29 November 2019

Steven Maijoor
Chair
ESMA
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Dear Mr Maijoor

Consultation Paper: MAR Review Report

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

On 3 July 2016, the majority of the provisions of Regulation (EU) No 596/2014 on market abuse (the "**Market Abuse Regulation**" or "**MAR**") came into effect in the E.U. and the U.K. MAR replaced and repealed Directive 2003/6/EC on insider dealing and market manipulation (market abuse) ("**MAD**" or the "**Market Abuse Directive**"). MAR harmonised the market abuse regime across the E.U. and expanded the scope of the core offences of insider dealing, unlawful disclosure of inside information and market manipulation. On 3 October 2019, the European Securities and Markets Authority ("**ESMA**") issued a Consultation Paper as part of a review of certain aspects of MAR (the "**Consultation**"). The FMLC is grateful for the opportunity to respond on certain key points.

Inside information: definition

Section 5 of the Consultation focuses on the definition of "inside information" given in Article 7 of MAR. ESMA states that, as necessitated by Article 38 of MAR, it is assessing whether the definition is sufficient to cover all information relevant for National Competent Authorities to effectively combat market abuse. It asks market participants questions such as whether they consider that the definition is sufficient for combatting market abuse (Question 14) and if they have identified information that they would consider "inside information" but which is not covered by the current definition (Question 15).

That the definition of inside information might be amended in the near future is likely to be a cause for alarm to market participants. The current definition is not perfect and the expansion by MAR of the definition which had existed in MAD had several knock-on effects for market participants. In the U.K., for example, the scope of the offence of dealing in inside information changed considerably.[1]

[1] That is because the implementation of MAD in the U.K.'s Financial Services and Markets Act 2000 incorporated a general defence in section 118 which permitted an insider to make a trade provided that he or she had exercised due care or diligence so as not to make use of inside information. That section was out of line with the European Court of Justice ("**ECJ**") decision in *Spector Photo Group v CBFA* [2009] C-45/08 that a person in possession of inside information who trades in the relevant security is presumptively in breach of the prohibition. It is the ECJ decision that is now reflected in MAR and the defence in section 118 has been abrogated accordingly.

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The market has, however, adapted to the definition and adopted appropriate practices. The FMLC would urge ESMA and the European Commission to refrain from tweaking the definition at this stage. An important component of legal certainty is predictability and stability. An amendment to the definition of inside information so soon after the last set of amendments will increase legal uncertainty and cause market disruption.

Scope of MAR and Spot FX contracts

Article 2(1) sets out the scope of MAR, which applies to financial instruments admitted to trading or traded on a trading venue. For certain limited provisions, Article 2(2) of MAR extends the application to spot commodity contracts and certain financial instruments that might impact the price of a spot commodity contract. Section 3 of the Consultation asks whether spot foreign exchange ("**spot FX**") contracts should be covered by MAR.

The current exclusion of spot FX contracts reflects the fact that such contracts are not financial instruments, the delineation between spot FX and FX derivatives that are financial instruments having been harmonised by Directive 2014/65/EU on markets in financial instruments ("**MiFID II**").[2] Spot FX contracts are characteristically contracts entered into for commercial purposes—for example, as a means of payment—rather than for investment purposes. Investment is, however, a key feature of the definition of inside information in MAR.[3] In addition, a host of interrelated obligations—including confidentiality, prohibition from entering into transactions, prevention and detection and issuer disclosure—flow from that definition. The Consultation itself highlights the technical difficulties in applying the current MAR definition of inside information to spot FX: in paragraph 20, ESMA asks who could be considered as the issuer for spot FX contracts. In practice, there would be none. In Question 2, ESMA states that structural changes would be necessary to apply MAR to spot FX contracts. The FMLC agrees that, spot FX transactions being ubiquitous, the regime may require broad exemptions and safe harbours to be workable, which raises further complexities around who and what might be exempted.

Market participants are likely to face difficulties in identifying what is relevant as inside information in the context of spot FX contracts. Relevant considerations in this context include which factors to take into account in determining whether information is precise, relates to the contract in question and would be likely to have a significant effect on price. These challenges arise in respect of other products outside the traditional issuer-securities markets—for instance, commodity derivatives, for which there is a specific insider dealing regime under MAR—but may be greater for spot FX, given that spot FX would be otherwise outside the scope of E.U. regulation (whereas other products are within the scope of MiFID II)[4] and the commercial nature of spot FX contracts highlighted earlier in the letter.

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2 A related observation is that the application of MAR insider dealing to "spot FX" may mean that some unlisted FX derivatives (which are financial instruments) may not be caught because they are not admitted to trading or traded on an E.U. trading venue but spot FX contracts (which are not financial instruments) would now fall within its scope.

3 Article 7(4) of MAR states that for the purposes of defining inside information such "information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments, derivative financial instruments, related spot commodity contracts, or auctioned products based on emission allowances *shall mean information a reasonable investor would be likely to use as part of the basis of his or her investment decisions.*" (Emphasis added.)

4 A list of financial instruments within the scope of MiFID II can be found in Annex I Section C to the Directive.

Stakeholders have highlighted to the FMLC that aspects of dealing with confidential information which are relevant to FX trading, including information relating to pending client orders, are already comprehensively covered by the FX Global Code.[5] Should the E.U. choose to regulate in this area, it might be important to review the application of the FX Global Code which has been adopted by market participants in several jurisdictions.[6] A new and specific E.U. regime, based on broadly defined conduct, may disrupt the process of bedding-down the FX Global Code and could even lead to the fragmentation of global FX and securities markets.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

Joanna Perkins
FMLC Chief Executive[7]

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5 Global Foreign Exchange Committee, FX Global Code August 2018, available at: https://www.globalfxc.org/fx_global_code.htm. See in particular Principles 11 (pre-hedging), 17 (last look) and 19 and 20 (handling confidential information).

6 In the U.K., the Financial Conduct Authority has introduced a mechanism to formally recognise industry codes of conduct, compliance with which would indicate that the person subject to the Senior Managers & Certification Regime is meeting the obligation to observe "proper standards of market conduct". The FX Global Code was recognised on 26 June 2019. Market participants in the U.K., therefore, consider themselves compliant with the Code's obligations.

7 The FMLC is grateful to Mark Kalderon (Freshfields Bruckhaus Deringer LLP) and Ferdisha Snagg (Cleary Gottlieb Steen & Hamilton LLP) for their help in drafting and reviewing this letter.