THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/03-102b

Market Abuse
Additional Level 2 Implementing Measures

Consultation Paper

April 2003

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EXECUTIVE SUMMARY

Background

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.

Purpose

The purpose of this consultation document from CESR is to seek comments on the advice that CESR proposes to give to the European Commission on a number of these implementing measures. The measures covered are those that are set out in a mandate received by CESR from the EU Commission.

Consultation Period

Consultation closes on 15th June 2003.

Areas Covered

- **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 abuse. CESR proposes that the technical implementing measures should only focus on principles and the process by which practices are accepted.

- **Inside information in commodity derivatives markets:** The directive recognises that there needs to be a different approach as regards inside information on commodity derivative markets. CESR's advice focuses on price, transaction and contract information together with information on the underlying markets. However in all cases the information varies according to the type of commodity market.

- **Insiders' lists:** The directive requires all issuers and third parties acting on their behalf or for their account with access to inside information to draw up lists of insiders. CESR proposes that those concerned should maintain lists of persons with access to inside information together with permanent lists of those who have regular access to inside information. These lists should be updated on a continuous basis to ensure that they are always current.

- **Disclosure of transactions:** The directive requires those in managerial positions within an issuer to disclose dealings in the shares of the issuer. CESR proposes that this obligation should cover members of the administrative, management or supervisory boards of the issuer together with senior managers having similar decision making capacity within the issuer.

- **Notification of suspicious transactions:** The directive requires intermediaries to notify the competent authority of transactions that they suspect of being abusive. CESR proposes that notification should occur once suspicions are aroused. These persons need not have any evidence. The notification obligation has to be fulfilled if the person professionally arranging transactions has sufficient indications that the transaction might be abusive.

Notification can be done by any means and confirmation can be provided in writing at the request of the competent authority.

Further Details

Full details of CESR's proposed advice, together with contact details can be found in the consultation paper.

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I INTRODUCTION

1. CESR invites responses to this consultation paper on its proposed advice to the European Commission regarding a second set of technical implementing measures for the Directive on Insider Dealing and Market Manipulation (Market Abuse).

2. Respondents to this consultation paper should address their input to Mr Fabrice Demarigny, Secretary General, CESR, by email at secretariat@europefesco.org.

Background

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

4. 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.

5. 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.

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

7. The CESR Expert Group on Market Abuse, responsible for developing the first advice to the Commission under the chairmanship of Pr. Stavros Thomadakis, is taking forward the work on the second mandate. The group will be supported by Mr Nigel Phipps of the CESR secretariat. The Consultative Working Group (the "CWG") established under the terms of CESR's Public Statement of Consultation Practices (Ref: CESR/01-007c) will continue to advise the Expert Group.

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

9. 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.

10. On 7 February 2002, CESR published a Call For Evidence (Ref: CESR/03-037) inviting all interested parties to submit views by 28 February 2003 on the issues which CESR should consider in its advice to the Commission. CESR received around 20 submissions and these can be viewed on the CESR website. A summary of the main issues emerging from responses to the Call for Evidence can be found at Annex C. The Expert Group has taken the issues raised in the submissions into consideration in the development of this consultation paper.

11. The timetable for handling the second mandate is set out below.

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.
16 June – 25 July	Formulation of CESR draft advice and final agreement on policy proposals by CESR Chairmen on 25 July.
26 July – 31 August	Finalisation of CESR advice.
31 August	Deadline for submission of CESR's advice to European Commission.

12. CESR regrets that it has been necessary to bring forward the consultation closing date by two weeks to ensure that consultation comments can be fully reflected in the final advice to be approved by the CESR Chairmen. A supplementary meeting of the Chairmen has been convened on 25 July 2003 to approve the level 2 advice on both market abuse and prospectuses.

References

13. The additional mandate asks 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.

14. 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

II PRELIMINARY STATEMENT BY STAVROS THOMADAKIS

15. This second mandate from the European Commission reflects the evolution of the text of the Directive during discussions in the European Parliament and the Council, including the addition of a number of areas requiring implementing measures. The mandate has been limited to those measures deemed by the European Commission to be necessary in order to ensure a full implementation of the Directive within the stipulated timetable (18 months after publication in the Official Journal).

16. Respondents to the consultation on CESR's first advice on market abuse highlighted the difficulties created by the very tight timetable which CESR had to impose to meet the Commission's deadline for receipt of the advice by 31 December 2002. CESR recognises this criticism and strived to ensure the maximum amount of time possible for the consultation process. The overall timetable for the Lamfalussy procedure is, however, largely outside of CESR's control and, in responding to this second mandate, each of the parties involved will again be working to tight deadlines.

