MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Prevention of Financial Markets Abuse

Guidance Notes

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INTRODUCTION

The Prevention of Financial Markets Abuse Act (henceforth referred to as 'the Act') came into force on the 1st April 2005. The purpose of the Act is to safeguard the integrity of **Maltese** and **European Community financial markets** and to enhance investor confidence in those markets. To meet this objective, the Act transposes and implements the EC Market Abuse Directive (henceforth referred to as 'the Directive').

The **Directive** was adopted by the European Parliament and the Council of the European Union on the 28th January 2003. The aim of the Directive is to bring about convergence among the different Member State regimes, by establishing a basic framework for the prevention of market abuse and so achieve greater confidence in the integrity of the financial system. With this objective in mind, the Directive sets up a universal EU legal framework which seeks to prevent, detect, investigate and sanction insider dealing and market manipulation.

The **Directive** is a framework directive under the new Lamfalussy process which has been complemented with a number of implementing measures issued by the EC Commission in the form of one regulation and three directives as follows:

(a) **Commission Regulation** (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments;

(b) **Commission Directive** 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation;

(c) **Commission Directive** 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the fair disclosure of conflicts of interest;

(d) **Commission Directive** 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions.

It is imperative to note that while Commission Directives require transposition in the legal framework of the Member State, Commission Regulations have direct effect and are, from the date they come into force, considered to form part of the legal framework of the Member State. Therefore, although the Commission Regulation mentioned above does not require transposition, parties affected by the said Regulation are nonetheless required to abide by the rules established therein.

The **Directive** and the implementing Commission Directives mentioned above have been transposed by way of the **Act** and three Legal Notices issued by the Minister under the Act, which came into force on the 1st April 2005 and which have the purpose of setting rules:

(a) of disclosure and notification applicable to issuers of financial instruments; persons acting on behalf of issuers of financial instruments; person discharging managerial responsibilities within an issuer of financial instruments; and persons professionally arranging transactions in financial instruments, **(Prevention of Financial Markets Abuse (Disclosure and Notification) Regulations, 2005 [L.N. 108 of 2005 as amended by L.N. 322 of 2005]**);

(b) for the fair presentation of investment recommendations and the disclosure of conflicts of interest **(Prevention of Financial Markets Abuse (Fair Presentation of Investment Recommendations and Disclosure of Conflicts of Interest) Regulations, 2005 [L.N. 106 of 2005]**); and

(c) for the consideration of market practices and manipulative behaviour **(Prevention of Financial Markets Abuse (Market Practices and Manipulative Behaviour) Regulations, 2005 [L.N. 107 of 2005])**.

PURPOSE

The Malta Financial Services Authority (henceforth referred to as the 'MFSA') as competent authority for the purposes of the **Act**, has the function of administering the said **Act**.

The purpose of these Guidance Notes is to:

(a) afford the persons affected by the provisions of the **Act** with some guidance on the meaning of the term Market Abuse and the administrative/criminal sanctions which may be applied when a person is found guilty of market abuse; and

(b) provide persons affected by the provisions of the **Act**, the Legal Notices and the Commission Regulation, with direction as to their respective responsibilities and the manner in which they should satisfy certain duties which emanate from the Prevention of Financial Markets Abuse regime.

SOURCE

In preparing these Guidance Notes reference was made to the Committee of European Securities Regulators' Level 3 – first set of CESR guidance and information on the common operation of the Market Abuse Directive accessible on CESR's web-site through the following web-address: http://www.cesr-eu.org/

DISCLAIMERs:

These Guidance Notes do not have the purpose of replacing the Act, the Legal Notices and the Commission Regulation. Persons falling within the scope of this Legislation are encouraged to obtain a proper understanding of its provisions.

The examples of types of market practice set out in these Guidance Notes are not intended to affect the scope of interpretation of the provisions of the applicable Legislation.

PART A - MARKET ABUSE

A.1. Guidance on the meaning of the term market abuse:

Market Abuse which is said to prevent full and proper market transparency arises in situations where an investor has been unfairly disadvantaged by others. The **Act** provides for two such situations, namely insider dealing and market manipulation.

1.0 Insider Dealing: where a person uses or seeks to use inside information (information not available to the public), to his own advantage or to the advantage of others.

