KING & SPALDING

Client Alert

Financial Services Regulatory and Funds Practice Group

January 7, 2015

DIFC Market Abuse Regime
DFSA publishes Code of Market Conduct

On 16 December the Dubai Financial Services Authority ('**DFSA**') published its Code of Market Conduct (the '**Code**') which will apply from 1 January 2015. The Code is intended to provide guidance and clarity to the market abuse regime which, in its current form, has been in place in the Dubai International Financial Centre ('**DIFC**') since 2012. At that time, changes were implemented to align the DIFC's market abuse regime with that applicable in the European Union under the Market Abuse Directive, as implemented in the UK.

The Code is the first practical guidance issued by the DFSA on the application of the market abuse regime in the DIFC. Assuming the DIFC regime is the same as that applying elsewhere, especially the UK, is an easy mistake to make. The Code being published presents firms with an opportunity to review current policies, procedures, systems and controls in this area and test them against the DFSA's understanding of the application of the regime.

This is especially important for those international firms relying on policies and procedures of home office entities because, as discussed below, although the DIFC regime is to an extent harmonised with EU legislation in this regard, it is unique in certain respects. The starting position is to understand in what respects the DIFC market abuse regime is the same and where it is different. Firms should undertake a comprehensive gap analysis of both internal policies and procedures and the underlying legislation to ensure they are in full compliance.

Particularities of the DIFC Market Abuse Regime

In many jurisdictions, market abuse offences can constitute criminal offences, conviction of which can lead to imprisonment. Given the legal construct of the DIFC and its position as a financial free zone in the Emirate of Dubai, the imposition of a criminal regime in respect of DIFC markets is not possible without the legislative intervention of the UAE. The DIFC market abuse regime is therefore a civil regime, carrying no threat of imprisonment, based largely on the civil market abuse regime currently in effect in the UK. Sanctions are civil and administrative in nature and can include fines, public censure, and for regulated persons, revocation of authorisation.

For more information, contact:

Jawad Ali
Tel: +971 4 377 9904
jali@kslaw.com

Phillip Sacks
Tel: +971 4 377 9916
psacks@kslaw.com

Jodi Griffiths
Tel: +971 4 377 9900
jgriffiths@kslaw.com

King & Spalding
Dubai
Al Fattan Currency House
Tower 2, Level 24
DIFC | Dubai International
Financial Centre
P.O. Box 506547
Dubai, UAE
Tel: +971 4 377 9900
Fax: +971 4 377 9955

www.kslaw.com

The application of the regime is broad and has the potential to be applied to any person, including a corporate person, whether or not they are regulated by the DFSA. It not only captures conduct undertaken inside the DIFC but extends to that undertaken outside the DIFC where that conduct affects DIFC markets or DIFC market users.

Furthermore, it applies to conduct relating to 'Investments' generally. This is in contrast to the EU position which limits the application of market abuse provisions to financial instruments admitted to trading on specified markets (or financial instruments the value of which relates to the value of financial instruments admitted to those markets).

The DIFC market abuse regime is therefore extra-territorial in its application and has the potential to apply to a greater range of investments than its European equivalent. Sanctions may not currently extend to criminal sanctions but civil penalties are available and give the DFSA teeth in its enforcement of the regime.

Code of Market Conduct

The Code provides further information and guidance on the application of the market abuse regime, mostly through examples of the types of conduct that may be considered market abuse under the Markets Law. For example, the type of conduct which, in the DFSA's view, could constitute market manipulation include: wash trades, 'painting the tape', layering, momentum ignition, quote stuffing, marking the open/close, abusive squeezes, directly or indirectly fixing prices or creating unfair trading conditions, colluding in the after-market of an initial public offering and creating a floor/ceiling in the price pattern. The Code also sets out the factors that the DFSA may take into account when considering whether conduct amounts to market abuse. The Code provides for general factors, for example the knowledge and experience of the users of the market, the structure of the market, the level of liquidity in the market, the legal and regulatory requirements of the market which it will consider when determining whether or not conduct constitutes market abuse. Additionally, the Code sets out specific factors that the DFSA will take into account in determining whether or not conduct constitutes some form of market abuse. The examples and factors set out in the Code are intended to be illustrative and not exhaustive. Firms should review compliance policies and procedures to ensure that the examples and factors listed in the Code are adequately reflected. Firms may wish to revisit any training and training materials provided to employees regarding market abuse.