17. CESR has, however, attempted to address some of the concern expressed by ensuring that its draft advice remains firmly within the confines of the mandate. Supplementary text has been reduced to ensure interested parties can focus on the precise areas which CESR is proposing to recommend to the European Commission for treatment at level 2.

18. Experience with the first mandate suggests that many respondents may use the consultation exercise to highlight their points of more general concern with the level 1 text. These are not, however, within CESR's power to address, as CESR must remain firmly within the terms of its level 2 mandate.

19. The new mandate focuses on four substantive areas:

- Guidelines for Competent Authorities to follow when considering whether practices should be regarded as accepted market practices.
- Inside information in the commodity derivatives markets.
- Maintenance of insider lists and disclosure of dealings by those in positions of managerial responsibility.
- Notification of suspicious transactions to the Competent Authority.

20. On accepted market practices, the focus will be on principles and process. There is clearly a link between the mandate in this area and CESR's previous advice on factors which may indicate that market manipulation has occurred. On commodity derivatives, in consultation with market operators, CESR has developed proposals which recognise the difference between commodity derivatives markets and securities markets. There are very few commodity derivative contracts currently traded on regulated markets in the ISD sense, but it is important to ensure that such instruments are provided for within the scope of the market abuse regime, in the light of the anticipated future revision of the ISD. On transactions' disclosure, the expert group proposes that members of the issuer's management and supervisory body should be within the scope of this provision and it is suggested that no threshold should apply. On insiders' lists, the expert Group is proposing that issuers should be required to draw up lists of insiders in connection with inside

information and to update them on a continuous basis. Finally, on suspicious transactions the expert group determines how and when persons professionally arranging transactions in financial instruments shall notify the competent authority of suspicious transactions.

21. CESR has included a number of questions to highlight those areas in which it would be particularly helpful to have views. Comments are, of course, welcome on all aspects of the proposed CESR advice but, if changes are required, any reasoning accompanied by any practical examples of the impact of the proposals will be very useful. CESR also welcomes specific drafting proposals when respondents are seeking changes to the proposed text.

The Consultative Working Group

22. CESR is grateful for the ongoing assistance of the Consultative Working Group (CWG), established in connection with the first mandate on market abuse. There have been two meetings between the CWG and CESR's Expert Group on the second mandate, during which the CWG provided comment and guidance on developing drafts of the paper. The CWG will continue to offer its views and advice to CESR as work on the second mandate progresses.

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

23. 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.

24. It is clear 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.

25. 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.

26. As regards market manipulation, the following advice applies to the consideration of potentially manipulative market practices in all relevant markets, including commodity derivative markets.

27. 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.

28. 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.

29. 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.

30. 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.

31. 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 in any circumstance an accepted market practice cannot involve a breach of applicable anti-market abuse regulations in the 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 accepted 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.

32. 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 us 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.

33. The second section considers certain procedures that Competent Authorities should follow when considering whether a practice can be regarded as an accepted market practice.

Level 2 advice

34. *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 intermediaries to operate fairly and efficiently and in the interests of clients 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).*

35. *Non-exhaustive list of factors to be taken into account by Competent Authorities when assessing particular practices:*

- *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;*
- *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;*
- *consideration of the prevalence of the practice amongst intermediaries. The more widespread a practice is, the more likely it is that it will be accepted;*
- *the risks inherent in the practice for the integrity of the wider market in the financial instrument, including any market in the financial instrument which exists on another trading venue and related markets in related financial instruments. The greater the risk to the integrity of the wider market, 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 comparable markets in the EU – it seems unlikely that a practice which breaches such rules or regulations could be regarded as acceptable. Similarly, the extent to which a practice breaches any applicable codes of conduct should also be considered, though this will be less*

persuasive given the lower regulatory status of codes of conduct compared to rules or regulations;

- *the structural characteristics of the market in question including 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.*

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

- *Competent Authorities should put in place suitable procedures to consult as appropriate relevant market participants (intermediaries, SROs, market authorities, professional associations, consumers associations, issuers) and other Competent Authorities, including those in other jurisdictions where comparable markets exist;*

- *conclusions regarding the acceptability of market practices should be published to aid transparency for all market users;*

- *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.*

Questions

Question 1: Is the proposed approach appropriate, focussing both on the characteristics of particular market practices and the procedures that Competent Authorities should follow?

Question 2: Are the suggested principles, factors and procedures appropriate? Would you consider adding more factors such as the degree to which a practice has a significant effect on prices and in particular on reference prices?

