



# **Market Guidelines in Relation to the Market Abuse Directive For European ABS and CMBS Transactions**

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Commercial Mortgage Securities Association Europe / European Securitisation Forum

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For European ABS and CMBS Transactions**

**1. Preamble**

The Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse) (together with its implementing Directives<sup>1</sup>, the **Market Abuse Directive** or **MAD**) is a minimum harmonisation Directive which seeks to ensure the integrity of the European capital markets and encourage public confidence in the trading of securities and derivatives by preventing, detecting, investigating and sanctioning against market abuse. To that end, it requires issuers to disclose promptly to the public and in as synchronised a fashion as possible information which may impact the price of listed securities (inside information), to avoid some investors having advantage over others by gaining earlier or greater access to this information. The MAD applies to all securities admitted to trading on a EU regulated market or of which an application has been made to be admitted to trading on a EU regulated market.

As the MAD contains no specific rules for asset-backed securities, the Commercial Mortgage Securities Association Europe (CMSA-Europe) and the European Securitisation Forum (ESF) (the **Associations**) created a joint task force to examine issues arising from the implementation of this Directive in the ABS and CMBS markets. The participants in the task force pointed out the difficulty in interpreting some of the provisions in the MAD concerning insider dealing, as outlined in section

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<sup>1</sup> Namely, (i) Commission Directive 2003/124/EC of 22 December 2003 implementing the MAD as regards the definition and public disclosure of inside information and the definition of market manipulation; and (ii) Commission Directive 2004/72/EC of 29 April 2004 implementing the MAD as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions.



2 of this document, in light of certain particular features of ABS and CMBS transactions notably, (i) the potentially inside information relates to a pool of securitised assets rather than to an operating company; (ii) the securities whose price may be affected are issued in a stratified structure; (iii) the issuer is a special purpose vehicle (SPV); and (iv) servicers, trustees or cash managers are entrusted with data collection and reporting duties and, as a result, are likely to come across potentially inside information. Further description of these issues may be found in section 3 of this document.

On the basis of the feedback received from members at the Task Force and at other groups and committees, the Associations issue these Market Guidelines to assist ABS and CMBS market participants in dealing with the above-summarised issues and thus in complying with the MAD requirements for assessment and disclosure of inside information in transaction post-issuance reporting. Market participants are encouraged to follow the recommendations contained in section 4 of this document, but, as a note of caution, market participants are also advised to consider circumstances arising in a transaction on a case-by-case basis. In addition, as the MAD is a minimum harmonisation directive, there may be jurisdiction-specific variations resulting from the implementation of the MAD which market participants are also advised to consider. This document, therefore, should not be relied on to the exclusion of consultation with legal and financial advisors or regulators at the relevant jurisdictional level.

The Associations believe that these Guidelines, when implemented, will not only contribute to fulfil the goals of the MAD but will also have a positive long-term effect on the European ABS and CMBS markets, as they will ultimately contribute to increased transparency, efficiency and liquidity in the secondary market, a goal not only pursued by the Associations and generally desired by market participants, but also one which forms a key component of the Lamfalussy framework as adopted by the European Council of March 2001.



## 2. Market Abuse Directive – key provisions for ABS and CMBS transactions

The key provisions of the MAD relevant to the ABS and CMBS markets and referred to in this document are the following:

- (a) *Definition of “inside information”* (Art. 1 of the MAD): “information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

[...]

For persons charged with the execution of orders concerning financial instruments, "inside information" shall also mean information conveyed by a client and related to the client's pending orders, which is of a precise nature, which relates directly or indirectly to one or more issuers of financial instruments or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments”.

