



Recommendation No. 2 of 2008 (14 August)
of the Board of the Hungarian Financial Supervisory Authority
on Inside Information and
on Delaying the Publication of Inside Information for Legitimate Reasons
and on the Rules for Maintaining Insider Lists
based on the Recommendation of The Committee of European Securities Regulators

I. The Goal and Scope of the Recommendation

One of the goals of the HFSA's activities is to facilitate the smooth and successful operation of the financial and capital markets, to facilitate the transparency of the market environment, and to facilitate the reinforcement of confidence in the financial markets. Within this framework the Board of the HFSA formulates and publishes recommendations. In general the purpose of the recommendations is to improve predictability in law enforcement and to facilitate the uniform application of the relevant legal statutes.

The goal of this recommendation is to facilitate the uniform interpretation of the concepts related to inside information, and thereby to unburden market participants in their efforts to comply with statutory obligations related to inside information (such as prohibitions on transactions, publication requirements, the obligation to maintain records) in order to enable the realisation of a uniform interpretation of compliant conduct and of daily market surveillance practices on the internal financial markets of the European Union.

We expect that the application of this recommendation will facilitate compliance with the legal statutes.

This recommendation is addressed primarily to publicly quoted companies limited by shares, their senior officers and secondarily to investment enterprises that execute client orders.

The definitive norms governing the contents of this Recommendation are as follows:

- Act CXX of 2001 on the capital market (the Capital Market Act – CMA), and in particular its Chapter XXI on insider trading and market abuses;
- Regulation No. 28 of 2005 (26 August) issued by the Minister of Finance on the circumstances to be considered when investigating suspicious conduct that indicates market abuse, on the process used to determine accepted market practices, and on the rules for delaying the publication of inside information for legitimate reasons;
- Regulation No. 2273/2003/EC on the implementation of Directive 2003/6/EC with regard to the exemptions concerning repurchase programs and with regard to the stabilisation of financial instruments;
- Recommendation No. 5 of 2006 (6 July) of the Board of the HFSA on the notification of suspicious transactions that indicate insider trading and market abuse (the supervisory regulation set forth in the recommendation does not constitute a mandatory norm).

This Recommendation represents an adaptation of Guidance Ref. CESR/06-562b of the Committee of European Securities Regulators (hereinafter referred to as the CESR).

II. The Concept of Inside Information

- 1 The following provide some guidance for the interpretation of the concept of inside information as defined under Article 201 Paragraph (3) of Act CXX of 2001 on the Capital Market (CMA).
- 2 Article 201 Paragraph (3) of the CMA defines the concept of “inside information” by means of the following four criteria. It is
 - Information which is substantial (specific);
 - Which has not yet become public;
 - Relating, directly or indirectly, to a financial instrument or to the issuer of a financial instrument;
 - And which, if it were made public, could be used to substantially (significantly) influence the price of that financial instrument.

We will now provide detail on the interpretation of the HFSA of the above four criteria.

Substantial (specific) information

- 3 Pursuant to Article 201 Paragraph (4) of the CMA “substantial information is any information that relates to an event or a circumstance that has occurred or that can be reasonably expected to occur, which is specific enough to enable conclusions to be drawn as to the possible effect of the given circumstance or event on the price of a given financial instrument.”
- 4 The substantial (specific) nature of the information is to be assessed on a case-by-case basis and depends on the information itself and on the unique characteristics of the case. However, the following general points can be made: In determining whether or not a given circumstance or event has occurred, a key issue is whether or not there is specific and objective evidence for this as opposed to market rumours and speculation, i.e. whether or not there is sufficient proof available for the occurrence of the given circumstance or event. When deciding on the cases in which an event can be reasonably expected to occur, the HFSA considers whether or not it was reasonable to draw the given conclusion on the basis of the ex ante information available at the time.
- 5 If the information concerns a process or event that drags on over a longer period of time and that can be split into stages, then each stage of the process as well as the overall process could constitute substantial information. An example might be a takeover bid. The fact that an official takeover offer may not be made at the end of the negotiations, does not mean that the approach to the target company in itself could not constitute substantial information.
- 6 Neither is it necessary for a piece of information to be complete to be substantial (specific). For example, an approach to a target company with the intent to make a takeover bid can be considered as substantial information even if the bidder has not yet made a decision on the offer price, i.e., if not every element of the takeover bid is as yet clarified.
- 7 Similarly, a piece of information could be considered as substantial (specific) even if it refers to events that could be alternatives of one another. For example, the fact that a company was proposing to launch a takeover bid for one of two companies could be considered substantial

information, even if it had not yet decided on which of the two companies the target should be.

