The Law Society

Response to discussion paper 2013/1649

ESMA's policy orientations on possible implementing measures under the Market Abuse Regulation

27 January 2014

Response to ESMA's discussion paper 2013/1649 dated 14 November 2013 - ESMA's policy orientations on possible implementing measures under the Market Abuse Regulation

Introduction

This response has been prepared jointly by the Market Abuse Joint Working Party of the Company Law Committees of the City of London Law Society and the Law Society of England and Wales.

The City of London Law Society ("**CLLS**") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees.

The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Law Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena.

The Market Abuse Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on public markets.

We are pleased to have the opportunity to comment on certain of the policy orientations that ESMA is envisaging and on certain of the related questions where we would hope that our contribution is useful. We have not sought to comment on all the questions or on all the matters discussed in the Discussion Paper.

I. Buy Back Programmes and Stabilisation (Article 3 of MAR)

Q.5: Do you think that a single competent authority should be determined for the purpose of buy-back transactions reporting when the concerned share is traded on trading venues in different Member States? If so, what are your views on the proposed options?

We think it would be helpful for issuers to report to a single competent authority and would support reporting to the home competent authority.

Q.9: Do you think that the volume-limitation for liquid shares should be lowered and three different thresholds regarding liquid, illiquid and shares with extreme low liquidity should be introduced?

No. We do not see why the current limit of 25 per cent. of the daily average volume should be lowered for liquid shares and do not agree with the different thresholds proposed.

Q.10: Do you think that for the calculation of the volume limit the significant volumes on all trading venues should be taken into account and that issuers are best placed to perform calculations?

We agree that the issuer should perform the calculations, but we consider that it is appropriate to oblige the issuer to base the calculation of the volume limit only on those trading venues **where the shares are traded with the issuer's consent** (our emphasis). We are disappointed that ESMA notes that "it might be too burdensome to oblige the issuer to check each and every trading venue including those where shares can be listed by third parties without notification to the issuer"; but nevertheless proposes to oblige issuers to do so.

Q.17: Do you think that in the case of bi- or multinational stabilisation measures a centralised reporting regime should be established to exclusively one competent authority? If so, what are your views on the proposed options?

We agree that a centralised reporting regime should be established and support reporting to the home competent authority.

Q.22: Do you agree that "block-trades" cannot be subject to the exemption provided by Article 3(1) of MAR?

We note that the term "block trades" is not defined (footnote 4). In practice the term "block trade" is used by the market in the context of both: (1) offerings which fall within the definition of "significant distribution" for the purposes of Article 5 paragraphs (4b) and (5a) of MAR and as described in paragraph 60 and (2) a range of other transactions of a significant size, which may not involve a distinct offering process. We believe it should be made clear that only the latter should be outside the exemption provided by Article 3(1) of MAR. We note that Recital 14 of the current Regulation 2273/2003/EC refers to block trades as "strictly private transactions".

II. Market Soundings (Article 7c of MAR)

It would appear from Article 16a to the MAR that the market sounding regime in Article 7c is a safe harbour and that compliance with the detailed provisions of the Regulations, including the RTS, is not mandatory. It would be helpful if ESMA specifically recognised this. When a market sounding does not involve disclosure of inside information, there is no basis for ESMA to regulate.

The discussion paper uses terminology inconsistently. In various instances in Part II (market soundings) the person being sounded out is described as the market participant's "client", at other times the "buy side". Neither of these are accurate as

market soundings will not necessarily be to the market participant's "client" and, on a takeover, where the bidder is sounding out target shareholders, they will be sell side rather than buy side. It might be preferable to use a generic term to refer to the person being sounded out such as "the proposed recipient" in order to avoid confusion.

Q.23: Do you agree with ESMA's proposals for the standards that should apply prior to conducting a market sounding?

Market sounding procedures should be proportionate and avoid creating unnecessary burdens which could tend to reduce legitimate discussion with investors by issuers about possible transactions and so make it more difficult for issuers to execute those transactions.

May we suggest that paragraphs 72 and 73 are reworded as set out below (as amended in bold)?

"72. Before seeking the agreement of the issuer, the disclosing market participant should inform **the issuer** of the following:

- the content of the information that will be disclosed to investors; and
- whether, **in its opinion**, the information to be disclosed is inside information or not.

73. **If the issuer and the disclosing market participant do not agree** as to whether the information is inside information or not, **the issuer shall determine whether or not it is** inside information."

Q.24 Do you have any views on the above?

In our view, it would not be appropriate to restrict the hours in which market soundings can take place for the reasons set out in paragraph 79, which we agree with.

