THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/03-212c

Advice on the Second Set of Level 2 Implementing Measures for the Market Abuse Directive.

AUGUST 2003

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I EXECUTIVE SUMMARY

The EU has recently adopted the Market Abuse Directive that aims to ensure the integrity of Europe's financial markets and to enhance investor confidence. Member States will be implementing the Directive during the course of 2004. However, to ensure proper implementation, the Directive requires additional technical implementing measures to be adopted by the EU.

In this paper, CESR sets out its advice to the European Commission regarding a second set of technical implementing measures for the Directive on Insider Dealing and Market Manipulation (Market Abuse). The areas covered by this advice are in accordance with the mandate given to CESR by the European Commission, which can be found in annex A. CESR's deadline for this advice was 31 August 2003.

The advice was drafted by the CESR Expert Group on Market Abuse under the Chairmanship of Professor Stavros Thomadakis, Chairman of the Hellenic Capital Market Commission. Nigel Phipps of the CESR Secretariat supported the group.

In developing its advice, CESR acted in accordance with its Public Statement of Consultation Practices (ref: CESR 01-007c). CESR received input from a Consultative Working Group of Market Practitioners. Annex B lists the members of this group. CESR was also assisted by representatives from Europe's commodity markets and by an expert from the US regulator, the Commodities and Futures Trading Commission (CFTC).

A full public consultation was undertaken and the advice has benefited from the significant response to this. Overall, seventy-five individual written responses were received by CESR. These covered a vast range of different market participants. Wherever possible, CESR has taken account of these, while remaining mindful of the scope of the mandate and its aims. The consultation was also supported by public hearings, both at the European and national levels.

While there were certain areas where respondents disagreed with CESR's approach, the general tenor was supportive, particularly with regard to CESR's treatment of accepted market practices, inside information on commodity derivatives and notification of suspicious transactions. Annex C provides more detail on the consultation process CESR employed.

This advice should be read in conjunction with a consultation Feedback Statement (ref: CESR 03/213) which is available on the CESR website (www.europefesco.org). Annex D contains relevant extracts from CESR's 1st set of Level 2 advice (CESR/02.089d)

Areas Covered

- **Guidelines for determining Accepted market practices:** The directive provides that when a market practice is legitimate and accepted by the competent authority, then the practice may not amount to market manipulation.

- **Definition of Inside Information for Derivatives on Commodities:** The directive recognises that there needs to be a specific approach as regards inside information on commodity derivative markets.

- **Lists of Persons having access to Inside Information:** The directive requires all issuers and third parties acting on their behalf or for their account to draw up lists of persons with access to inside information.

- **Disclosure of transactions:** The directive requires those in managerial positions within an issuer to disclose dealings in the shares of the issuer.

- **Notification of suspicious transactions:** The directive requires intermediaries to notify the competent authority of transactions that they suspect of being abusive.

II PRELIMINARY STATEMENT BY STAVROS THOMADAKIS

CHAIRMAN OF THE HELLENIC CAPITAL MARKET COMMISSION AND CHAIRMAN OF THE CESR EXPERT GROUP ON MARKET ABUSE

In the context of meeting the objectives to create a single market in financial services, as set out in the Financial Services Action Plan, CESR was set a demanding deadline by the EU Commission for the provision of this advice.

I am pleased to report that in the seven months given to CESR, it was possible to undertake an extensive consultation process including a call for evidence, the use of a market participants group for expert advice during the policy formation process and a two and a half month public consultation. CESR and its members also hosted a European public hearing as well as a number of national consultative events. In addition, CESR also sought ad-hoc input from commodity derivative experts to deal with this part of its mandate. CESR's advice has benefited from the input of all these expert sources.

CESR recognises the pressures this consultation phase has placed on all parties. We believe the advice, once implemented, will justify the efforts made through its contribution to maintaining efficient and transparent markets which is vital to retaining investor confidence and to the continuation of a thriving and innovative financial services industry.

All readers of this advice should bear in mind that CESR's aim has been to provide advice to complement adequately the areas identified in the Directive that required the development of technical measures in a manner to create a balanced and coherent regulatory framework for the prevention and combat of market abuse in Europe.

III GUIDELINES FOR DETERMINING ACCEPTED MARKET PRACTICES

Extract from the mandate

Implementing measures related to the definitions of 'Accepted market practices', and of 'Inside information' for derivatives on commodities (Article 1 of the Directive)

In order to take account of developments on financial markets and to ensure uniform application of the Directive in the Community, DG Internal Market requests CESR to provide technical advice on possible draft implementing measures related to these definitions. Such measures shall not alter the substance of the definitions contained in Article 1.

In developing its advice, CESR shall have regard to the need to:

- respect national market practices where these do not unduly impinge on the coherence and the progress towards the Single Market;
- promote harmonisation throughout the community;
- promote sufficient transparency of accepted market practices for all market users.

Implementing measures consisting of guidelines related to the definition of 'Accepted market practices' (Article 1 paragraph 5 of the Directive)

Article 1 paragraph 5 states: "(5) "Accepted market practices" shall mean practices that are reasonably expected in one or more financial markets and are accepted by the competent authority in accordance with guidelines adopted by the Commission in accordance with the procedure laid down in Article 17(2)."

The possible draft implementing measures, which shall consist of guidelines to be followed by a competent authority when accepting market practices, should take account of:

- factors which need to be taken into account in deciding whether and when a practice can be accepted by a competent authority, in particular including whether and when a practice can be reasonably expected in one or more financial markets

- the need to consider existing market practices and recognise emerging ones.

