



The CSMAD: Forthcoming Changes to EU Market Abuse and Insider Dealing Rules

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Summary

The European Union's Market Abuse Regulation¹ (MAR) will replace the European Union's Market Abuse Directive² (MAD) on July 3, 2016. In much of the European Union, the directive on criminal sanctions for insider dealing and market manipulation³ (CSMAD) will be implemented in parallel with MAD. While not all EU countries are required to implement the CSMAD, its effects will be far-reaching.

Background

MAD already applies to any persons anywhere in the world who conduct:

- (1) insider dealing;
- (2) improper disclosure of inside information;
- (3) misuse of inside information;
- (4) manipulating transactions; or
- (5) manipulating devices.

MAD also applies when the above are conducted in connection with certain types of instruments, including (1) financial instruments admitted to trading on an EU-regulated market or in respect of which a request for admission to trading on such market has been made; and (2) related instruments the price or value of which depends on, or has an effect on, the price or value of a financial instrument traded on such market (i.e., derivatives), among others.

In essence, MAD applies to any person who trades on EU-regulated markets or enters into derivative contracts that refer to such instruments—even if they are not in the European Union or if there is no EU nexus to their trading activities (e.g., where they and their counterparty enters into over-the-counter derivatives transactions (which refer to EU financial instruments) outside of the European Union). MAD already has extraterritorial effect, but MAR and the CSMAD will extend EU rules even further and require that EU regulators impose stricter penalties on those found guilty of the relevant offenses.

¹ Regulation (EU) No 596/2014: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0596&from=EN>

² Directive 2003/6/EC: https://www.esma.europa.eu/system/files/Dir_03_6.pdf

³ Directive 2014/57/EU: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0057&from=EN>



EU Objectives

It is intended by the European Commission that the CSMAD should work with MAR to create a stronger market abuse regulatory framework with harmonized sanctions throughout the European Union, with minimum rules on criminal offenses and criminal sanctions for anybody conducting market abuse anywhere within the European Union or on EU markets. MAD currently only requires EU countries to adopt administrative sanctions which are “effective, proportionate and dissuasive” but allows each country to elect whether or not to impose criminal sanctions. In the past, this led to divergent market abuse and insider dealing penalties from country to country in the European Union, as well as difficulties for regulators and enforcement agencies in coordinating and enforcing such rules. Most EU countries have forms of administrative and criminal sanctions, although in some EU countries the administrative and criminal sanctions can be applied cumulatively. Maximum prison sentences can vary widely across the European Union with as little as 30 days imprisonment in Estonia for insider dealing and up to 12 years in Italy and Slovakia for the same offence of insider dealing. Equally, for the offence of market manipulation there are huge variances in the criminal penalties applied (again, only 30 days in Estonia and up to 15 years in Slovakia). The European Commission has been concerned that the differences could lead to persons conducting regulatory arbitrage so as to carry out market abuse across borders within the European Union, operating from the most lenient jurisdictions.

It is hoped that the new framework will give certainty to the rules in force across all 28 countries of the European Union and allow regulators and enforcement agencies to effectively work together to fight financial crime.

Scope of the New Rules

The CSMAD and MAR apply to the activities of insider dealing, inducing another person to engage in insider dealing, unlawful disclosure of inside information and market manipulation, each when conducted in relation to financial instruments:

- (1) which are admitted to trading on a regulated market or in respect of which a request for admission to trading on a regulated market has been made; or
- (2) which are traded on a multilateral trading facility (MTF), admitted to trading on an MTF or in respect of which a request for admission to trading on an MTF has been made; or
- (3) which are traded on an organized trading facility (any type of facility or system that is not an MTF or regulated market, but which is operated by an investment firm or market operator whereby multiple third-party buying and selling interests in financial instruments are able to interact in the system so as to result in a contract); or
- (4) which is not described by (1), (2) or (3), but the price or value of which depends on, or has an effect on, the price or value of a financial instrument referred to in (1), (2) or (3) (including, but not limited to, credit default swaps and contracts for difference).

New Criminal Penalties

Unlike the current position under MAD, which imposes only civil penalties (i.e., fines) on persons found guilty of these offenses, the CSMAD requires that serious cases of such activities, when committed intentionally, must constitute criminal offenses in EU jurisdictions and be punished by



criminal penalties. The CSMAD mandates minimum requirements for such penalties, although it remains open to each EU country to go beyond the requirements of the CSMAD—for example, applying criminal sanctions to less serious cases, or when the offenses are committed recklessly. It is not currently clear which, if any, EU countries will elect to have stricter rules than those set forth in the CSMAD.

The CSMAD cites various factors which should be considered by EU authorities as indicators of seriousness, including: (1) the impact on the integrity of the market; (2) the actual or potential profit derived or loss avoided; (3) the level of damage caused to the market; (4) high values of the financial instruments traded; (5) whether the person is part of a criminal organization; and (6) whether the person has committed such an offence before, among others.

The CSMAD mandates that the minimum penalties should be a minimum of four years' imprisonment for insider dealing, market manipulation and recommending or inducing another person to engage in insider dealing; and two years' imprisonment for unlawful disclosure of inside information. For most firms trading on the UK markets, dealing in financial instruments admitted to trading on a UK-regulated market or in derivatives whose price is referable to such instruments (wherever in the world such persons are physically located), the CSMAD will not introduce great changes, as the UK has for many years had criminal sanctions covering a range of financial crimes, including insider dealing. However, there will now be clarity on the likely penalties that could be suffered by a person in other EU countries where there may not have previously been any criminal penalty.

Opting-out

Under the Lisbon Treaty⁴, certain EU countries are not automatically bound by EU legislative proposals relating to freedom, security and justice, and instead they may opt in to any such proposals on a case-by-case basis. Denmark has opted out of the CSMAD, as has the United Kingdom. The UK government's view⁵ is that UK criminal law already covers all of the offenses in CSMAD in UK criminal law and also goes further by capturing, for example, acts of market abuse that are committed recklessly, as well as those committed intentionally. Notwithstanding the extensive nature of the UK offenses pre-CSMAD, the UK government has stated that it still intends to revise the scope of UK criminal offenses for market abuse.

It remains to be seen whether the criminal penalties in the UK or Denmark will be tougher than the minimum requirements set forth in the CSMAD, though this seems likely. The current maximum penalty in the UK for insider dealing is seven years' imprisonment, and it is possible that the maximum could be increased in line with that in the United States, where under the US Securities Exchange Act of 1934 (as amended by the Sarbanes-Oxley Act of 2002), individuals face up to 20 years' imprisonment.

Conclusion

The CSMAD will introduce mandatory criminal sanctions for those found guilty of market abuse and insider dealing across most of the European Union (with the exception of Denmark and the United Kingdom, where independent legislative efforts are also under way to increase existing

⁴ The Lisbon Treaty is an agreement between European Union ("EU") member states which amended the two treaties forming the constitutional basis of the EU (the Maastricht Treaty and the Treaty of Rome).

⁵ See Hansard, Statement by Mark Hoban, Financial Secretary to the Treasury of 20 February 2012 (columns 58-59WS: <http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120220/wmstext/120220m0001.htm#1202202000003>)



criminal penalties). Any persons *anywhere in the world* who trade on EU markets or in derivatives and other instruments whose price or value is referable to those instruments trading on EU markets, should be aware of these impending changes, even if they never set foot in Europe, and ensure that their compliance policies and procedures are updated accordingly.⁶

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⁶ A similar but briefer version of this client briefing, written by the same author, first appeared in *Financier Worldwide*, May 2015 edition.



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