Q.25: Which of the three options described above in paragraph 82 do you think should apply? Should any other options be considered?

We are in favour of option 1 for the reasons given in paragraph 82. In addition, options 2 and 3 presuppose that the disclosing market participant has an ongoing client relationship with the parties to be wall crossed which will not always be the case.

Q.26: Do you agree with these proposals for scripts? Are there any other elements that you think should be included?

As noted above, we do not consider that ESMA is empowered to regulate non-wall-crossed soundings and so it should not prescribe contents requirements for non-wall-crossed sounding scripts. In the non-wall-crossed script, the warning that there may be inadvertent disclosure of inside information is unhelpful to the recipient and will encourage ill-discipline on the part of the disclosing market participant. Element ii of the wall-crossed sounding script is required in advance of the wall-crossed sounding and so should not be included in the script. It would be helpful if ESMA would expressly confirm that the opening request for consent to be wall-crossed in respect of a named issuer (with nothing more) is permitted.

Subject to our comments on element ii, we agree with the proposal for the wall-crossed sounding scripts, which is in any event very much UK market practice. However, we do not see the need for explaining the reasons why the disclosing market participant considers the information to be inside information, but we would agree that the script should be allowed to include, as an option, the reasons in the event that the buy-side participant challenges that it is inside information.

Q.28: Do you agree with the requirement for disclosing market participants set out in paragraph 89?

Paragraph 89 seems to impose a continuing obligation to maintain a list of contacts. This is objectionable for the reasons given in relation to Option 3 in paragraph 82.

Q.29 *Do you agree with these proposals regarding recorded lines?*

We note that the requirement for recorded lines and Chinese walls (paragraph 98) will make it much harder, if not impossible, for the issuer itself to undertake market soundings. This is a departure from the position contemplated by MAR which very clearly permits the issuer to act as the disclosing market participant (Article 7c(1)(a)), so long as record keeping arrangements are in place. The requirement for an issuer to put in place internal arrangements akin to those required by a financial institution are disproportionate and, as mentioned in our answer to Q.23, are likely to prevent an issuer from itself taking market soundings from its own shareholders.

Q.30: Are you in favour of an ex post confirmation procedure? If so, do you agree with its proposed form and contents?

We do not consider that written ex-post confirmation of agreement to be wall-crossed should be required from the buy side unless the telephone calls to the buy-side are not recorded (for example if there is a direct telephone call by the issuer). In other cases, the telephone calls to the buy side will be recorded and we consider it should be sufficient and proportionate to have the disclosing market participant keep as record the wall-crossed sounding script tagged with a link to the recording of the phone call.

Q. 32 Do you agree with these proposals regarding disclosing market participants' internal processes and controls?

We think that this is wholly unrealistic. There will likely be a number of employees involved in the transaction who are not responsible for conducting the sounding (both in the issuer and in the bank concerned). See also our response to question 29 above.

Q.35: Do you think that the buy side should or should not also inform the disclosing market participant when it thinks it has been given inside information by the disclosing market participant but the disclosing market participant has not indicated that it is inside information?

We think that the buy side should inform the disclosing market participant in the circumstances set out in paragraph 107. Provided that the buy side is not also obliged to inform the competent authority (see our answer to Q.36), we do not think that informing of the disagreement should be damaging to their relationship with the sell side.

Q.36: Do you agree with the proposal for the buy side to report to the competent authorities when they suspect improper disclosure of inside information, particularly to capture situations where such an obligation does not already otherwise arise under the Market Abuse Regulation?

We do not agree with ESMA's statement in paragraph 111 that reporting by the buy side where the buy side suspects that the disclosing market participant has not complied with Article 7C(5) would mirror the suspicious transaction reporting obligations on the sell side. As noted by ESMA in paragraph 107, the sell side may, in good faith, consider that it is not inside information. We think that requiring, or even merely encouraging, the buy side to notify the relevant CA of a potential violation would be likely to discourage transactions. We support an obligation to notify the disclosing market participant as being preferable.

This proposal also appears to presuppose that all buy side entities are sophisticated entities with compliance functions to ensure that they are aware of, and can comply with, relevant notification obligations. A disclosing market participant may approach a large individual investor who would be unlikely to be aware of any such notification obligation, how to go about complying with it or the consequences of failing to do so.

Q37. Do you have any views on the proposals in paragraphs 113 to 115 above?

In paragraph 115 ESMA recommends that the buy side should ensure that any follow-up calls to the sell side following a sounding approach that did not result in a wall-crossing should be conducted on company recorded mobile and land lines. In this regard, ESMA appears to be imposing additional obligations on market-participants and persons being sounded out which are not contemplated by MAR. If a

buy side participant is not already required to have recorded lines under national legislation then they may be unable to comply with this proposal.

