CLEARY GOTTLIEB

ALERT MEMORANDUM

July 1, 2014 clearygottlieb.com

MAD II Adopted by European Parliament and Council

On June 12, 2014, the market abuse regulation[1] ("**MAR**") and the directive on criminal sanctions for market abuse[2] ("**CSMAD**"), together known as MAD II, were published in the Official Journal.

MAD II will replace the existing market abuse directive ("**MAD I**").[3] Like its predecessor, MAD II prohibits market abuse on EU regulated markets.[4] Market abuse encompasses trading in financial instruments on the basis of inside information, the improper disclosure of inside information and the manipulation of market prices through practices such as the dissemination of rumours or the conducting of certain trades in related instruments. The existing market abuse directive was perceived to have a number of shortcomings, which were highlighted following the onset of the financial crisis in 2008. MAD II is intended to address these shortcomings by (i) broadening the scope of the market abuse rules to capture new markets, notably the spot commodities markets and multilateral trading facilities; (ii) updating the market abuse regime to reflect recent market developments, such as emission allowances trading and high-frequency trading; (iii) harmonizing the application of market abuse rules, exemptions and sanctions across the EU; and (iv) strengthening administrative sanctions for market abuse and introducing criminal sanctions for the first time. Accordingly, it is important for all market participants to have an understanding of the MAD II framework.

Discussions about replacing the existing market abuse directive began as far back as late 2008[5], and led to the European Commission ("**Commission**") launching a full consultation

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[1] Regulation (EU) No 596/2014 of the European Parliament and of the Council of April 16, 2014 on market abuse.

[2] Directive 2014/57/EU of the European Parliament and of the Council of April 16, 2014 on criminal sanctions for insider dealing and market manipulation (market abuse).

[3] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse).

[4] As defined in MiFID II: "a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of this [MiFID II]".

[5] EU Commission Conference on the Market Abuse Directive, Brussels, November 12, 2008. A summary of the discussion can be found at http://ec.europa.eu/internal_market/securities/docs/abuse/summary_confernce_en.pdf.

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in June 2010.[6] Following consultation, the Commission published its MAD II legislative proposals on October 20, 2011. Since then, MAD II has been negotiated at length, first between the Commission and the Council of the European Union ("**Council**") and then between the European Parliament and the Council. Political agreement was reached on September 9, 2013 with respect to MAR, and on February 4, 2014 with respect to CSMAD. The Council adopted MAD II on April 14, 2014, roughly coinciding with the adoption of the new markets in financial instruments directive ("**MiFID II**"), to which MAD II cross-refers.

This summary discusses the key provisions of MAD II and highlights where and how these differ from the market abuse regime currently in force.

I. THE MARKET ABUSE REGULATION

MAR prohibits insider dealing, the misuse of inside information and market manipulation. As MAR is a regulation, transposition into national law is not required. The Commission intends this to result in greater consistency across EU Member States, and in turn, lower compliance costs for regulated persons. Nonetheless, MAR will not become effective until July 3, 2016 (simultaneously with the existing market abuse directive being repealed and shortly before MiFID II comes into effect). This 24-month period is intended to allow for implementing technical standards to be put in place.

A. SCOPE

The scope of MAR is significantly wider than that of the existing market abuse rules. Like the existing market abuse regime, MAR will apply to financial instruments admitted to trading on an EU regulated market or for which a request for admission to trading has been made. However, MAR will, in addition, cover financial instruments:

- traded on organized trading facilities (OTFs);
- traded, admitted to trading or for which a request for admission to trading on a multilateral trading facility (MTF) has been made;
- traded over the counter and which have an effect on the price or value of financial instruments subject to MAR; and
- traded pursuant to EU Regulation 1031/2010 (*i.e.* emissions allowances).

