The New EU Market Abuse Regulation

An overview for UK issuers

The UK's civil market abuse regime aims to ensure the smooth functioning of the market for financial securities by curbing behaviours that distort the price of securities and harm investor confidence in the integrity and impartiality of the market.

At the EU-level, concerns of market distortion arising through regulatory arbitrage have led to the introduction of new harmonising measures in the form of an EU Regulation on Market Abuse ("**MAR**"). MAR will have direct effect in all EU Member States, including the UK, and most of its provisions will apply from 3 July 2016.[1]

Although MAR bears many similarities to the UK's existing regime, there are key differences which expand the scope of the market abuse regime and change permitted behaviours and the ways in which listed companies need to operate within safe harbours. There are also changes to the rules governing the disclosure and control of inside information and the reporting of transactions by persons discharging managerial responsibilities ("**PDMRs**").

Issuers will need to amend their policies and procedures accordingly.

This briefing provides an overview of some of the key changes which will affect issuers from 3 July 2016.

Key changes effected by MAR:

- A requirement for issuers to inform the FCA if they have delayed the disclosure of inside information and, if requested by the FCA, to explain why such delay was consistent with MAR.
- Amendments to the regime for the approval and reporting of PDMR transactions, including the deletion of the Model Code and the introduction of an annual threshold.
- Substantial amendments to the FCA Handbook, including chapters 2 and 3 of the Disclosure and Transparency Rules and the Code of Market Conduct.
- An extension of the civil market abuse regime to new markets and instruments and to add extraterritorial scope.
- A new offence of "attempted market manipulation".
- The introduction of specified procedures for issuers to follow when conducting market soundings.

Key actions for issuers:

- Update internal policies and procedures (including share dealing codes, inside information policies and processes for market soundings) to reflect the new regime.
- Provide training to directors, other PDMRs, insiders and other relevant employees on their obligations under the new regime.

[1] MAR will not apply to organised trading facilities, SME growth markets, emission allowances or related auctioned products until 3 January 2017.

Background and implementation

Following a review of the Market Abuse Directive ("**MAD**"), the European Commission published a proposal to replace MAD with MAR. MAD was primarily implemented in the UK through Part VIII (Penalties for market abuse) of the Financial Services and Markets Act 2000 ("**FSMA**") and Chapters 2 (Disclosure and control of inside information by issuers) and 3 (Transactions by persons discharging managerial responsibilities and their connected persons) of the Disclosure and Transparency Rules ("**DTRs**").

MAR will introduce significant changes to the current UK civil market abuse regime.[2] MAR will replace the market abuse provisions in Part VIII of FSMA, which are expected to be repealed. Substantial changes will also be made to the Model Code in Chapter 9 of the Listing Rules (the "**Model Code**"), as well as to parts of the FCA Handbook, including the Code of Market Conduct and Chapters 2 and 3 of the DTRs.

While MAR will have direct effect, the UK Government will amend relevant primary and secondary legislation to ensure compatibility with MAR. These amendments will be made by statutory instrument, and a draft of the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2016 is currently available for comment.

The FCA issued a consultation paper setting out its proposals for the implementation of MAR in November 2015 and requested that comments be submitted by 4 February 2016. Following the close of that consultation, the FCA intends to publish amended FCA Handbook provisions this spring.[3]

Identifying inside information

Article 7 of MAR defines "inside information" as:

> "information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments".[4]

MAR further provides that information is likely to have "a significant effect" on price if it is information that a reasonable investor would be likely to use as part of the basis of his or her investment decisions.

This definition is substantively similar to the "inside information" definition contained in section 118C of FSMA (which will be repealed and replaced by MAR). Given the relatively modest changes introduced by MAR, we expect that much of the existing UK guidance and principles of interpretation, such as the Upper Tribunal's decision in *Ian Hannam v FCA*[5], will continue to be relevant. Issuers should review their inside information policies and update them as necessary to reflect the changes introduced by MAR.

[2] The UK's criminal offences of insider dealing (under Part V of the Criminal Justice Act 1993) and market manipulation (under sections 89 and 95 of the Financial Services Act 2012) are distinct from the civil market abuse provisions. Changes to the criminal offences of insider dealing and market manipulation are not anticipated at this time.

