ESMA Publishes Consultation Paper on the Market Abuse Regulation

11 October 2019

Introduction

The Market Abuse Regulation (MAR)[1] has been directly applicable in EU Member States since 3 July 2016. It extended the scope of the previous EU insider dealing and market abuse regime under the Market Abuse Directive.

On 3 October 2019, the European Securities and Markets Authority (ESMA) published a consultation paper (the Consultation Paper) on MAR.[2] This follows a request for technical advice from the European Commission, which is required by Article 38 of MAR to present a report assessing various provisions of MAR to the European Parliament and the Council of the European Union.

The Consultation Paper is primarily directed at issuers of financial instruments admitted to trading or traded on EU trading venues, investment firms, asset management companies and persons discharging managerial responsibilities (PDMRs) in issuers. Therefore, it will be of particular interest to investment banks, companies with an equity and/or debt listing in the EU and their advisors.

The Consultation Paper considers and requests market participants' views on the following topics:

- the possibility of extending the scope of MAR to include spot FX contracts;
- the scope of the benchmark provisions of MAR;
- the definition of inside information;
- the delayed disclosure of inside information;
- market soundings;
- insider lists;
- PDMRs;
- buy-back programmes;
- collective investment undertakings; and
- market surveillance by national competent authorities.

Spot FX contracts

The scope of MAR is set out in Article 2. It applies to (i) financial instruments that are admitted to trading or for which a request for admission to trading on a regulated market has been made, (ii) financial

[1] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC. The text of MAR can be found **here**.

[2] Consultation paper (ESMA70-156-1459): MAR Review Report. The Consultation Paper can be found **here**.

instruments that are admitted to trading or for which a request for admission to trading on a multilateral trading facility has been made, (iii) financial instruments traded on an organised trading facility, and (iv) financial instruments not covered by points (i) to (iii) the price or value of which depends on or has an effect on the price or value of any financial instrument referred to in points (i) to (iii).

Foreign exchange spot transactions do not constitute financial instruments as defined in the recast Directive on Markets in Financial Instruments (MiFID II)[3] and are consequently outside of the scope of MAR. Article 2(2)(a) of MAR extends the prohibitions on insider trading and market manipulation to certain spot commodity contracts which could have an effect on the price or value of an in-scope financial instrument but this currently does not cover spot foreign exchange.

The Consultation Paper describes examples of misconduct in the spot FX market to support expanding the scope of MAR; however, it also identifies a number of practical difficulties associated with including spot FX. In particular, spot FX is predominantly an over-the-counter market that relies on non-MiFID II trading venues where prices are often determined not on the interactions of supply and demand, but instead on the relationship and creditworthiness of the counterparties. The Consultation Paper also notes that key concepts in MAR would need to be adapted in order to make them workable in the spot FX context and that extending the scope of MAR to spot FX in the same manner as it applies to spot commodity contracts (i.e.: expanding the prohibition of market manipulation to cases where a transaction, order or behaviour in a spot FX contract/financial instrument has or is likely or intended to have an effect on the price or value of a financial instrument/spot FX contract) would raise practical difficulties. In addition, the Consultation Paper notes that any extension would increase the administrative and cost burden on National Competent Authorities (NCAs) such as the Financial Conduct Authority (FCA) and market participants.

The scope of the application of the benchmark provisions of MAR

The Consultation Paper considers that, as MAR deals with the prohibition of the attempted manipulation of benchmarks, while the Benchmarks Regulation (BMR)[4] focuses on the provision, calculation, administration and use of benchmarks, MAR and the BMR are complementary regulatory frameworks. However, it notes that certain definitions and other operative provisions in MAR should be updated with respect to benchmarks, for example, administrative sanctions for manipulation of benchmarks should expressly include administrators of and contributors to benchmarks.