- (b) *Prohibition of using inside information*

Article 2 of the MAD: “Member States shall prohibit any person...who possesses inside information from using 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”;

Article 3 of the MAD: “Member States shall prohibit any person subject to the prohibition laid down in article 2 from:



- (a) 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;
- (b) recommending or inducing another person, on the basis of inside information, to acquire or dispose of financial instruments to which that information relates”.
- (c) *Issuer’s disclosure obligations* (Art. 6.1 of the MAD): “Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns the said issuers”.
- (d) *Reasonable Investor test* (Art. 1.2 of Directive 2003/124/EC) “For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC, “information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments or related derivative financial instruments” shall mean information a reasonable investor would be likely to use as part of the basis of his investment decisions”.
- (e) *Method of disseminating inside information* (Art. 2.1 of Directive 2003/124/EC): “Member States shall ensure that the inside information is made public by the issuer in a manner which enables fast access and complete, correct and timely assessment of the information by the public”<sup>2</sup>.

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<sup>2</sup> By way of example, the UK’s Disclosure Rules state that: “an issuer must notify an RIS as soon as possible of any inside information which directly concerns the issuer unless DR 2.5.1R applies” (Disclosure Rule 2.2.1R). An RIS must be approved by the Financial Services Authority (FSA) and be included in the list of RIS maintained by the FSA, which is accessible via their website at [www.fsa.gov.uk](http://www.fsa.gov.uk). For transactions listed in Ireland, inside information may also be disseminated via an FSA-approved RIS or through the Company Announcement Service of the Irish Stock Exchange. For transactions listed in Luxembourg, the Circulaire CSSF 06/257 deems the disclosure obligation discharged where the inside information is published in one of the most circulated newspapers in Luxembourg, in the website of the Luxembourg Stock Exchange or through an agency specialised in the publication of financial information.



### 3. Market Abuse Directive – issues for ABS and CMBS transactions

Current features of ABS and CMBS transactions that have raised questions and concerns among market participants in relation to the implementation of the MAD include the following:

- (a) In contrast to equity or ordinary fixed income transactions, inside information in the context of ABS and CMBS transactions usually does not relate to a corporate or financial institution issuer. It rather relates to a securitised pool of assets held by a special purpose vehicle (SPV) and serviced by a servicer, which may be the originator or another specialised third party. Therefore, there is potentially a wider range of information relating to the underlying assets and/or obligors which could be sensitive and/or confidential in nature.
- (b) The stratified structure of ABS and CMBS transactions at the securities level (with junior tranches of securities typically absorbing losses without interrupting payments to more senior tranches) may mean that an event occurring in the securitised pool of assets has a “significant effect” on the price of a junior tranche of securities but not on another more senior tranche. As a matter of practice, subordinate investors often request greater information than that provided to other investors given that they are taking a higher risk. Notwithstanding this stratified structure and that a piece of information would be likely to only have a significant effect on the price of a junior tranche, if the information is inside information it must be disclosed to the public by virtue of the MAD and hence to the holders of all tranches of debt securities issued in the relevant transaction. Market participants should, therefore, avoid distinguishing among tranches of securities when disclosing potentially inside information in respect of a particular transaction.
- (c) As noted above, an issuer of securities which are admitted to trading on an EU regulated market is the entity that is legally responsible to disclose inside information under the MAD. In ABS and CMBS transactions, the issuer is typically a bankruptcy remote entity set up with the sole purpose of channelling cash-flows from the underlying assets to the securities holders in



an efficient manner. As such, the SPV issuer is unlikely to have the infrastructure or expertise to assess whether a particular piece of information constitutes inside information and, as a matter of fact, there are many transactions where the SPV issuer does not directly receive information in relation to the underlying assets and, accordingly, is not in a position to discharge its legal obligation to disclose inside information.

- (d) By contrast, servicers are entrusted, among other reasons, with monitoring the portfolio of assets for the purpose of on-going post-issuance reporting to investors and accordingly are the ones most likely to come across inside information as a result of performing their normal contractual obligations. Other transaction participants, such as trustees, cash managers and calculation agents, may also sometimes carry out specific reporting duties. None of these parties are legally responsible for assessing and disclosing to the public “inside information” and, in some cases, they may not have the expertise or the resources to make such an assessment.

