

The Market Abuse Regulation White Paper

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Introduction

The EU Market Abuse Regulation (MAR) came into effect on July 3, 2016. The Regulation has created a stringent regime for detecting and dealing with market abuse, such as insider trading and market manipulation.

MAR strengthens and significantly extends the EU's previous framework for dealing with market abuse: The Market Abuse Directive (MAD). MAD was replaced following a review of the efficacy of the regime, and as a result of lessons learned during both the financial crisis and the LIBOR/EURIBOR rate rigging scandals.

Through MAR, the EU aims to enhance the integrity of its financial markets and provide more robust protections for investors. The end goal is to build confidence in the EU's financial markets by ensuring:

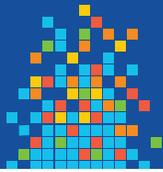
- new markets and OTC trading platforms are regulated
- gaps in the regulation of commodities and derivatives are closed
- legal certainty is established, and enforcement strengthened.

Along with other emerging regulations, such as the EU Benchmarks Regulation (BMR) and the closely-related Markets in Financial Instruments Directive II (MiFID II), MAR represents a step-change in reporting requirements for buy-side firms. Understanding how the regulation applies to their businesses, and what steps they need to take to ensure compliance, is one of the most pressing challenges facing compliance officers today.



For more info
on the MAR
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The Scope of MAR

MAR extends the stipulations of MAD to a much broader base of organizations in the following ways:

- MAR uses a much broader definition of financial instruments (taking its lead from the definition given under the 2014/65/EU [MIFID II])
- MAR applies to financial instruments where a request has been made to admit them to a regulated market, as well as to those already admitted to a regulated market
- MAR covers financial instruments that have been admitted to trading or are actively traded on Multilateral Trading Facilities (MTF), financial instruments traded on Organized Trading Facility (OTF) and emission allowances.

However, several key exemptions apply:

- The prohibition of insider dealing and market manipulation does not apply to trading in own shares in buy-back programs, or trading in securities for the stabilization of securities
- MAR does not apply to public authorities in pursuit of monetary, exchange rate or public debt management policy
- Other exceptions are linked to special policy areas, such as the EU's climate policy or its agricultural policy.



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Some key definitions

- 1 MAR specifies three types of market abuse: insider dealing, unlawful disclosure of inside information and market manipulation. These behaviors are specifically prohibited unless covered by an exemption.
- 2 Market manipulation under MAR includes using “a fictitious device or any other form of deception or contrivance” to give “false or misleading signals”, or to secure prices at an artificial level.
- 3 Under MAR, inside information applies to “information of a precise nature, which has not been made public” relating to commodity derivatives or to the related spot commodity contract, and which, “if it were made public, would be likely to have a significant effect on the prices of such derivatives or related spot commodity contracts”.
- 4 Where a transaction is legitimate and in accordance with the market practices sanctioned by the competent authority, MAR allows for ‘Accepted Market Practices’ (AMPs), such as for certain liquidity contracts¹. However, representatives of issuers, financial services providers, consumers, other authorities, market operators and ESMA must be consulted by a national competent authority before it can accept an AMP.
- 5 Suspicious Transaction and Order Reporting (STOR) is the reporting obligation under MAR to monitor and report market manipulation and insider dealing, or attempted market manipulation or insider trading.

¹ See Points for convergence in relation to MAR accepted market practices on liquidity contracts, ESMA, April 2017

