The new market abuse regime

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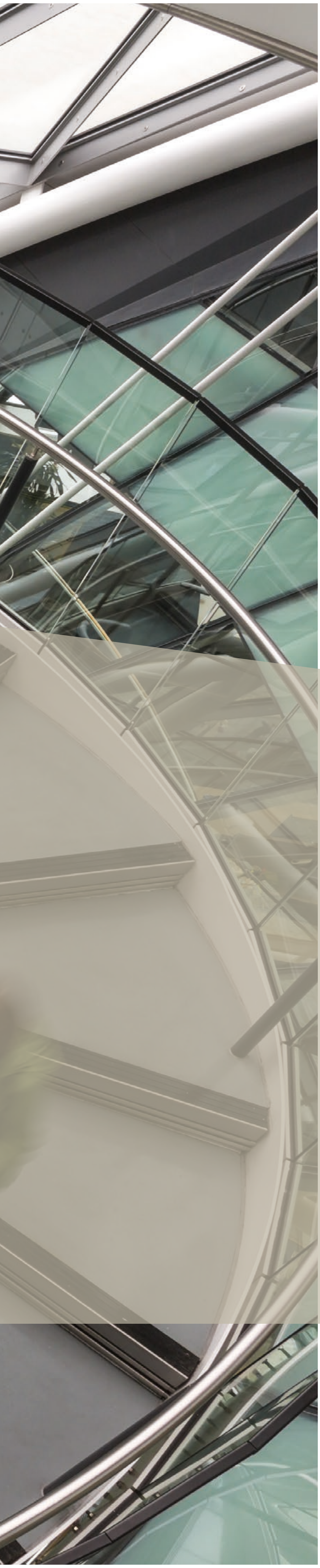
Hogan Lovells



On 3 July 2016, a new market abuse regime became law across the EU. This has resulted in significant changes to the regime that existed previously. These changes affected both the civil regime and, for most EU member states, the criminal regime, although the UK has opted out of this aspect. The new regime impacts issuers, trading venues and market participants, although issuers will probably see the most change.

Even where issuers were covered by the prior regime, many of the rules have altered and necessitate changes to compliance procedures, systems and training as a result. The increased scope of the rules also means that some issuers not previously caught are now subject to compliance regimes for the first time and will have had to put new procedures in place.

This note focuses on the implications of the new market abuse regime for UK issuers.

Need to know:

The European market abuse regime changed with effect from 3 July 2016.

Key areas subject to revision were:

- disclosures of inside information and the process for delaying them,
- notification of managers' dealings and when they are prohibited,
- the content and management of insider lists, and
- a new market soundings regime.

The changes mean that some issuers and securities not covered by the old rules are now within the scope of the new regime and will need to conform with new compliance requirements.

Issuers who were covered by the old regime will have to monitor their policies, procedures and staff training to ensure they comply with the new rules, especially as market practice develops under the new regime.

MAR changes the scope of existing definitions and rules as well as introducing new or amended compliance procedures – whilst issuers have had to review and update their processes, systems and arrangements for MAR's implementation, further change may be required as market practice develops

What is changing and why

The change is due to the EU Market Abuse Regulation (MAR). As MAR is a Regulation, it has direct effect in each EU member state. For this reason, there will be much greater harmonisation as regards market abuse rules across the EU. By contrast, the old regime was implemented by way of a Directive (the Market Abuse Directive or MAD) which set out minimum standards for a market abuse regime in each member state. However, because MAD did not have direct effect, it relied on each member state putting in place measures to give effect to it. Whilst this resulted in a common legal framework for preventing and detecting market abuse and ensuring a proper flow of information to the market, it was not fully harmonised.

