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The Market Abuse Regulation

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Overview

The civil market abuse regime in the United Kingdom (**UK**) is changing. From 3 July 2016 the majority of the requirements under the European Union's Market Abuse Regulation (**MAR**) come into effect. Although MAR runs in tandem with the European Directive on Criminal Sanctions for Market Abuse, the UK is not implementing this directive, so there will be no change to the UK's criminal market abuse regime.

The new MAR regime builds on that in the Market Abuse Directive (**MAD**) which it repeals, so much of its content is familiar. But MAR is wider in scope. It covers more financial instruments and more trading venues. It extends market manipulation to include attempted market manipulation and prohibits abusive behaviour in respect of benchmarks. This means more issuers and their staff and more trading venues will be caught by MAR. Where MAR also differs is in the degree of its prescriptive detail.

What is MAR?

MAR is a European regulation so it has direct effect in the UK. It replaces the previously existing civil market abuse regime with the European law in MAR itself (Level 1) and in detailed European texts underpinning it (Level 2). These include Implementing Technical Standards (**ITS**) and Regulatory Technical Standards (**RTS**). The European legal framework also has Level 3 Guidelines. These, along with the RTS and ITS, are drafted by the European Securities and Markets Authority (**ESMA**). They contain relevant detail - although they are not yet all finalised.

What is market abuse?

There are three market abuse behaviours specified in MAR: insider dealing, unlawful disclosure of inside information and market manipulation. These behaviours are specifically prohibited, subject to certain carve-outs. There continue to be exemptions for buy-back programmes and stabilisation.

Which financial instruments and venues does MAR apply to?

A significant change under MAR is that it applies to a wider range of financial instruments and trading venues than MAD and the resulting regime in the UK, because it uses the wider definition of "financial instrument" under the new Markets in Financial Instruments Directive (**MiFID II**). So emission allowances and trading on the new, organised trading facilities (**OTF**) which are to be introduced under MiFID II will be brought within MAR's scope. Accordingly MAR covers financial instruments:

- admitted to trading on a regulated market – or for which a request for admission to trading has been made;
- traded on a multilateral trading facility (**MTF**) – or for which a request for admission to trading has been made;
- traded on an OTF; or
- not covered by any of the above, but their price or value depends on or effects the price or value of such a financial instrument.

MiFID II is expected to be implemented on 3 January 2018. In the meantime, MAR's references to MiFID II must be read as referring to MiFID I. So the extended range of instruments and venues under MiFID II, which were not covered in MiFID I, will not apply until 2018.

The scope of MAR is also wider than the regime under the UK's Financial Services and Markets Act 2000 (**FSMA**) in that it brings financial instruments traded on, or for which a request has been made for admission to trade on, an MTF into scope.

How to identify inside information

The definition of "inside information" in Article 7 of MAR is the key to understanding both the positive obligations on disclosure that issuers have under MAR and to identify when either insider dealing and unlawful disclosure of inside information are carried out. It is a definition made up of four parts:

- information of a *precise nature*;
- which *has not been made public*;
- *relating, directly or indirectly, to one or more issuers or to one or more financial instruments*; and which,
- *if it were made public, would be likely to have a significant effect on the prices* of those financial instruments or on the price of related derivative financial instruments.

These are familiar as the definition remains similar to that in MAD.

Information will be of a "precise nature" if it indicates a set of circumstances which exists or may reasonably be expected to come into existence, or an event which occurred or may reasonably be expected to occur, specific enough to conclude as to its possible effect on the prices of the financial instruments or related derivative financial instrument (Article 7.2). This is very much the same as under FSMA.

MAR clarifies that even an intermediate step in a protracted process can be sufficient to comprise inside information if the step satisfies the criteria above (Article 7.3). Each stage – as well as the entire process – could constitute inside information if the criteria in the definition are met. Examples MAR provides at Recital 17 include: the progress of contract negotiations; provisionally agreed terms in negotiating a contract; the possible placement of financial instruments; conditions for marketing financial instruments; provisional terms for placing financial instruments; and whether an instrument should be included in or removed from a major index.

