EUROPEAN COMMISSION

MEMO

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European Parliament's endorsement of the political agreement on Market Abuse Regulation

In recent years financial markets have become increasingly global, giving rise to new trading platforms and technologies. This unfortunately has also led to new possibilities to manipulate these markets. The European Parliament voted today to formally endorse the political agreement on a Regulation on insider dealing and market manipulation (i.e. market abuse) to tackle market abuse more effectively, subject to alignment with the final political agreement on MiFID II and revisions by legal linguists and revisers.

This Regulation updates and strengthens the existing framework to ensure market integrity and investor protection provided by the Market Abuse Directive (2003/6/EC). The new framework will ensure regulation keeps pace with market developments, it will strengthen the fight against market abuse across commodity and related derivative markets, explicitly ban the manipulation of benchmarks, such as LIBOR, and reinforce the investigative and sanctioning powers of regulators.

EU rules will be adapted to the new market reality, notably by extending their scope to include all financial instruments which are traded on organised platforms and over the counter (OTC), and adapting rules to new technology. The manipulation of benchmarks such as LIBOR will be explicitly prohibited, market abuse occurring across both commodity and related derivative markets will be prohibited, and cooperation between financial and commodity regulators is reinforced. Supervisors will have access to the information they need to detect and sanction market abuse. Since the sanctions currently available to supervisors often lack a deterrent effect, sanctions will be tougher and more harmonised. Possible criminal sanctions are the subject of a separate but complementary proposal on which it is hoped that negotiations between the European Parliament and the Council on a political agreement could conclude by the end of this year (see also IP/11/1218).

Objectives of the new Regulation

Keeping pace with market developments: The regulatory framework provided by the original Market Abuse Directive has been outpaced by the growth of new trading platforms, OTC trading and new technology such as high frequency trading (HFT). The new Regulation extends the scope of existing EU legislation to financial instruments only traded on multilateral trading facilities (MTFs), other organised trading facilities (OTFs) and when traded OTC so that trading on all platforms and of all financial instruments which can impact them will now be covered by market abuse legislation. It also provides an indicative list of HFT strategies which shall be considered as market manipulation, such as placing orders which has the effect of disrupting or delaying the functioning of a trading system ("quote stuffing"). Commodity markets have become increasingly global and interconnected with derivative markets, leading to new possibilities for cross-border and cross-market abuse. The scope of the legislation is therefore extended to market abuse occurring across both commodity and related derivative markets.

In the recent LIBOR scandal, serious concerns have been raised about false submissions of banks' estimated interbank lending rates. Any actual or attempted manipulation of such key benchmarks can have a serious impact on market integrity, and could result in significant losses to consumers and investors, or distort the real economy. The manipulation of benchmarks, including LIBOR and EURIBOR will be clearly prohibited.

Reinforcing regulators' investigative and sanctioning powers: The new Regulation extends the current reporting of suspicious transactions also to suspicious unexecuted orders and suspicious OTC transactions. Everyone professionally involved in executing transactions will have to have systems in place to detect suspicious transactions. The new regulation grants supervisory powers to regulators to investigate possible cases of market abuse, subject to adequate and effective safeguards. It also requires Member States to provide for mechanisms for the reporting of actual or potential breaches of the provisions of this Regulation to competent authorities (whistleblowing). Finally, attempted market abuse will also be prohibited, making it possible for regulators to impose a sanction in cases where someone tries to insider deal or manipulate the market.

Common principles are proposed, notably the maximum fine should not be less than three times any such profit. In parallel, a proposal for a Directive on criminal sanctions for market abuse requires Member States to introduce criminal sanctions for the offences of insider dealing and market manipulation where these are committed intentionally. Trilogue negotiations on the Directive are expected to commence in the second half of this year.

Reducing administrative burdens on SME issuers: The disclosure requirements for issuers on SME markets will be adapted to their needs, and issuers on such markets will be subject to tailored rules for the requirement to draw up lists of insiders.

Next steps

Final adoption of the Market Abuse Regulation would take place after a final political agreement on MiFID II, since aspects of the MAR (notably its scope) depend on the final text of MiFID II and these will need to be aligned. The date as of which the new market abuse rules would apply is to be aligned with that of MiFID II.

Regulation on Market Abuse: Frequently Asked Questions

1. What is market abuse and how is it currently regulated?

Insider dealing consists of a person trading in financial instruments when in possession of price-sensitive inside information in relation to those instruments. Market manipulation occurs when a person artificially manipulates the prices of financial instruments through practices such as the spreading of false information or rumours and conducting trades in related instruments. Together these practices are known as market abuse.

Adopted in early 2003, the Market Abuse Directive (MAD) has introduced a comprehensive framework to tackle insider dealing and market manipulation practices, jointly referred to as "market abuse". The Directive aims 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").

