

REPORT ON “STOCK REPURCHASE PROGRAMS”



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A. Introduction

A.1 Background and purpose

Stock Repurchase Programs (SRPs) are becoming an increasingly common practice worldwide. Companies engage in SRPs for a variety of capital management reasons. Depending on the laws in their jurisdictions, they can use a number of mechanisms to effect repurchases: open market operations, privately negotiated purchases, or tender offers. In some countries, issuers may also buy back shares through the use of derivatives. In the last global bull market, SRPs were commonly perceived as contributing to the relatively slow growth in net outstanding equity, in subsequent earnings per share growth, and in rising share prices.

SRPs raise a number of issues for regulators. These relate in particular to the proper treatment of a company’s shareholders and the need to ensure that SRPs are conducted in a manner consistent with orderly markets and market integrity. As a result, SRPs are widely subject to regulation. The vehicles used to implement regulation vary considerably and often include corporate and tax laws, securities laws, rules and regulations, as well as market and listing rules. Several jurisdictions have implemented, or are in the process of implementing, changes in their regulatory approaches to SRPs. This, together with the increase in the volume of repurchase transactions in recent years, the increased interest in the use of derivatives, and the potential for shares to be repurchased through multiple trading venues, has led the IOSCO Technical Committee to review the operation and regulation of SRPs.

The purpose of this report is to identify and assess issues relating to SRPs and provide a comprehensive descriptive analysis of the various regulatory approaches to SRPs in the jurisdictions of the IOSCO Technical Committee Standing Committee on the Regulation of Secondary Markets (SC2) members.¹ A compilation of the survey responses from SC2 members is included as an appendix to this report.² Also, at various points, the report discusses the survey responses from several Emerging Markets Committee (EMC) members.³ A compilation of survey responses from EMC members is also included as an appendix to this report.⁴

The report concludes by identifying principles intended to assist regulatory authorities in determining what measures they should consider in respect of SRPs in order to promote the fair treatment of shareholders, orderly markets, and market integrity.

¹ Members of the IOSCO Technical Committee Standing Committee on the Regulation of Secondary Markets (SC2) from the following jurisdictions have contributed to this report: Australia, Brazil, Ontario, Quebec, France, Germany, Hong Kong, Japan, Italy, Malaysia, Mexico, Singapore, Spain, Switzerland, United Kingdom, and USA.

² The survey was conducted at the initiation of the project. Subsequent changes to an individual jurisdiction’s regulation of SRPs are reflected in the tables in the main body of the report, but the survey response may not be updated.

³ EMC members from the following jurisdictions responded to the survey – Argentina, Brazil, Bulgaria, Czech Republic, Egypt, Lithuania, Malaysia, Oman, Poland, South Africa, Thailand, and Turkey.

⁴ Because only a number of EMC member responded to the survey, the analysis of the responses may not necessarily reflect the circumstances of the majority of EMC members. Nevertheless, it demonstrates how SRPs are handled within the jurisdictions of EMC members where they are perhaps more active.

A.2 Structure of paper

The remainder of this report is organized as follows:

Section B provides a definition of SRPs and describes the scope and main mechanisms used for SRPs.

Section C discusses the key regulatory issues relating to SRPs, and the regulatory tools adopted in the jurisdictions of SC2 members to address these issues.

Section D contains the report's conclusions and recommendations.

There are two appendices attached to the report:

Appendix 1 is a compilation of the survey responses from SC2 members.

Appendix 2 is a compilation of the survey responses from EMC members.

B. Definition and Mechanisms for SRPs

B.1 Definition and scope of SRPs

SRPs are generally defined as transactions undertaken by issuers for the purpose of repurchasing a proportion of their previously issued securities. The ways in which SRPs are established and operated vary among jurisdictions, reflecting different corporate and tax laws, listing and market rules, anti-manipulation regulations, and accounting principles.

The main purposes of SRPs include:⁵

- modifying a company's capital structure in order to raise the debt/equity ratio and/or to improve the return on equity and enhance earnings per share;⁶
- deploying excess cash flow, including following the sale of operating divisions, subsidiaries or other significant assets, with the company's own shares forming the preferred investment;
- substituting cash dividend payouts, often to achieve a tax-advantaged form of distribution;

⁵ Issuers may repurchase securities for other purposes too. For example, they may do so as part of a change of control/ownership process, in which the reduction in total shares issued leaves a major shareholder with a proportionately larger holding. These transactions are often subject to takeover rules. In some jurisdictions (e.g. France and Spain), issuers may also facilitate liquidity provision in their shares by entering into an agreement with an investment firms who acts as liquidity provider.(normally as a member of an exchange) The way such agreements are implemented and regulated varies from jurisdiction to jurisdiction.

⁶ Enhanced earnings per share means higher than would otherwise be the case, e.g., following the exercise of stock options.

- establishing a source of issued shares that can be readily accessed/released to satisfy the needs of dividend reinvestment, stock option and employee stock ownership plans;
- increasing the availability of treasury shares to fund acquisitions.

Companies also use SRPs in order to signal management's belief that the company's stock is undervalued or management's optimism about the firm's prospects.⁷

B.2 Main mechanisms for SRPs

The main mechanisms used for SRPs include:

- Open Market Repurchase Programs (OMR)*. In this case, the company repurchases its shares in the open market. This is the most common mechanism used by companies to repurchase shares and gives them considerable flexibility as to the timing, price, and size of repurchases. (As with other mechanisms discussed below, it can be used in combination with the other methods).
- Self-Tender Offers (STO)*. Here, the company offers all shareholders the opportunity to tender shares at a fixed-price (fixed-price self-tender offer) or according to the ascending order of shareholder bids within a range of acceptable prices set by the company (Dutch auction self-tender offer).⁸ This method allows the company to repurchase a substantial quantity of its shares in a single operation and generally grants every shareholder the same opportunity to sell its shares.⁹
- Off-market/Over-the-counter Repurchases*. In this case, the company repurchases its securities from a single or a limited group of shareholders in private, selective transactions. This type of transaction can provide wider choices in the way in which it is carried out and could include, for example, *Accelerated* or *Forward Share Repurchases* or *OTC Derivative-Based Share Repurchases*.
 - *Accelerated or Forward Share Repurchases*. This type of OTC transaction involves the company making an agreement to purchase a portion of its own shares from one entity, typically an investment firm, by an immediate payment or by fixing the price of shares to be repurchased in the future.

⁷ According to the "signalling theory," the main purpose of SRPs is to signal that the company's stock is underpriced and the consequent increase in share prices reflects investors' response to such information. See, e.g., Theo Vermaelen, "Common Stock Repurchase and Market Signalling," *Journal of Financial Economics* 9 (1981), 139-183. In particular, some economic studies have reported that managerial signalling of asymmetric information appears to be the most widely accepted interpretation of such gains. See Robert Lawless, Stephen P. Ferris, and Bryan Bacon, "The influence of Legal Liability on Corporate Financial Signaling," 23 *J. Corp. L.* 209, 215-16, 230-31 (1998). See also Clifford P. Stephens and Michael S. Weisman, "Actual Share Reacquisitions in Open-Market Repurchase Programs," *Journal of Finance* 53 (1998), 313-314. Other studies have reported that "there are no real efficiency benefits of such signalling, that managers are unlikely to have an incentive to signal and, as an empirical matter, managers do not use share repurchases for signalling." Jesse M. Fried, "The Uneasy Case for Share Repurchases," *The Law and Economics Workshop – University of Michigan Law School* (2001).

⁸ In STOs, shareholders may be presented with a tender offer whereby they have the option to submit (or tender) a portion or all of their shares within a certain time frame and at usually a price higher than the current market price.

⁹ STOs may be subject to a variety of rules, depending on the circumstances in which they are used.

