Market newsletter 3/2016

June 2016

The Market newsletter addresses topical matters concerning interpretations, regulation, as well as supervisory findings relating to listed companies' disclosure obligation, financial reporting enforcement, securities trading and insider issues. Articles other than those pertaining to IFRS enforcement will appear mainly in English. The newsletter is published by FIN-FSA's Supervision of Markets and Conduct of Business Department.

In this newsletter, we discuss the following topics:

Topical matters at ESMA

Level 2 regulation relating to Benchmarks Regulation

ESMA invites comments on Level 2 regulation of the Benchmarks Regulation. Comments should be submitted by 30 June 2016.

Level 3 guidelines relating to Central Securities Depositories Regulation

ESMA invites comments on the Level 3 guidelines relating to the Central Securities Depositories Regulation. The guidelines address the procedure in the event of a default of a central securities depository participant. Comments should be submitted by 30 June 2016.

Use of block chain technology in the securities market

ESMA invites comments on the use of blockchain technology (distributed ledger technology) in the securities market. Comments should be submitted by 2 September 2016.

Level 3 guidelines relating to Market Abuse Regulation

ESMA is currently finalising the Level 3 guidelines relating to the Market Abuse Regulation. The guidelines address market sounding, delay of the public disclosure of inside information, and the public disclosure of inside information relating to commodity derivatives.

For further information, please contact:

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Issuers need LEI code for notification of managers' transactions

An issuer needs an LEI code (Legal Entity Identifier) for the notification and public disclosure of transactions of managers and persons closely associated with them. Issuers can apply for an LEI code either from the Finnish Patents and Registration Office or from another body that allocates codes to Finnish companies or other entities.

If a company already has a valid LEI code registered in the GLEIF (Global Legal Entity Identifier Foundation) database at www.gleif.org, this code can and should be used. Further information on LEI codes and the application process is available on the website of the Finnish Patents and Registration Office.

For further information, please contact:

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Contacting FIN-FSA on MAR issues

FIN-FSA is currently unable to answer all the contacts it is receiving relating to the Market Abuse Regulation. We understand companies' situation and their need to obtain answers to questions, but we hope that as many as possible will direct their queries by email to the address markkinat(at)finanssivalvonta.fi. This will enable us to forward the questions to as wide a group of MAR experts as possible. Moreover, we will also try to answer frequently asked questions on the MAR website or in the Market newsletters. Unfortunately, we cannot promise to answer each questioner individually.

Change to definition of a manager's closely associated entities

The Market Abuse Regulation (MAR), which will begin to be applied on 3 July 2016, will bring changes to the definition of entities closely associated with a person discharging managerial responsibilities within an issuer and with a natural person closely associated with a person discharging managerial responsibilities.

How is a controlled entity defined according to MAR?

Entities (legal persons) closely associated with a person discharging managerial responsibilities are defined in Article 3 (1) (26)(d) of MAR. According to the provision, closely associated person is amongst other things a legal person, trust or partnership which is

directly or indirectly controlled by

- a person discharging managerial responsibilities or
- a natural person closely associated with a person discharging managerial responsibilities (a spouse, a partner considered to be equivalent to a spouse in accordance with national law or a dependent child or a relative who has shared the same household for at least one year)

A controlled entity is not specifically defined in the MAR. To the definition of control can be applied Chapter 2 Section 4 of the Securities Market Act (SMA), according to which a person has control in an entity when he or she has:

1. a majority of the voting rights produced by all the shares or corresponding units of the entity and the majority of votes is based on a holding, membership, articles of association, memorandum of association or on rules or other contract comparable thereto; or

2. the right to appoint or dismiss the majority of the members of the Board of Directors or a corresponding body of an entity or of a body of the entity which has the said right, and if the right of appointment or dismissal is based on the same facts as the majority of votes referred to in paragraph 1.

In addition, Chapter 2 Section 4 of the SMA has more detailed provisions on how voting restrictions, own shares and indirect and actual control affect the creation of control.

The control referred to in Chapter 2 Section 4 of the SMA may arise only for one natural or legal person. For example, a company owned together by a person discharging managerial responsibilities and his or her spouse with equal shares is not a controlled entity of either. Such a company is, however, generally a closely associated entity as a so-called entity in which influence is exercised (see below).