In essence, market abuse may occur when investors have been unreasonably disadvantaged, directly or indirectly, by others who:

- have used information that is not publicly available to trade in financial instruments to their advantage (insider dealing);
- have distorted the price-setting mechanism of financial instruments; or
- have disseminated false or misleading information.

The MAD creates some tools to prevent and detect market abuses, like insiders' lists, suspicious transaction reports and the disclosure of managers' share transactions. It also obliges issuers of financial instruments traded on a regulated market to make public as soon as possible inside information that they possess, with limited possibilities to delay.

In order to promote enforcement, the Directive gives national competent authorities powers of investigation (such as access to data or on-site inspections) and the power to take administrative measures or impose "effective, proportionate and dissuasive" sanctions.

2. Why is the MAD being reviewed?

The MAD introduced a framework to harmonise core concepts and rules on market abuse and strengthen cooperation between regulators. However, a number of problems have been identified by the Commission and these can be broadly categorised in five groups:

- gaps in regulation of new markets, platforms and over-the-counter (OTC) trading in financial instruments;
- gaps in regulation of commodities and commodity derivatives;
- regulators cannot effectively enforce the MAD;
- lack of legal certainty undermines the effectiveness of the MAD; and
- administrative burdens, especially for small and medium-sized companies (SMEs).

This is why the Commission has adopted proposals to replace the MAD with a Regulation on Market Abuse (MAR) and a Directive on criminal sanctions for market abuse.

Market Abuse Regulation (MAR)

3. What are the main objectives of the Regulation?

The Regulation aims to update and strengthen the existing framework to ensure market integrity and investor protection provided by the Market Abuse Directive. The new framework will ensure regulation keeps pace with market developments, strengthens the fight against market abuse across commodity and related derivative markets, reinforces the investigative and administrative sanctioning powers of regulators and harmonises certain key elements while reducing administrative burdens on SME issuers where possible.

4. How do the MAR rules fit in with the MiFID review proposals, and other recent initiatives such as those on OTC derivatives and short-selling?

Together, MAD and MiFID guarantee the competitiveness, efficiency and integrity of EU financial markets. They need to be updated in tandem to ensure that they are fully coherent and support each other's objectives and principles. The political agreement reached on MAR is subject to agreement on MiFID II, because the new MiFID rules contain part of the regulatory framework on which MAR is based. Notably, the new MiFID will ensure that all types of organised trading are regulated. The MAR will apply market abuse rules to all organised trading. Moreover, the pan-EU competition facilitated by MiFID has given rise to new challenges in terms of cross-border supervision. Harmonisation of the rules and competent authorities' powers is a necessary step.

The importance of market integrity has also been highlighted by the current global economic and financial crisis. In this context, the Group of Twenty (G20) agreed to strengthen financial supervision and regulation and to build a framework of internationally agreed high standards. 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".

The importance of the efficient functioning of the MAD was underlined in the Commission Communication "Driving European recovery"**,** which intends to tackle the most important shortcomings in the markets that have been observed in the current financial crisis. In its Communication on "Ensuring efficient, safe and sound derivatives markets: Future policy actions", the Commission said it would extend MAD's relevant provisions to comprehensively cover derivatives markets. The importance of efficient coverage of OTC transactions in derivatives has been stressed also in discussions at various international fora[1] including the G20 and the International Organisation of Securities Commissions as well as in the recent US Treasury Financial Regulatory Reform programme[2].

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[1] IOSCO notes that *"The high level of interconnectivity between credit derivatives, the obligations of the underlying reference entities e.g., corporate bonds, equities and cash markets means market misconduct (manipulation and insider trading) and disruptions in one market can affect another.", Consultation Report on Unregulated Markets and Products, May 2009, p. 28.*

[2] *"Market integrity concerns should be addressed by making whatever amendments to the CEA and the securities laws which are necessary to ensure that the CFTC and the SEC, consistent with their respective missions, have clear, unimpeded authority to police and prevent fraud, market manipulation, and other market abuses involving all OTC derivatives." Financial Regulatory Reform. A New Foundation: Rebuilding Financial Supervision and Regulation, Dept. of Treasury, June 2009 p.48;*

5. What changes does the Regulation make so that market abuse legislation keeps pace with market developments?

The MAD is based on the concept of prohibiting insider dealing or market manipulation in financial instruments which are admitted to trading on a regulated market. However, since the adoption of MiFID, financial instruments have been increasingly traded on multilateral trading facilities (MTFs), on other types of organised trading facilities (OTFs), such as swap execution facilities or broker crossing systems, or traded OTC. These new trading venues and facilities have provided more competition to existing regulated markets, gaining an increased share of liquidity and attracting a broader range of investors. But the increase in trading across different venues has made it more difficult to monitor for possible market abuse. Therefore the Regulation extends the scope of the market abuse framework to apply to any financial instrument admitted to trading on an MTF or organised trading facility, as well as to any related financial instruments traded OTC which can have an effect on the covered underlying market. This is necessary to avoid any regulatory arbitrage among trading venues, to ensure that the protection of investors and the integrity of markets are preserved on a level playing field in the whole Union, and to ensure that market manipulation of such financial instruments through derivatives traded OTC, such as credit default swaps (CDS), is clearly prohibited.