Whilst MAR updates the civil market abuse framework, it is complemented by the Directive on Criminal Sanctions for Market Abuse (CSMAD) which introduces minimum rules for criminal sanctions for market abuse. However, the UK (together with Denmark) has opted out of CSMAD. Therefore, the UK criminal sanctions regime as set out in Part 5 of the Criminal Justice Act 1993 (insider dealing) and Part 7 of the Financial Services Act 2012 (market manipulation) will remain. The CSMAD regime will nonetheless remain relevant to UK persons operating in those member states where CSMAD does apply. Affected member states had to transpose CSMAD into their national laws by 3 July 2016, the same date when MAR became law.

Prior to MAD, the UK already had a set of market abuse provisions contained in the Financial Services and Markets Act 2000 (FSMA). In order to implement MAD, FSMA was therefore adapted and supplemented by provisions contained in what is now the FCA Handbook which includes, amongst other things, the Listing Rules, the Disclosure Guidance and Transparency Rules and the Code of Market Conduct. As mentioned, because MAR is a Regulation, it will have direct effect and does not require any implementing legislation. However, the UK has still had to make sure that its existing laws and regulations are compatible with MAR and, if not, amend them so that they are. For this reason, HM Treasury has amended FSMA (and other relevant legislation) to ensure that UK law is compatible with MAR. The changes to such legislation were set out in a new statutory instrument - The Financial Services and Markets Act 2000 (Market Abuse) Regulations.

In addition, the FCA has revised its Handbook, key changes being revisions to the Disclosure Rules, now called Disclosure Guidance, and the deletion of the Model Code. The AIM Rules for companies have also been amended to make them consistent with MAR.

Another significant change is that, as MAR applies directly, issuers now need to read both the Handbook (or the AIM Rules) and MAR itself (together with its secondary level legislation and guidance), rather than simply being able to rely on the Handbook alone. AIM companies will also find themselves subject to scrutiny by two regulators – the LSE in respect of the AIM Rules, and the FCA which is the competent authority in respect of compliance with MAR.

Extended scope

The aim of MAR is to enhance market integrity and investor protection. To this end, MAR updates and strengthens the previous MAD framework by extending its scope to new markets and trading strategies, and adapting rules to accommodate new technologies and behaviours. It has also introduced an extra-territorial dimension.

More markets and securities are covered

MAR applies to a wider range of financial instruments and trading venues. Unlike MAD, MAR is not limited to regulated markets and extends to cover instruments that are not traded on a trading venue but whose price or value depends on those that are. As such, a wider number of issuers and market participants are caught by MAR. MAR applies to:

– financial instruments admitted to trading on a regulated market or for which a request for admission to trading on such a market has been made,

– financial instruments traded on a multilateral trading facility (MTF) such as AIM, admitted to trading on an MTF, or for which a request for admission to trading on an MTF has been made,

– financial instruments traded on an organised trading facility (OTF) – a new term introduced by MIFID II to cover facilities or systems for buying and selling interests or orders related to financial instruments such as derivatives, and

– financial instruments not covered by any of the points above but whose price or value depends on, or has an effect on, the price or value of a financial instrument referred to above, including, but not limited to, credit default swaps and contracts for difference, and spot commodities in certain situations.

Whilst this note focuses on the UK position for financial instruments and issuers under MAR, it should be noted that MAR also applies to emission allowances (and related auctioned products), and emission allowance market participants (EAMPs).

Although most of MAR took effect on 3 July 2016, where it refers to OTFs, SME growth markets, emission allowances or auctioned products based on them, those provisions will not be effective until MIFID II becomes law (currently expected to be 3 January 2018). This is because the terms in question are derived from that legislation.