Article 7.4 clarifies that information that would, if it were made public, be likely to have a significant effect on prices of financial instruments or derivative financial instruments, is information a reasonable investor would be likely to use as part of the basis for their investment decisions. The reasonable investor test is already part of the UK regime in s.118C FSMA, so in the UK it is not new. MAR elevates the significance of this test by including it in the text of Article 7.4.

Recital 14 assumes a reasonable investor's decision is based on the information already available to them. Important factors in assessing whether a reasonable investor would be likely to take the new information into account include: the anticipated impact it has on the totality of the issuer's activities and how reliable the source of the information is, along with any other market variables likely to affect the financial instruments.

What is the public disclosure obligation for issuers?

The general disclosure obligation is that relevant issuers must inform the public as soon as possible about inside information which directly concerns them (Article 17.1). Such information must be publicised so it can be accessed quickly for complete, accurate and timely assessment by the public. The disclosure may not include marketing.

Issuers whose securities are admitted to trading on a regulated market must also ensure the information is made available to the officially appointed central storage mechanism. All issuers must also post and keep on their website for at least five years all inside information they are required to disclose publicly.

Delay in the disclosure of inside information to the public

Issuers may delay disclosing inside information in the following circumstances under MAR: (i) disclosing immediately is likely to prejudice the issuer's legitimate interests; (ii) the delay is not likely to mislead the public; and (iii) the issuer is able to ensure the information remains confidential (Article 17.4).

If at any stage it is no longer possible to retain the information confidentially, it must be disclosed as soon as possible – particularly if it is the subject of a market rumour (Article 17.7). Issuers may also delay disclosure in a protracted process involving inside information as well as in relation to isolated incidents, if the conditions are met.

To delay disclosure issuers need to follow detailed processes in the ITS. Among other things in the current draft ITS, issuers must put processes in place to record dates and times when inside information first existed within the issuer and when the decision to delay was taken.

Issuers must notify the Financial Conduct Authority (**FCA**) when they do disclose information that it is a delayed disclosure (Article 17.4). They must provide a written explanation to the FCA for how they considered it met the above criteria, should the FCA request this. The notification must identify the persons who make the notification and those responsible for the decision to delay.

ESMA's Guidelines on legitimate interests of issuers to delay inside information and situations in which the delay of disclosure is likely to mislead the public

In these draft Guidelines ESMA lists six cases showing when immediate disclosure may harm the issuer's legitimate interests. The indicative list includes: on-going negotiations, contracts or other decisions that require approval from another party or body (other than the shareholders) such as competition authorities, and new inventions where immediate disclosure could jeopardise the issuer's intellectual property rights. ESMA notes that the list is not exhaustive.

ESMA provides reference to three situations in the Guidelines where delay of disclosure will always mislead the public and must be disclosed. The list is not exhaustive. The situations are where the inside information:

- is materially different to an earlier public announcement about the matter to which the inside information relates;
- relates to the issuer's financial objectives being unlikely to be met and where such objectives were previously announced; and
- contrasts with market expectations based on signals given by the issuer previously.

The final report is not expected until the third quarter of 2016 – so there is no certainty that the Guidelines will be available before 3 July 2016. Issuers who decide to delay disclosure imminently after that date may have to do so without finalised Guidelines.

Obligation to prepare and maintain insider lists

This obligation is not new but issuers will need to review the process and form these lists must take. At a minimum, Article 18 sets out that the list must include the identity of any person with access to inside information; details of why they are included on the list; the date and time they accessed inside information; and the date the list was compiled. It must be kept up to date and retained for at least five years after it is first compiled or updated and be provided to the FCA as soon as possible on their request.