Under what circumstances can an entity be considered under MAR to be closely associated with a person discharging managerial responsibilities? How is an entity in which influence is exercised defined in MAR?

In contrast with the provisions of the SMA, which will be repealed, the obligations under MAR are the same for controlled entities and so-called entities in which influence is exercised. Therefore the division into controlled entities and entities in which influence is exercised will not be significant in the future in respect of the obligation to notify managers' transactions.

According to Article 3 (1) (26)(d) of MAR, a legal person, trust or partnership is closely associated with a person discharging managerial responsibilities if

- a person discharging managerial responsibilities or a natural person closely associated with him or her discharges managerial responsibilities[1] in the legal person, trust or partnership, or
- a legal person, trust or partnership is directly or indirectly controlled by a person discharging managerial responsibilities or a natural person closely associated with him or her, or
- a legal person, trust or partnership has been set up for the benefit of a person discharging managerial responsibilities or a natural person closely associated with him or her, or
- the economic interests of a legal person, trust or partnership are substantially equivalent to those of a person discharging managerial responsibilities or a natural person closely associated with him or her.

1 The discharge of managerial responsibilities has been defined in Article 3 (1) (25) of MAR, see question and answer above.

MAR does not specifically define what the aforementioned "the economic interests are substantially equivalent" means. A corresponding definition has previously been included in Article 1(2) of the Commission Directive 2004/72/EC, implementing the Market Abuse Directive (2003/6/EC, MAD). The provision had been nationally enforced in the repealed Chapter 12 Section 4.1(6) of the SMA. According to the provision, being closely associated required that a person discharging managerial responsibilities or a natural person closely associated with him or her own directly or indirectly 10% of the said closely associated entity. Although MAR does not allow for a corresponding percentage ownership limit to be prescribed nationally, this limit may be used until further notice as an interpretation aid in defining closely associated entities. Therefore, for example, a company owned by a person discharging managerial responsibilities together with his or her spouse with equal shares is a closely associated entity of the person discharging managerial responsibilities.

In the different language versions of Article 3 (1) (26)(d) of MAR there are differences that allow differing interpretations to be made in different Member States as to whether an entity may be closely associated merely because a person discharging managerial responsibilities or a natural person closely associated with him or her discharges managerial responsibilities within the said entity or whether, additionally, there must always be between the said entity and a person discharging managerial responsibilities within an issuer or a natural person closely associated with him or her an ownership or other financial connection, as referred to in the provision.

Before the situation is clarified, FIN-FSA will not require notification of transactions of closely associated entities with which a person discharging managerial responsibilities or a natural person closely associated with him or her does not have an ownership or other financial connection, as referred to in Article 3(1) (26)(d) of MAR.

For further information, please contact:

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New market sounding procedures begin to be applied on 3 July 2016

The Regulation of the European Parliament and of the Council on market abuse (596/2014, MAR) came into force on 3 July 2014 and it will begin to be applied on 3 July 2016. Article 11 of MAR includes procedures relating to market sounding. More detailed procedural guidelines relating to participants conducting market soundings are set out in the Commission's Level 2 regulations. The Commission Implementing Regulation (EU) 2016/959 lays down more detailed provisions on the systems and notification templates to be used by disclosing market participants, and on the format of the records. The Commission Delegated Regulation (EU) 2016/960 contains supplementary provisions on the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings. In addition, the European Securities and Markets Authority (ESMA) will issue guidelines, currently still in draft form, for persons receiving the market sounding (situation at 20 June 2016).

What is market sounding and whom will the regulatory standards affect?

Market sounding is defined in Article 11(1) of MAR. According to the provision, "sounding comprises the communication of information, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it, such as its potential size or pricing, to one or more potential investors".

According to the scope of Article 11 of MAR, the provisions of the regulation relating to market sounding will be applied to

- an issuer
- a secondary offeror of a financial instrument, in such quantity or value that the transaction is distinct from ordinary trading and involves a selling method based on the prior assessment of potential interest from potential investors (in practice generally offerors of an investment service)
- a third party acting on behalf or on the account of a person referred to above.

Market sounding is typically done in connection with block trades, private placement arrangements and issuances of shares and bonds. The regulatory standards relating to market sounding will also be applied with certain conditions to a situation in which a party planning to make a public takeover or merger discloses inside information to the parties entitled to the said securities, such as, for example, major shareholders. A condition is that the parties need the information to form their opinion on the offering of securities, and the opinion on the arrangement of those receiving the market sounding can be reasonably considered necessary for making a decision on a takeover bid or merger.

