

Market manipulation: risks arising from rumours, soundings and information
Kingsley Napley
31 July 2018

This evening's lecture is in relation to an EU Regulation with the following catchy title:

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

The Regulations are 61 pages long and have 16 pages of recitals...

The recitals reflect the content of the Regulations (thus are the Regs repetitious), in more ordinary language with some important guidance. They are worth reading through.

This talk will introduce and look at the more important parts of the Regulations.

First, a key to acronyms which feature in the Regulations:

MAD - Market Abuse Directive

MAR - Market Abuse Regulation

ITS - Implementing Technical Standards

RTS - Regulatory Technical Standards

ESMA - European Securities and Markets Authority

PDMR - Person discharging managerial responsibilities

MTF - Multilateral trading facility

MiFID - Markets in Financial Instruments Directive

MAR is a European regulation so it has direct effect in the UK. It replaces the previously existing civil market abuse regime with the European law in MAR itself (Level 1) and in detailed European texts underpinning it (Level 2). These include Implementing Technical Standards (**ITS**) and Regulatory Technical Standards (**RTS**). The European legal framework also has Level 3 Guidelines. These, along with the RTS and ITS, are drafted by the European Securities and Markets Authority (**ESMA**). They contain relevant detail - although they are not yet all finalised.

Before turning to the Regulations themselves:

In 1983, the film Trading Places was released, in which insider information relating to the Concentrated Orange Juice Market was intended to make a huge profit for the Duke brothers, knowing (wrongly) that they could go long until the release of the crop reports. The main two characters played by Dan Ackroyd and Eddie Murphy switched the crop reports supplied to the Duke brothers to give a false conclusion, whilst they correctly short their stock transactions.

From fiction to reality...

CHARTER CHAMBERS

In 1985, after merging two pipeline companies to form Enron Corp., founder Kenneth Lay established the market for selling electricity. He successfully lobbied the U.S. Congress to deregulate the sale of natural gas. Lay also lobbied for, and was granted, government deregulation over his company's earnings reports.

With Enron's newfound accounting free reign, executives promptly set to cooking the books. First, they failed to report losses in order to keep investors interested in what seemed like a profitable company.

Second, the financial officers concealed debts so that they didn't show up in the company's accounts. Lay and CEO Jeff Skilling used accounting loopholes and misappropriated investments to keep billions off the company's records.

In 2001, after eight years of witnessing Enron's stock market manipulation, in-house accountant Sherron Watkins blew the whistle.

The Enron scandal ended in one of the biggest bankruptcies in history. Enron stock crashed from \$90 per share in mid-2000 to less than \$1 by the end of November 2001. Investors lost more than \$70 billion.

Finally, a headline from the 19 January 2018 edition of *The Independent* –

FCA: City watchdog secures just 12 insider trading convictions in five years

Almost a fifth of takeovers are preceded by suspicious share price movements, regulators own figures show.

The Financial Conduct Authority has prosecuted just eight cases of insider trading in the past five years, securing 12 convictions, despite its own research suggesting that the crime remains commonplace, newly released figures show.

Insider trading – where investors buy or sell shares or other financial assets based on information that is not known to the wider market – potentially makes perpetrators millions of pounds in profit or allows them to avoid big losses.

According to the watchdog's published statistics, stock prices of the 350 biggest companies listed in the UK moved suspiciously during the two days before a takeover announcement in 30 per cent of cases prior to 2010. That figure fell to a low of 15 per cent in 2014 before rising to 19 per cent in 2016, the most recent year for which figures are available.

According to *The Times*' analysis of FTSE 100 companies, the share price of a firm that issued a major profit warning dropped the day before the announcement in 67 per cent of cases, also suggesting that shareholders may be trading on inside information.

An FCA spokesperson said: "We do investigate all suspicious activity, and we are committed to ensuring that we're always improving our ability to detect, investigate and take action using our criminal, civil, and administrative powers."

The regulator opened up 84 insider trading cases in 2017, a record that surpassed its previous best of 70 in 2016, but conviction rates remain low due to the difficulty and expense of building up the required evidence and bringing cases against suspects who are often wealthy and have access to expensive legal teams.

And in the US...

A less publicized and more sinister version of short selling can take place on Wall Street. It's called "short and distort" (S&D).

Nothing is inherently wrong with short selling, which is permissible under the regulations of the Securities and Exchange Commission (SEC). However, the short-and-distort type of short seller uses misinformation and a bear market to manipulate stocks. S&D is illegal, as is its counterpart, the pump and dump, which is mainly used in a bull market.

What are 'Bear' and 'Bull' markets?

A bear market is a condition in which securities prices fall and widespread **pessimism** causes the stock market's downward spiral to be self-sustaining. Investors anticipate losses as pessimism and selling increases. Although figures vary, a downturn of 20 percent or more from a peak in multiple broad market indexes, such as the Dow Jones Industrial Average (DJIA) or Standard & Poor's 500 Index (S&P 500), over a two-month period is considered an entry into a bear market.

It is named for the way in which a bear attacks its prey — swiping its paws downward. This is why markets with falling stock prices are called bear markets.

While there is no agreed upon definition of what makes a bear market, it's generally accepted that a bear market is characterized by a drop of 20 percent or more over a two-month period.

The opposite is a "bull market," or a market in which prices for securities are rising or will expect to rise. Just like the bear market, the bull market is named after the way in which the bull attacks by thrusting its horns up into the air.