- OTC Derivative-Based Share Repurchases (see description included below)

d) *Derivative-Based Share Repurchases*. Here, a company repurchases shares as a result of the exercise of derivative contracts. By selling a put option or warrant on its own shares, the issuer provides a put buyer with the right to sell it a specified number of shares at a fixed price in the future. By buying a call option, the issuer gains the right to buy a specified number of shares at a fixed price in the future. By combining the sale of puts with the purchase of calls into a collar (often a zero cost collar), the issuer can lock future repurchases into a fixed price range. Derivative-based repurchases may be carried out through contracts traded on an options exchange or through OTC transactions.

B.3 Share repurchases in today’s markets

According to the survey conducted among SC2 members, the most frequently used mechanisms for SRPs are OMR, STO and, where permitted, off-market transactions.¹⁰ Several jurisdictions (France, Mexico, and USA) have explicitly referred to the use of derivative-based share repurchases, though they may also be used in other jurisdictions where regulation does not expressly prohibit them. Four jurisdictions (Italy, Malaysia, Singapore, and Switzerland) place restrictions on the type of mechanism that can be used. In some of these jurisdictions, SRPs can be executed only by means of STO and/or OMR. Other jurisdictions do not impose restrictions as to the type of mechanism that can be used.

C. Regulatory Issues and Associated Tools

SRPs may potentially offer benefits to companies and their shareholders. However, they also pose regulatory concerns relating to the fair treatment of shareholders and market integrity. For example, it is important that SRPs be established in a way that pays proper regard to shareholder interests. SRPs also need to be operated in a manner consistent with orderly markets and market integrity. All SC2 members permit SRPs, but they also regulate their operation.¹¹ This section describes the regulatory issues in detail and explores the regulatory tools adopted by SC2 members to address them.

C.1 Fair treatment of shareholders

With respect to shareholder interests, SRPs raise two main issues. One concerns a shareholder’s interest in approving, or being consulted on, the proposed program. The other relates to the interests of shareholders with respect to the method adopted for effecting the repurchase program.

¹⁰ Also, according to the survey conducted among the EMC members, the most frequently used mechanisms are OMR and STO, which are generally undertaken for the purpose of returning cash to shareholders, providing price support, and financial management.

¹¹ Significant similarities are present in the jurisdictions of five European Union members (France, Germany, Italy, Spain, and the United Kingdom). SRPs are permitted in the vast majority of the jurisdictions of EMC members. However, these jurisdictions also place controls and restrictions on how SRPs are conducted.

Program merits

Companies normally pursue SRPs because they see a benefit to the company and its shareholders. Typically, this may take the form of a more efficient capital structure, enhanced earnings per share, or a tax efficient method of distributing cash to shareholders. The benefit resulting from SRPs can be substantial. But, in addition to providing potential benefits, a company's repurchase of shares potentially carries risks. It may constitute a material change in its use of resources, may alter its risk profile and may also signal some change in strategic policy. If the resultant increase in leverage is excessive, or the company's credit rating is weakened, this may not serve the longer term interests of shareholders. Moreover, the execution of SRPs is not risk-free. Adverse market movements could also prove costly for a company and its shareholders.

The issue therefore arises as to whether the establishment of a SRP is an event that should require shareholder approval or, at the least, some formal disclosure. While management is unlikely to initiate a SRP unless it considers it to be in the shareholders' interests, shareholders may nonetheless wish to have the opportunity to consider, *inter alia*, any alternative use of resources, any specific circumstances driving the proposals (e.g., "greenmail"¹²) or the extent to which the strategic aim of the SRP may be influenced by management incentives that may be shorter in time horizon than their own.

SRP structures

Also important to shareholders is the way in which SRPs are structured. Different methods of conducting SRPs have different consequences. In general, shareholders have the opportunity to participate on equal terms when a company offers to repurchase shares by way of a tender offer open to all shareholders. Other methods do not offer participation to all shareholders on identical terms, though that does not mean that they do not serve shareholders' interests. Where a company buys back stock in the open market, shareholders still have an opportunity to sell shares into a market supported by the issuer, but their certainty of sale and price is replaced by the flexibility of being able to choose the time (and therefore price) at which they sell shares. In the case of a company repurchasing shares through off-market agreements with only one or a restricted number of shareholders, other shareholders have no opportunity to benefit directly from the buy-back arrangements, but may benefit indirectly from any resultant rise in the share price.

The main risks for shareholders with respect to SRP structures are therefore exclusion from participation and the possibility that transactions with other shareholders, especially off-market transactions, might be undertaken on terms detrimental to their (and the company's) interests.

Regulatory tools for addressing fair treatment issues

The jurisdictions of all SC2 members have some form of regulation designed to ensure that SRPs are executed with proper regard to both shareholder interests and those of the corporate entity. Regulation normally focuses on approval and disclosure processes, financial restrictions designed to protect a company's capital, and controls on the use of different types of SRP.¹³

¹² Greenmail is a term used to describe a situation in which one or more significant shareholders threaten to use their votes to influence the affairs of a company, in conflict with the management's policy, unless the management offers to buy back their shares.

¹³ Similarly, all the respondent jurisdictions of EMC members have provisions relating to fair treatment of shareholders.

Approval/disclosure processes

Most SC2 members require SRPs to be authorized at shareholders' meetings. In a few jurisdictions (USA, Quebec and Ontario), a company's board of directors may have the authority to implement a SRP without shareholder approval. This is also the case in Brazil if a company's by-laws provide for it; otherwise, shareholder approval must be sought. In Germany, SRPs normally have to be approved by shareholders, but the law also provides for management to launch SRPs without shareholder approval if the SRP is intended to avert severe and imminent damage to the company. Other approaches to approval are governed by the characteristics of the proposed SRP. In Australia, for example, the board may approve OMRs for up to 10% of the equity, but shareholder approval is required for SRPs for larger amounts and/or which involve selective repurchases. Whether or not a country's laws require shareholder approval of an SRP, managers generally have considerable discretion in determining, within the confines of relevant regulation, the details of how an SRP is implemented.¹⁴

Financial restrictions

The jurisdictions of all SC2 members impose a limit on the financial resources that can be used to finance a SRP in order to preserve a company's capital. Typically, companies may purchase their own shares only out of distributable profits, or up to the total amount of capital reserves on the face of their balance sheet. In some cases, the law requires the satisfaction of specified tests designed to ensure that implementing the SRP will not leave the company with insufficient capital.¹⁵

Issuers may also consider regulations affecting the status of repurchased shares. In some jurisdictions, repurchased shares held "in treasury" can be reissued or resold (provided that the issuer complies with the relevant registration, disclosure, and anti-manipulation provisions under the applicable securities provisions.)¹⁶ In other jurisdictions, companies are not permitted to hold repurchased shares in treasury or to resell them after or during a SRP and must cancel them and reduce capital accounts.

¹⁴ In the jurisdictions of most EMC members, SRPs (and the terms and conditions of the SRPs) have to be approved by the general meeting of shareholders. In Argentina, a decision by the board of directors (stating the reasons for the acquisition, a report by the audit committee, and a report by the supervisory board are required in order to conduct a SRP. On the other hand, discretionary power may be delegated to the board of directors/management board. In the case of Bulgaria, Lithuania, and South Africa these powers cannot be delegated.

¹⁵ The financial sources, which can be used to finance SRPs in the majority of jurisdictions of EMC members, are reserves and retained profits. In Malaysia, there are no restrictions on the types of funds that can be used provided the SRPs are backed by an equivalent amount of retained profits and/or share premium (the company can borrow for the purpose of SRP). In Argentina, the company must prove to the CNV (the national securities regulator) that it has enough liquidity and that the SRP will have no impact on its solvency. Similar provisions exist in Malaysia as well.

¹⁶ Most of the jurisdictions of EMC members permit an issuer to sell its own shares held "in treasury" before, during, and after a SRP.

