The Global Implications of the EU's New Civil Market Abuse Regime

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On 3 July 2016 the EU Market Abuse Regulations ("MAR")[1] will come into force, replacing the previous civil market abuse regime as set out in the Market Abuse Directive ("MAD"). Given its extra-territorial effect, the changes brought in by MAR are likely to have implications for market participants located outside the EU. This note sets out some relevant background to the changes, and the driving force behind them, before summarising some of the provisions which may impact US market participants. Some of the changes are entirely novel, whilst others merely extend the scope of MAD. For many market participants the following five key aspects of MAR may be of interest:

1. **Extra-territorial effect:** actions or omissions committed in the US, which constitute market abuse under MAR, will be captured and therefore could be the subject of sanction in the European Union.
2. **Indirect application:** MAR's application can extend to any US financial instrument where its price or value depends on, or has an effect on, the price or value of a financial instrument which is on an EU regulated market.
3. **Commodity contracts:** abusive conduct committed in the context of spot commodity trading is captured by MAR where it is likely or intended to have an effect on the price of EU financial instruments, no matter where in the world that conduct takes place.
4. **Orders or behaviour outside a trading venue:** MAR recognises that market abuse does not just occur through actual transactions. The placing of orders and behaviour which is unconnected with any trading venue can also affect markets.
5. **High Frequency Trading:** MAR prohibits specified conduct affected through High Frequency Trading.

Background

The rules and sanctions enacted in MAR are civil in nature. Their criminal equivalents are contained in the Criminal Sanctions for Market Abuse Directive ("CSMAD"), a separate piece of legislation which comes into force on the same day. As a Regulation, MAR is directly applicable in the law of all EU Member States. In contrast CSMAD, a Directive, sets down minimum standards which have to be incorporated into the domestic law of individual member states. The UK has opted-out of

CSMAD, choosing instead to retain its current domestic legislative framework for criminal market abuse.

The enactment of MAR was, in part, a response to MAD becoming outdated. The globalisation of financial markets, changes to the platforms on which they operate and allegations of widespread abuse, particularly in the context of benchmark manipulation, prompted the scope of the regime to be reassessed. Hence the provisions of MAR extend the scope of the EU's market abuse regime in a number of material ways. In essence, MAR seeks to capture transactions and conduct which, although not directly related to financial instruments traded on EU venues, are still capable of affecting the value or cost of such instruments. Crucially, MAR is not limited to financial instruments traded on the regulated market. Given that MAR has extra-territorial effect, these changes could therefore prove relevant to companies operating outside of the EU.

Key Changes

The key extensions to the EU civil market abuse regime, as brought in by MAR, are as follows

- MAR applies not only to financial instruments traded on a regulated market, but also to those which are traded on Multilateral Trading Facilities (MTFs) and Organised Trading Facilities (OTFs). It also captures behavior and transactions relating to the auctioning of emission allowances on an authorised platform. MTFs, OTFs and emission allowances are all defined in the Markets in Financial Instruments Directive II (MIFID II), which does not come into force until January 2018. Accordingly, these markets will not be subject to MAR until that date.
- More wide-ranging, and not contingent on MIFID II, is Article 2(1)(d) of MAR. This provision extends the scope of MAR, in relation to market manipulation, to *any* financial instrument, the price or value of which *depends on, or has an effect on,* the price or value of a financial instrument directly covered by MAR (i.e. those on regulated markets, OTFs and MTFs), for example credit default swaps and contracts for difference.[2]
- MAD only applied to financial and derivative markets, and not to the related (non-financial) spot markets. Acknowledging that conduct across non-financial spot markets can influence and affect related financial and derivative markets, and vice versa, MAR extends the reach of what constitutes market manipulation to apply to:[3]
  - spot commodity contracts, which are not wholesale energy products, where the t*ransaction, order or behaviour has or is likely or intended to have an effect on* the price or value of an applicable financial instrument; and
  - types of financial instruments, including derivative contracts or derivative instruments for the transfer of credit risk, *where the transaction, order, bid or behaviour has or is likely to have an effect on the price or value of a spot commodity contract where the price or value depends on the price or value of those financial instruments.*
- Reflecting the same rationale, the definition of inside information under MAR is extended to cover price sensitive information that is relevant to the related spot commodity contract as well as to the derivative itself
- The risk that the manipulation of markets can be achieved more remotely is broadly

addressed through Article 2(3), which extends MAR to cover any order or behavior concerning a financial instrument, even where the behavior does not take place on a trading venue.[4]

- Under MAD, for a person to be guilty of market abuse it was necessary to demonstrate that either an order was placed or a transaction executed. Although not clearly defined, an *'attempted market manipulation'* is now covered by MAR.[5]
- The manipulation of benchmarks is brought within the scope of MAR and is generally defined: any behaviour which manipulates the calculation of a benchmark is now prohibited.[6]
- MAR expressly categorises specific strategies, employed in High Frequency or Algorithmic Trading, which if carried out are likely to constitute market abuse:[7]
  - disrupting or delaying the functioning of the trading system or being likely to do so;
  - making it more difficult for other persons to identify genuine orders on the trading system, including by entering orders which result in the overloading or destabilisation of the order book; and
  - creating or being likely to create a false or misleading signal about the supply of, or demand for, or price of, a financial instrument, in particular by entering orders to initiate or exacerbate a trend.

As with its predecessor, MAR has extra-territorial effect. Article 2(4) states that the prohibitions and requirements in MAR capture any actions and omissions, *in the EU and in a third country,* concerning the financial instruments to which MAR applies. Coupled with the extensions identified above, this provision could have far-reaching implications for market participants located outside the EU. For example, behaviour by US participants in the commodities market could fall within the remit of MAR's regime, where that behaviour is likely to have an effect on the price or value of a financial instrument traded on a relevant EU venue. This would be the case even if the instrument is predominantly traded on a US platform.

Conclusion

MAR expressly acknowledges that the previous regime was no longer fit for purpose given “legislative, market and technological developments”. Its provisions are calculated to extend the protection of market integrity by casting a regulatory net beyond the specific financial instruments traded on EU venues. Accordingly, market participants and actors may now need to monitor more closely activity which, although not ostensibly within the EU's remit, is capable of affecting the value of instruments that are.

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[1] The full text of the Regulations can be found here.

[2] Under MAD the scope of the provisions on insider dealing already apply to *any* financial instrument. MAR will now extend that principle to market manipulation.

[3] Article 2(2)(a) and (b)

[4] By way of comparison, the current provisions under MAD focus only on transactions and do not extend to orders or other behaviour.

[5] Article 15

[6] Article 12(1)(d)

[7] Article 12(2)(c)