Explanatory Text

1. In the Market Abuse Directive, the notion of "accepted market practices" appears in two different contexts. On the one hand, this notion is used in Article 1, paragraph 1, subparagraph (2) in the context of inside information for commodity derivatives; on the other hand it is used in Article 1, paragraph 2, subparagraph (a) in the context of a defence for market manipulation.

2. It is clear from Article 1(5) of the Directive that CESR is requested to provide advice on guidelines for Competent Authorities to follow when considering whether a practice should be deemed to be an accepted market practice and not to draw up a list of accepted market practices.

3. As regards the issue of inside information in commodity derivative markets, the next section considers more specifically the factors that need to be taken into account in deciding whether and when users of markets on which commodity derivatives are traded would expect to receive information in accordance with accepted practices on those markets.

4. As regards market manipulation, the following advice applies to the consideration of potentially manipulative market practices in all relevant markets, both regulated markets and OTC markets, including commodity derivative markets.

5. For a better understanding of the scope of the mandate, clarity is also required on the distinction between "activities" carried out in financial markets and the concept of market "practices". This advice is based on the view that the term "activities" would cover different types of operations or strategies that may be undertaken such as arbitrage, hedging, or short selling. On the other hand, market "practices" would cover the way that these activities are handled and executed in the market.

6. For clarification purposes, it is necessary to consider the way in which the accepted market practices "defence" operates in conjunction with the Directive's definition of market manipulation. The Directive provides that when certain practices appear to meet the definitions of market manipulation set out in Article 1(2)(a), they may nevertheless not amount to market abuse where the person concerned establishes that his reasons were legitimate and the transactions or orders to trade conform to accepted market practices on the regulated market concerned. It is important to note that the mandate does not request advice on what might amount to legitimate reasons.

7. If it is necessary to consider whether a practice can be regarded as an accepted market practice, it is likely that at least some of the indicators set out in CESR's previous advice (CESR/02.089d "CESR's advice on Level 2 implementing measures for the proposed Market Abuse Directive") will have been triggered, although this will not necessarily be the case since these indicators are not exhaustive.

8. The primary focus of the Directive is the protection of market integrity against possible abuse. When considering whether behaviour can be deemed to be an accepted market practice, it is necessary to consider very carefully why a practice which appears to fall within the Directive's definition of market manipulation in Article 1(2)(a) can be justified. The proposed advice focuses on consideration of how a practice impacts the wider market, in particular the price formation process, rather than customer protection or conduct of business issues which will vary according to the circumstances of specific transactions.

9. CESR's proposed advice is in two sections. The first section sets out certain factors which should be considered by Competent Authorities when analysing any given market practice. These focus on the characteristics of the practice in question, but also include some overriding principles governing the need to ensure market integrity. Safeguarding market integrity is a duty not only for intermediaries, but also for investors and the markets themselves. The factors are indicative and are not intended to be conclusive in determining whether a practice should be classified as acceptable. Other factors are also likely to be relevant, such as the prevalence of a particular practice, but the conclusions to be drawn from such an analysis are less clear. In some circumstances, the increased prevalence of a practice might suggest it should be more acceptable, but the reverse may not always be true, since a new and innovative market practice which is not widespread may not be unacceptable. Similarly, the fact that a practice is widespread may not necessarily always mean that it is deemed to be acceptable by Competent Authorities.

10. The mandate itself also requires the advice to have regard to several issues such as harmonisation, transparency and the need to respect different national market practices. It would imply that when a particular practice has been deemed to be acceptable in one jurisdiction, it cannot involve a breach of applicable anti-market abuse regulations in that jurisdiction where the relevant trading mechanism is operating or any relevant market rules designed to prevent market abuse in that jurisdiction. But in some circumstances, the same practice might be deemed to be unacceptable in another jurisdiction. Order handling and execution rules are particularly important in this regard since while a practice may be undertaken for a legitimate reason, the way in which it is executed will in part determine the extent to which it has an unacceptable impact on a market.

11. The second section considers certain procedures that Competent Authorities should follow when considering whether a practice can be regarded as an accepted market practice. Over time, there may be reasons why a practice that has previously been regarded as acceptable by a Competent Authority becomes unacceptable. This might be due to changes in the wider market environment, including changes to the market infrastructure. In such circumstances, it seems appropriate that the same procedures should be followed if the continued acceptability of a practice needs to be reviewed.

12. *Overriding principles to be observed by Competent Authorities to ensure that accepted markets practices do not undermine market integrity, while fostering innovation and the continued dynamic development of financial markets:*

    - *new or emerging market practices should not be assumed to be unacceptable simply because they have not been previously described as acceptable by the Competent Authority;*
    - *the need to safeguard the operation of market forces and the interplay of proper supply and demand;*
    - *the need for market participants to operate fairly and efficiently without interfering in normal market activity. In this sense, it would be useful to analyse the impact of a market practice against the main market parameters considered by the market participants (eg. weighted average price of a single session, daily closing price, market conditions before carrying out this accepted market practice).*

13. *Non-exhaustive list of factors to be taken into account by Competent Authorities when assessing particular practices whether they occur on a regulated market or an OTC market:*