The **Act** prohibits anyone in possession of inside information from **(a)** dealing (or attempting to deal) in financial instruments, **(b)** encouraging others to deal and **(c)** disclosing the information. The **Act** categorises inside information into three:

(i) in respect of financial instruments that are not commodity derivatives, it is defined as information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, including information regarding any takeover offer for a company, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments;

(ii) in relation to derivatives on commodities, it is defined as information of a precise nature which has not been made public, relating, directly or indirectly, to one or more such derivatives and which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practices on those markets; and

(iii) for persons charged with the execution of orders concerning financial instruments (Investment Services Licence Holders/Investment Firms), inside information shall also mean information conveyed by a client and related to the client's pending orders, which is of a precise nature, which relates directly or indirectly to one or more issuer or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

It is imperative to note that in all situations, information is deemed to be of a precise nature if it indicates a set of circumstances which exist or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so and if it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments.

2.0 Market Manipulation: where a person seeks to distort the price of financial instruments, or effects transactions or orders to trade or disseminates information in a manner which gives or is likely to give false or misleading signals about financial instruments. Market manipulation is prohibited by the Act.

2.1 Definition of market manipulation: The **Act** defines four ways in which the market could be manipulated:

(i) **False or Misleading transactions:** where transaction or orders to trade, give false or misleading signals as to the demand for, supply of or price of financial instruments.

The Committee of European Securities Regulators (hereinafter referred to as 'CESR') provides the following guidance as to what type of transactions could be considered as false or misleading:

(a) Wash trades. This is the practice of entering into arrangements for the sale or purchase of a financial instrument where there is no change in beneficial interests or market risk or where the transfer of beneficial interest or market risk is only between parties who are acting in concert or collusion. (Repo transactions and stock lending/borrowing or other transactions involving transfer of securities as collateral do not constitute wash trades.)

(b) Painting the tape. This practice involves engaging in a transaction or series of transactions which are shown on a public display facility to give the impression of activity or price movement in a financial instrument.

(c) Improper matched orders. These are transactions where both buy and sell orders are entered at or nearly at the same time, with the same price and quantity by different but colluding parties, unless the transactions are legitimate trades carried out in conformity with the rules of the relevant trading platform (e.g. crossing trades).

(d) Placing orders with no intention of executing them. This involves the entering of orders, especially into electronic trading systems, which are higher/lower than the previous bid/offer. The intention is not to execute the order but to give a misleading impression that there is demand for or supply of the financial instrument at that price. The orders are then withdrawn from the market before they are executed. (A variant on this type of market manipulation is to place a small order to move the bid/offer price of the financial instrument and being prepared for that order to be executed if it cannot be withdrawn in time.)

(ii) **Price positioning:** where transactions or orders to trade, secure by a person or persons, acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level.

CESR provides the following guidance as to what type of transactions could be considered as price positioning:

(a) Marking the close. This practice involves deliberately buying or selling securities or derivatives contracts at the close of the market in an effort to alter the closing price of the security or derivatives contract. This practice may take place on any individual

trading day but is particularly associated with dates such as future/option expiry dates or quarterly/annual portfolio or index reference/valuation points.

(b) Colluding in the after market of an Initial Public Offer. This practice is particularly associated with Initial Public Offers of securities immediately after trading in the security begins. Parties which have been allocated stock in the primary offering collude to purchase further tranches of stock when trading begins in order to force the price of the security to an artificial level and generate interest from other investors – at which point they sell their holdings.

(c) Abusive squeeze. This involves a party or parties with a significant influence over the supply of, or demand for, or delivery mechanisms for a financial instrument and/or the underlying product of a derivative contract exploiting a dominant position in order to materially distort the price at which others have to deliver, take delivery or defer delivery of the instrument/product in order to satisfy their obligations. (It should be noted that the proper interaction of supply and demand can and often does lead to market tightness but that this is not of itself market manipulation. Nor does having a significant influence over the supply of, demand for, or delivery mechanisms for an investment/product by itself constitute market manipulation.)

(d) Creation of a floor in the price pattern. This practice is usually carried out by issuers or other entities which control them, and involves transactions or orders to trade employed in such a way that obstacles are created to the share prices falling below a certain level, mainly in order to avoid negative consequences for their share or credit ratings. This needs to be distinguished from legitimate trading in shares as part of "buy-back" programmes or the stabilisation of financial instruments.

(e) Excessive bid-ask spreads. This conduct is carried out by intermediaries which have market power – such as specialists or market makers acting in cooperation – in such a way intentionally to move the bid-ask spread to and/or to maintain it at artificial levels and far from fair values, by abusing of their market power, i.e. the absence of other competitors.

(f) Trading on one market to improperly position the price of a financial instrument on a related market. This practice involves undertaking trading in one market with a view to improperly influencing the price of the same or a related financial instrument in another market. Examples might be conducting trades in an equity to position the price of its derivative traded on another market at a distorted level or trading in the underlying product of a commodity derivative to distort the price of the derivative contract. (Transactions to take legitimate advantage of differences in the prices of financial instruments or underlying products as traded in different locations would not constitute manipulation.)