Issuers, or persons acting on their behalf, must take all reasonable steps to ensure that any person on the list confirms to them in writing the legal and regulatory duties that person has (i) in respect of inside information and (ii) that it is aware of the sanctions applicable to insider dealing and unlawful disclosure of inside information. So, the person giving their acknowledgement needs to know, in practical and legal terms, what it means to be an insider and what the requirements are for insiders of *that* issuer.

Issuers are responsible for ensuring their insider list complies with the requirements even if it is compiled and maintained by a third party. Issuers always retain access rights to their list.

The Commission has set out the precise format for the various sections of the insider list – including for permanent insiders, and deal-specific or event-based information - and for updating insider lists in its Implementing Regulation laying down the ITS.

Requirements for managers to disclose their dealings

The managers' disclosure requirements in Article 19 apply to persons discharging managerial responsibilities (**PDMRs**) (broadly directors and senior executives who have regular access to inside information) and their closely associated persons (including close family).

PDMRs and their closely associated persons must notify both the issuer and the FCA of every own account transaction relating to shares or debt instruments of the issuer or derivatives of or other financial instruments linked to them. The scope is new, as the FCA's amended Handbook text in its policy statement on Implementation of the Market Abuse Directive (**PS16/13**) shows at Disclosure and Transparency Rule (**DTR**) 3.1, which now includes debt instruments (previously DTR 3.1 applied only to shares).

PDMRs and their associates must notify such transactions to the issuer and the FCA no later than three business days after the transaction date. The FCA has confirmed in PS16/13, that notifications made to it are required only once the total amount of the relevant transactions has reached Euro 5,000. However, PS16/13 confirms issuers may notify all relevant transactions, not just when the Euro 5,000 threshold is met.

The Commission Implementing Regulation contains the template for notification and public disclosure by PDMRs and their closely associated persons.

Are there closed periods when PDMRs cannot deal?

The basic requirement in MAR Article 19.11 – 19.13 is that PDMRs must not conduct any transaction on their own account or on the account of any third party, directly or indirectly, relating to the shares, debt instruments, or derivatives or other financial instrument linked to them in the closed period. MAR sets this at thirty calendar days before the announcement of an interim financial report or a year-end report which the issuer is obliged to make public. This applies whether the requirement is one of national law or of the venue where the issuer's shares are admitted to trading. There are some exceptions – notably where exceptional circumstances exist such as severe financial difficulty and for employee share or saving schemes transactions.

Requirements for issuers to disclose the dealings of their PDMRs and the persons closely associated with them

Once they have received the relevant information from their PDMRs and persons closely associated with them, issuers must make the information public promptly and no later than three business days after the transaction. So issuers have the same time to disclose the information to the public as PDMRs and their closely associated persons have to supply that information to them and the FCA. Issuers should consider setting internal procedures to require notification from PDMRs and their closely associated persons well within that timeframe to give them sufficient time to make the information public.

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The market abuse prohibitions

The prohibitions (Articles 14 and 15) are drafted widely. They prohibit engaging in or attempting to engage in insider dealing and market manipulation. The insider dealing prohibition also prohibits persons possessing inside information (**insiders**) from recommending or inducing another to engage in dealings based on the inside information. If an insider does so, the person acting on the basis of their recommendation or inducement is insider dealing – if they knew or ought to have known the recommendation or inducement is based on inside information.

Exemptions from the market abuse prohibitions for buy-backs and stabilisation

Trading in own shares in buy-back programmes and stabilisation programmes are not caught by the prohibitions if they comply with Article 5 of MAR and the relevant RTS.

Trading in own shares in buy-back programmes is exempt if the purpose is to reduce the issuer's capital, or to meet obligations arising from debt finance instruments exchangeable into equity, or from share option programmes or similar share allocations to employees or board members of the issuer or an associated company. An issuer must disclose full details of the programme before trading and report, in accordance with MAR, that the trades are part of a buy-back programme to the trading venue's competent authority, which may be the FCA and then disclose them to the public. The issuer must also ensure the programme complies with adequate price and volume limits and the RTS.