    - *the transparency (to the rest of the market) of the practice in question. The more transparent a practice is, the more likely it is that it is to be accepted. However, practices on OTC markets are less transparent than on regulated markets but this does not mean that such practices are automatically any less acceptable;*
    - *the extent to which the practice in question takes into account the trading mechanism of the market concerned and enables market participants to react properly to the said practice by responding to the new market conditions in a timely manner. Practices which inhibit the interaction of supply and demand by limiting the opportunities for other market participants to respond to transactions are less likely to be acceptable;*
    - *the risks inherent in the practice for the integrity of directly or indirectly related markets in the financial instrument, including any market in the financial instrument which exists on an exchange (or other trading venue) and related markets in directly related financial instruments. The greater the risk to the integrity of a related market within the EU, the more unlikely it is to be accepted;*
    - *the result of any investigation of the practice by any regulatory body, including the extent to which a practice breaches existing rules or regulations designed to prevent market manipulation on the market in question or on directly or indirectly related markets in the EU. It seems unlikely that a practice which breaches such rules or regulations could be regarded as acceptable, but there may be circumstances in which a practice could be deemed to be acceptable on* one EU market and unacceptable on *another. Similarly, the extent to which a practice breaches any relevant codes of conduct*

should also be considered;

- *the structural characteristics of the market in question including whether it is a regulated or OTC market, the type(s) of financial instrument traded on the market and the type of market participants, including the extent of retail participation in the market;*

- *the degree to which the practice in question has an impact on market liquidity and efficiency. Practices which enhance liquidity and efficiency are more likely to be acceptable than those that reduce liquidity and efficiency.*

14. *Procedures to be followed by Competent Authorities when considering whether to accept or continue to accept particular market practices:*

- *competent Authorities should put in place suitable procedures to consult as appropriate relevant bodies, including market participants, SROs, professional associations, investor associations, issuers, and market operators. Other Competent Authorities, including those in other jurisdictions where comparable markets exist, should also be consulted in order to attempt to reach a common position on the acceptability of practices;*

- *conclusions regarding the acceptability of market practices should be published by the Competent Authority and by CESR to aid transparency for all market users. This should include a description of the factors taken into account in determining whether a practice is regarded as acceptable, particularly where different conclusions have been reached regarding the acceptability of the same practice on different EU markets;*

- *regulators should ensure they are aware of emerging market practices. Market practices change rapidly to meet investors' needs and therefore regulators should be alert to new market practices.*

- *views on the continued acceptability of market practices should be reviewed following significant changes to the relevant market environment, for example changes to trading rules or the market infrastructure.*

IV DEFINITION OF "INSIDE INFORMATION" FOR DERIVATIVES ON COMMODITIES MARKETS

Extract from the mandate

Implementing measures related to the definitions of "Accepted market practices", and of "Inside information" for derivatives on commodities (Article 1 of the Directive)

In order to take account of developments on financial markets and to ensure uniform application of the Directive in the Community, DG Internal Market requests CESR to provide technical advice on possible draft implementing measures related to these definitions. Such measures shall not alter the substance of the definitions contained in Article 1.

In developing its advice, CESR shall have regard to the need to:

- respect national market practices where these do not unduly impinge on the coherence and the progress towards the Single Market;
- promote harmonisation throughout the community;
- promote sufficient transparency of accepted market practices for all market users.

Implementing measures related to the definition of "Inside information" for derivatives on commodities (Article 1 paragraph 1 subparagraph 2 of the Directive)

Article 1 paragraph 1 subparagraph 2 states: "In relation to derivatives on commodities, 'inside information' shall mean information of a precise nature which has not been made public, relating, directly or indirectly, to one or more such derivatives and which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practices on those markets."

The possible draft implementing measures should take account of:

- factors which need to be taken into account in deciding whether and when users of markets on which such commodity derivatives are traded would expect to receive the piece of information in accordance with market practices accepted by the competent authority on those markets.

Explanatory Text

15. Insider dealing and market manipulation prevent full and proper market transparency, which is a prerequisite for trading on commodity derivatives markets as well as other financial markets. In addition, "front running" in commodity derivatives may constitute market abuse under the terms of the Directive and member states are required to tackle this practice.

16. In considering implementing measures relating to the definition of "inside information" for commodity derivatives it is necessary to take account of (i) the markets on which the underlying commodities are traded, the characteristics of those commodities and the information relating to them which is required or expected to be disclosed; (ii) the generally accepted function of commodity derivatives markets of enabling users of those markets to transfer risk fairly; and (iii) the characteristics, structures and rules of the markets on which commodity derivatives are traded and the characteristics of users of those markets.

17. The markets on which the underlying commodities are traded are local, national and international markets. Some markets are regulated (to a greater or lesser extent) and others are not, but each market has its own rules and accepted market practices in relation to the disclosure of information relating to the commodities traded on it. These rules and accepted market practices reflect the characteristics of the commodities themselves and the markets on which they are traded. Accordingly, disclosure obligations may vary from market to market for the same commodity and from one country to another for the same type of commodity market. Other disclosure obligations may also be relevant: for example, information about some commodities is disclosed as a result of disclosure obligations on listed issuers or as a result of other EU regulation (e.g. in relation to electricity). Much information about commodities is relevant to users of commodity derivatives markets, and the competent authority should have regard to the disclosure regime of the underlying commodities markets. However, the competent authorities and users of commodity derivatives markets may have no control over the disclosure of information relating to the underlying commodities or markets on which they are traded.