As we are about to talk about information...

Recital 48 reads:

(48) Given the rise in the use of websites, blogs and social media, it is important to clarify that disseminating false or misleading information via the internet, including through social media sites or unattributable blogs, should be considered, for the purposes of this Regulation, to be equivalent to doing so via more traditional communication channels.

Back to the Regulations

Highlights

Article 1

Subject matter

This Regulation establishes a common regulatory framework on insider dealing, the unlawful disclosure of inside information and market manipulation (market abuse) as well as measures to

CHARTER CHAMBERS

prevent market abuse to ensure the integrity of financial markets in the Union and to enhance investor protection and confidence in those markets.

ESMA Q&A at A5.1:

A main objective of the Market Abuse Regulation (MAR) is to enhance market integrity. This is notably achieved through a prompt and fair disclosure of information to the public.

Recital extracts:

Whereas:

(1) A genuine internal market for financial services is crucial for economic growth and job creation in the Union.

(2) An integrated, efficient and transparent financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth. Market abuse harms the integrity of financial markets and public confidence in securities and derivatives.

...

(4) There is a need to establish a more uniform and stronger framework in order to preserve market integrity, to avoid potential regulatory arbitrage, to ensure accountability in the event of attempted manipulation, and to provide more legal certainty and less regulatory complexity for market participants. This Regulation aims at contributing in a determining manner to the proper functioning of the internal market and should therefore be based on Article 114 of the Treaty on the Functioning of the European Union (TFEU), as interpreted consistently in the case-law of the Court of Justice of the European Union.

...

(7) Market abuse is a concept that encompasses unlawful behaviour in the financial markets and, for the purposes of this Regulation, it should be understood to consist of insider dealing, unlawful disclosure of inside information and market manipulation. Such behaviour prevents full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets.

...

(14) Reasonable investors base their investment decisions on information already available to them, that is to say, on *ex ante* available information. Therefore, the question whether, in making an investment decision, a reasonable investor would be likely to take into account a particular piece of information should be appraised on the basis of the *ex ante* available information. Such an assessment has to take into consideration the anticipated impact of the information in light of the totality of the related issuer's activity, the reliability of the source of information and any other market variables likely to affect the financial instruments, the related spot commodity contracts, or the auctioned products based on the emission allowances in the given circumstances.

Article 2

...

CHARTER CHAMBERS

3. This Regulation applies to any transaction, order or behaviour **concerning any financial instrument** as referred to in paragraphs 1 and 2, irrespective of whether or not such transaction, order or behaviour takes place on a trading venue.

Chapter 2

Article 7

Inside Information

1. ... inside information shall comprise the following types of information:

(a) 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;

(b) in relation to commodity derivatives, ... [as a above] ... and where this is information which is reasonably expected to be disclosed or is required to be disclosed in accordance with legal or regulatory provisions at the Union or national level, market rules, contract, practice or custom, on the relevant commodity derivatives markets or spot markets;

(c) in relation to emission allowances or auctioned products based thereon, ... [as a above];

(d) for persons charged with the execution of orders concerning financial instruments, it also means information conveyed by a client and relating to the client's pending orders in financial instruments, which is ... [as a above].

2. ...information shall be deemed to be of a precise nature if it indicates a set of circumstances which exists or which may reasonably be expected to come into existence, or an event which has occurred or which may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices...

4. ... information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments [etc] ... shall mean information a reasonable investor would be likely to use as part of the basis of his or her investment decisions.

Article 8

Insider dealing

1. ...insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates. The use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates where the order was placed before the person concerned possessed the inside information, shall also be considered to be insider dealing. In relation to auctions of emission allowances or other auctioned products based thereon that are held pursuant to Regulation (EU) No 1031/2010, the use of inside information shall also comprise submitting, modifying or withdrawing a bid by a person for its own account or for the account of a third party.

2. ...recommending that another person engage in insider dealing, or inducing another person to engage in insider dealing, arises where the person possesses inside information and:

(a) recommends, on the basis of that information, that another person acquire or dispose of financial instruments to which that information relates, or induces that person to make such an acquisition or disposal, or

(b) recommends, on the basis of that information, that another person cancel or amend an order concerning a financial instrument to which that information relates, or induces that person to make such a cancellation or amendment.

3. The use of the recommendations or inducements referred to in paragraph 2 amounts to insider dealing within the meaning of this Article where the person using the recommendation or inducement knows or ought to know that it is based upon inside information.

4. This Article applies to any person who possesses inside information as a result of:

(a) being a member of the administrative, management or supervisory bodies of the issuer or emission allowance market participant;

(b) having a holding in the capital of the issuer or emission allowance market participant;

(c) having access to the information through the exercise of an employment, profession or duties; or

(d) being involved in criminal activities.

This Article also applies to any person who possesses inside information under circumstances other than those referred to in the first subparagraph where that person knows or ought to know that it is inside information.

5. Where the person is a legal person, this Article shall also apply, in accordance with national law, to the natural persons who participate in the decision to carry out the acquisition, disposal, cancellation or amendment of an order for the account of the legal person concerned.

Recital extract:

(19) This Regulation is not intended to prohibit discussions of a general nature regarding the business and market developments between shareholders and management concerning an issuer. Such relationships are essential for the efficient functioning of markets and should not be prohibited by this Regulation.

...

