

Amendments to the Market Abuse Directive - 10 Key Points

Background

On October 20, 2011 the European Commission tabled proposals to revise the Market Abuse Directive by introducing a Regulation on Market Abuse and a Directive on Criminal Sanctions for Market Abuse. The proposals seek to address five broad problems with the Market Abuse Directive, Directive 2006/6/EC of the European Parliament and of the Council of 28/01/2003 on insider dealing and market manipulation ("MAD") identified by the European Commission: (i) gaps in the regulation of new markets, platforms and OTC trading in financial instruments; (ii) gaps in the regulation of commodities and commodity derivatives; (iii) a current inability on the part of Regulators to enforce MAD; (iv) a lack of legal certainty which is currently undermining the effectiveness of MAD and (v) current administrative burdens placed on small and medium sized companies by MAD. Overall, the proposals aim to update and strengthen the existing MAD framework to better ensure market integrity and efficiency and investor protection. The Market Abuse regime is being updated in tandem with MiFID (Directive 2004/39/EC). The aim of the European Commission has been to update MAD and MiFID together to ensure that they are fully coherent and support each other's objectives and principles.

1. Extension of scope to other Financial Instruments

MAD is based on prohibiting insider dealing or market manipulation in financial instruments which are admitted to trading on a regulated market. Since MiFID, new trading venues and facilities have provided more competition to existing regulated markets and an increase in trading venues has made monitoring for possible market abuse more difficult. The proposed Regulation extends the scope of the market abuse framework to any financial instrument admitted to trading on a Multilateral Trading Facility (MTF) or Organised Trading Facility (OTF) as well as to any related financial instruments traded OTC which can have an effect on the covered underlying market. This has been thought necessary to prevent regulatory arbitrage among trading venues, to ensure investor protection and the integrity of the markets (referred to above) and to ensure that market manipulation of such financial instruments through derivatives traded OTC (eg CDSs) is clearly prohibited.

2. Alignment of commodity derivatives definition of inside information

Under the current MAD regime, investors in commodity derivatives may be thought to be less protected than investors in derivatives of financial markets because there is a clear lack of a binding definition under MAD of insider

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information in relation to commodity derivatives markets. The Proposal for a Regulation on Market Abuse aligns the definition of inside information in relation to commodity derivatives to the general definition of inside information by extending it to price sensitive information which is relevant to the related spot commodity contract as well as the derivative.

3. Cross market manipulation

The definition of market manipulation is extended in the Proposal for a Regulation on Market Abuse to capture cross market manipulation — for example, transactions in the derivatives markets used to manipulate the price of related spot markets and transactions in spot markets which are used to manipulate derivatives markets.

4. Reclassification of emission allowances

The Proposal for a Regulation on MiFID (please see separate briefing note) reclassifies Emission allowances as financial instruments. As a result, they will also fall into the MAD framework. A specific definition of inside information for emission allowances has been introduced into the Proposal for a Regulation on Market Abuse.

5. Greater access to information for Regulators

The Proposal for a Regulation on Market Abuse contains key measures to ensure that Regulators have access to the information that they need to detect and to sanction market abuse. The Proposal extends suspicious transaction reporting to orders and to OTC transactions. It specifies that Regulators may obtain existing telephone and data traffic records from telecoms operators where there is a reasonable suspicion of insider dealing or market manipulation (as defined in the Proposal for a Directive). It also grants competent authorities access to private documents or premises where there is a reasonable suspicion of insider dealing or market manipulation, subject to a judicial warrant. It requires Member States to provide for the protection of whistleblowers and sets common rules where incentives are provided to them for reporting information about market abuse. A new offence of "attempted market manipulation" is to be introduced to make it possible for regulators to impose a sanction in cases where someone tries to manipulate the market but does not succeed in trading.

6. Increased penalties

Principles are established in relation to administrative sanctions — fines should not be less than the profit made from market abuse where this can be determined and the maximum fine should not be less than two times the amount of any such profit. For "natural persons", the maximum fine should not be less than 5 million Euros and for "legal persons" it should not be less than 10% of annual turnover with Member States being free to exceed these limits. Additionally, competent authorities need to take account of aggravating or mitigating factors.

7. Proposed Directive on criminal sanctions

A Proposal for a Directive on Criminal Sanctions for Market Abuse requires Member States to introduce criminal sanctions for the offences of insider dealing and market manipulation where these are committed intentionally.

8. New offence of attempted market manipulation

The Proposal for a Directive on criminal sanctions requires Member States to criminalise inciting, aiding and abetting insider dealing and market manipulation as well as attempts at these forms of market abuse. Liability is also extended to legal persons. Member States are required to ensure that the criminal offences defined in the Directive are punished by criminal sanctions which are effective, proportionate and dissuasive.

9. Reduction of administrative burdens on SME issuers

The Proposal for a Regulation on Market Abuse adapts the market abuse framework to the characteristics and needs of issuers whose financial instruments are admitted to trading on SME growth markets. The Regulation requires those issuers to disclose inside information in a modified and more simple market specific way. The Regulation also clarifies the scope of the reporting obligations in relation to managers' transactions.

10. Next Steps

The Proposal for a Regulation on Market Abuse now passes to the European Parliament and the Council for negotiation and adoption. Once adopted, the Regulation would apply from 24 months after its entry into force. The Proposal for a Directive on Criminal Sanctions for Market Abuse now passes to the European Parliament and the Council for negotiation and adoption. Once it is adopted, Member States will have 2 years to transpose the Directive into their respective national laws.

The Commission has published its legislative proposals in relation to the Markets in Financial Instruments Directive (MiFID). These proposals are known as MiFID II and are the subject of a separate alert.

If you would like to discuss any aspect of this alert or require further information on the matters referred to in it, please contact Sam Millar (+44 207 862 4821) or Tony Katz (+44 207 862 4822), Partners in Orrick's London Financial Institution Regulatory Practice.