18. Commodity derivatives markets have developed to facilitate the fair transfer of risk between market users (who are generally professional entities) by trading contract rights. These markets are very different from securities markets, and those differences, in particular the different disclosure rules applying to commodities (and derivatives on them) and to issuers of securities, mean that it is neither possible nor desirable to import equity securities markets disclosure rules to commodity derivatives markets.

19. Disclosable information in relation to commodity derivatives markets generally falls into one of four categories: (i) prices for commodity derivatives contracts; (ii) information about transactions and the positions of commodity derivatives market users; (iii) information relating to the terms and conditions of contracts which are traded on commodity derivatives markets or the characteristics, structures and rules of those markets; and (iv) information relating to commodities underlying

commodity derivatives markets. Third party client order information is neither information on which trading should be based nor is it information which should be disclosed, although market users are not restricted from using their own proprietary order information for trading purposes unless this amounts to market manipulation.

20. The disclosure of information by commodity derivatives markets users to the market or competent authority and to the public contributes to price formation and to market transparency. The determinants of whether and when price information is expected to be received are the law, rules, contracts and customs of the relevant market. Taken together these are the accepted practices of the market in question, and market users' expectations about receipt of that information are that the information will be disclosed in compliance with those accepted market practices.

21. Information about transactions and the positions of market users may include information about trading volumes and positions on either an aggregated or individual basis. This information provides transparency to market users, helps price formation and reveals market trends and major positions, and markets have accepted practices relating to the disclosure of this information which reflect the characteristics of the commodity derivative and the particular market. The determinants of whether and when transaction information and the positions of market users are expected to be received are also the law, rules, contracts and customs of the relevant market, and market users' expectations about receipt of that information are that it will be disclosed in compliance with those determinants.

22. Users of commodity derivatives markets expect to receive information relating to the terms and conditions of contracts which are traded on those markets or the characteristics, rules or structures of those markets from the market operator and/or competent authority on an equal footing in a timely manner. Trading should not be based on, for example, information relating to the terms and conditions of contracts which are traded on commodity derivatives markets until the information has been disclosed to the market as a whole.

23. Information relating to underlying commodities which commodity derivatives market users expect to receive depends on the features of the underlying commodity market and the nature of the commodity itself. The information may relate to the production, consumption, supply, demand, transactions, trading positions, prices, stocks or characteristics of the relevant commodity and what constitutes useful information will depend on the commodity concerned – for example, global data about some commodities is not generally of use to market users (e.g. disclosure of stock levels of a commodity without disclosure of quality). For each commodity and the markets on which it is traded there are generally accepted practices which determine the expectations of commodity derivatives market users about the receipt of that information. The expectation of commodity derivatives markets users about the receipt of such information is that it will be disclosed in accordance with the law, rules, contracts and customs of the relevant market on which the commodity underlying the derivative is traded.

Level 2 Advice

24. *Users of commodity derivatives markets expect to receive information relating, directly or indirectly, to one or more commodity derivatives* ***which*** *is:*

    i routinely made available to the users of those markets; or

    ii required to be disclosed in accordance with legal or regulatory provisions, market rules, contracts or customs on the relevant underlying commodity market or commodity derivatives market.

25. *Users of commodity derivatives markets expect to receive such information* ***when*** *it:*

    i becomes generally available to the users of those markets; or

    ii is disclosed to the users of those markets in accordance with the legal or regulatory provisions, market rules, contracts or customs of the relevant underlying commodity market or commodity derivatives market.

26. *In accepting practices, the Competent Authority for the relevant commodity derivatives market will act in accordance with the procedures set out in paragraph 14 above.*

V LISTS OF PERSONS HAVING ACCESS TO INSIDE INFORMATION

Extract from the mandate

Implementing measures concerning the conditions under which issuers, or entities acting on their behalf, are to draw up a list of those persons working for them and having access to inside information; implementing measures concerning the conditions under which such lists are to be updated (Article 6 paragraph 10 fourth indent of the Directive)

Article 6 paragraph 10 fourth indent states: "(10)[In order to take account of technical developments on financial markets and to ensure uniform application of this Directive, the Commission shall adopt, in accordance with the procedure referred to in Article 17(2), implementing measures concerning:…]

- the conditions under which issuers, or entities acting on their behalf, are to draw up a list of those persons working for them and having access to inside information, as referred to in paragraph 3, together with the conditions under which such lists are to be updated."

Article 6 paragraph 3 states: "… Member States shall require that issuers, or persons acting on their behalf or for their account, draw up a list of those persons working for them, under a contract of employment or otherwise, who have access to inside information. Issuers and persons acting on their behalf or for their account shall regularly update this list and transmit it to the competent authority whenever the latter requests it".

The possible draft implementing measures should take account of:

- the criteria which trigger the duty to draw up insiders' lists
- the criteria which trigger the duty to update insiders' lists.

Explanatory Text

27. The scope of CESR's mandate seeks advice in relation to the criteria which trigger the duty to draw up and update insiders' lists. Significantly, the mandate does not give CESR the scope to advise, or propose measures, in relation to other methods of controlling the distribution of inside information; however, it is essential that issuers have adequate systems, controls and procedures in place both to monitor the flow of inside information and also to enable them to comply with their obligations under the Directive.

28. CESR's advice would give flexibility to issuers to enable them to create and update insiders' lists in a way which best reflects their internal arrangements. For example, issuers within which the only persons who have access to inside information are those who habitually have such access would be required to draw up and update a list containing only those individuals.