Table 1 - Broad approach adopted in the jurisdictions of SC2 members

	Body responsible for approving SRP	Restrictions relating to:		
		Treatment of repurchased shares	Max allowed number (% of the outstanding capital)	Financial resources
<i>Australia</i>	Board of directors and/or shareholders' meeting ⁽¹⁾	Cancellation of repurchased shares	No	Not prejudice to the ability to pay creditors
<i>Brazil</i>	Board of directors and/or shareholders' meeting	No	10% free float	Up to the amount of capital reserves
<i>Ontario & Quebec</i>	Board of directors	Cancellation of repurchased shares (*)	5% of outstanding shares or 10% of public float applies to OMRs. Otherwise, no	Not in violation of solvency or liquidity tests under corporate statutes
<i>France</i>	Shareholders' meeting	No, but intended treatment must be disclosed (**)	10%	Not exceed retained earnings free from legal or statutory commitment
<i>Germany</i>	Shareholders' meeting ⁽²⁾	Fixed catalogue	10%	Ability to create reserves without reducing capital or any reserve
<i>Hong Kong</i>	Shareholders' meeting	Cancellation of repurchased shares	10%, applies only to on-market share repurchase	SRP shall be out of "distributable profits" or the proceeds of a fresh issue of shares for the purpose
<i>Japan</i>	Shareholders' meeting	No (**)	No	SRP shall be out of "distributable profits"
<i>Italy</i>	Shareholders' meeting	No (**)	10%	Not exceed distributable earnings / reserves
<i>Malaysia</i>	Shareholders' meeting	No (**)	10%	No restrictions on the types of funding so long as the SRP is backed by equivalent retained and or a share premium account
<i>Mexico</i>	Shareholders' meeting	No (*)	Maximum of 3% of outstanding shares in a period of 20 days, unless through a public offering.	Not exceed retained earnings ⁽⁵⁾
<i>Singapore</i>	Shareholders' meeting	Cancellation of repurchased shares ⁽⁴⁾	10%	SRP shall be out of "distributable profits"
<i>Spain</i>	Shareholders' meeting	No (*)	5%	Yes. The issuer must create a reserve for the same amount as the repurchase of the securities.
<i>Switzerland</i>	Shareholders' meeting	No (**)	10%	Yes. Show reserve in the amount of acquisition value.
<i>United Kingdom</i>	Shareholders' meeting	No, but intended treatment must be disclosed (**)	No	SRP shall be out of "distributable profits"
<i>USA</i>	Board of directors ⁽³⁾	No (*)	No	The law of the company's jurisdiction of incorporation may have statutory capital impairment provisions

(1) Shareholder approval is required where it is a selective repurchase or where the SRP is for more than 10% of the company's issued securities in any 12 month period.

(2) In some cases (e.g., to avert severe and imminent damage to the company), management does not need any approval but is required to provide information on the SRP to the supervisory board immediately and to shareholders' at their next general meeting.

- (3) Shareholder approval depends on the law of the company’s jurisdiction of incorporation. For companies incorporated in Delaware, for example, no shareholder approval is required in advance, subject to the company’s articles of incorporation and by-laws.
- (4) Amendments to the Singapore Companies Act will be tabled in 2004 to permit repurchased shares to be held in treasury instead of having to be cancelled.
- (5) There are three other restrictions: (i) on an annual basis, the company’s shareholders approve the amount to be allocated from the reserve in its stockholders’ equity account for the repurchase of its stock; (ii) any cumulative preferential dividend must have been already paid; and (iii) no debt securities of issuers within SRPs must be in default.
- (*) Where selling of repurchased shares is allowed, it is treated as a new distribution (*e.g.*, as a prospectus offering).
- (**) Selling of repurchased shares is allowed but requires specific disclosure (*i.e.*, in addition to general disclosure rules concerning price sensitive information).

Permitted types of SRPs

Some jurisdictions permit only certain forms of share repurchase methods and subject them to specific conditions. In particular, some jurisdictions regard off-market/OTC share repurchases as violating an issuer’s obligation to treat shareholders equally and, therefore, prohibit them.¹⁷ Additionally, some SC2 members regulate partial tender offers by requiring, among other things, that shareholders receive identical consideration and that their securities be purchased *pro rata*.

Other jurisdictions permit off-market share repurchases, provided certain requirements regarding notice and price are met. In many jurisdictions, off-market/OTC share repurchases are prohibited when the issuer is engaged in a tender offer (or a distribution).

Table 2 sets out the types of SRPs permitted in the jurisdictions of SC2 members and any specific requirements attaching to them.¹⁸

Table 2 – Specific requirements in the jurisdictions of SC2 members relating to types of SRPs and the fair treatment of shareholders

	Specific provisions that seek to promote fair treatment of shareholders (in addition to general basic provisions)	Off-market/OTC share repurchases (or “selective” buybacks) permitted
<i>Australia</i>	Shareholder approval required for a selective repurchase or the repurchase of more than 10% of a company’s shares in a 12 month period	Yes
<i>Brazil</i>	Only OMRs are allowed	No
<i>Ontario & Quebec</i>	Only STOs and OMRs are allowed with limited exemptions	Yes (in limited circumstances)
<i>France</i>	Approval of shareholders meeting specifying the types of authorized mechanisms	Yes, provided the price does not exceed the price available at that time on-exchange in the central order book
<i>Germany</i>	--	No

¹⁷ In the majority of jurisdictions of EMC members, off-market share repurchases are prohibited.

¹⁸ In the jurisdiction of one EMC member (Czech Republic), the issuer may repurchase its shares from a single shareholder in a privately negotiated transaction unless the buyback is open to the public. In the jurisdictions of another EMC member (Egypt), it is possible if a company has the approval of a specialized committee of the stock exchange. In Thailand, selective buy-backs are allowed when the repurchase is conducted for dissenting shareholders.

	Specific provisions that seek to promote fair treatment of shareholders (in addition to general basic provisions)	Off-market/OTC share repurchases (or “selective” buybacks) permitted
<i>Hong Kong</i>	General offer is required, unless the repurchase is made (i) through the exchange under the listing rules, or (ii) through specific manners, or (iii) off-market with a 75% of shareholders approval.	Yes
<i>Japan</i>	A special resolution of the ordinary shareholders’ meetings is required to conduct SRPs by negotiated transactions.	Yes
<i>Italy</i>	Only STOs and OMRs are allowed	No
<i>Malaysia</i>	Only OMRs are allowed.	No
<i>Mexico</i>	Only STOs and OMRs are allowed	Derivative-based repurchase
<i>Singapore</i>	Shareholder approval is required for all types of SRPs	No listed companies
<i>Spain</i>	Only STO to cancel shares and OMRs otherwise are allowed	Advice against
<i>Switzerland</i>	Only STOs and OMRs are allowed	No
<i>United Kingdom</i>	Purchases of more than 15% of outstanding shares are effected by STO or partial offer	Yes
<i>USA</i>	Yes, during self-tender offers	Yes (if issuer is not engaged in STO or distribution)

C.2 Information asymmetry and insider trading

In addition to issues specific to the interests of existing shareholders, SRPs raise concerns regarding the interests of potential investors in the company and market users in general. The first of these issues relates to the privileged informational position of the issuer.

Except in rare circumstances, the senior management of companies has greater access to information relevant to judging a company’s prospects and share valuation than anyone else in the marketplace. This holds true regardless of the obligations placed on issuers to disclose all price-sensitive information in a full and timely manner. Companies’ management is, for instance, often aware of the overall significance attaching to a number of smaller pieces of information which on their own may not be material; and they will be aware of evolving developments before they become disclosable. Issuers are therefore in a special position in respect of any transaction in their own securities. This raises issues of the types of control required to minimize any risk that an issuer may abuse this position – or the perception that there may be such abuse.