Question 3: The Directive focuses on accepted market practices "on the regulated market concerned", but the prohibitions of the Directive also apply to OTC trading. Is it necessary to make any distinction between standards of acceptable market practices on regulated markets and OTC practices? Is it also necessary to make distinctions between standards of acceptable market practices in different kind of regulated markets or MTFs (e.g. order driven or price driven)?

Question 4: Do you agree that a practice need not be identifiable as already having been explicitly accepted by a competent authority before it can be undertaken?

Question 5: CESR is committed to the future discussion of specific market practices as part of the Level 3 work necessary to increase the harmonisation of accepted practices where appropriate. Please specify any examples of particular practices which you consider could be classified as accepted market practices for the purposes of the Directive.

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

37. 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.

38. 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.

39. 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.

40. 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 securities markets disclosure rules to commodity derivatives markets.

41. Disclosable information in relation to commodity derivatives markets generally falls into one of four categories: (i) prices for commodities 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.

42. 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.

43. 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.

44. 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 commodities derivatives markets until the information has been disclosed to the market as a whole.

45. 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

46. *Users of commodity derivatives markets expect to receive information* ***which*** *is:*

i. *generally available to the users of those markets; or*

ii. *required as a result of legal or regulatory provisions, market rules, contracts or customs on the relevant commodity derivatives market; or*

iii. *required as a result of legal or regulatory provisions, market rules, contracts or customs in accordance with practices on the relevant underlying commodity market.*

The above information must however be received in accordance with practices on those commodity derivative markets accepted by the Competent Authority. In accepting practices, the Competent Authority will act in accordance with the procedures set out in paragraph 36 above.

47. *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 published to the users of those markets in accordance with:*

a. *the legal or regulatory provisions, market rules, contracts or customs of the relevant commodity derivatives market; or*
b. *the legal or regulatory provisions, market rules, contracts or customs of the relevant underlying commodity market.*

Questions

Question 6: Has CESR correctly identified all the relevant and material market, product and information factors relevant to the definition of "inside information" for commodity derivatives?

Question 7: Is there further information which is material, relevant and disclosable in relation to commodity derivatives markets?

Question 8: Does the draft advice accurately reflect the information relating to underlying commodities which commodity derivatives markets users expect to receive?

Question 9: Is there any additional guidance that CESR should consider giving in relation to the definition of "inside information" for commodity derivatives?

V INSIDERS' LISTS

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.*

Introduction

48. According to Article. 6 of the Directive, confidentiality issues immediately arise when inside information is not disclosed, i.e. when it is not yet possible to disclose it or when the issuer decides to delay disclosure.

49. In this respect the duty required by the Directive of drawing up a list of persons that have access to inside information may assist prevention. The requirement for a list implies that the issuer should control and monitor inside information flows within its sphere of activity. The Directive invites economic actors to define procedures aimed at preventing the undue circulation of inside information (see Recital 24 of the Directive).

50. In addition, the list provides the competent authority with a tool to assist detection and investigation of insider dealing cases. Competent authorities have broad experience in working with "insiders' lists" especially in investigations concerning insider dealing. The list is useful for the competent authority to check if those on the list carried out suspicious transactions before the public disclosure of the inside information.

The criteria which trigger the duty to draw up insiders' lists

Explanatory text

51. As stated above, if inside information is not disclosed it immediately gives rise to the need to ensure the confidentiality of the inside information and to control access to it. Therefore issuers and persons acting on their behalf or for their account should immediately establish a list of persons who have access to that specific inside information.

52. Because persons on the list are deemed by the competent authorities to have access to inside information, CESR holds the view that an issuer should establish a list for each matter or event when it becomes inside information that is not yet disclosed. Otherwise, if an issuer creates a single list covering different inside information, misleading consequences might occur, i.e. a person that is on the list could be supposed to possess specific inside information which he/she does not. In addition, by establishing a number of lists, the issuer can better monitor the access to inside information.

53. Depending on the inside information, CESR is inclined to extend the duty to draw up the list to a wide range of persons acting on behalf of or for the account of the issuer.

54. Insiders' lists should be closed when the inside information becomes public, but they should not be destroyed, because they might be needed for future investigations.

55. In order to identify when an information becomes inside information and therefore when issuers and persons acting on their behalf or for their account should establish a list, issuers should refer to CESR's first advice on Level 2 Implementing Measures on the Market Abuse Directive (CESR/02.089d) on the definition of inside information and of its disclosure.