These extensions to the scope of MAR reflect the fact that securities are increasingly traded off-market. MAR also increases the scope of the market abuse regime, with respect to market manipulation only, in order to capture cross-market behaviours by which transactions conducted on derivatives markets affect the price or value of commodities on the underlying

[6] *Public Consultation on a Revision of the Market Abuse Directive*, June 25, 2010, available at http://ec.europa.eu/internal_market/consultations/docs/2010/mad/consultation_paper.pdf.

spot markets, and vice versa.[7] To facilitate detection of cross-market abuses, MAR requires that competent authorities exchange information with the authorities responsible for the spot commodity markets. More detailed advice on these information exchanges will be provided in implementing technical standards that are being developed by the European Securities and Markets Association ("**ESMA**") and in sector-specific legislation.[8]

Benchmarks represent another area in which MAR introduces rules for the first time. In direct response to the LIBOR-rigging scandal of summer 2012, MAR includes provisions relating specifically to the calculation of benchmarks. See Prohibitions, below.

Controversially, EU market abuse rules will become fully extra-territorial under MAR: the prohibition of market abuse will apply to acts and omissions, irrespective of whether carried out inside or outside the EU, and regardless of whether they take place on a trading venue.

The expanded scope of the market abuse regime under MAR may leave market participants uncertain as to precisely which instruments fall within it. It remains to be seen whether the Commission will address this uncertainty by, for example, publishing a comprehensive list of instruments to which the rules apply.

B. PROHIBITIONS

MAR prohibits insider dealing, improper disclosure of inside information and market manipulation. It also, unlike MAD I, prohibits *attempted* insider dealing and market manipulation. This represents another significant extension of the market abuse regime.

The insider dealing and improper disclosure prohibitions are premised on the concept of "inside information". Inside information is non-public information of a precise nature relating directly or indirectly to a financial instrument or an issuer thereof, and which, if made public, would likely have a significant effect on the price of the financial instrument or related derivatives. MAR expands this definition beyond financial instruments to include information on emission allowances, as well as on commodities derivatives and spot commodity contracts where that information is required to be or is reasonably expected to be disclosed. ESMA is to publish guidelines on where information is required or reasonably expected to be disclosed.

Information is of a precise nature where it concerns a circumstance or an event (whether current or reasonably expected) and is specific enough to enable a market participant to draw a conclusion as to the effect of such circumstance or event on the price of the instrument in question. Where the circumstance or event is the result of a protracted process, information relating to intermediate steps in that process should also be considered precise information.[9]

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[7] However, abusive behaviour on the commodity spot markets that does *not* affect financial instruments is beyond the scope of MAR. The commodity spot markets will instead be subject to specific sectoral regulation.

[8] Such as the Commission's Proposal for a Regulation of the Parliament and of the Council on Energy Market Integrity and Transparency, COM (2010) 726 (Dec. 12, 2010).

[9] This represents a codification of the European Court of Justice's judgment in Case C-19/11, *Markus Geltl v. Daimler AG* (June 28, 2012).

The recitals to MAR give examples including provisionally agreed contractual terms and the mere fact that a placement of financial instruments is being considered. Accordingly, issuers must carefully consider whether inside information has come into being (and the obligations that follow) at every stage of a transaction, including the very earliest stages.

The test under MAR for price-sensitivity has been the subject of some concern. Information which, if made public, would likely have a significant effect on the price on the instruments to which it relates ("**price-sensitive information**") is defined as information that a reasonable investor would likely use as part of the basis of his investment decision. This reprises the 'reasonable investor test' that previously appeared in a Directive[10] implementing MAD I. However, the reasonable investor test was understood[11] under MAD I to be a *precondition* to information being price-sensitive, rather than the *definition* of price-sensitive information itself, as it appears under MAR. This clearly expands (and obscures) the definition of inside information, which may be particularly problematic for issuers grappling with the question of whether information must be announced to the market. Market participants[12] have sought clarification on this point from ESMA in their responses to the its discussion paper[13] on implementation options for MAR ("**Discussion Paper**").

