

December 2005

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 119 – CONFLICTS BETWEEN FSAP DIRECTIVES

**Legal assessment of various directives arising from the European Commission's
Financial Services Action Plan – inconsistencies, conflicts and lacunae between
directives**

The logo for the Financial Markets Law Committee is a light blue, tilted rectangular box containing the text "Financial Markets Law Committee" in a dark blue, sans-serif font. The text is arranged in four lines, following the tilt of the box.

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Introduction

1. The role of the Financial Markets Law Committee (“FMLC”) is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.
2. In October 2005 the FMLC was approached by the London Stock Exchange (“LSE”), following discussions between the latter and the European Commission in relation to a number of issues arising out of certain Financial Services Action Plan (FSAP) directives. The FMLC understands that the Commission expressed the view that it would be helpful for the FMLC to consider the relevant issues and to provide comments. The LSE has provided the FMLC with a copy of its subsequent letter to the European Commission dated 14 October 2005 (a copy of which can be found at Appendix 1).
3. The FMLC formed a Working Group of experts to consider these issues, the members of which are listed above. This paper sets out the view of the FMLC on the issues raised in the LSE’s letter, which the Committee hopes the Commission will find useful.

Home Member State

4. Article 6 of the Market Abuse Directive¹ (“MAD”) provides that Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information² directly concerning the issuer. Article 10 then provides that Member States shall apply the provisions of the directive to actions in relation to financial instruments where they are admitted

¹ Directive 2003/6/EC (OJ L 96, 12.4.2003)

² As defined in Article 1 of MAD – “inside information” is information relating to a financial instrument or an issuer of a financial instrument that has not been made public and, if made public, would be likely to have a significant effect on the price of the financial instrument or the price of a related derivative financial instrument.

to trading on a regulated market within a Member State (or for which a request for admission has been made).³

5. In the view of the FMLC, Articles 6 and 10 of MAD give rise to uncertainty. In particular, a lack of clarity exists at the level of identifying *the Member State whose rules will apply* to substantiate the Articles' requirements. For example, the issuer will not always know which national rules apply to determine a) the method by which the public must be given information required; and b) when a breach of the requirement has occurred.⁴
6. The FMLC considers that it would be desirable for the Commission to clarify the position in relation to the correct choice of home State for the purposes of obligations under Article 6 of MAD. The Committee believes that this is an important matter of policy for the Commission and Member States to resolve.
7. For purposes of assisting the Commission and Member States, the FMLC notes that the Transparency Obligations Directive⁵ ("TOD") provides that regulated information disclosed by an issuer is to be filed with the competent authority of the issuer's home Member State (see Article 19). "Regulated information" comprises all information an issuer is required to disclose under the provisions of both TOD and Article 6 of MAD.⁶ Article 19 is in line with the general philosophy of the FSAP, which is that it is for the home Member State regulator of an issuer to take the lead, therefore relieving the issuer of the burden of needing to deal with all 25 Member States' regulators.

³ Article 10 of MAD provides that, for financial instruments admitted to trading on a regulated market situated within a Member State, the relevant actions are those within that Member State or abroad. In contrast, where the financial instrument is admitted to trading on a regulated market situated within another Member State, the relevant actions are only those within the Member State.

⁴ There is, however, limited certainty in respect of the requirements of Article 6(4). Article 6(1) of Directive 2004/72/EC provides that the rules of notification with which persons have to comply under MAD Article 6(4) shall be those of the Member State where the issuer is registered. In the case of third country issuers the rules shall be those of the issuer's home Member State according to the definition given in the Prospectus Directive (as to which see below, paragraph 11).

⁵ Directive 2004/109/EC (OJ L 390, 31.12.2004)

⁶ See the definition of "regulated information" in Article 2 of TOD.

8. Further, Article 21 of TOD requires that Member States must ensure that issuers disclose regulated information (including information under Article 6 of MAD) by using media that may reasonably be relied upon for the effective dissemination of information to the public *throughout the Community*. It would seem odd that an issuer who complies with its home State regime for the pan-EEA dissemination of information to the public should also have to comply with the requirements of other States prescribing specific (and possibly different) methods of dissemination, which are designed to achieve the same result.
9. Therefore, the FMLC considers that, on the basis of the provisions of TOD, there is a strong argument that, for the purposes of Article 6 of MAD, compliance by the issuer with the rules of its home Member State should be sufficient. Any other approach would not be consistent with TOD or the general approach under the FSAP.
10. Theoretically, the following alternative interpretations are also available to the Commission, referring the relevant regulatory questions to the rules of:
 - a. regulators in all Member States where the financial instrument in question is admitted for trading; or
 - b. regulators in all Member States where the financial instrument could be traded (effectively all 25 Member States).

