



BRIEFING PAPER

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Market Abuse Directive/Regulation

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Inside:

- 1. Background**
- 2. The Market Abuse Regulation & Criminal Sanctions Market Abuse Directive**
- 3. UK Implementation**

Contents

Summary	3
1. Background	4
2. The Market Abuse Regulation & the Criminal Sanctions Market Abuse Directive	7
3. UK Implementation	9

Summary

In the late 1990s, EU leaders and the Commission identified financial services as a key area in urgent need of reform in order to move ahead with a deeper and more effective single market. In 1998, the Commission published its 'Framework for Action'. This framework evolved into an Action Plan which was adopted by the European Commission on 11 May 1999. What came to be known as the Market Abuse Directive (MAD) was one element of this wider programme.

The 2007 financial crisis prompted a rethink of the 2004 Directive which coincided with implementing the original. More complications arose when it became clear that MAD was also dependent upon other new directives which were themselves being re-examined post crisis.

With many of the topics interleaving in subject matter with each other, the problem of how to introduce new rules became acute. A Treasury brief of the time described the problem as 'too many moving targets'.

The Market Abuse Regulation and Criminal Sanctions for Market Abuse Directive emerged from this review. The two key issues dealt with are inside information or dealing and market manipulation, with appropriate criminal penalties attached to offences. The legislation must be enforced nationally by July 2016. The FCA is the lead agency for this work in the UK.

1. Background

In the late 1990s, EU leaders and the Commission identified financial services as a key area in urgent need of reform in order to move ahead with a deeper and more effective single market. In 1998, the Commission published its 'Framework for Action'. This framework evolved into an Action Plan which was adopted by the European Commission on 11 May 1999. The Action Plan included indicative priorities and time-scales for legislative and other measures to tackle three strategic objectives, namely:

- ensuring a Single Market for wholesale financial services;
- open and secure retail markets; and
- state-of-the-art prudential rules and supervision.

What came to be known as the Market Abuse Directive (MAD)¹ was one element of this wider programme.

Adopted in early 2003, the Market Abuse Directive (MAD) introduced a framework to tackle insider dealing and market manipulation practices, jointly referred to as "market abuse". The Directive aimed to increase investor confidence and market integrity by prohibiting those who possess inside information from trading in related financial instruments ("insider trading"), and by prohibiting the manipulation of markets through practices such as spreading false information or rumours and conducting trades that result in abnormal prices. ("market manipulation").

The UK, like other national governments, had the task of implementing the Directive, which in the UK's case meant fitting it around existing rules as they appeared in either the [Financial Services and Markets Act 2000](#) or in the then, Financial Services Authority's, rulebook. Where things became difficult was that the 2007 financial crisis prompted a complete rethink and examination of the Commission's approach to market abuse rules. Hence, simultaneously with implementing the original directive, it was being rethought. More complications arose when it became clear that MAD was also dependent upon other new directives which were themselves being re-examined post crisis.

The 'holistic' post crisis scrutiny, at the EU level has caused problems, both at the EU level and domestically. With many of the topics interleaving in subject matter with each other, the problem of knowing whether a directive or regulation worked, did not overlap, contradict or leave gaps, with another is difficult to solve when none are yet finalised. Put simply, until at least some of the balls come down you don't know where to start. But which ball should land first? A Treasury brief of the time described the problem as 'too many moving targets'.

For the UK, this problem existed in other areas too. For example, with respect to domestic regulatory initiatives regarding controls on

¹ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003, on insider dealing and market manipulation

5 Market Abuse Directive/Regulation

remuneration, where the UK timetable for reform has been ahead of the EU's but the UK (FSA) has had to keep an eye on the metaphorical rear view mirror, to judge whether its rules would comply with a directive yet to be agreed.

With respect to market abuse, the Commission was, in 2011, trying to align:

- a new [Regulation](#) (to replace MAD);²
- a new [Directive](#) (on criminal sanctions for insider dealing and market manipulation);³ and
- the 2004 Markets in Financial Instruments Directive (MIFID), which itself was subject to review and change.