A new category of inside information proposed in the Commission's October 2011 draft of MAR – information not generally available but which, if it were, would likely be considered relevant to a reasonable investor's decisions – has not been retained in MAR as adopted. Market participants and professional organizations had voiced concerns about the uncertainty that would have been introduced by creating a new category of inside information that need be neither precise, nor price sensitive.

Insider dealing

Insider dealing is committed when a person in possession of inside information uses that information in deciding whether or not to acquire or dispose of a financial instrument to which that information relates. Crucially, a person who transacts while in possession of inside information will be presumed to have "used" that information in the transaction.[14] As a new addition to the market abuse regime, MAR provides that making decisions to cancel or amend

[10] Directive 2003/124/EC of the European Parliament and of the Council of 22 December 2003 implementing Directive 2003/6/EC as regards the definition and public disclosure of inside information and the definition of market manipulation, Article 1(2).

[11] See, for example, the UK Financial Services and Markets Act 2000, s.118C(6).

[12] The London Stock Exchange Group and the Association of British Insurers, among others.

[13] ESMA/2013/1649, Discussion Paper on ESMA's policy orientations on possible implementing measures under the Market Abuse Regulation (Nov. 14, 2013).

[14] The recitals to MAR reassert this rebuttable presumption from the judgment of the European Court of Justice in Case C-45/08, *Spector Photo Group NV v. Commissie voor het Bank Financie-en Assurantiewezen*, although the presumption does not explicitly appear in the substantive text of MAR.

existing orders for financial instruments on the basis of inside information counts as insider dealing.

The offence will only be committed where the person using the inside information obtained it through his position in the management or capital of the issuer, through his profession or employment, through criminal activity, or otherwise in circumstances in which he knew or ought to have known the information was inside information ("**Article 8(4) Circumstances**").

As well as prohibiting attempted insider dealing for the first time, MAR also introduces indirect and accessory insider dealing offences that come into play where a person possessing inside information uses it to recommend or induce another person to acquire or dispose of financial instruments. In these circumstances, if that other person knows or ought to know that the recommendation or inducement is based on inside information, he too will have committed insider dealing. The recommender is also considered to have breached the prohibition on insider dealing (and is likely to have made an improper disclosure too).

Improper disclosure of inside information

MAR states that a person will be considered to have improperly disclosed insider information where he divulges that information to any other person, except if such disclosure is made in the normal course of his employment, profession or duties. The improper disclosure regime applies only where the inside information has been obtained in one of the Article 8(4) Circumstances.

As an addition to the MAD I regime, MAR provides that a person is deemed to have made an improper disclosure where he recommends or induces another person to acquire or dispose of financial instruments based on certain information while knowing (or in circumstances under which he ought to have known) that the information was inside information.

Market manipulation

Market manipulation is the practice of interfering in the free and fair operation of a market to create a misleading impression in an attempt to gain a market advantage. MAR sets out 9 broad types of activity/behaviour that constitute market manipulation.

MAR prohibits the following activities/behaviours in relation to financial instruments and spot commodity contracts. Items 4, 7 and 9 are new additions.

1. Giving misleading signals about the supply, demand or price, or securing the price at an artificial level, unless an accepted market practice applies (see below).

2. Affecting price by means of a fictitious device or other deception or contrivance.

3. Disseminating information that gives misleading signals about the supply, demand or price or secures the price at an artificial level, where the disseminator knows or ought to know the information was false or misleading.

4. Manipulating benchmarks, particularly by transmitting false or misleading information or providing misleading inputs where the perpetrator knows or ought to know that the information or inputs are false or misleading.

5. Securing a dominant position over supply or demand with the effect of fixing prices or creating other unfair trading conditions.

6. Trading at the opening or close of the market with the effect of misleading investors as to opening and closing prices.

