

Survey on Open Market Repurchase Regulations: cross-country examination of the ten largest stock markets*

Jaemin Kim^a, Ralf Schremper^b, Nikhil Varaiya^a

^a College of Business Administration, San Diego State University, San Diego, CA 92182, USA

^b RTL Group S.A., boulevard Pierre Frieden, L-1543 Luxembourg

Abstract

This paper offers a survey of open market share repurchase regulations in the ten largest stock markets around the world: the United States, Japan, the United Kingdom, France, Germany, Canada, Italy, the Netherlands, Switzerland, and Hong Kong. We find that in many nations except the U.S., open market share repurchases are subject to relatively stricter regulations in terms of disclosure and execution. Disclosure requirements in the U.S., in particular, are among the least stringent.

*We thank Emanuele Bajo, Paolo Biffis, Michel Dorion, Nobuyuki Isagawa, Dusan Isakov, Sylvain Gauthier, Tim Grange, Edith Ginglinger, Debby van Hek, Hyuk-Jong Lee, Masashi Murakami, Gueram Sargsyan, Andria Squirrell, Theo Vermaelen, Rudolf Volkart, Jorgen Unemar and anonymous others from various regulatory agencies or stock exchanges from Austria, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Korea, Spain, Sweden, Switzerland, the U.K., and the U.S. for their help getting institutional details about share repurchase regulations and related matters.

1. Introduction

Open market share repurchase has become a popular corporate payout method, not only in the U.S., but also in many nations around the world (Brewis (1998), Grullon and Ikenberry (2000), Grullon and Michaely (2002), and Fama and French (2001)). In recent years, open market repurchases were introduced in Austria, France, Germany, Japan, Korea, the Netherlands, and Norway, as legal reforms facilitated share repurchases or simplified the procedures or tax provisions pertaining to share buybacks.

The regulation that governs open market share repurchases in the U.S. is unique in the sense that reporting of repurchase activity to the authorities is not mandatory. This is in stark contrast to relatively stringent Securities and Exchange Commission (SEC) reporting and disclosure requirements that usually accompany other corporate events such as tender offer repurchases, insiders' trading activities, and equity offerings. Kim and Varaiya (2004) find evidence supporting a contention that non-mandatory disclosure in the U.S. can create a conflict of interest between a repurchase firm's insider shareholders and outside shareholders: at the same time that a firm is buying back its own shares and supporting its share price,¹ the firm's insiders can be selling their holdings of the firm's stock. At any given point in time, however, outside shareholders have no knowledge as to whether or not the firm is engaged in buyback trading or not, because of lack of disclosure. With respect to the disclosure issue, Fried (2004) suggests that open market share repurchase firms be required to disclose in advance their buyback orders to be placed with their brokers, arguing that open market share repurchase can be exploited to transfer wealth from uninformed shareholders to insider-managers.

In this paper, we undertake a survey of open market share repurchase regulations in the ten largest stock markets around the world. The ten stock markets from the ten nations are selected based on stock market (equity) capitalization in 2000. The ten stock markets are, from the largest to the smallest, the United States, Japan, the United Kingdom, France, Germany, Canada, Italy, the Netherlands, Switzerland, and Hong Kong.² We find that in many nations except the U.S., open market share repurchase is relatively strictly regulated in terms of disclosure and implementation. Disclosure requirements in the U.S., in particular, are among the least stringent, unlike those of many other stock markets we examine in this study.

In the next section, we begin by reviewing open market repurchase regulations in the U.S., and in Section 3, we turn to the nine other countries. In Section 4, we present a summary of cross-country repurchase regulations.

¹ Kim (2004) finds that when open market repurchase announcing firms actually engage in buyback trading, daily return standard deviation and CAPM beta decrease, and when the firms are not buying back, daily return standard deviation and CAPM beta do not decrease.

² With respect to the People's Republic of China, we consider only the Hong Kong Stock Exchange.

2. Open market share repurchase regulations in the U.S.

In terms of stock market capitalization, the U.S. stock market is the largest in the world. We determine stock market capitalizations as of 2000 based on 2001 World Development Indicators published by the World Bank. The total world stock market capitalization as of year 2000 is \$35.4 trillion based on 97 countries for which data are available. The United States stock market capitalization is \$16.6 trillion, or 47 % of the global total. The largest three countries, the U.S., Japan, and the U.K., account for 68 %, more than two thirds of the total world stock market capitalization. The ten stock markets altogether account for 86 % of the global total. Figure 1 shows a breakdown of world stock market capitalizations by the ten stock markets and the rest of the world. We start with the largest, the U.S.

SEC Rule 10b-18, enacted in 1982, regulates open market share repurchases in the U.S. Before SEC Rule 10b-18 was adopted in 1982, open market share repurchases involved significant uncertainties regarding potential liability under the anti-manipulation provisions of Sections 9(a)(2) and 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934.³ Without explicit rules or guidelines, an open market share repurchase firm faced a possibility of being charged with illegal price manipulation.

From the 1960's, several rules including SEC Rule 10b-10 and Rule 13e-2 were proposed to regulate open market repurchases. Each of these rules, if it had been adopted, "would have been a proscriptive rule with disclosure requirements, purchasing limitations and general anti-fraud liability," quoted from Supplementary Information provided for the 1999 amendment to Rule 10b-18.⁴

Instead, in the middle of the deregulation wave of the early eighties, the SEC adopted Rule 10b-18 that gave safe harbor to open market share repurchase firms. According to this rule, compliance with the rule's conditions is voluntary and disclosure of the repurchase activity is not mandatory. According to Grullon and Michaely (2002), this rule is a major factor behind the recent upsurge in open market share repurchases in the United States. Grullon and Michaely (2002) document evidence consistent with the hypothesis that before the 1982 enactment of Rule 10b-18, the widespread fear of legal liability deterred firms from actively engaging in open market buybacks despite their tax advantage relative to dividends.

³ Rule 10b-5 has comprehensive provisions against fraud and price manipulation related to the purchase or sale of any security, and has been interpreted broadly by the courts.

⁴ Federal Register, Vol 64, No.188, Rules and Regulations, SEC, 17 CFR Part 240. [Release No. 34-41905; File No. S7-27-98]

As mentioned earlier, SEC Rule 10b-18 gives repurchasing firms immunity from the anti-manipulation provisions of the Securities Exchange Act of 1934, provided that certain conditions are satisfied. The four conditions are listed below.⁵

- (1) (*Manner of purchase*) Repurchases are made through only one broker or dealer in a given day.
- (2) (*Timing condition*) No repurchase is made as an opening transaction or during the last half hour of a trading day.
- (3) (*Price condition*) No repurchase is made at a price exceeding the highest current independent bid price or the last independent sale price, whichever is higher.
- (4) (*Volume condition*) Non-block repurchase volume does not exceed the higher of (A) one round lot or (B) the number of round lots closest to 25% of the average daily trading volume for the preceding four calendar weeks.