Market sounding and prohibition on disclosing inside information

Adherence to the procedures of Articles 11 (3) and 11 (5) of MAR gives participants conducting market soundings a "safe harbour" with respect to suspicions of violating the prohibition on disclosing inside information of Article 10 of MAR. Disclosure of information that takes place during market sounding is deemed to have taken place in the normal exercise of a person's employment, profession or duties if the person disclosing the information adheres to the procedures specified in the above-mentioned articles.

Procedures relating to market sounding

Disclosing market participant

A disclosing market participant must have in place procedures relating to market sounding as well as the recording of calls relating to market sounding. Market sounding may take place, for example, orally in connection with a meeting, via an audio or video call, in writing or by means of electronic communications. The procedures must provide instructions that market sounding conducted by telephone is done only using recorded telephone lines, if a recording procedure is available. In addition, procedures must specify the standard set of information that is always given to the recipients of information before actual sounding begins.

Information and consents to be given in connection with market sounding

According to the Article 11(3) of MAR, a disclosing market participant shall, prior to conducting market sounding, specifically consider whether the market sounding will involve the disclosure of inside information and shall make a written record of its conclusion and the reasons therefor.

Before actual market sounding begins, the disclosing market participant shall tell the person receiving the market sounding the following facts

- that market sounding is involved
- notification of the recording of the audio or video call and that this requires the consent of the person receiving the market sounding
- clarification that the person receiving the market sounding is entitled to receive the information
- notification of the fact that, in the assessment of the disclosing market participant, the information to be given includes inside information, and reference to Article 11(7) of MAR, according to which the person receiving the market sounding has an independent obligation to assess whether the information is inside information
- where possible, an estimation of when the information will cease to be inside information
- notification of obligations relating to the receipt of inside information (prohibitions of the use and disclosure of inside information/emphasis on the confidentiality of the information).

In addition, the express consent to receive the information shall be obtained from the person receiving the market sounding. The disclosing market participant shall also make a record of the personal and contact information of the person receiving the market sounding, in accordance with Article 4 of the Delegated Regulation.

If, in the assessment of the disclosing market participant, the information to be given in connection with the market sounding is not inside information, the above-mentioned information should be disclosed to the person receiving the market sounding where applicable.

If the contact preceding market sounding and the market sounding itself are not recorded, the participant conducting market sounding shall make a written note of all information and consents given before and during the market sounding. The template for written minutes and notes is specified in Article 2 of the Commission Implementing Regulation and its annexes.

In addition, the participant conducting market sounding shall keep a list of parties who have not given their consent to market sounding.

The disclosing market participant shall ensure that the person receiving the market sounding is notified when the disclosed information ceases to be inside information. Article 5 of the Commission Delegated Regulation specifies the information to be given where the information has ceased to be inside information.

Reliable storage of information

A disclosing market participant shall ensure that information relating to market sounding is kept on a durable medium that enables the accessibility and readability of the information. Information relating to market sounding shall be stored for at least five (5) years. The Commission Delegated Regulation contains more detailed provisions on the storage of information.

Procedures relating to the persons receiving the market sounding

ESMA Level 3 Guidelines provide more detailed instructions on procedures relating to the person receiving the market sounding.

According to Article 11 (7) of MAR, the person receiving the market sounding has an independent obligation to assess whether it is in possession of inside information or when it ceases to be in possession of inside information. The assessment should also take into account information received by the person receiving the market sounding from elsewhere or from other sources. If the assessments of the market participant conducting the sounding and the person receiving the sounding differ from each other, the recipient must notify the participant conducting the market sounding of its own assessment. This notification should not be done, however, if the recipient's assessment is based on other information than that received in connection with the market sounding.

The person receiving the market sounding shall have internal procedures to ensure the reliable handling of inside information/confidential information received in connection with the market sounding. Reliable handling also includes instructing and training staff. According to the ESMA Guidelines, the person receiving the market sounding must also maintain a list of persons who have received inside information or confidential information relating to market sounding.