7. Placing, cancelling or modifying orders (including by means of algorithms or high-frequency trading) to manipulate supply, demand or price by:

    a. disrupting or delaying the trading system (e.g., by 'quote stuffing');

    b. obscuring genuine orders, particularly by overloading or destabilising the order book ('layering'); or

    c. entering orders to initiate or exacerbate a trend ('momentum ignition').

8. Taking a position on securities before profiting from that position by publicly voicing via the media an opinion about such securities or their issuer ('pump and dump' / 'trash and cash'). This will not constitute market manipulation if the conflict of interest is simultaneously and effectively disclosed.

9. Buying or selling emissions allowances or derivatives thereof to fix auction prices at an artificial level or otherwise mislead bidders.

In most cases it is enough that the behaviour is *likely* to bring about the stated effect. MAR also states that attempted market manipulation is prohibited.

The annex to MAR provides a non-exhaustive list of indicators that authorities shall take into account in determining whether a person has committed the market abuse that employs "false or misleading signals" or "fictitious devices, deceptions or contrivances". The indicators mainly relate to the context in which the transaction was carried out. In addition to the annex, MAR gives the Commission the power to adopt delegated acts to clarify or update the elements of the market manipulation offence. ESMA has already given a preliminary view on the indicative list in its Discussion Paper, identifying the ratio of cancelled orders and the volume of financial instruments per order as being particularly relevant.

Note that as the market manipulation rules now extend to spot commodity contracts, they appear to capture the market manipulation technique known as 'corner and squeeze'. Using this technique, the market manipulator first "corners" the market in a commodity by

simultaneously purchasing large quantities of that commodity in the spot market and in the forwards/futures market for delivery at a future date. At the date of delivery under the forwards/futures contracts, the market manipulator "squeezes" the spot commodity market by withholding supply, enabling him to charge higher prices for his position in the underlying commodity.

C. EXCLUSIONS AND EXCEPTIONS

Although MAR is exceptionally wide-reaching in its scope, it contains a number of safe-harbour provisions.

Activities excluded from the scope of MAR

Where a company buys shares in its own capital back from shareholders, it is necessarily trading while in possession of inside information. Nonetheless, MAR does not apply to shares bought back for the sole purpose of reducing share capital or redistribution to holders of employee stock options or call options embedded in debt instruments.

Similarly, MAR provides an exemption for stabilization – an activity that would otherwise amount to market manipulation. Investment banks may maintain the price of securities at an artificial level without falling within MAR, provided that stabilization is within certain limits and for a limited, predetermined period.

Both buy-backs and stabilization activities must be notified to the competent authority, publicly disclosed, and conducted in accordance with regulatory technical standards that have yet to be published. ESMA has indicated in its Discussion Paper that it is considering requiring a single competent authority to be determined for the purpose of notifications where the instrument in question is traded in several Member States. It has also sought views on whether the issuer or the stabilizing agent should be responsible for notification, and whether the stabilization exception should apply to block trades, among other things.

Further exemptions are provided for Member States and certain national and supranational institutions undertaking certain activities in relation to monetary policy, public debt management, EU climate policy and the Common Agricultural Policy.

Legitimate behaviours not constituting insider dealing

MAR sets out the following circumstances ("legitimate behaviours") in which a person dealing securities while in possession of inside information shall not be deemed to have engaged in insider dealing, unless a competent authority is able to establish an illegitimate reason for the transaction.

- Market-making, where an acquisition or disposal of financial instruments to which the inside information relates was made legitimately in the normal course of the market-maker's functions.

- Brokerage, where, on the basis of an order authorized by a third party, a person acquires or disposes of financial instruments legitimately in the normal course of his employment, profession or duties.

- Discharge of supervening obligations, where financial instruments are acquired or disposed of in order to satisfy a contractual, legal or regulatory obligation arising in good faith prior to the inside information becoming known to the person concerned.

- M&A, where inside information obtained in the context of a public takeover or merger is used solely for the purpose of that takeover or merger and is made public prior to acceptance of the offer or the approval of the merger. This legitimate behaviour does not apply to stakebuilding.