When companies engage in open market SRP transactions, there also is the risk of possible misuse of material information by the companies’ managers or other insiders. For example, insiders may take advantage in their personal dealings of privileged knowledge relating to SRP transactions. This could be knowledge relating to the timing of transactions – which would tend to create upward pressure on the share price – or knowledge relating to prices achieved versus a company’s target or estimated fair value price.

Regulatory tools for dealing with information asymmetry

There are a number of ways in which regulators can protect against potential abuse of price sensitive information by issuers and other insiders. The requirement, in all the jurisdictions of SC2 members, for companies to disclose price-sensitive information on a full and prompt basis should certainly go some way towards reducing the likelihood that a company will be holding a significant informational advantage over its own shareholders and other potential investors while in the course of purchasing its own shares. If an issuer repurchased shares and it subsequently became clear that it had failed to make required disclosures ahead of those purchases, regulators may be able to apply

sanctions under insider dealing or listing disclosure obligations, or both. In addition to general anti-fraud or other specific laws that prohibit insider trading, some jurisdictions also have specific restrictions that primarily apply to open market and off-market SRP transactions.

However, it is often difficult, at the margin, to identify price sensitive and/or properly disclosable information. Moreover, as described earlier, companies generally tend to hold some information advantage over potential counterparties, and there are times, e.g., in the approach to periodic profit announcements, that this advantage will increase. As a result, many regulators also prescribe ‘closed periods’ in which a company may not deal in its own securities (and some companies voluntarily impose internal “good practice” policies that restrict trading by directors, employees, and the company itself, during certain periods).¹⁹

Table 3 below sets out the specific limits adopted in the various jurisdictions of SC2 members regarding trading in connection with a SRP when an issuer publishes financial information.²⁰

Table 3 – Specific time limits, in addition to the general anti-fraud laws, regarding insider trading in the jurisdictions of SC2 members

	Specific time limits for SRPs* Prior to the disclosure of financial statements
<i>Australia</i>	No
<i>Brazil</i>	No
<i>Ontario & Quebec</i>	If the information is material then the company must stop trading immediately until the information is properly disseminated. Normally companies will impose blackout periods surrounding events such as periodical financial reporting.
<i>France</i>	An issuer may not implement a SRP during the period of two weeks prior to the publication of its half-yearly or annual financial statements or as soon as it becomes aware of any information which, if it were disclosed, would be likely to have an influence on the price of the shares, and as long as the information has not been made public
<i>Germany</i>	No
<i>Hong Kong</i>	Under the Listing Rules, in an on-market share repurchase, an issuer may not repurchase shares on the SEHK at any time after a price sensitive development has occurred or has been the subject of a decision until such time as the price sensitive information is made publicly available. In particular, during the period of one month immediately preceding either the preliminary announcement of the issuer’s annual results or the publication of the issuer’s interim report, the issuer may not repurchase shares on the SEHK, unless the circumstances are exceptional
<i>Japan</i>	Stock exchange guidelines urge issuers to pay special attention to compliance during the week preceding the disclosure of annual or half-year financial results.
<i>Italy</i>	No
<i>Malaysia</i>	No
<i>Mexico</i>	Cannot trade if there is material information that will be disclosed.**
<i>Singapore</i>	The Best Practice Guide of SGX-ST provides that an issuer and its officers should not deal in the issuer’s securities during the period commencing two weeks before the announcement of the company’s financial statements for the first three quarters of its financial year, or one month before the half-year or financial year end, as the case may be, and ending on the date of announcement of the relevant results.

¹⁹ In Quebec, Ontario and in the USA, when corporate insiders (e.g., officers or directors of a company) buy and sell stock in their own companies, they must report their trades (changes in ownership) to the regulatory authorities within a specified number of business days. In order to prevent the unfair use of information which may have been obtained by a corporate insider, the US also imposes potential profit recovery provisions, which state that any profits realized by corporate insiders from any purchase and sale of stock in their own companies within any period of less than six months shall inure to, and be recoverable by, the company.

²⁰ The jurisdictions of most EMC members have general regulations for insider trading and disclosure of information that apply to SRPS rather than imposing any specific rules. In Thailand, the company is not allowed to buy or sell its shares during the announcement of material information. In South Africa, under certain circumstances, a company (or its subsidiary) may not repurchase its securities within 40 business days prior to the publication of its annual, provisional, and interim reports.

	Specific time limits for SRPs* Prior to the disclosure of financial statements
<i>Spain</i>	No
<i>Switzerland</i>	The offeror shall interrupt repurchases: i) if it delays the disclosure of information considered price-sensitive under the regulations of the exchange on which the shares are listed; ii) during the ten trading days prior to publication by the media of the offeror's financial results; iii) if the date of reference for the company's last published consolidated report is more than nine months earlier.
<i>United Kingdom</i>	Purchases may not be undertaken when the company is in either a prohibited period (in the knowledge of price sensitive information) or in a closed period (2 months before publication of full year results, one month before publication of interims).
<i>USA</i>	Many U.S. companies impose "blackout" periods that prohibit trading by the company during certain periods (e.g., a 10-day period prior to a quarterly or annual earnings release). Many U.S. companies also have policies that limit trading by the company to certain "window periods" (e.g., 2 full business days after the company's issuance of a press release disclosing quarterly or annual financial results until, for example, the 15 th day of the third month of the current quarter).

* In addition to basic anti -fraud laws

** In Mexico, issuers must have an information mechanism so that persons related to the issuer do not act as counterparts to the transactions. In order to avoid conflicts of interest, issuers must not trade their own shares if any relevant event has not been disclosed to the market. Any director of the board or executive officer, that due to their jobs, has knowledge of such relevant events, is responsible for its disclosure. Also, issuers must not buy-back before any public tender offer takes place.

C.3 Orderly markets and manipulation

The operation of SRPs inevitably has implications for companies' share prices and secondary market trading in their shares. The potential impact of open market SRPs on both volumes and share price could be significant, and could extend over a considerable period. In addition, where a company has other securities in issue, there may be indirect implications for the trading in those securities too. It is therefore important that SRPs are conducted in a manner conducive to the orderliness of the market and in a way that minimizes the possibility of the market being misled or the share price distorted.

In theory, an issuer should always be seeking to repurchase its shares as cheaply as possible, and with as little impact as possible on the price. However, an issuer's view of market prospects may convince it that it would best achieve its objectives by repurchasing shares as quickly as possible. If that view translates into activity that has a significant short-term impact on the share price, this increases the risk of a disorderly market.

A wider concern, involving more complex issues, lies in the fact that management's interest in repurchasing shares as cheaply as possible may be offset by a stronger interest in there being a high, or rising, price for their securities. A 'strong' share price facilitates the use of shares as currency for a bid or financing. Equally, it may help to deter unwelcome bidders – or force them to pay a premium for control. The level of share price may also determine whether the company's shares remain listed on a market or enter, remain, or are dropped from a particular market index. At a personal level, certain elements of the managers' own remuneration may be linked to stock price performance, or managers may be approaching a date after which they will be permitted to sell material amounts of shares.

As a result, there is always the potential for unregulated SRP activity to be manipulative or fraudulent. At one extreme, a company might buy shares in a manner carefully calculated to inflate its share price for another purpose.²¹ At the other, a company might plan to influence investor

²¹ Some regulators impose restrictions on share buy-back activity while an issuer is involved in a distribution of its shares.

assessments of the company's share value by announcing a SRP but then, without any convincing explanation, decide to make no more than token repurchases.

All the above risks may be accentuated where the SRP process operates with too little transparency. A central characteristic of an orderly (equity) market is that there is sufficient transparency of information-rich activity to enable efficient pricing. In the case of SRPs, there is material information both in a company's decision to initiate an SRP, and, subsequently, in the way it executes it. Insufficient disclosure of this information may impair pricing efficiency and, in some instances, the failure to disclose may even mislead.

