Validation Stage Impact Assessment

Title of proposal(s)	EU Market Abuse Regulation
Department	HM Treasury
Expected date(s) of implementation	Implementation deadline: 3 July 2016
Lead departmental contact (email address)	Katie.Dunn@hmtreasury.gsi.gov.uk
RPC Ref:	RPC-HMT-3361(1)

Description of the proposal(s) and expected scale of impacts

The current EU-wide framework for tackling market abuse and market manipulation was implemented in 2005 via the Market Abuse Directive (MAD). Since then, financial markets have seen the creation of new forms of financial instruments and the emergence of new trading platforms and venues. In order to ensure that conduct regulation keeps pace with market developments, the European Commission began consultation on a proposal for a Regulation on insider dealing and market manipulation (MAR) in 2011. Agreement was reached in 2014, and MAR will come into effect on 3 July 2016.

MAR moves the legal footing of the EU regime from a Directive to a Regulation, and is directly applicable in order to harmonise the civil market abuse regime across the EU. Where the UK's existing framework goes beyond the minimum requirements as imposed by MAR, we have sought to maintain the existing framework. This will ensure that the high standards of market conduct regulation in the UK are maintained and the integrity of UK markets is not jeopardised. To do otherwise would weaken the UK's ability to detect and take action against market abuse. The changes will also not impose additional marginal costs to business.

MAR is a directly applicable Regulation. However, to give effect to the elements of MAR which conflict with/supersede existing UK legislation, HMT needs to make changes through secondary legislation to ensure that UK statute is compliant with MAR. The SI includes a broad range of measures, copied below. The measures that are relevant for business are underlined and emboldened.

- The FCA is designated as the UK competent authority for the purposes of the market abuse regulation;
- **Rules are put in place governing when issuers must provide the FCA with an explanation of a delay in disclosing inside information;**
- A procedure is put in place for applications under the market abuse regulation;
- The UK's domestic regime on disclosure rules in respect of financial instruments and civil penalties for market abuse is repealed (as it will be replaced with the identical provisions under the directly applicable Regulation and the existing powers must be removed to avoid a "clash");
- **The FCA is given powers to**
  - **require information from issuers and other persons;**

- **compel the publication of information by issuers,**
- **compel the publication of corrective statements by issuers and other persons;**
- suspend trading in financial instruments;
- impose penalties, prohibitions and suspensions or restrictions for contraventions of the market abuse regulation,

- The meaning of the term 'person closely associated' in the market abuse regulation is defined;
- Guidance is given on interpreting Article 8.4 and 12.5 of the Regulation are to be interpreted and when a person will be regarded as contravening the Regulation;
- The Financial Services and Markets Act (FSMA) 2000 and other primary and secondary legislation are amended to make them compatible with the Market Abuse Regulation and take account of the other changes the regulations are making to FSMA 2000.
- The current market abuse regime for certain types of emission allowances is updated to ensure the FCA has similar powers under that regime as they do under the market abuse regime (to take account of changes to the governing EU legislation due to replacement of the Market Abuse Directive by the Market Abuse Regulation.
- Other changes implemented through the SI are very minor consequential issues that do not relate to business.

The provisions that have not been highlighted above are out of scope on the grounds that they stem from a directly applicable EU Regulation, and that they either:

- do not impose any impact on business;
- are trivial consequences of repealing the existing market abuse regime to replace it with the directly applicable Regulation, which is identical; or
- impose a cost to business, but only when they have been found guilty of market abuse, which is therefore a result of non-compliance.

Broadly speaking, the Statutory Instrument goes beyond the minimum requirements of MAR in two areas, and therefore represents gold plating, although with no additional costs to business. The areas are summarised below, with more detail in the body of the IA.

1. the sanctioning regime (where we retain the FCA's ability to impose unlimited fines as permitted under MAR, as to do otherwise would drastically weaken the UK's sanctioning regime); and
2. the threshold beyond which managers are expected to disclose transactions to the regulator (€5,000 or €20,000). However, this is a false choice in that we have no sound market justification in the UK for choosing the higher threshold, as confirmed by industry during the FCA's public consultation.

The provisions that do apply to business do not represent a significant change in the existing framework – the FCA has concurrent powers in other policy areas to enable effective supervision of firms (and indeed some of these powers already as a part of MAD). Overall, the changes to domestic regulation outlined in this document are marginal from the current framework and will mainly affect firms that the FCA suspect of committing market abuse.

