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Client Alert Commentary

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The MAR Review — ESMA's Final Report

ESMA advises the European Commission to consider some, but not all, of ESMA's original proposals — and gives guidance on pre-hedging and market soundings along the way.

Key Points:

- **Pre-hedging / front running:** ESMA proposes developing detailed guidance on acceptable practice, but identifies a number of factors such as trade by trade transparency that may be disruptive to some existing practices.
- **Market soundings:** ESMA has maintained its stance that the market soundings regime is compulsory, and is unmoved by arguments driven by conflicts of laws and extraterritorial effect.
- **Insider lists:** ESMA has provided some flexibility on the question of who should be included on an insider list, and how large a permanent insider list should be, without changing the thrust of its overall position that deal lists should capture only those who have accessed inside information.

As part of the European Commission's review of the workings of the Market Abuse Regulation (EU) 596/2014 (MAR), ESMA launched a consultation paper on 3 October 2019 and has now published its feedback in a Final Report, which is being made available to the market and the Commission.

ESMA is proposing amendments in a number of key areas:

Spot FX contracts

One of the Commission's key consultation considerations was whether or not spot FX should be included within the ambit of MAR. Despite speculation that ESMA did not think that this was a good idea, it has undertaken some detailed analysis, and its Final Report suggests it has maintained an open mind on whether FX should be included within the MAR regime. However, on balance, its final conclusion is not to propose amendments at the moment, and instead to take into account progress with the embedding of the FX Global Code.

Benchmarks

ESMA has concluded that there is sufficient alignment between the various definitions in MAR and the Benchmarks Regulation (EU) 2016/1011 (BMR), but has proposed an extension of the sanctions in MAR

to include manipulation by the administrators of benchmarks. This extension would include administrators not based in the EU, on the basis that (like all aspects of MAR) enforcement is potentially extraterritorial.

Buybacks exemption

ESMA had already suggested a number of ways to simplify the buybacks regime. On the question of which market should receive reports on buyback transactions, ESMA has chosen option 3, the most liquid market. ESMA considers that this should be readily identifiable, and is likely to be the place where most buybacks actually occur.

ESMA also confirms its original suggestion that the list of data to be submitted should be simplified.

Both of the above measures are likely to be welcomed by industry participants if adopted by the Commission.

Definition of inside information

ESMA has largely followed industry feedback and concluded that it would not be helpful to try to change the definition of inside information. However, ESMA has proposed potential guidance based upon the existing definition to assist in certain areas, such as commodity derivatives.

Front running

Front running transactions by persons charged with the execution of client orders is prohibited by MAR. ESMA proposes broadening the identity of persons who could be caught by the front running prohibition, so that it is not only persons charged with executing client orders, but others (e.g., at the issuer) who have information about such orders. Potentially, this could include institutional investors who have information about orders from other institutional investors.

Pre-hedging

One of the most controversial aspects of ESMA's original call for evidence contained its views on the legitimacy (or otherwise) of certain pre-hedging activities. ESMA notes in its Final Report that there was no common view amongst respondents on the effects or potential harms / benefits of pre-hedging activity. ESMA proposes that further guidance be produced, and offers (to the Commission) to draft it. However, ESMA makes a number of observations relating to pre-hedging. In ESMA's view: pre-hedging should be a risk management tool and relate to possible or actual orders; pre-hedging should be intended to benefit the client, and that benefit should be traceable in the behaviour of the broker, rather than being undertaken for speculative purposes; and a particularly close assessment needs to be undertaken of pre-hedging illiquid instruments.

In addition, ESMA identifies a number of factors that it thinks firms should assess already when looking at the risks of pre-hedging. These include: having a clear mandate from the client requesting the broker to pre-hedge (it is not clear whether a suggestion from the broker to the client would meet this suggestion); the client being made aware of, and consenting to, pre-hedging activities, both on an ex ante and on a case by case basis (which would conflict with any existing practice whereby clients were generally aware, by the nature of the transaction, that pre-hedging might be undertaken without case by case consent being sought); there being a benefit to the client of pre-hedging which is passed to the client (although ESMA does not make clear how this could be assessed); taking reasonable steps to minimise the impact of pre-hedging on the market; and providing information ex post to the client on how pre-hedging impacted actual execution (which may not always be the existing practice, and which runs contrary to

other ESMA initiatives about limiting the amount of unnecessary information being provided to clients — for example, the MiFID costs and charges regime).