A common misunderstanding by both practitioners and academics on these provisions is that even if a repurchase firm does not abide by the provisions, this alone does not make the firm's action illegal or in violation of anti-price manipulation laws. By not conforming to the provisions of Rule 10b-18, the firm no longer has the safe harbor protection or immunity. However, the firm is not subject to legal liability, solely based on this non-compliance. Paragraph (d), the last paragraph of Rule 10-18, explicitly states this. Therefore, buying back shares at the opening of a trading day, for example, is a legitimate transaction.⁶ The entire text of SEC Rule 10b-18 is given in Appendix.

An important point is that repurchase firms are not required to conform to the provisions and that because of non-disclosure, even the conformity itself is not readily observable.⁷ As a matter of fact, nowhere in SEC Rule 10b-18 is there mention of the reporting or disclosure of actual share repurchase transactions.

3. Open market share repurchase regulations in nine other nations

⁵ The Supplementary Information provided for the 1999 amendment to Rule 10b-18 (Footnote 3) lists regulatory intents for each of the four conditions provided by the Rule.

⁶ Rule 10b-18 was amended in 1999 so that the timing conditions are relaxed when there is a market-wide trading suspension. For example, a buyback transaction at the re-opening after a market-wide trading suspension, which is legitimate even without the amendment, also gets safe-harbor protection.

⁷ Cook, Krigman, and Leach (2002) provide a comprehensive review of the history of repurchase regulation in the U.S. They contend that conformity to Rule 10b-18 is essentially unverifiable and present evidence that repurchase firms do not comply with the conditions set forth by the rule.

In this section, as we examine open market share repurchase regulations of the nine other stock markets from the largest, we focus on the following aspects of the regulations: (1) whether a prerequisite for the share repurchase is an approval at the shareholder meeting or whether just a board approval is sufficient, (2) whether there is any restriction on repurchase prices, repurchase volume, and timing of repurchase, (3) what are the disclosure requirements, and (4) whether there is any restriction on insiders' trading activity in relation to repurchase trading activity.

Also, five out of the nine countries, the U.K., France, Germany, Italy, and the Netherlands, are European Union (EU) member countries. At the end of this section, we briefly discuss the European Community (EC) Directive on share repurchases, as this directive results in similarities in open market share repurchase regulations among the five EU member countries.

3.1. Japan

In the second largest stock market in the world, public corporations were prohibited from repurchasing their own shares until 1994, when the Commercial Law was changed to allow share repurchases. However, different from the U.S., a significant tax disadvantage for share repurchases effectively blocked firms from engaging in share buybacks even after the change in Commercial Law. As the Tax Law regarded share repurchases as dividend payments, all shareholders, not just selling shareholders, would be subject to ordinary income taxes proportional to their equity holdings, should a firm buy back its own shares. It was after the Tax Reform Act of 1995, which repealed this tax treatment, that public firms started share repurchase programs. Since 1995, share repurchases blossomed in Japan (Hatakeda and Isagawa (2001)). An approval at the shareholder meeting was a pre-requisite until 1997, when the Commercial Law was again changed so that open market share repurchase firms no longer need an approval at the shareholder meeting. A board approval is sufficient to implement an open market buyback program.

Detailed provisions for implementing a share repurchase program are established by the Tokyo Stock Exchange.⁸ These provisions place significant restrictions on an open market share repurchase firm in terms of repurchase price, repurchase quantity, and repurchase timing. A repurchasing firm should not buy back its own shares at a price above the previous trading day's closing price. With respect to the timing of repurchase, the firm is prohibited from engaging in buyback trading during the last half hour of

⁸ The guidelines established by the Tokyo Stock Exchange use the term, "encourage" or "recommend" instead of "require." Upon discussion with an expert in the area, we conclude that this "encouragement," an expression common in Japan, in effect amounts to "requirement," and we interpret as such.

a trading day and during a one-week period prior to the end of a fiscal year. Also, the number of shares to be repurchased in a day cannot exceed 25 % of the average daily trading volume of the previous month.

Disclosure requirements, in particular, are quite strict, compared to the U.S. In Japan, repurchasing firms are required to file detailed information of their repurchase activity with the stock exchange. Such information includes how many shares they plan to buy back, when to buy back, and which securities firm to hire. Also, once the repurchasing firms execute buyback transactions, the firms have to submit detailed reports to the stock exchange at the close of a trading day.

With respect to insiders' trading activity in conjunction with share repurchase trading, the guidelines set forth by the Tokyo Stock Exchange go to great length to explain "the matters of attention" for insiders. For example, (1) an insider who is in a position to make a firm's share repurchase decisions should not trade his own holdings of the firm's shares while a buyback program is underway, (2) a repurchasing firm should establish trading rules for insiders to avoid conflicts of interest, and (3) if there is any potential conflict of interest, the public should be informed of it.

3.2. United Kingdom

The Companies Act of 1981 legalized share repurchases in the U.K. There are significant restrictions on share buybacks in terms of quantity, timing, and price range, and also in terms of taxes.⁹ An approval at the shareholder meeting is required for open market share repurchases, and this authorization is valid for 18 months. The repurchase cannot exceed 15 % of the number of outstanding shares of any class of equity, and the price to be paid should not be more than 5 % above the average price for the five business days before the repurchase day.¹⁰

In contrast to the U.S., an open market share repurchase decision has to be reported immediately to the Financial Supervisory Authority (FSA) acting as the United Kingdom Listing Authority (UKLA).¹¹ According to UK Listing Rules, once repurchases are made, these too must be reported to the UKLA as soon as possible or no later than 7:30 AM on the following business day. The report must include the date of purchase, the number of equity shares purchased, and the highest and lowest purchase prices in a day.

With respect to insiders' trading activity, it is noteworthy that repurchasing firms are not permitted to engage in buyback trading during periods when 'directors and related parties,' or insiders are not allowed to trade. This means that repurchasing firms cannot repurchase shares in one- or two-month

⁹ See Rau and Vermaelen (2002) for U.K. share repurchases and their tax treatment.

¹⁰ The repurchase of 15 % or more of the outstanding shares is treated as a tender offer repurchase.

¹¹ Under the Financial Services and Market Act of 2000, the FSA assumed its full powers and responsibilities as the single statutory regulator for deposit-taking, insurance, and investment businesses. This is when the FSA took over the role of the UKLA from the London Stock Exchange.

