Securities and Markets Stakeholder Group

Date: 31 March 2016
ESMA/2016/SMSG/010

ADVICE TO ESMA

Response to ESMA's Consultation Paper on Draft Guidelines on the Market Abuse Regulation

I. Executive summary

The objective of this paper is provide advice to ESMA on the Consultation Paper on Draft Guidelines on the Market Abuse Regulation (MAR).

The SMSG commends ESMA for its ongoing commitment to establishing the single rulebook on market abuse (which is of particular importance given the Capital Markets Union agenda) and welcomes the consistent harmonisation of requirements applying to market soundings under the Market Abuse Regulation as this is a new element of the market abuse regime and its scope is uncertain. As also stated in the MAR, the SMSG underlines that market soundings are important for the proper functioning of the financial markets and that it thus important that organisational and reporting requirements imposed on either of Disclosing Market Participants (DPMs), Market Soundings Recipients (MSRs) or issuers themselves are balanced. In this respect, the SMSGs agrees with most of the proposed guidelines and only recommends to clarify some aspects of the new regime as well as uses the opportunity to comment on the indicative list of legitimate interests of issuers which are likely to be prejudiced by immediate disclosure of inside information.

The SMSG welcomes ESMA's understanding of the indicative list being non-exhaustive and considers various examples of possible legitimate interests, including the legitimate interests of issuers with a two-tiered board structure as provided for under draft guideline 1c.

However, the SMSG asks ESMA to review the wording of the conditions specified in guideline 1c (decisions taken or contracts entered into by an issuer with a two-tiered board structure) and points to relevant fundamental principles of company law in Member States whose issuers have a two-tiered board structure.

II. Background

1. On 2 July 2014, the EU Regulation on Market Abuse (MAR) entered into force. The MAR requires ESMA to issue the following guidelines: (i) e addressed to persons receiving market soundings, (ii) on the legitimate interests of issuers which can justify a delay in the publication of inside information and (iii) on the situations in which the delay of disclosure is likely to mislead the public.

2. On 28 January 2016, ESMA published its Consultation Paper on draft guidelines on the Market Abuse Regulation (ESMA/2016/162 – "CP on Guidelines"). The CP is the follow-up of ESMA's Discussion Paper on ESMA's policy orientations and initial proposals for MAR implementing measures published on 14 November 2013 ("DP on MAR").

3. On 21 April 2014, the SMSG responded to ESMA's DP on the MAR (ESMA/2014/SMSG011). Furthermore, the SMSG provided advice to ESMA on 21 September 2015 regarding ESMA's future work on MAR Level 3-Measure (ESMA/2015/SMSG/025 – "PP on Level 3").

4. After having published its CPs, ESMA requested the SMSG's opinion on the proposed guidelines. The SMSG herewith gives advice to ESMA. In addition, the SMSG reiterates its opinion on the importance of having an easy access to the single rulebook on market abuse.

III. Comments

1. General comments on the importance to build a single rulebook on market abuse

5. The MAR establishes a common regulatory framework on insider dealing, the unlawful disclosure of inside information and market manipulation. The purpose of the MAR is to promote the integrity of financial markets in the Union and enhance investor protection and confidence in those markets, while ensuring uniform rules and clarifying key concepts. In order to ensure uniform conditions, the Commission (COM) is empowered to adopt implementing acts and ESMA is required to elaborate on the standards to be adopted by the COM. Furthermore, ESMA is required to issue guidelines regarding the interpretation of relevant aspects of the MAR. The MAR, the accompanying level 2-regualtions and level 3-measures will build a single rule book on market abuse in Europe.

6. The future single rulebook on market abuse will form a complex regime. This is mainly due to the fact that the MAR will be accompanied by a number of additional level 2-regulations. ESMA has proposed 11 RTS/ITS (which will likely be adopted by the COM as regulations) and provided technical advice to the COM regarding 5 topics (which will probably also be dealt with by separate regulations). The MAR and most of the level 2-instruments will contain a number of highly detailed provisions. Some topics, such as market soundings, disclosure of inside information and manager transactions, will be subject to different acts at level 2 and measures at level 3. It will therefore be challenging for market participants to apply the law, especially because many of them are not familiar with the process of capital market legislature in Europe.