- 8 The HFSA considers two circumstances in deciding whether or not a piece of information is specific enough to allow a conclusion to be drawn about its impact on price. A piece of information is specific enough, if in its possession a reasonable investor can make an investment decision without, or at very low, financial risk, i.e., if the investor can assess with a high degree of safety the direction in which the price of the financial instrument would move if the information became public. For example, if someone learns that a takeover bid will be made for an issuer, he/she can normally expect the price of the issuer's shares to rise upon the takeover bid becoming public. On the other hand a piece of information is to be considered specific enough also if it would be immediately used on the market, i.e., if market participants would make their investment decisions with consideration to the information as soon as the information has become public.

Publication

- 9 Pursuant to Article 201/C Paragraph (1) of the CMA, the issuer of a security quoted on a regulated market is obliged to make public, without delay, and to publish on its internet home page all inside information relating to itself. At the same time, when investigating insider trading, a piece of information can be considered as public also if it became public with the involvement of the issuer, but not in an adequate way, or through a third party.

Ability to substantially (significantly) influence price

- 10 Article 201 Paragraph (5) of the CMA provides the following definition for the ability of a piece of information to substantially influence price:

“Information with the ability to influence price shall include all information that would be used with high likelihood by an investor when making an investment decision.”

- 11 For the purposes of this Recommendation and pursuant to Article 5 Paragraph (1) Section 20 of the CMA, Investor should be interpreted as an investor on the market who proceeds reasonably and has an average knowledge of the market
- 12 Those with potential inside information need to assess on an ex ante basis whether or not the information is likely to have a substantial (significant) influence on price. They need to consider the degree of probability with which an investor proceeding reasonably would use that piece of information when making his/her investment decision. This degree of probability should be higher than a mere chance that the investor will use the information, but it need not reach the degree of full certainty.
- 13 It is not possible to specify, neither in a percentage form nor as an absolute value, what changes in price could be considered as substantial (significant). With “blue-chip” securities for example, even smaller changes in price could be considered as substantial (significant), while larger changes in price may be needed for less liquid, more volatile securities. The following are the factors to be considered in determining whether or not a change in price is significant:

- The significance of the event in question in the context of the totality of the company's activities;
 - The relevance of the information as regards the main determinants of the financial instrument's price;
 - The reliability of the information source;
 - The market variables that affect the price of the financial instrument in question (such as price, return, volatility, liquidity, relationships among financial instruments, demand, supply, etc.)
- 14 In relation to whether or not the information is likely to substantially influence price, it is also necessary to consider, whether or not:
- The type of information is the same as information which has, in the past, had a significant effect on prices;
 - Pre-existing analyst opinions and reports have assessed this type of information to be price sensitive;
 - The company itself has previously treated similar events or circumstances as price-sensitive information.
- 15 It should be emphasised that these factors serve/may serve only as indicators. The significance or price-sensitivity of a piece of information may vary by company, depending on a number of factors. Thus, among others, consideration should be made of the company's size and of the market sentiment about the company and about the given sector. In addition, what is likely to have a substantial price effect can also vary according to the asset class of the financial instrument. For example, while the same piece of information may be price sensitive for an equity issuer, it may not necessarily be so for an issuer of debt securities.

Potential inside information concerning the issuer

Information which directly concern the issuer

- 16 The following is a non-exhaustive list of circumstances and events, that may have already occurred or that are highly likely to occur, that might constitute inside information prior to becoming public. Circumstances and events that are highly likely to occur also include events and circumstances the occurrence of which depends on decisions made by management and/or on some external circumstance. If some circumstance or event is not shown on the list, it does not mean that it cannot be considered as inside information. Also, none of the circumstances or events on the list should be considered automatically as inside information, the features and characteristics of each event must be considered.
- The emergence of an intent or a bid to acquire a significant ownership stake or influence in the issuer;
 - Changes in the control of the corporation;
 - Changes in management and in the supervisory board;
 - Operations involving owners' equity, issue of debt securities or warrants to buy or subscribe securities;
 - Increasing or reducing the registered capital;