The definition of inside information

The definition of inside information in MAR applies to four distinct subsets of inside information: (i) financial instruments generally (e.g. shares, bonds, derivatives), (ii) commodity derivatives specifically, (iii) emission allowances or auctioned products based thereon, and (iv) the scope of inside information for persons charged with the execution of orders in financial instruments. In each case, inside information means information which is precise, relates directly or indirectly to an issuer or a financial instrument, has not been made public, and would, if made public, be likely to have a significant effect on the price of the relevant financial instrument or on the price of a related derivative financial instrument.

---

[3] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast). The text of MiFID II can be found **here**.

[4] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014. The text of the BMR can be found **here**.

The Consultation Paper examines whether the definition of inside information is effective in enabling NCAs to combat market abuse and asks market participants if the definition could be improved with respect to (i) commodity derivatives, (ii) front running conduct (i.e. where a broker is aware of a forthcoming client order or transaction and uses that information to acquire or dispose of a financial instrument ahead of the relevant order or transaction) and (iii) pre-hedging activities.

Delayed disclosure of inside information

MAR requires an issuer to inform the public as soon as possible of inside information which directly concerns it. An issuer may delay disclosing inside information to the public in order to protect its legitimate interests and where the relevant information can be kept confidential and the delay will not mislead the market. Where an issuer decides to delay disclosure, immediately after the information is disclosed to the public, it must inform the NCA that the disclosure of inside information was delayed and, at the discretion of the NCA, provide a written explanation on how the conditions described above were met.

The Consultation Paper requests market participants' views on whether the conditions for the delay of disclosure are sufficiently clear for issuers to effectively rely on them in order to delay disclosure. It explains that the Commission has received indications that the delay of disclosure of inside information is used to a varying extent across jurisdictions in the EU which is contrary to the harmonised approach originally intended through the introduction of MAR. In some Member States, issuers regularly rely on the mechanism in MAR that permits delayed disclosure of confidential information, whereas in other Member States it is used on an exceptional basis. One of ESMA's objectives is to identify the reasons for this divergent approach to delaying disclosure.

The Consultation Paper asks for market participants' views on the obligation to notify NCAs of the delay of disclosure of inside information where the information has subsequently ceased to be inside information. According to the Questions and Answers on the Market Abuse Regulation, in these circumstances an issuer is neither obliged to publicly disclose the information nor to inform the NCA of the reasons for delaying disclosure. However, ESMA explains in the Consultation Paper that the notification for delayed disclosure, even where the information ceases to be inside information, would enable NCAs to better identify possible cases of insider dealing. The Consultation Paper also asks for market participant's feedback on the potential inclusion in MAR of a requirement for issuers to establish and maintain effective arrangements, systems and procedures for the identification, handling and disclosure of inside information.

Market soundings

Under MAR, unlawful disclosure of inside information arises where a person discloses inside information other than in the normal exercise of an employment, profession or duties. MAR provides a safe harbour for the disclosure of inside information which is carried out in accordance with the market sounding procedures set out in Article 11 of MAR and Delegated Regulation 2016/960 (the Delegated Regulation)[5]. A market sounding comprises the communication of information, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as its potential size or pricing. The disclosure of inside information by a person intending to make a takeover bid for the securities of a company or a merger with a company also

[5] Commission Delegated Regulation (EU) 2016/960 of 17 May 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings. The text of the Delegated Regulation can be found **here**.

constitutes a market sounding provided that the information disclosed is necessary to enable the shareholders in the target company to form an opinion on their willingness to offer their securities and the willingness of such shareholders to offer their securities is reasonably required for the decision to make the takeover bid or merger. Note that the definition of market sounding is not limited to the communication of inside information only; it covers any information relating to a potential transaction. For that reason, market participants may follow the market sounding procedures even where the information being disclosed is not considered to be inside information in order to rely on the safe harbour should it subsequently be shown that the information disclosed was inside information.