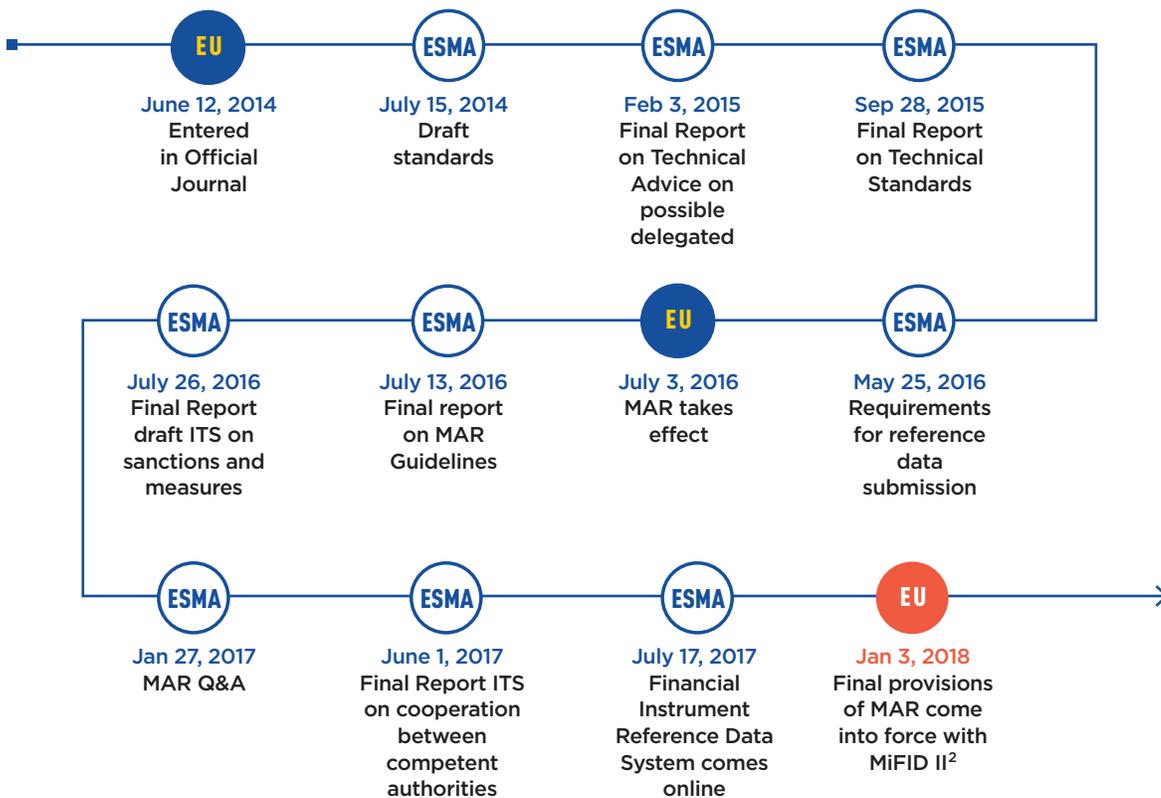


What is ESMA's role?

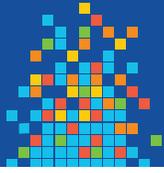
The European Securities and Markets Authority (ESMA) has three main functions in relation to MAR:

- 1 Technical Standards** MAR empowered ESMA to develop draft regulatory technical standards (RTS) and implementing technical standards (ITS).
- 2 Technical Advice** ESMA was also mandated to provide technical advice to the European Commission to help promote common, uniform and consistent supervisory approaches and practices in the day-to-day application of Market Abuse Regulation.
- 3 Implementation** Finally, ESMA has also been tasked with publishing 1) a list of any financial instrument that falls under the scope of MAR 2) a list of thresholds that apply and the justifications provided by competent authorities for such thresholds for notification of managers' transactions, and 3) an annual report on administrative sanctions imposed by competent authorities, as well as criminal sanctions.

MAR timeline



² Provisions relating to OTFs, SME growth markets, emission allowances or auctioned products based on emissions allowances will only apply from January 2018



MAR in a Nutshell

MAR strengthens the MAD regime in a variety of ways, including:

- Creating two new offences:
 - 1 attempting market manipulation
 - 2 attempting to manipulate a benchmark
- Extending the definition of insider trading to include spot commodity trading
- Regulating abusive use of high-frequency trading and algorithmic trading
- Requiring specific steps to be taken for market soundings and mandating extensive record keeping around such soundings
- Mandating that issuers disclose to the public as soon as possible any inside information that directly concerns the issuer
- Increasing reporting requirements around managers' transactions
- Introducing minimum rules for measures, sanctions and fines (Regulators are empowered to impose fines of up to at least EUR 5 million in the case of an individual and EUR 15 million, or 15 per cent of annual turnover, in the case of a legal person³).