56. On the basis of the different kind of inside information and of the different regime for their disclosure, as required by level 1 provisions and envisaged by level 2 advice, the following illustrative system may be developed :

- in relation to inside information regarding situations which enable the issuer to delay disclosure (see point 70 of CESR's first Level 2 advice on public disclosure, reference as above), issuers, or persons acting on their behalf or for their account, are expected to draw up a list for each matter or event when it becomes inside information . In this case the list should be updated with any new person who gets to know the information during the period when disclosure is delayed;

- in relation to inside information regarding, for instance, the invention of a new product or model or formula, the issuer could draw up a list that includes persons that work in the relevant business units, departments, laboratories or offices, until the inside information is disclosed. In this case the list should be drawn up when the company is aware or suspects the success – or, in more general terms, the results - of the new invention;

- in relation to inside information that is produced by an issuer on a continuous basis which it is not yet possible to disclose (see article. 6(1) of the Directive) –persons that work in the relevant offices could be deemed to be always in possession of the inside information and thus the issuer should draw up a "permanent" list of those persons or offices, namely the CEO, secretaries, compliance officers, etc.

57. The above examples show that establishing lists are quite demanding activities that require continuous monitoring of inside information flows.. Therefore, it would suggest the need

for dedicated resources (such as a compliance office) that could govern all these activities. These persons should also be able to assess the impact of specific information on the global issuer's market performance, which is affected by all the information produced by the issuer.

Level 2 advice

58. *Issuers and persons acting on their behalf or for their account should immediately establish an "insider" list of natural and legal persons who have, or have had, access to a matter or event when it becomes inside information.*

59. *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 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.*

60. *Each list should indicate at least:*

- *the related matter or event,*
- *the person's functions and responsibilities,*
- *when the person had access to it for the first time,*
- *if and when the person had no more access to subsequent information relating to the event or matter.*

61. *In the event that an issuer has internal persons who have regular access to inside information within the issuer, the issuer should draw up a "permanent" list of these persons.*

62. *Depending on the nature of the inside information, persons acting on behalf or for account of the issuer may include:*

- *the issuer's financial, economic and legal advisors,*
- *the issuer's auditors,*
- *rating agencies,*
- *communication strategy consultants and communication agency,*
- *persons belonging to the same issuer's group,*
- *the issuer's banks,*
- *financial intermediaries involved in executing relevant transactions.*

63. *The "insider" list should be closed when the inside information becomes public. All lists should be kept until it is legally no longer possible for a case of insider dealing to be brought against the issuer, persons acting on its behalf or for its account or persons on the list.*

Questions

Question 10: Do you agree on the relevance of establishing a list for each matter or event when it becomes inside information?

Question 11: Should the minimum content of the list be specified at Level 2?

Question 12: Should Level 2 give examples of those persons acting on behalf of or for the account of the issuer who should be required to draw up lists?

Question 13: To what extent is drawing up a list of "permanent insiders" useful?
Should Level 2 identify the jobs which typically provide access to inside information?

Question 14: Would it be useful to further develop at Level 3 the "illustrative system" outlined?

Question 15: Would it be useful to describe the meaning of the expression 'working for them' (article 6, paragraph 3) for example, to give clarification regarding people who are not employees of the issuer?

The criteria which trigger the duty to update insiders' lists

Explanatory text

64. Given the preventative and surveillance purposes of the Directive, CESR holds the view that insiders' lists should be updated on a continuous basis (i.e. whenever a change occurs). If issuers, or persons acting on their behalf or for their account, are only required to update the lists on a regular basis (such as monthly or quarterly), there would not be the same ongoing need to monitor and control inside information to ensure confidentiality, nor to provide the competent authorities with timely and reliable data.

65. CESR is aware that the duties of drawing up the list and of updating it on a continuous basis generate significant costs for issuers and related persons. Nevertheless CESR believes that these costs are more than offset by the benefits for market integrity and for issuers themselves.

66. Several issuers have already put in place similar procedures in order to either reduce conflicts of interests (the case of intermediaries) or to ensure confidentiality or for the purpose of enhancing their reputation. Finally, it should be noted that these rules are already in place in some jurisdictions both for high and low capitalisation issuers.

67. Even when issuers, or persons acting on their behalf or for their account, establish permanent lists they should update them on a continuous basis.

68. Being a continuous activity, it seems appropriate that issuers and related persons should consider the appointment of dedicated resources for managing these functions.

Level 2 advice

69. *Issuers and persons acting on their behalf or for their account should update insiders' lists on a continuous basis, i.e. when a new natural or legal person is informed of the relevant inside information or obtains access to inside information.*

Questions

Question 16: Do you agree with the approach adopted regarding the criteria which trigger the duty to update insiders' lists?