‘closed periods’ prior to the preliminary announcements of firms’ performance, when insiders are prohibited from trading their holdings of the firms’ shares.

3.3. France

In France, open market share repurchases were not illegal before the 1998 law change, but they were difficult to implement. Since the 1998 law reform simplified procedures of their execution, open market share repurchases by French firms have become popular (Ginglinger and L’Her (2002)). According to the Commission des Operations de Bourse (COB) communiqué of 31 January 2000, 51.5 % of the companies listed on the Paris Stock Exchange sought shareholders’ approval to initiate buyback programs between September 1998 and September 1999. COB is the French regulatory agency on securities trading.

In France, an approval at the shareholder meeting is a prerequisite for an open market share repurchase program. In addition to a shareholder approval, an open market share repurchase firm needs approval by the COB. A repurchasing firm can buy back up to 10 % of the number of outstanding shares within the maximum period of 18 months.¹² Share buyback ought to be executed at a price not less than the lowest market price and not higher than the highest market price recorded on the day when the repurchase is made. The number of shares repurchased in a day must not exceed 25% of the average daily trading volume as computed for three previous trading days.¹³ Also, firms are prohibited from repurchase trading for 15 days prior to the public announcement of the annual reports, or when the firms become aware of any information, which, if known to public, would have a significant impact on the market.

In addition to the usual disclosure in financial statements,¹⁴ repurchase firms have to file separate, monthly reports of repurchase activity with the COB for the duration of buyback programs.

With respect to insiders’ trading activity in conjunction with share repurchase activity, the COB regulation stipulates that insiders are to inform the COB every month of the number of shares they have sold to their own companies.

¹² The 10 % limit deserves elaboration. To be precise, the 10 % limit is the 10 % of the issuer’s capital, defined as follows. The par value of a class of equity share is multiplied by the number of outstanding shares of that equity, and this value is summed across different classes of equity shares. Thus, the 10 % limit on capital is equivalent to 10 % of the total number of outstanding shares of all the equity class combined. An exception to this occurs when par values for different classes of equity are different and the firm is buying back more than two kinds of equity. This 10 % limit, as described here, applies to Germany, Italy, Switzerland, and the Netherlands, in addition to France. We will consistently use the expression, ‘10 % of the number of outstanding shares,’ to have the same meaning as indicated here.

¹³ For illiquid stocks, the average daily trading volume is computed for 15 trading days prior to the share repurchase.

¹⁴ It is interesting to note that in France as well as in Germany, Italy, Netherlands, and Switzerland, repurchased shares are generally recorded as an asset item valued at the acquisition price. In the U.S., share repurchases increase Treasury Stock, a deduction item in the stockholders’ equity.

3.4. Germany

Open market share repurchase was illegal in Germany until 1998, when the Corporation Control and Transparency Act permitted share buybacks. A prerequisite for a buyback program is approval at the shareholder meeting, in which the maximum and the minimum repurchase price have to be determined. The maximum number of shares to be repurchased cannot exceed 10% of total outstanding shares, and repurchase has to be made out of distributable profits within the maximum period of 18 months.

Under the German Securities Trading Act (Wertpapierhandelsgesetz), firms are required to report open market share repurchase announcements to the investing public via the Deutsche Gesellschaft für Ad hoc-Publizität (DGAP). DGAP is the German central news information service agency that distributes financial information to the investing public on behalf of exchange-listed companies.¹⁵ In addition to reporting buyback transactions in financial statements, management has to inform the Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin), the German financial supervisory authority, if the number of repurchased shares exceeds 5% or 10% of the number of shares outstanding. In other words, if buybacks cross those hurdle percentages, they have to be disclosed to the public.

3.5. Canada

In Canada, there are several regional exchanges. In this paper, we focus on the Toronto Stock Exchange (TSE), the largest and the most representative stock exchange in Canada. Share repurchases in Canada are regulated by the by-laws of each stock exchange (Li and McNally (1999)). According to the TSE company manual, the by-laws of the TSE, open market share repurchases in Canada are called Normal Course Issuer Bids, as compared to Substantial Issuer Bids that include fixed-price tender offers, Dutch-auction tender offers, and takeover bids.

An open market buyback program can last for one year, and is limited to the greater of 10 % of public float or 5 % of outstanding shares of the class of shares approved for repurchase.¹⁶ For a 30-day period, this volume limit is 2 % of the number of outstanding shares. Also, an open market repurchase firm is not allowed to buy back its shares at a price greater than the most recent trade price.¹⁷

¹⁵ For further details on the regulation of share repurchases in Germany, see an article written in German by Ralf Schremper, 2002, Aktienrückkauf und Kapitalmarkt, Peter Lang Verlag, Frankfurt am Main.

¹⁶ Public float is the number of shares outstanding minus the number of shares held by insiders.

¹⁷ To be precise, the last trade price is the last independent trade price, which means the price resulting from transactions unrelated to share repurchase or insiders' trading activity.

Like the U.S., and unlike aforementioned European countries, an approval at the shareholder meeting is not required, but a board approval is sufficient to initiate a Normal Course Issuer Bid. Once board approval is obtained, an open market share repurchase firm has to file a notice of intention with the TSE for authorization. A repurchase firm also has to file a repurchase activity report with the TSE within ten days after the end of each month. Once a month, the TSE publishes comprehensive records of the status of all authorized buyback programs.¹⁸

With respect to insiders' trading activity, the TSE Company Manual dictates that repurchasing firms disclose the names and the intentions of insiders and the associates of insiders, if these individuals plan to sell their holdings during the course of the firms' buyback programs.

3.6. Italy

In Italy, as in the other European countries explained earlier, the authorization at the shareholder meeting is a prerequisite, and this shareholder authorization is valid for a maximum period of 18 months. At the shareholder meeting, the maximum number of shares to be acquired and the minimum and maximum purchase price have to be determined. Repurchase has to be made out of the company's distributable profits, and the number of shares to be purchased cannot exceed 10% of total outstanding shares. The repurchase price cannot be higher than the volume weighted average price of a previous trading day, and monthly repurchase volume cannot be higher than 25 % of the average monthly trading volume for the preceding six months.

With respect to disclosure requirements, share repurchases are treated in the same way as public offers such as tender offers or equity offerings, and are thus subject to essentially the same disclosure obligations.¹⁹ In other words, open market share repurchase firms in Italy should file separate reports to the Borsa Italiana (the Italian Stock Exchange) and the Commissione Nazionale per le Società e la Borsa (CONSOB) before and after the implementation of share buyback programs.²⁰ CONSOB is the public authority responsible for regulating the Italian securities market.