- Mergers, splits and spin-offs;
- Disposal or acquisition of ownership stakes in other corporations, acquisition or disposal of major assets or business lines;
- Reorganisations that have an effect on the issuer's assets and liabilities, financial position, profit or loss;
- Decisions concerning buy-back programs or transactions in other listed financial instruments;
- Changes in the rights attached to the issuer's own shares of given types, share classes and share series (Article 183 of the Business Corporations Act);
- Initiation of liquidation and bankruptcy procedures, of final settlement procedures and to pronounce the company dissolved; orders by a court for dissolution or for a bankruptcy procedure; and orders by the court of corporations for a final settlement and to pronounce the company as dissolved;
- Significant and relevant legal disputes;
- Cancellation of a credit line by a bank;
- Dissolution without a legal successor;
- Significant changes in the value of assets;
- Insolvency of the company's suppliers or debtors;
- Significant reductions in the value of real-estate properties;
- Physical destruction of uninsured inventories;
- New permits, patents and trademarks;
- Increases or decreases in the value of financial instruments included in the portfolio;
- Decreases in the value of patents, rights or other intellectual assets due to market innovation;
- Purchase offers for specific assets;
- Development of a new innovative product or technology;
- Enforcement of product liability or environmental liability claims against the corporation;
- Significant changes in expected earnings and losses;
- Significant new orders received from clients, their cancellations or significant modifications;
- Launch of a new business line or shutting down an existing business line (business activity);
- Changes in the investment policy of the issuer,
- Date of dividend payment, changes in the date, changes in the amount of the dividend, changes in the dividend policy.

Inside information which indirectly concern the issuer

17 Inside information could also include information that indirectly concerns the financial instrument or its issuer. The below list contains such types of information. The examples in

the list, in similar to the previous examples, do not provide an exhaustive list of indirect information, and are also subject to the contents of Section 22.

- 18 Where information qualifies as inside information, the duty to retain the inside information and the statutory prohibition to refrain from entering into a transaction shall apply. However, the issuer is not obliged to promptly disclose information that is indirectly related to the issuer or to the financial instrument. In many cases the issuer is not aware of the existence of the inside information prior to its publication, or may not make it public even if he/she is aware of its existence until it is made public by some other authority or public institution. If however, the publication of events or circumstances indirectly related to the issuer could have such direct consequences for the issuer that would satisfy the criteria for (direct) inside information, then the obligation of public disclosure is clearly to be applied.

Statistics and data published by public institutions;

Reports of (credit) rating agencies in preparation;

Investment recommendations, analyses covering listed financial instruments;

Decisions by central banks concerning interest rates;

Decisions by the state (government) involving taxation, the regulation of the industrial sector, debt management, etc;

Decisions for changes to the driving principles – especially to the composition – of market indices;

Decisions by regulated and non-regulated markets on the operation of the market;

Decisions with regard to corporations by other authorities that supervise competition and the market participants;

Decisions by government bodies, regional and local self-government authorities and other public bodies;

Changes to the mode of trading (such as if the financial instruments of the issuer will be traded in a different market segment in the future, such as in auction instead of continuous trading); changes in market makers or in trading conditions.

III. Delaying of inside information out of legitimate interest

- 19 Pursuant to Article 203 Paragraph (4) of the CMA an issuer may, in his/her own responsibility, delay the publication of inside information in order **to prevent harm to his/her legitimate interests** if:
- a) The delay does not cause a deception of the public;
 - b) The issuer promptly notifies the HFSA of the delay;
 - c) The issuer ensures the confidentiality of the information in question.
- 20 The following are outline examples of situations where an issuer may delay the publication of information with reference to harm to his/her legitimate interests.

Legitimate interest:

- 21 Pursuant to Article 9 of Regulation 28 of 2005 (26 August) of the Minister of Finance on the circumstances to be considered when investigating conduct that indicates market abuse, on the process to determine accepted market practices, and on the rules concerning the delayed publication of inside information out of legitimate interests (hereinafter referred to as the Regulation), legitimate interest, in particular, may relate to the following:
- a) If the publication of the inside information is detrimental to the outcome of an on-going negotiation, in particular if the negotiation has taken place to avoid insolvency, and if the information could result in misleading conclusions;
 - b) If the premature publication of research & development results is a threat to the interests of the corporation or its shareholders, or if the information would result in deceptive conclusions;
 - c) If the validity of a decision by the board of directors of the issuer requires the approval of the general assembly or the supervisory board and if the publication of the information prior to its approval would result in misleading conclusions;
 - d) If the information is incomplete and if its publication would result in misleading conclusions.
- 22 The term “in particular” in the Regulation indicates, that the above circumstances, under which the publication of the inside information may be delayed with reference to a legitimate interest, are not exhaustive, but are listed as examples. The option to delay is therefore also open to the issuer in other situations if the situation meets the conditions set forth under Article 203 Paragraph (4) of the CMA. The right to delay is an exception to the primary rule of prompt publication, and therefore it is not expedient to provide a lengthy list of delay situations. It is the responsibility of the issuer to decide whether or not the special circumstance at hand gives reason, with consideration to the conditions set forth under Article 203 Paragraph (4) of the CMA, to delay the inside information.
- 23 The set of circumstances discussed under Article 9 Section a) of the Regulation could include the following examples:
- a) Where public disclosure of contractual negotiations or of the fact that negotiations are taking place could jeopardise the conclusion of the contract or could result in damages for the other party, subject to the provision however, that any confidentiality agreement between the issuer and a third party shall not exempt the issuer of its public disclosure obligations;
 - b) Product developments, patents, inventions, provided that the most significant events that impact product developments (such as clinical trial results for new pharmaceutical products) should be disclosed as soon as possible;
 - c) When an issuer decides to sell a holding in another issuer and if the transaction could fail if it was disclosed to the public prematurely.
 - d) Impending improvements that could be jeopardised by premature public disclosure;
- 24 Article 9 Section c) of the Regulation concerns the case where decision making takes place in a complex hierarchical system within the issuer’s organisation.
- 25 It should be emphasized that meeting the test for having a legitimate interest in delaying a disclosure is not by itself sufficient reason to delay the disclosure. In all the situations a