V1 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

Introduction

70. According to Article 6 (4) of the Directive persons discharging managerial responsibilities within an issuer shall, at least, notify to the competent authority the existence of transactions conducted on their own account relating to shares of the issuer. Where applicable, persons closely associated to persons discharging managerial responsibilities are under the same obligation. Derivatives or other financials instruments linked to the shares of the issuer are within the scope of the notification duty.

The criteria for identifying persons discharging managerial responsibilities within an issuer

Explanatory Text

71. In CESR's opinion the obligation to disclose certain transactions (Transaction Disclosure) has in general three aims:

- to act as a preventative measure against market abuse by increasing transparency
- to provide additional information to the investors and the markets
- to provide additional information for the supervisory authorities

72. However, regarding disclosure of transactions, Article 6 paragraph 10, 5th indent provides for implementing measures only for the disclosure to the competent authority and not to the public. To specify these disclosure requirements it is necessary to find sufficient criteria to identify the persons with managerial responsibilities within issuers and persons closely associated with them. A too wide approach is likely to mislead the public with too many, maybe meaningless, transaction reports. On the other side, a too small group of persons under the disclosure obligation may fail to achieve the necessary transparency. It is CESR's view that the requirement "..within an issuer.." in the text of the directive excludes external persons such as auditors and other advisers and service providers who may be closely linked to the issuer, but who are not to be regarded as closely associated with the persons discharging managerial responsibilities within the issuer.

Level 2 Advice

73. *Persons discharging managerial responsibilities within an issuer are persons who typically have access to inside information and who have decision making powers. This is usually the case for:*

- *members of the administrative, management or supervisory bodies of the issuer,*
- *senior managers who are not necessarily members of these bodies but perform similar decision-making functions within the issuer*

Question 17: Is the above description for "*persons discharging managerial responsibilities within an issuer*" sufficient for level 2 legislation? Are there other persons that should be considered as belonging to the management of the issuer or should there be a specific restriction to persons who can assess the economic and financial situation of the company?

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

Explanatory Text

74. It is CESR's understanding that the disclosure obligation for persons closely associated with the persons discharging managerial responsibilities should help to avoid a circumvention of the rules. For that reason it is important to cover all entities whose economic interests are substantially equivalent to those of the persons discharging managerial responsibilities.

Level 2 Advice

75. *Persons closely associated are all persons sharing 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 is the sole shareholder or controlling shareholder of this trust, company or other legal person or has otherwise the power to manage its business or to materially influence its management decisions. An indicator for this is an economic equivalence of interest between the trust, company or other legal person and the person discharging managerial responsibilities.*

Question 18: Is the above description sufficient for level 2 legislation? Are there other persons that should be considered as belonging to this category?

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

Explanatory Text

76. Currently, there are different models of disclosure duties across Europe. In the majority of Member States the time frame for disclosure starts with the conclusion of the transaction. In some Member States there is a threshold implemented, in other Member States each single transaction is to disclose. As thresholds are difficult to handle for the obliged persons and decrease transparency, it is more efficient to have a full disclosure duty. It is CESR's view that level 1 and the mandate do not provide the possibility of exemptions, e.g. for transactions under safe harbours or transactions in connection with stock options.

Level 2 Advice

77. *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 regardless of the size of the transaction.*

Question 19: Is the above description sufficient for level 2 legislation? Should there be a threshold concerning the disclosure obligation to the competent authority?

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

78. For an effective supervision it is important that the competent authority gets knowledge of the transaction as soon as possible. Therefore, the disclosure should be in any case within 2 working days. The competent authority needs some details to identify the transaction. 'Competent authority' should be the competent authority in all the Member States in which the issuer has requested or has had approved the admission to trading of their financial instruments on a regulated market. The exact mechanics of notification should be left to Level 3.

Level 2 Advice

79. *The disclosure to the competent authority should be made as soon as possible, in anycase within 2 working days. The notification must contain:*

- *name, address, nature of notification duty of the person/relation to the company*
- *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 amount/number of financial instruments*

Question 20: Is the above description sufficient for level 2 legislation? Are there any other details that should be covered on this level, for example the number of the relevant securities that the person holds after the transaction?

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

80. 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.

81. 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.

82. 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.

83. 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.

84. 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

85. 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.

86. In its first Advice on Level 2 Implementing Measures on the Market Abuse Directive (CESR/02.089d), 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.

87. 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.

88. 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.

89. 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 D).

90. 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.

91. 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.

92. 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.

93. 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

94. *As regards the criteria for determining the notifiable transactions, CESR proposes 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. These persons need not have any evidence. The notification obligation has to be fulfilled if the person arranging transactions has 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 such case, the whole group of transactions should be notified.*

Question 21: Do you agree with the proposed approach?

Timeframe for notification

Explanatory Text

95. 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.

