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Client Alert: EU Market Abuse Regulation

INTRODUCTION

With effect from 3 July 2016, the European Market Abuse Regulation (Regulation 596/2014) ("**MAR**") will replace the European Market Abuse Directive (2003/6/EC) ("**MAD**") that has been in place since 2003. MAR introduces a harmonized EU market abuse framework aimed at enhancing market integrity and investor protection, and it will have direct effect in all EU member states. Along with MAR, the Directive on Criminal Sanctions for Market Abuse (2014/57/EU) ("**CSMAD**") will also come into effect across the EU, with the exception of the UK and Denmark, who have not opted into the directive. CSMAD complements MAR by introducing criminal sanctions for market abuse.

Unlike MAD, which covered activities on regulated markets only, MAR extends the scope of the market abuse framework to financial instruments traded on multilateral trading facilities ("**MTFs**"), including unregulated exchanges such as London's AIM, Luxembourg's Euro MTF and Ireland's GEM where many high-yield and investment grade bonds are listed, and organized trading facilities ("**OTFs**"), as well as to financial instruments whose value depends on or has an effect on the value of any such financial instruments traded on MTFs and OTFs, including derivatives such as credit default swaps.

Because MAR applies to financial instruments traded on a wide range of European trading venues, the regulation could have a broad, extra-territorial effect. For example, conduct by market participants outside the EU could be subject to sanction under MAR if it relates to financial instruments that are traded on a European trading venue. Additionally, non-EU issuers of debt or equity securities that are listed on such a European exchange will need to comply with MAR's requirements. Finally, MAR would apply to non-EU financial instruments whose price or value affects or depends upon a financial instrument listed in the EU.

KEY FEATURES

MAR was developed as a result of a scheduled review of the existing market abuse regime, which had become outdated in some respects due to increased globalization of

financial markets and a number of new trading platforms. In the wake of LIBOR and manipulation investigations and an intensified focus on market abuse sanctions, EU regulators incorporated a number of important changes in the new regime. In particular, MAR will:

- Extend the scope of the regime to cover MTFs, OTFs, and additional financial instruments;
- Introduce an expanded definition of "inside information";
- Extend the application of the market manipulation offence to capture attempted manipulation;
- Impose restrictions on dealings by persons discharging managerial responsibilities and persons closely associated with them ("**PDMRs**");
- Formalize the process that should be used for "market sounding" and the process that should be followed before disclosing inside information in the context of a market sounding;
- Broaden the pre-existing regime on investment recommendations;
- Extend the obligation to report suspicious transactions to include suspicious orders; and
- Enhance supervisory, investigatory and civil enforcement powers of national regulators and place greater obligations on the European Securities and Markets Authority ("**ESMA**") to co-ordinate investigatory work and enforcement action conducted by national regulators.

INSIDER DEALING AND MARKET MANIPULATION

Under MAD, companies were required to disclose price sensitive information unless a delay was jusitified. MAR broadens MAD's scope by requiring companies to have decision-making and record-keeping procedures to decide whether to delay such information and, upon announcing the information, to notify the regulator of any delay in announcement and explain how the delay complied with MAR. In addition, MAR requires companies to prepare and maintain lists of persons with access to such price sensitive information.

MAR and CSMAD also add new offences, including attempt to commit market abuse and canceling orders on the basis of information acquired after the order was placed.

To ensure compliance, companies should examine the policies they have in place to disclose price sensitive information. In the event of a delay in disclosure of such infor-

mation, companies should record the rationale for the delay. Companies should also maintain detailed lists of persons with access to inside information and ask such persons to record in writing that they acknowledge the procedures and related sanctions.

Given the potential extra-territorial reach of MAR, as discussed above, it is important to note that what constitutes insider dealing in countries outside the European Union may differ from the scope of insider dealing under MAR. For example, under MAR, "inside information" is defined as "*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*." MAR also takes into account whether information is "*information a reasonable investor would be likely to use as part of the basis of his or her investment decisions*." In contrast to the United States, under MAR there is no requirement that there be a fiduciary or fiduciary-like relationship or a duty of trust or confidence between the source of inside information and the recipient of it. As such, it would be possible for activity that is permissible under U.S. laws related to insider trading to be subject to sanction under MAR.

MANAGEMENT DEALINGS

MAR requires persons discharging managerial responsibilities and persons closely associated with them ("**PDMRs**") to disclose details of their dealings of shares and debt instruments, as well as related financial instruments.

Furthermore, MAR:

- Reduces the time limit for notification of dealings by PDMRs to three days from the current four;
- Introduces a minimum threshold for notification by PDMRs by providing that reporting requirement apply only if transactions carried out in a calendar year exceed the value of €5,000; and
- Reduces the "close period" during which directors and senior management may not deal in securities from sixty days to thirty days prior to the publication of an interim or annual report.

Companies are required to draw up a list of all of their PDMRs and must notify all of them, in writing, of their obligations; PDMRs are then required to pass on such notification to all persons closely associated with them.

To ensure compliance, companies should review their policies and, in addition to getting written acknowledgement from current PDMRs, train any future PDMRs on these policies.

MARKET SOUNDINGS REGIME

MAR introduces a set of new rules that apply to "market soundings," which are communications to gauge the interest of investors in a potential transaction. The rules generally formalise procedures that are already market practice.

Persons carrying out the market sounding ("**DMPs**") are required to:

- Assess whether the market sounding will involve the disclosure of inside information;
- Record in writing their conclusion as well as the information disclosed, indicating the criteria used; and
- Make the records available to the competent authority upon request.

Furthermore, before disclosing any inside information, DMPs are required to obtain the consent of the investor, informing them to refrain from dealing on the relevant financial instrument and keep that inside information confidential. In addition, the DMPs must inform the investors when the information is no longer considered to be confidential.

Finally, DMPs must maintain a record of all information given to the person receiving the market sounding, must use a script and must keep records and sounding lists, even when they consider that no inside information is being relayed during a market sounding. Companies and advisors could consider recording market sounding conversations as a means of complying with this requirement.

To ensure compliance, companies should review their policies and ensure that relevant employees receive adequate training. They should also obtain confirmation from any advisors that the advisors will follow these procedures.

INVESTMENT RECOMMENDATIONS

MAR broadens the pre-existing regime on investment recommendations, requiring that persons who produce or disseminate investment recommendations or other information recommending or suggesting an investment strategy must take reasonable care to ensure that such information is objectively presented, disclose their interests or indicate conflicts of interest concerning the financial instruments to which that information relates.

Furthermore, MAR lowers to 0.5% the threshold triggering the duty to disclose potential conflicts of interest arising from the holding of positions in the issued share capital of the issuer to which a recommendation relates.

SUSPICIOUS TRANSACTIONS

Finally, MAR extends reporting duties to "suspicious orders" (MAD only required reporting of suspicious transactions).

Reporting should follow the harmonized template for suspicious transactions and orders reports ("**STORs**") that ESMA proposes in its draft standards. The draft standards require that firms, as part of their market abuse detection systems, should keep records of the analysis carried out with regard to suspicious orders and transactions that have been examined and the reasons for submitting a STOR or not. This means that firms will also have to keep an audit trail of near-misses.

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