The Committee is aware of arguments in favour of these alternative interpretations, as well as the approach referred to above, i.e. that referring the relevant issues to the Home Member State of the issuer. It believes that if confusion in the market is to be avoided then the position should be clarified.

11. In passing, we note that the definition in TOD of “home Member State” could benefit from further clarification, particularly in regard to the “home Member State” of third country issuers. The relevant issues have been raised previously

by the FMLC in the context of the Prospectus Directive (“PD”)⁷ and the requirement to file information with the issuer’s home Member State pursuant to Article 10(2) of that directive.⁸ The definition of home Member State for third country issuers in TOD (see Article 2(i)) incorporates the definition in PD (see Article 2(1)(m)(iii)).

Market makers

12. Article 9(5) of TOD provides an exemption for market makers from certain TOD requirements on notification of the acquisition or disposal of major holdings in an issuer, subject to a requirement that the market maker is authorised under the Markets in Financial Instruments Directive (MiFID).⁹ Further to this provision, the proposed Level 2 legislation for TOD proposes that the market maker shall notify the competent authority of the home Member State of the issuer of its market making activities (see Article 7 of DG Internal Market’s Working Document ESC/34/2005 in relation to possible implementing measures).
13. If this proposal is adopted, the market maker wishing to engage in market making activities will almost certainly be obliged to observe notification requirements as follows:
 - a. notification to the competent authority of the market makers’ home Member State of executed transactions in the relevant shares, as part of the general obligations under Article 25(3) of MiFID;
 - b. notification to the competent authority of the issuer’s home Member State that it conducts (or intends to conduct) market making activities,

⁷ Directive 2003/71/EC (OJ L 345, 31.12.2003)

⁸ A copy of the FMLC’s paper on these issues is available on its website at www.fmlc.org.

⁹ Directive 2004/39/EC (OJ L 145, 30.4.2004). There is an additional requirement under Article 9(5)(b) that the market maker does not intervene in the management of the issuer or exert any influence on the issuer to buy the shares or back the share price. (The FMLC has been given to understand that in France there can be occasions when market makers will enter into arrangements with issuers under liquidity provider agreements but it is not clear how Article 9(5)(b) or other provisions of the FSAP Directives will affect this practice.)

pursuant to Level 2 TOD requirements. In addition, the competent authority of the issuers' home Member State can request a market maker to provide certain information; and

- c. notification to the regulated market in which the relevant shares are traded, in accordance with current market practice and rules likely to be adopted by the regulated market.
14. Presumably the availability of the market maker exemption will also be determined by this multiplicity of public authorities, leading to the possibility that the market maker would be exempt under the interpretation used by one competent authority, but not exempt under the rules of another.
 15. Clearly, the overlay of different reporting requirements creates the potential for market makers to be sending a number of different notifications to competent authorities that cut across each other, both in terms of the timing and content of the notification. To promote certainty and coherence, careful analysis is required to ensure that the definition of "market maker" is applied consistently by the different competent authorities and that any requirements as to the timing and content of the notification either do not overlap, or where there is overlap, that the requirements are the same and/or complementary. It is clearly not helpful to investors to receive conflicting or inconsistent information: either because market makers are exempt in one country but not another; or because the timing of a notification in country A is different from that in country B.
 16. Although the suggestion that there should be a single notification to the market maker's home competent authority (as contemplated by MIFID) is initially attractive, the FMLC notes that Article 9 of TOD imposes an obligation to notify the *issuer's* home Member State regulator when shareholdings pass above or below certain thresholds (and confers an exemption on qualifying market makers). Therefore, although it may be more consistent in the context

of the Level 2 proposals to follow the MiFID approach, this may give rise to a question about the internal consistency of TOD itself.¹⁰

17. Given the arguments both for and against the notification to either the market maker's home Member State competent authority or the issuer's home Member State competent authority, the FMLC does not express a view on the correct approach the Commission should take. However, the FMLC does consider that any regime that involves notification to different competent authorities must be carefully implemented to ensure that the requirements do not overlap in such a way as to create inconsistent reporting requirements on the market maker, which would lead to uncertainty and complexity in the notification regime.

Minimum standards on dissemination

18. The FMLC agrees with the LSE that the minimum standards on dissemination of information will be a crucial area in the implementation of TOD in Member States. Although the FMLC has no comment to make in relation to the proposed Level 2 legislation, the FMLC considers that it will be important for this issue to be closely examined during the transposition workshops, in order to ensure that the provisions in individual Member States implementing TOD provide a sensible and coherent framework of minimum standards that reflect modern practice in international financial markets.