Level 2 Advice

96. *As regards the time of notification, CESR proposes the following:*

In relation to a transaction or a group of transactions, notification without delay shall mean:

- *immediately after the suspicious transaction has been carried out;*
- *after completing a transaction, immediately after a party under obligation to notify becomes aware of any fact, as a result of which the transaction seems to be suspicious*

Question 22: Do you think that other possibilities should be taken into account?

Transactions particulars to be notified

Explanatory Text

97. It should be noted that transactions referred to in Article 6.9 of the Directive, are not limited to execution of orders; such transactions include any transaction entailing a transfer of financial instruments.

98. Level 2 Advice

99. *The following details shall be included in the notification to the competent authority:*

Nature of the transaction and mode of execution (e.g. acquisition through a stock exchange order, through subscription to an IPO, etc.);

Reason(s) why the person professionally arranging transactions suspects that this transaction, or series 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;

In the case of reception, transmission and/or execution of a stock exchange order:

- *the market in which it was executed (e.g. ASE parallel market);*
- *the type of order executed (limit order, market order, other characteristics of the order);*
- *the type of trading market (block trade, retail trade, etc).*
- *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.*

Question 23: Do you think that other elements should be mentioned?

Means of notification

Explanatory Text

100. 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.

101. 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.

102. As regards the format of the notification, CESR suggests the following:

Level 2 Advice

103. *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 .*

Question 24: Do you think that the proposed advice is appropriate?

ANNEX A

EUROPEAN COMMISSION
Internal Market DG

Brussels, 31 January 2003
MARKT/G2 D(2003)
Orig.

An Additional Mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Directive on Insider Dealing and Market Manipulation (Market Abuse)

This additional mandate supplements the first mandate on the Market Abuse Directive and follows the agreement on implementing the Lamfalussy recommendations reached with the European Parliament on 5 February 2002. In this agreement, the Commission committed itself to a number of important points including on transparency. For this reason, this request for additional technical advice to CESR will be made available on DG Internal Market's web site.

After adoption of the Market Abuse Directive on 3 December 2002, the initial provisional mandate of 18 March 2002 has been converted into a formal mandate and is not affected by this additional mandate.

1. BACKGROUND

In its Resolution on more effective securities market regulation, the Stockholm European Council called for rapid implementation of the prioritised Financial Services Action Plan, in order to achieve an integrated securities market **by the end of 2003**, including notably the priorities set out in the Lamfalussy Report.

To meet this challenge, the European Council not only endorsed the proposed four-level approach (essential principles, implementing measures, co-operation and enforcement); it also welcomed the proposed establishment of an independent Regulators Committee (CESR) to act as an advisory group to assist the Commission in its preparation of draft implementing measures.

On 18 March 2002, DG Internal Market addressed to CESR two first provisional requests for technical advice; one of those was a request for technical advice on possible implementing measures on the Market Abuse Directive. If the political

deadline of 2003 is to be met, this will mean not only Directives being adopted before this deadline, but the technical implementing measures as well.

Timely adoption of the implementing measures is even more important given that some Member States may need 6 months – in case the implementing measures are adopted in the form of a Directive - to have them implemented into national legislation. Implementation of Level 1 and most of Level 2 measures will need to occur at the same time – so respecting the deadlines is imperative. In order to speed up the implementation process, the European Commission might consider proposing Regulations for the implementation of Level 2 measures. The Stockholm European Council, the European Parliament itself and the Lamfalussy report all urged the use of Regulations whenever possible.

The first CESR mandate focussed on a number of priority issues and was drafted on the basis of the initial Commission proposal adopted on 30.5.2001 COM(2001) 281 final. Both the European Securities Committee and the EMAC were informed. CESR adopted its advice on the first mandate on 16 December 2002.

During discussions in the European Parliament and the Council the text of the Directive has been changed in a number of cases. In particular, several implementing measures which were not included in the initial Commission proposal, were added. Consequently, an additional mandate to CESR seeking its technical advice is needed.

2. THE PRINCIPLES THAT CESR SHOULD TAKE ACCOUNT OF

2.1. The working approach agreed between DG Internal Market and the European Securities Committee

On 30 January 2003, DG Internal Market consulted the European Securities Committee on a draft request for additional technical advice. At that meeting, it was agreed that DG Internal Market would request additional technical advice on certain priority issues having been introduced into the Directive by the European Parliament and the Council, and that CESR should immediately start the groundwork on these to meet the 2003 deadline set by the Stockholm European Council Resolution. The meeting agreed that this request should be based on the following approach:

- 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 start work on the basis of the Directive adopted on 3 December 2002.

- The technical advice given by CESR should not take the form of a legal text.