MAR clarifies that use of one's own knowledge of one's intention to acquire or dispose of financial instruments does not constitute use of inside information. This clarification is important as it will facilitate stakebuilding ahead of a public takeover or merger, provided that the acquirer is not in possession of inside information that may have been obtained through access to the target or its management.

In addition to the above, MAR provides that where a legal person deals in securities while in possession of inside information, it will not be considered to have engaged in insider dealing where it has systems in place to ensure that the natural person making the decision to acquire or dispose of the instruments in question was not himself in possession of the inside information. In other words, where a market participant has put in place and implemented Chinese walls that effectively separate those in possession of inside information from those making acquisition/disposal decisions in relation to financial instruments, knowledge of the former will not be attributed to the legal entity.

Hedging, defined as entering into transactions (especially commodity derivatives transactions) for the purposes of covering direct contractual losses, was a legitimate behaviour in certain drafts of MAR. The version of MAR adopted does not include hedging in the list of legitimate behaviours. This means that a market participant using inside information to hedge will be deemed to have engaged in insider trading, whether or not a competent authority has established illegitimate use of that information. This is especially significant given that MAR extends the market abuse regime to commodities derivatives. Natural resources companies may wish to consider establishing firewalls to prevent inside information from their principal operations being passed on to their trading arms, even if their trading arms conduct hedging transactions only.

Market soundings not constituting improper disclosure of inside information

A disclosure of inside information is not improper where it is made in the normal course of one's employment, profession or duties. Under a new safe harbor established by MAR, this will be the case where a disclosure is made to potential investors in the course of "market soundings" conducted to gauge investment appetite and the appropriate terms for a transaction. This includes disclosures made to target shareholders in the context of a takeover where the

approval of such shareholders is required and the information provided to them is necessary to allow them to determine their willingness to offer their shares in return.

In order for a disclosure to qualify as a market sounding, the discloser must obtain the prior consent of the disclosee and warn him that the information must remain confidential and must not be used to inform a decision to acquire or dispose of a financial instrument to which it relates. The consent and evidence of the warnings must be recorded and submitted to the competent authority upon request. These provisions are clearly designed to prevent inadvertent disclosures of inside information. ESMA's Discussion Paper indicates that it would be prudent for market soundings to follow a "script" to ensure the detailed regulatory requirements are satisfied. Furthermore, the discloser must keep detailed records. Although ESMA will publish implementing technical standards on this bookkeeping requirement, MAR states that records must be kept of the information disclosed, the consent obtained and the warnings given. These records must be kept for five years and be provided to competent authorities on request.

MAR makes clear that the disclosee must come to his own decision on whether information disclosed is inside information. This suggests that agreeing to receive information on a 'non-wall-crossed basis' will be insufficient to protect against the improper disclosure rules, although this remains good practice.[15] ESMA seeks views in its Discussion Paper on whether sell-side firms should be required to keep lists of buy-side firms that do not wish to be wall-crossed, as well as on the circumstances in which the buy side can consider information to be "cleansed", i.e. no longer inside information.

Accepted market practices not constituting market manipulation

As under MAD I, transactions conducted in line with accepted market practices *and* for legitimate reasons will not constitute certain forms of market manipulation. "Accepted market practices" is a term of art applying to a given list of market practices specific to the market in question and which are pre-approved by the competent authorities after consideration of a non-binding opinion of ESMA.

MAR reprises from the Accepted Market Practices Directive[16] a number of factors that competent authorities must take into account when establishing their lists of accepted market practices. Most significantly, these include the characteristics of the market and its participants, whether the practice creates risks for related EU markets, whether the practice improves market liquidity and efficiency, and the extent to which the practice breaches market abuse rules. The full list of accepted market practices and the markets they apply to will be published on the ESMA website.

