



# PLAYING YOUR PART IN FAIR AND EFFICIENT MARKETS

EFFICIENT AND FAIR CAPITAL MARKETS RELY ON TRANSPARENCY. HERE THE FCA'S **JULIA HOGGETT** EXPLAINS THE PRINCIPLES BEHIND THE MARKET ABUSE REGULATION AND HOW IT IMPACTS CORPORATES.

Companies navigate a complex regulatory environment every day. We know that the rules we create as a regulator can be perceived to add to this complexity. But we can help firms navigate this environment if we have an eye on simplicity in our actions.

In 2017, the Financial Conduct Authority (FCA) published its Mission reflecting the desire of the FCA to provide firms and consumers with greater clarity

about how and why we do what we do. We are also seeking to provide greater clarity to the market about our expectations, because we believe we achieve more as a regulator when market participants understand what we expect of them.

We recognise that the rationale for our rules is not always clear and that this can create a negative perception, leading at worst to patchy adherence or even non-compliance.

## **The Market Abuse Regulation**

The relevance of the Market Abuse Regulation (MAR) may not be immediately obvious - particularly for those not active in the UK capital markets, or not currently listed and only carrying debt in the form of bank lines. However, its principles are useful to understand because institutions not currently active in the capital markets may choose

to issue securities or undertake the acquisition of a company with listed securities in the future. They also represent good market hygiene.

## **Why MAR exists**

MAR is critical to ensuring markets operate with proper disclosure, ensuring a level playing field for all investors and minimising the risk of asymmetric information in the market.

The UK's financial markets allow funding and capital to be raised that can be invested across society. They allow for effective risk pricing and risk transfer facilitating anything from the pricing of commodities and FX transactions to the appropriate pricing of a 25-year mortgage.

We all benefit from the functioning of those markets, but they will only be effective if they are, and are perceived to be, fair and effective. Appropriate application and policing of MAR ensures investment funds are not caught out by abusive behaviour, which in turn helps ensure better performance for the pension funds of many citizens. It encourages greater retail participation in our markets by preventing legitimate investors from being abused by opportunistic and/or potentially criminal behaviour and, ultimately, it enhances the reputation of the UK as a leading global capital market.

Fundamentally, effective markets operate on trust. Trust allows efficient capital raising and investment and risk to be priced and transferred effectively. As the UK's securities regulator, we seek to ensure that the regulatory framework, understanding of that framework and supervisory infrastructure around it maximises the trust in the UK markets.

### Scope of MAR

MAR spans all listed instruments, including: fixed income and equity, and listed derivatives such as credit default swaps (CDSs). It covers instruments that are not listed, but which are traded on multilateral trading facilities (MTFs) or organised trading facilities (OTFs). In some instances, MAR covers

spot commodity contracts and derivatives of these contracts. It also encompasses instruments that are neither listed or traded, but whose price or value depends on, or has an effect on, the price or value of financial instruments, which are listed or traded, including CDSs and contracts for difference.

For these instruments, it identifies abusive behaviour that impacts secondary market trading, such as insider dealing and market manipulation. But it also covers the obligations on issuers in the primary markets.

MAR applies to a wide range of corporate issuers – not just London Stock Exchange listed firms, but all firms that have their securities traded or admitted to trading on any EU-regulated market, MTF, such as an alternative investment market, or OTF.

MAR includes rules on disclosure – including what information an issuer must share with the market, when the issuer must share it, and how the issuer must manage the information.

MAR also codifies how key individuals, such as managers at firms, report their trading activity, including the timely disclosure of trading by those discharging managerial responsibilities within listed companies.

The FCA has powers to take enforcement action against issuers for breaches of these obligations under MAR – including misleading the market or illegitimately delaying disclosures.

The obligation to apply key aspects of MAR sits with the issuing company, as well as market participants, and requires the necessary systems and controls to be in place. However, it also requires the ability to identify inside information, and the understanding of what to

## MAR includes rules on disclosure – including what information an issuer must share with the market

do next. Knowledge of MAR is therefore highly relevant to anyone in a corporate management role.

### Inside information

The identification of inside information is key, but its definition is both fluid and situational.

Article 7 of MAR tells us that the information must be of a precise nature, not have been made public, relate directly or indirectly to one or more issuers or financial instruments, and, if made public, be likely to have a significant effect on the prices of those financial instruments or related derivatives.

Identifying inside information requires a series of situational judgements. It cannot be just a set of rules, it must be a state of mind – a vigilance to identify the potential for such information, the skill to make the assessment as to whether the conditions are met and then the awareness of what to do next.

### Processes and governance

It is important to be familiar with the regime and understand clearly where in your business inside information could arise and who could hold it.

There is no easy answer to knowing how to identify inside information and there is no 'one size fits all' classification framework. It requires judgement and an understanding of what information the market is currently pricing in and how it is operating. We recognise that levels of sophistication of systems and controls vary across companies.