7. The SMSG has already encouraged ESMA to establish an interactive single rulebook on its website (SMSG PP on Level 3 para. 6-8). It takes this opportunity to reiterate its recommendation that a comprehensive compendium of the level 1-text (MAR), COM's delegated acts and the corresponding RTS/ITS, as well as the related ESMA Guidelines and Q&As be provided. It would also be useful if the compendium included references to the increasingly important body of The European Court of Justice (ECJ) case law on the EU market abuse regime. The SMSG is convinced that such an online tool – similar in design to EBA's online 'single rulebook' – will be of great help for market participants who will thus be able to easily access the new level 1- and corresponding level 2-provisions and level 3-measures. As already stated in the SMSGs' Position Paper, ESMA should, however, also make clear that the single rulebook on market abuse does not encompass the powers of the NCAs and sanctions provided by administrative and criminal law which continue to be subject to national laws.

2. Market soundings

8. Market soundings are interactions between a seller of financial instruments and one or more potential investors prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and its pricing, size and structuring (Art. 11 (1) MAR). The MAR

acknowledges that market soundings are important for the proper functioning of financial markets and should not in themselves be regarded as market abuse. Provided that a 'disclosing market participant' (DMP) complies with the requirements laid down in the MAR, disclosure of inside information made in the course of a market sounding shall be deemed to be made in the normal exercise of a person's employment, profession or duties and so in compliance with the MAR (Art. 11 (4) MAR).

9. In order to ensure consistent harmonisation, ESMA is to develop draft RTS/ITS to determine appropriate arrangements, procedures and record keeping requirements for persons to comply with the requirements laid down in the MAR (Art. 11 (9) MAR). The draft RTS/ITS mainly deal with the requirements applying to disclosing market participants (DMP). In addition, ESMA must issue guidelines addressed to 'persons receiving the market sounding' (MSR) regarding certain aspects of the communication with a DMP (Art. 11 (11) MAR). ESMA's proposals for guidelines take into account the rules contained in the draft RTS/ITS on market soundings.

2.1. General remarks

10. ESMA has explained in depth the new market sounding regime in its Final Report on draft RTS/ITS (ESMA/2015/1455) and clarified a number of interpretational questions which arose in the course of the consultation process. The SMSG commends and welcomes this approach and wishes to highlight the importance of providing guidance to the market in this responsive way. ESMA's CP on draft guidelines takes this approach a step further and clarifies that the protection afforded by the market sounding regime of MAR is only available to DMPs as listed in Art. 11 (1) (a)-(d) MAR. Thus, brokers who receive inside information from an advisor during the course of a market sounding (and then, in turn, 'sound' their clients) will not be captured by the market sounding regime. The SMSG agrees with ESMA's view; however, it wishes to clarify that, in those cases in which Art. 11 MAR is not applicable, the disclosure of inside information might still be made in the normal exercise of an employment, a profession or duties, as laid down in Art. 10 (1) MAR, and so in compliance with the MAR. ESMA could, accordingly, reinforce this point in its guidelines. Another important issue ESMA could deal with is whether a fund manager (MSR) may disclose inside information received by a DMP in the course of a market sounding to his investor(s).

2.2. Specific remarks

11. The SMSG agrees with most of the proposed guidelines and only recommends that some aspects be clarified.

2.2.1 Guideline 3 (MSR's assessment as to whether they are in possession of inside information)

12. The proposed guideline 3 No. 2 states: "While taking into account the DMP's notification that the information disclosed in the course of the market sounding is no longer inside information, MSRs should independently assess whether they are still in possession of inside information taking into consideration all the information available to them …"

13. The SMSG agrees with the proposed guideline. The MSR needs to make an independent assessment whenever the DMP comes to the conclusion that the information disclosed is no longer inside information. This follows from Art. 11 (6) MAR. To make an independent assessment, it will be im-

portant for the MSR to learn from the DMP why the information ceases to be inside information according to the DMP's assessment.