Equivalence for third country issuers

19. The question of what constitutes an equivalent requirement in a third country is an important issue. The FMLC considers that it would be very helpful if the Commission were to make it clear that the concept of "equivalence" in the FSAP measures is considered to be based more on a concept of whether the

¹⁰ The uncertainty in regard to this issue for market makers is exacerbated by the uncertainty identified by the FMLC in connection with establishing the home Member State of third country issuers (see the FMLC paper at www.fmlc.org). The question arises how a market maker is meant to know which home Member State a third country issuer has chosen. (The issuer is not required to publish its election.)

requirement in the third country is “of like effect” as opposed to being “identical” or “equal”.¹¹

20. The FMLC has become aware, in the course of other work it has been pursuing in relation to the FSAP, that market participants hold very strong views on this question. Whilst the FMLC is unable to put forward views that touch on policy issues in connection with this question, it would be very happy to put the Commission in touch with relevant market participants or act as a conduit for the Commission to access these views.

Previous FMLC issues

21. The FMLC has had an ongoing dialogue with the Commission on a number of issues relating to the PD and TOD. In particular, the FMLC has raised issues relating to the meaning of home Member State in relation to third country issuers and also relating to liability for disseminated information.¹²
22. The FMLC would like to take this opportunity to thank the Commission for the time it has taken to listen to and understand the views of the FMLC. However, the FMLC considers that the issues it has raised remain outstanding.
23. The question of liability for disseminated information is particularly relevant to the question of disclosure in one, as opposed to 25, Member States. It seems that the Commission wishes to rely on a distinction between disclosure (which may imply that the issuer will incur investor liability) and dissemination (which carries no such implication). The FMLC is concerned that this helpful distinction may not be reflected successfully in the

¹¹ The ECJ, in dealing with the question whether national measures which derogate from the principle of freedom to provide services are in “the general good” has considered the parallel issue of whether “the general-good objective [is already] safeguarded by rules to which the provider of services is already subject in the Member State where he is established”. The general approach of the Court appears to have been to ask whether any rules of the Member State in which the service provider is established are “comparable to” or “of like effect to” the national measures in question, not whether they are “identical”. (See authorities referred to in the European Commission’s 1997 Interpretative Communication “Freedom to provide services and the interest of the general good in the Second Bank Directive”).

¹² Papers on these topics are available from the FMLC website at www.fmlc.org

implementing measures of individual Member States. Notwithstanding any distinction that may be drawn on the basis of the provisions of TOD, this issue is clearly still relevant to the approach that may be taken in relation to implementing the provisions of MAD, as discussed above.

Appendix 1



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14 October 2005

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Dear David and Pierre

INCONSISTENCIES BETWEEN FSAP DIRECTIVES

Following a meeting with some of your staff earlier this week, I thought it would be useful to provide you with our thoughts in relation to the way in which the various securities-related directives work together. We would like to take this opportunity to highlight a couple of areas where we feel there is currently inconsistency between the Financial Services Action Plan (FSAP) directives, and our views on how these can be remedied.

As you know, the London Stock Exchange has been a strong supporter of the FSAP. We can see the huge benefits of delivering a single market for securities issuance and trading, and believe that Europe is well-placed to deliver such a market in a way which would lead to genuine progress in advancing the Lisbon Agenda.

Over the last five years, the London Stock Exchange has dramatically increased its engagement with the European institutions on individual directives. We have found that the dialogue has been very positive. We are supportive of the key directives and believe much progress has been made on framing the European single market for financial services.

As we have consistently said, the true test will come following implementation. It is with this in mind that I am writing to you. It is vital that any snags in, or between the directives, are removed if the market is to deliver on the framework. Given the sequencing of the directives it is inevitable such snags will exist. As such, there remains a key responsibility on the Commission. I am very conscious that you are fully engaged in the post FSAP agenda, and finalisation of the White Paper.

We believe a key part of the White Paper is to ensure the success of FSAP directives. It is vital that the directives are consistent and complement each other as much as possible. It is natural that differences and problems will emerge, and these often do not come to light until after they are implemented in the Member States. In such circumstances it is vital to look to the options at hand to resolve such issues or to give clarification.

Home Member state (TD Level 2: Article 3)

We believe that this piece of level 2 legislation provides the European Securities Committee with an excellent opportunity to address a problem that has come to light with the Market Abuse Directive (MAD). Specifically, an issue has arisen over the division of responsibility between regulators with respect to dissemination of price sensitive information (PSI).

Dissemination of PSI is mandated by Article 6 of MAD, and responsibility is placed on all competent authorities to ensure that the requirement is monitored and enforced. Unfortunately this is as far as it goes and has led some regulators to believe that it must have disclosure rules for any issuer that has securities admitted to trading on a regulated market in their jurisdiction, whether or not they are already subject to the supervision of another competent authority.

The other FSAP directives go to great lengths to place primary responsibility for their enforcement with a single regulator, generally the “home” regulator for that entity. This underpins the idea of the passport which is central to FSAP: an issuer should be able to offer securities across the EU, and have those securities traded on multiple markets on the basis of one approval and one set of rules. Clearly the benefits of this approach would be nullified if all 25 EU regulators took the approach outlined above.

