Market Abuse - Regulation Overview

1. European Regulation

1.1. Market Abuse Directive
The Market Abuse Directive (MAD) is a European law that requires member states to implement equivalent legislation.

MAD Level 1 - Art 6(9) requires brokers to report suspicious transactions. It states:

"Member States shall require that any person professionally arranging transactions in financial instruments who reasonably suspects that a transaction might constitute insider dealing or market manipulation shall notify the competent authority without delay."

MAD Level 2 / Art 9 describes the content of that notification:

"Member States shall ensure that persons subject to the notification obligation transmit to the competent authority the following information:

(a) description of the transactions, including the type of order (such as limit order, market order or other characteristics of the order) and the type of trading market (such as block trade);
(b) reasons for suspicion that the transactions might constitute market abuse;
(c) means for identification of the persons on behalf of whom the transactions have been carried out, and of other persons involved in the relevant transactions;
(d) capacity in which the person subject to the notification obligation operates (such as for own account or on behalf of third parties);
(e) any information which may have significance in reviewing the suspicious transactions."

1.2. Market Abuse Directive II / Regulation
MAD is currently under review. The new draft is referred to as MAD II. The text is split into a "Regulation" (MAR) and a Directive (MAD II). While a Regulation becomes immediately binding law across EU Member States, a Directive requires each country to implement equivalent laws.

MAD II / MAR will require the European Securities and Markets Authority (ESMA) to establish a number of Europe-wide standards and ESMA is tasked with providing technical standards for investment firms on detecting and reporting suspicious trades (MAR Article 11).

MAR (Annex 1) includes a non-exhaustive list of indicators of manipulative behaviour.

2. UK Regulation

2.1. Financial Services and Markets Act 2000
The Financial Services and Markets Act 2000 (FSMA) regulates market abuse in the UK. The relevant sections are FSMA 2000 s.118/119.

2.2. Criminal Justice Act 1993
The Criminal Justice Act 1993 (CJA) regulates insider dealing in the UK. The relevant sections are CJA 1993 Part V and Schedule 2.
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2.3. Supervision Manual
The Supervision Manual (SUP) is part of the FSA Handbook. In Section SUP 15.10.2 it states:

“\textit{A firm which arranges or executes a transaction with or for a client in a qualifying investment admitted to trading on a prescribed market and which has reasonable grounds to suspect that the transaction might constitute market abuse must notify the FSA without delay.}”

3. Statements by Regulators

3.1. ESMA Guidelines
The ESMA Guidelines on systems and controls in an automated trading environment is an interpretation and explanation of existing regulation by the European regulator. The Guidelines were issued to complement existing MiFID (2007) regulation and set out ESMA’s view of how EU law should be applied.

Guideline 6 relates to investment firms’ organisational obligations to have policies and procedures in place to minimise the risk that their automated trading activity gives rise to market abuse. It states:

\textit{“Investment firms should monitor the activities of individuals/algorithms trading on behalf of the firm and the trading activities of clients, taking account of orders submitted, modified and cancelled as well as transactions executed. This should involve having adequate systems in place (including automated alert systems), using a sufficient level of time granularity, to flag any behaviour likely to give rise to suspicions of market abuse (in particular market manipulation), including (where the firm has sight of this) cross-market behaviour.”}

The types of market manipulation that could be of particular concern in an automated trading environment are described in Guideline 5 (paragraph 2 under General guideline for Regulated Markets and MTFs).

3.2. FSA Letter
At the end of 2012, the FSA and a number of other EU regulators wrote to investment firms highlighting their existing responsibility regarding the detection of market abuse, particularly in regard to layering and spoofing.

4. Sources

- Criminal Justice Act 1993
- ESMA Guidelines – Guidelines Systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities
- Financial Service and Markets Act 2000
- FSA – Obligations Letters – Detection Market Abuse
- MAD I – Level 1 Directive 2003/6/EC
- MAD I – Level 2 Directive 2004/72/EC
- MAD II – Draft European Parliament (19th October 2012)
- MAD II – Draft European Commission (20th October 2011)
- MAD II – Draft Council of the European Union (3rd December 2012)
- MAR – Draft European Parliament (22nd October 2012)
- MAR – Draft European Commission (20th October 2011)
- MAR – Draft Council of the European Union (5th December 2012)
- Supervision Manual (SUP)

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