2.2.2 Guideline 4 (Discrepancies of opinion between DMP and MSR)

14. The proposed guideline deals with the situation where, on one hand, the DMP takes the view that no inside information is disclosed, whereas the MSR, on the other hand, is of the opinion that the information received does constitute inside information. The SMSG asks ESMA to consider the reverse situation where the DMP reaches an assessment that the information has to be considered as inside information, whilst the MSR disagrees with this interpretation.

15. The draft guideline 4 stipulates certain obligations for a MSR, provided that the MSR receives the DMP's notification informing it that the information communicated in the course of the market sounding ceased to be inside information and the MSR disagrees with the DMP's conclusion. The SMSG wishes to clarify that this only applies if the information ceases to be inside information according to the DMP's assessment.

2.2.3 Guideline 6 (list of MSR's staff that are in possession of the information)

16. According to ESMA's draft guideline 6, MSRs should draw up a list of the persons working for them that are in possession of the information communicated in the course of the market soundings.

17. The SMSG observes there could be some ambiguity as to how "persons working for them" is to be interpreted and therefore seeks further clarification. Would only own employees, i.e. staff, and possibly directors, be covered or also advisors, consultants etc. that are contracted and thus 'working for' the MSR (and who have access to this information) and hence come within the MSR's information storage and reporting responsibility? Annex II (page 33) only mentions "staff", so some additional clarification may be needed so that whoever is in possession of such information (employed or not) and who has received it by way of working for the MSR should be covered.

2.2.4 Guideline 7 (assessment of related financial instruments)

18. Guideline 7 provides that where the MSR has assessed they are in possession of inside information as a result of a market sounding, the MSR should identify all the issuers and financial instruments to which that inside information relates.

19. The SMSG takes the view that the scope of the guideline is unclear. Should the MSR only assess instruments it is involved with?

2.2.5 Guideline 8 (written minutes or notes)

20. The SMSG asks whether the own version of the minutes may be signed electronically.

3. Disclosure of inside information

21. Article 17(4) MAR provides an exemption from the obligation to disclose inside information immediately, stating that issuers and emission allowance market participants may, on their own responsibility, delay disclosure to the public of inside information provided that certain conditions are met:

(a) immediate disclosure of the information is likely to prejudice the legitimate interests of the issuer or the emission allowance market participant;

(b) the delay of disclosure is not likely to mislead the public; and

(c) the issuer or emission allowance market participant is able to ensure the confidentiality of that information.

An issuer is required to satisfy all three requirements before being able to rely on the exemption contained in Article 17(4) MAR.

22. In the CP on draft guidelines, ESMA established a non-exhaustive and indicative list of legitimate interests of the issuers which are likely to be prejudiced by immediate disclosure of inside information, as well as situations in which delay of disclosure is likely to mislead the public. In doing so, ESMA has sought to meet its mandate under Article 17(11) MAR. ESMA has taken into account the comments received in the course of a public consultation conducted as part of the DP published in November 2013. Furthermore, ESMA has considered the recommendations the SMSG has submitted to ESMA in its Position Paper on the future level 3-regime.

3.1 General remarks

23. The SMSG agrees generally with ESMA's approach specifying legitimate interests of the issuer as a requirement for the delay of the disclosure of inside information. In particular, the SMSG welcomes ESMA's understanding of the indicative list of legitimate interests as being non exhaustive (CP draft guidelines para. 66 and 69). This reflects the legislature's intention (cf. recital 50: "following non-exhaustive circumstances").

