilling obligations arising from employee share option programmes and other allocations of shares to employees.

119. *Share buy-backs must be undertaken in accordance with the second Company Law Directive (77/91/EEC).*

120. *The programme must have been approved in a general meeting of the holders of the shares.*

121. *Prior to the start of trading, full details of the programme must be published through an officially appointed mechanism in the jurisdictions in which an issuer has requested that its shares be admitted to trading on a regulated market. These details must include the purpose of the programme the maximum consideration, the maximum number of shares to be bought and the duration of the programme which cannot exceed 18 months. All subsequent changes to the programme must be published through the same officially appointed mechanism(s).*

122. *The issuer must have in place the mechanisms necessary to ensure that it is able to fulfil trade reporting obligations to the relevant competent authority and/or market. The system must be capable of providing at least the information set forth in article 20 (1) of the Investment Services Directive (93/22/EEC).*

123. *No more than 10% of the subscribed capital can be bought back.*

124. *When executing trades under the programme, an issuer;*

a) may not purchase shares at a price higher than either the price of the last independent trade or the current independent bid. In the case where the issuer buys back its shares by use of derivatives (whether by selling a put option, buying a call option, entering into a forward purchase or otherwise), the strike price shall not be above either the price of the last independent trade or the current independent bid;

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:

either

published at the time the programme is announced and should be based on the average daily volume traded in the 20 trading days preceding the announcement of the programme;

or,

if not announced with the programme, be based on the average daily volume traded in the 20 trading days preceding the date of purchase.

However, in the event that exceptional reasons exist (e.g. due to the low level of transactions) the issuer may deviate from the above mentioned 25% limit providing the issuer:

a) informs the Competent Authority in due time of its intention to deviate from the 25% limit, and

b) publishes its intention to deviate from the 25% limit through the officially appointed mechanism(s) used to announce the programme,

c) does not exceed 50% of the average daily volume.

125. *The issuer, in order to benefit from the safe harbour:*

(1) must not sell any own shares during the life of the programme;

(2) must not trade during closed periods in those jurisdictions that have closed periods;

(3) must not trade when the issuer decides to delay the publication of inside information as set out in article 6(2) of the directive.

The above restrictions do not apply if:

a) The buy-back programme is lead managed by an investment firm which makes its dealing decisions in relation to the issuer's shares independently of, and without influence by, the issuer with regard to the timing of the purchases.

- b) the issuer has in place a “formulaic” buy back programme. “Formulaic” means a programme where the date and quantity of purchases is set out at the time of the announcement of the programme (e.g. 1000 shares every 3rd Friday of the month for 6 months).*
- c) the issuer is an investment firm or credit institution and has in place policy and procedures to ensure that effective information barriers (Chinese Walls) exist between those responsible for the handling of inside information and those responsible for executing client orders.*

Restriction (1) above does not apply if:

the issuer is an investment firm or credit institution and has in place policy and procedures to ensure that effective information barriers (Chinese Walls) exist between those responsible for the purchase decisions under the buy back programme and all other decisions relating to the trading of own shares.

Additional Guidance

- 126. Ex-post disclosure:** Before the market opens, the issuer must disclose to the market details of all trading under a buy back programme undertaken during the previous trading day.

Stabilisation

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 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

127. At level 1, the directive establishes a safe harbour for Stabilisation. If Stabilisation is undertaken in accordance with the level 2 implementing measures, then the prohibitions in the Market Abuse Directive will not apply.

128. 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.

129. 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.

130. CESR is particularly mindful that the safe harbour is only available for activity that is directly linked to the purpose of Stabilisation as set out in the conditions below. Therefore behaviour undertaken for other purposes will have to be undertaken in a manner that does not contravene the prohibitions of the directive.

131. The advice set out in this paper draws heavily on the recently finalised CESR Paper “Stabilisation and Allotment – a European supervisory Approach” (ref CESR 02-020b). 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.

132. As set out in the CESR Paper, Overallotment Facilities and Greenshoe Options as well as the establishment of a short position during allotment are closely related to Stabilisation, by providing resources and a hedge respectively for Stabilisation activity. Such transactions can be part of a specific safe harbour providing the level 2 measures applicable to these transactions are followed.

Explanatory text

133. In the event that the Relevant Securities or Associated Securities are also traded on a third country exchange, any Stabilisation undertaken in that third country jurisdiction will benefit from the safe harbour providing that the trading is undertaken in accordance with the level 2 implementing measures. In order to ensure the international competitiveness of EU markets, CESR would advise the EU Commission to explore whether the rules of third countries or of their exchanges can be recognised as equivalent to the EU rules.

Level 2 advice

134. ***Stabilisation*** –refers to 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. Activity that is not directly linked to this purpose will not benefit from the safe harbour.

