Centre for Financial Market Integrity

Committee of European Securities Regulators
11-13 Avenue de Friedland
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Market Abuse Directive
Level III – Third set of CESR guidance and information on the common operation of the Directive to the market

Public Consultation

The CFA Institute Centre for Financial Market Integrity ("CFA Institute Centre") welcomes the opportunity to comment on CESR's "Market Abuse Directive, Level III – Third set of CESR guidance and information on the common operation of the Directive to the market" (the "Consultation").

We are very supportive of the continuing efforts to prepare ground for convergent implementation and application of the Market Abuse regime. The CFA Institute Centre supports fair and open global capital markets and advocates for investors' protection. Accordingly, we place great importance to the Market Abuse Directive, having participated in the consultation process over the past six years.

Our response to the Consultation reflects the collaborative efforts of CFA Institute Centre and a working group of investment professionals, drawn from our membership (collectively, the "Working Group"). Representatives of the Working Group[1] span several EU Member States. Consequently, the views expressed herein broadly capture the opinions of our membership, and reflect a cross-section of industry expertise. The contribution of the Group reflects the importance CFA Institute Centre places on this initiative.

The Consultation - the final stream of CESR's level 3 work - addresses stabilisation and buy-back programmes, and rumours. On stabilisation and buy-back programmes, we appreciate CESR's clarification that stabilisation outside Art. 8[2]'s exemptions needs to be evaluated on a case-by-case basis and does not necessarily qualify as abusive. Our Working Group also agrees with CESR on the exclusion of selling activities from the safe harbour, given the lack of a direct link between such activities and the aim of stabilisation itself, i.e. price support.

[1] Members of the Group, with affiliated CFA societies, are set out at the bottom of this letter.
[2] Article 8 of the Directive 2003/6/EC states that the prohibitions provided in the Market Abuse Directive "shall not apply to trading in own shares in 'buy-back' programmes or to the stabilisation of a financial instrument".

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For what concerns refreshing the greenshoe[3], we understand CESR's approach, but at the same time we would like to suggest the introduction of another parameter to be applied when deciding over the abusive nature of such activities. Specifically, we would like to underline the presence of powerful economic incentives behind the decision to refresh the greenshoe. These incentives include fees for the underwriter and increased cash revenues for issuers, which ultimately damage shareowners, who bear the consequences of dilution.

Finally, on rumours, we would like to suggest the introduction of clearer mechanisms for the identification of rumours requiring action on the part of the regulator. For a rumour to require a regulatory response, as CESR indicates, a link with a piece of inside information is needed. We would like to add a quantitative mechanism based on trade volumes to this "qualitative" analysis, in order to make the overall regime more predictable and in order to facilitate harmonization of the regime within the EU.

Overall, we believe that the proposals set out herein will help to produce a more coherent application of the Directive, and will add value to its provisions. We recommend these proposals be taken into account in the final feedback statement already scheduled by CESR.

We attach our response that addresses the questions of the Consultation. Please do not hesitate to contact us, should you wish to discuss any of the points raised.

Yours faithfully,

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[3] Refresh the greenshoe means to cover the initial overallotments with market purchases, yet nevertheless go on to exercise the greenshoe option to cover any syndicate short positions created by the initial overallotment.

The CFA Institute Centre[4] is part of CFA Institute[5]. With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of nearly 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries, of whom nearly 87,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

Our responses to the Consultation's questions (where relevant) are set out below.

Safe harbour principle - Do you have any comments on CESR's view that stabilisation outside of the exemption in Article 8 should not be regarded as abusive solely because it occurs outside of the safe harbour?

We agree with CESR on this point, as it allows some reasonable flexibility in the application of the Directive, and we appreciate such a clarification provided to market actors in all Member States. At the same time, we would also like to see guidance for stabilisation and buy-back programmes to be provided separately in future policy statements. This is for two reasons. Firstly, stabilisation and buy-back programmes have different timeframes and purposes: stabilisation is undertaken to facilitate the underwriting of securities and takes place within the offering period, whereas buy-back programmes are used to manage the shares outstanding and share price of an issues and occurs after the offering period. Secondly, and more generally, as acknowledged by CESR there is legitimate concern within the industry on the scope of some of the Directive's provisions, especially when considering the different regimes in place within the EU. As a consequence, guidance should be as clear as possible.