Regulatory tools to promote orderly markets

Determination of precisely when SRP activity may create a disorderly market or move into the area of potential manipulation is often a difficult judgment. Regulators therefore tend to establish limits on the way in which SRPs may be conducted, either through prescriptive rules or the creation of safe harbors.

Anti-manipulation measures

All the jurisdictions of SC2 members have general anti-manipulation rules that apply to SRPs. In addition, many of those jurisdictions impose specific mandatory quantity limits on OMR transactions, while five jurisdictions provide a voluntary safe harbor if certain conditions are met.²² Both approaches are designed to minimize the market impact of the issuer repurchases.

The differences between a "prescriptive" and a "safe harbor" approach can be summarized as follows:

- Under the prescriptive approach, a company's repurchase activity is subject to mandatory restrictions that typically limit the price and volume of the OMR transactions. For example, in some jurisdictions, the OMR transactions may not exceed a certain percentage of the global trading volume in the security and must be executed at prices that do not accelerate the market trend (*i.e.*, at a price that does not exceed the last independent transaction price or, in some cases, a certain percentage above the average market price). Other jurisdictions restrict the volume of purchases so as not to exceed either a certain percentage of the total number of shares traded on the market during a certain period of time (*e.g.*, the preceding two months) or the total number of outstanding shares or both.
- In contrast, the safe harbor approach imposes no mandatory limitations on an issuer's ability to repurchase its shares in the open market. Instead, the safe harbor provides issuers with protection from liability under the anti-manipulation laws, and guidance when repurchasing their securities in the open market, provided certain conditions (trading limits) are met. The safe harbor conditions typically relate to the volume, timing, price, and manner of a purchase. Although companies are not required to follow the specific limits outlined in the rule, failure to meet any one of the conditions will disqualify all of the issuer's repurchases from the safe harbor for that day.

²² None of the jurisdictions of EMC members provide a "safe harbor" against charges of market abuse. Instead, these jurisdictions have mandatory regulatory provisions against market abuse such as stabilization periods, price, time, and volume limits.

Table 4 below summarizes the mandatory limits and voluntary safe harbor conditions in the jurisdictions of SC2 members.

Table 4 – Mandatory limits and safe harbor conditions in the jurisdictions of SC2 members for OMRs

	Specific restriction	Specific limits within the mandatory rules or the protection of the safe harbor In relation to:			
		<i>Intra-day time</i>	<i>Price</i>	<i>Volume</i>	<i>Duty to use a single broker</i>
<i>Australia</i>	Mandatory Rule	-	not more 5% above the average (calculated over the last 5 days) of the market price	-	-
<i>Brazil</i>	Mandatory Rule	-	At market price	-	-
<i>Ontario & Quebec</i>	Mandatory Rule	-	Price: not above the last independent price	Volume: 2% of outstanding shares in 30 days, do not exceed the greater of 10% of public float or 5% of outstanding shares in 12 months	Yes, if done under exchange rules
<i>France</i>	Safe ²³ Harbor	Not during the opening and closing auctions and during the auction following a trading halt	Transactions must be done either on the exchange order book or, if done outside the order book, at a price than is no higher than the price in the order book	Daily volume not higher than 25% of the average trading volume over 3 previous trading days for the most liquid stocks (and 15 previous trading days for the others)	Yes, but one more is allowed when derivatives are used
<i>Germany</i>	Safe Harbor in progress	-	-	-	-
<i>Hong Kong</i>	Mandatory Rule	-	-	Volume: in any one calendar month not more than 25% of the volume traded during the previous month	-
<i>Japan</i>	Safe Harbor	Transactions may not be done during the last 30 minutes before the closing of the market	The repurchase price shall not be higher than the last transaction price	Daily volume may not be higher than 25% of the average daily trading volume during the previous month.	Yes
<i>Italy</i>	Guidance ⁽¹⁾	-	Transactions shall counterbalance the trend of market price: that is the purchase price and the sale price are, respectively, not higher or not lower than the last price of the day before;	the daily volumes do not exceed 25% of the average daily trading volume registered on the six months preceding each relevant trade	-
<i>Malaysia</i>			Price: not more than	No specific limits on	Up to two

²³ Restrictions regarding timing, intra-day limits and daily volume of purchases do not apply when transactions are undertaken by independent third-party liquidity providers who subscribe to, and commit to implement, the broker/dealer professional association code of conduct governing the activity of liquidity providers. This code of conduct aims at ensuring that the broker/dealer performing a liquidity provider function for a specific stock acts independently from the issuer.

	Specific restriction	Specific limits within the mandatory rules or the protection of the safe harbor In relation to:			
		<i>Intra-day time</i>	<i>Price</i>	<i>Volume</i>	<i>Duty to use a single broker</i>
	Mandatory Rule	-	15% above the average (calculated over the last 5 days) of the market price	volume but the maximum number of shares that can be repurchased is 10% of outstanding capital	brokers are allowed
<i>Mexico</i>	Mandatory Rule	Not during the first and last half hour of the trading session	At current market price	Daily volume not more than 1% of outstanding shares (3% in 20 days) ⁽²⁾	Yes
<i>Singapore</i>	Mandatory Rule	-	Price: not more 5% above the average (calculated over the last 5 days) of the market price	-	-
<i>Spain</i>	Guidance ⁽¹⁾	-	price not higher (lower, in case of sales) than the highest (lowest, in case of sales) independent published bid or last independent transaction price	An issuer may effect daily purchases, as a general rule, in an amount up to 25% of the average daily trading volume in its stocks	-
<i>Switzerland</i>	Safe Harbor	-	Not higher than the last independent transaction or official price	Daily volume not higher than 25% of the average trading volume over 30 previous days	Yes
<i>United Kingdom</i>	Mandatory Rule	-	Price: not more 5% above the average (calculated over the last 5 days) of the market price	-	-
<i>USA</i>	Safe Harbor	Not the opening transaction of the day or during the last half hour of the trading session ²⁴	Not higher than the highest independent bid or the last independent transaction price	Daily volume not higher than 25% of the average daily trading volume over 4 previous weeks	Yes

(1) Guidance normally provides a (regulatory) interpretation of a statutory requirement or rule and, though it may not be binding, may nonetheless be considered by courts or regulatory authorities in determining compliance with statutory requirements or rules.

(2) In Mexico, if the issuer's intention is to repurchase more than 1% of outstanding shares during the same trading session, this must be disclosed to the market at least ten minutes preceding the time of the repurchases. Such a relevant event must include information related to share class, price, and percentage of capital stock. If the issuer intends to repurchase 3% or more of outstanding shares during one or more trading sessions within a period of 20 days, they must repurchase them through a tender offer.

(3) In jurisdictions subject to EU directives, the table reflects the position before Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programs and stabilization of financial instruments. Please refer to footnote 27.

²⁴ On November 10, 2003, the SEC adopted amendments to Rule 10b-18 (safe harbor for issuer repurchases). See Securities Act Release No. 8335 (November 10, 2003, 68 FR 64952 (November 17, 2003)). Among other things, the amendments allow issuers whose securities are actively traded to stay in the market longer at the end of the trading day and to repurchase a greater number of shares during periods of severe market decline.