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Market Abuse Regulation changes disclosure process

From 3 July 2016, an issuer's ongoing disclosure obligation will be based on Article 17 of the Market Abuse Regulation (MAR), according to which an issuer shall inform the public as soon as possible of inside information which directly concerns that issuer.

The ongoing disclosure obligation provision of Chapter 6 Section 4 of the Securities Market Act (SMA) has been interpreted in such a way that, in respect of decisions made, a public disclosure obligation has, as a rule, arisen after a decision is made. According to MAR, the public disclosure obligation also extends to decisions in preparation. In practice, this means that the threshold for publicly disclosing information is brought forward compared with the current practice.

The timing of public disclosure will not, however, necessarily change significantly from the present timing, because an issuer will still retain the possibility to delay the public disclosure of inside information. Although conditions for delaying public disclosure are, in practice, the same as current regulations in terms of content, MAR sets certain procedural obligations for the delay of public disclosure that shall be taken into account in the disclosure process.

Inside information potentially arising in connection with financial reporting

FIN-FSA does not in itself consider that the preparation of financial reporting requires the establishment of an insider project. An issuer may ensure the trading restriction of individuals other than those entered in the insider list by means of the company's internal trading restriction guidelines.

When financial information is sufficiently credible and accurate, an issuer should assess whether the financial report contains inside information, and whether potential inside information is of a kind that should be publicly disclosed as a profit warning as soon as possible. If a profit warning is not involved, an issuer may make a decision on delaying the public disclosure of inside information in the manner required by MAR.

Disclosure process

An issuer should take the requirements of MAR into account in its internal disclosure process. When inside information arises, an issuer must have the capability to assess and decide whether an immediate public disclosure obligation applies to the inside information or whether conditions exist for delaying public disclosure. In connection with making a decision to delay, an issuer must ensure that the decision and its conditions are documented and stored in a permanent way. All conditions for delay must be fulfilled throughout the duration of the delay, and an issuer must ensure that there is continuous monitoring of the fulfilment of the conditions for delay. In the event a possible leak of information, an issuer must have the capability to publicly disclose the inside information immediately.

When inside information that has been delayed is publicly disclosed, FIN-FSA should be notified of the following:

- the company's name
- the contact information of the individual making the notification (name, position in the company, email address, telephone number)
- the information that was subject to delayed disclosure (title of stock exchange release, date and time of disclosure of stock exchange release)
- date and time of the decision to delay public disclosure
- identity of all persons with responsibilities for the decision of delaying the public disclosure (name and position in the company).

Notification is made on a form which can be obtained on FIN-FSA's website. The form should be sent via encrypted email https://securemail.bof.fi to FIN-FSA's address kirjaamo(at)finanssivalvonta.fi.

For the supervision of disclosure, FIN-FSA will, if necessary, request from the company an explanation on the fulfilment of the conditions for delaying public disclosure.

Further information is available on FIN-FSA's MAR website.

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ESMA guidelines on Alternative Performance Measures enter into force on 3 July 2016

ESMA published Guidelines on Alternative Performance Measures (APM) on 30 June 2015. The Guidelines enter into force on 3 July 2016. They replace the corresponding recommendation published by CESR in 2005 (CESR Recommendation on Alternative Performance Measures).

This article brings together the key points of the ESMA Guidelines. It is possible that the views expressed by the Financial Supervisory Authority in this article may subsequently have to be revised on the basis of possible future ESMA guidance.

Objective of the ESMA Guidelines

Performance measures adjusted in different ways are presented alongside IFRS performance measures. An IFRS performance measure and an APM may differ from each other significantly, and for this reason comment in the media on companies' financial performance in a reporting period may be very contradictory according to which performance measure is commented on. The calculation and content of APMs may also vary, which makes comparisons between companies more difficult.

One objective of the Transparency Directive is the creation of harmonised EU-level investor protection by giving a true and fair picture of companies' performance and financial position. For this reason, ESMA considers that a harmonised approach to the presentation of APMs is necessary. The objective of the ESMA Guidelines is to promote the transparency, comparability and reliability of disclosed APMs.

Where are the ESMA Guidelines applied?

The Guidelines apply to APMs disclosed by issuers or persons responsible for the prospectus when publishing regulated information and prospectuses. The Guidelines therefore apply, for example, to other performance measures than IFRS performance measures disclosed in an annual report or in the explanatory statement of an interim report. If an APM is disclosed in financial statements prepared in accordance with the IFRS framework, the Guidelines do not apply to it.