The Consultation Paper considers reformulating the market soundings obligations in MAR to clarify its obligatory rather than optional nature, i.e. that whenever a behaviour meets the definition of a market sounding the relevant obligations apply. The Consultation Paper also considers establishing administrative sanctions for failure to comply with the prescriptive market sounding procedures in MAR and the Delegated Regulation, irrespective of any further sanctions which may apply to conduct constituting market abuse or unlawful disclosure of inside information. Moreover, it discusses the possibility of limiting the definition of market sounding (for example, excluding certain types of transactions) and simplifying the market sounding procedures.

Insider lists

The Consultation Paper notes the importance of insider lists to NCAs in the context of market abuse investigations. It considers:

- possible changes to ensure that only insiders who actually access inside information are included on insider lists;
- expanding the requirement to apply to anyone accessing inside information, even if they do not have a specific relationship with or act on behalf of or on the account of the issuer; and
- the role of the permanent insider list.

Persons discharging managerial responsibilities

MAR imposes reporting obligations and dealing restrictions on PDMRs and their closely associated persons. The Consultation Paper contemplates increasing the minimum reporting threshold for PDMRs from EURO 5,000 on an EU wide basis and whether NCAs should retain the option of keeping a higher threshold. It also discusses whether the prohibition on PDMRs dealing during a closed period of 30 days before the announcement of an interim financial report or year-end-report is working well and whether it should be extended beyond PDMRs to also include issuers and closely associated persons. In addition, the Consultation Paper considers whether additional exemptions from the closed period no dealing obligation should be considered.

Buy-back programmes

Under MAR, buy-back programmes are able to benefit from an exemption from certain provisions of MAR provided that the issuer reports each transaction relating to the buy-back programme to the NCAs of the trading venues on which the shares are admitted to trading and also to the NCAs of each trading venue where the shares are traded. In ESMA's view, this creates a compliance problem as issuers are not necessarily aware of all of the trading venues on which their shares are traded. For that reason, the Consultation Paper asks for the views of market participants on whether, in the context of buy-back programmes, the scope of the reporting obligation should be limited to only the NCAs of the trading venues where the issuer requested admission to (or approved) trading. The Consultation Paper also considers whether the content of information to be reported should be amended, in order to avoid placing an excessive compliance burden on issuers.

Collective investment undertakings

The Consultation Paper considers whether Collective Investment Undertakings (e.g.: Collective Investment Undertakings in Transferable Securities (UCITS) or Alternative Investment Funds (AIFs)) admitted to trading or trading on a trading venue should be differentiated with respect to other issuers, specifically with respect to PDMR obligations, disclosure of inside information and insider lists. Currently, Collective Investment Undertakings can be considered "issuers" under MAR, even those without legal personality.

Market surveillance by national competent authorities

The Consultation Paper discusses the possibility of establishing an EU framework for cross-market order book surveillance in relation to market abuse and issues relating to both the lack of administrative sanctions in certain jurisdictions and the cross-border enforcement of sanctions.

Next Steps

The consultation closes to responses on 29 November 2019. ESMA intends to submit its final review report to the European Commission by Spring 2020. Any changes stemming from the Consultation Paper are unlikely to take effect for some time.

In the context of the UK's withdrawal from the EU, steps have been taken to incorporate MAR into UK domestic law. Moreover, the UK has indicated that it intends to maintain a degree of regulatory alignment with the EU post-withdrawal. However, considering that it will be some time before any of the topics raised in this consultation paper form the basis for concrete legislative changes to MAR at the EU level, it is not possible to predict whether any changes to EU MAR will be incorporated into a post-Brexit UK version of MAR.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Dan Hirschovits	020 7418 1023	dan.hirschovits@davispolk.com
Will Pearce	020 7418 1448	will.pearce@davispolk.com
Simon Witty	020 7418 1015	simon.witty@davispolk.com
Mark Chalmers	020 7418 1324	mark.chalmers@davispolk.com
Jennifer Duffy	020 7418 1067	jennifer.duffy@davispolk.com