AUTORITÉ DES MARCHÉS FINANCIERS

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Europe strengthens its market abuse regulations

Starting 3 July 2016, Europe will have a reformed framework for combatting market abuse.
The Market Abuse Regulation (MAR) published 12 June 2014 and related technical standards were and will apply early this summer, replacing the Market Abuse Directive of 28 January 2003. The main changes have to do with the scope of application, market transactions, tools for prevention and detection, and administrative sanctions.

Summary

Introduction

Adopted with a host of post-crisis regulatory reforms, the European Market Abuse Regulation aims to improve financial market integrity and investors' protection by updating and strengthening the current system for combatting market abuse, extending its scope of application to new markets and new trading strategies, and introducing new requirements. The European Commission is expected to publish implementing measures shortly that will pave the way for the regulation's application. To this end, the ESMA sent its technical advice on future delegated acts and draft technical standards to the European Commission in 2015. The mechanism will also be supplemented by three Guidelines the ESMA will write in accordance with the regulation.

Expanded scope of application

Previously limited solely to regulated markets, the regulation extends the scope of the Community's market abuse mechanism to, notably, instruments traded on multilateral trading facilities (MTF) or organised trading facilities (OTF), emissions allowance auctions,and trading, and spot commodities contracts whose value is linked to a financial instrument. In addition, certain provisions also explicitly target index manipulation.

In France, the Law of 26 July 2013 on the Separation and Regulation of Banking Activities anticipated many of these changes (extending the prohibition of market abuse to instruments traded solely on MTFs, the prohibition of index manipulation and the prohibition of "cross-market abuse" involving commercial contracts on commodities whose value is linked to financial instruments).

Indicators of market manipulation

Given the MAR's scope of application and recent technological developments (characterised by increased use of algorithmic trading and high-frequency trading, cross-market and cross-product trading, and the creation of highly varied financial instruments), the European Commission will be adopting delegated acts to clarify the indicators of market manipulation listed in Annex 1 of the MAR and, if necessary, to introduce new ones.

Executing a transaction based on information supplied by an insider

The MAR targets a new form of market abuse by considering as insider dealing instances of a non-insider carrying out a transaction based on a recommendation or an invitation to buy or sell coming from an insider, provided that the person knows or should know that the recommendation/invitation is based on inside information.

Transactions and market pratices qualifying for safe Harbour

The European regulation introduces new information and clarifies practices such as market soundings prior to a financial transaction. It also details the conditions under which issuers' share buyback programmes and stabilisation operations must be executed if they are to enjoy safe harbour.

Market sounding

Owing to a joint initiative by France and the UK, the MAR includes a new article on market sounding that notably stipulâtes:

- an assessment of the nature of the information (inside or not) that the sounding firm is preparing to disclose;
- the conditions, notably for record-keeping, under which inside information may be legitimately disclosed in the course of market soundings;
- the obligation to inform the persons sounded once the information being disclosed ceases to be inside information;

Conversely, the article also imposes an obligation on the person sounded to make their own assessment of the nature of the disclosed information.

The draft RTS and ITS contain clarifications notably on the procedures and practices for conducting soundings and for record-keeping obligations.

Accepted market practice (AMP)

The regulation also covers investment recommendations (article 20) With no significant changes made to the level 1 text, the draft RTS draws heavily on the MAD implementing directive 2003/125/EC.
The principal adjustments deal with expanding the scope of the provisions that previously targeted only persons producing financial analysis professionally. The provisions' scope is being expanded to include gradually all persons producing investment recommendations. The concept of the "expert" is introduced.
The second significant change has to do with disclosing conflicts of interest. Until now, any long position (buyer) held in excess of a 5% threshold had to be disclosed in the financial analysis. Now, the draft RTS requires the issuer of the recommendation to disclose if it owns

a net long or short position exceeding the threshold of 0,5% of the total issued share capital of the listed company to which the recommendation relates.

The MAR substantially strengthens the transparency requirements that must be followed with respect to the public and competent authorities before, during and upon completion of implementing an accepted market practice (AMP).

In the absence of a grandfather clause for current practices, the MAR requires them to be re-examined by competent authorities in the light of a set of criteria and according to a procedure detailed in the draft RTS, with the results reported to the ESMA by the national competent authority.

Share buybacks

While the MAR maintains the provisions currently governing buyback programmes, some fairly significant changes have been introduced by the draft technical standards the ESMA has sent to the European Commission.

For example, to enjoy safe harbour, transactions must be made on a regulated market or MTF. Furthermore, the use of derivative instruments does not qualify for safe harbour.

With respect to market intervention, restrictions on price and volume will be assessed as a function of the market on which the transactions are planned, and where shares are traded through a continuous trading process, the safe harbour provision will not apply to interventions carried out during auction phases.

Lastly, except under certain conditions, issuers may not sell shares while a buyback programme is being implemented or trade during a restricted period similar to the one during which directors must refrain from making trades.

Stabilisation measures

The draft RTS clarify how stabilisation operations may be implemented by using derivatives, where trading may take place within the safe harbour, related reporting obligations, and the market practice known as «refreshing the Greenshoe», which consists of a sale of shares by an institution conducting stabilisation operations to restore its purchasing capacity in order to deal with a potential subsequent downward movement.

Issuers management of insider information

Publishing inside information

The Market Abuse Regulation differs from the Directive with respect to publishing inside information on two points:

- introducing the possibility for financial institutions to delay publication for financial stability reasons under certain conditions,
- introducing an obligation to inform the competent authority that the publication has been deferred in writing at time when inside information is published, if the competent authority requests it, and to state the manner in which the preconditions have been met.

The draft technical standard specifies the technical procedures for publishing inside information, and the procedures according to which the publication of inside information is deferred.