24. ESMA is of the opinion that the possibility to delay the disclosure of inside information "represents the exception to the general rule" and "therefore should be narrowly interpreted (CP on draft guidelines para. 69). However, to understand the importance of the right to delay it is important to take into account the legislative history and the context in which the definition of "inside information" has been developed. The ECJ has defined the term "inside information" for the purposes of insider trading law rather than market efficiency. Particular emphasis therefore has been placed by the ECJ on the regulatory aims and purposes of the insider trading law prohibitions, rather than considerations of market efficiency. As a consequence, the ECJ has stated that an "intermediate step" in a protracted process can be considered inside information (see *Geltl* case). Article 7(3) MAR codifies the ECJ's approach and adopts a definition of "inside information" which reflects the Court's opinion in the *Geltl* case. Under this approach, the concept of "inside information" is a very broad concept, which in the view of the SMSG is justified when considered from the perspective of prohibiting insider trading law. However, applying this concept – in the same form – in the disclosure context is difficult, since the concept was not designed for the regulatory purpose of ensuring that issuers comply with their disclosure obligations. In consequence, the possibility to delay disclosure of inside information has played an important role in practice since the *Geltl* case. Moreover, a general consensus has emerged that the right to delay disclosure of inside information is no longer to be interpreted in a narrow way (which is acknowledged by the NCAs, courts and also in literature).

25. The provisions of the MAR about the disclosure of inside information reflect this understanding. According to Art. 17 (4) MAR, in the case of a protracted process that occurs in stages an issuer may delay the public disclosure of inside information relating to this process (provided that the require-

ments for a delay are met). This new paragraph on "intermediate steps" recognises that delay is of particular importance where the inside information is still only an intermediate step in an ongoing process. It also explains why the right to delay is "no longer" seen as narrow (because it has been expanded to include situations where the inside information is only an intermediate step and not yet final).

3.2. Legitimate interests of the issuer for a delay of the disclosure

3.2.1 Guideline 1 a) (issuer is conducting negotiations)

26. According to ESMA's CP, the following circumstances could constitute a legitimate interest: "the issuer is conducting negotiations, where the outcome of such negotiations would likely be jeopardized by immediate public disclosure of that information".

27. This circumstance is already mentioned in recital 50 MAR. The SMSG therefore agrees to include it in the indicative list of legitimate interests. However, we are concerned that ESMA prefers a different wording. According to recital 50 MAR, such circumstances may be "ongoing negotiations, or related elements, where the outcome or normal pattern of those negotiations would be likely to be affected by public disclosure." The SMSG recommends to adopt the example of a possible legitimate interest as identical as possible. It is concerned that ESMA's guideline could be understood as limiting the right to delay of the disclosure against the legislature's intention and contrary to the current approach to delay and market needs considered in section 3.1 above.

3.2.2 Guideline 1 b) (issuer is in grave and imminent danger)

28. According to ESMA's CP, the following circumstances could also constitute a legitimate interest: "the financial viability of the issuer is in grave and imminent danger, although not within the scope of the applicable insolvency law, and immediate public disclosure of the inside information would seriously prejudice the interests of existing and potential shareholders, jeopardising the conclusion of the negotiations aimed at ensuring the financial recovery of the issuer".

29. Again, this circumstance is already mentioned in recital 50 MAR. ESMA's drafted guidelines slightly differ from the wording in recital 50 MAR. The SMSG agrees with ESMA's proposal which may be somewhat more generic but reflects the intention of the level 1-legislator. However, given the sensitivity of this issue, it might be wiser to stick to the wording in the recital.

3.2.3 Guideline 1 c) (decisions taken or contracts entered into by an issuer with a two-tiered board structure)

30. A further example of a possible legitimate interest refers to issuers with a two-tiered board structure. ESMA describes the situation in which a delay might be justified as follows: "the inside information relates to decisions taken or contracts entered into by the management body of an issuer which need, pursuant to national law or the issuer's bylaws, the approval of another body, other than the shareholders' general assembly of the issuer, in order to become effective."

31. According to ESMA's draft guidelines, a delay is permissible provided that all of the following conditions are met:

    (i) immediate public disclosure of that information before such a definitive approval would jeopardise the correct assessment of the information by the public;

(ii) an announcement explaining that such approval is still pending would jeopardise the freedom of decision of the other body;

(iii) the issuer arranged for the decision of the body responsible for such approval to be made, possibly, within the same day; and

(iv) the decision of the body responsible for such approval is not expected to be in line with the decision of the management body, as for instance it would be where such body is the expression of the same shareholders represented in the management body or in cases where such body has consistently approved the management body's decisions on similar issues."

