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Client Alert Commentary

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ESMA's Consultation Paper on the MAR Review

Consultation provides chance for industry to comment on which elements of the regime are working well and where change is needed.

Key Points:

- ESMA is seeking industry views on various aspects of MAR and whether they are operating as they should.
- As well as suggesting some areas in which the regime could be changed, the paper also offers up what is effectively new guidance on certain elements — including the definition of inside information and the nature of the market soundings regime.

MAR requires the European Commission to report on the regime's effectiveness. On 3 October 2019, ESMA launched a consultation on a number of MAR topics as part of this process. Responses are due by 29 November 2019 to enable ESMA to produce a report early in 2020.

Amongst the key topics being reviewed are the following.

Scope of MAR, including spot FX

One of the key controversies of the MAR review is whether MAR should be extended to include spot FX. However, it is worth noting that spot FX is not currently a regulated instrument for the purposes of MiFID, and therefore many of the key elements of the interaction between MiFID and MAR are not present if the extension is only made to MAR. For instance, pre- and post-trade transparency, the notion of there being an issuer of an instrument, and notification requirements seem ill-fitting when considering non-MiFID instruments.

For these reasons, amongst others, ESMA seems reluctant to recommend an extension of MAR to include spot FX, at least given the current underlying regulatory framework. Instead, ESMA points to progress made following the introduction of the FX Global Code of Conduct as an alternative means of making improvements in this area. In the UK, however, the creation of a new market abuse regime for spot FX remains a possibility after this was recommended by the Fair and Effective Markets Review back in 2015. Although this recommendation has not been taken forward to date, the prospect of a UK-specific regime seemingly remains on the cards.

Scope — benchmarks

ESMA points out the difference in the definitions used in MAR and the BMR relating to infringements such as manipulation. In particular, the BMR definition includes financial contracts and investment funds in a way not typically within the scope of MAR. ESMA does not seem to consider there is a particular reason to narrow this gap, particularly as various administrative sanctions exist in relation to the BMR, which means that the area is not entirely unregulated. Further, as the BMR is also subject to an ongoing review by the European Commission, ESMA again seems reluctant to recommend extensive changes in this area. However, it is possible that the inclusion in MAR of references to the roles of submitters and administrators might be recommended, so that misconduct by them can also be addressed.

Buy-back programmes

ESMA suggests a number of practical steps that could be taken to lessen the burden when conducting buy-back programmes. One would be that issuers would only need to report to the NCA of the most relevant market in terms of liquidity, rather than (potentially) a variety of regulators. A second proposal is that only a subset of 10 fields should be reported, rather than the existing number, which exceeds 40. Finally, ESMA proposes the use of aggregated daily information relating to volume and weighted average price, rather than by transaction-by-transaction disclosure. All of these measures are likely to be welcomed, and may well receive legislative support in Brussels.

Definition of inside information

One of the most controversial topics in MAR is the breadth of the definition of inside information, and there are a number of technical aspects of the definition that frequently cause difficulty in practice. However, it is likely that, in part, this is a result of deliberate drafting — not every situation can be covered in detail and transactions that are potentially within the scope of MAR are intended to be looked at conservatively if they fall into any grey area. ESMA may be flooded with answers to the question “have market participants experienced any difficulties when identifying what information is inside information?”, but ESMA does not propose particular revisions. Instead, ESMA uses the consultation as an opportunity to give what is, in effect, additional guidance on topics such as pre-hedging.

For instance, ESMA points out that pre-hedging can distort competition and harm clients’ interests, and gives three specific examples where this could be the case in a request for quote context:

- When a broker pre-hedges and then declines to provide a quote
- When a broker could fill an order from its existing inventory but trades aggressively instead
- When a broker trades in a way which disadvantages other brokers including the one executing the order for the client

Finally, ESMA reminds market participants of the need for “sufficient transparency and disclosure about their use of pre-hedging arrangements”, without giving any guidance on what might or might not be sufficient.

Delayed disclosure of inside information

The Commission had expressed an interest in exploring whether, in certain situations, information is mature enough to trigger a prohibition on trading, but insufficiently mature to be disclosed to the public. The legislation contains only a single trigger but, in practice, it can be interpreted to produce different results in these two circumstances. ESMA chooses not to contribute much further to this debate, perhaps because of the perceived difficulties in coming up with two different triggers. Instead, it asks for examples of cases where identification of when information became inside information was problematic. ESMA

does, however, point out that where an issuer has chosen to delay the disclosure of inside information, but the information has subsequently become non-price sensitive, the delay to disclosure should still be notified to the relevant NCA.

Market soundings

The market soundings regime has always been a particularly controversial part of MAR. On the one hand, ESMA recognises that the definition is broad, and is keen (without giving details) on assessing whether certain types of transactions should be outside the scope. ESMA is also prepared to consider whether the definition "prior to the announcement of a transaction" is appropriate or should be further amended. However, ESMA does then take a stance on the on-going controversy over whether the regime is a safe harbour, or a mandatory obligation. ESMA's view is that it is the latter, and there is likely to be significant lobbying from the industry on this point.

Further, ESMA suggests making the use of recorded telephone lines mandatory, which may assist in one regard — because it would arguably remove the need for consent to be sought, but on the other hand would require the use of taped lines in circumstances where alternatives currently exist (even if they may not commonly be used).

Insider lists

In this section, ESMA leans towards giving informal guidance on MAR as it exists, rather than consulting on whether to change it. For instance, in line with other recent statements from certain national regulators, in ESMA's view existing insider lists should only include persons who have actually accessed a piece of inside information, and not those who could potentially have done so because of their role in a support function, but who did not. ESMA goes on to look at the role of permanent insiders, commenting that there appears to be inflation in the persons included in the lists. In ESMA's view, "only an extremely limited group of individuals should meet that definition", and ESMA then goes on to name seven roles that might meet the definition, such as the CEO. It is to be hoped that ESMA will reflect further on whether this guidance is too restrictive, and that a variety of roles could have access to most of the inside information most of the time.

Managers' transactions

ESMA's paper contains a detailed description of various elements of the regime relating to transactions by Persons Discharging Managerial Responsibility. Amongst ESMA's observations are that the €5,000 basic threshold appears to be sensible, and that the 20% threshold contained in the fund regime (where a holding of less than 20% is to be disregarded) is also "functioning well". ESMA does, however, seem to have the view that persons closely associated with PDMRs should also be subject to the closed period requirements, which could in some individual circumstances prove problematic.

Application of MAR to funds

ESMA's consultation considers some of the difficulties in applying basic MAR concepts to funds, where there might not be an issuer where a fund has no legal personality, and where external companies such as asset managers and depositaries could play important roles. ESMA considers, for instance, how to apply the PDMR regime to funds to ensure that those within management companies who may have information relating to the value of the fund are subject to similar restrictions to company directors.

Next steps

There is likely to be significant feedback provided to ESMA by market participants and trade associations. One tactical point to be considered is whether to add topics to the European Commission and ESMA lists. For instance, on the definition of inside information, much further guidance and clarity could be sought. However, such attempts also face the risk that the clarity may not be of the type that is hoped for. Caution will need to be applied in considering whether, and if so how, to try to expand on the existing review framework.

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