further evaluation should be done to decide whether or not the conditions specified under Article 203 Paragraph (4) of the CMA apply.

- 26 As regards how companies should behave in the period between the creation of the inside information and the time when it is disclosed (during the delay) we recommend that if a decision was made by the issuer to delay the disclosure of the inside information, the company should record the reasons for doing so. This provides a clear audit trail which may be to the advantage of the issuer if the HFSA should inquire about the reason for the delay, in addition to the reasons reported to the HFSA or in order to verify those. During the time of the delay the issuer must ensure the confidentiality of the information within the corporation and should ensure that insiders comply with their resulting obligations (such as the prohibition on trading). If the issuer subsequently becomes aware that the information was leaked, it shall immediately disclose the inside information in the manner specified. During the delay period issuers should continuously verify whether or not the delay in disclosing the information is likely to be misleading to the public. If yes, the issuer must take prompt measures for public disclosure. In order to fulfil its duties the HFSA verifies whether or not the delay was justified and if it finds that some or all of the conditions for the delay were missing, it calls upon the issuer to disclose the inside information with immediate effect.

IV. When does information relating to a client's pending orders constitute inside information?

- 27 For persons charged with the execution of orders concerning financial instruments, Article 201 Paragraph (3) Section a) of the CMA considers inside information to mean all substantial information, which in addition to fulfilling the general criteria mentioned above (CMA Article 201 Paragraph (3) Section a)), is conveyed by the client and is related to the client's pending order.
- 28 Persons charged with execution should also manage such inside information in a way to avoid effectuating the various factual situations as described under CMA Article 201 Paragraph (1) Sections a)-d), namely:
- a) Use the information to deal directly or indirectly, or to issue an order to deal in the financial instrument affected by the inside information (CMA Article 203 Paragraph (1) Section a) excludes from the prohibition transactions executed on the basis of an agreement that was made prior to gaining possession of the inside information);
 - b) Convey inside information to any other person (however, pursuant to CMA Article 203 Paragraph (1) Section b) this activity does not constitute insider trading if the information is provided by the charged person by virtue of his/her position in the course of his/her work or usual responsibilities);
 - c) Recommend to any other person to enter into a transaction for the financial instrument affected by the inside information;
 - d) Any of the acts described above, by any other person, if he/she knew or should have known if proceeding with the due diligence that could generally be expected in the given situation, that the information used constitutes inside information.
- 29 Such persons typically include the employees of investment service providers. The following guidelines provide assistance to employees of investment service providers to be able to decide in which cases a pending client order constitutes inside information.

“Pending client orders” as inside information

- 30 As an implicit consequence of the provisions of the CMA, a piece of information provided by the client and related to a pending client order constitutes inside information if it fulfils the general criteria for inside information, i.e., it is:
- a) Substantial information;
 - b) Which has not yet become public;
 - c) Relating, directly or indirectly, to a financial instrument or to the issuer of a financial instrument;
 - d) And which, if it were made public, could be used to substantially influence the price of that financial instrument.

Pending order

- 31 Pursuant to Hungarian capital market regulations (Investment Services Act Article 64 Paragraph (2)) a pending order shall mean an order having been issued by a client to a broker, where:
- a) The order issued by the client has a limit price;
 - b) The order cannot be executed within the actual market conditions;
 - c) The interests of the clients would be harmed if the order was executed.
- 32 Thus, merely polling several investment service providers with regard to the amount of the financial instrument that they would be willing to sell or buy, and at what price (see the book-building procedure), does not by itself constitute a pending order. At the same time the information could still constitute inside information subject to the general criteria for inside information.