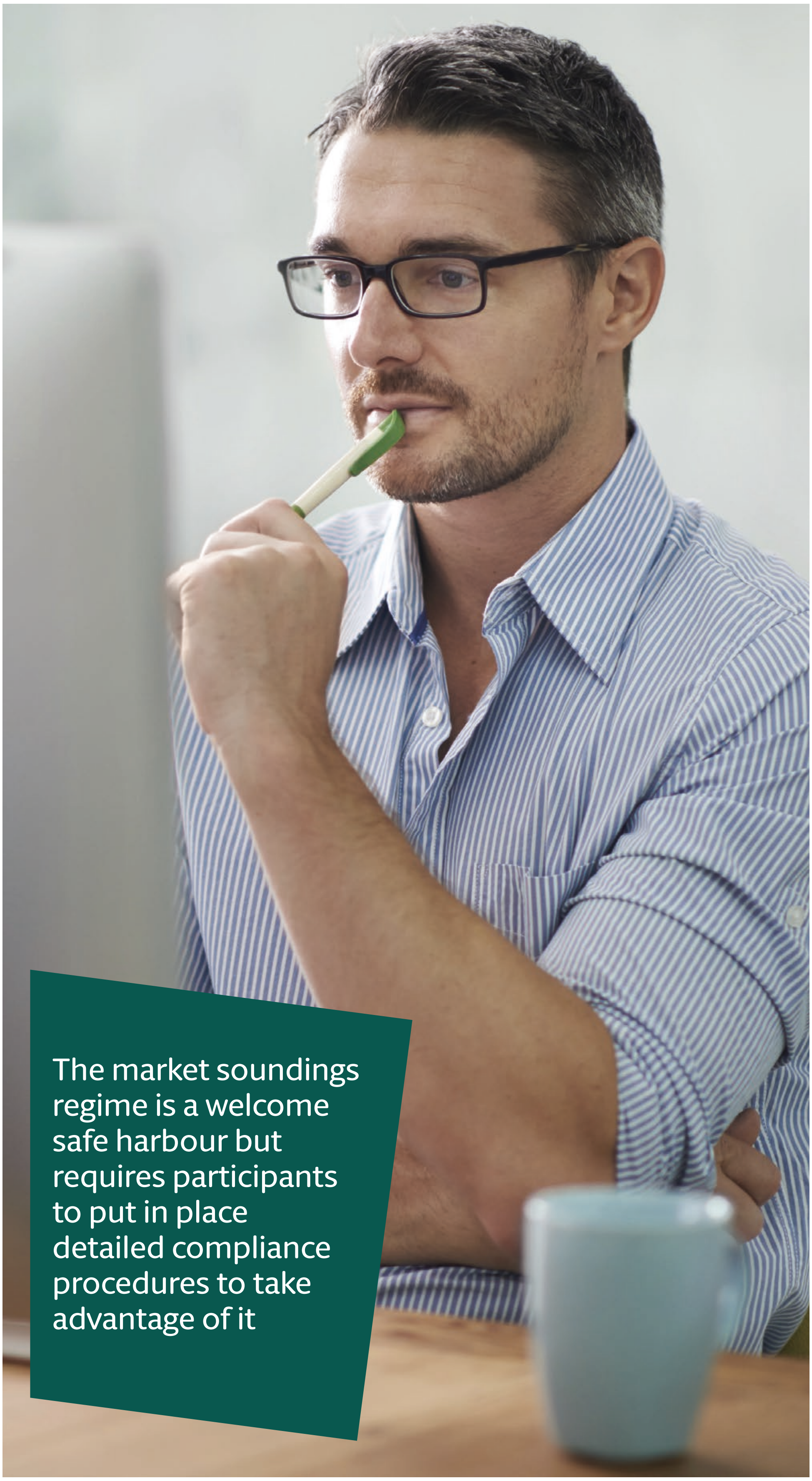
Extra-territorial reach

While MAR is an EU Regulation, it applies to conduct that occurs outside the EU but which relates to financial instruments traded in the EU or where the financial instrument is dependent on, or affects the value of, such an instrument. As such, a party with no connection to the EU may be caught by MAR.

The prohibitions

The principal offences under MAR remain those of insider dealing, unlawful disclosure of inside information, and market manipulation, although these have been broadened in scope. In addition, where procedures are specified to ensure compliance, these have, generally, been revised or are new requirements.