2.2. Consultation of the public

The Stockholm European Council endorsed the Lamfalussy recommendations on consultation and transparency. In particular, it invited the Commission to make use of early, broad and systematic consultation with the institutions and all interested parties in the securities area, especially by strengthening its dialogue with consumers

and market practitioners. It also stated that CESR should "*consult extensively, in an open and transparent manner, as set out in the final report of the Committee of Wise Men and should have the confidence of market participants*".

Article 5 of the Commission Decision establishing the CESR provides that "*before transmitting its opinion to the Commission, the Committee [CESR] shall consult extensively and at the early stage with market participants, consumers and end-users in an open and transparent manner*".

In this respect, DG Internal Market also draws CESR's attention to the European Parliament's Resolution on the implementation of financial services legislation of 5 February 2002 and the Commission's formal Declaration in response.

DG Internal Market will ensure that the Stockholm European Council recommendations on consultation have been fully met. In particular, it will satisfy itself that CESR has consulted all interested parties on its technical advice in accordance with the CESR Public Statement on Consultation Practices. This mandate will also be posted on DG MARKT's website.

Once the Commission has received the CESR's advice, it will draw up draft legal texts to put forward to the ESC and the European Parliament. It simultaneously publishes those texts on its Internet site. If the Commission amends its draft to reflect discussions in the ESC, those amended drafts will also be made public on the website.

Interested parties will have the opportunity to comment on published draft legal texts. The Commission has set up a dedicated e-mail address (Markt-ESC@cec.eu.int), allowing all interested parties to send their contributions to the Chairman of the ESC. All such comments will in turn be made public on the same Commission website.

Interested parties will have sufficient time to participate in this exercise because the ESC will not be asked for a vote until at least three months have elapsed from the publication of initial draft implementing rules. This will also allow the European Parliament to follow the process and, if it so wishes, to make its views known.

2.3. Market integrity and investor protection

In giving its advice on possible implementing measures, CESR should take full account of the key objective of the Market Abuse Directive: the need to increase market integrity and to protect investors.

2.4. Scope of this additional mandate

The European Parliament and the Council have introduced provisions to establish a number of implementing measures on the basis of Articles 1, 6 and 14. In some cases, implementing measures are not immediately necessary in order to implement the provisions of the Directive. Consequently, this additional mandate is limited to

implementing measures considered by the European Commission as necessary to fully implement the provisions of the Directive.

3. cesr is invited to provide advice on the following two priority issues by 31 August 2003 at the latest:

3.1. 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.

(1) 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.

(2) 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.

3.2. Implementing measures regarding some preventative measures related to issuers, corporate managers and professional intermediaries (Article 6 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 for some provisions of Article 6 of the Directive. Such measures shall not alter the substance of these provisions.

(1) 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.

(2) 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

(3) 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 10 last 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:…]*
- technical arrangements governing notification to the competent authority by the persons referred to in paragraph 9."
Article 6 paragraph 9 states: *" 9. 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."*
The possible draft implementing measures should take account of:

- 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.

ANNEX B

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ANNEX C

Call For Evidence – summary of main points made

CESR published a Call For Evidence on 7 February seeking input on the key issues which it should consider in dealing with the second mandate on the Market Abuse Directive. 18 responses were received. At CESR's invitation, a further five submissions were made by participants in CESR's ad hoc meeting with commodity derivatives markets experts. These papers deal specifically with the issues which CESR should take into account in developing its advice on inside information for commodity derivatives. The full text of all responses can be viewed on the CESR website

The following is a short summary of the principal recurring issues which emerged in the responses to the Call For Evidence. A full list of those who responded can be found at the end of this paper.

Accepted Market Practices

A number of respondents pointed out that market practices would, to a large extent, depend on the individual market in question. To this extent, it was acknowledged by a significant number of respondents that there was no single definition of accepted market practice which could be developed by CESR and which would apply to all markets.

Flowing from this, support was expressed for a fairly high-level approach which would focus on those factors which the competent authority should take into account in deciding whether a particular practice should be accepted or not. A number of respondents emphasised that CESR should not attempt to create a list of accepted practices, nor attempt to make detailed EU rules on specific practices in different markets.

Some respondents also expressed concern that CESR's work in this area could capture conduct which, in some markets at least, may currently reflect accepted business practices. These respondents suggested that CESR's advice in this area should take the form of guidance for market participants to clarify what is deemed to be an acceptable method of operation. A number of those responding in this way offered a selection of examples which could possibly be included in the guidance as a non-exhaustive illustration of the types of practice which are acceptable.