Following discussion with the FCA, a conservative breakdown of the expected costs is provided below. It is therefore likely that the costs to business could be lower than this.

Rules are put in place governing when issuers must provide the FCA with an explanation of a delay in disclosing inside information

The FCA believe that the majority of instances in which firms choose to delay disclosure of inside information will be in response to Merger and Acquisition deals, and, in considering the current level of information requests, and the increase in scope to a broader range of issuers, the FCA expect to request 15 explanations per annum.

In terms of cost to the issuer, given they will already have systems and controls in place and they are required to keep records of the decision to delay, there should not be additional costs to the issuer. However, in practice firms may wish to run their response past a legal advisor before they respond to the regulator which may attract a marginal cost. We therefore **expect costs arising from this measure to total £15,000, reflecting costs of £1000 per notification in relation to man hours and legal advisory fees**.

The FCA is given powers to require information from issuers and other persons

This power only applies to information and documents that the FCA reasonably requires for the purpose of the exercise of their duties under MAR. Given parallels with existing powers to require information from an issuer for the purposes of investigating potential infringements, the FCA expect that the expansion to other persons will result in an additional 30 requests per annum (compared to around 36 currently), with a **cost to business of approximately £15,000 in total (i.e. £500 per request)**. Similarly, this information is likely to be readily available for the issuer in the course of their normal operations, and this Regulation will not require them to change that behaviour.

The FCA is given powers to compel the publication of information by issuers

The FCA estimates that they will require the publication of a further 10 statements per annum (up from 10 currently) (costing £750 each), with **a cost of £7,500 in total**. Again, this information is almost certainly going to be readily available for the issuer in the course of their normal operations, and this Regulation will not require them to change that behaviour.

The FCA is given powers to compel the publication of corrective statements by issuers and other persons

Based on the FCA's existing powers to compel publication of corrective statements from issuers, the FCA expect to use this power very rarely as it would be extremely unusual to require a corrective statement from a non-issuer. Therefore they expect an absolute maximum of 5 instances per year (up front 2 currently), with **a maximum cost of £7,500 in total (i.e. £1,500 per instance). There is a very real possibility that there will be less than 5 instances per year.**

We therefore expect that the total cost to industry as a result of these measures will be £45,000 per annum.

To analyse each provision in turn:

1. Rules are put in place governing when issuers must provide the FCA with an explanation of a delay in disclosing inside information

MAR requires issuers[1] and Emissions Market Allowance Participants (an "EAMP")[2] to inform the public of inside information which directly concerns that issuer or, for EAMPs, concerns emission allowances they hold. This is essential to avoid insider dealing and ensure that investors are not misled. However, this obligation may, under certain circumstances, prejudice the legitimate interests of the issuer or EAMP. Article 17(4) of MAR therefore permits issuers and EAMPs to make a decision to delay public disclosure provided that certain conditions are met. These are:

- immediate disclosure is likely to prejudice the legitimate interests of the issuer or EAMP;
- delay of disclosure is not likely to mislead the public; and
- the issuer or EAMP is able to ensure the confidentiality of that information

As stated explicitly in MAR, where an issuer has decided to delay the disclosure of inside information, it shall inform the competent authority (in the UK, the Financial Conduct Authority – the FCA), that disclosure of the information was delayed and shall provide a written explanation justifying this decision. 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. **Therefore, while the Regulation imposes a directly applicable provision on firms to provide this information, there is discretion for Member States to require this on demand.**

[1] An issuer is a legal entity that develops, registers and sells securities for the purpose of financing its operations – for example a company that sells a bond to raise cash.

[2] An EAMP is any person who enters into transactions, including the placing of orders to trade, in emission allowances, auctioned products based thereon, or derivatives thereof.

As this would affect the FCA's domestic rulebook, the FCA consulted on this issue, and came to the independent conclusion that, as the majority of the notifications would not raise supervisory concerns and that, since MAR increases the scope of financial instruments subject to the civil regime, it would not be proportionate to receive written explanations every time a decision to delay disclosure is made. This could impose burdensome and unnecessary costs to industry. The approach set out in the consultation was therefore that a written explanation is only required on request from the FCA. Therefore, of the binary option presented to Member States (1. Demand all notifications, or 2. Only upon request), the UK has chosen the least burdensome option.