Q.39: What are your views on these options?

We recommend option 2 with the disclosing market participant being required to assess timing and method of cleansing, prior to disclosure, and to be in a position (but not be obliged) to agree the cleansing strategy with the buy side.

Section IV: Accepted Market Practices

Q.49 Do you agree with ESMA's approach in relation to entities which can perform or execute an AMP?

In paragraph 157 ESMA considers that only authorized firms (MiFID firms / credit institutions) should be entitled to benefit from the accepted market practices defence. This seems overly restrictive: since MAR extends the scope of the market abuse regime to cover a far broader range of instruments, including OTC commodity derivatives and certain spot commodity contracts, it seems likely that entities could be engaging in practices which are normal on the commodity markets, but which could not be considered to be "accepted market practices". There may be other examples. Since the scope of MAR goes beyond the traditional financial markets, the scope of accepted market practices should also go beyond the traditional financial markets.

Q.50 Does ESMA need to account for situations where some disclosure obligations might be exempted?

Accepted market practices provide an exemption from the prohibition on market manipulation. ESMA refers to the need for an accepted market practice to have a substantial level of transparency: including *ex ante* and *ex post* public disclosure. It is not clear whether ESMA is referring to adequate disclosure that the accepted market practice exists, or whether ESMA is intending to require market participants to disclose their activities before engaging in them. The former would be appropriate (in line with MAR 1 Annex 2 of the FCA Handbook (http://www.fshandbook.info/FS/html/FCA/MAR/1/Annex2)), the latter would not as ESMA does not have the power to make accepted market practices contingent on market participants disclosing their activity. Some clarification in this regard would be useful.

General Comment on paragraphs 166 and 182

Article 8a of MAR enables competent authorities to identify accepted market practices and notify them to ESMA. It does not give competent authorities or ESMA the power to amend those accepted market practices so that they have particular features or so that only certain people may rely on them (some competent authorities may have this power, but others may not, particularly where the relevant accepted

market practice does not relate to the financial markets). Paragraph 166 appears to assume that all competent authorities will have the necessary powers.

In paragraph 182, ESMA indicates that it will require competent authorities to impose additional account segregation obligations on entities using particular market practices. Under Article 8a of MAR, ESMA does not appear to have the powers to do this.

Section VI. Public Disclosure of Inside Information and Delays (Article 12 of MAR)

Q.72: Do you agree to include the requirement to disclose as soon as possible significant changes in already published inside information? If not, please explain.

We have no objection to the retention of this requirement in the MAD implementing directive 2003/124/EC on the basis that there would be no change in the application of this requirement from how it is currently implemented. The word "significant" is important as notification of minor changes would be unhelpful to the market and should not require disclosure. The test should remain that the significant change would be likely to have a significant effect on the price of the relevant securities.

Q.74: What are your views on the options for determining the competent authority for the purpose of notifying delays in disclosure of inside information by issuers of financial instruments?

We favour the Transparency Directive based approach.

Q.76: Do you agree with the approach to the ex-post notification of general delays and the ways to transmit the required information? If not, please explain.

We consider that the approach is likely to be very burdensome for issuers and hope that all Member States with markets on which there is a substantial volume of trading will adopt in their national law that a record of the explanation for the delay in disclosure of inside information may be submitted only upon request of the competent authority (CA). We agree that where this alternative does not apply, written notification should take place immediately after the delayed disclosure has been made and that the CA should make clear on its website how the notification process operates.

Q.77: Do you agree with the approach to require issuers to have minimum procedures and arrangements in place to ensure a sound and proper management of delays in disclosure of inside information? If not, please explain.

Q.78: Do you agree with the proposed content of the notification that will be sent to the competent authority to inform and explain a delay in disclosure of inside information? If not, please explain.

Q.79: Would you consider additional content for these notifications? Please explain.

We agree that issuers should have appropriate arrangements in place to manage delays. We are concerned, however, that the procedures and arrangements within the issuer should be sensible and proportionate; the procedures and arrangements that ESMA sets out in paragraphs 271 to 274 and in particular 274(b) will be very burdensome and not beneficial. The circumstances in which an assessment has to be made whether any information is inside information; whether its disclosure needs to be delayed; and for how long, will always demand a speedy response and are likely to involve several consecutive and all party conversations over a short timeframe between the directors, importantly the chairman and non-executive directors, as well as executive directors and senior management, the company secretary, in house and external counsel, sometimes within multiple jurisdictions, the financial advisers and other relevant parties. Accordingly, we do not agree that there should be a template on the format and content of the notification to be sent to the CA and in particular we do not consider that any additional content is required.