3.7. Netherlands

¹⁸ Ikenberry, Lakonishok, and Vermaelen (2000) study open market share repurchases of Toronto Stock Exchange listed firms and show evidence consistent with the undervaluation hypothesis.

¹⁹ We thank Emanuele Bajo and Paolo Biffis for helpful comments on Italian share repurchase.

²⁰ According to CONSOB Regulation 11971/1999, if a firm wants to initiate an open market buyback program, the firm has to send a directors' report on the repurchase program to the CONSOB, and also the firm has to submit the minutes of the shareholders' meeting convened to approve the purchase of own shares within thirty days after the meeting to the CONSOB.

In 2001, new tax legislation reduced tax costs of share repurchases in the Netherlands, enabling Dutch corporations to implement open market share repurchases. Like other EU member states, Dutch firms need an approval for open market buyback programs at the shareholder meeting, and the approval is valid for 18 months. Firms cannot buy back in excess of 10% of the number of shares outstanding, and repurchases have to be made out of distributable profits. The maximum number of shares to be acquired within the 10 % limit, and the minimum and maximum repurchase price to be paid have to be determined at the shareholder meeting.

Repurchase transactions should be reported, before the end of the following trading day, to the Autoriteit Financiële Markten (Authority FM), the Dutch supervisory authority for securities trading. Also, in case a repurchase firm acquires 5% or more of the total number of shares outstanding, the firm is required to report this information to the Authority FM as soon as possible.

Section 46 of the Insider Trading Stipulations Act of 1995 states that if insiders of a firm are to trade during a buyback program, the firm has to make public announcements about this before insiders make actual transactions. The Act also states that once insiders trade, this has to be publicly disclosed.

3.8. Switzerland

Share buybacks were legalized in 1992 by the change in the Swiss Corporation Law. While the Swiss Corporation Law provides the general legal framework for share buybacks, the Swiss Takeover Board (TOB) and the Swiss Exchange (SWX) set detailed guidelines for share buybacks. In Switzerland, the only non-EU member nation among all the European nations in our study, share buybacks have to be approved at the shareholder general meeting, and the maximum percentage of shares to be acquired is 10% of the number of outstanding shares.²¹ Firms cannot implement share buyback programs for ten days prior to earnings announcements. Also, the repurchase price cannot exceed 5 % of at-the-time market price if the firm establishes a second trading line as explained below, and the daily repurchase volume cannot exceed 25 % of the average daily trading volume of the preceding month.

An important issue to note about Swiss share repurchase is taxation. Suppose a Swiss company buys back its own shares in the open market and puts them in Treasury Stock. If so, after 6 years, the firm ought to pay ‘grossed-up’ tax rate of 53.85 %, or 35% divided by $(1 - 35\%)$, of the repurchase price. This is higher than the usual withholding tax rate of 35 %. In other words, a Swiss repurchase company faces substantial tax risk when it implements an open market repurchase program.

²¹ If share repurchase exceeds 2 % of the total capital, a repurchase firm also needs an approval of the Swiss Takeover Board (TOB). For institutional details of Swiss buybacks, see Dumont, Isakov, and Perignon (2004).

According to Dumont, Isakov, and Perignon (2004), this is why open market buyback were virtually non-existent until 1997 when the second trading line method was introduced to facilitate share repurchase in the open market.²² When a firm establishes a second trading line for share repurchase, the firm becomes the only buyer in this specially designated market segment and repurchased shares are cancelled. Then the firm is subject to 35 % withholding tax, as opposed to 53.85 %.

The second trading line buyback transactions are fully disclosed on a real time basis. There is only one buyer, the firm itself, and the price and quantity of the shares being traded are directly visible by the public. Once a repurchase firm completes such a share repurchase program, the firm also must immediately make a public announcement on the outcome of the program.

With respect to insider restrictions in conjunction with share buyback, TOB stipulates that buyback firms disclose in advance whether large shareholders plan to participate in the program or not. Also, when a buyback program is underway, insiders should abstain from trading for 20 days prior to earnings announcements, whereas the buyback firm itself should not engage in buyback trading for 10 days prior to earnings announcement.

3.9. Hong Kong

The amendments to the Companies Ordinance in 1991 permitted Hong Kong Stock Exchange (HKEX) listed firms to repurchase their own shares in the open market.²³ A firm is required to obtain shareholder approval to implement an open market buyback program. A firm can buy back up to 10 % of the shares outstanding within the maximum of one-year period following shareholder approval. In a given month, a firm can repurchase up to 25 % of the total number of shares traded in the previous calendar month. As for restriction on repurchase timing, a firm may not repurchase its shares for the one-month period prior to the annual earnings announcement. Also, repurchases have to be made out of distributable profits. Laws and regulations that govern share repurchases in Hong Kong include the Companies Ordinance, HKEX Listing Rules, and the Securities and Futures Ordinance.

With respect to disclosure requirements, shareholder approval should be filed with the Securities and Futures Commission, a supervisory authority in Hong Kong, and with the HKEX. Once shares are repurchased on any given day, this must be reported to the HKEX no later than 9:30 AM on the following

²² Dumont et al (2004) reports that there were 42 open market buyback announcements including second trading line announcements for the period of 1997-2002.

²³ Brockman and Chung (2001) examine open market share repurchases of Hong Kong stock exchange listed companies and find that the adverse selection component of the bid-ask spread increases as repurchase firms implement buyback programs.

trading day. The report has to include the number of shares repurchased and the price at which the shares were purchased.

With respect to the trading activity of an insider or “a connected person,” the HKSE Listing Rules state that a company may not repurchase shares (1) knowingly from a connected person, or (2) when a price sensitive development occurs.

3.10. EC (European Community) Directive on share repurchase

As aforementioned, there are similarities in share repurchase regulations among the five European Union (EU) member countries studied in this paper. The five nations are the U.K., France, Germany, Italy, and the Netherlands. The regulatory similarities arise due to the EC Directive issued in 1976 on share repurchase regulations for at-the-time European Community member nations.²⁴

The rules set forth in the Second Council (Council of the European Communities) Directive 77/91/EEC in 1976 are outlined as follows: (1) A firm with the intention of implementing an open market share repurchase program should acquire an approval from the shareholders at the shareholder meeting. (2) The shareholder approval is valid for a maximum of 18 months. (3) The maximum number of repurchased shares cannot exceed 10 % of the number of shares outstanding. (4) At the shareholder’s meeting, the maximum number of shares to be repurchased with the 10 % limit, and the maximum and minimum repurchase price to be paid ought to be determined. (5) A firm cannot just use any cash to buy back. Share repurchase should be made out of distributable profits only. For example, a firm cannot use cash proceeds from debt issues to repurchase its own shares.