(23) The essential characteristic of insider dealing consists in an unfair advantage being obtained from inside information to the detriment of third parties who are unaware of such information and, consequently, the undermining of the integrity of financial markets and investor confidence. Consequently, the prohibition against insider dealing should apply where a person who is in possession of inside information takes unfair advantage of the benefit gained from that information by entering into market transactions in accordance with that information by acquiring or disposing of, by attempting to acquire or dispose of, by cancelling or amending, or by attempting to cancel or amend, an order to acquire or dispose of, for his own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates. Use of inside information can also consist of trading in emission allowances and derivatives thereof and of bidding

CHARTER CHAMBERS

in the auctions of emission allowances or other auctioned products based thereon that are held pursuant to Commission Regulation (EU) No 1031/2010 (1).

(24) Where a legal or natural person in possession of inside information acquires or disposes of, or attempts to acquire or dispose of, for his own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates, it should be implied that that person has used that information. That presumption is without prejudice to the rights of the defence. The question whether a person has infringed the prohibition on insider dealing or has attempted to commit insider dealing **should be analysed in the light of the purpose of this Regulation**, which is to protect the integrity of the financial market and to enhance investor confidence, which is based, in turn, on the assurance that investors will be placed on an equal footing and protected from the misuse of inside information.

Example:

(25) Orders placed before a person possesses inside information should not be deemed to be insider dealing. However, where a person comes into possession of inside information, there should be a presumption that any subsequent change relating that information to orders placed before possession of such information, including the cancellation or amendment of an order, or an attempt to cancel or amend an order, constitutes insider dealing. That presumption could, however, be rebutted if the person establishes that he or she did not use the inside information when carrying out the transaction.

(28) Research and estimates based on publicly available data, should not per se be regarded as inside information and the mere fact that a transaction is carried out on the basis of research or estimates should not therefore be deemed to constitute use of inside information. However, for example, where the publication or distribution of information is routinely expected by the market and where such publication or distribution contributes to the price-formation process of financial instruments, or the information provides views from a recognised market commentator or institution which may inform the prices of related financial instruments, the information may constitute inside information. Market actors must therefore consider the extent to which the information is non-public and the possible effect on financial instruments traded in advance of its publication or distribution, to establish whether they would be trading on the basis of inside information.

(29) In order to avoid inadvertently prohibiting forms of financial activity which are legitimate, namely where there is no effect of market abuse, it is necessary to recognise certain legitimate behaviour. This may include, for example, recognising the role of market makers, when acting in the legitimate capacity of providing market liquidity.

Article 9

Legitimate behaviour

1. For the purposes of Articles 8 and 14, it shall not be deemed from the mere fact that a legal person is or has been in possession of inside information that that person has used that information and has thus engaged in insider dealing on the basis of an acquisition or disposal, where that legal person:

- (a) has established, implemented and maintained adequate and effective internal arrangements and procedures that effectively ensure that neither the natural person who made the decision on its behalf to acquire or dispose of financial instruments to which the information relates, nor another natural person who may have had an influence on that decision, was in possession of the inside information; and

CHARTER CHAMBERS

(b) has not encouraged, made a recommendation to, induced or otherwise influenced the natural person who, on behalf of the legal person, acquired or disposed of financial instruments to which the information relates.

[or]

2. [as 1 above] :

(a) for the financial instrument to which that information relates, is a market maker or a person authorised to act as a counterparty, and the acquisition or disposal of financial instruments to which that information relates is made legitimately in the normal course of the exercise of its function as a market maker or as a counterparty for that financial instrument;

or

(b) is authorised to execute orders on behalf of third parties, and the acquisition or disposal of financial instruments to which the order relates, is made to carry out such

3. [as 1 above]...where that person conducts a transaction to acquire or dispose of financial instruments and that transaction is carried out in the discharge of an obligation that has become due in good faith and not to circumvent the prohibition against insider dealing and:

(a) that obligation results from an order placed or an agreement concluded before the person concerned possessed inside information; or

(b) that transaction is carried out to satisfy a legal or regulatory obligation that arose, before the person concerned possessed inside information.

4. [as 1 above]... where such person has obtained that 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.

5. ...the mere fact that a person uses its own knowledge that it has decided to acquire or dispose of financial instruments in the acquisition or disposal of those financial instruments shall not of itself constitute use of inside information.

6. Notwithstanding paragraphs 1 to 5 of this Article, an infringement of the prohibition of insider dealing set out in Article 14 **may still be deemed to have occurred if the competent authority establishes that there was an illegitimate reason for the orders** to trade, transactions or behaviours concerned.

Article 10

Unlawful disclosure of inside information

1. ...unlawful disclosure of inside information arises where a person possesses inside information and discloses that information to any other person, except where the disclosure is made in the normal exercise of an employment, a profession or duties.

...