[3] It is expected that the European Securities and Markets Authority will publish further guidance in early summer 2016 - this may affect the content and timing of the final FCA guidance.

[4] MAR also includes bespoke "inside information" definitions for commodity derivatives, for emissions allowances and related auction products and for persons charged with the execution of orders concerning financial instruments. While these areas are outside the scope of this overview note, firms with activities in these areas should be mindful of these additional definitions.

[5] Please see our previous client briefing on the *Hannam* decision.

The civil market abuse offence

The current UK regime

The current civil law offence of market abuse is set out in section 118 of FSMA, which is supplemented by guidance and examples in the FCA's Code of Market Conduct. Section 118 sets out six types of behaviour that constitute market abuse, broadly: (i) insider dealing; (ii) improper disclosure of inside information; (iii) manipulating transactions; (iv) manipulating devices; (v) dissemination; and (vi) misleading behaviour and market distortion.

Section 118 of FSMA will be repealed in its entirety when MAR comes into force on 3 July 2016. In addition, much of the FCA's Code of Market Conduct will be replaced with a signpost to the relevant provisions of MAR and related regulatory technical standards.

Market abuse offences under MAR

MAR provides that it is an offence to: (i) engage or attempt to engage in insider dealing; (ii) recommend that another person engage in insider dealing or induce another person to engage in insider dealing; (iii) unlawfully disclose inside information; or (iv) engage in or attempt to engage in "market manipulation".

These offences are very similar to the current civil law offences in the UK[6] although there are certain key differences:

- *Scope of the new market abuse regime*: MAR extends the scope of the EU market abuse regime beyond regulated markets to financial instruments traded on multilateral trading facilities (MTFs) or other organised trading facilities (OTFs) and certain over-the-counter activities (including derivatives and credit default swaps). MAR also extends the market abuse regime to cover behaviour both within and outside the EU in relation to instruments admitted to trading on an EU trading venue. This extra-territorial reach could potentially have sweeping consequences: for example, abusive trading by a New York-based hedge fund with a US bank as counterparty in a US-listed security would apparently be subject to the MAR regime if that US security were traded on a single European OTF.

- *Attempted market manipulation*: MAR introduces a new prohibition on attempting to engage in market manipulation. Behaviour amounting to attempted market manipulation is described as any attempt to engage in any of the activities amounting to market manipulation. Such an attempt may include situations where the activity is started but is not completed, for example as a result of a technical failure or an instruction to trade that is not acted upon.

- *Manipulation of benchmarks*: MAR's market manipulation offence includes the manipulation of benchmarks. Under section 91 of the Financial Services Act 2012, it is already a criminal offence in the UK to make false or misleading statements relating to benchmarks or to engage in a course of conduct that creates a false or misleading impression that may affect the setting of a benchmark. Since the current UK criminal offence has a lower threshold than the new MAR offence, as the current offence can be committed by a person either knowing that it is false or misleading or simply being reckless as to whether it is so, we do not expect that MAR will materially change the UK offences in relation to benchmarks.

Safe harbour for market soundings

MAR introduces a new "market soundings" safe harbour to the offence of unlawfully disclosing inside information. Market soundings (also known as "pre-marketing") comprise the communication of information, before the announcement of a transaction, to one or more potential investors in order to gauge their interest in a possible transaction and the conditions relating to it, such as its potential size or pricing.

[6] The existing "misleading behaviour and market distortion" market abuse behaviour goes beyond the requirements of MAR (i.e. it is "super-equivalent") and will be repealed on 3 July 2016 and not replaced.

The market sounding safe harbour will apply provided certain disclosure and record-keeping conditions are met. For example, before conducting a market sounding, the issuer must specifically assess whether the market sounding will involve the disclosure of inside information. Before disclosing such inside information, the issuer must also: (i) obtain the consent of the person to whom the disclosure is made to receive inside information; and (ii) inform that person that they will be restricted by MAR from trading or acting on that information and that they will be obliged to keep the information confidential.

Issuers must put in place procedures to provide certain information to the person receiving a market sounding. This prescribed information must be provided in a pre-determined sequence. There is also a requirement to inform the recipient as soon as possible once the information disclosed in the course of a market sounding ceases to be inside information.