Furthermore, these post-issuance reports are frequently made available via posting in password-protected websites. Access to these reports is normally limited to current investors, with prospective investors being granted access if identified as such by an existing investor. To the extent that such reports contain inside information, this type of dissemination alone may not be in compliance with MAD and may well give rise to issues for both issuers and investors as a result (i.e. pursuant to article 2 of the MAD, those investors to whom disclosure has been made will themselves commit market abuse if they deal in securities on the basis of not publicly disclosed inside information).



#### **4. Market Guidelines: assessment and disclosure of Inside Information. Post-issuance reporting**

In order to seek to comply with the MAD insofar as it relates to the disclosure of inside information, the Associations recommend that market participants adopt the practices described in these Market Guidelines, although it is recognised that certain aspects of the Guidelines may give rise to the need for participants in existing transactions to make certain modifications to them to bring them into line with the Guidelines.

##### ***Procedures and party responsible for assessing and disclosing inside information***

The Associations recommend that the parties originating and arranging transactions put in place adequate procedures in every transaction to ensure (i) that potentially inside information can be identified by servicers<sup>3</sup>; (ii) that these parties know exactly how to manage that information from a MAD standpoint, that is, whether to report it to another party or to directly disclose it; and (iii) that the final decision-making to assess and disclose inside information is centralised within the appropriate transaction party, whether the SPV issuer or another party by delegation in accordance with the guidelines below.

In this connection, the Transaction Documents (Offering and contractual documents) must clearly include the following under a separate heading:

- (a) Identification of the transaction party responsible for assessing and disclosing inside information to the public in relation to that particular transaction: a clear statement as to whether (i) the SPV issuer alone will assess and, where necessary, disclose/procure the disclosure of inside information or (ii) the SPV issuer is to delegate by contract the assessment

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<sup>3</sup> Unless otherwise stated, these guidelines also apply to all other service providers within a transaction, in addition to the servicer of the portfolio which are likely to come across potentially inside information, such as the cash managers with respect to credit derivatives.



and /or disclosure functions to a third party (albeit that, by virtue of MAD, the SPV issuer will nevertheless remain legally responsible to make the required disclosures).

Where any party, other than the SPV issuer, is appointed to assess and disclose inside information, the SPV issuer should be kept duly informed of any such disclosure and should be entitled by the Transaction Documents to revoke this delegation upon the occurrence of specific events and/or make disclosures where it feels that such disclosures should be made even though the third party has not made a disclosure.

In either case, the party that in practice takes on the role of assessment and disclosure should be provided with adequate means to receive and process the information arising in a transaction in accordance with the MAD requirements, which should include in-house expertise or the financial resources to engage external advisors when it becomes necessary to assess the potential price sensitivity of particular information arising out of a transaction.

The Transaction Documents should also determine notification and disclosure procedures along the following lines:

- (i) Where the SPV issuer retains responsibility for assessment and disclosure, the servicer should be required to notify it of the occurrence of any potentially price sensitive information in the manner determined in the Transaction Documents (see subsection 4(b) below) and the SPV issuer will need to disclose the information where it determines that it is necessary to do so having regard to the applicable legal requirements under MAD.
- (ii) Where the SPV issuer delegates this responsibility to another transaction participant or third party, this party should directly assess and disclose as soon as possible the inside information in the manner determined in the Transaction Documents (see subsection 4(b) below). Where the servicer is the originator of the securitised assets or is reasonably close to the originator or the arranger of the transaction, the servicer may be the most



suitable party to perform this role properly. However, the parties originating and arranging transactions are advised to make this determination on a case-by-case basis in light of the circumstances arising in the particular transaction. Where no other party is found or acceptable to the transaction parties to perform this role, the SPV issuer will need to retain responsibility as described in the preceding paragraph (i).

- (b) A description of the set of events with respect to the pool of securitised assets which may have a significant effect on the price of the securities backed by that pool. This description of events should be construed by servicers and SPVs as an indicative and non-exhaustive list of events that may occur for the purpose of complying with the MAD disclosure obligation. The servicer should be instructed to monitor the portfolio accordingly and, as the case may be pursuant to subsection 4(a) above, report to the SPV or to the third party appointed for the purposes of assessing and/ or disclosing inside information, or directly disclose the occurrence of any such event upon becoming aware of it.