> As MAR applies to more types of financial instrument and a wider range of trading venues, some issuers and investors who were not caught by the old market abuse regime will need to become familiar with new compliance obligations



The market soundings regime is a welcome safe harbour but requires participants to put in place detailed compliance procedures to take advantage of it

Inside information and insider dealing

The definition of inside information is broadly unchanged from the old UK regime. However, it is extended to cover price sensitive information relating to spot commodity contracts, as well as emission allowances and auctioned products based on them. Given that the changes are not substantial, we expect that the previous guidance and bases of interpretation, including decisions such as that of the Upper Tribunal in the Hannam case, will continue to be relevant.

Whilst largely the same as under the old UK regime, the offence of insider dealing has been widened, and now includes the cancellation or amendment of an order after coming into possession of inside information.

Unlawful disclosure and the market soundings safe harbour

The prohibition on unlawfully disclosing inside information, that is, disclosing it other than in the normal course of a person's employment, profession or duties, remains. However, MAR introduces a useful safe harbour regime for the disclosure of inside information as part of a market sounding, which would otherwise be unlawful.

The recitals to MAR describe a market sounding as an interaction between a seller of a financial instrument and one or more potential investors prior to the announcement of a transaction in order to gauge the interest in a possible transaction and its pricing. By complying with certain provisions, a person who disseminates information as part of a market sounding (known in MAR as a disclosing market participant or DMP) can protect himself against allegations of unlawful disclosure. Whilst MAR specifies many of the conditions that a DMP must comply with to gain the benefit of the safe harbour, the detailed arrangements, systems and procedures (including certain prescribed form templates) are contained within Technical Standards.

Key obligations of the compliance regime will include the need for the DMP to:

- ascertain who does and who does not wish to receive market soundings,
- provide recipients with certain information when providing them with a sounding,
- assess whether the sounding includes inside information,
- assess when inside information ceases to be so, and inform the recipient of this, and
- keep records for 5 years (many in a prescribed form) and provide them to the FCA on request.

It will not only be DMPs who will have to comply with procedures in order to avail themselves of the safe harbour – recipients of market soundings will also have to follow certain rules and put in place training and procedures. Such recipients (known as a market sounding recipient or MSR) will have to comply with a separate set of guidelines. The final form of the guidelines was published by ESMA on 13 July 2016 – see the resources section below for a link to the text.

Exceptions to the inside information offences

In addition to the market soundings regime mentioned above, MAR includes two exemptions to the offence of insider dealing and the unlawful disclosure of inside information. The first is that of legitimate behaviour.

MAR recognises that it is necessary to recognise certain legitimate behaviour so as to avoid inadvertently prohibiting forms of legitimate financial activity where there is no effect of market abuse. This may include, for example, recognising the role of market makers when acting in the legitimate capacity of providing market liquidity. Importantly, this exception also covers having access to inside information relating to another company and using it in the context of a public takeover to gain control of that company or proposing a merger with that company. This exception does not, however, apply to stake-building.

Buy-backs and stabilisations are also excluded from the inside information offences – see the market manipulation section below.

Requirement to disclose inside information and the ability to delay disclosure

The obligation to disclose inside information as soon as possible remains. MAR also includes provisions very similar to those under the old UK regime to enable issuers to delay disclosure provided that certain conditions are met. These are that:

- immediate disclosure is likely to prejudice legitimate interests,
- delay of disclosure is not likely to mislead the public, and
- the issuer is able to ensure the confidentiality of the information.

To assist issuers in determining whether the first two conditions can be satisfied, ESMA is tasked with producing guidelines on what might constitute a “legitimate interest” for delay, and when a delay in disclosure may be likely to mislead the public. The final form of the guidelines was published by ESMA on 13 July 2016 – see the resources section below for a link to the text.

In addition to having to comply with the conditions specified above, if an issuer delays disclosure, it must notify the FCA of the delay at the time that it actually makes the disclosure. MAR provides that member states may then require issuers to either:

- provide a written explanation of how the conditions were satisfied; or

– provide such an explanation if requested to do so by the competent authority.