6. What does the Regulation do to tackle market abuse occurring across both financial and commodity markets, which are international by nature?

Commodity spot markets and related derivative markets are highly interconnected and market abuse may take place across these markets. This raises special concerns for spot markets because transparency rules and market integrity apply to derivatives markets but not to the related spot markets. It is beyond the scope of the Regulation to govern directly those non-financial markets, which should be subject to specific and sectoral regulation and supervision as provided for in the field of energy by the Regulation on energy market integrity and transparency (REMIT). However, the lack of a clear and binding definition under the existing MAD of inside information in relation to commodity derivatives markets may allow information asymmetries in connection with those related spot markets. This means that under the current market abuse framework, investors in commodity derivatives may be less protected than investors in derivatives of financial markets.

Therefore, since a person can benefit from inside information in a spot market by trading on a financial market, the Regulation redefines inside information in relation to commodity derivatives to ensure legal certainty and better information for investors.

Moreover, the MAD only prohibits any manipulation which distorts the price of financial instruments. As certain transactions in the derivatives markets can also be used to manipulate the price of the related spot markets, and transactions in the spot markets can be used to manipulate derivatives markets, the definition of market manipulation is extended in the Regulation to also capture these types of cross-market manipulation.

The Regulation also introduces an obligation to cooperate and exchange information between financial regulators and the regulators of spot commodity markets where they exist to ensure a consolidated overview of financial and spot markets and to detect and sanction cross-market and cross-border abuses. It gives financial regulators the power to require that data on spot markets be submitted directly to them in a specified format.

7. What does the Regulation do to tackle the abuse of benchmarks, such as LIBOR?

Since March 2011, investigations have been taking place in relation to possible manipulation of the EURIBOR and LIBOR benchmarks for interbank lending rates by a number of banks. The suspicion was that banks had provided estimates of the interest rate at which they would accept offers of funding which were different from the rate they would have accepted in practice. As a result, the integrity of the rates has been called into question – rates which are used as benchmarks for borrowing and as references for the pricing of many financial instruments such as interest rate swaps and consumer contracts such as mortgages, loans and credit cards. Furthermore, the individual contributor banks' estimates provided misleading information to the market about their likely costs of funding.

In order to capture the direct manipulation of benchmarks and in order to ensure that such manipulation of benchmarks is an offence, the Regulation explicitly prohibits this.

8. Why is the manipulation of benchmarks a cause for concern?

Many financial instruments are priced by reference to benchmarks. While it may be difficult or impossible for a competent authority to prove that manipulation of a benchmark had an effect on the price of related financial instruments, any actual or attempted manipulation of important benchmarks can however have a serious impact on market confidence and could result in significant losses to investors or distort the real economy. It is therefore essential to prohibit manipulation of benchmarks unequivocally, and to clarify that competent authorities could impose administrative sanctions for the offence of market manipulation in these cases, without the need to prove or demonstrate incidental issues such as price effects. It is also essential that all necessary steps be taken to prevent such manipulation and to enable and facilitate the work of competent authorities in imposing sanctions. A stringent legal framework will act as a credible deterrent to such behaviour, thereby protecting investors and restoring market confidence. These regulatory steps should include criminal sanctions.

9. What are benchmarks and what types of benchmarks and manipulation will be prohibited by the Regulation?

A benchmark is any rate, index or figure made available to the public or published that is periodically or regularly determined by the application of a formula to, or on the basis of the value of one or more underlying assets, or prices, including estimated prices, actual or estimated interest rates or other values, or surveys and by reference to which the amount payable under a financial instrument or the value of a financial instrument is determined. Underlying assets or prices referenced in benchmarks can include equities (e.g. the FTSE 100 index), bonds (e.g. NASDAQ OMX fixed income), interest rates (e.g. LIBOR or EURIBOR), or commodities such as agricultural products (e.g. cocoa LIFFE London), metals (e.g. Gold COMEX) or oil (e.g. Brent oil ICE). All benchmarks are included in the Regulation, provided that these determine the amount payable under a financial instrument. The Regulation will prohibit natural or legal persons from transmitting false or misleading information, providing false or misleading inputs, or any action which manipulated the calculation of a benchmark, including the manipulation of benchmarks' methodologies.