CHARTER CHAMBERS

Article 11

Market soundings

1. A market sounding comprises the communication of information, prior to the announcement of a transaction, in order 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...
2. Without prejudice to Article 23(3), disclosure of inside information by a person intending to make a takeover bid for the securities of a company or a merger with a company to parties entitled to the securities, shall also constitute a market sounding, provided that:
 - (a) the information is necessary to enable the parties entitled to the securities to form an opinion on their willingness to offer their securities: and
 - (b) the willingness of parties entitled to the securities to offer their securities is reasonably required for the decision to make the takeover bid or merger.
3. A disclosing market participant shall, prior to conducting a market sounding, specifically consider whether the market sounding will involve the disclosure of inside information. **The disclosing market participant shall make a written record of its conclusion and the reasons therefor.** It shall provide such written records to the competent authority upon request. This obligation shall apply to each disclosure of information throughout the course of the market sounding. The disclosing market participant shall update the written records referred to in this paragraph accordingly.
4. For the purposes of Article 10(1), disclosure of inside information made in the course of a market sounding shall be deemed to be made in the normal exercise of a person's employment, profession or duties where the disclosing market participant complies with paragraphs 3 and 5 of this Article.
5. For the purposes of paragraph 4, the disclosing market participant shall, before making the disclosure:
 - (a) obtain the consent of the person receiving the market sounding to receive inside information;
 - (b) inform the person receiving the market sounding that he is prohibited from using that information, or attempting to use that information, by acquiring or disposing of, for his own account or for the account of a third party, directly or indirectly, financial instruments relating to that information;
 - (c) inform the person receiving the market sounding that he is prohibited from using that information, or attempting to use that information, by cancelling or amending an order which has already been placed concerning a financial instrument to which the information relates; and
 - (d) inform the person receiving the market sounding that by agreeing to receive the information he is obliged to keep the information confidential.

The disclosing market participant shall make and maintain a record of all information given to the person receiving the market sounding, including the information given in accordance with points (a) to (d) of the first subparagraph, and the identity of the potential investors to whom the information has been disclosed, including but not limited to the legal and natural persons acting on behalf of the potential investor, and the date and time of each disclosure. The disclosing market participant shall provide that record to the competent authority upon request.

6. Where information that has been disclosed in the course of a market sounding ceases to be inside information according to the assessment of the disclosing market participant, the disclosing market participant shall inform the recipient accordingly, as soon as possible.

CHARTER CHAMBERS

The disclosing market participant shall maintain a record of the information given in accordance with this paragraph and shall provide it to the competent authority upon request.

7. Notwithstanding the provisions of this Article, the person receiving the market sounding shall assess for itself whether it is in possession of inside information or when it ceases to be in possession of inside information.

Recital extracts:

(32) Market soundings are interactions between a seller of financial instruments and one or more potential investors, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and its pricing, size and structuring. Market soundings could involve an initial or secondary offer of relevant securities, and are distinct from ordinary trading. They are a highly valuable tool to gauge the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned. They may be particularly beneficial when markets lack confidence or a relevant benchmark, or are volatile. Thus the ability to conduct market soundings is important for the proper functioning of financial markets and market soundings should not in themselves be regarded as market abuse.

(33) Examples of market soundings include situations in which the sell-side firm has been in discussions with an issuer about a potential transaction, and it has decided to gauge potential investor interest in order to determine the terms that will make up a transaction; where an issuer intends to announce a debt issuance or additional equity offering and key investors are contacted by a sell-side firm and given the full terms of the deal to obtain a financial commitment to participate in the transaction; or where the sell-side is seeking to sell a large amount of securities on behalf of an investor and seeks to gauge potential interest in those securities from other potential investors.

(34) Conducting market soundings may require disclosure to potential investors of inside information. There will generally only be the potential to benefit financially from trading on the basis of inside information passed in a market sounding where there is an existing market in the financial instrument that is the subject of the market sounding or in a related financial instrument. Given the timing of such discussions, it is possible that inside information may be disclosed to the potential investor in the course of the market sounding after a financial instrument has been admitted to trading on a regulated market or has been traded on an MTF or an OTF. Before engaging in a market sounding, the disclosing market participant should assess whether that market sounding will involve the disclosure of inside information.

Article 12

Market manipulation

1. For the purposes of this Regulation, market manipulation shall comprise the following activities:
 - (a) entering into a transaction, placing an order to trade or any other behaviour which:
 - (i) gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances; or
 - (ii) secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level;

unless the person entering into a transaction, placing an order to trade or engaging in any other behaviour establishes that such transaction, order or behaviour have been carried out for legitimate reasons, and conform with an accepted market practice as established in accordance with Article 13;

(b) entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances, which employs a fictitious device or any other form of deception or contrivance;

(c) disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances or secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading;

(d) transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person who made the transmission or provided the input knew or ought to have known that it was false or misleading, or any other behaviour which manipulates the calculation of a benchmark.

2. The following behaviour shall, inter alia, be considered as market manipulation:

(a) the conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument, related spot commodity contracts or auctioned products based on emission allowances which has, or is likely to have, the effect of fixing, directly or indirectly, purchase or sale prices or creates, or is likely to create, other unfair trading conditions;

(b) the buying or selling of financial instruments, at the opening or closing of the market, which has or is likely to have the effect of misleading investors acting on the basis of the prices displayed, including the opening or closing prices;

(c) the placing of orders to a trading venue, including any cancellation or modification thereof, by any available means of trading, including by electronic means, such as algorithmic and high-frequency trading strategies, and which has one of the effects referred to in paragraph 1(a) or (b), by:

(i) disrupting or delaying the functioning of the trading system of the trading venue or being likely to do so;

(ii) making it more difficult for other persons to identify genuine orders on the trading system of the trading venue or being likely to do so, including by entering orders which result in the overloading or destabilisation of the order book; or

(iii) 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;

(d) the **taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument, related spot commodity**

CHARTER CHAMBERS

contract or an auctioned product based on emission allowances (or indirectly about its issuer) while having previously taken positions on that financial instrument, a related spot commodity contract or an auctioned product based on emission allowances and profiting subsequently from the impact of the opinions voiced on the price of that instrument, related spot commodity contract or an auctioned product based on emission allowances, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way;

(e) the buying or selling on the secondary market of emission allowances or related derivatives prior to the auction held pursuant to Regulation (EU) No 1031/2010 with the effect of fixing the auction clearing price for the auctioned products at an abnormal or artificial level or misleading bidders bidding in the auctions.