Unfortunately it appears that MAD was finalised before the idea of the passport had been fully articulated. Indeed, the brevity of the detail on how disclosure of PSI is to be regulated under MAD confirms this to be the case.

However, we believe that this issue can now be addressed. Much as the TD determines the manner in which PSI should be disseminated under MAD, it could also be used to clear up this issue and clarify the division of responsibility between competent authorities. Clearly when an issuer has its securities traded in multiple member states, requiring that issuer to submit to the rules and pay a regulatory fee to the competent authority in all those member states because of a provision of MAD is at odds with the intentions of FSAP and furthermore, completely unnecessary. Responsibility should be placed with the home competent authority in line with the other FSAP directives. Other competent authorities could then accept the passport of securities that originate from other member states and place reliance on the home competent authority doing its job.

This issue is one that must be resolved and we believe that TD implementing measures could be an expeditious way of correcting what was clearly an oversight in the original directive.

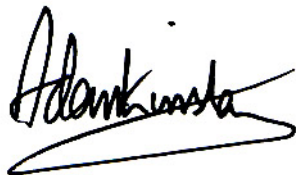
Market Makers (TD Level 2: Article 7)

This refers to the notification that a market maker must make when it conducts or intends to conduct market-making activities. The draft text says that they should notify the competent authority of *the issuer* of the shares in which they intend to make a market. This means that such firms would have to have a relationship with (potentially) 25 different competent authorities, which would be an undue burden on firms.

This is inconsistent with MiFID proposals whereby firms will transaction report (Article 25) to their home competent authority, and then it is up to the competent authorities to share this information amongst themselves. We believe that this approach should also apply here – the firm should notify their home competent authority of all the issuers in which they conduct market making activities and the competent authorities should then share this information as appropriate. Alternatively, a second best approach would be for market operators themselves to receive and send on this information.

We have some further comments on the draft Level 2 text which are outlined in the appendix. I hope our views are helpful to the Commission's work. Please do not hesitate to contact me if you wish to discuss any aspect of this letter.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Adam Kinsley', with a long horizontal flourish underneath.

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APPENDIX

Further comments on the Commission's draft implementing measures of the Transparency Directive

Minimum Standards on dissemination (TD Level 2: Article 13)

This is a very important area – a vital aspect of FSAP is a level playing field for investors when investing across borders. Financial markets need immediate access to all the available information on a company and the trading in its shares. This simply cannot be delivered effectively by newspapers. The real-time electronic push method is the only way to ensure efficient markets. The Service Providers have such an important position that it is essential that they are well managed and have proper arrangements such as security systems in place.

Whilst we approve of the Commission text, we believe it is very important to keep the proposed recitals in the document, as there are some important points contained in these.

We support the wording in 13(2) “as close to simultaneously as possible” however we need some clarity on what is meant by “regulated information shall be communicated to more than one type of media” – presumably this does not interfere with the issuer being certain that he has fulfilled his obligation by sending to a Service Provider and it being disseminated to various media from there.

Equivalence for third country issuers (TD Level 2: Article 14)

Interim management statement - Paragraph 4 basically sets out that issuers will be deemed to be meeting equivalent requirements to those set out in Article 6 of TD (interim management statements) if they either publish quarterly financial reports (which is already permitted under Article 6.2 of the TD) or apply the requirements of Article 6. Therefore, ‘equivalent’ appears to have been interpreted as ‘equal’, with no discretion given to competent authorities.

Timescales - we believe that the purpose of article 23(1) is for Member States to be able to allow third country issuers to be exempted from the requirements if they are subject to equivalent domestic laws. We do not believe that the meaning of equivalence should be restricted to substance of information, but could also apply to time limits contained within 11(4), 11b and 11c.

- Under TD, investors have to notify issuers with 4 trading days and the issuer then has to make this public within 3 trading days (i.e. 7 trading days in total). Under 14(7) of the draft advice, equivalence is determined to less than or equal to 7 trading days in total (i.e. equivalent equals identical!). We believe there could be more flexibility on this issue, to allow competent authorities to deem different timescales as acceptable if they see fit. In particular, a third country issuer will be operating under its own national laws and will not have control over the timescale in which their investors make notifications to them.
- The draft text only proposes to allow thresholds that are less than 5% and 10% (i.e. 4% and 8%). We believe that ‘equivalent’ thresholds do not have to be as

restrictive, for example if a third country has 6% and 12% thresholds, the home competent authority should be allowed to accept these if they see fit.

Recitals - we support the recitals and believe that they are an important part of this document (particularly “equivalence can be declared when general disclosure rules of third countries provide users with understandable and broadly equivalent assessment of issuers’ position that enable them to make similar decisions as if they were provided with the information according to requirements under the Transparency Directive, even if the requirements are not identical”).

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