(iii) **Fictitious devices:** where transactions or orders to trade, employ fictitious devices or any other form of deception or contrivance;

CESR provides the following guidance as to what type of transactions could be considered as price positioning:

(a) Concealing ownership. This is a transaction or series of transactions which is designed to conceal the ownership of a financial instrument via the breach of disclosure requirements through the holding of the instrument in the name of a colluding party (or parties). The disclosures are misleading in respect of the true

underlying holding of the instrument. (This practice does not cover cases where there are legitimate reasons for financial instruments to be held in the name of a party other than the beneficial owner – e.g. nominee holdings. Nor do all failures to make a required disclosure necessarily constitute market manipulation.)

(b) Dissemination of false or misleading market information through media, including the internet, or by any other means (in some jurisdictions this is known as 'scalping'). This is done with the intention of moving the price of a security, a derivative contract or the underlying asset in a direction that is favourable to the position held or a transaction planned by the person disseminating the information.

(c) Pump and dump. This practice involves taking a long position in a security and then undertaking further buying activity and/or disseminating misleading positive information about the security with a view to increasing the price of the security. Other market participants are misled by the resulting effect on price and are attracted into purchasing the security. The manipulator then sells out at the inflated price

(d) 'Trash and cash'. This is the opposite of pump and dump. A party will take a short position in a security; undertake further selling activity and/or spread misleading negative information about the security with the purpose of driving down its price. The manipulator then closes their position after the price has fallen.

(e) Opening a position and closing it immediately after its public disclosure. This practice is typically carried out by portfolio managers and other large investors whose investment decisions are usually valued by market participants as relevant signals of future price dynamics. The canonical unfair conduct consists in closing the position previously acquired immediately after having publicly disclosed it putting emphasis on the long holding period of the investment. However, making a report or disclosure will not, in itself, give rise to a false or misleading impression if it was made in the way specified by any applicable legal or regulatory requirement and was expressly required or permitted by such a requirement.

(iv) **False or misleading information:** where the dissemination of information via the media or any other means e.g. internet, gives misleading signals, news or rumours about financial instruments by persons who knew or ought to have known that it was false or misleading. This type of market manipulation involves dissemination of false and misleading information without necessarily undertaking any accompanying transaction. This could include creating a misleading impression by failure properly to disclose a price sensitive piece of information which should be disclosed.

CESR provides the following guidance as to when a person may be considered as providing false or misleading information:

(a) Spreading false/misleading information through the media. This involves behaviour such as posting information on an internet bulletin board or issuing a press release which contains false or misleading statements about a company whose shares are admitted to trading on a regulated market. The person spreading the information knows that it is false or misleading and is disseminating the information in order to create a false or misleading impression. Spreading false/misleading information

through an officially recognised channel for disseminating information to users of a regulated market is particularly serious as it is important that market participants are able to rely on information dissemination via such official channels.

(b) Other behaviour designed to spread false/misleading information. This type of market manipulation would cover a course of conduct designed to give false and misleading impression through means other than the media. An example might be the movement of physical commodity stocks to create a misleading impression as to the supply or demand for a commodity or the deliverable into a commodity futures contract.

2.2 **Defences**: The prohibitions in the **Act** are not absolute. In respect of **2.1 (i)** and **(ii)** above **('false or misleading transactions' and 'price positioning')**, if someone can establish that there are legitimate reasons for his/her behaviour and it conforms to accepted market practice on the market concerned (which is a practice that the competent authority of the said regulated market considers as acceptable) then the behaviour will not be regarded as market abuse.

The intention of the accepted market practice concept is to avoid penalising justifiable behaviours which would otherwise constitute market manipulation. However, to benefit from the defence provided, in addition to the transaction/order to trade conforming with an accepted market practice, the person who entered into the transaction or issued the order to trade must establish that their reasons for so doing are **legitimate**. In the absence of a legitimate purpose the accepted market practice defence would not be available.

The decision as to whether a process constitutes an accepted market practice or not, is a matter of national discretion. Accepted market practices with respect to the Maltese market are therefore the responsibility of the Malta Financial Services Authority. L.N. 107 of 2005 provides for a non-exhaustive list of factors against which the MFSA will be assessing a particular market practice.

2.3 **Particular Instances of Market Manipulation:** The **Act** also provides for three particular instances where a person is considered to have manipulated the market:

- conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument which has the effect of fixing, directly or indirectly, purchase or sale prices or creating other unfair trading conditions;

- the buying or selling of financial instruments at the close of the market with the effect of misleading investors acting on the basis of closing prices;

- taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument, or indirectly about its issuer, while having previously taken positions on that financial instrument and profiting subsequently from the impact of the opinions voiced on the price of that instrument, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way.