Fundamentally, the spirit of the requirement is ensuring that your organisation can react quickly, and identify and release inside information as soon as possible. We understand that issuers will not always get marginal judgement calls right. Central to our monitoring of corporate disclosures is to review the approach and level of consideration that issuers and their directors have taken to comply with their obligations.

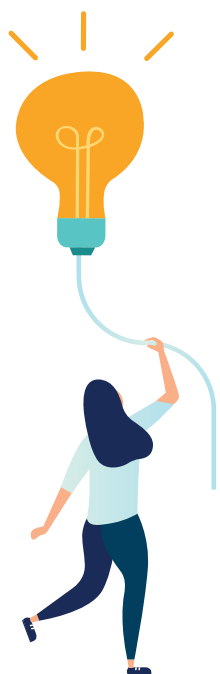
### 'Precise' information

A common question is what does 'precise' mean in the context of inside information? It is important to highlight that 'precise' does not necessarily mean 'exact'.

This may sound like semantics, but understanding that information does not have to be exact or certain in nature for it to be considered inside information is crucial to avoid erroneously applying this requirement.

MAR states that 'precise' means (broadly speaking) that there is a reasonable expectation of a set of circumstances or an event occurring, the effect of which is specific enough so that conclusions can be drawn about the possible effect on the price of a financial security. The fuller definition of 'precise' is set out in Article 7(2) of MAR.

Case law – both UK and European – has added further clarification in terms of referring to a 'realistic prospect' test where the prospect of the event or circumstances occurring must be "more than fanciful".



## MAR exists, in part because that perceived conflict between confidence and liquidity exists

As with many aspects of MAR, deciding if a piece of information is 'precise' requires awareness and judgement.

### Announcements

We also understand that there are challenges around when to announce inside information. MAR requires inside information to be disclosed as soon as possible, unless there are grounds for delay. Disclosure of inside information may be delayed where there is a legitimate interest to do so, but only where delaying would not be misleading and the confidentiality of the information can be ensured.

We are cognisant that taking time to ensure information is accurate before disclosing it is important. A short delay to get the information right may be acceptable if the conditions for delay are met, but we would expect this, in most cases, to be more hours than days.

### Financial information

One question we are often asked is whether or not periodic financial information is inside information. The answer, perhaps unhelpfully, is: it depends.

When preparing periodic financial reports, issuers should

assess on an ongoing and case-by-case basis whether the information they hold fulfils the criteria defining inside information as set out in MAR. In undertaking this assessment, issuers should begin from the assumption that information relating to financial results could constitute inside information. Issuers should not consider that information to be included in periodic financial reports will always, or never, constitute inside information.

### Insider lists

Another area of uncertainty that we are aware of is how organisations should comply with Article 18 of MAR in keeping insider lists.

The principle is simple: those who have access to inside information need to be on an insider list. Information that is material to a firm, to its prospects and to the price of its securities is something that institutions have a legitimate interest in managing carefully.

It is important to highlight that unlawful disclosure of inside information is, in itself, an offence alongside the more well-known insider dealing offence – no matter what type of firm the inside information relates to.

Leaving aside the legal risk to staff who share this information, or knowingly, or unknowingly, trade ahead of an announcement when having access to inside information – it is, at its gravest, a criminal offence with potential custodial sentences of up to seven years in prison. There is also the reputational risk to the issuer

or, more crucially, it could have a material impact on the ability to successfully negotiate an M&A transaction.

Insider lists must be up to date, complete and, on our request, provided to the FCA in a timely manner. Issuers should ensure that third parties acting on their behalf, such as corporate brokers and accounting firms, also keep their own insider lists.

### PDMRs

Article 19 of MAR introduced changes relating to disclosure of, and restrictions on, dealings by persons discharging managerial responsibility (PDMRs).

These disclosures have two objectives: first, to be preventative to insider dealing, and second, to be a source of useful information for the rest of the market – PDMR decisions ultimately reflect the sentiments of those most closely involved with the performance of the company.

### Conflicts of interest and conclusion

We know that MAR is challenging – effective compliance requires strong use of judgement and making difficult decisions.

One of the most important elements for maximising compliance with the regime is understanding what it is trying to achieve.

Lending and capital raising is founded in confidence. It can feel as if there is a conflict between ensuring the market is fully and appropriately informed of the good and the bad in your credit story, and maintaining

that element of confidence. A market that trusts its issuers to tell them the good and the bad will also be more likely to trust that the good is genuinely good and that the bad is just as described and no more.

MAR exists, in part because that perceived conflict between confidence and liquidity exists. Therefore, a failure to adhere to the trust placed in issuers by those who provide it capital, by not meeting the requirements of MAR, is an offence. But, at its heart, it is because trust in markets is the foundation on which effective capital raising can rest. ♥

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