The Code also provides guidance on any defences available, for example regarding insider dealing, where dealing occurs as a result of a person's legitimate performance of its functions as an underwriter, liquidator or receiver, or market maker. The availability of some defences will be dependent on compliance systems in operation. For example, firms undertaking execution only transactions for clients without advising or encouraging the client in respect of the transaction and those operating effective Chinese wall arrangements will not be considered engaging in insider dealing. To ensure the viability of such defences, firms should review compliance arrangements relating to execution only transactions and Chinese wall arrangements to ensure that they are sufficiently robust to avoid market abuse.

In some respects, however, the Code is thin and fails to take into consideration recent global developments in this area (such as changes arising out of the EU Market Abuse Regulation and recent case law in Europe and the UK). For example, regarding the definition of inside information, it provides no further guidance on what qualifies as "information of a precise nature" beyond that set out in the Markets Law. Firms will be aware that the Upper Tribunal in the UK has recently considered what is meant by events reasonably expected to occur in its review of enforcement action taken by the Financial Services Authority (FSA) against Ian Hannam. The Tribunal concluded that there must be a 'realistic prospect' of the events occurring as opposed to 'a more likely than not' scenario for it to be considered inside information. It would be helpful if the Code could clarify whether this is the approach to be adopted in the DIFC also. It would be prudent for firms to not only consider the guidance in the Code but look to external sources of guidance when designing and implementing compliance policies and systems.

Preventing, Detecting and Reporting Market Abuse

The DFSA believe that the Code will assist persons in monitoring and preventing market abuse and, where they are under an obligation to do so, report suspected market abuse. At present, the DFSA places such obligations on authorised market institutions and authorised firms operating an alternative trading system (which, consistent with the scope of EU regulation, can be either a multilateral trading facility or organised trading facility). Of course, the application of the DIFC's market abuse regime is broader than just investments traded on exchange or an alternative trading system and extends to all investments in the DIFC. All regulated entities should operate compliance policies to assist in the identification, deterrence and prevention of market abuse which include reporting processes.

Regulated firms are obliged to assist in the deterrence and prevention of market abuse by establishing and maintaining systems and controls that ensure, as far as reasonably practical, the firm or its employees do not engage in conduct, or facilitate others to engage in market misconduct. Little guidance on the nature of the systems and controls required is provided beyond the requirement for investment firms to implement policies and procedures in respect of personal account transactions. The guidance of the Code provides a benchmark for assessment of the systems and controls firms currently operate.

Unlike in the UK where regulated firms are under a specific obligation to notify the regulator without delay where there are reasonable grounds for suspecting market abuse in respect of a transaction it has executed or arranged, there is no equivalent obligation on DFSA regulated firms. However, it is likely that the DFSA would expect to be notified of any reasonable suspicion of market abuse under Principle 10 of the Principles for Authorised Firms (relations with regulators). Accordingly, authorised firms should review their current compliance monitoring processes to ensure that they are adequate to monitor transactions for potential market abuse and incorporate adequate reporting processes.

King & Spalding Comment

Firms operating in the DIFC and those whose securities and trading actions have effect in the DIFC may wish to take this opportunity to review their compliance policies, procedures, systems and controls as they relate to the identification, deterrence and prevention of market abuse. The additional guidance provided under the Code could also make for valuable refresher training for employees

Although modelled on the requirements of the EU Market Abuse Directive as implemented in the UK, the DIFC regime has been sculpted to fit the specific characteristic of its market resulting in some significant differences between the EU and DIFC regimes. Firms relying on market abuse policies, procedures, systems and controls modelled on the European requirements should undertake a thorough gap analysis to ensure that they are in full compliance with the DIFC regime.

King & Spalding Financial Services Regulatory practice can advise firms on the application of the DIFC market abuse regime and assist with the development of robust compliance policies, procedures, systems and controls. King & Spalding attorneys also have a proven track-record in supporting clients with regulatory enforcement actions relating to market misconduct.

***