Sell- side trading during stabilisation periods - Do you have any comments on CESR's views that sell transactions are not subject to the exemption provided by Article 8?

We agree with CESR. The exemption provided by Article 8 focuses on price support, which is best achieved through the purchase rather than the sale of a security. The ability to engage in both buy and sell transactions during a stabilisation period (as through the greenshoe facility) enables the managers of the offering to manipulate the price of the security for their own gain. We feel that such behaviour runs counter to the principle of stabilisation, which is to support a price, and not to act as mechanism for earning trading profits.

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[4] The CFA Institute Centre develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards ("GIPS®"), and the Asset Manager Code of Professional Conduct ("AMC"). It represents the views of investment professionals and investors before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and the transparency and integrity of global financial markets.

[5] CFA Institute is best known for developing and administrating the Chartered Financial Analyst curriculum and examinations and issuing the CFA Charter.

We also want to direct CESR's attention to an additional important point concerning sell transactions, and more generally trading activities, during stabilisation periods. We refer to the relationship between "syndicate desk" and "trading desk" within the lead firm of the syndicate. Given the growing complexity of financial institutions, investment advisory departments ("syndicate" in this case) coexist with the institutions' trading desks, which engage in proprietary and non-proprietary trading.

During a stabilisation period these relationships are those most likely to create concrete opportunities for abusive behaviour and market manipulation. The Directive does not mention the need to establish information barriers between stabilisation participants and their trading desks, or at least strictly control their relationship. However, we feel that the final feedback statement should deal with this important issue.

On these matters there is not a common standard within the industry. Within some financial institutions a compliance/legal officer sits on the trading floor during the execution of stabilisation or buy-back programmes. In other institutions, there is direct contact between stabilisation operators and trading desks, but these are carefully scrutinised and subject to record-keeping obligations.

These differences are more firm specific rather than country specific. Nevertheless we urge CESR to issue guidance on the subject.

Article 2, para. 1 of the Implementing Directive[6] states:

> *Member States shall ensure that the following non exhaustive factors are taken into account by competent authorities (…) when assessing whether they can accept a particular market practice:*
>
> *(e) The risk inherent in the relevant practice for the integrity of, directly or indirectly, related markets, whether regulated or not, in the relevant financial instrument within the whole community.*

In order to ensure a coherent and effective application of the Directive throughout the EU, we urge CESR to include guidance on written policies and procedures regulating the flow of information between the desk responsible for stabilisation and the trading desk.

Finally, we suggest the information flow between "syndicate" and "trading" to be treated as regulated information and, as such, subject to the Transparency Directive. We do not believe that record-keeping obligations are sufficient to preserve and enhance market integrity during these market operations.

Refreshing the greenshoe - Do you have any comments on CESR's clarification that selling securities that have been acquired through stabilising purchases, including selling them to facilitate subsequent stabilising activity, is not behaviour that is covered by Article 8?

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[6] Commission Directive 2004/72/EC of 29 April 2004.

We agree with CESR on the principles highlighted in par 13-16: refreshing the greenshoe falls outside the scope of the safe harbour principle and of the exemption provided by Art. 8, but does not necessarily qualify as abusive activity.

Judgement needs to be applied on a case-by-case basis in order to identify behaviour that is not in line with the aim of providing resources and hedging for stabilisation activity.

Activity to refresh the greenshoe—i.e., make full use of the over-allotment option included in the underwriting agreement—should undergo thorough scrutiny not only because of its potential abusive nature and because it falls outside Art. 8's exemptions, but also because of the incentives behind these market operations. Refreshing the greenshoe, notwithstanding its effects on share price, has a direct economic consequence: it increases the fees earned by the underwriter, who profits from these operations, and the liquidity cashed in by the issuer, who increases the capital raised by issuing additional securities.