29. CESR's advice identifies the criteria which trigger the duty to update the lists of persons who have access to inside information. For example, when a person that does not have habitual access to inside information gains an occasional access to an issuer's inside information, i.e., because inside information is not disclosed as soon as possible, the list should be promptly updated to include this person and the date of the update should be included on the list. Also, when the reason that a person with occasional access to inside information ceases to apply, the list should be updated to remove that person.

30. In relation to the reason why a person is on an issuer's list, the list should indicate, in general terms at least, the nature of the inside information to which the person listed has access.

31. CESR's advice in response to this part of the mandate does not address the issue of what information is inside information, nor when it may arise. Inside information is defined in the Directive, and has been subject to advice from CESR; and the circumstances in which it might exist (rather than being publicly disclosed, at which point it ceases to be inside information) are identified by reference to that definition.

Level 2 Advice

32. *Issuers and persons acting on their behalf or for their account should draw up a list of all those persons working for them, under a contract of employment or otherwise, who have access to inside information whether on a habitual or on an occasional basis.*

33. *Issuers and persons acting on their behalf or for their account should review and update the list when (i) there is a change in the identity or function of any person on the list; or (ii) there is a change in the reason why any person is on the list or (iii) a new person has to be added to the list.*

34. *The list should state at least:*

- *the identity of all persons with access to inside information;*
- *the functions of those persons;*
- *the reason why the person is on the list;*
- *the date the list was created and updated.*

35. *A complete record of the list should be kept for at least 5 years.*

36. *Issuers and persons acting on their behalf or for their account should ensure that the persons that may have access to inside information are aware of 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.*

VI DISCLOSURE OF TRANSACTIONS

Extract from the mandate

Implementing measures concerning the categories of persons subject to a duty of disclosure of transactions conducted on their own account and the characteristics of a transaction, including its size, which triggers that duty; implementing measures concerning the technical arrangements for disclosure to the competent authority (Article 6 paragraph 10 fifth indent of the Directive)

Article 6 paragraph 10 fifth indent states: "(10)[In order to take account of technical developments on financial markets and to ensure uniform application of this Directive, the Commission shall adopt, in accordance with the procedure referred to in Article 17(2), implementing measures concerning:…]

- the categories of persons who are subject to a duty of disclosure as referred to in paragraph 4 and the characteristics of a transaction, including its size, which trigger that duty, and the technical arrangements for disclosure to the competent authority."

Article 6 paragraph 4 states: "4. Persons discharging managerial responsibilities within an issuer of financial instruments and, where applicable, persons closely associated with them, shall, at least, notify to the competent authority the existence of transactions conducted on their own account relating to shares of the said issuer, or to derivatives or other financial instruments linked to them. Member States shall ensure that public access to information concerning such transactions, on at least an individual basis, is readily available as soon as possible."

The possible draft implementing measures should take account of:

- the criteria for identifying persons discharging managerial responsibilities within an issuer

- the criteria for identifying persons closely associated with persons referred to at the previous indent

- the criteria (including in terms of size) for determining when a transaction triggers the duty of disclosure

- the criteria for how and when the persons mentioned above shall inform the competent authority of the existence of transactions conducted on their own account relating to shares of the said issuer or to derivatives or other financial instruments linked to them.


CESR

Introduction

37. Article 6 paragraph 10, 5th indent provides for implementing measures only for the disclosure to the competent authority and not to the public. The mandate requests CESR to give advice regarding the categories of persons who are subject to a duty of disclosure and the characteristics of a transaction, including it size, which trigger that duty, and the technical arrangements for disclosure to the competent authority.

38. According to the European Commission, article 6(4) when read in conjunction with recital 26, would appear to have a narrow scope. Article 6(4) refers to "…transactions conducted on their [persons with managerial responsibilities within issuers] own account……" and recital 26 says "…transactions conducted by [a person with managerial responsibilities within issuers]…….". In this context, it is questionable whether the following activities fall within the scope of article 6(4):

- The transfer of financial instruments as part of an inheritance;
- An acceptance of a gift;
- The transfer of shares or the grant of stock options by an issuer.

39. However, it should be recorded that, with the exception of inheritance, the majority of CESR members believe that disclosure duties should also apply for these activities.

The criteria for identifying persons discharging managerial responsibilities within an issuer

Explanatory Text

40. When implementing this requirement it is crucial to find sufficient criteria for identifying persons with managerial responsibilities within issuers and persons closely associated with them. CESR's advice is principally focussed on those persons who are members of the administrative, management or supervisory bodies of the issuer. In addition, where in some countries top executives who do not participate in these bodies have decision making powers and decide on the future development and business prospects of the issuer, they should disclose their transactions.

41. CESR is of the view that the requirement "..within an issuer.." excludes external persons such as auditors and other advisers and service providers who may be closely linked to the issuer, but are not to be regarded as being closely associated with the persons discharging managerial responsibilities within the issuer.

Level 2 Advice

42. *Persons discharging managerial responsibilities within an issuer are:*

- *members of the administrative, management or supervisory bodies of the issuer,*
- *top executives who are not members of these bodies and who habitually have access to inside information and who have decision making powers.*

The criteria for identifying persons closely associated with persons referred to at the previous indent

Explanatory Text

43. The disclosure of transactions by persons closely associated with persons discharging managerial responsibilities would help to prevent the evasion of the transaction disclosure rules. For that reason it is important to cover all entities whose economic interests are substantially equivalent to those discharging managerial responsibilities. Moreover all relatives living on a long-term basis in the same household with the person discharging managerial responsibilities should disclose their transactions in financial instrument of the relevant issuer.