Definition of Inside Information for Commodity Derivatives

Some respondents suggested that it was premature to include a mandate to undertake work in this area at this stage. Commodity derivatives will only come within the scope of the Market Abuse Directive when the current review of the Investment Services Directive has been completed (assuming the current proposal to include commodity derivatives as ISD instruments is retained) and the ISD is implemented throughout the EU.

A further recurring theme was the need for CESR to acknowledge and develop advice which would recognise the differences between commodity derivatives (and related trading and market practices) and other financial instruments. In particular, it was pointed out that commodity derivatives have no underlying issuer on whom to impose obligations relating to disclosure of regular and ad hoc information.

A few respondents gave examples of the types of information which are likely to be price sensitive in the context of commodity derivative markets. These included information which is

required under legal or regulatory disclosure requirements and information or statistics released by government bodies.

Generally, support was expressed for CESR adopting a high-level approach in this area. It was also pointed out that the aim of the advice should be to encourage a common approach by similar markets across the member states, rather than adopting a "one size fits all" approach across the very different markets which come within the scope of this article.

Lists of insiders

A few respondents highlighted the fact that this provision, which applies to both issuers and intermediaries, may already be a requirement for financial institutions in a number of member states and that it may be appropriate to draw up regulations for issuers, modelled on those applicable to financial institutions. It was, however, suggested that CESR should seek in its advice to achieve a balance between imposing requirements which are likely to bring tangible benefits in terms of monitoring potential insiders and avoiding an excessively detailed and prescriptive regime which would be likely to become a burdensome obligation. A heavy-handed approach would also risk creating too much information of low value.

Respondents made a number of suggestions regarding the extent of the list. Generally speaking, it was considered that those who would regularly have access to inside information should be on the list. Specific suggestions included Board members and a small number of senior staff, those working in confidential areas in the financial, legal and strategic departments and members of staff with "key functions". One respondent did, however, point out that it was important to bear in mind that the sort of information which will be inside information can vary. Some can be easily predicted (for example, future results information) and some arises on a more ad hoc basis.

Different suggestions were made on the criteria which would trigger the duty to update the lists, including quarterly or six monthly intervals, or when individuals join or leave the issuer.

Disclosure of Transactions

As far as the criteria for identifying persons discharging managerial responsibility within an issuer is concerned, a number of respondents suggested that being a member of the management and supervisory board should be the relevant criteria. A number of suggestions were made as to those who should fall within the definition of "closely associated persons". These included, on the one hand, family ties (for example, close relatives, the director's immediate family, members of the director's household and those for whom he is the primary economic support) and, on the other, legal entities over which the director exercises control. Those responses commenting on the criteria for determining when a transaction should trigger the duty of disclosure tended to favour a de minimis provision. A number of responses were, however, silent on this point.

Suspicious Transactions

In this section, a number of respondents suggested the need for flexibility, particularly in terms of the notification procedure. The more burdensome the procedure, the less likely it is that there will be a good flow of information. In this respect, some respondents suggested that notifications should be capable of being made by phone, fax, cable or digitally. It was also suggested that the money laundering approach was not a particularly good model to follow in this respect.

Some respondents emphasised the need for the confidentiality of the notification between the intermediary and the competent authority. The issue of the intermediary's potential liability – when a suspicious trade is reported in good faith, but subsequently proves to be legitimate- was a recurring source of concern for a number of respondents. The Directive itself provides no immunity against such civil liability and some respondents considered that CESR could include such a provision in its advice to the Commission.

Respondents to the Call For Evidence

Banking

European Association of Public Banks (EAPB)

International Primary Market Association (IPMA)

Association of German Banks/Bundesverband deutscher Banken (BdB)

Association of German Public Sector Banks (VOEB)

British Bankers Association (BBA)

Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)

German Savings Banks and Giro Association/Deutscher Sparkassen und Giroverband e.V. (DSGV)

Zentraler Kreditausschuss (ZKA)

Landesbank Hessen-Thuringen (Helaba)

Investment Services

International Swaps and Derivatives Association (ISDA)

Association Francaise des Entreprises d'Investissement (AFEI)

Futures and Options Association (FOA)

London Investment Banking Association (LIBA)

Issuers

Deutsches Aktieninstitut e.V.

Insurance, Pensions, Asset Managers

European Asset Management Association (EAMA)

Assogestioni

French Asset Management Association (AFG-ASFI)

Investment Management Association (IMA)

Regulated Markets and Exchanges

Euronext.liffe, International Petroleum Exchange, London Metal Exchange (joint response)

London Metal Exchange

London Stock Exchange

Nordic Power Exchange (Nordpool)

PowerNext, EEX, Nordpool (joint response)

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.