Although the ESMA Guidelines apply to periodic disclosure reports, as specified in the Securities Market Act (annual and half-yearly reports), reporting consistency may be considered to require that the principles of the Guidelines be also applied to interim reports published for the first and third quarters or other financial reports and also the financial statements bulletin.

What is an alternative performance measure?

In the ESMA Guidelines, an alternative performance measure (APM) is understood as a financial measure of historical or future financial performance, financial position or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework (in the EU, IFRS).

APMs include, for example

- EBITDA
- operating earnings
- earnings before non-recurring or other adjustment items
- cash earnings
- net debt.

How should APMs be presented?

All APMs and their components should be defined. The APMs disclosed should be given meaningful labels, and a reconciliation of each APM to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period should be disclosed. In addition, issuers or persons responsible for the prospectus should explain why they believe that an APM provides useful information regarding the financial position, cash flows or financial performance as well as the purposes for which the specific APM is used.

Definitions and labelling

Definitions of APMs should be disclosed in connection with the financial statements, and how each APM is calculated should be clearly shown. The definitions should, for example, cover all adjustment items with which some IFRS performance measure may be adjusted.

APMs should be labelled so that they cannot be confused with IFRS performance measures. They should not, moreover, be mislabelled as non-recurring, infrequent or unusual. According to the ESMA Guidelines, items that affected past periods and will affect future periods (such as restructuring costs or impairment losses) will rarely be considered as non-recurring, infrequent or unusual. The Guidelines do not, however, give examples of which items may be non-recurring, infrequent or unusual.

If a company has previously presented items such as, for example, operating profit excluding non-recurring items and non-recurring items that according to the Guidelines cannot be considered as non-recurring, infrequent or unusual, the APM should be relabelled appropriately. Consistency of disclosure requires that possible adjustment items be defined in advance and that they be disclosed in the calculation basis of each APM.

A profit forecast given for 2016 should, if necessary, be changed in line with the ESMA Guidelines. This can be done in the Q2 2016 half-yearly report, if the company considers that there is no need to give a profit warning before the publication of the half-yearly report.

Reconciliation

A reconciliation of each APM to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period should be disclosed. Reconciliation is understood to be a numerical bridge calculation, specifying the most significant reconciliation items, between an IFRS performance measure included in the financial statements and an APM. If an APM can be directly calculated using figures and a calculation formula contained in the financial statements/half-yearly report, it is not necessary, in the view of FIN-FSA, to present a separate reconciliation calculation.

Where an APM is not reconcilable because it does not derive from the financial statements, such as profit estimates, future projections or profit forecasts, the issuer should provide an explanation about the consistency of that APM with the accounting policies applied by the issuer in its financial statements prepared in accordance with IFRS.

If, for example, a profit forecast has been given for an APM, the issuer should state how the reconciliation would be done if the financial statements would be available. An APM given as a profit forecast and, in time, disclosed in the financial statements should be calculated using the same calculation basis.

Presentation

APMs should not be displayed with more prominence or emphasis than performance measures derived directly from the income statement, nor should they divert attention away from them. For example, when adjusted operating profit or EBITDA are presented, the operating profit presented in the income statement should be shown alongside them.

The definition and calculation of an APM should be consistent from one period to another. If an issuer stops disclosing an APM or replaces an APM, the issuer should provide justifications for the change.

APMs should be accompanied by comparative information for corresponding periods.

Compliance with the ESMA Guidelines by reference

Except in the case of prospectuses, compliance with the Guidelines by reference is possible. Accordingly, direct reference to other documents previously disclosed that contain information relating to APMs is sufficient. Information relating to APMs should be readily and easily accessible on the issuer's website.

Transition to compliance with the ESMA Guidelines

Stock exchange releases and financial reports presenting APMs that are disclosed on or after 3 July 2016 should present all information required by the ESMA Guidelines.

Information required by the ESMA Guidelines may be disclosed, for example, as a separate stock exchange

release before 3 July 2016, in which case stock exchange releases disclosed on or after 3 July 2016 may refer to this release available on the company's website. If a company has not disclosed in a stock exchange release the information required by the ESMA Guidelines, it should provide the information at the latest in the Q2 2016 half-yearly report.

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