European Regulatory Snapshot: FCA consultation on implementation of the Market Abuse Regulation

November 19, 2015

Introduction

The Market Abuse Regulation (MAR)[1] will have direct application in the Member States of the EU from 3 July 2016, replacing both the previous Market Abuse Directive (MAD)[2] and implementing national legislation in Member States. In particular, the UK Financial Conduct Authority (FCA) is prevented from retaining rules, evidential provisions or guidance in its Handbook which conflict with MAR or any implementing guidance or technical standards.

As provided for in MAR, the European Securities and Markets Authority (ESMA) recently released its *Final Report* containing *Draft Technical Standards* (Final Report)[3], setting out many of the detailed rules and procedures required by MAR. Subject to approval by the European Commission, these technical standards will take the form of Regulations which will be binding in their entirety and directly applicable in all Member States.

UK implementation of MAR

On 5 November 2015, the FCA published *Consultation Paper 15/35* (Consultation Paper)[4] to address the major changes in the FCA's interpretative power and policy discretion.

In the Consultation Paper, the FCA proposed the deletion or modification of much of the FCA Handbook provisions relating to the civil market abuse regime, including:

- a renaming of the "Disclosure Rules" to "Disclosure Guidance" and subsequent amendments within the Disclosure Rules and Transparency Rules (DTRs) chapter of the FCA Handbook;
- the deletion of the Model Code contained in Chapter 9 of the Listing Rules (Model Code); and
- a re-framing and re-design of the Code of Market Conduct (CoMC).

As part of this process, the rules governing the disclosure of inside information, disclosures by persons discharging managerial responsibilities (PDMRs) and guidance on market conduct contained in the CoMC will be significantly amended, in many cases by wholesale deletions and signposting to the relevant MAR provision.

Disclosure of inside information

The position under MAR will be very similar to the current position under DTR 2.5. However, issuers of securities admitted to trading only on a multilateral trade facility (MTF) or organised trading facility (OTF) will also be brought within the scope of the public disclosure obligation.

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[1] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC. The text of MAR can be found here.

[2] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse). The text of MAD can be found here.

[3] ESMA, "Final Report Draft technical standards on the Market Abuse Regulation". The Final Report can be found here.

[4] CP15/35: Policy proposals and Handbook changes related to the implementation of the Market Abuse Regulation (2014/596/EU). The Consultation Paper can be found here.

Delay of public disclosure

Under Article 17(4) of MAR, issuers will continue to be able to delay the disclosure of inside information where:

- immediate disclosure is likely to prejudice the issuer's legitimate interests;
- the delay is not likely to mislead the public; and
- the issuer is able to ensure the confidentiality of the information.

However, subject to the discretion of national competent authorities (NCAs), MAR requires issuers to provide NCAs with a written explanation of its decision to delay the disclosure of inside information. The FCA has proposed that an issuer will only be required to provide a written explanation of its decision to delay the disclosure of inside information to the FCA where the FCA requests such an explanation. In our view, however, in practice issuers are likely to retain a written explanation in case the FCA does request such an explanation after the fact, bearing in mind that MAR will require issuers to inform the FCA about the fact of the delay after the event in all cases.

In addition, under the new regime, safe harbours for the delay of disclosure of inside information within the DTRs have been deleted and replaced with signposts to the relevant MAR provisions.

Market soundings and wall-crossings

MAR introduces a new and detailed regime for wall-crossings, known as "market soundings" in the context of the legislation. The ESMA Final Report contained extensive guidance on this new procedure. Our summary of these technical standards is provided in Appendix A.

In a similar way to the new market sounding regime, MAR and the ESMA Final Report provide for a much more prescriptive approach for firms producing insider lists. ESMA has suggested a mandatory standard form which must be used for such lists. The form, although shortened from the initial draft provided by ESMA earlier in the year, still requires a diverse range of data (such as individuals' home addresses, home phone numbers and national identification numbers) to be gathered and held in electronic format. The rigid format for insider lists means that many firms and advisers will have to change their existing systems. The extension of the scope of MAR will mean a wider range of issuers will be caught: these issuers will need to keep insider lists (sometimes for the first time) and ensure that they follow the ESMA prescribed format.

Disclosure of dealings and changes to the Model Code

In relation to PDMRs, Article 19 of MAR requires PDMRs to notify all transactions in certain financial instruments to the issuer and the competent authority (as is currently contained in DTR 3). In accordance with the de minimis requirements of MAR, the FCA has proposed that disclosure by PDMRs will be required where their transactions within a calendar year exceed €5,000, rather than the optional increased threshold of €20,000. ESMA has provided a detailed template for the notification in the Final Report.

In addition, ESMA has reduced the time limit under which PDMRs must make a notification to the issuer from four business days to three business days. Each notification will be publicly disclosed in its entirety (rather than some sections remaining confidential to the regulator as was initially envisaged by ESMA).

The Model Code currently restricts PDMRs from dealing in an issuer's shares at particular times and sets standards for permitted dealings. However, given the rules and procedures in MAR around dealings by PDMRs, the FCA considers that the Model Code is incompatible with MAR. Therefore, the FCA proposes to replace the current Model Code with guidance for firms to use when developing their processes, particularly around clearance procedures. Article 19 of MAR will contain the substantive obligations relating to the disclosure of PDMRs' transactions, rather than the Model Code.

An issuer looking for guidance or safe harbours in relation to a particular type of dealing, the prohibited periods for dealing, the measures relating to short term dealing by PDMRs and dealings by

connected persons will need to look at MAR, implementing legislation or ESMA guidance (to be issued in 2016).