These rules are not strictly followed, however. An example is that in the U.K., a firm can buy back up to 15 % of the total shares, not 10 %. Besides, each EU country can use its own discretion to impose rules in addition to the rules established by the Directive. For these reasons, there are cross-sectional variations in repurchase regulations among EU nations as well as significant similarities.

4. Summary of cross-country repurchase regulations

The regulatory provisions examined in the preceding sections are summarized in Table 1. Shown in the first column (Approval) is whether board approval is sufficient or approval at the shareholder meeting is required to initiate an open market share repurchase program. The next three columns show restrictions, if any, on the timing, price, and volume of open market share repurchases. The fifth column (Separate Disclosure) reports whether there are separate disclosure requirements on share buyback

²⁴ European Community (EC) member nations are now called European Union (EU) member nations.

activity in addition to standard disclosure in financial statements. For the Major Reporting Authority column, we list the main supervisory authorities that regulate share buybacks or handle disclosure requirements. In the column for Insider Trading, we note whether there are any explicit trading restrictions or disclosure requirements on insiders in a period when a repurchase program is underway.

In the U.S., a board decision is sufficient to initiate an open market share repurchase program. This means that a repurchase decision is essentially up to management discretion. But in many other nations including the five EU nations, Hong Kong, and Switzerland, an open market buyback program has to be authorized by the shareholders at the shareholder meeting, where the terms and conditions of the repurchases are determined. The kinds of terms and conditions to be decided at the meeting include the purpose of the repurchase, the maximum number of shares to be repurchased, the repurchase price range, and other details deemed necessary by the shareholders. These conditions are bound by statutory restrictions in terms of timing, price, and amount of share repurchases.

As shown in the first column of Table 1, timing restrictions exist in all the markets except for the U.S. In particular, in Japan, France, Hong Kong, and Switzerland, buyback trading is prohibited for certain periods prior to earnings announcements.

In terms of price restrictions, in Japan, the U.K., France, Canada, Italy, and Switzerland, there are specific limits to repurchase prices so that repurchase firms cannot manipulate prices upward. In France, Germany, Italy, the Netherlands, and the U.K., the maximum and the minimum repurchase prices have to be determined beforehand at the shareholder meetings.

Similarly, there are various caps on repurchase share volume in all the nine countries other than the U.S. The idea behind volume restriction is to prevent repurchase firms from influencing the market with large buyback trading volume. The U.S. is the only country without such volume restrictions, as shown in Table 1.

As emphasized previously, timing, price, and volume conditions of SEC Rule 10b-18 in the U.S. are safe-harbor provisions. Not following those conditions does not make a repurchase firm in violation of any law, as stated in the last paragraph of SEC Rule 10b-18. For example, buying back shares at the opening or during the last half hour period is a legitimate transaction. Thus, we do not treat those safe-harbor provisions as restrictions equivalent to those restrictions shown in Table 1 for stock markets in other nations.

Most importantly, we note that in many nations other than the U.S., open market repurchase firms have separate reporting obligations, in addition to basic, standard disclosure in financial statements. Once share buybacks are executed, these have to be reported to either stock exchanges or other supervisory authorities. In Japan, the U.K., the Netherlands, and Hong Kong, such reports have to be filed immediately or within a one-day period. In Canada and France, separate disclosure is required on a

monthly basis. In Switzerland, share repurchase transactions are fully disclosed and visible as Swiss firms establish second trading lines solely for the purpose of buying back their own shares in the open market. In Germany, if the number of repurchased shares reaches 5 % or 10 % hurdle rates, ad-hoc announcements should be made.

How insiders' trading activity is regulated in conjunction with share repurchase activity deserves special attention, given the conflict-of-interest argument of Kim and Varaiya (2004). In Japan, the U.K., France, Canada, the Netherlands, Hong Kong, and Switzerland, there are *explicit* trading restrictions or additional disclosure requirements for insiders who wish to trade during a period when a buyback program is underway. This is in stark contrast with the regulations in the U.S. SEC Rule 10b-18 does not mention insiders' trading activity at all. As a matter of fact, the rule does not mention anything about disclosure, either. While there are some cross-sectional variations, as well as similarities, of repurchase regulations among the ten stock markets, it stands out that the United States seems to be the most lenient country in terms of regulating open market share repurchases.

Our next task is to examine the extent to which differences in repurchase regulations have differential impacts on repurchase activities across the ten largest stock markets. Is the magnitude and popularity of U.S. repurchase activity relative to the other nine stock markets due to differences in their regulatory environments? A comparative analysis of repurchase activity would necessitate assembling a dataset of repurchase activity across these countries.

Appendix

The following is the full text of SEC Rule 10b - 18, downloaded from the Lexis-Nexis Academic Universe.

TITLE 17 -- COMMODITY AND SECURITIES EXCHANGES
CHAPTER II -- SECURITIES AND EXCHANGE COMMISSION
PART 240 -- GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934
SUBPART A -- RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934
MANIPULATIVE AND DECEPTIVE DEVICES AND CONTRIVANCES

17 CFR 240.10b-18

§ 240.10b-18 Purchases of certain equity securities by the issuer and others.

(a) Definitions. Unless the context otherwise requires, all terms used in this section shall have the same meaning as in the Act. In addition, unless the context otherwise requires, the following definitions shall apply:

(1) The term affiliate means any person that directly or indirectly controls, is controlled by, or is under common control with, the issuer;

(2) The term affiliated purchaser means:

(i) A person acting in concert with the issuer for the purpose of acquiring the issuer's securities; or

(ii) An affiliate who, directly or indirectly, controls the issuer's purchases of such securities, whose purchases are controlled by the issuer or whose purchases are under common control with those of the issuer;

Provided, however, That the term "affiliated purchaser" shall not include a broker, dealer, or other person solely by reason of his making Rule 10b-18 bids or effecting Rule 10b-18 purchases on behalf of the issuer and for its account and shall not include an officer or director of the issuer solely by reason of his participation in the decision to authorize Rule 10b-18 bids or Rule 10b-18 purchases by or on behalf of the issuer;

(3) The term Rule 10b-18 purchase means a purchase of common stock of an issuer by or for the issuer or any affiliated purchaser of the issuer, but does not include any purchase of such stock

(i) Effected during the restricted period specified in § 242.102 of this chapter, during a distribution (as defined in § 242.100 of this chapter) of such common stock or a distribution for which such common stock is a reference security, by the issuer or any of its affiliated purchasers;

(ii) Effected by or for an issuer plan by an agent independent of the issuer;