There may be multiple times on the same or consecutive days at which the decision to delay disclosure occurs. In paragraph 274 it is said in paragraph (b) that the records evidencing the fulfilment of the conditions for the delay, both initially and on an on-going basis during the delay period, must be set up and maintained each time the disclosure of inside information is delayed. This approach, which analyses a lengthy delay as a series of decisions to delay, seems to us not to reflect reality and we would prefer to suggest that once a decision to delay has been made, it is kept under "regular review" including if any material change in circumstances (e.g. new rumours) occurs. That will allow flexibility for issuers in the way the obligation is handled.

Negotiations in relation to an acquisition or disposal or other price sensitive transaction may continue for many months, during which time the disclosure will be delayed. It is not clear if ESMA is suggesting there should have be to be a daily record (which we would not support) in such a case. Also, in cases where an issuer has to deal with an unexpected situation, such as a possible leak of information or an unexpected event in the issuer's group, it is not clear how much detail ESMA is suggesting should be recorded about the way in which the issuer decides to delay disclosure. We are concerned that if the record keeping requirement is too onerous, this will run the risk either that the issuer is slowed in taking the decision whether it can delay disclosure as it records how it reaches its decision or that an expensive burden is imposed on the issuer because it is required to have one or more people dedicated to creating the relevant record. We suggest that in paragraph 274(b) the

words “each time the disclosure of inside information is delayed” are deleted and replaced by “and kept under regular review” and we suggest that “regular review” might be the weekly standard applicable to CAs in Article 12(4). We also suggest a redraft of the final words of paragraph 271 by deleting the words “recorded, evidenced and motivated” and replacing them by “recorded together with the reasons for the decision”.

Q.80: Do you consider necessary that common template for notifications of delays be designed?

We do not agree that templates would facilitate the speedy preparation of the notification by the issuer (paragraph 286) and think it more likely that the detail required will have the opposite effect.

Q.82: Do you agree with the approach followed by ESMA with respect to legitimate interests for delaying disclosure of inside information? Do you consider that CESR examples are still appropriate? If not, please explain and provide circumstances and/or examples of what other legitimate interest could be considered.

We consider that the CESR examples of legitimate interests remain appropriate. We would also add as a legitimate interest where the issuer is in discussion with anti-trust or financial services or other regulatory authorities as to whether or not they would permit a proposed acquisition or disposal and in particular on the conditions they might impose should they grant permission.

Q.83: Do you agree with the main categories of situations identified? Should there be others do consider?

Article 12.10 of MAR requires ESMA to issue guidelines to establish a non-exhaustive indicative list …. of situations where the omitted disclosure is likely to mislead the public. We think that ESMA is going beyond this requirement in stating “disclosure will **always** (our emphasis) be required ….” in paragraphs 307 and 308. We think that it is deliberate that no recital in MAR provides any hint on what could be such situations. We agree with CESR’s statement in paragraph 2.12 of the Second CESR Guidance that “it is aware, however of the argument that any delay in disclosing information would be misleading. CESR does not share this view. If this argument were correct, then clearly there would have been no purpose including a provision in the Directive which allowed for delay since the criteria for doing so could never be met”. We think this principle should be clearly stated in the technical standards.

We are concerned at the statement in paragraph 307 that “ESMA considers that disclosure will **always** be required where the undisclosed inside information contradicts the market’s current expectations”. We agree that this should be the case where the market’s current expectations have been generated by the company

but this is covered by paragraph 308 and we think that 307 is much too wide. It would be very onerous to require a company to make such disclosures unless it is the company itself that has made the announcements on which the market's current expectations are based. If the market has a particular expectation which arises other than as a result of something the company has said (for example because of an unfounded rumour) we do not think the company should be required to make a disclosure.

We think that there would be very few situations where "immediate and appropriate disclosure is absolutely necessary and mandatory" because the omitted disclosure is likely to mislead the public (paragraph 306). We think that those situations should be limited to those set out in paragraph 308, that is where the undisclosed inside information contradicts previous public announcements of the issuer; with "contradicts" being interpreted as including something inconsistent with the necessary implications of the issuer's previous announcement(s).

VII. Insider List (Article 13)

Q.84: Do you agree with the information about the relevant person in the insider list?

Article 13(1)(b) requires the list to disclose the identity of each person having access to inside information and we consider that the name by which the person is currently known and their contact details (work telephone and email addresses) should be all that is required.