The content and format of the insider lists and the format for updates

The MAR differs little from the 2003 directive with respect to insider lists. However, a new provision gives an exemption to issuers whose financial instruments are admitted to trading on an SME Growth Market provided, on the one hand, that they ensure that persons with access to inside information understand the relevant legal and regulatory obligations, and, on the other hand, that they can provide the competent authority with a list of insiders upon request.

The draft technical standards (ITS) cover the exact format for insider lists and how they are updated.

Notification and publication of disclosures by senior managers

The obligation for senior managers to disclose their transactions was included in the 2003 directive. The MAR reinforces this obligation by:

- reducing the time frame for disclosure from five to three days;
- introducing at level 1 (text adopted by legislators) not only a “negative window”, i.e. a rule against senior managers of listed companies trading in the financial instruments of issuers to which they are linked in the month preceding the publication of annual and

half-yearly reports, but also the ability for issuers to authorise certain transactions during this window under certain conditions.

The draft technical standards (ITS) lay out the format issuers must use to report information to the competent authority, and the template to be used for reporting transactions.

Reporting suspicious behaviour

Report by financial institutions

Article 16 of the MAR strengthens the mechanism for reporting suspicious behaviour (suspicious transaction and order report, or STOR) by expanding the system created by the Market Abuse Directive of 28 January 2003.

French regulations had already largely anticipated this development:

> by including the notion of “suspicious orders” into that of “suspicious behaviour”, irrespective of whether or not orders are executed, altered or cancelled;

> by extending the obligation to report suspicious behaviour in relation to:

- instruments that can be traded solely on a so-called ‘organised’ MTF (OMTF), with such platforms also being subject to the prohibition of market abuse,
- financial instruments linked to instruments admitted to a regulated market or traded on an OTF.

The MAR goes further, however. The mechanism for reporting suspicious transactions and orders now includes the following:

Implementation measures The implementation measures for the European Market Abuse Regulation may take the form of delegated acts, proposed by the European Commission based on technical advice from the ESMA. They may also take the form of regulatory technical standards (RTS) or implementing technical standards (ITS) proposed by the ESMA and adopted by the European Commission. These measures will then be subject to an approval procedure by the European Parliament and Council.

- attempted market abuse;

- attempted or actual market abuse in relation to an instrument that can be traded on a “standard” MTF (such as the Marché libre) or on a future OTF, or a related instrument;
- attempted or actual manipulation of a spot commodity contract related to a financial instrument.

Furthermore, the new mechanism apply to a larger number of participants, as trading venues are now subject to it.

The technical standards will specify the reporting procedures, the level of automation of the detection systems and procedures, the record-keeping obligations, and the conditions under which participants may delegate the function of detecting suspicious orders and transactions.

Whistleblowing

The MAR introduces a new mechanism to allow whistleblowers to report any actual or potential infringement of the said regulation to the competent authorities. The European Commission has adopted an implementing directive to specify the procedures for receipt of reports of infringements and their follow-up by the competent authorities. The directive also defines the procedures designed to protect the whistleblower (notably in the context of his/her employment) and the reported person.

Sanctions

The MAR contains important provisions on the nature of the measures and sanctions that must be available to Member State regulators and how they are publicised, in parallel with the penal sanctions provisions in Directive 2014/57/EU (“MAD II”). It also contains newer provisions on the amounts of administrative sanctions and the criteria used to determine the level of sanctions. These provisions are written with some room for adaptation, as if they were part of a directive, and will be transposed by the “Sapin II” law, with provisions equivalent to those of the MiFID II Directive, the UCITS V Directive, the PRIPS Regulation and the Central Securities Depositories Regulation (CSDR). The provisions of the revised Transparency Directive were recently transposed.

Administrative sanction amounts

The MAR states that competent authorities must at least have the power to enforce administrative pecuniary sanctions at least three times the amount of the profits gained from the infringement or the losses avoided, if such amounts can be determined. If the

profits or losses cannot be determined, natural persons found guilty of market abuse must be assessed sanctions of at least €5 million and legal persons, at least €15 million or 15% of their total annual turnover.

Article L. 621-15 of the Monetary and Financial Code, which since enactment of the Law of 22 October 2010 stipulates sanctions of up to €100 million or ten times the profits gained in such cases, will thus be adjusted accordingly, notably to add the turnover criterion.

Criteria for determining administrative sanctions

Article 31 of the MAR sets out seven criteria for determining the type and level of administrative sanctions. Among them, only the seriousness of the infraction and the profits gained were already explicitly included in French law (advantages or profits cited in the aforementioned Article L.621-15).
The others notably cover the measures taken by the person responsible for the infraction or its repetition.

Administrative measures available to competent authorities

The MAR expressly confers upon the regulator the power to issue a public notice designating the person responsible for the infringement and the nature of the infringement, which means that the law needs to be amended to reflect this.

New sanctions to be added

Article 30.2g of the MAR gives competent authorities the ability to temporarily ban persons discharging managerial responsibilities within an investment firm or another natural person who is held responsible for the infringement, from dealing on their own account or performing management functions in an investment firm. The article also allows for a permanent ban from exercising management functions in investment firms in the event of repeated market abuse.

Expansion of the concept of obstruction

The MAR clearly states that a refusal to cooperate or comply with an investigation, inspection or request issued by the monitoring teams of a regulator must be considered an infringement of its provisions and must thus be subject to a measure or sanction handed down by the regulator. Currently, Article L 621-15 II f) of the Monetary and Financial Code leaves open only the possibility of an administrative sanction for an obstruction committed during an investigation. Refusal to cooperate in the context of a control is only covered by

criminal obstruction (Article L. 642-2 of the Monetary and Financial Code). Text will thus be added to Article L. 621-15 to include controls.

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