(iii) If it is a fractional interest in a security, evidenced by a script certificate, order form, or similar document;

- (iv) Pursuant to a merger, acquisition, or similar transaction involving a recapitalization;
 - (v) Which is subject to Rule 13e-1 under the Act [§ 240.13e-1];
 - (vi) Pursuant to a tender offer that is subject to Rule 13e-4 under the Act [§ 240.13e-4] or specifically excepted therefrom;
 - (vii) Pursuant to a tender offer that is subject to section 14(d) of the Act and the rules and regulations thereunder.
- (4) The term Rule 10b-18 bid means (i) A bid for securities that, if accepted, or (ii) A limit order to purchase securities that, if executed, would result in a Rule 10b-18 purchase;
- (5) The term plan has the meaning contained in § 242.100 of this chapter;
- (6) The term agent independent of the issuer has the meaning contained in § 242.100 of this chapter;
- (i) The agent is not an affiliate of the issuer; and
- (ii) Neither the issuer nor any affiliate of the issuer exercises any direct or indirect control or influence over the times when, or the prices at which, the independent agent may purchase the issuer's common stock for the issuer plan, the amounts of the security to be purchased, the manner in which the security is to be purchased, or the selection of a broker or dealer (other than the independent agent itself) through which purchases may be executed;

Provided, however, That the issuer or its affiliate will not be deemed to have such control or influence solely because it revises not more than once in any three-month period the basis for determining the amount of its contributions to the issuer plan or the basis for determining the frequency of its allocations to the issuer plan, or any formula specified in the plan that determines the amount of shares to be purchased by the agent;

- (7) The term consolidated system means the consolidated transaction reporting system contemplated by Rule 11Aa3-1 [§ 240.11Aa3-1];
- (8) The term reported security means any security as to which last sale information is reported in the consolidated system;
- (9) The term exchange traded security means any security, except a reported security, that is listed, or admitted to unlisted trading privileges, on a national securities exchange;
- (10) The term NASDAQ security means any security, except a reported security, as to which bid and offer quotations are reported in the automated quotation system ("NASDAQ") operated by the National Association of Securities Dealers, Inc. ("NASD");
- (11) The term trading volume means:
- (i) With respect to a reported security, the average daily trading volume for the security reported in the consolidated system in the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected or the Rule 10b-18 bid is to be made;
 - (ii) With respect to an exchange traded security, the average of the aggregate daily trading volume,

including the daily trading volume reported on all exchanges on which the security is traded and, if such security is also a NASDAQ security, the daily trading volume for such security made available by the NASD, for the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected or the Rule 10b-18 bid is to be made;

(iii) With respect to a NASDAQ security that is not an exchange traded security, the average daily trading volume for such security made available by the NASD for the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected or the Rule 10b-18 bid is to be made;

Provided, however, That such trading volume under paragraphs (a)(11) (i), (ii) and (iii) of this section shall not include any Rule 10b-18 purchase of a block by or for the issuer or any affiliated purchaser of the issuer;

(12) The term purchase price means the price paid per share

(i) For a reported security, or an exchange traded security on a national securities exchange, exclusive of any commission paid to a broker acting as agent, or commission equivalent, mark-up, or differential paid to a dealer;

(ii) For a NASDAQ security, or a security that is not a reported security or a NASDAQ security, otherwise than on a national securities exchange, inclusive of any commission equivalent, mark-up, or differential paid to a dealer;

(13) The term round lot means 100 shares or other customary unit of trading for a security;

(14) The term block means a quantity of stock that either

(i) Has a purchase price of \$ 200,000 or more; or

(ii) Is at least 5,000 shares and has a purchase price of at least \$ 50,000; or

(iii) Is at least 20 round lots of the security and totals 150 percent or more of the trading volume for that security or, in the event that trading volume data are unavailable, is at least 20 round lots of the security and totals at least one-tenth of one percent (.001) of the outstanding shares of the security, exclusive of any shares owned by any affiliate;

Provided, however, That a block under paragraphs (a)(14) (i), (ii) and (iii) of this section shall not include any amount that a broker or a dealer, acting as principal, has accumulated for the purpose of sale or resale to the issuer or to any affiliated purchaser of the issuer if the issuer or such affiliated purchaser knows or has reason to know that such amount was accumulated for such purpose, nor shall it include any amount that a broker or dealer has sold short to the issuer if the issuer or such affiliated purchaser knows or has reason to know that the sale was a short sale.

(15) The term market-wide trading suspension means either:

(i) A market-wide trading halt imposed pursuant to the rules of a national securities exchange or a registered national securities association, in response to a market-wide decline during a single trading session; or

(ii) A market-wide trading suspension ordered by the Commission pursuant to Section 12(k) of the Act, 15 U.S.C. 78l(k).

(b) Conditions to be met. In connection with a Rule 10b-18 purchase, or with a Rule 10b-18 bid that is made by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, an issuer, or an affiliated purchaser of the issuer, shall not be deemed to have violated section 9(a)(2) of the Act or Rule 10b-5 under the Act, solely by reason of the time or price at which its Rule 10b-18 bids or Rule 10b-18 purchases are made of the amount of such bids or purchases or the number of brokers or dealers used in connection with such bids or purchases if the issuer or affiliated purchaser of the issuer:

(1) (One broker or dealer) Effects all Rule 10b-18 purchases from or through only one broker on any single day, or, if a broker is not used, with only one dealer on a single day, and makes or causes to be made all Rule 10b-18 bids to or through only one broker on any single day, or, if a broker is not used, to only one dealer on a single day; Provided, however, That

(i) This paragraph (b)(1) shall not apply to Rule 10b-18 purchases which are not solicited by or on behalf of the issuer or affiliated purchaser; and

(ii) Where Rule 10b-18 purchases or Rule 10b-18 bids are made by or on behalf of more than one affiliated purchaser of the issuer (or the issuer and one or more of its affiliated purchasers) on a single day, this paragraph (b)(1) shall apply to all such bids and purchases in the aggregate; and

(2) (Time of purchases) Effects all Rule 10b-18 purchases from or through a broker or dealer

(i) In a reported security, (A) such that the purchase would not constitute the opening transaction in the security reported in the consolidated system; and (B) if the principal market of such security is an exchange, at a time other than during the one-half hour before the scheduled close of trading on the principal market; and (C) if the purchase is to be made on an exchange, at a time other than during the one-half hour before the scheduled close of trading on the national securities exchange on which the purchase is to be made; and (D) if the purchase is to be made otherwise than on a national securities exchange, at a time other than during the one-half hour before the termination of the period in which last sale prices are reported in the consolidated system;

(ii) In any exchange traded security, on any national securities exchange, (A) such that the Rule 10b-18 purchase would not constitute the opening transaction in the security on such exchange; and (B) at a time other than during the one-half hour before the scheduled close of trading on the exchange;

(iii) In any NASDAQ security, otherwise than on a national securities exchange, if a current independent bid quotation for the security is reported in Level 2 of NASDAQ; and

(3) (Price of purchase) Effects all Rule 10b-18 purchases from or through a broker or dealer at a purchase price, or makes or causes to be made all Rule 10b-18 bids to or through a broker or dealer at a price.

