

Expanding the Market Abuse Regime for European Securities and Investments - What Impact for Investment Managers?

The European Commission has published legislative proposals for a new Market Abuse Directive (the “New Directive”) and a new Market Abuse Regulation (“MAR”) to replace the current Market Abuse Directive (“MAD”) which underpins the laws on insider dealing and market manipulation throughout the European Union (“EU”). MAR will introduce a single directly applicable rulebook governing market conduct throughout the EU to be enforced via Member State administrative sanction. The New Directive will require all Member States to introduce criminal sanctions for intentional insider dealing and market manipulation. As the Council of Ministers and European Parliament will require time to negotiate and finalise the proposals, the timing of the implementation of the new Directive and MAR is uncertain although it is only likely to come into effect in 2014.

More instruments, more trading venues

Currently, MAD applies to financial instruments admitted to trading on an EU regulated market. MAR will extend this to cover instruments traded on a multilateral trading facility (“MTF”) and organised trading facility (“OTF”) as defined in the proposed Markets in Financial Instruments Regulation (“MIFIR”). It also extends the market manipulation prohibition to instruments whose value relates to the traded instruments, e.g. an OTC derivative referenced to a security traded on the Irish Stock Exchange (under MAD, the related instruments prohibition applies only to insider dealing). MAR expressly recognises an OTC credit default swap (“CDS”) as an example of a related instrument. MAR will also extend the scope of the regime to capture emissions allowances.

Investment managers will need to reconsider the scope of their trading policies and practices. In particular, those managers who operate outside the EU will need to consider their actions with respect to any instrument which simply happens to be admitted to trading on an MTF located in the EU. Moreover, in light of the requirements proposed under MIFIR that many OTC derivatives, such as a CDS, be traded on OTFs, MAR will be relevant to conduct related to any instrument, such as an unlisted debt security, referenced under a CDS traded on an OTF.

Insider dealing: no longer simply a case of price-sensitive information

Under MAD, insider dealing or improper disclosure can only occur with respect to non-public information of a precise nature that would be likely to have a significant effect on the price of the relevant financial instruments. MAR expands this definition to make it clear that inside information includes information that a reasonable investor would regard as relevant when deciding the terms of a transaction. MAR creates an express defence for legal persons who put in place effective Chinese Walls but does not otherwise reverse the *Spector Photo Group* decision in which the European Court of Justice held that it is unnecessary to prove that inside information influenced a decision to deal.

Investment managers who are in possession of confidential information will no longer be able to limit their enquiry as to whether the information is precise and price sensitive but will need to ask whether a reasonable investor would regard the information as relevant to the decision to trade in the relevant instrument. This may have the effect of further aligning the market abuse regulatory regime with industry standards, such as the Loan Market Association Guidelines on dealing with confidential and price sensitive information, and civil laws governing breach of confidence or misappropriation of information. This may mean, in practice,

that managers who come into possession of confidential information regarding the issuer of any debt security will need to consider the market abuse position.

The fact that the definition of inside information will not change for the purposes of determining whether an issuer of a financial instrument is required to make a public disclosure will not help the investment manager. Nor will the fact that the disclosure obligation will not apply to issuers who have not approved trading of their financial instruments on an EU regulated market, MTF or OTF. Under MAR, an investment manager will no longer be able to derive comfort from the fact an issuer has not publically disclosed the piece of information in respect of which the manager has doubts. Of course, even under MAD, issuers can delay public disclosure, a privilege that MAR will retain. However, under MAR issuers will now be duty bound to notify the delay to the competent authority without delay.

Market manipulation: a broader category of behaviour, commodity contracts caught

Under MAR, market manipulation will catch any behaviour, not just transactions and orders to trade that may give a false or misleading signal or otherwise fall within the other categories of market manipulation currently caught by MAD. MAR extends those categories of behaviour to capture algorithmic or high frequency trading undertaken without an intention to trade but for the purpose of, *inter alia*, disrupting or delaying the trading system. MAR also seeks to punish “attempted market manipulation” in cases where someone tries to manipulate the market without actually trading. Generally, reliance on accepted market practices will no longer provide a defence.

MAR will extend the market manipulation provisions (but not insider dealing) to behaviour in spot commodity contracts, excluding wholesale energy products, which are related to or have an effect on financial or derivatives markets.

For investment managers who employ algorithmic or high frequency trading as part of their strategies and those whose strategies allow them to trade in the spot commodity markets, MAR introduces further elements of regulatory risk that their systems and controls will need to address. As to commodity derivatives, MAR also aligns the definition of inside information with the general definition of inside information thereby capturing information which is relevant to the related spot commodity contract.

Enforcement: more power, heavier penalties

MAR seeks to reinforce the powers of the relevant Member State authorities to detect market abuse. It extends the duty under MAD to report suspicious transactions to orders and to OTC transactions. It also gives authorities the power to obtain existing telephone and data traffic records from telecoms operators and to gain access to private documents or premises (subject to judicial warrant) where there is a reasonable suspicion of insider dealing or market manipulation.

The New Directive identifies the offences of intentional insider dealing and intentional market and requires Member States to make them punishable by measures that are effective, proportionate and dissuasive. It also requires Member States to criminalise inciting, aiding and abetting insider dealing and market manipulation, as well as attempts at these forms of market abuse, and extends liability to legal persons.

If you have any additional questions about MAD, MAR or the New Directive, please contact [Andrew Henderson](mailto:andrew.henderson@ropesgray.com) in our London office at andrew.henderson@ropesgray.com or +44 (0)20-3122-1277.