

## *Financial Services and Markets*

### *EC Consultation on a revision of the Market Abuse Directive*

On 28 June 2010 the European Commission issued a consultation paper on proposed changes to the Market Abuse Directive. As with the recent short selling consultation (see our briefing [HERE](#)), the consultation on the Market Abuse Directive sets out a series of high-level, but potentially significant, proposals which will be subject to a short consultation period. Consultation ends on 23 July 2010. The Commission plans to adopt its formal proposals before the end of the year.

#### **Introduction**

The consultation proposes changes by:

- widening the scope of the Directive in a number of ways;
- enhancing the enforcement and sanctions powers of competent authorities; and
- developing a 'single rulebook'.

#### **Extension of the scope of the Directive**

The Commission proposes to extend the scope of the Directive in the following ways:

- to apply the Directive to instruments which are admitted to trading and/or traded on multilateral trading facilities (but with an adapted regime for SMEs);
- to extend the scope of market manipulation offence;
- to align the definition of inside information in the context of commodity derivatives to that applying to other investments.

#### *Instruments trading/admitted to trading on MTFs*

The Commission proposes that the Directive should be extended to capture all financial instruments, including derivatives, which are admitted to trading on an MTF, such as AIM, or in respect of which a request for admission to trading has been made. OTC and derivative transactions in relation to such instruments would also be caught.

However, the regime requiring issuers to disclose information to the market would be adapted in the case of small and medium-sized enterprise (SME) issuers – the Commission notes that applying the detailed issuer obligations in the Directive to an SME issuer on certain types of MTF (such as a junior market for SMEs) would impose a disproportionate cost on the issuer.

#### *Market manipulation*

The scope of the Directive would be further expanded so that it catches market manipulation through the use of OTC instruments that can influence the prices of a financial instrument traded on a regulated market or on an MTF.

The Commission also proposes to introduce a new market abuse offence of attempting to manipulate the market. As the Commission puts it, this 'would help in enforcing the market abuse prohibition as regulators would not have to prove that behaviour intended to manipulate the market actually had that effect'. This proposal is in line with one of the recommendations made by IOSCO in its March 2009 paper on the commodity futures markets.

There is also a suggestion that the definition of market manipulation be adapted to allow more readily for the inclusion of new patterns of behaviour. The Commission identifies by way of example some automated electronic trading practices.

*Inside information and commodity derivatives*

At the moment, there are two definitions of 'inside information' depending upon whether one is looking at commodity derivatives or another form of investment. The components of both definitions are broadly identical (in that they relate to information of a precise nature which is not generally available and which relates, directly or indirectly, to the relevant investment (or issuer)). However, there is one material difference. Instead of looking at whether information would be likely to have a significant effect on price, the test for commodity derivatives turns on whether a particular piece of information is of a kind which regular market users would expect to receive in accordance with *accepted market practices* (see Article 1, paragraph (1)(1) of the Directive and section 118C(3) of the Financial Services and Markets Act 2000).

The Commission is now proposing to align the definition of inside information for commodity derivatives with the definition for other instruments by dropping the accepted markets practices test in favour of the 'significant effect on price' test. This would mean that one of the defining criteria would be whether the information would be likely to have a significant effect on the price of the relevant commodity derivative or affect the price of the underlying asset. In relation to non-commodity investments this is currently assessed by reference to the relevance of the information to a reasonable investor's investment decisions. Therefore, while such information would include information which must be disclosed in accordance with EU or UK legal or regulatory requirements, market rules, contracts or customs on the relevant market, this would also include broader categories of information. How this would work in markets which have few requirements for the regular disclosure of inside information is not clear.

**Enforcement Powers and Sanctions**

The consultation paper contains a number of suggestions intended to increase the powers of competent authorities. These are:

- new requirements on transaction reporting – the Commission believes that it may be necessary to introduce some new requirements on transaction reporting, but suggests that this issue should be included in the ongoing MiFID review;
- a clarification that the E-privacy Directive does not impinge upon the power of regulators to obtain telephone and data traffic records when investigating suspected market abuse cases;
- a requirement on Member States to ensure that administrative sanctions for market abuse are sufficiently severe. In this regard, one notable proposal is that there should be a minimum fine for market abuse and that where there is a quantifiable gain arising out of a market abuse breach, the amount of any fine should be at least twice that amount. Currently, the FSA will impose a fine of at least £100,000 against an individual who has committed a market abuse referable to his employment, but this is only in cases assessed to be 'seriousness level 4 or 5'. The FSA usually expects to assess market abuse committed deliberately as seriousness level 4 or 5. (See DEPP 6.5C). If the Commission proposal is adopted, the FSA's discretion to impose no fine (for example in non-deliberate cases) would be removed. This would be a significant loss of flexibility compared to the current ability the FSA has to match the sanction to the level of culpability, and may give rise to unfair results;
- co-operation between competent authorities, with ESMA and with third countries – the Commission suggests that competent authorities need to do more to exchange information between themselves and cooperate in investigations and that ESMA should play a role in the coordination process and in imposing mediation in circumstances where a competent authority refuses to act on the request of another authority.

**Single market abuse rule book**

In order to enhance convergence between different Member States, the Commission proposes that there should be a move towards a single rule book, particularly by reducing or eliminating some national options and discretions and possibly introducing technical standards. The initial suggestions include:

- reducing the discretion allowed to issuers in relation to delayed disclosure to the public – currently Member States have the option, which has not been exercised in the UK, of requiring issuers to inform the regulator without delay of their intention to delay disclosure. The Commission argues that there is a case for eliminating this option by requiring listed issuers to inform the relevant regulator when they have delayed disclosure;
- clarifying the definition of 'accepted market practices' to address situations where an accepted market practice in one Member State might be challenged in another Member State;
- requiring that Member States should ensure that operators of regulated markets and MTFs adopt appropriate systems, controls and procedures designed to effectively prevent and detect market abuse and make notifications where necessary.

Once a single rule book is adopted, it is expected that its scope will expand beyond these items.

**Next steps**

As we have noted above, the consultation closes **on 23 July 2010**, allowing very little time in which to respond. On the basis of the responses it receives, the Commission will prepare its formal proposal, which is currently scheduled for adoption before the end of this year.

The Commission consultation is at:

[http://ec.europa.eu/internal\\_market/consultations/2010/mad\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/mad_en.htm)

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