135. *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.*

136. *Stabilisation must be undertaken in accordance with the following conditions.*

137.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, in a jurisdiction that permits trading prior to the commencement of trading on a Regulated Market (i.e. when issued trading), 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 is undertaken subject to the rules, including disclosure and trade reporting, of the Regulated Market on which the Securities are to be admitted to trading.*

(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 instruments 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 instruments received the proceeds of the issue, or if earlier than that, ending no later than 60 days after the date of Allotment*

138.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

Stabilisation may only be undertaken for the purpose of price support.

(c) Debt securities convertible or exchangeable into equity securities

Stabilisation may only be undertaken for the purpose of price support. If Stabilisation of the underlying equity instrument is undertaken, it 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 market price of the underlying equity security at the time of the public announcement of the final terms of the new issue.

139.III Stabilisation disclosure

The possibility of Stabilisation, together with adequate disclosure of the risks and other aspects of Stabilisation which could be material to an investor's decision to subscribe for or purchase the Relevant Securities, must be disclosed in the prospectus in one clearly identified section². The existence and maximum size of any Overallotment Facility or Greenshoe, the

² While awaiting the level 2 implementing measures for the prospectus directive, 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;

exercise period of the Greenshoe and any conditions for the use of the Overallotment Facility or exercise of the Greenshoe must also be disclosed.

140. IV Post Stabilisation Disclosure

Within one week after the end of the Stabilisation Period, the Stabilisation transactions 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.*

141. V Record keeping

Systems must be in place to record Stabilisation orders and transactions. Such systems must be capable of recording each Stabilisation order or transaction together with, as a minimum, the information set forth in article 20 (1) of the Investment Services Directive (93/22/EEC).

142. VI The stabilisation manager

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.

Ancillary Stabilisation

143. Ancillary stabilisation activity which comprises (i) exercising an Overallotment Facility; and (ii) exercising a Greenshoe Option 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 for the purpose of facilitating Stabilisation activity.

144. Ancillary stabilisation activity must be undertaken in accordance with the conditions set out in III. – VI above as well as with the following conditions.

145. The Overallotment Facility

-
- 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.

The Overallotment Facility may only be exercised in accordance with the disclosure made according to III. above. The exercise of an Overallotment Facility by an Investment Services Firm for the purpose of Stabilisation will result in a short position. Such a position is within the safe harbour providing that the uncovered short position (i.e. the short position not covered by the Greenshoe Option) does not amount to more than 5% of the original offer. Relevant Securities may only be overallotted during the subscription period and at the offer price.

146. The Greenshoe Option

The Greenshoe Option must not be exercised where Relevant Securities have not been overallotted by the beneficiary or beneficiaries of the Greenshoe. The Greenshoe Option, as a matter of best practice, should not amount to more than 15% of the original offer. The exercise period of the Greenshoe Option should be consistent with the Stabilisation period. The exercise of the Greenshoe must be disclosed to the public promptly and in suitable detail, including the date of exercise and the number and nature of Relevant Securities involved.

Additional Guidance

147. Transactions undertaken to liquidate positions established during the Stabilisation period should be undertaken so as to minimise market impact given due regard to prevailing market conditions at the time.

Definitions

Associated Securities – Associated Securities shall mean the following financial instruments³ :

- (1) contracts or rights to subscribe for, acquire or dispose of Relevant Securities,
- (2) financial derivatives on Relevant Securities,
- (3) where the Relevant Securities are convertible or exchangeable debt instruments, the securities into which such convertible or exchangeable debt instruments may be converted or exchanged, and
- (4) instruments which are issued or guaranteed by the issuer or guarantor of the Relevant Securities and, because of the similarity of their terms, the market price of those instruments is likely materially to influence the price of the Relevant Securities.

Greenshoe option: option granted by the Offeror in favour of the Investment Services Firm(s) involved in the offering for the purpose of covering overallotments, providing that for a certain period of time after the offer of the Relevant Securities such firm(s) may purchase up to a certain amount of Relevant Securities at the offer price.

³ Including financial instruments which are not admitted to trading on a Regulated Market or where no request for admission to trading on such market has been made, provided that regulators are satisfied that adequate standards of transparency are in place for transactions in such financial instruments.

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.

Overallotment facility – a clause in the underwriting agreement or lead management agreement which permits acceptance of subscriptions or offers to purchase in respect of a greater number of Relevant Securities than originally offered.

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 financial instruments equivalent to shares (such as depositary receipts) and debt instruments including convertible and exchangeable debt instruments as well as instruments equivalent thereto (such as depositary 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 instruments identical thereto which are already admitted to trading on a Regulated Market. Relevant Securities will include instruments that become fungible after an initial period because, although they are substantially the same, the Relevant Securities have different initial dividend or interest payment rights.

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.