Accepted market practices established under the existing market abuse directive will continue in effect unless and until the relevant competent authority withdraws them following

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[15] This echoes the position taken by the United Kingdom's (now defunct) Financial Services Authority in its Decision Notice of January 12, 2012 (the Einhorn / Greenlight Capital case) available at http://www.fsa.gov.uk/pubs/decisions/dn-einhorn-greenlight.pdf .

[16] Directive 2004/72/EC of the Parliament and of the Council of April 29, 2004 implementing Directive 2003/6/EC.

consultation with ESMA. ESMA has indicated in its Discussion Paper a provisional preference for restricting the use of accepted market practices to entities subject to the provisions of MiFID.

The Commission's original MAR legislative proposal sought to phase out the accepted market practices concept in the interests of consistent application of the market manipulation rules, only for the concept to be reincorporated in subsequent drafts in recognition of the realities of market trading. To address the Commission's concerns about accepted market practices, the European authorities may in practice attempt to reign in the concept using means such as ESMA regulatory technical standards.

D. ENFORCEMENT, INVESTIGATORY POWERS AND SANCTIONS

The burden of enforcement of MAR is shared between market operators, issuers, employees and competent authorities.

Market operators have obligations (i) to make arrangements for preventing and detecting market abuse, (ii) to report suspicious transactions, and (iii) to provide competent authorities with detailed notifications of when financial instruments are traded for the first time, requested to be admitted to trading, or cease trading.

Issuers are also involved in policing MAR. Most issuers (with the exception of some growth-market-listed companies) are required to draw up and maintain insider lists detailing every person who has access to inside information, whether employees, advisors, contractors or otherwise. The list must be provided to the competent authority on request and must detail the identity, reason and date of inclusion of the insider. Issuers may outsource administration of the list, but will remain ultimately responsible for its accuracy.

Employees who report breaches of MAR are entitled to protection against any resulting retaliation, discrimination or unfair treatment, will have their identities kept secret, and may even be granted a financial reward. These 'whistleblowing' provisions are a new addition to the market abuse rules and employers will be required to put mechanisms in place to implement them.

Competent authorities use the information gathered from issuers and market operators to investigate and sanction market abuse. In an attempt to make this process more joined-up and consistent, MAR makes detailed provision for coordination among competent authorities.

Investigatory Powers

MAR grants competent authorities very considerable investigatory powers. As a *minimum*, competent authorities will have powers to enter business premises, seize documents and data, summon and question any person, procure telephone records, sequester assets, suspend trading in the instrument in question and impose temporary bans on the professionals involved, among others.

Sanctions

MAR requires Member States to put in place civil sanctions for breaches of the market abuse prohibitions, as well as for breaches of certain of the provisions relating to record-keeping, notifications and complying with investigations. Unlike MAD I, MAR does not leave it to Member States to determine the appropriate sanctions for market abuse. MAR provides for both fines and non-pecuniary measures. Member States are required to put in place such administrative sanctions regardless of whether criminal sanctions are already in place.

The maximum level of the fines provided for by MAR depends on the nature of the perpetrator and the provision breached.

	Legal Person	Natural Person
Breach of insider dealing, improper disclosure or market manipulation provisions	€15 million or 15% of consolidated annual turnover[17]	€5 million
Breach of most of the other provisions of MAR	€2.5 million or 2% of consolidated annual turnover	€1 million
Overarching minimum fine applicable to any breach of MAR	Three times the profits gained or losses avoided	

Confusingly, these maximum fines set out in MAR are in fact 'minimum maximum' fines. In other words, Member States must not set the upper limit for fines below the amounts stated above, but they are allowed to impose even more onerous fines.

In addition to fines, MAR also requires Member States to put in place a wide range of non-pecuniary sanctions including cease and desist orders, orders for disgorgement of profits, public warnings, withdrawal or suspension of regulatory authorizations, and temporary or permanent bans on the exercising of management functions by the managers implicated in the breach.