In the UK, issuers need only provide the explanation when asked to do so by the FCA.

Financial institutions have the benefit of a new provision enabling them to delay disclosure where it may entail a risk to their financial stability. Again, conditions must be satisfied, and, in this situation, consent from the competent authority must be obtained before disclosure is delayed.

Insider lists

As under the previous UK regime, MAR requires issuers to maintain up-to-date lists of persons with inside information. Each list must be retained for 5 years. The precise format of the lists and the basis for updating them are contained in Technical Standards. The format and content of the list is more prescriptive than under the old regime and require additional information to be recorded.

To alleviate the burden on smaller companies, SME growth market issuers (which will include AIM companies) will not have to maintain insider lists provided certain conditions are satisfied, including that they are able to provide the competent authority with a list on request. Whilst this will be a welcome relaxation for qualifying issuers, the relevant provisions are not due to come into force until MIFID II becomes law. This is because certain terms in MAR, including “SME growth market”, are dependent on MIFID II. MIFID II is due to become law on 3 January 2018.

Managers’ transactions

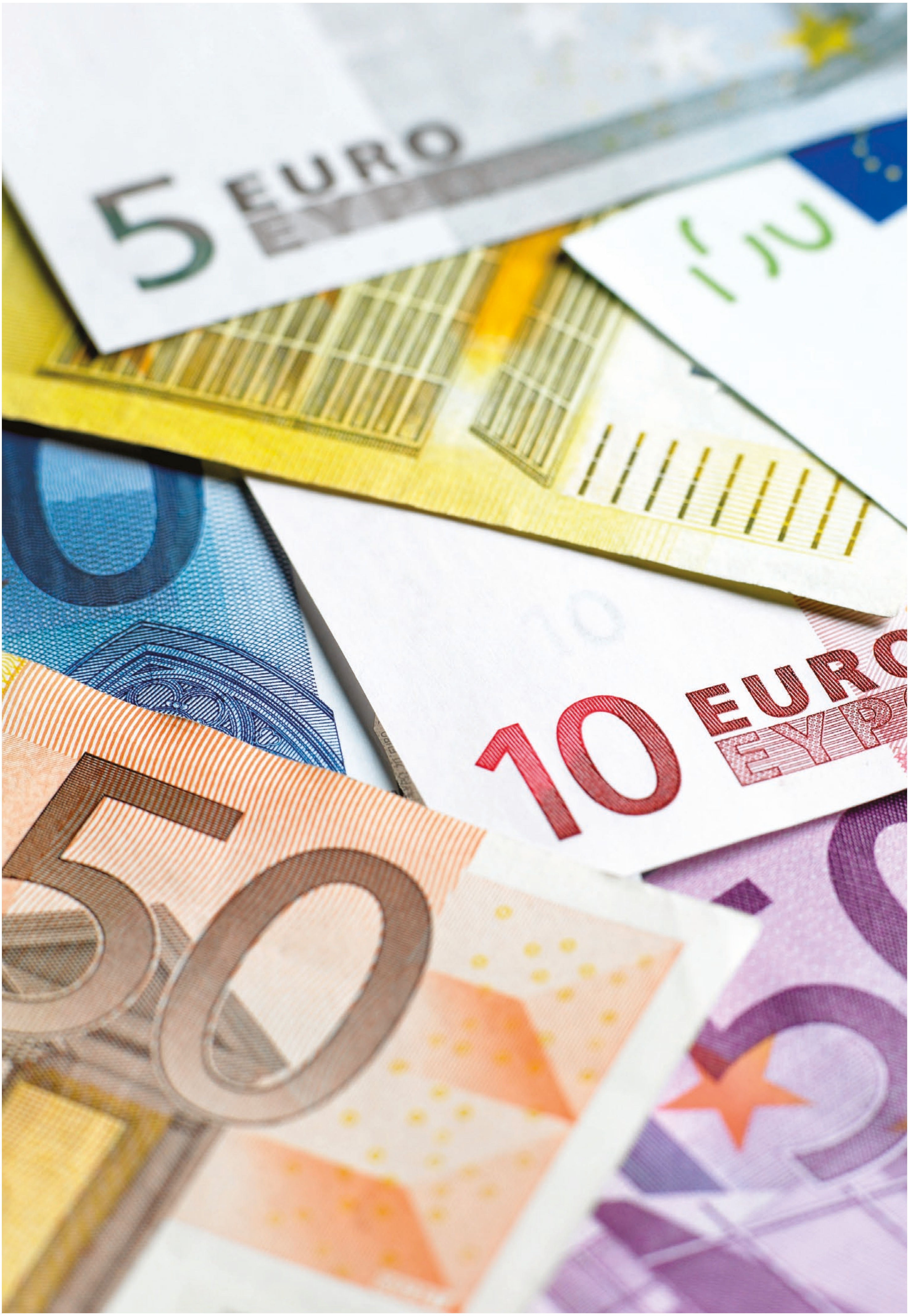
MAR contains similar provisions to those under the old UK regime which regulate transactions in an issuer’s financial instruments by its managers and persons closely connected with them, although there are some important distinctions including around the concept of close periods.