A record of all information given to the person receiving the market sounding should be maintained, including the prescribed information given and the identity of the potential investors to whom the information has been disclosed. All records must be kept for five years.

Issuers wishing to conduct market soundings on or after 3 July 2016 should ensure that their policies and procedures are consistent with the relevant provisions of MAR so as to ensure that those soundings benefit from the safe harbour. Appropriate training should also be given to all individuals involved in market sounding exercises.

“Legitimate behaviour” and “accepted market practices”

In addition to the safe harbour for market soundings, MAR identifies certain categories of behaviour wherein the possession of inside information will not give rise to a presumption of insider dealing. These safe harbours for “legitimate behaviour” and “accepted market practices” mirror the existing MAD provisions.

Examples of “legitimate behaviour” include where a person has established, implemented and maintained adequate and effective internal arrangements and procedures (i.e. Chinese walls) and the decision to deal is taken by individuals not in possession of inside information, or where a person has obtained inside information in the conduct of a public takeover or merger with a company and uses that inside information solely for the purpose of proceeding with that merger or public takeover (provided that at the point of approval of the merger or acceptance of the offer by the shareholders of that company, any inside information has been made public or has otherwise ceased to constitute inside information). However, MAR provides that the safe harbour will not apply if the competent national authority establishes that there was an illegitimate reason for the relevant behaviour, transaction or order to trade.

As under the existing MAD regime, “accepted market practices” may be established by national regulators, provided certain criteria and conditions set out in MAR are met. Accepted market practices must be notified to and approved by the European Securities and Markets Authority (“**ESMA**”). There are currently no accepted market practices in the UK and the FCA has not indicated whether it will seek to establish any under the new regime.

Disclosure and control of inside information

Chapter 2 of the DTRs sets out the current rules (and some supplementary guidance) regarding the disclosure and control of inside information by issuers. The FCA proposes to amend Chapter 2 to make it consistent with MAR, with a number of the existing provisions being either replaced with cross-references to the relevant MAR provisions or otherwise amended.

As under current UK law, issuers will have an obligation to disclose to the public all inside information relating to them as soon as possible. The MAR regime will continue to permit UK issuers, on their own responsibility, to delay disclosure if the following conditions are satisfied:

- disclosure is likely to prejudice the legitimate interests of the issuer;
- delay of disclosure is not likely to mislead the public; and
- the issuer can ensure the confidentiality of that information.

MAR will introduce a new requirement for issuers to inform the competent national authority that the disclosure was delayed. This notification should take place immediately after the delayed inside information has been publicly disclosed. MAR also requires issuers to provide national authorities with a written explanation of how the above-listed conditions were satisfied in respect of the delay of a particular piece of inside information, although in the UK it is proposed that such an explanation will only be required if the FCA requests it.

Where an issuer delays the public disclosure of inside information, it must keep a record of the circumstances of the delay. The draft technical standards produced by ESMA set out the details of the information that must be recorded.

Currently, Chapter 2 of the DTRs sets out a non-exhaustive list, based on MAD, of what might be legitimate reasons for an issuer to delay disclosure. The FCA proposes to delete this language so as to align the UK rules more closely with MAR and intends to look closely at ESMA's forthcoming guidance on a list of legitimate reasons for delay under MAR.

MAR, as with MAD, provides that issuers must draw up a list of persons working for them who have access to inside information. MAR states that insider lists must include the identity of any person having access to inside information; the reason for including that person in the insider list; the date and time at which that person obtained access to inside information; and the date on which the insider list was drawn up. To harmonise insider list requirements across the EU, the MAR regime includes a detailed template of information that must be included within insider lists. The requirements are similar to those already set out in the FCA's template insider list.

Issuers will need to review and update their inside information policies and procedures in order to align them with the MAR regime, particularly the new requirements:

- to prepare and retain written records of the details of any decision to delay disclosure and the justification for the delay;
- to notify the FCA that disclosure was delayed at the time such information is subsequently disclosed; and
- relating to the content of insider lists.