Competent authorities must consider a non-exhaustive list of factors when determining the severity of sanctions to be imposed. Factors include the gravity of the breach, the benefit derived by the perpetrator, previous breaches, measures taken to prevent repetition of the breach, the financial strength and responsibility of the perpetrator, and the level of cooperation

[17] In an apparent oversight, MAR does not indicate which of the two fining measures should be used. It is submitted that it would be more in line with the Rule of Law (the 'Rule of Lenity' in particular) for this ambiguity to be resolved in favour of the market abuser.

with the authorities. MAR states that co-operators will not be considered to have breached any legal, contractual, regulatory or administrative obligation not to disclose information.

Once the competent authority has made the sanctioning decision, it should publish it on its website unless that would cause disproportionate harm, prejudice an on-going investigation, or jeopardize the stability of the financial markets. In such cases, publication should almost always be delayed or anonymized rather than cancelled outright.

In contrast to the Commission's original draft, MAR does not require Member States to guarantee a right to appeal against market abuse decisions.

E. DISCLOSURES, NOTIFICATIONS AND RECOMMENDATIONS

Disclosure of inside information

Issuers continue to be required to make inside information public as soon as possible in a way that enables its complete, correct and timely assessment by the public. However, given the broadened scope of MAR, a greater number of issuers will be concerned by this disclosure obligation: not only issuers of financial instruments admitted to trading on a regulated market[18], but issuers of any financial instruments within the scope of MAR. See Scope, above.

As under MAD I, disclosure of inside information may be delayed for as long as it can be kept confidential in circumstances where immediate disclosure would be likely to prejudice the issuer's legitimate interests and mislead the public. The recitals to MAR give examples of situations where the issuer's legitimate interests may be harmed: (i) where negotiations are in course (especially if they regard the issuer's financial viability), and (ii) where a decision taken by the management is subject to approval by another body within the issuer. ESMA has stated in its Discussion Paper that it does not intend to provide an exhaustive or more comprehensive list of examples of legitimate interests than that under MAD I.

Unlike MAD I, MAR requires issuers to immediately inform the competent authority of the use of provisions in the legislation that allow issuers to delay the disclosure of inside information, as well as the reasons for their use. This represents a considerable additional administrative burden on issuers, but national legislators are given discretion to require such notifications only on demand. In response to the ESMA Discussion Paper, the City of London Law Society has expressed concern about the burdens created by this change to the MAD I regime, and states that it would be preferable for the UK (and other Member States) to legislate for on-demand notifications only.

In response to the financial crisis, MAR introduces a new provision that allows financial institution issuers to delay disclosure in order to protect the financial system. It applies for as long as: the inside information can be kept secret, disclosure risks undermining the issuer and the financial system, delaying disclosure is in the public interest, and the competent authority

[18] Or to which an application for admission to trading on a regulated market has been made.

consents. This provision might be used, for example, where the issuer has confidentially sought liquidity support from a lender of last resort.

Note that where there is a rumour that is sufficiently accurate to show that inside information has been leaked, the issuer can no longer claim that that information can be kept confidential and will have to make an immediate disclosure.

Notifications of managers' transactions

As under MAD I, whenever a manager[19] of an issuer (or his close relative or controlled entity) deals in the securities of that issuer or derivatives thereof for his own account, he triggers a two-part disclosure requirement. Within 3 business days of the transaction, (i) the manager must notify the issuer and the competent authority of the transaction, and (ii) the issuer must publish details of the transaction. Relevant details include the identity of the manager, the nature of the transaction and its price.

Although this provision does apply to "any transaction" (including pledges and brokered transactions), it is subject to minimum thresholds. Dealings of up to €5,000 in one year will not trigger the disclosure requirement, and competent authorities may increase this threshold to €20,000.