Level 2 Advice

44. *Persons closely associated with a person discharging managerial responsibilities within an issuer are:*
- *The spouse (or any partner considered by national law as equivalent to the spouse) and the dependent children of the person discharging managerial responsibilities;*
- *other relatives of the person discharging managerial responsibilities, sharing on a long term basis the same household as the person discharging managerial responsibilities.*
- *Furthermore, all trusts, companies and other legal persons are subject to the disclosure requirements, if a person discharging managerial responsibilities within an issuer, or a person closely associated with him, has the power to manage its business or to materially influence its management decisions.*

The criteria (including in terms of size) for determining when a transaction triggers the duty of disclosure

Explanatory Text

45. CESR, almost unanimously, proposes not to include thresholds as the disclosure obligations could be easily circumvented. Furthermore, it is not possible to find a common threshold due to the diversity of EU markets in terms of structure and liquidity. One member maintains the view that a threshold for disclosing transactions should be proposed.

Level 2 Advice

46. *The disclosure obligation to the competent authority should cover all transactions in shares of the said issuer or in derivatives or other financial instruments linked to them within the scope of article 6(4) of Directive 2003/6/EC.*

The criteria for how and when the persons mentioned above shall inform the competent authority of the existence of transactions conducted on their own account relating to shares of the said issuer or to derivatives or other financial instruments linked to them

Explanatory Text

47. To ensure effective supervision, disclosure of the transaction to the Competent Authority must occur as soon as possible.

Level 2 Advice

48. *Member States should ensure that the disclosure should be made to the Competent Authority within three working days from the trading date. The notification must contain:*

- *name and the reason for responsibility to notify*
- *name of the relevant issuer*
- *name, class/description of the financial instrument*
- *nature of the transaction (acquisition/disposal/other)*
- *date (trading day) and market of the transaction*
- *price and volume of financial instruments*

VI SUSPICIOUS TRANSACTIONS

Extract from the Additional Mandate

Implementing measures concerning technical arrangements governing notification of suspicious transactions to the competent authority by any person professionally arranging transactions in financial instruments (article 6 paragraph 10 last indent of the directive)

Article 6, paragraph 9, of Directive 2003/6/EC of the European Parliament and the Council on Insider Dealing and Market Manipulation (Market Abuse) (hereinafter referred to as "the Directive") states that "Member States shall require that any person professionally arranging transactions in financial instruments who reasonably suspects that a transaction might constitute insider dealing or market manipulation shall notify the competent authority without delay."

Article 6, paragraph 10, last indent, of the Directive states that the Commission shall adopt implementing measures concerning "technical arrangements governing notification to the competent authority by the persons referred to in paragraph 9."

In respect of the above-mentioned provisions and in view of the adoption of implementing measures in accordance with Article 17.2 of the Directive, CESR's technical advice has been requested on the following aspects:

"the criteria for determining how and when persons professionally arranging transactions in financial instruments shall notify the competent authority of suspicious transactions; in particular, the criteria for determining the notifiable transactions, the timeframe for such notification and the characteristics of the transactions to be notified, taking into account the Directive on Insider Dealing and Market Manipulation (Market Abuse) and the first advice delivered by CESR to the European Commission on 31 December 2002."

Introduction

49. Article 6.9 of the Directive illustrates the concern on the part of the European legislator to make market integrity a focus for all professional economic operators, both through combating market abuse and by preventing such abuse.

50. Based on the spirit of the measures taken at European level to prevent and combat money laundering (see the European Parliament's opinion of 14 March 2002 on the proposed Market Abuse Directive), Article 6.9. imposes upon persons professionally arranging transactions in financial instruments the obligation to notify without delay to the competent authority those transactions which they have reasons to suspect might constitute insider dealing or market manipulation.

51. This is both a preventive measure to compel persons subject to that obligation to be critical towards the transactions in financial instruments they carry out, and a possible tool for supervision by the competent authority.

52. CESR is aware that the Directive does not specify that notification in good faith to the competent authority does not, on the part of its initiators, constitute a breach of any duty of confidentiality imposed by a contract or legal, regulatory or administrative provision, nor that such notification in good faith does not entail any liability whatsoever.

53. Although aware of the usefulness of such provision, CESR is of the opinion that it falls outside the scope of the mandate as it has been given by the Commission.

Criteria for determining the notifiable transactions

Explanatory Text

54. In accordance with Article 6.9 of the Directive, transactions in financial instruments which might constitute insider dealing or market manipulation within the meaning of the Directive must be notified to the competent authority. As a result, said transactions must be assessed by reference to the elements constituting insider dealing and market manipulation as defined in Articles 1 to 5 of the Directive, completed with any implementing measure adopted by the European Commission.

55. CESR considers that a balance has to be reached in the reading of the Directive between the obligation stated by Article 6.9 and the responsibility of the competent authority. According to Article 6.9 of the Directive, the notification has to be made if the person arranging the transaction *suspects* that the transaction might be abusive. That person is not responsible for investigating whether the transaction indeed constitutes an infringement of the Directive or not. This responsibility lies with the competent authority. CESR considers that the Directive does not require the notifying person to be in possession of evidence. However that person will nevertheless need to have sufficient indications that the transaction might be abusive before notifying a transaction. In order to make this assessment, internal procedures are advisable.