Code of Market Conduct (CoMC)

Following the introduction of MAR and consequential amendments to the Financial Services and Markets Act (FSMA), the FCA will no longer be obliged to provide guidance on what behaviours constitute market abuse and the factors to take into account when deciding this. The FCA has decided against deleting the CoMC, instead proposing to preserve as much of the content as possible in order to help the industry understand MAR. That said, the new document (to be known as MAR 1 rather than the CoMC) will no longer consist of provisions that have 'evidential' or 'conduct' status (including the safe harbours) but will instead consist solely of guidance.

Most of the provisions of existing MAR 1.3 which relate to insider dealing and indicative behaviours will be deleted and replaced with a signpost to Articles 7 to 9 of MAR. In addition, the FCA has proposed to delete existing Annex 2 of MAR 1, which contains a non-exhaustive list of factors the FCA will take into account in assessing whether a behaviour constitutes an accepted market practice, and replace this with a signpost to Article 13 of MAR.

Key areas of uncertainty in implementation

Despite the publication of both the Consultation Paper and ESMA's Final Report, there remain significant areas of uncertainty in relation to the new regime.

The FCA acknowledges that in a number of areas ESMA has not yet produced the "Level 3" guidance required under MAR and that this will have a significant impact on the nature of guidance that the FCA is able to give in its amended Handbook (as national regulators are required to follow ESMA guidance on a "comply or explain" basis).

The consultation period under the FCA Consultation Paper closes 4 February 2016; however, additional ESMA Level 3 guidance is not expected until early summer 2016. Therefore, it is possible that the guidance in the Handbook will have to be materially altered again just prior to the start of the MAR regime. Furthermore, ESMA has also relied on informal Q&A guidance in relation to previous EU financial services laws. This informal guidance often sets out key policy choices in relation to the legislation, notwithstanding the fact that it is not legally binding and is drafted without any market consultation or discussion. It is not clear at this stage whether ESMA plans to issue substantial Q&As in relation to MAR.

Compared with the implementation process for previous EU Regulations, the FCA has taken a relatively robust approach to retaining elements of the existing UK regime as guidance in an effort to be helpful to corporate finance market participants. That said, the introduction of MAR next year represents a major change in the scale, application and detail of the market abuse regime. Issuers and their advisers will have to adapt to a regime where both UK guidance and detailed EU legislation will need to be understood and complied with going forward.

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Appendix A

MAR Provisions Relating to Market Soundings and Wall-Crossings

MAR introduces a new and detailed regime for wall-crossings, known as "market soundings" in the context of the legislation.

A "market sounding" is defined in Article 11(1) of MAR as: the communication of information, prior to the announcement of a transaction, to gauge the interest of potential investors in a possible transaction and the conditions relating to it, such as its potential size or pricing, to one or more potential investors by:

- an issuer;
- a secondary offeror of a financial instrument, in such quantity or value that the transaction is distinct from ordinary trading and involves a selling method based on the prior assessment of potential interest from potential investors;
- an emission allowance market participant; or
- a third party acting on behalf or on the account of a person referred to in any of the above three categories.

Under MAR, disclosure of inside information made in the course of a market sounding will be deemed to be made in the normal exercise of a person's employment, profession or duties (meaning there will not be an unlawful disclosure of inside information – a "safe harbour") where the disclosing market participant (DMP) complies with the requirements of Article 11 of MAR, which include:

- Determining whether information disclosed is inside information and keeping written records of that determination.
- Keeping records in relation to the disclosure of the information, including: consent of the recipient to receive the inside information, informing the recipient of the prohibition on insider trading, date and time of disclosure and identity of recipient(s).
- Informing the recipient as soon as possible once the information ceases to be inside information.
- Keeping records of the disclosure process for five years.
- Informing the market participant that by agreeing to receive the information he is obliged to keep the information confidential.

Although the focus of these new requirements are on the DMP, Article 11(7) of MAR also provides that recipients need to determine for themselves whether they have or cease to have inside information, even where they have been told by the DMP that the information is, in the view of the DMP, not or no longer inside information. ESMA has stated that it will provide further guidance on the obligations on recipients in due course.

The ESMA final report refers to a number of technical standards in relation to these Article 11 requirements. In particular, the final report provides clarification on the following issues:

- The circumstances where a DMP will be acting for a "market sounding beneficiary" (MSB, e.g., an issuer represented by an investment bank on an offering) and when the DMP will benefit from the Article 11 safe harbour. This will include situations where the DMP is acting for the MSB under a general mandate or oral instructions. The safe harbour is not extended to situations where a DMP has not been mandated by an MSB, yet carries out a market sounding exercise on its own initiative.
- Market soundings for the purpose of undertaking a block trade where the DMP is acting on behalf of a secondary market offeror will be captured within the Article 11 safe harbour.

- DMPs will be required to keep a list of investors who have said that they do not wish to be sounded in relation to all potential transactions or particular types of transactions.
- The standard set of information which will need to be provided to recipients by DMPs conducting market soundings (and which will differ depending on whether the market sounding is considered to involve the disclosure of inside information or not). ESMA has not, however, followed through on its earlier consultation proposal to provide standardised market scripts for market soundings.

The market sounding requirements in Article 11 will apply, regardless of whether inside information is transmitted, meaning that extensive record keeping requirements will apply in relation to all those who have been sounded.

Article 11 of MAR will therefore result in a significant increase in the obligations of issuers and their advisers in corporate finance deals. As expected, the ESMA final report has set out a highly granular regime that will require firms to generate a detailed paper trail to back up their decisions in relation to market sounding activity and show that they have kept comprehensive records of the disclosure process.