As the European Scrutiny Committee said in its Report on the predicament that the Government found itself in:

The dependency of the draft Directive on the wider draft Regulation, which was at an early stage of review and was itself driven by the review of the Markets in Financial Instruments Directive...made it very difficult to assess with confidence the scope and implications of the draft Directive... – there were just too many uncertainties at the time.⁴

The issue became further politicised as the proposals created criminal sanctions in UK law for market abuse offences set out by an EU directive. The legal basis for the criminal directive is article 83(2) of the treaty on the functioning of the European Union and this was the first use of the relevant provision since the Lisbon treaty was agreed and, under the UK's opt-out, the UK and Ireland had discretion on whether to apply them. The decision by the Government not to opt-in prompted a debate in the House where the Minister, Mark Hoban, outlined the Government's reasons for not adopting:

The Government's decision not to opt in at this time is a reflection of the sequencing of the directive compared with related legislative proposals. The proposed directive is entirely dependent on the outcome of the market abuse regulation, and the markets in financial instruments directive, which are both in relatively early stages of negotiation. The Government believe that it is very challenging to assess the implications, scope and way in which the criminal directive may develop, given the broader uncertainty of the market abuse framework, which itself is simultaneously subject to a major review.

The key issue here is ensuring that the interaction between the criminal and administrative regimes is clear and workable for all member states. Above all, we need to address the flexibility of when to apply a criminal penalty and when an administrative penalty needs to be retained within member states' national systems. That must be determined on a case-by-case basis, in the light of the evidence of an individual case. In addition, there was uncertainty about whether the powers of competent authorities would be weakened in respect of accessing telephone records in

² Draft Regulation on insider dealing and market manipulation; COM (2011) 651

³ Draft directive on criminal sanctions for insider dealing and market manipulation; COM (2011) 654

⁴ European Scrutiny Committee 3rd Report 2012-13, HC86-iii

the regulation and, potentially, the accompanying criminal directive.

It is essential that competent authorities have the flexibility to determine the appropriate type of penalty—whether it is criminal or administrative—and the powers available to them to investigate suspected cases of market abuse. The Council has itself recognised the difficulties involved in trying to complete negotiations on the criminal directive, with linked proposals being negotiated simultaneously. Therefore, the presidency decided to pause progress on the directive, in order to wait for policy progress to be made in the market abuse regulation.⁵

Several hundreds of pages of explanatory material were collated for the debate (the debate bundle). The bundle included:

[European Scrutiny Committee 57th Report HC 428-ii](#)

[EU Document 16000/11 COM\(2011\) 654 final](#)

[EU Doc 16010/11](#)

[European Scrutiny Committee First Report of Session 2012-13 \(HC 86-i\)](#)

[Opinion of the European Central Bank](#)

⁵ [HC Deb 19 June 2012 c826](#)

2. The Market Abuse Regulation & the Criminal Sanctions Market Abuse Directive

The EU Commission's Market Abuse page on its website can be found [here](#).

As explained above, the review of the MAD resulted in a new Market Abuse Regulation (MAR) which repealed previous MADs.⁶ A good explanation of the scope and aim of MAR was published by the European Securities and Markets Authority:

MAR aims at enhancing market integrity and investor protection. To this end MAR updates and strengthened the existing MAD framework by extending its scope to new markets and trading strategies and by introducing new requirements.

[MAR applies to a broad range of financial instruments]

However, some exceptions apply. The prohibition of insider dealing and market manipulation does not apply to trading in own shares in buy-back programs or trading in securities for the stabilization of securities when some conditions laid down in MAR are met. Moreover, MAR does not apply to public authorities in pursuit of monetary, exchange rate or public debt management policy. Other specific exceptions apply in the framework of the EU's climate policy or the EU's Agricultural Policy for instance.

MAR provides a defense if the transaction was legitimate and in accordance with market practices accepted by the competent authority – these are referred to as 'Accepted Market Practices' (AMPs). The Regulation describes the non-exhaustive factors that a competent authority should take into account before deciding whether or not to accept a market practice.

The competent authority must in particular consult as appropriate relevant bodies such as representatives of issuers, financial services providers, consumers, other authorities, market operators and ESMA, before officially accepting an AMP.

MAR provides for a minimum set of supervisory and investigatory powers which the national competent authorities should be entrusted with under national law. Those include, among others: (i) the access to any document or data and the right to receive or take a copy thereof; (ii) the right to carry out on-site inspections or to require recordings or data traffic held by investment firms, credit institutions or financial institutions and, insofar permitted by national law, by telecommunications operators; and (iii) the power to impose a temporary prohibition of the exercise of professional activity.

[...]

Without prejudice to the criminal sanctions laid down in CS MAD, MAR provides for a set of administrative sanctions and other administrative measures.