Article 13

Accepted market practices

1. The prohibition in Article 15 shall not apply to the activities referred to in Article 12(1)(a), provided that the person entering into a transaction, placing an order to trade or engaging in any other behaviour establishes that such transaction, order or behaviour have been carried out for legitimate reasons, and conform with an accepted market practice as established in accordance with this Article.

Recital extracts:

(42) Without prejudice to the aim of this Regulation and its directly applicable provisions, a person who enters into transactions or issues orders to trade which may be deemed to constitute market manipulation may be able to establish that his reasons for entering into such transactions or issuing orders to trade were legitimate and that the transactions and orders to trade were in conformity with accepted practice on the market concerned. An accepted market practice can only be established by the competent authority responsible for the market abuse supervision of the market concerned. A practice that is accepted in a particular market cannot be considered applicable to other markets unless the competent authorities of such other markets have officially accepted that practice. An infringement could still be deemed to have occurred if the competent authority established that there was an illegitimate reason behind these transactions or orders to trade.

Article 14

Prohibition of insider dealing and of unlawful disclosure of inside information

Article 15

Prohibition of market manipulation

Article 16

Prevention and detection of market abuse

1. Market operators and investment firms that operate a trading venue shall establish and maintain effective arrangements, systems and procedures aimed at preventing and detecting insider dealing, market manipulation and attempted insider dealing and market manipulation,

CHAPTER 3 DISCLOSURE REQUIREMENTS

Article 17

Public disclosure of inside information

1. An issuer shall inform the public as soon as possible of inside information which directly concerns that issuer.

The issuer shall ensure that the inside information is made public in a manner which enables fast access and complete, correct and timely assessment of the information by the public

4. An issuer or an emission allowance market participant, may, on its own responsibility, delay disclosure to the public of inside information provided that all of the following conditions are met:

- (a) immediate disclosure is likely to prejudice the legitimate interests of the issuer or emission allowance market participant;
- (b) delay of disclosure is not likely to mislead the public;
- (c) the issuer or emission allowance market participant is able to ensure the confidentiality of that information.

In the case of a protracted process that occurs in stages and that is intended to bring about, or that results in, a particular circumstance or a particular event, an issuer or an emission allowance market participant may on its own responsibility delay the public disclosure of inside information relating to this process, subject to points (a), (b) and (c) of the first subparagraph.

Where an issuer or emission allowance market participant has delayed the disclosure of inside information under this paragraph, it shall inform the competent authority specified under paragraph 3 that disclosure of the information was delayed and shall provide a written explanation of how the conditions set out in this paragraph were met, immediately after the information is disclosed to the public. Alternatively, Member States may provide that a record of such an explanation is to be provided only upon the request of the competent authority specified under paragraph 3.

5. In order to preserve the stability of the financial system, an issuer that is a credit institution or a financial institution, may, on its own responsibility, delay the public disclosure of inside information, including information which is related to a temporary liquidity problem and, in particular, the need to receive temporary liquidity assistance from a central bank or lender of last resort, provided that all of the following conditions are met:

- (a) the disclosure of the inside information entails a risk of undermining the financial stability of the issuer and of the financial system;
- (b) it is in the public interest to delay the disclosure;
- (c) the confidentiality of that information can be ensured; and
- (d) the competent authority specified under paragraph 3 has consented to the delay on the basis that the conditions in points (a), (b) and (c) are met.

6. For the purposes of points (a) to (d) of paragraph 5, an issuer **shall notify the competent authority specified under paragraph 3 of its intention to delay the disclosure of the inside information and provide evidence that the conditions** set out in points (a), (b) and (c) of paragraph 5 **are met**. The competent authority specified under paragraph 3 shall consult, as

appropriate, the national central bank or the macro-prudential authority, where instituted, or, alternatively, the following authorities:

7. Where disclosure of inside information has been delayed... and the confidentiality of that inside information is no longer ensured, the issuer or the emission allowance market participant shall disclose that inside information to the public as soon as possible.

This paragraph includes situations where a rumour explicitly relates to inside information the disclosure of which has been delayed in accordance with paragraph 4 or 5, where that rumour is sufficiently accurate to indicate that the confidentiality of that information is no longer ensured.

Recital extract:

(49) The public disclosure of inside information by an issuer is essential to avoid insider dealing and ensure that investors are not misled. Issuers should therefore be required to inform the public as soon as possible of inside information. However that obligation may, under special circumstances, prejudice the legitimate interests of the issuer. In such circumstances, delayed disclosure should be permitted provided that the delay would not be likely to mislead the public and the issuer is able to ensure the confidentiality of the information. The issuer is only under an obligation to disclose inside information if it has requested or approved admission of the financial instrument to trading.

What are rumours?

On one definition... a rumour is the opposite of fact. A fact is verified piece of information supported by data whereas a rumour is an unverified piece of information, which is unsubstantiated by any data. Since rumours are not backed by any data, they are normally quite exaggerated pieces of information and can be far from truth.