A stabilisation programme is exempt if it is for a limited period and information about the programme is disclosed in the period MAR specifies, to the competent authority of the trading venue concerned, which may be the FCA. The stabilisation programme must also comply with adequate price limits and with the stabilisation conditions in the RTS.

How does the inside information definition apply to insider dealing?

Insider dealing in Article 8 arises when a person in possession of inside information uses it to deal, or to attempt to deal or to recommend or induce another to do so. Dealing includes acquiring or disposing of financial instruments to which the inside information relates, as well as to cancelling or amending an order concerning such a financial instrument that was made before having inside information in relation to that instrument.

A person so using the recommendation or inducement will also be insider dealing where they know or ought to know that the recommendation or inducement is based on inside information. In the UK the FCA judges what a reasonable person knows, or ought to know, in such circumstances.

Unlawful disclosure of inside information

This arises if any natural or legal person has inside information which they disclose other than in the normal course of their employment, profession or duties.

Onward disclosure of recommendations or inducements are unlawful disclosure of inside information, if the person doing so knew, or ought to know, that they were based on inside information (Article 10).

Market soundings

A market sounding is the communication of information before the transaction is announced to specific investors to gauge their interest. To be exempt the specified procedure must be adhered to precisely. There are record keeping obligations for the disclosing party, both before and after making a sounding that discloses inside information which the FCA can request to see. The disclosing party must keep these records for five years.

Details on the procedure for market soundings is in a RTS. The draft includes templates of the records that disclosing market participants conducting market soundings must make.

Market soundings are a useful safe harbour where all the requirements in MAR, the RTS and Guidelines are complied with. But, unless disclosure is made in accordance with the requirements for market soundings, Article 17.8 of MAR specifies that where an issuer or a person acting on their behalf discloses any inside information to a third party in the normal course of their employment, profession or duties, then unless the recipient owes a duty of confidentiality, the information must be treated in the normal way for disclosures of inside information. So the issuer must disclose the information to the market. This must be done simultaneously with any intentional disclosure or as soon as possible where inside information was inadvertently disclosed.

Market manipulation

Market manipulation is committed if a person carries out any of the specified activities or behaviours in Article 12 of MAR. These include:

- Giving false or misleading signals: a transaction, an order to trade or any other behaviour which gives, or is likely to give, false or misleading signals about the supply of, demand for or price of a financial instrument; or secures, or is likely to secure, the price of one or several financial instruments, at an abnormal or artificial level.

- Using fictitious devices or other deception or contrivance: a transaction, placing an order to trade or any other behaviour or activity affecting, or that is likely to affect, the price of one or several financial instruments; using a fictitious device or any other form of deception or contrivance.

- Disseminating information through the media, internet or using any other means: which gives, or is likely to give, false or misleading signals as to supply, demand or price of financial instruments; or secures, or is likely to secure, their price at an abnormal or artificial level, including circulating rumours knowing or when the person ought to have known the information was false or misleading.

- Certain behaviours, in addition to the activities mentioned above, also constitute market manipulation. They include collaborating to secure a dominant position over the supply or demand for a financial instrument or creating other unfair trading conditions (including by algorithmic and high-frequency trading).

MAR provides some further guidance to help identify these behaviours in its Annexes.

Conclusions

MAR, the Level two texts and Level three Guidelines underpinning it are the new civil law on market abuse in the UK from 3 July 2016. Much in this new regime will be familiar as the UK civil market abuse regime is not changing substantially. But there are points of difference and elements that are new both in MAR itself and particularly also in the wealth of detail and prescriptive requirements provided in the ITS, RTS and Guidelines.

Time is certainly ticking as there are only a matter of weeks to become familiar with all of the available requirements and to prepare properly so firms, their systems and staff are ready to comply with this new regime from 3 July 2016. The difficulty now is that despite the short timeline much of the detail in Levels two and three is not yet finalised.

This is not a comprehensive guide to MAR. It is not and must not be used as a substitute for specific legal advice.

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