Aside from the disclosure requirement, managers should remember that they may not deal in their issuer's securities during "closed periods" of 30 days before the announcement of the issuer's interim or year-end accounts. This prohibition may be waived in exceptional circumstances, such as severe financial difficulty, or in relation to a small list of transactions that provide limited scope for abuse. In its Discussion Paper, ESMA states proposes that exceptional circumstances should only be relied upon where the reason for the transaction is "extremely urgent, unforeseen, compelling and external to the issuer".

Investment recommendations

In addition to mandatory disclosures and notifications, MAR regulates voluntary disclosures of recommendations for investment strategies made by professionals or by any person directly proposing an investment decision. Such persons must take reasonable care to ensure the information is objectively presented and that their conflicts of interest are disclosed.

II. DIRECTIVE ON CRIMINAL SANCTIONS FOR MARKET ABUSE

CSMAD is the limb of MAD II that introduces mandatory criminal sanctions for serious cases of intentional insider dealing, unlawful disclosure of inside information and market manipulation. The new Directive is intended to promote investor confidence, foster consistent cross-border enforcement and strengthen social disapproval for market abuse.

[19] I.e., a person discharging managerial responsibilities, as defined in MAR .

Member States have until July 3, 2016 to transpose the provisions of CSMAD into national law. The United Kingdom has not opted in to CSMAD, but the government has indicated that it intends to opt in at a later date following further negotiation.[20] Market participants should recall that UK domestic legislation already criminalizes market abuse independently of CSMAD.

A. SCOPE

Unlike the civil sanctions provided for by MAR, CSMAD only *requires* Member States to put in place criminal sanctions for serious and intentional infringements of the market abuse rules. The recitals to CSMAD provide suggestions on factors to consider when determining seriousness, including the impact on market integrity, the gain derived, recidivism and the position of the perpetrator. Unless significant further clarification is provided, the exact perimeter of the criminal sanctioning regime will remain uncertain and harm the Commission's goal of harmonization.

In other respects, CSMAD is very closely aligned in scope with MAR and reprises much of its wording, including in relation to exclusions and exemptions, the financial instruments concerned, and the definition of the core market abuse offences. However, the definition of market abuse deviates notably from MAR.

Firstly, the list of manipulating techniques is truncated. CSMAD only applies to manipulation of benchmarks; manipulation using fictitious devices, contrivances or deceptions; and manipulation involving giving misleading signals or securing an artificial price in the absence of an accepted market practice (see 1. to 4. in Market Manipulation, above).

Secondly, while MAR applies where an activity is merely "likely" to cause a manipulative effect, CSMAD applies only where the activity does create such an effect. Note, however, that CSMAD does criminalize attempted market abuse (including market manipulation), as well as inciting and aiding and abetting market abuse.

As regards, geographic scope, CSMAD applies at a minimum to market abuse committed (i) within a Member State, or (ii) by a Member State national in a territory where market abuse is an offence. CSMAD further provides that a Member State may extend its jurisdiction under MAR to offences committed by habitual residents of that Member State, or where the offence is committed for the benefit of a legal person established in that Member State.

B. SANCTIONS

CSMAD requires Member States to put in place effective, proportionate and dissuasive criminal penalties for market abuse, whether committed by a natural person or a legal person.

[20] Daily Hansard – Written Ministerial Statements (Feb. 20, 2012), available at http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120220/wmstext/120220m0001.htm#1202202000003

Sanctions must be imposed with consideration of fundamental rights and in compliance with the rule against double jeopardy.

The new Directive provides that the maximum sentence for natural persons may be no less than 4 years in cases of insider dealing or market manipulation, and 2 years in cases of unlawful disclosure of inside information.

As regards legal persons, CSMAD directs that breaches should be punished by way of fines (unquantified), exclusion from public aid, temporary or permanent bans on the person's commercial activity, judicial supervision, winding-up, or the temporary or permanent closure of branches implicated in the wrongdoing.

A legal person will only be implicated in market abuse where a person in a leading position within the entity committed market abuse for the benefit of that entity. The person in a leading position must have the ability to represent, control or make decisions for the legal person in question.

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