⁶ Market Abuse Regulation: [REGULATION \(EU\) No 596/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014](#)

CS MAD complements MAR by requiring all Member States to provide for harmonised criminal offences of insider dealing and market manipulation, and to impose criminal terms of imprisonment of at least two to four years, depending on the relevant offence.⁷

The CS MAD referred to above is [Directive 2014/57/EU](#) – on criminal sanctions for market abuse. The reason for a separate directive was outlined by the Commission:

The Market Abuse Directive currently requires Member States to adopt administrative sanctions which are effective, proportionate and dissuasive, and leaves them free to decide whether or not to impose criminal sanctions. An assessment of existing sanctions regimes by the Commission shows that the current sanctions are lacking impact and are insufficiently dissuasive, which results in ineffective enforcement of the Directive. In addition, the definition of which forms of insider dealing or market manipulation constitute criminal offences diverges considerably from Member State to Member State.

For example, five Member States do not provide for criminal sanctions for disclosure of inside information by primary insiders and eight Member States do not do so for secondary insiders. Since market abuse can be carried out across borders, this divergence undermines the internal market and leaves a certain scope for perpetrators of market abuse to carry out such abuse in jurisdictions which do not provide for criminal sanctions for a particular offence.

The Commission considers that minimum rules on criminal offences and on criminal sanctions for market abuse are essential for ensuring the effectiveness of the EU policy on market integrity. Criminal sanctions demonstrate social disapproval of a qualitatively different nature compared to administrative sanctions or compensation mechanisms under civil law. Common minimum rules on the definition of criminal offences for the most serious market abuse offences would also facilitate the cooperation of law enforcement and judicial authorities in the Union, especially considering that the offences are in many cases committed across borders.

13. Which offences will be subject to criminal sanctions?

The proposal for a Directive defines the two offences, insider dealing and market manipulation, which should be regarded by Member States as criminal offences if committed intentionally. In line with the scope of the proposed Market Abuse Regulation, transactions for certain purposes are excluded from the scope: buy-backs and stabilisation programmes, monetary policy and debt management activities and activities concerning emission allowances in pursuit of climate policy.

The proposal 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. Liability should also be extended to legal persons.⁸

⁷ ESMA: [Market abuse and accepted market practices](#)

⁸ EU Commission; [Proposals for a Regulation on Market Abuse and for a Directive on Criminal Sanctions for Market Abuse: Frequently Asked Questions](#), October 2011

3. UK Implementation

The Financial Conduct Authority – the UK regulator responsible for implementing MAR - published a list of key requirements emanating from MAR:

Inside information and disclosure: the definition of inside information is broadly unchanged, but has been widened to capture inside information for spot commodity contracts. The obligation to disclose inside information has been extended to some EAMPs. Issuers and EAMPs must notify the regulator after delaying disclosure of inside information, and financial institutions must seek consent from the regulator prior to delaying disclosure due to financial stability concerns.

Insider dealing and unlawful disclosure: it is clarified that the use of inside information to amend or cancel an order shall be considered to be insider dealing. It is also clarified that recommending or inducing another person to transact on the basis of inside information amounts to unlawful disclosure of inside information.

Market manipulation: the manipulation offence has been extended to capture attempted manipulation. Benchmarks, and in some situations spot commodities, are now in scope of the manipulation offence. Examples of behaviours and activities that shall be considered as market manipulation are set out e.g. acting in collaboration to secure a dominant position over the supply or demand of a financial instrument, and certain algorithmic trading strategies which disrupt the functioning of a trading venue.

Market soundings: introduces a framework for persons to make legitimate disclosures of inside information in the course of market soundings.

Buy-back programmes and stabilisation measures: makes revisions to the existing framework for conducting buy-back programmes and stabilisation measures.

Accepted market practices (AMPs): continues to permit regulators to establish an accepted market practice which is subject to certain criteria and conditions.

Insider lists: places an obligation on issuers and EAMPs to draw-up and maintain a list of all those persons working for them that have access to inside information. Issuers on SME growth markets will only be required to draw up a list when it is requested by the regulator.

Suspicious transaction and order reports (STORs): extends the existing obligation to report suspicious transaction reports, to include suspicious orders too. Trading venues are also caught by the obligation to submit STORs.

Managers' transactions: persons discharging managerial responsibilities within issuers (PDMRs), and persons closely associated with them, must notify the issuer and the regulator of relevant personal transactions they undertake in the issuer's financial instruments. The issuer in turn must make that information public within three business days.

Investment recommendations: continues to require persons producing or disseminating investment recommendations to

ensure information is objectively presented, and to disclose any conflicts of interest.

Whistleblowing: places requirements on regulators and firms to be able to receive whistleblowing notifications.⁹

MAR is due to come into force in the UK in July 2016. The latest available information on specific proposals for implementation can be found in an [FCA Consultation Paper CP15/35](#) published in November 2015.

A pre-implementation briefing by City Lawyers Travis Smith can be found [here](#).

⁹ [FCA website](#)

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