³ For more information please see [MAR Legislative Tracker](#) Simmons & Simmons, 2017

€5m

The maximum fine regulators are empowered to impose in the case of an individual; €15m in the case of a legal person.

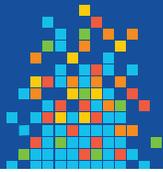
The Prevention and Detection of Market Abuse

The one stipulation of MAR that will have the most direct impact on buy-side firms is that MAR **extends suspicious transaction reporting requirements to investment professionals.**

Article 16 of MAR states:

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, in accordance with Articles 31 and 54 of [MiFID 2]. A person referred to in the first subparagraph shall report orders and transactions, including any cancellation or modification thereof, that could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation to the competent authority of the trading venue without delay.”

2 “Any person professionally arranging or executing transactions shall establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions. Where such a person has a reasonable suspicion that an order or transaction in any financial instrument, whether placed or executed on or outside a trading venue, could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation, the person shall notify the competent authority as referred to in paragraph 3 without delay”.



What This Means for Buy-side Firms

Article 16 is hugely important to buy-side firms as it means they are for the first time responsible for market surveillance and reporting – a task that had been traditionally carried out by brokers on behalf of investment firms.

One of the key challenges emerging from the MAR regime is, therefore, how buy-side firms can update their compliance systems, processes and expertise to manage this significant task.

In its Final Report of Draft Technical Standards on MAR, published on September 28, 2015, ESMA provided some guidance on how this can be achieved: “...entities will need to have in place a system which is capable of the analysis of every transaction and order, individually and comparatively, and which produces alerts for further analysis. ESMA is of the view that in the large majority of cases this will necessitate an automated surveillance system”.

When Should Managers Report Suspicious Activity?

MAR requires managers at investment firms to report suspicious orders or trades ‘without delay’. ESMA has provided some clarification on this, stating that managers should report as soon as ‘reasonable suspicion has formed in relation to a trading behavior’. Crucially, firms must report through the templates provided in ESMA’s Regulatory Technical Standards to be deemed compliant⁴.

Guidelines on Market Soundings

ESMA has also provided useful guidance in relation to the factors, the steps, and the records that the persons receiving the market soundings will have to consider under MAR. ESMA defines market sounding as “a 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.”

The guidelines outline the following:

Internal procedures and staff training

Persons receiving a market sounding should:

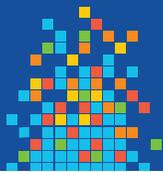
- Ensure “the information received in the course of the market sounding is internally communicated only through pre-determined reporting channels and on a need-to-know basis”
- Ensure that the individual(s), function or body entrusted to assess whether the person in possession of inside information as a result of the market sounding are clearly identified and properly trained to that purpose
- Manage and control the flow of inside information arising from the market sounding

Following receipt of a market sounding, firms must assess whether they are in possession of inside information as a result of the sounding and should identify all the issuers and financial instruments to which they believe that inside information relates.



For more info
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⁴ Detailed information on how firms can report suspicious activity can be found at [Final Report: Draft Implementing Technical Standards on sanctions and measures under Regulation \(EU\) No 596/2014 on market abuse, ESMA, July 2016](#)



Investment recommendations

Another stipulation of MAR that directly affects buy-side firms concerns investment recommendations and cases where information is used to recommend or suggest an investment strategy. Under MAR, firms will need to *“take reasonable care to ensure that such information is objectively presented, and to disclose their interests or indicate conflicts of interest concerning the financial instruments to which that information relates”*.

ESMA has presented technical advice on how firms can achieve compliance against this stipulation in its Final Report, published in 2015.

The Financial Instrument Reference Data System

As of July 17, 2017, market operators, investment firms and multilateral trading facility operators have been able to transmit reference data concerning financial instruments – both those that are in active trade and those that have been submitted for admission to trading – through the Financial Instrument Reference Data System (FIRDS). The implementation of FIRDS by ESMA enables compliance with Article 4(1) of MAR⁵.