In the jurisdictions of SC2 members operating a safe harbor regime, the objectives underlying the four conditions (*i.e.*, timing, price, volume, and manner of purchase), appear quite similar, for example:

- a) **Timing conditions.** These generally bar an issuer from effecting SRP transactions at the opening or during the last half hour of the regular trading session because market activity at such times is considered to be a significant indicator of the direction of trading, the strength of demand, and the current market value of the security.
- b) **Price conditions.** These are intended to protect market integrity by preventing transactions from being executed at prices that can accelerate the price trend. The pricing conditions generally limit an issuer's bids or purchases to prices no higher than the highest independent published bid and/or the last independent transaction price reported for the security.
- c) **Volume conditions.** Volume conditions limit the amount of securities a company may repurchase in the market in a single day. This is to prevent an issuer from dominating the market for its securities through substantial purchasing activity. Under the volume limitations, companies can typically effect daily purchases up to a certain percentage (generally 25%) of the average daily trading volume during a certain period of time (usually from three days to four weeks) preceding the time of the repurchase.²⁵
- d) **Manner of purchase conditions.** The manner of purchase condition generally requires the issuer to use a single broker or dealer per day to bid for or purchase its common stock. The single broker-dealer condition is intended to avoid the appearance of widespread trading in a security that could result if the issuer uses many brokers or dealers to repurchase its stock.²⁶

In jurisdictions where these provisions are not applied as safe harbor conditions, they are generally mirrored in the specific rules applied to SRPs.²⁷

Transparency

Regulators also do a considerable amount to safeguard the fairness and efficiency of markets by ensuring adequate disclosure of relevant information. In all their key phases, SRPs may involve information material to markets, as well as to shareholders. This information relates to:

- The potential size of the SRP, its form, intended duration, and the potential impact on the company's financial position;

²⁵ In three jurisdictions (Mexico, Ontario, and Quebec), the limit refers to the companies' outstanding shares.

²⁶ Malaysia now allows a listed company to appoint up to two stockbroking firms for the purposes of purchasing its own shares or selling treasury shares.

²⁷ In the European Union, Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse) is due to be implemented by member states by late 2004. The directive provides for a safe harbour in respect of SRPs where various conditions are met. These relate in particular to transparency, price limits (including for derivatives) and daily volume limits. Further pertinent conditions relate to repurchases when an issuer is in a closed period, has delayed the disclosure of price-sensitive information or is selling its shares. Exemptions are provided where the issuer's SRP is being managed independently by an investment firm or credit institution and the issuer has no influence over the timing of repurchases.

- The rate of reduction in the company's current outstanding share capital as the SRP progresses, and the prices paid for the purchases;
- Transaction information on the SRP purchases so that market users know the volume and prices being generated by issuer activity.²⁸

The SC2 survey revealed the following disclosure requirements:²⁹

- a) ***Pre-implementation disclosure.*** In the jurisdictions of SC2 members that require shareholders to authorize a SRP, companies must give shareholders no less than a minimum period of notice ahead of any vote on a resolution proposing a SRP. The documents sent to shareholders must set out information on the terms and conditions for the SRP and any other information relevant to shareholders in deciding how to vote on the resolution.³⁰

Where a board's decision is sufficient to implement a SRP (*e.g.*, Ontario, Quebec and USA), the disclosure of terms and conditions for the SRP depends on whether the information is material under the particular circumstances.³¹

Where the SRP is undertaken through a STO, disclosure requirements are similar across jurisdictions. In particular, companies proposing a tender offer for a class of their own securities must file with regulators an extensive disclosure document (*i.e.*, circular or prospectus) and disclose certain information, including any possible material changes, regarding the STO to the public.

- b) ***Continuous disclosure.*** Many jurisdictions of SC2 members impose specific disclosure requirements for SRP transactions. These often require issuers to disclose details about their SRP transactions on a daily basis. Usually, these reports have to be filed immediately, or no later than the opening session of the following trading day. Other jurisdictions require periodic disclosure of the number of shares purchased, as well as the purchase volume for each of the highest and lowest prices paid.
- c) ***Termination disclosure.*** Specific requirements on issuers to disclose the expiration of a SRP are less common. Instead, the need to release of any public information concerning the

²⁸ In Quebec and Ontario, an issuer must also arrange for an independent valuation of an STO and include a summary of the valuation in the disclosure documents.

²⁹ In the jurisdictions of some EMC members, when a company decides to implement a SRP, certain information is required to be disclosed (*e.g.*, the objective of the SRP, number of shares to be purchased, length of the SRP, and, in some cases, the costs and risk of the SRP). This is typically done either by notifying the stock exchange or giving notice at the general shareholders' meeting. In the jurisdiction of some EMC members, no particular disclosure rules are in place for SRPs. Issuers, however, are obliged to include the share repurchases and the legal reason for their acquisition in the company's annual report (*e.g.*, Czech Republic).

³⁰ A special exception from any disclosure requirement is provided in Switzerland for repurchases representing a maximum of 2% of outstanding shares.

³¹ For instance, a SRP may involve a material expenditure of cash, or may otherwise involve an event of material importance to security holders that could trigger an obligation to disclose information to the public. With respect to the disclosure requirements imposed on the subsidiaries and/or parent companies about transactions in the issuer's shares, most of the jurisdictions of EMC members do not have any specific rules other than the general disclosure rules. However, in Poland, the issuer is obligated to provide in its current report detailed information on the acquisition or disposal of securities issued by the issuer or its subsidiary.

expiration or termination of a SRP generally depends on whether the information is material under the particular circumstances. Several jurisdictions require the issuer to file a document with the competent authority once the company has decided to terminate the program or to provide information on the expired plan to the shareholders' meeting. The document includes details of the company's actual repurchases. Another jurisdiction requires the issuer to disclose each plan or program that has expired during the relevant period, and each program that the issuer has determined to terminate prior to expiration or under which the issuer does not intend to make further purchases.

Table 5 below shows the specific disclosure requirements regarding OMRs in the jurisdictions of SC2 members.³²

Table 5 – Specific disclosure requirements for OMRs in the jurisdictions of SC2 members

	Specific disclosure requirements regarding OMRs ¹ at the time of:		
	<i>Pre-implementation</i>	<i>Continuous disclosure</i>	<i>Termination</i>
<i>Australia</i>	An issuer must release an announcement to the exchange immediately upon deciding that it wants to buy back shares.	<p>Daily disclosure</p> <ul style="list-style-type: none"> • half an hour before the start of trading on each business day after any day on which shares are bought back; • the issuer has to publish a document indicating the number of shares bought, the total paid, min and max price, the number of remaining shares to repurchase 	Yes (2)
<i>Brazil</i>	No	No	No
<i>Ontario & Quebec</i>	A press release has to be issued at least two days prior to the starting of the NCIB (1)	<p>Monthly disclosure</p> <ul style="list-style-type: none"> • The issuer has to report within 10 days of the end of each month: the date of purchase, the number of securities purchased each day and the average price, if shares are to be cancelled 	Yes (2)
<i>France</i>	Issuers must file a prospectus describing the SRP with the AMF at the time of the Annual Meeting or at the latest when the Board of Directors effectively decides to undertake a SRP, before the beginning of the SRP	<p>Monthly reporting and disclosure</p> <ul style="list-style-type: none"> • The issuer has to file within 10 days of the end of each month an extensive report on the daily number of securities purchased (or sold), the average price, the name of the broker-dealer, the options purchased or sold, as well as cumulative data since the beginning of the SRP program. Purchases, sales and cancellation of securities by the issuer are disclosed on a monthly basis. 	Information on the completed SRPs has to be provided to the shareholders' meeting.
<i>Germany</i>	No	No	No
<i>Hong Kong</i>	No	<p>Daily reporting</p> <ul style="list-style-type: none"> • For an on-market share repurchase, the issuer must report to the SEHK by 9:30am of the business day after the day shares have been repurchased. 	Yes (2)
<i>Japan</i>	No	<p>Monthly disclosure</p>	Information on the completed SRPs has to be provided
<i>Italy</i>	No	<p>Monthly disclosure</p>	No
<i>Malaysia</i>	Yes	<p>Daily reporting</p> <ul style="list-style-type: none"> • Listed companies must inform the exchange of any purchase, resale or cancellation of its shares by 6.30pm of the day of purchase, resale or 	No

³² While all the jurisdictions of SC2 members require the disclosure of price sensitive information in connection with a SRP, most of these jurisdictions also have specific disclosure requirements.