A key change is that persons discharging managerial responsibilities (PDMRs) and persons closely associated with them (often referred to as PCAs) will have to notify not only the issuer but also the FCA of transactions by them in the issuer’s instruments.

The issuer must then make the information public. The time limit for notifying the issuer/FCA is reduced from four to three business days after the transaction, and the issuer must publish the details within the same time limit. For this reason, in their internal compliance procedures, many issuers are choosing to require PDMRs to notify them within two business days so that the issuer can in turn meet the deadline for publishing the details.

Further details are included in Technical Standards which supplement MAR. These include the format and template in which the information is to be notified and made public. The level of information required is greater than under the old UK regime. However, whilst MAR imposes a slightly more onerous set of procedures, it does introduce an annual threshold so that PDMRs do not have to make any notification until this has been met. MAR enables competent authorities to choose to set this threshold at either €5,000 or €20,000. In the UK, the FCA has set it at €5,000.

Whilst MAR is aimed at harmonising rules across the EU, the ability to delay disclosures of inside information is one area where member states may apply different rules



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Managers must continue to disclose dealings but, whilst the regime is more onerous, it is subject to an annual limit before it applies – this is another area where member states can choose to apply slightly different rules – as such, limits of either €5,000 or €20,000 may apply in different member states

A further area which sees a step change regarding managers' dealings is the period during which dealings are prohibited. The UK provisions used to be set out in the Disclosure Rules and the Model Code which formed part of the FCA's Listing Rules. Under these rules, dealings were prohibited during a "close period" and any period when there existed any matter constituting inside information. A close period was, broadly, the shorter of either 60 days before announcement of the issuer's yearly or half yearly results or the period from the end of the relevant accounting period until the announcement of such results.

Under MAR, PDMRs are only prohibited during what is referred to as a "closed" period. This is defined as the period of 30 calendar days before the announcement of an interim financial report or year-end report which the issuer is required to publish under either the rules of the relevant trading venue or national law. In the UK, it is usual for issuers to publish preliminary announcements some time before they publish their actual reports, but, because preliminary announcements are not a UK requirement, there was a concern that, under MAR, they would not bring a closed period to an end, as they used to under the, now defunct, Model Code. Due to this concern, the FCA issued a clarificatory statement shortly before MAR became law confirming that, subject to contrary advice from ESMA, it will treat preliminary announcements as ending a closed period under MAR.

MAR contains some exceptions to the prohibition on PDMR dealings during a closed period, and these are supplemented by more detailed provisions set out in a Delegated Regulation (2016/522). The exceptions cover not only situations such as severe financial difficulty of the PDMR, but also dealings under employee share schemes.