As a consequence, the decision to refresh the greenshoe may be in part justified, or at a minimum encouraged, by the economic incentives faced by issuers and underwriters. This, however, would clearly be detrimental for shareowners who would ultimately bear the consequences of dilution of ownership interest.

This is an aspect that CESR has not taken fully into account, hence we would like to see this highlighted in the final guidance. This would enable national regulators to monitor the role of these economic incentives when analysing the legitimacy of the greenshoe operations.

Third country stabilisation regimes - What would you regard as the difference in approach that gives rise to the most significant practical problem?

The main issue relates to the different approach between the European Union and the United States. Market actors operating in both jurisdictions face legal uncertainty, aggravated by the fact that both regimes claim extra-territoriality in their scope.

We see an inconsistency in the timeframe of the stabilisation regime application. Whereas the EU stabilisation regime has its focus on the period after the offering and is permitted for the subsequent 30 days, in the US the regime application focuses primarily on the period preceding the pricing of the distribution. Sensible differences exist also in relation to "greenshoes" and the size of the overallotment facility.

We believe that a further clarification would be welcome. Regulatory dialogue should be undertaken in order to analyse the feasibility of the home country regime principle or at least a formal recognition of the two regimes (as was the case between the SEC's Rule 104 and the UK's safe harbour exemption before the introduction of MAD). This would be not only the clearest solution for market participants, but also the easiest on the regulatory level.

Reporting mechanisms - Do you support the proposal that all competent authorities should publish the mechanism by which reports of stabilisation and buy-back *programmes transactions should be submitted and that ideally this should be a dedicated email address?*

We clearly support this position, but we would also suggest a central European system to be put in place.

CFA Institute Centre has always been in favour, when it relates to the sharing of information, of a central repository at the EU level. Even on these matters, we sense that an EU-wide reporting mechanism would increase efficiency and transparency within European capital markets.

There are of course spillovers and mutual influences among European markets that should be recognized by regulators, particularly when these take place for shares within the same industry. This is particularly true in the case of MiFID and the fragmentation of trading venues that followed. Market participants should therefore have the possibility to access information at the EU level.

Mechanisms for public disclosure - Do you support the proposal that adequate public disclosure is made through the mechanism used to implement the TD and gives rise to the obligation for this information to also be stored under the TD provisions? Do you agree that only public disclosure of buy-back transactions is required?

We do support public disclosure through the mechanisms identified by the Transparency Directive. At the same time, however, we urge CESR to undertake a thorough review of how these mechanisms are implemented in different Member States in order to ensure the application of a consistent regime.

Rumours

Do you have any comments in relation to this draft guidance on the issue of rumours?

CESR identified the need for a public reaction by the issuer only when rumours clearly are a consequence of a leak of inside information. In these cases a "no comment" policy is clearly not acceptable.

Identification of rumours

It is difficult to identify the presence of a rumour and relate it to share price movements. Our Working Group suggests the implementation of quantitative measurements together with the qualitative ones already in place. A good example of such a measurement could be the definition of a double-identification mechanism. This could be a combination of price movements' thresholds and trade volumes that appear to be disproportionate to overall market activity.

The benefit of this policy would be twofold. Such an analysis would alleviate uncertainty for both market actors and issuers. This is badly needed, particularly given the presence of such a variety of approaches within the EU. And secondly, given the easier application of such a mechanism, it could be the first step towards a harmonization of Member States' practices in this field.

We advise CESR to consider the feasibility of this approach in the identification of rumours.

Response
The guidance provided by CESR is reasonable, as it does not impose arbitrary disclosure on issuers (nor on other market participants) and does not include suspension from trading. However, this would make such a mechanism effective only if consistently and thoroughly applied.

A systematic application of this provision would also improve the efficacy of other Market Abuse regime's provisions. A regulatory requirement on issuers to comment on rumours originating from insider information would better implement self-policing mechanisms and to establish stricter compliance rules regulating internal communications. These would as a consequence include restrictions on the number of employees part of insiders' lists, whose value is at the moment reduced by their over representation.

7th January 2009.