We do not agree with the level of detail proposed. We are concerned at the amount of detail required in paragraph 318 and on privacy implications under the UK Data Protection Act 1998 which implements the EC Data Protection Directive (1995/46) as this includes personal data. We believe that the amount of data proposed to be required goes beyond what issuers would normally hold regarding their employees and it is disproportionate in that it is more information than is required to achieve the objective of identifying the individuals concerned. We are concerned that this level of disclosure may go beyond what is lawfully permitted under the UK Data Protection Act. In addition, it would be very burdensome and disproportionate for issuers to obtain this information and to keep it safe and up to date.

Our concerns on privacy are based on the UK Data Protection Act which is based on EU law. Outside the EU there may be equivalent legislation relevant for issuers operating in these jurisdictions which places similar prohibitions on processing of personal data.

VIII. Managers' Transactions (Article 14 of MAR)

Q.92: What are your views on the minimal weight that the issuer's financial instrument should have for the notification requirement to be applicable? What could be such a minimal weight?

We consider that the starting point should be that transactions executed in derivatives on indices or baskets should be notifiable conditional on the financial instrument of the concerned issuer carrying a certain weight within the index or basket. We suggest that ESMA follows the FCA's rule in DTR 5.3.3(2)(c) (http://www.fshandbook.info/FS/html/FCA/DTR/5/3) where the transaction would be notifiable only where the shares in the basket represent 1 per cent. or more of the class in issue or 20 per cent. or more of the aggregate value of the securities in the basket or index, or both, with an override that use of the derivative must not be connected to the avoidance of notification.

Q.94: What are your views on the possibility to aggregate transaction data for public disclosure and the possible alternatives for the aggregation of data?

In relation to paragraph 360, we think that more information is set out in the draft template in Annex VI for notification to the CA than is necessary, such as personal data including address, postcode and telephone number. We do not consider that Article 14 of MAR requires more details to be provided to the CA than to the public and so the template for disclosure to the public should be sufficient.

We agree with the principle of aggregation and favour the third alternative, namely that all the transactions on a financial instrument carried out on the same day would be aggregated but not netted, indicating the timeframe of the executions and the price range (lowest and highest prices) and/or the weighted average price.

Q.95: What are your views on the suggested approach in relation to exceptional circumstances under which an issuer may allow a PDMR to trade during a trading window?

We agree with ESMA's approach to dealing in exceptional circumstances in VIII.4.1, which is similar to paragraphs 9 to 10 of the Model Code, set out as Annex 1 to Chapter 9 of the FCA's Listing Rules (http://www.fshandbook.info/FS/html/FCA/LR/9/Annex1).

Q.96: What are your views on the suggested criteria and conditions for allowing particular dealings and on the examples provided? Please explain.

We ask ESMA to include all the circumstances set out in paragraphs 12 to 26 of the Model Code as criteria and conditions for allowing particular dealings. The Model Code has been developed by the UK competent authorities over many years. We also ask ESMA to clarify that certain actions that might otherwise be deemed to be

dealing, as set out in paragraph 2 of the Model Code, are not subject to the provisions of Article 14 of MAR.

IX. Investment Research

In paragraph 383 ESMA states that since there is no longer a definition of "relevant person" in MAR (i.e., persons producing or disseminating recommendations in the exercise of his profession or the conduct of his business), the provisions on production and dissemination of investment research should apply to any person. The definition of "relevant person" was introduced in Level 2 legislation under MAD 1 (2003/125/EC) and there is no particular reason why ESMA should not be able to do this again. Extending the obligations to comply with conflicts of interest requirements disclosures to persons not producing or disseminating recommendations in the conduct of their business could lead to some odd results – e.g., if someone indicates on his Twitter feed that he thinks that a particular company is a good investment, he would need to comply with all the formalities in relation to investment research.

Q. 104 Do you agree on the introduction of a disclosure duty for net short positions? If yes, what threshold do you consider would be appropriate and why?

If ESMA intends to require disclosure of net short positions held by "financial analysts", these should only be required to be disclosed if they are required to be publicly disclosed under the Short Selling Regulation.

Q. 110 Do you think a case-by-case assessment for non-written recommendations is appropriate or that specific rules should be developed?

The adaptations for non-written recommendations should be set out somewhere, either in ESMA guidance or national competent authority guidance. Leaving this to be decided on a case-by-case basis (as ESMA indicates that it intends to do in paragraph 412) will essentially mean that firms will only know after the fact if they are considered to have applied the disclosure and other requirements appropriately.

If you have any queries or would like to discuss any aspect of this response, please contact Victoria Younghusband.

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