ESMA Q&A at A5.1:

ESMA recalls that, if and when a publication (e.g. an article published in the press or internet postings) which is not resulting from the issuer's initiative in relation to its disclosure obligations or a rumour in the market relates explicitly to (a piece of) information that is inside information within the issuer, according to Article 17(7) of MAR that issuer is expected to react and respond to the relevant publication or rumour if that (piece of) information is sufficiently accurate to indicate that the confidentiality of this inside information is no longer ensured. In such circumstances, which should be the exception rather than the rule and should be examined by the issuer on a case-by-case basis, a policy of staying silent or of "no comment" by the issuer would not be acceptable. The issuer's reaction or response should be made publicly available in the same conditions and using the same mechanisms as those used for the communication of inside information, so that an ad hoc announcement has to be published without undue delay.

Practical matters (July 2017 AFM):

A number of examples are given below of possible inside information:

Significant facts concerning the financial position and/ or results:

CHARTER CHAMBERS

- disclosure of periodic financial results;
- significant deviations from earlier forecasts, and generally accepted market expectations or ratings;
- development of major new products;
- substantial changes in credit and in security provided for credit, including covenants being broken;
- cancellation of significant credit facilities by one or more banks;
- substantial changes in reporting policies;
- an equity deficit;
- replacement of external auditor;
- significant legal cases, fines, claims, product liability, environmental damage, etc.

Significant facts concerning the company's strategy:

- purchase or sale of key shareholdings and/or business units;
 - forming or dissolving significant joint ventures;
 - extensive reorganisation;
 - strategic change of direction; radical change in the company's operations;
 - dissolution of the company;
 - merger or acquisition;
 - significant intervention by external supervisors;
 - application for suspension of payments or bankruptcy.
- significant facts concerning capital, control or governance:*
- combining or splitting of shares;
 - change in the rights of the different categories of financial instruments;
 - changes in the executive or supervisory board of an issuer;
 - dividend announcements, including the ex-dividend date (or changes to it) and changes to dividend policy;
 - major change in spread of shareholdings and/or free float;
 - implementing or activating anti-takeover measures;
 - If a decision is taken to buy back shares in the company.

Situations to be avoided

- delaying publication simply because complete clarity cannot be provided;
- delaying solely to protect the image of the company or the directors;
- delaying publication of inside information until the publication of the next scheduled report;
- in the case of bad news, delaying publication until the situation or event has been resolved;
- issuing a press release that does not directly provide a clear interpretation of results or forecasts (e.g. use of the Mock scale);
- disseminating inside information during presentations, interviews, etc;
- allowing the interests of individual shareholders to prevail over those of the investing public as a whole;
- including a reference in a press release to another source where (supplementary) inside information is available;
- referring in a press release to relevant information contained in previous press releases, without including that information in the new press release;
- placing inside information in a prospectus;
- publicly disclosing only parts of a constellation of facts;

CHARTER CHAMBERS

- disclosing inside information solely in records kept by supervisory authorities;
- hiding or disguising bad news in a whole package of information;
- publishing only the effects of situations or the corresponding remedial measures, and not informing about reason or cause;
- protecting investors because of their perceived inexperience or lack of knowledge;
- believing that investors prefer not to be ‘flooded’ with information.

What must an issuer publicly disclose?

- Publish good news and bad news, both as soon as possible;
- publicly disclose deviations from previously published forecasts or targets as soon as possible;
- if and when a rumour relates explicitly to inside information, the disclosure of which has been delayed, and if that rumour is sufficiently accurate to indicate that the confidentiality of this inside information is no longer ensured, that issuer shall disclose that inside information to the public as soon as possible. In such a case, a policy of staying silent or of “no comment” by the issuer would not be acceptable.
- in the event of a false rumour going around the market, consider issuing a press release if the response of the company could cause a significant movement in price or trading volume;
- have a press release issued if inside information is disclosed unintentionally during an interview or presentation;
- issue clear and unambiguous forecasts, or avoid issuing any at all;
- serve the entire investing public: private investors are just as important as analysts and institutional investors;
- in case of doubt, publish!
- preferably use accepted profit terminology, and use it consistently;
- if non-accepted profit terminology is used, indicate and explain it clearly;
- consider issuing a press release if a director is quoted incorrectly about inside information;
- check forthcoming prospectuses for inside information, and if present, issue a separate press release;
- provide a clear heading and summary that accurately reflect the contents and meaning of the press release;
- aim to publish news before or after trading hours (while not forgetting the "without delay" criterion).

The relevant considerations depend on the actual situation and circumstances.

It may be possible to rightfully decide to delay the public disclosure of inside information. The Issuer must decide independently and bears sole responsibility for the delay. Three conditions all have to be satisfied:

1. immediate disclosure is likely to prejudice the legitimate interests of the issuer or emission allowance market participant; i.e. ongoing negotiations
2. it is unlikely that the delay in disclosure would mislead the public; and
3. the issuer or emission allowance market participant is able to guarantee that the information concerned is kept confidential.

If just one of these conditions ceases to be satisfied, the inside information in question must be publicly disclosed as quickly as possible.

CHARTER CHAMBERS

Any delay must be documented to show how the deferment conditions were satisfied. A copy of this written explanation should be submitted to the relevant authority on its request. The minimum data the issuer must keep in order to continue satisfying the deferment conditions are:

- the date on which the inside information came into being;
- the date on which the decision to delay publication was made;
- the date on which the issuer or emission allowance market participant expects it can publicly disclose the information;
- the names of the persons responsible for delaying the disclosure, as well as of those whose responsibilities include monitoring compliance with the conditions and possible publication of the inside information;
- evidence of the continuing fulfilment of the deferment conditions, including every change during the delay period, as well as the restricted sharing of the information concerned and the procedures that have to be initiated if preserving confidentiality of the inside information can no longer be guaranteed.