(i) For a reported security, that is not higher than the published bid, as that term is defined in Rule 11Ac1-1(a)(9) under the Act, that is the highest current independent published bid or the last independent sale price reported in the consolidated system, whichever is higher;

(ii) On a national securities exchange, for an exchange traded security, that is not higher than the current independent bid quotation or the last independent sale price on that exchange, whichever is higher;

(iii) Otherwise than on a national securities exchange for a NASDAQ security, that is not higher than the lowest current independent offer quotation reported in Level 2 of NASDAQ; or

(iv) Otherwise than on a national securities exchange, for a security that is not a reported security or a NASDAQ security, that is not higher than the lowest current independent offer quotation, determined on the basis of reasonable inquiry; and

(4) (Volume of purchases) Effects from or through a broker or dealer all Rule 10b-18 purchases other than block purchases

(i) Of a reported security, an exchange traded security or a NASDAQ security, in an amount that, when added to the amounts of all other Rule 10b-18 purchases, other than block purchases, from or through a broker or dealer effected by or for the issuer or any on that day, does not exceed the higher of (A) one round lot or (B) the number of round lots closet to 25 percent of the trading volume for the security;

(ii) Of any other security, in an amount that (A) when added to the amounts of all other Rule 10b-18 purchases, other than block purchases, from or through a broker or dealer effected by or for the issuer or any affiliated purchaser of the issuer on that day, does not exceed one round lot or (B) when added to the amounts of all other Rule 10b-18 purchases other than block purchases from or through a broker or dealer effected by or for the issuer or any affiliated purchaser of the issuer during that day and the preceding five business days, does not exceed 1/20th of one percent (0.0005) of the outstanding shares of the security, exclusive of shares known to be owned beneficially by affiliates.

(c) Conditions following a market-wide trading suspension. The conditions of paragraph (b) of this section shall apply in connection with a Rule 10b-18 bid or a Rule 10b-18 purchase effected during a trading session following the termination of a market-wide trading suspension, except that the time of purchase condition in paragraph (b)(2) of this section shall not apply, either:

(1) From the reopening of trading until the scheduled close of trading; or

(2) At the opening of trading on the next trading day, if a market-wide trading suspension is in effect at the scheduled close of a trading session.

(d) No presumption shall arise that an issuer or affiliated purchaser of an issuer has violated the anti-manipulation provisions of sections 9(a)(2) or 10(b) of the Act, 15 U.S.C. 78i(a)(2) or 78j(b), or § 240.10b-5, if the Rule 10b-18 bids or Rule 10b-18 purchases of such issuer or affiliated purchaser do not meet the conditions specified in paragraphs (b) or (c) of this section.

HISTORY:

[47 FR 53339, Nov. 26, 1982; 62 FR 520, 543, Jan. 3, 1997, as corrected at 62 FR 11321, 11323, March 12, 1997; 64 FR 52428, 52433, Sept. 29, 1999]

References

- Brewis, J., 1998. Euro corporates push for share repurchase rights. *Corporate Finance* 164 (July issue), 30-34.
- Brockman, P., Chung, D., 2001. Managerial timing and corporate liability: evidence from actual share repurchases. *Journal Financial Economics* 61, 417-448.
- Cook, D., Krigman, L., Leach, C., 2003. An analysis of SEC guidelines for executing open market repurchases. *Journal of Business* 76, 289-315.
- Dumont, P., Isakov, I., Perignon, C., 2004. Stock Repurchase on a Second Trading Line. Unpublished working paper. HEC-University of Geneva.
- Fama, E., French, K., 2001. Disappearing dividends: Changing firms characteristics or lower propensity to pay? *Journal of Financial Economics* 60, 3-43.
- Fried, J., 2004. Share Repurchase and Managerial Opportunism. *California Law Review*, forthcoming.
- Grullon, G., Ikenberry, D., 2000. What do we know about stock repurchases? *Journal of Applied Corporate Finance* 13, 31-51.
- Ginglinger, E., L'Her, J., 2002, Ownership structure and open market stock repurchases in France. Unpublished working paper. Universite Paris-XII.
- Grullon, G., Michaely, R., 2002. Dividends, share repurchases, and the substitution hypothesis. *Journal of Finance* 57, 1649-1684.
- Hatakeda, T., Isagawa, N., 2001. Stock price behavior surrounding repurchase announcements: evidence from Japan. Unpublished working paper. Kobe University (Japan).
- Ikenberry, D., Lakonishok, J., Vermaelen, T., 2000. Open market stock repurchase: the Canadian experience. *Journal of Finance* 55, 2373-2397.

Kim, J., 2004. Buyback trading of open market share repurchase firms and the volatility decline. Unpublished working paper. San Diego State University.

Kim, J., Varaiya, N., 2004. Disclosure on Open Market Repurchase Transactions in the U.S.: Does it create a conflict of interest? Unpublished working paper, San Diego State University.

Li, K., McNally, W., 1999. Information signaling or agency conflicts: what explains Canadian open market share repurchases? Unpublished working paper. University of British Columbia.

Rau, R., Vermaelen, T., 2002. Regulation, taxes, and repurchases in the U.K. *Journal of Business* 75, 245-282.

Table 1
Summary Table for Open Market Repurchase Regulations of the Ten Largest Stock Markets

This table summarizes regulatory provisions on open market share repurchases for each of the ten countries. They are, from the largest stock market capitalization, the U.S., Japan, the U.K., France, Germany, Canada, Italy, the Netherlands (NL), Switzerland (SL), and Hong Kong (H.K.). In the box below, each column with respect to the implementation of an open market share repurchase program. A (share) repurchase means an open market share repurchase. EA stands for an annual earnings announcement.