Dealings by persons discharging managerial responsibilities

The current UK rules regulating dealings by PDMRs are contained within Chapter 3 of the DTRs and the Model Code. Chapter 3 will mostly be deleted and replaced by the provisions of MAR, while the FCA proposes to retire the Model Code but, where possible, to retain its provisions in guidance on PDMR dealings. The FCA also proposes to introduce new rules requiring premium listed companies to have effective systems and controls regarding dealing clearance procedures.

The current UK rules require PDMRs of issuers (and the "connected persons" of such PDMRs) to report transactions in the issuer's shares or any financial instruments relating to the shares. The issuer is, in turn, required to announce any information so reported to it as soon as possible (and in any event by the end of the business day following receipt of the information from the relevant PDMR or connected person).

The European Commission has expressed concerns that the MAD disclosure obligations are not sufficiently clear, particularly in relation to transactions taken on behalf of a PDMR by a portfolio manager and where PDMRs seek to pledge or lend shares. Under MAR, any PDMR (and "persons closely associated" with a PDMR[7]) must notify the issuer and the competent national authority of every transaction conducted on their own account (including pledging or lending) relating to the shares or debt instruments of that issuer. These notifications must be made promptly and in any event within three business days of the relevant transaction.[8]

The reporting obligation only applies to subsequent transactions after a threshold of €5,000 has been reached in a calendar year (although a competent authority can decide to increase the threshold to €20,000 by informing ESMA and justifying its decision).[9] No such annual threshold applies under the current UK regime.

The Model Code currently provides that PDMRs should not be given clearance to deal in the relevant issuer's securities during "close periods", broadly being those periods that are the shorter of: (a) 60 days before the announcement of the issuer's yearly or half-yearly results; or (b) the period from the end of the relevant accounting period until the announcement of such results.

The equivalent MAR provision provides that a PDMR must not conduct any transactions relating to the financial instruments of the relevant issuer during a "closed period" of 30 calendar days before the issuer releases any interim financial report or year-end report which is required by national law or the rules of the relevant securities exchange.[10] The Model Code requirement that PDMRs seek to prohibit dealings by their "connected persons" in the issuer's securities during "close periods" has not been reproduced in MAR, although issuers may wish to retain this requirement as part of their dealing code.

MAR sets out certain exemptions to the "closed period" rule, including certain transactions relating to employee share schemes, transactions where the beneficial interest in the relevant security does not change or where there are exceptional circumstances (such as severe financial difficulties) that require the immediate sale of shares. Notably, MAR does not retain all of the exemptions currently available under the Model Code such as those which permit certain dealings connected to a rights issue or a takeover offer or dealings under a trading plan where the PDMR has no influence or discretion.

As result of these changes, UK issuers will need to make significant changes to their securities dealing codes and related policies and procedures.

7 As the MAR concept of "closely associated persons" of PDMRs differs somewhat from the "connected persons" definition used under the current UK rules, PDMRs should review their position before the new rules come into force on 3 July 2016.

8 Under the current rules, PDMRs and connected persons must notify the issuer within four business days.

9 The FCA proposes to adopt the default position of a €5,000 threshold.

10 The MAR definition of "closed period" is problematic in the UK, where it is customary for issuers to release a preliminary announcement of their annual results some time before publishing their year-end report. Under the Model Code, a close period applies in the run-up to this announcement. However, as preliminary announcements are not required by UK law, the MAR closed period would only apply in the run-up to the publication of the issuer's annual report. We hope the FCA will clarify the position in their final guidance.

Conclusion

In anticipation of MAR entering into force on 3 July 2016, issuers should consider taking the following actions:

- updating internal policies and procedures (including share dealing codes, insider information policies and processes for market soundings) to reflect the new regime; and
- providing training to directors, other PDMRs, insiders and other relevant employees on their obligations under the new regime.

For further information on the matters highlighted in this briefing, please contact one of the following or your usual Slaughter and May contact:

Nilufer von Bismarck - Partner
T +44 (0)20 7090 3186
E nilufer.vonbismarck@slaughterandmay.com

Kristina Locmele - Associate
T +44 (0)20 7090 3963
E kristina.locmele@slaughterandmay.com

Nick Pacheco - Associate
T +44 (0)20 7090 3143
E nicholas.pacheco@slaughterandmay.com

Edward Burrows - Associate
T +44 (0)20 7090 4214
E edward.burrows@slaughterandmay.com

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