Non-interference with negotiations to which the company is a party may qualify as a legitimate interest. For this to be so, public disclosure of the item being negotiated would probably affect the outcome or the normal course of the process of these negotiations. In particular, if the financial viability of the issuer is under serious, imminent threat, excluding application of the relevant insolvency legislation, the public disclosure of information may be delayed for a limited period.

An essential criterion here is that public disclosure of the fact that negotiations are taking place and the question of which parties are involved may adversely affect the negotiations. This could harm the interests of both existing and potential shareholders.

In a two-tier board system, the ability of the supervisory body to exercise its function would be impeded if decisions by the management body were already made public before the supervisory body could take its own decision.

Arguably, delay may be justified where the executive board of an issuer has made decisions or concluded agreements and these must still be endorsed by the supervisory board or similar company body. Public disclosure before endorsement has been obtained, together with the simultaneous announcement that endorsement is still outstanding, could prevent the public from making a correct assessment of the information.

A weighing up of interests will have to be performed and reviewed.

As to guaranteeing that the inside information will be kept confidential. This guarantee comprises two parts, controlling access to inside information and having measures to publish the inside information if that confidentiality can no longer be guaranteed. Internal procedures are critical to this. Information may not be easily guaranteed to be confidential if the group of people who know it grows too large.

Also consider delay in order to maintain stability of the financial system

Article 18 **Insider lists**

1. Issuers or any person acting on their behalf or on their account, shall:

CHARTER CHAMBERS

- (a) draw up a list of all persons who have access to inside information and who are working for them under a contract of employment, or otherwise performing tasks through which they have access to inside information, such as advisers, accountants or credit rating agencies (insider list);
- (b) promptly update the insider list in accordance with paragraph 4; and
- (c) provide the insider list to the competent authority as soon as possible upon its request.

Article 30

Administrative sanctions and other administrative measures

...

2. Member States shall, in accordance with national law, ensure that competent authorities have the power to impose at least the following administrative sanctions and to take at least the following administrative measures in the event of the infringements referred to in point (a) of the first subparagraph of paragraph 1:

- (a) an order requiring the person responsible for the infringement to cease the conduct and to desist from a repetition of that conduct;
- (b) the disgorgement of the profits gained or losses avoided due to the infringement insofar as they can be determined;
- (c) a public warning which indicates the person responsible for the infringement and the nature of the infringement;
- (d) withdrawal or suspension of the authorisation of an investment firm;
- (e) a temporary ban of a person discharging managerial responsibilities within an investment firm or any other natural person, who is held responsible for the infringement, from exercising management functions in investment firms;
- (f) in the event of repeated infringements of Article 14 or 15, a permanent ban of any person discharging managerial responsibilities within an investment firm or any other natural person who is held responsible for the infringement, from exercising management functions in investment firms;
- (g) a temporary ban of a person discharging managerial responsibilities within an investment firm or another natural person who is held responsible for the infringement, from dealing on own account;
- (h) maximum administrative pecuniary sanctions of at least three times the amount of the profits gained or losses avoided because of the infringement, where those can be determined;
- (i) in respect of a natural person, maximum administrative pecuniary sanctions of at least:
 - (i) for infringements of Articles 14 and 15, EUR 5 000 000 or in the Member States whose currency is not the euro, the corresponding value in the national currency on 2 July 2014;
 - (ii) for infringements of Articles 16 and 17, EUR 1 000 000 or in the Member States whose currency is not the euro, the corresponding value in the national currency on 2 July 2014; and
 - (iii) for infringements of Articles 18, 19 and 20, EUR 500 000 or in the Member States whose currency is not the euro, the corresponding value in the national currency on 2 July 2014; and
- (j) in respect of legal persons, maximum administrative pecuniary sanctions of at least:
 - (i) for infringements of Articles 14 and 15, EUR 15 000 000 or 15 % of the total annual turnover of the legal person according to the last available accounts approved by the management body, or in the Member States whose currency is not the euro, the corresponding value in the national currency on 2 July 2014;

CHARTER CHAMBERS

- (ii) for infringements of Articles 16 and 17, EUR 2 500 000 or 2 % of its total annual turnover according to the last available accounts approved by the management body, or in the Member States whose currency is not the euro, the corresponding value in the national currency on 2 July 2014; and
- (iii) for infringements of Articles 18, 19 and 20, EUR 1 000 000 or in the Member States whose currency is not the euro, the corresponding value in the national currency on 2 July 2014.

Recital extract (re enforcement):

(64) For the purpose of detecting cases of insider dealing and market manipulation, it is necessary for competent authorities to have, in accordance with national law, the ability to access the premises of natural and legal persons in order to seize documents. Access to such premises is necessary where there is a reasonable suspicion that documents and other data relating to the subject matter of an investigation exist and may be relevant to prove a case of insider dealing or market abuse. Additionally access to such premises is necessary where the person of whom a demand for information has already been made fails, wholly or in part, to comply with it or where there are reasonable grounds for believing that if a demand were to be made it would not be complied with or that the documents or information to which the information requirement relates would be removed, tampered with or destroyed. If prior authorisation is needed from the judicial authority of the Member State concerned, in accordance with national law, access to premises should take place after having obtained that prior judicial authorisation.