Additional Information: ESMA’s Q&A

In order to *“promote common, uniform and consistent supervisory approaches and practices in the day-to-day application of Market Abuse Regulation”*, ESMA has produced an extensive Q&A document, which it regularly updates. The Q&A is based on questions asked by the public, financial market participants, competent authorities and other stakeholders. Many of the replies

illuminate the responsibilities that buy-side firms will have to bear, including:

- **Blanket cancellation of orders:** “where a firm decides to adopt a blanket cancellation policy for its proprietary trading, the fact that the cancellation may or may not constitute insider dealing will have to be assessed on case-by-case basis, by determining whether or not the cancellation was indeed performed without using the inside information.”
- **Scope of obligation to detect and report market abuse:** “ESMA considers that the obligation to detect and identify market abuse or attempted market abuse under Article 16(2) of MAR applies broadly, and ‘persons professionally arranging or executing transactions’ thus includes buy side firms, such as investment management firms (AIFs and UCITS managers), as well as firms professionally engaged in trading on own account (proprietary traders).”
- **Nature of investment recommendations:** *“When determining whether a communication is an “investment recommendation”, an assessment should be made based on the substance of the communication, irrespective of its name or label and the format, form, or the medium through which it is delivered (whether electronically, orally or otherwise).*

And: *“With regard to an investment firm, any information that comprises direct or indirect investment proposals in respect of a financial instrument or an issuer will be considered as information recommending or suggesting an investment strategy as defined under point (i) of Article 3(1) (34) of MAR. This is regardless of whether or not the production of investment recommendations is the main business of the investment firm.”*

⁵ See [MAR Guidelines, Persons receiving market soundings](#), ESMA, November 2016



Conclusions

Reduce your regulatory risk

MAR greatly increases the compliance burden and associated costs for buy-side firms, who can no longer rely only on the controls provided by their brokers and other partners. The compliance requirements of MAR are significant, and many firms may find that traditional approaches to compliance are no longer fit for purpose.

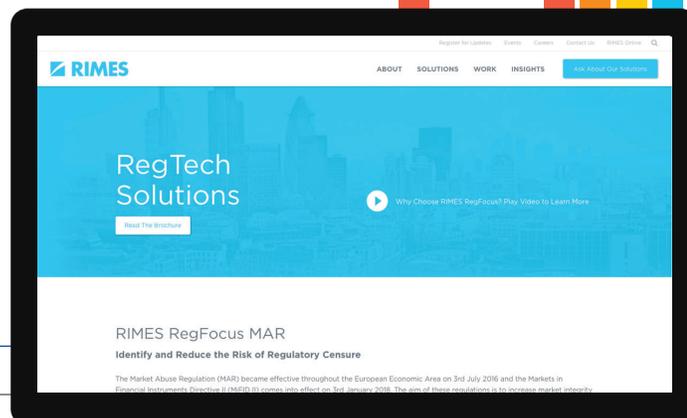
In this environment, the business case for managed compliance services, delivered over the cloud, become compelling. This new breed of “RegTech” services offer firms a means of meeting even the most complex of reporting requirements, immediately, and without having to invest in new expertise or in-house systems.

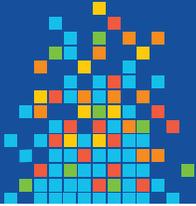
RIMES RegFocusSM MAR is the leading RegTech solution for the buy-side, offering a sustainable, cost-effective solution to the many complex challenges of MAR and MiFID II compliance, and facilitating a comprehensive review of all order and trade activity across related legal entities to confirm that best execution has been obtained.

For more information visit
www.rimes.com/regfocus-mar
or email info@rimes.com



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About RIMES

RIMES is a buy-side specialist that truly understands the data management challenges faced by its clients. It serves over 300 investment managers, pension funds, hedge funds, wealth managers, private banks, custodian banks and insurance companies in 40 countries, including 60 of the 100 largest global asset managers and 9 of the 10 largest custodians by TAUM.

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