This provision is out of scope on the basis that it meets the following criteria:

1.

2. The FCA is given powers to

- **2.1. require information from issuers and other persons;**
- **2.2. compel the publication of information by issuers;**
- **2.3. compel the publication of corrective statements by issuers and other persons;**
- **2.4. suspend trading in financial instruments; and**
- **2.5. impose penalties, prohibitions and suspensions or restrictions for contraventions of the market abuse regulation**

In order to effectively enforce MAR, the FCA require an expansion of their current investigatory and enforcement powers. All of these measures are therefore out of scope on the basis that they implement new or changed obligations arising from European Union Regulations, Decisions and Directives, except in cases of gold-plating. Furthermore, provisions 2.4. and 2.5. will only be applied to firms that have been found to have committed market abuse, and are therefore also out of scope on the basis that they are sanctioning powers which can only be administered where there has been a demonstrable breach of the regime. The changes are adding additional tools to an existing suite of sanctions, rather than creating a new regime.

As a consequence of MAR, there will be the introduction of uniform minimum investigatory and sanctioning powers for national competent authorities. **While the UK's sanctioning regime exceeds the minimum requirements laid out in MAR, this is merely to ensure a continuity with the existing market abuse regime, as permitted in MAR. To reduce the UK's enforcement capability in line with the minimum requirements of MAR would represent a significant weakening of the UK's sanctioning regime. Therefore there is no increased burden to industry as a result of this decision not to deregulate towards the lower requirements outlined in MAR. Although this could be considered gold plating, it will not impose any additional costs on business.**

Furthermore, MAR updates the notification regime for managers' transactions. This requires Persons Discharging Managerial Responsibilities (PDMRs) within an issuer or EAMP, and persons closely associated with them, to notify all transactions in specified financial instruments to the issuer or the EAMP. These financial instruments include the shares or debt instruments of the issuer or

emission allowances and the notification must be made once a threshold has been passed within a calendar year. The issuer or EAMP is then obliged to make this information public. The logic behind this provision is to increase transparency around managerial transactions as a preventative measure against market abuse, particularly insider dealing.

MAR allows Member States to choose the threshold above which those with managerial responsibilities within an issuer or EAMP and persons closely associated with them are required to notify all transactions to the competent authority. This is a binary option of either €5,000 or €20,000, with Member States choosing the upper limit having to justify to the European Securities & Markets Authority the particular market conditions that have prompted their decision.

The FCA believes that the notification of transactions conducted by PDMRs on their own account, or by a person closely associated with them, provides both valuable information for market participants and a vital tool for competent authorities to supervise markets. While maintaining the €5,000 threshold appears the more burdensome approach, this ensures continuity with the existing market abuse regime (i.e. there is no increased burden to industry as a result of these provisions). If the UK had decided to opt for the higher threshold, the decision would have to be justified to ESMA. Based on the FCA's consultation, there was no evidence put forward by market participants (as subjects of these requirements) that justified the higher bound. Indeed, many saw the €5,000 threshold as providing value to the market.

To note, the current market abuse regime for certain types of emission allowances is also being updated to ensure the FCA has similar powers under that regime as they do under the market abuse regime (to take account of changes to the governing EU legislation due to replacement of the Market Abuse Directive by the Market Abuse Regulation.

The SI will also allow the FCA's to use it powers to enforce the market abuse regulation to police market abuse regime in relation to emission allowances under the EU emission allowance regulation. This is in response to an obligation on the UK in the emission allowance regulation to give the FCA enforcement powers for the purposes of the emission allowances auctioning regulation equivalent to those it has to enforce the Market Abuse Regulation. Therefore, the FCA must be empowered with the relevant powers to ensure an effective enforcement of this directly applicable regime. These provisions are therefore out of scope on the basis that they implement new or changed obligations arising from European Union Regulations, Decisions and Directives, except in cases of gold-plating. Furthermore, again, a number of these provisions will only be applied to firms that have been found to have committed market abuse, and are therefore also out of scope on the basis that they are related to enforcement action.

For the avoidance of doubt, all of the costs listed above apply to both the emissions allowances regime under MAR, and the regime more broadly. **The list of costs above (totalling £45,000) is therefore exhaustive.**