As part of its review of the FCA Handbook for the purpose of ensuring compatibility with MAR, the FCA originally proposed replacing the Model Code with guidance for companies to use when creating internal procedures for PDMRs applying for clearance to deal. However, on reflection, the FCA concluded that implementing this proposal would be unnecessarily onerous on issuers and PDMRs and would not provide the legal certainty needed by stakeholders. As a consequence, the FCA decided that the Model Code would be deleted and it therefore no longer forms part of the FCA Handbook. Nonetheless, the FCA noted that it would support development of industry-led codes of best practice, and, on 24 June 2016, a specimen dealing code and policy was published jointly by ICSA, the Quoted Companies Alliance (QCA), and the GC100 – see the resources section below for a link.

Market manipulation

Not only does the market manipulation offence remain a key component of MAR, but it has also been widened in scope. The three key areas where MAR differs from the previous regime are:

– attempted market manipulation is now caught,

– manipulation of benchmarks is now in scope (this was already a criminal offence in the UK), and

– certain algorithmic trading strategies which disrupt the functioning of a trading venue now amount to manipulation.

Changes to the concept of a "closed period", and a new definition of persons closely associated with PDMRs, are part of a revised regulatory landscape in respect of managers' dealings

Exceptions to the manipulation offences

MAR includes two possible exemptions from the manipulation offences – accepted market practices and buybacks and stabilisations.

Accepted market practice (AMP) – despite the Commission wanting to remove this concept from MAR because it was concerned that it leads to a lack of harmonisation across the EU, it was retained following representations from certain member states. An AMP requires a member state to apply to its competent authority for certain behaviour to be exempted because it is a behaviour that can be reasonably expected to occur in that national market. MAR provides a tightly regulated framework around the recognition of AMPs. There were no AMPs under the old UK regime and none are currently proposed for the UK under MAR.

Buy backs and stabilisations – this is the second exception to the manipulation offences. Importantly, it also applies to the inside information offences. This exception recognises that trading in own shares as part of a buy-back programme or as part of a stabilisation measure can be legitimate in certain circumstances and provided that certain criteria are met. The exemption is broadly the same as that provided for under the old UK regime. The relevant MAR provisions are supplemented by Technical Standards.

Comment

MAR has meant that issuers have had to review their compliance procedures, systems and training programmes to ensure that they are compliant with MAR with effect from 3 July 2016. However, as some guidance is still awaited in final form, and as market practice develops, it is likely that issuers will need to keep these under review and adapt them over time.

If you have any questions about the new market abuse regime or if you would like to discuss the impact it may have on your business, including your systems and procedures, please contact any of the listed contacts to this note or your usual Hogan Lovells contact.

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Resources

Below are links to the underlying materials referred to in this note (if you are reading this in hard copy, please access the note in soft copy from www.hoganlovells.com to use the hyperlinks). NB, the materials listed here do not reflect the complete MAR framework.

The Market Abuse Regulation (596/2014)

EU Regulation 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending various EU Directives including MAR

Regulatory Technical Standards (2016/1052):

the conditions applicable to buy-back programmes and stabilisation measures

Regulatory Technical Standards (2016/960):

the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings

Implementing Technical Standards (2016/959):

the systems and notification templates to be used by disclosing market participants and the format of the records for market soundings

Implementing Technical Standards (2016/1055):

the technical means for appropriate public disclosure of inside information and for delaying the public disclosure of inside information

Implementing Technical Standards (2016/347):

the format of insider lists and method for updating insider lists

Implementing Technical Standards (2016/523):

the format and template for notification and public disclosure of managers' transactions

Delegated Regulation (2016/522):

exemption for certain third countries' public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers transactions

ESMA Final Report (2016/1130) – guidelines

- for persons receiving market soundings, and
- on legitimate interests of issuers to delay inside information and situations in which the delay of disclosure is likely to mislead the public

ICSA, QCA and GC100 specimen share dealing code and policy document

The Financial Services and Markets Act 2000 (Market Abuse) Regulations 2016 (SI 2016 No. 680)

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