When is the information conveyed by the client inside information?

- 33 There are two factors of particular significance to decide whether or not information conveyed by the client constitutes inside information: is the information substantial (specific) and can it be used to substantially (significantly) influence price?
- 34 The substantial (specific) nature of such information and its suitability to substantially (significantly) influence price fundamentally depend on three parameters: price, quantity and time of execution. Further potentially important elements include the identity of the client and of the financial instrument concerned by the order.
- 35 In addition, the market impact (significant influence on price) of the features of the client order also depends on the characteristics of the market where the order is to be executed. The impact on price depends on the possible types of transactions, of the liquidity of the given market and of the modes of trading (auction-based or continuous trading).

Price sensitivity

- 36 The price sensitivity of a pending client order could be influenced by the following factors:
- a) The size of the order as a function of usual transaction sizes on the given market, in relation to the usual daily trading volume on the specific market. The larger the order is in comparison to the usual transaction size on the given market, the higher the probability that the order constitutes a substantial influence on price;
 - b) The liquidity of the market when the order is executed;
 - c) The liquidity of the financial instrument: the lower the liquidity of a financial instrument on the given market, the more likely that a single order will have an effect on its price;
 - d) The limit price specified by the client and how it is related to the spread between the actual best buy and sell offers;
 - e) The time interval specified by the client for execution: the shorter the term specified by the client for execution, the higher the probability that the order will have an effect on the price of the financial instrument;
 - f) Execution timing: the influence that the timing of execution has on the determination of the open price, close price, minimum price and maximum price;
 - g) The identity of the client;
 - h) The extent to which the given order impacts the conduct of other market participants.

Substantial (specific) nature

- 37 Pursuant to Article 201 Paragraph (4) of the CMA “substantial information is any information that 1) relates to an event or a circumstance that has occurred or that can be reasonably expected to occur, and 2) which is specific enough to enable conclusions to be drawn as to the possible effect of the given circumstance or event on the price of a given financial instrument or related derivative financial instruments.”
- 38 As it was indicated at the general description of the definition, in order for information that is available on a client order to constitute inside information, it is not a pre-requisite for all of the order parameters to be known. The more parameters of a client order are known, the higher the probability that the order will constitute substantial information.
- 39 The more a client order fits the general trading practices of the client, the more substantial (more specific) an individual order will be (the unknown elements of the order can be deducted from the client’s orders that were issued earlier).

V. Expectations to be considered in relation to the rules on the maintenance of insider lists

- 40 Pursuant to CMA Article 201/D Paragraph (1), in order to facilitate the audits performed by authorities in relation to insider trading, the issuer, or the person acting on behalf and in the name of the issuer shall maintain records of the persons with access to inside information

who perform **activities** for him/her on the basis of an employment relationship or some other legal relationship.

- 41 Since within its scope of responsibilities the HFSA continuously controls (i.e., also outside the framework of the market supervision procedure) the provisions related to the retention of insider lists and the market processes and circumstances that could provide reason to suspect insider trading or market abuse, the responsibilities of the HFSA in this area constitute a continuous activity within the framework of control by the authority (and not only a market supervision procedure).
- 42 The HFSA proposes that the issuer or the person acting on its behalf and in its name to maintain the records, and the internal organisational unit or person charged with the maintenance of the records to be reported to the HFSA, and that this name be also included unambiguously within the regulations.
- 43 When contacted by the HFSA for such a purpose, the person maintaining the records must promptly provide the requested data.
- 44 In order for the lists to meet their purpose as specified in the law, the person maintaining the insider lists must maintain the insider lists in a way that makes the details of the inside information, as specified under CMA Article 201/D Paragraph (3), available in a breakdown by person, so that the inside information's date of creation, date of becoming known and date of deletion can be found even following its publication.
- 45 Thus, insider lists must contain the group of persons with access to the given inside information in a breakdown by inside information. If a given person is in possession of different pieces of inside information, either distinctly or with overlaps in time, then the person must be entered into the records separately for each piece of inside information.

VI. Closing Provisions:

- 46 The substance of this Recommendation, issued by the Board of the HFSA, expresses the requirements as set forth in the statutory regulations, the principles and methods recommended for implementation on the basis of the law enforcement practice of the HFSA, as well as the market standards and the usual market practices. The Board of the HFSA calls your attention to the fact that the financial organisation may incorporate the contents of this Recommendation into its regulations. In this case the financial organisation is entitled to state, whether or not the contents of the relevant regulations comply with the Recommendation of the corresponding number issued by the Board of the Hungarian Financial Supervisory Authority.