It is not clear whether ESMA expects the broad statements that it makes about its views on existing practice, and risk management, in this area to be taken as its views on past, existing, and future market practice, or merely a contribution to the debate which will (presumably) form part of a future consultation. Market participants will need to assess whether any practices change as a result of the statements that ESMA makes.

Delays to the disclosure of price sensitive information

ESMA's Final Report takes the view that changes to the definition of situations where delays are permitted is not required. However, ESMA is "keen to consider a revision of its guidelines in order to provide further clarity". So it appears that further (or amended) ESMA Q&A may be drafted in this area, based upon circumstances (such as M&A activity) which has been flagged to ESMA by respondents as being problematic.

Market soundings

ESMA reiterates its view that the market soundings regime is compulsory for disclosing market participants (DMPs). Indeed, ESMA recommends that the Commission amend MAR to introduce a pan-European sanctions regime for violations of the market soundings requirements. ESMA does not propose to narrow (or clarify) the definition of a market sounding, but it does recommend that where a sounding does not involve the transfer of inside information, a number of minor administrative points should not apply (such as the need to make a statement about future cleansing intentions).

ESMA recommends to the Commission that the existing "obligation" (which is disputed by some market participants) to repeat market sounding reminders, when subsequent conversations occur, should not apply provided an initial wall-crossing has been undertaken in a MAR market soundings-compliant manner. It is interesting to see that ESMA is unmoved by arguments put to it about the broad geographical scope of MAR, and potential conflict of laws points (e.g., in relation to exchanging written minutes of market sounding meetings).

Insider lists

ESMA conceptually still believes that insider lists should only include persons who have actually accessed information. They concede, however, that the list could include "persons who, to the best of their knowledge, have effectively accessed a piece of information". Going slightly further still, ESMA also states that it considers "the inclusion of persons who could potentially have access to a piece of inside information on the insider list as acceptable". However, ESMA continues to refrain from opening the door to including persons who theoretically could access (rather than potentially have accessed) information.

ESMA has backed down from proposing a closed list of individuals who could be on a permanent insider list. This will be welcomed by industry participants, but they should note that ESMA reflects that the core requirement is to ensure that the event-based insider lists are properly filled.

PDMRs

ESMA proposes to extend the exemption which permits dealing by persons discharging managerial responsibility (PDMRs) during closed periods to include some non-equity instruments (such as bonds) that are held within employee share schemes. Further, decisions by independent asset managers,

managing the assets of PDMRs, would also be subject to a formal exemption. ESMA also proposes an exemption for corporate actions, providing that PDMRs are not treated advantageously compared to other parties.

ESMA does not propose extending the ban on PDMR transactions to parties acting on behalf of the company or PDMR (who would be caught by other prohibitions if the information was inside information).

Listed funds

ESMA's view remains that funds that choose to list are issuers and should be treated like any other issuer. Therefore, ESMA sees no compelling argument to exempt them from the key requirements in MAR. ESMA does not propose extending the PDMR bans to the managers of funds, noting that some controls are in place already in measures such as the AIFMD and UCITs. ESMA remains of the view that MAR should be clarified such that the management company is made responsible for disclosing inside information, and keeping insider lists, on behalf of the fund.

Tax schemes

ESMA does not propose making amendments to MAR in order to cover a fairness (or otherwise) of tax schemes (such as Cum-Ex), but ESMA does recommend legislative changes that permit regulators and tax authorities to share information more straightforwardly.

Conclusion and next steps

The process now reverts to the Commission, to consider various submissions including the ESMA Final Report, and to then consider legislative proposals to amend MAR. It is likely that lobbying at Commission level will focus upon a number of key areas:

- Not including spot FX transactions within the scope of MAR until progress globally has been assessed in line with the FX Global Code
- Tempering ESMA's enthusiasm for providing detailed guidance of the type contemplated in relation to pre-hedging
- Whether the market soundings regime is compulsory or a safe harbour

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