10. How does the Regulation deal with emission allowances?

Emission allowances are reclassified as financial instruments as part of the proposal for a regulation on markets in financial instruments (see MEMO/11/716). As a result, they will also fall within the scope of the market abuse framework. As it is typically not the issuer of an emission allowance who possesses inside information, the standard definition of inside information does not sufficiently ensure disclosure of relevant inside information. Therefore, a specific definition of inside information for emission allowances is introduced. The obligation to disclose inside information will be effectively placed on companies with large installations regulated by the EU Emissions Trading System, as it is they who possess the relevant information. For more information on emission allowances, see also MEMO/11/719).

11. How does the Regulation reinforce the powers of competent authorities to detect market abuse?

The Regulation includes a number of measures to ensure regulators have access to the information they need to detect and sanction market abuse. The Regulation extends suspicious transaction reporting to orders and to OTC transactions. A number of powers are granted to supervisory authorities to ensure that they have access to the information they need to detect and sanction market abuse (e.g. access to premises, access to existing data traffic records held by telecommunication operators, access to existing telephone records held by investment firms), in accordance with national law and subject to adequate and effective safeguards. It also requires Member States to provide for the protection of whistleblowers and accused persons. Finally a new offence of "attempted market manipulation" is introduced to make it possible for regulators to impose a sanction in cases where someone tries to commit market abuse.

12. How does the Regulation strengthen the administrative sanctions that can be imposed for market abuse?

Since the sanctions currently available to regulators are often weak and lack a deterrent effect, the Regulation introduces greater harmonisation of administrative sanctions. Common principles are proposed, notably that the maximum fine should be three times the amount of profits gained or losses avoided. For natural persons there are three levels of fines. For the offences of insider dealing and market manipulation a fine of at least €5 million should apply, and fines of €1 million and €500 000 for the remaining offences. For legal persons there are also three levels of fines. For the offences of insider dealing and market manipulation a fine of at least €15 million or 15% of annual turnover should apply and fines of €2.5 million or 2 % of its total annual turnover €1 million for the remaining offences of the Regulation, with Member States being free to exceed these limits. In imposing sanctions, competent authorities should take account of other aggravating or mitigating factors, such as the gravity of the offence, previous offences or a suspect's cooperation with an investigation.

In the event of repeated breaches of the offences of insider dealing and market manipulation, the competent authorities shall have the power to impose a permanent ban against any person discharging managerial responsibilities in an investment firm or any other natural person who is held responsible, from exercising management functions in investment firms.

In parallel, a proposal for a Directive on criminal sanctions for market abuse requires Member States to introduce criminal sanctions for the offences of insider dealing and market manipulation as defined in the Directive, where these are committed intentionally (see below). The trilogue negotiations on the Directive are expected to commence under the Lithuanian Presidency. Once adopted, Member States will have two years to transpose the Directive into national law.

13. What does the Regulation do to reduce administrative burdens, especially on SME issuers?

Insiders' lists are an important tool for competent authorities when investigating possible market abuse. However, differences in national laws implementing the MAD have imposed unnecessary administrative burdens on issuers. The Regulation aims to eliminate these by providing that the precise data to be included in such lists should be defined in delegated acts and implementing technical standards adopted by the Commission.

Applying the new market abuse framework of the Regulation in an undifferentiated manner to all SME growth markets may deter issuers on those markets from raising capital on the capital markets. The Regulation therefore allows inside information to be published by those SME growth markets, on behalf of issuers whose financial instruments are admitted to trading on SME growth markets. Those issuers are also subject to a tailored obligation to provide insiders' lists to the competent authorities.

The Regulation clarifies the scope of the reporting obligations in relation to managers' transactions. These reports serve important purposes by deterring managers from insider trading and providing useful information to the market about the manager's view on the price movements of the shares of the issuers. The Regulation clarifies that any transaction made by a person exercising discretion on behalf of a manager of an issuer or whereby the manager pledges or lends his shares must also be reported to the competent authorities and be made accessible to the public. Moreover, it introduces a threshold of €5 000, uniform in all Member States, which triggers the obligation to report such manager's transactions. It also provides for the freedom of competent authorities to increase this threshold to €20 000 under several conditions and procedures.

14. What are the next steps in the adoption of the Regulation?

The Regulation shall be subject to revisions by legal linguists and revisers, endorsement by the Parliament and Council, alignment with the final political agreement on MiFID II and formal adoption by the Parliament and Council following MiFID II. Once adopted the regulation would apply from 24 months after its entry into force.

Proposal for a Directive on Criminal Sanctions for Market Abuse

15. What about the Directive on Criminal Sanctions for Market Abuse?

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.

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.

The proposal has been subject of a first reading opinion by the European Parliament and the Council has agreed a general approach. Trilogue negotiations on the Directive are expected to commence under the Lithuanian Presidency now that the negotiations on MAR are completed. Once adopted, Member States will have two years to transpose the Directive into national law.

More information is available at:

http://ec.europa.eu/internal_market/securities/abuse/index_en.htm