Approval	Whether a board approval is sufficient or an approval from the shareholder meeting is required.
Timing Restriction	Whether there are any restrictions on the timing of share repurchase: e.g. repurchase trading is prohibited for the last 30 minutes of a trading day; repurchase should be done in a 12-month period after authorization.
Price Restriction	Whether there are any restrictions on the price of share repurchase: e.g. repurchase transactions cannot be made at a price higher than the most recent closing price.
Volume Restriction	Whether there are any restrictions on the number of shares to be repurchased: e.g. the maximum number of shares to be repurchased cannot exceed 10 % of the total outstanding shares.
Separate Disclosure	Other than a disclosure in a financial statement, whether there are any separate, additional disclosure requirements: e.g. a detailed repurchase report has to be filed with the authority of the stock exchange.
Insider Trading	Whether there are any trading restrictions or disclosure requirements on insiders in a period when a repurchase program is underway.
Major Reporting Authority	What organization is the major authority that a repurchase firm has to report to; what is the main supervisory authority regulating share repurchase.
Other Issues	Whether there are any other related issues: e.g. there is a significant tax disadvantage for open market share repurchases.

Table 1

	Approval	Timing Restriction	Price Restriction	Volume Restriction	Separate Disclosure	Insider Trading	Major (Reporting) Authority	Other Issues
US	Board	None	None	None	None	None	SEC	
Japan	Board	Last 30 min, week before year end	No higher than last day price	25 % of daily volume	Daily	Yes	Tokyo Stock Exchange	
UK	Shareholder meeting	18 mo limit	No higher than 5 % of 5 day price	15 % of total shares	Daily	Yes	FSA (Financial Supervisory Authority)	EU nation
France	Shareholder meeting	18 mo limit, 15 days before EA	No higher than daily high	10 % of total shares, 25 % of daily volume	Monthly	Yes	COB (Comm. on Securities Trading)	EU nation
Germany	Shareholder meeting	18 mo limit	Shareholder meeting: max and min	10 % of total shares	Some ad-hoc, 5%-10% hurdles	None	BaFin (Financial Supervisory Authority)	EU nation
Canada	Board	12 mo limit	No higher than most recent price	5 % of total shares, 10% public float	Monthly	Yes	Toronto Stock Exchange	TSE listed firms only
Italy	Shareholder meeting	18 mo limit	No higher than most recent price	10 % of total shares, 25 % of monthly volume	Yes (treated as public offers)		CONSOB (Comm. on Financial Markets)	EU nation
NL	Shareholder meeting	18 mo limit	Shareholder meeting: max and min	10 % of total shares	Daily	Yes	Authority FM (FM: Financial Market)	EU nation
SL	Shareholder meeting	10 days before EA	No higher than 5 % of the current market price	10 % of total shares, 25 % of monthly volume	Second Trading Line	Yes	Swiss Takeover Board (TOB)	Tax
HK	Shareholder meeting	12 mo limit, 1 mo before EA	None	10 % of total shares, 25% monthly volume	Daily	Yes	HK Stock Exchange	

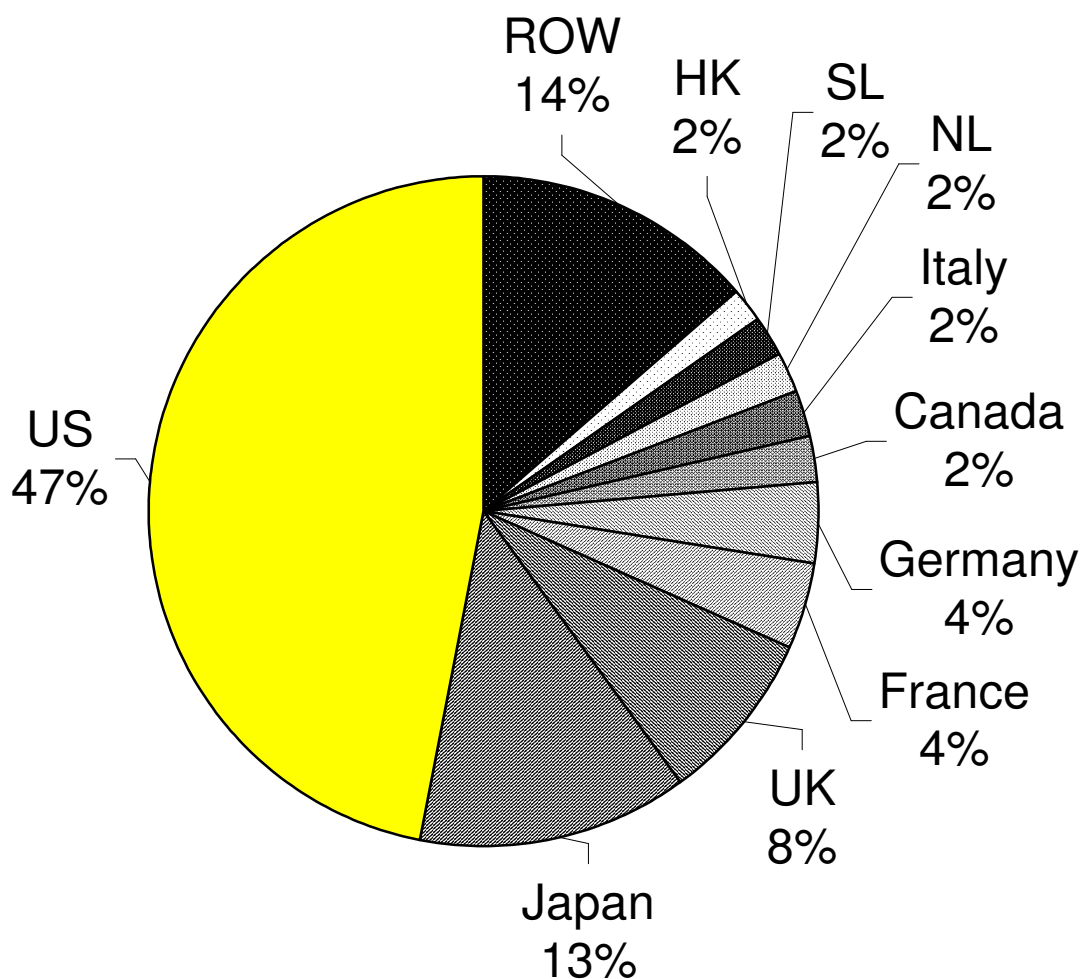


Fig. 1. World Stock Market Capitalization: Figure 1 shows a breakdown of world stock market capitalization by ten largest-cap stock markets and the rest of the world as of year 2000. The ten stock markets are, from the largest, the U.S, Japan, the U.K., France, Germany, Canada, Italy, the Netherlands (NL), Switzerland (SL), and Hong Kong (H.K.). ROW stands for 'the rest of the world.' The total world stock market capitalization is USD 35.4 trillion from 97 countries for which the data are available. The source of the stock market capitalization data is the 2001 World Development Indicators published by the World Bank.