56. Regarding the elements constituting insider dealing and market manipulation, CESR provides technical advice on different parts of the definitions of insider dealing and market manipulation for the purpose of the adoption of implementing measures in its first Advice on Level 2 Implementing Measures on the Market Abuse Directive (CESR/02.089d).

57. More specifically, for the purpose of this paper, it is useful, besides the provisions of the Directive, to refer to the parts of CESR's advice relating to the definition of inside information (Article 1.1) and of market manipulation (Article 1.2) and to the safe harbours mentioned in Article 8 of the Directive.

58. As regards *market manipulation*, CESR's first Advice on Level 2 Implementing Measures on the Market Abuse Directive sets out indicative factors that identify

possible market manipulative behaviours involving either transactions or orders to trade 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, certain indicative factors relating to transactions or orders to trade which employ fictitious devices or other forms of deception or contrivance are also identified.

59. CESR considers that these non-exhaustive factors can be taken into account by market participants subject to Article 6.9 of the Directive in view of determining whether a given transaction might constitute market manipulation within the meaning of Article 1.2 (a) and (b) of the Directive. In that connection, reference is made to paragraphs 47 and 50 of CESR's first Advice for the list of those factors (See Annex C).

60. In addition to these Level 2 advised factors, CESR has also identified "diagnostics flags", i.e. indicators of market manipulative behaviours that could lead to the regulator's further scrutiny, such as sudden and unusual changes in the price of a financial instrument, unusual concentration of transactions in a limited number of clients, unusual repetition of transactions among a limited number of persons over a given period of time (paragraphs 42 – 44 of the first CESR Advice). Although these "diagnostic flags" are meant for supervision by the competent authority and may require a broader view of the market, the persons subject to a notification obligation according to Article 6.9 of the Directive can also use some of these indicators in their assessment of the suspicious nature of a transaction.

61. Competent Authorities should consult where appropriate to ensure a degree of certainty about the elements that trigger the duty to disclose suspicious transactions, in order to facilitate the decisions made by intermediaries. This should underpin a common and workable approach within the internal market.

62. As regards *insider dealing*, according to Article 2 of the Directive, insider dealing also covers the fact of any person referred to in Article 2.1, second subparagraph, who possesses inside information, to use that information by acquiring or disposing of, or by trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates.

63. According to Article 3 of the Directive, insider dealing also covers the fact of the above-mentioned person disclosing inside information to any other person unless such disclosure is made in the normal course of the exercise of his employment, profession or duties, and recommending or inducing another person, on the basis of inside information, to acquire or dispose of financial instruments to which that information relates.

64. CESR considers that the purpose of the present advice cannot be to give technical advice on the constitutive elements of the prohibitions stated in the above-mentioned Articles 1 to 5 of the Directive, e.g. on the use of inside information, etc., which are Level 1 issues.

Level 2 Advice

65. *The criteria for determining the notifiable transactions shall include the following:*

- *In order to determine whether a transaction in financial instruments might constitute insider dealing or market manipulation, transactions must be assessed by reference to the elements constituting insider dealing and market manipulation as defined in Articles 1 to 5 of the Directive itself, completed with any implementing measure adopted by the European Commission in accordance with Article 17.2 of the Directive.*
- *Persons subject to the obligation to notify the competent authority shall decide on a case-by-case basis whether a transaction is suspicious. The notification obligation has to be fulfilled if the persons have sufficient indications that the transaction might be abusive.*
- *Certain transactions can seem completely void of anything suspicious when considered separately, but can take on a more suspicious aspect when seen in perspective with other transactions, a certain conduct or other information (e.g. information to the effect that the third party for whose account the transaction is executed could be an insider). In this case, the assessment shall include all such elements.*

Timeframe for notification

Explanatory Text

66. According to Article 6.9 of the Directive, the notification to the competent authority must occur "without delay" once the person professionally arranging transactions in financial instruments reasonably suspects that a transaction might constitute insider dealing or market manipulation.

67. The notification must occur immediately after the person becomes aware of any fact, as a result of which the transaction seems to be suspicious. Depending on the type/nature of transaction(s), notification without delay shall mean immediately after the suspicious transaction(s) has (have) been carried out or, after completing a transaction, immediately after a party under obligation to notify becomes aware of such fact as a result of which the transaction(s) seems to be suspicious.

Level 2 Advice

68. *In relation to a transaction or a group of transactions, notification without delay shall mean immediately after a party under obligation to notify becomes aware of any fact, as a result of which the transaction or the group of transactions seem to be suspicious.*

Transactions particulars to be notified

Explanatory Text

69. It should be noted that transactions referred to in Article 6.9 of the Directive include any transaction entailing a transfer of financial instruments.

Level 2 Advice

70. *The following information shall be included in the notification to the competent authority:*

- *Type/Nature of the transaction (e.g. acquisition through an order to buy or sell, through subscription to an IPO, etc.);*
- *Reason(s) why the person suspects that this transaction, or group of transactions, might constitute insider dealing or market manipulation;*
- *Name and any other means of identification (e.g. investment account number, passport number, etc.), address of the person on behalf of whom the transaction has been executed;*
- *Names and any other means of identification, addresses of other parties involved;*
- *Name and nature of the financial instrument concerned;*
- *Capacity in which the person subject to the notification obligation operates (for own account, on behalf of a third party, etc.);*
- *Whether the transaction(s) is (are) carried out on or outside a regulated market;*

