Market abuse

2011/0295(COD) - 20/10/2011 - Legislative proposal

PURPOSE: to prevent market abuse through insider dealing and market manipulation.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

BACKGROUND: market abuse harms the integrity of financial markets and public confidence in securities and derivatives.

Directive 2003/6/EC of the European Parliament and the Council on insider dealing and market manipulation (market abuse) completed and updated the Union's legal framework to protect market integrity.

The European Commission has assessed the application of the Directive and has identified a number of problems which have negative impacts in terms of market integrity and investor protection, lead to an uneven playing field and result in compliance costs and disincentives for issuers, whose financial instruments are admitted to trading on SME growth markets, to raise capital. The main problems are as follows:

- **market and technological developments**, gaps in the regulation of new markets, platforms and over the counter instruments have emerged. Similarly, these same factors have led to gaps in the regulation of commodities and related derivatives.
- **regulators lack certain information and powers**, and sanctions are either lacking or insufficiently dissuasive, which mean that regulators cannot effectively enforce the Directive;
- lastly, the **existence of numerous options and discretions in the Directive**, as well as a lack of clarity on certain key concepts, undermines the effectiveness of the Directive.

The importance of market integrity has been highlighted by the current global economic and financial crisis. In line with the G20 findings, the report by the High-Level Group on Financial Supervision in the EU recommended that a sound prudential and conduct of business framework for the financial sector must rest on strong supervisory and sanctioning regimes.

In its Communication on "Ensuring efficient, safe and sound derivatives markets: Future policy actions" the Commission undertook to extend relevant provisions of the Directive in order to cover derivatives markets in a comprehensive fashion.

Furthermore, a review of existing sanctioning powers and their practical application aimed at promoting convergence of sanctions across the range of supervisory activities has been carried out in the Commission Communication on sanctions in the financial services sector.

The Directive should now be replaced to ensure that it keeps pace with developments in the market, given the legislative, market and technological developments that have resulted in considerable changes to the financial landscape. The aim is to increase market integrity and investor protection, while ensuring a single rulebook and level playing field and increasing the attractiveness of securities markets for raising capital.

IMPACT ASSESSMENT: the initiative is the result of extensive consultations with all major stakeholders, including public authorities (governments and securities regulators), issuers, intermediaries and investors.

The Commission conducted an impact assessment of policy alternatives. Policy options related to: (i) regulation of new markets, platforms and OTC instruments, commodities and related derivatives; (ii) sanctions, (iii) powers of competent authorities; (iii) clarification of key concepts and (iv) reducing administrative burdens.

The overall impact of all the preferred policy options will lead to considerable improvements in addressing market abuse within the EU. This will be done through:

- **improving market integrity and investor protection** by clarifying which financial instruments and markets are covered, ensuring that instruments admitted to trading only on a multilateral trading facility (MTF) and other new types of organised trading facilities (OTFs) are covered;
- **improving protection against market abuse through commodity derivatives** by improved market transparency ;
- ensuring better detection of market abuse by offering the necessary powers to competent authorities to perform investigations and improve the deterrence of sanctioning regimes by introducing minimum principles for administrative measures or sanctions;
- a **more coherent approach regarding market abuse** by reducing options and discretions for Member States;
- **introducing a proportionate regime for issuers**, whose financial instruments are admitted to trading on SME growth markets.

LEGAL BASIS: **Article 114** of the Treaty on the Functioning of the European Union.

CONTENT: the proposed regulation aims to establish a common regulatory framework on market abuse to ensure the integrity of financial markets in the Union and to enhance investor protection and confidence in those markets.

Scope: the development of new platforms, new technologies such as high frequency trading and an increase in trading across different venues has made it more difficult to monitor for possible market abuse.

The proposal:

- **extends the scope of the market abuse framework** applying to any financial instrument admitted to trading on a MTF or an OTF, as well as to any related financial instruments traded OTC which can have an effect on the covered underlying market;
- specifies further specific examples of **strategies using algorithmic trading and high frequency trading**, such as quote stuffing, layering and spoofing, that fall within the prohibition against market manipulation;
- **extends the scope of the Directive** so that the general definition of inside information in relation to financial markets and commodity derivatives should also apply to all information which is relevant to the related commodity;
- expressly prohibits attempts at market manipulation, which will enhance market integrity;
- reclassifies emission allowances as financial instruments as part of the review of the Markets in Financial Instruments Directive. As a result, they will also fall into the scope of the market abuse framework.

Inside information: the state of contract negotiations, terms provisionally agreed in contract negotiations, the possibility of the placement of financial instruments, conditions under which financial instruments will be marketed, or provisional terms for the placement of financial instruments may be relevant information for investors. Therefore, such information should qualify as inside information.

Public disclosure of inside information:

- in accordance with the proposal, **issuers will be required to inform the competent authorities of their decision to delay the disclosure of inside information immediately after such a disclosure is made**. The responsibility for assessing whether such delay is justified remains with the issuer. Competent authorities will have the power to investigate ex post whether in fact the specific conditions for the delay were met will increase investor protection and market integrity;
- the market abuse framework is adapted to the characteristics and needs of issuers, whose financial instruments are admitted to trading on SME growth markets. Issuers are exempt, under certain conditions, from the obligation to keep and constantly update insiders' lists, and benefit from the new threshold for the reporting of manager's transactions mentioned below. The proposal introduces a **threshold of EUR 20 000**, uniform in all Member States, which triggers the obligation to report such manager's transactions.

ESMA and Competent Authorities:

- the proposed regulation **allows competent authorities access to continuous data** by requiring such data to be directly submitted to them in a specified format. By gaining access to spot commodity market traders' systems, competent authorities are also able to monitor real-time data flows;
- competent authorities will be able to **require existing telephone and existing data traffic records** held by a telecommunication operator or by an investment firm, or to have **access to private premises and seize documents**, where a reasonable suspicion exists that such records related to the subject-matter of the inspection may be relevant to prove insider dealing or market manipulation as defined in the proposal;
- as market abuse can take place across borders and different markets, ESMA has a **strong coordination role and competent authorities are required to cooperate and exchange information** with other competent authorities and, when applicable to commodity derivatives, with the regulatory authorities responsible for the related spot markets, within the Union and in third countries.

Sanctions: this Regulation introduces minimum rules for administrative measures, sanctions and fines. This does not prevent individual Member States from fixing higher standards.

The proposal provides for the disgorgement of any profits where identified, including interests, and, in order to ensure an appropriate deterrent effect, it introduces fines which must exceed any profit gained or loss avoided as a result of the violation of this Regulation. Moreover, criminal sanctions have a stronger deterrent effect than administrative measures and sanctions. The proposal for a Directive on sanctions introduces the requirement for all Member States to put in place effective, proportionate and dissuasive criminal sanctions for the most serious insider dealing and market manipulation offences.

Protection and incentives for whistleblowers: the regulation enhances the market abuse framework in the Union introducing appropriate protection for whistleblowers reporting suspected market abuse, the possibility of financial incentives for persons who provide competent authorities with salient information that leads to a monetary sanction, and enhancements of Member States' provisions for receiving and reviewing whistleblowing notifications.

BUDGETARY IMPLICATIONS: the specific budget implications of the proposal relate to task allocated to ESMA. Total appropriations are estimated at **EUR 832 000 from 2013 to 2015**.

DELEGATED ACTS: the proposal contains provisions empowering the Commission to adopt delegated acts in accordance with Article 290 TFEU.