As explained in subsection 3(b) above, the determination and disclosure of inside information should not make any distinction between the listed tranches of securities in a transaction, but rather an event with a significant effect on the price of a subordinate tranche should be disclosed as inside information regardless of potentially not having the same effect on the price of a senior tranche.

The party responsible for disclosing inside information should ensure that such disclosure complies with all the formal requirements of the applicable national law and the MAD.

***Recommendations for post-issuance reporting and Market Abuse Directive***

In order to minimise the costs of implementing the procedures described in the previous heading of this section 4 and to generally reduce the risk of non-compliance with the MAD, the Associations would point out that, in large measure, disclosure obligation could be discharged through the



inclusion of inside information in a transaction’s regular post-issuance reporting, provided that such reporting follows the best practices that the Associations recommend in this section heading, adapted to the specifics of inside information disclosure as described below.

The Associations recommend that the Transaction Documents provide under a separate heading a description of the practices and procedures that will be observed for post-issuance reporting in every particular transaction, with regard to the matters described under the following bullet subsections.

- *Standardisation of reports:*

- (i) Post-issuance reporting: the Transaction Documents should describe the specific categories, formats, types or fields of data that will be reported on and the definition of key reporting fields. The Associations recommend the use to this end of existing industry standardised reports where available, such as the ESF’s Standardised Reporting Fields and Definitions for RMBS (available at [www.europeansecuritisation.com/pubs/FinalESFGuidelines16May06.pdf](http://www.europeansecuritisation.com/pubs/FinalESFGuidelines16May06.pdf)) and the CMSA-Europe’s European Investor Reporting Package, UK only, version 1.0 for CMBS (available at [www.cmbs.org/Europe/CMSA\\_E-IRP/CMSA%20EIRP.pdf](http://www.cmbs.org/Europe/CMSA_E-IRP/CMSA%20EIRP.pdf)).
- (ii) Disclosure of inside information: the determination of reporting fields should also include the sets of events mentioned in subsection 4(b) above. The use of industry standards is also recommended in this regard as it will help with the argument that the “reasonable investor test” has been satisfied given that such industry standard reports have been prepared after extensive discussions with market participants, including investors, and so are likely to be used by a “reasonable investor” as part of the basis of his investment decisions”. Use of these standards, however, should not be relied on to the exclusion of a complete assessment of what information arising in a transaction may be inside information requiring disclosure.



- *Availability of, and access to, post-issuance reports:*
  - (i) Post-issuance reporting: the Transaction Documents should specify the communication and distribution channels that will be used to disseminate post-issuance reports, or from which such reports may be obtained (e.g. internet websites, third party information vendors, etc.). Post-issuance reports should be made generally available to the marketplace and not limited to current investors.
  - (ii) Disclosure of inside information: The disclosure of post-issuance reports to the market place, and not only to existing or prospective investors, would result in the inside information contained in them becoming public and, as a result, not capable of constituting market abuse. This would greatly reduce insider dealing risk for investors which are currently making use of password-protected information. Where password protection is maintained, market participants are reminded that those aspects in the reports that may constitute inside information must be disclosed through the appropriate channels and, in such a case, the Associations recommend that investors having access to such reports are made aware that a disclosure in accordance with the MAD has been effected.
  
- *Regularity of post-issuance reportings:*
  - (i) Post-issuance reporting: the Transaction Documents should indicate the timing and frequency (e.g. monthly, quarterly or other periodic schedule) that will be observed in the production and dissemination of post-issuance reports. The Associations recommend monthly post-issuance reporting to facilitate the timely disclosure of any inside information contained in the post-issuance reports. Where quarterly reporting is used in a transaction, monthly updates if necessary are then recommended.



- (ii) Disclosure of inside information: Market Participants are reminded that the MAD requires inside information to be disclosed as soon as possible. In this regard, the Associations would therefore note that the SPV issuer or the relevant transaction party will need to be geared up to make *ad hoc* disclosures of inside information that they become aware of outside the ordinary course of post-issuance reporting regime established for a transaction.