32. There are two reasons why the SMSG asks ESMA to reconsider this guideline. First, the SMSG is concerned that the proposed guideline might not reflect the legislators' intention. The requirements for a delay due to this reason are described in recital 50 as follows: "provided that public disclosure of the information before such approval, together with the simultaneous announcement that the approval remains pending, would jeopardise the correct assessment of the information by the public." Thus, the legislators apply only one condition for delay: that an announcement made before approval has been obtained would jeopardise the correct assessment. Further conditions for a delay are not mentioned in recital 50. Thus, the SMSG takes the view that ESMA does not have the competence to limit the issuers' right to delay.

33. Second, the third and fourth condition do not reflect fundamental principles of company law in Member States whose issuers have a two-tiered board structure. The supervisory body in a two-tiered issuer is a legally independent body, which operates separately from the management board. The supervisory body reflects the interests of various shareholders and stakeholders (in particular in companies which are subject to co-determination). However, neither shareholders nor stakeholders (employees or trade unions) have the right to give instructions to the members of the supervisory body. These are obliged to act in the best interests of the company. It is not possible to draw conclusions about a supervisory body's approach based on past conduct and prior instances of approval (as currently presumed under the fourth criterion above), as the supervisory body is mandated under national company law to consider each decision (even those decisions giving rise to similar issues or circumstances) anew and in light of the wider, constituent interests –including non-shareholder interests – the supervisory body represents. We therefore believe that the fourth criterion ought to be abolished.

34. With respect to the third prerequisite, there are several difficulties with applying this prerequisite in practice. The condition, as presently worded, does not take into account the fact that disclosure obligations may arise daily in a protracted process and thus the question arises whether the issuer may delay disclosure or not. The condition is thus difficult to implement, as the supervisory board cannot be consulted on an every-day basis each time there is an "intermediate step" which constitutes inside information.

35. The SMSG agrees with ESMA that no possibility of delay should be granted where the issuer does not arrange for a decision to be adopted by the supervisory board. However, there are strong reasons not to prescribe a certain time period within which the issuer has to arrange for the decision of the supervisory body. ESMA should confine its guidelines to the first two conditions and additionally make clear that the delay be as short as possible.

3.2.4 Guideline 1 d) (issuer has developed a product/invention)

36. A further case where immediate disclosure of the inside information is likely to prejudice the issuers' legitimate interests is described as follows: "the issuer has developed a product or an invention and the immediate public disclosure of that information is likely to jeopardise the intellectual property rights of the issuer."

37. This example was already mentioned in the CESR second set of Guidance. The SMSG agrees with the inclusion in the indicative list of legitimate reasons. However, for the sake of consistency, the SMSG recommends to formulate the guideline in the same way as guideline 1.a) and 1.e) ("would likely be jeopardised" instead of "is likely to jeopardise"). The SMSG further suggests to include services as they are also economic commodities and the issuer may have the need to protect its rights when developing a new service.

3.3. Situations where the delay in the disclosure is likely to mislead the public

38. In its Position Paper, the SMSG recommended to interpret the requirement "not misleading the public" in accordance with former CESR guidance (Level 3 – second set of CESR guidance, CESR/06-562b) and current guidance by NCAs. ESMA has taken this into account and proposed draft guidelines which provide three situations where the delay of disclosure of inside information is likely to mislead the public.

39. The SMSG welcomes ESMA's new approach. However, further clarification might be necessary as the concept of "market expectation" is rather vague. The SMSG recommends a two-step test: ESMA's guidelines should require that (i) the issuer has made statements that go contrary to the new inside information, and (ii) this prior information from the issuer is deemed to have affected the market's expectations and impacted on price formation, i.e. has been noticed or is otherwise of a character that reasonable investors would pay attention to. Thus, not any and all 'statements/indications' from the issuer would necessarily be seen as relevant as an obstacle to delay, e.g. if they were made to a small constituency or were very vague.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 5 April 2016

Jesper Lau Hansen
Chair
Securities and Markets Stakeholder Group