		<p>cancellation.</p> <ul style="list-style-type: none"> Listed companies must also inform the Securities Commission and the Registrar of Companies at the Companies Commission of any purchase, resale, or cancellation of its shares within 14 days of a transaction. 	
<i>Mexico</i>	No	<p>Daily reporting</p> <ul style="list-style-type: none"> Issuers must report the total number of shares repurchased, the price paid per share, the identity of the investment firm used to effect the purchases, and the outstanding shares by the day after any repurchase.⁽³⁾ 	No
<i>Singapore</i>	Yes	<ul style="list-style-type: none"> Issuers have to disclose purchases to the Stock Market by 9am of the day after the listed company has purchased the shares (for a <i>market acquisition</i>) and by 9am on the second market day after the close of acceptances of the offer (for an <i>off-market acquisition on equal access scheme</i>). 	No
<i>Spain</i>	No	No	No
<i>Switzerland</i>	Yes	<p>Report each 10 days</p> <ul style="list-style-type: none"> Where repurchases are not carried out via a specific trading line, the offeror must announce, once every ten trading days, the numbers of shares it has bought and sold and the net number of shares purchased since the beginning of the repurchase program. 	The result of the SRP has to be published in newspapers and electronic media
<i>United Kingdom</i>	No	<p>Daily disclosure</p> <ul style="list-style-type: none"> Purchases must be notified to the market by 7.30am on the business day following the calendar day on which dealing occurred. The notification must include the date of purchase, the number of equity shares purchased and the purchase price for each of the highest and lowest prices paid, if relevant. 	No
<i>USA</i>	No	<p>Quarterly disclosure</p> <ul style="list-style-type: none"> Issuers are required to make quarterly disclosure of all issuer repurchases of equity securities (<i>e.g.</i>, total number of shares repurchased during last quarter, average price paid per share, number of shares purchased that were purchased as part of a publicly announced plan, and maximum number of shares that may yet be purchased under the plans or programs). 	Issuers are required to disclose each plan or program under which the issuer does not intend to make any more repurchases

- (1) The Normal Course Issuer Bid (“NCIB”) is defined as an issuer bid made through the facilities of a Stock Exchange where the purchases do not exceed the greatest of 5% of the issued and outstanding shares or 10% of the public float over a 12-month period. In addition, purchases cannot exceed 2% of the outstanding shares in any given 30-day period. The press release for the NCIB should include the particulars of the bid, including the date of the bid, the number of shares being purchased, the percentage of shares being purchased relative to the issued and outstanding shares or the public float, the issued and outstanding number, previous purchases and average price of these purchases, what the company intends to do with the shares (for example, cancel them) and the reason for the NCIB.
- (2) In addition to the disclosure requirements concerning the dissemination of price sensitive information, this jurisdiction imposes specific reporting requirements regarding a company’s decision to suspend or terminate a SRP.
- (3) In Mexico, quarterly disclosure is also required. Through the public report as addendum to quarterly financial statements, issuers must include all repurchase transactions during that period. Annual disclosure is required within notes to the issuers’ financial statements (in order to comply with Mexican Accounting Principles, equity must be integrated and described considering repurchased shares). Finally, continuous disclosure includes any repurchase without tender offer

(derivatives, stock option plans for employees, repurchase transactions involving strategic shareholders with a specific stock limit).

The regulatory approaches in the jurisdictions of SC2 members vary in terms of the disclosure requirements imposed in respect of repurchases made through other companies affiliated to the issuer (or acting in concert with it). Some jurisdictions impose the same duties on subsidiaries or affiliated purchasers as they place on the issuers (Brazil, Ontario, Quebec, Germany, Hong Kong, Spain, Switzerland, UK and USA). Other jurisdictions do not impose any specific disclosure requirements on the subsidiary or affiliated companies (Australia and Malaysia), although disclosure may be required to be included in the parent company's disclosure. In a few jurisdictions (Mexico and Singapore), subsidiaries are not allowed to carry out transactions in issuer's shares.

C.4 Use of derivative products in SRPs

So long as securities laws and issuers' charter documents do not prohibit the use of derivatives, issuers may choose to carry out SRPs through derivative products instead of buying back shares directly. Several jurisdictions of SC2 members, notably the US and France, have seen issuers use derivatives to execute repurchase programs.

Derivative-based SRPs generally take one of three forms: the issuer may sell puts, buy calls, or sell puts *and* buy calls (as described in section B.2). These transactions may take place through the facilities of an options exchange or bilaterally in the over-the-counter market. In the latter case, the counterparty is often a broker-dealer.

Such buy-backs are often viewed as structurally more flexible than regular cash-based transactions and may in some cases be subject to different accounting treatment. They also offer companies the possibility of reducing the costs of their buy-in programs, as a result of the premiums earned from "writing" (selling) put options.

Alternatively, the issuer may announce a SRP and then find that the market has started to rise. Use of call options allows the issuer to lock in future purchases at a maximum price. This may also increase flexibility for an issuer if it is restricted to buying at or below the market price.

However, the use of derivatives is not without risk, either to shareholders or to the market generally. While the issuer should be able to assess the commercial risk/benefit balance for the company in using derivatives, shareholders may wish to be aware that the company is proposing a SRP with a different risk profile – and that the use of bilateral arrangements may reduce their ability to participate in the SRP. If the options contracts are standardized contracts traded on an exchange, they may be considered to be available to all shareholders, but bilateral over-the-counter arrangements are, by definition, not widely available. Because it appears that derivative-based SRPs usually occur on the OTC markets and represent bilateral transactions, a potential issue arises as to the fair treatment of shareholders.³³

In respect of the wider market, it appears that SRP disclosure requirements in the jurisdictions of most SC2 members do not require specific disclosure of options transactions. There is therefore the

³³ However, even where a company sells OTC put options, shareholders may still benefit if buyers of the options cover their puts through market purchases of the underlying shares.

potential for surreptitious market impact. The use of derivatives may, for example, undermine the purpose of any restrictions on share repurchase activity if hedging activity by the derivative counterparty allows more stock to be purchased (directly or indirectly) than would have been allowed to the issuer through direct cash market purchases. This could occur if writers of call options sold to the company, or purchasers of put options sold by the company, decided that they needed to cover their exposure through purchases of the shares.

Regulatory tools relating to use of derivative products

To address the issues outlined above, regulators have adopted various approaches. The SC2 survey conducted among its members shows that some jurisdictions (*e.g.*, Italy) prohibit derivative-based SRPs altogether, while in some others (*e.g.*, Australia) other aspects of securities regulation effectively prevent them from using such SRPs.³⁴

Where derivatives are permitted and used, the approach focuses on tailoring the regulation to the specific risks posed. Detailed rules and guidance on the use of derivatives are possibly most highly developed in France. Most recently, in April 2003, the COB (which became the AMF in November 2003³⁵) launched a consultative process regarding the possible establishment of a safe-harbor for SRPs executed through derivative instruments. The proposal basically incorporates earlier guidelines pertaining to the use of derivatives.³⁶ In addition, issuers using derivative products in SRPs would have to follow an overarching principle of care and prudence, as well as take into account the potential impact of such derivatives on the market price volatility. The maturity of the options could not exceed the remaining period covered by the authorization granted by the shareholders meeting, with a maximum of 18 months, and the options would have to be sold at the market price. Where the issuer uses derivatives to hedge “optional positions” (*e.g.*, positions held through an employee stock option program or any other equity linked instrument, such as convertible bonds), the maturity of the option would not be subject to the same restrictions. In all instances, the issuer would be required to have “adequate” risk management procedures in place for the derivative instruments and to file comprehensive reports with the AMF.

Where there are no specific bans on the use of derivative-based SRPs, some jurisdictions are considering whether to require specific disclosure regarding the use of derivatives. However, it may be more difficult to require full and prompt disclosure regarding derivative-based share repurchases. For example, with respect to share repurchases involving a put option, regulators need

³⁴ Singapore, where issuers had previously been unable to use derivatives for SRPs, amended its legislation in 2003 to allow for SRPs using contingent purchase contracts.