- *Date and time of the transaction;*
- *Size of the transaction (volume/number of financial instruments concerned and value/price);*
- *Any information and documents which may have significance in reviewing the case;*
- *In the case of reception, transmission and/or execution of an order to buy or sell financial instruments:*
    - ♦ *the market in which it was executed;*
    - ♦ *the type of order executed (limit order, market order, other characteristics of the order);*
    - ♦ *the type of trading market (block trade, retail trade, etc).*

71. *The person subject to the notification obligation shall include in his notification as much information, mentioned in paragraph 70, as available at the time of notification and at least the reasons why he suspects that a transaction, or group of transactions, might constitute insider dealing or market manipulation. Without prejudice to paragraph 68 the remaining information shall be provided to the competent authority as soon as possible.*

Means of notification

Explanatory Text

72. As regards the mode of notification, the notification should be made by the person professionally arranging transactions in financial instruments himself, whether the person is a natural or a legal person according to Article 1.6 of the Directive**.**
73. Although the employees of the person professionally arranging transactions in financial instruments are not subject to any notification duty themselves, their collaboration is of course an important element. In this perspective, the existence of internal procedures which make the employees aware of the notification duty is advisable.

Level 2 Advice

74. *Notification to the competent authority can be done in writing, by e-mail or by telephone, provided in the latter case that confirmation is sent as soon as possible by any written form if the competent authority requests it.*

ANNEX A

http://europa.eu.int/comm/internal_market/en/finances/mobil/docs/cesr/cesr-mandate-insiderdealing_en.pdf

ANNEX B – Members of the Consultative Working Group

Dr C Hausmaninger, Hausmaninger Herbst Wietrzyk, Austria

Mr P Verelst, Interbrew NV, Belgium

Dr U Bosch, Deutsche Bank AG, Germany

Dr C Di Noia, Assonime, Italy

Mr J Thiriart, Luxembourg Stock Exchange, Luxembourg

Professor S Eisma, De Brauw Blackstone Westbroek, Netherlands

Mr F Rognlien, Association of Norwegian Stockbroking Companies, Norway

Mr A del Campo, Banco Bilbao Vizcaya Argentaria, Spain

Mr L. Milberg, The Swedish Shareholders Association, Sweden

Mr M McKee, British Bankers Association, UK

ANNEX C – CESR's Process for delivering its Advice

1. The Market Abuse Directive ("the Directive") was adopted on 3 December 2002.

2. On 31 December 2002, CESR submitted its first technical advice *CESR's Advice on Level 2 Implementing Measures for the proposed Market Abuse Directive (Ref: CESR/02.089d)* to the European Commission in response to the Commission's request (mandate first published on 27 March 2002) for technical advice on the Directive.

3. On 31 January 2003, the Commission published *An additional mandate to CESR for technical advice on possible implementing measures concerning the Directive on Insider Dealing and Market Manipulation (Market Abuse) (Ref: MARKT/G2 D(2003)*. The Commission asked CESR to deliver its technical advice by 31 August 2003.

4. Annex A of this paper sets out the full text of the additional mandate.

5. A full list of members of the CWG can be found at Annex B.

6. The CESR Expert Group has also been assisted in developing its advice on inside information for commodity derivatives by an ad hoc group of market experts. The CESR Expert Group held one meeting with the ad hoc group and subsequently received a number of additional written submissions. CESR is grateful for the input of the ad hoc group in this area.

7. The timetable for handling the second mandate was as follows:

2003 31 January	Commission publishes second mandate to CESR on Market Abuse Directive.
7 February	CESR publishes Call For Evidence (Ref: CESR/03-037) on website.
28 February	Deadline for submissions to CESR on Call For Evidence.
1 March – 15 April	CESR, with expert assistance from the Consultative Working Group and an ad hoc group of market experts on commodity derivatives, prepares draft consultation paper.
15 April	CESR publishes consultation paper. Consultation period begins.
12 May	Open hearing on consultation paper in Paris.
15 June	Consultation period closes.
31 August	Submission of CESR's advice to the European Commission in accordance with the deadline set in the mandate.

	accordance with the deadline set in the mandate.

References

8. The additional mandate asked that CESR should have regard to a number of principles and a working approach agreed between DG Internal Market and the European Securities Committee in developing its advice. These are as follows:

    - CESR should take account of the principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001.

    - CESR should take full account of the key objectives of the Market Abuse Directive: the need to increase market integrity and to protect investors.

    - CESR should not seek to produce a legal text.

    - CESR has immediately started work on the additional technical advice, on the basis of the Directive adopted on 3 December 2002, in order to meet the December 2003 deadline set by the Stockholm European Council for achievement of an integrated EU securities market.

9. Papers already published by CESR which are relevant to this mandate are:

    - *A European Regime Against Market Abuse (Ref: FESCO/00-061)* September 2000

    - *Measures to Promote Market Integrity (Ref: CESR/01 – 052h)* February 2002

    - *CESR's Advice on Level 2 Implementing Measures for the proposed Market Abuse Directive (Ref: CESR/02.089d)* December 2002

    - *CESR Market Abuse Feedback Statement (Ref: CESR/02-287b)* December 2002

ANNEX D

Extract from CESR's Advice on Level 2 Implementing Measures for the proposed Market Abuse
Directive (CESR/02.089d)

Article 1 - Market Manipulation

Extract from the 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.

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

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

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

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.
It should be stressed that the proposed directive does not lay down any 'defence' regarding transactions or orders to trade treated in this part of the paper.

Level 2 advice

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.