(65) Existing recordings of telephone conversations and data traffic records from investment firms, credit institutions and financial institutions executing and documenting the execution of transactions, as well as existing telephone and data traffic records from telecommunications operators, constitute crucial, and sometimes the only, evidence to detect and prove the existence of insider dealing and market manipulation. Telephone and data traffic records may establish the identity of a person responsible for the dissemination of false or misleading information or that persons have been in contact at a certain time, and that a relationship exists between two or more people. Therefore, competent authorities should be able to require existing recordings of telephone conversations, electronic communications and data traffic records held by an investment firm, a credit institution or a financial institution in accordance with Directive 2014/65/EU. Access to data and telephone records is necessary to provide evidence and investigate leads on possible insider dealing or market manipulation, and therefore for detecting and imposing sanctions for market abuse. In order to introduce a level playing field in the Union in relation to the access to telephone and existing data traffic records held by a telecommunications operator or the existing recordings of telephone conversations and data traffic held by an investment firm, a credit institution or a financial institution, competent authorities should, in accordance with national law, be able to require existing telephone and existing data traffic records held by a telecommunications operator, insofar as permitted under national law and existing recordings of telephone conversations as well as data traffic held by an investment firm, in cases where a reasonable suspicion exists that such records related to the subject matter of the inspection or investigation may be relevant to prove insider dealing or market manipulation infringing this Regulation. Access to telephone and data traffic records held by a telecommunications operator does not encompass access to the content of voice communications by telephone.

[Mitigation...]

Article 31

Exercise of supervisory powers and imposition of sanctions

1. Member States shall ensure that when determining the type and level of administrative sanctions, competent authorities take into account all relevant circumstances, including, where appropriate:

- (a) the gravity and duration of the infringement;
- (b) the degree of responsibility of the person responsible for the infringement;
- (c) the financial strength of the person responsible for the infringement, as indicated, for example, by the total turnover of a legal person or the annual income of a natural person;
- (d) the importance of the profits gained or losses avoided by the person responsible for the infringement, insofar as they can be determined;
- (e) the level of cooperation of the person responsible for the infringement with the competent authority, without prejudice to the need to ensure disgorgement of profits gained or losses avoided by that person;
- (f) previous infringements by the person responsible for the infringement; and
- (g) measures taken by the person responsible for the infringement to prevent its repetition.

Article 34

Publication of decisions

1. Subject to the third subparagraph, competent authorities shall publish any decision imposing an administrative sanction or other administrative measure in relation to an infringement of this Regulation on their website immediately after the person subject to that decision has been informed of that decision. Such publication shall include at least information on the type and nature of the infringement and the identity of the person subject to the decision.

Recital extracts:

(73) In order to ensure that decisions made by competent authorities have a dissuasive effect on the public at large, they should normally be published. The publication of decisions is also an important tool for competent authorities to inform market participants of what behaviour is considered to be an infringement of this Regulation and to promote good behaviour amongst market participants. If such publication causes disproportionate damage to the persons involved or jeopardises the stability of financial markets or an ongoing investigation the competent authority should publish the administrative sanctions and other administrative measures on an anonymous basis in accordance with national law or delay the publication. Competent authorities should have the option of not publishing sanctions and other administrative measures where anonymous or delayed publication is considered to be insufficient to ensure that the stability of the financial markets will not be jeopardised. Competent authorities should also not be required to publish measures which are deemed to be of a minor nature and the publication of which would be disproportionate.

CHARTER CHAMBERS

(74) Whistleblowers may bring new information to the attention of competent authorities which assists them in detecting and imposing sanctions in cases of insider dealing and market manipulation. However, whistleblowing may be deterred for fear of retaliation, or for lack of incentives. Reporting of infringements of this Regulation is necessary to ensure that a competent authority may detect and impose sanctions for market abuse. Measures regarding whistleblowing are necessary to facilitate detection of market abuse and to ensure the protection and the respect of the rights of the whistleblower and the accused person. This Regulation should therefore ensure that adequate arrangements are in place to enable whistleblowers to alert competent authorities to possible infringements of this Regulation and to protect them from retaliation. Member States should be allowed to provide for financial incentives for those persons who offer relevant information about potential infringements of this Regulation. However, whistleblowers should only be entitled to such financial incentives where they bring to light new information which they are not already legally obliged to notify and where that information results in a sanction for an infringement of this Regulation. Member States should also ensure that whistleblowing schemes that they implement include mechanisms that provide appropriate protection of an accused person, particularly with regard to the right to the protection of his personal data and procedures to ensure the right of the accused person of defence and to be heard before the adoption of a decision concerning him as well as the right to seek effective remedy before a court against a decision concerning him.

Finally,

The key concept to the Regulations, if there is one... is timing. In the Deutsche Bank response to the consultation on the Guidance to the regulations, they observed (31 March 2016):

Premature disclosure, as a result of the stringent approach proposed by the draft guidelines, would increase the risk of transaction failure. This is neither in the interest of the issuer, nor its stakeholders (such as employees, creditors, shareholders, suppliers and clients), the transaction counterparties and notably other market participants. The draft guidelines would effectively prevent issuers from striking a balance between public disclosure and maintaining its financial viability.

Henry Grunwald QC & Alexander dos Santos
31 July 2018