³⁵ On November 24, 2003, the COB merged with the Conseil des Marchés Financiers to become the Autorité des Marchés Financiers (AMF).

³⁶ Among other things, the authorization provided by the shareholders meeting must explicitly include the potential use of derivatives. In addition, the overall positions held at any time by the issuer may not lead him to hold or potentially be in a position to hold more than 10% of its own shares. The options may not expire after the end date of the SRP authorised by the shareholders meeting or during the two weeks prior to the publication of the issuer’s yearly or half yearly results. Under the agreement signed between the issuer and the broker dealer purchasing the put options, the broker dealer may not, for the management of its positions, trade in the underlying cash market in violation of the safe harbour provisions (price, volume, timing). Moreover, the options should have a maturity of at least 3 months. There should be monthly reporting to, and disclosure by, the regulators of the options underwritten and exercised.

to decide whether the disclosure should be made at the time the put option is written, or when it is exercised.

C.5 General regulatory tools regarding compliance with SRP rules

The ability of regulators to monitor market activity depends on the investigative tools and powers available to the competent authority in the particular jurisdiction. It also depends on whether the jurisdiction imposes record keeping requirements on companies regarding their SRPs.³⁷

Only five jurisdictions of SC2 members (Brazil, France, Malaysia, Mexico, and Spain) impose specific record keeping requirements on companies regarding their SRP transactions.³⁸ However, all the members' jurisdictions have rules that impose general requirements with respect to the records that broker-dealers must keep regarding a client's trades, including an issuer's repurchases.

With regard to the particular authority responsible for verifying compliance with SRP requirements, the survey reveals similar approaches among SC2 members. For example, in jurisdictions where the disclosure requirements for SRPs are part of the market rules, it is the responsibility of the market to enforce the SRP rules.³⁹

D. Conclusions and Recommendations

SRPs can provide a mechanism for enabling publicly traded companies to manage their capital efficiently. Decisions to implement SRPs, and the manner in which the programs are executed, are in most instances of material significance to both existing and potential investors. However, the interests of the main parties involved in, or affected by, SRPs are not necessarily identical. It is therefore important for regulatory authorities to help ensure that SRPs are conducted so as not to undermine the fair treatment of shareholders, orderly markets, and market integrity.

The IOSCO Technical Committee recommends that market authorities regulate SRPs on the basis of the following principles. In jurisdictions in which several authorities are responsible for the laws and/or regulations governing different aspects of SRPs, the Technical Committee urges regulatory authorities to use their best endeavors so that their domestic legislation/ regulation is consistent with these principles. Jurisdictions may vary in how they implement the principles, as each jurisdiction must take into consideration its particular legal framework, legislative powers, and market characteristics.

D.1 Fair Treatment of shareholders

Principle 1: SRPs should treat shareholders in a fair manner

³⁷ There are slight differences among the jurisdictions of EMC members relating to record keeping requirements for SRPs. Some of these jurisdictions (Argentina, Brazil, Egypt, South Africa, and Thailand) have specific record keeping requirements for SRP transactions, while other jurisdictions apply general rules.

³⁸ In the USA, issuers are required to maintain records of the broker-dealers through which they have effected issuer repurchase transactions. The broker-dealers must maintain records of issuer repurchase transactions that they effect.

³⁹ According to provisions adopted in the majority of jurisdictions of responding EMC members, the lead securities regulators are responsible for verifying compliance with SRP disclosure requirements. In some of those jurisdictions, the stock exchanges have similar responsibility.

Implementation Measures:

To support the principle of fair treatment of shareholders, the following should be considered:

1. An appropriate approval process for issuers when establishing SRPs. The scope and structure of the proposed SRP should be subject to prior scrutiny and approval by the issuer's board and, possibly, also by its shareholders. Where shareholder approval is required, the shareholders should be provided with adequate information to make an informed decision about the SRP. Where shareholder approval of specific SRPs is not required, the authority and the powers of the board to approve SRPs should be clearly stated.
2. Limits on financial resources that can be used to finance an SRP in order to preserve an issuer's capital.
3. Appropriate provisions in respect of the use of different types of SRPs.

D.2 Controls over the company as an 'insider'

Principle 2: Regulatory authorities should seek to ensure that their insider dealing regulations apply to the issuer's trading during SRPs.

Implementation Measures:

1. To address the potential information advantage that issuers hold vis-à-vis shareholders and potential investors, companies should be subject to general insider provisions that state that they will not be permitted, subject to any specified exceptions, to repurchase shares (or enter into arrangements that will result in the repurchase of shares) at any time when they hold disclosable price-sensitive information.
2. Regulatory authorities should consider whether to make black-out periods mandatory for issuers.
3. Where regulators consider it desirable to permit companies to sustain open market SRPs without interruption, they should permit this only where discretion over the conduct of the programs has been delegated to an independent third party, the parameters of programs have been pre-determined, or other equivalent safeguards exist.

D.3 Measures to promote an orderly market and market integrity

Principle 3: SRPs should be conducted in a manner that is consistent with orderly markets and market integrity.

Implementation Measures:

Regulators should address the risk that the additional demand created by share repurchases can create disorderly conditions and that SRPs could be used for manipulative purposes. Regulators can employ a number of tools to address these risks, some of which may address both these issues.

(i) Transparency requirements.

Issuers should be required to provide market users with sufficient information relating to their SRPs. Relevant information, which may vary depending on the form of SRP, will normally relate to:

- the formal proposal for a SRP, including information on why the program is being proposed and how the SRP is to be implemented;
- progress of the SRP, including timely information on the volume and prices of repurchases, however effected, and including purchases made by affiliated companies or companies acting in concert;
- completion of the SRP, expiration of any time limit on the SRP, or any decision by the issuer to terminate or permanently discontinue the SRP;
- the impact of the SRP on the issuer's financial position

(ii) Orderly market and anti-manipulation measures

To restrict the potential for repurchases to create disorderly market conditions or to be used for manipulative purposes, regulators should adopt measures to address the potential for open market repurchases to affect the behavior of the share price. Such measures might include controls on repurchases in any, or all, of the following: prices paid, daily volumes, the timing of repurchase activity, and the number of broker-dealers through whom purchases are made. Anti-manipulation provisions could take the form of mandatory restrictions on a company's repurchase activity or provide companies with a "safe harbor" from liability for manipulation, provided certain trading limits, such as those mentioned above, are met.

D.4 Appropriate Use of Derivatives

Principle 4: Derivative transactions should be used in SRPs in a manner that is consistent with the restrictions/requirements applying to SRPs generally; any additional risks posed by the use of derivatives should be addressed.

Implementation Measures:

1. Regulatory authorities should take steps to help ensure there are controls in place to prevent the use by issuers of derivatives in ways likely to produce outcomes that controls on direct share purchases are designed to prevent.
2. Regulatory authorities should consider the information to be provided by the issuer to shareholders and market participants relating to their intention to use derivatives in implementing SRPs.
3. Derivatives transactions should be reported and disclosed in a way that is consistent with general SRP reporting requirements, either by:
 - (a) Reporting and disclosure of the purchase of the underlying shares upon exercise/settlement of a derivatives transaction, or

- (b) Reporting and disclosure of derivatives transactions in addition to reporting and disclosure of exercise/settlement resulting in the purchase of underlying shares.

4. Regulators should consider whether any additional restrictions or requirements are needed to take into account any additional risks that may arise from the use of derivatives.

D.5 Compliance with SRP Requirements

Principle 5: Regulatory authorities should have the ability to oversee compliance with the rules applicable to SRPs.

Implementation Measures:

Regulatory authorities and market operators should have the ability to monitor issuers' transactions and determine whether further information should be required through:

1. Record-keeping requirements that help ensure that information on SRP transactions is available for review; and
2. Reporting of trades executed in the course of the SRP.