A.2. <u>The Scope of the Act's provisions:</u>

The provisions outlined above apply with respect to financial instruments admitted to trading on a regulated market in Malta (Recognised Investment Exchanges) or in any other Member State or EEA State or for which a request for admission to trading on such market has been made.

A.3. Administrative and criminal sanctions:

In terms of the **Act,** a person guilty of Market Abuse may:

(a) either be subject to a fine sanctioned by the MFSA which may not exceed Lm 40,000; or

(b) if subject to criminal proceedings, upon conviction by the Criminal Court, be subject to a fine which may not exceed Lm 400,000 or up to three times the profit made or the loss avoided by virtue of the said person's actions, whichever is the greater, or to imprisonment for a term not exceeding seven years or to both such fine and imprisonment.

The **Act** also affords a proviso which ensures that in no case a person may be sanctioned more than once for the same action. In this regard where the MFSA imposes a fine on a person guilty of market abuse, no proceedings may be taken or continued against the said person in respect of the same action.

A.4. Exemptions – buy back programmes and stabilisation of financial instruments - Commission Regulation (EC) No 2273/2003 ('the Regulation'):

Article 8 of the **Directive** provides that the prohibitions provided therein shall not apply to trading in own shares in 'buy back' programmes or to the stabilisation of a financial instrument, provided such trading is carried in accordance with implementing measures adopted to that effect. The **Regulation** implements the exemptions for buy-back programmes and stabilisation.

Article 4 (4) of the **Act**, which transposes article 8 of the Directive, provides for an exemption from the provisions therein with respect to:

(a) trading in own shares in 'buy back' programmes; or

(b) action taken for the purpose of stabilising the price of financial instruments;

provided (a) or (b) above is conducted within the parameters established by the **Regulation**.

PLEASE NOTE: The above-mentioned exemptions only cover behaviour directly related to the purpose of buy-back and stabilisation activities as provided for by the **Regulation**. Behaviour which is not directly related to the purpose of the buy-back and stabilisation activities shall therefore be considered as any other action covered by

the **Act** and may, if it is established that the action in question constitutes market abuse as defined by the **Act,** be the object of administrative or criminal sanctions as outlined in A.3. above.

4.1 Buy Back Programmes

Definition: The **Regulation** defines a buy-back programme as: *trading in own shares in accordance with articles 19 to 24 of Council Directive 77/91/EEC.*

Objective of the buy-back programmes: In order to benefit from the exemptions provided for by the Act, article 3 of the Regulation stipulates that:

(i) the buy-back programme must comply with articles 4, 5 and 6 of the Regulation [**Article 4 dictates a number of procedural conditions and disclosure requirements with which an issuer must comply with when effecting a buy back programme; Article 5 stipulates a number of requirement which apply when the issuer executes the trades under a buy-back programme; Article 6 provides for a number of restrictions to the trading by the issuer in its own shares]**; and

(ii) the sole purpose of that buy-back programme must be to reduce the capital of an issuer (in value or in number of shares) or to meet obligations arising from any of the following:

   a. debt financial instruments exchangeable into equity instruments;

   b. employee share option programmes or other allocations of shares to employees of the issuer or of an associate company.

4.2 Stabilisation of a Financial Instrument

Definition: The **Regulation** defines *stabilisation* as: any purchase or offer to purchase *relevant securities*, or any transactions in *associated instruments* equivalent thereto, by investment firms or credit institutions, which is undertaken in the context of a *significant distribution* of such relevant securities exclusively for supporting the market of these relevant securities for a predetermined period of time, due to a selling pressure in such securities. Terms in italics are also defined in the **Regulation**.

Conditions for Stabilisation: In order to benefit from the exemptions provided for by the Act, article 7 of the **Regulation** stipulates that the buy-back programme must comply with articles 8, 9 and 10 of the Regulation [**Article 8 provides for a set of time limits within which stabilisation may be carried out; Article 9 stipulates a number of disclosure and reporting requirements relative to stabilisation; Article 10 dictates the applicable price conditions for the effecting of the stabilisation exercise.]**

PART B – DUTIES / DISCLOSURE OBLIGATIONS

The proper functioning of a capital market mainly depends on the confidence the investing public has in such market. Public confidence depends on the transparency and smooth functioning of such market. Market abuse and other sorts of market misconduct damage public confidence. In this regard, as well as prohibiting market abuse, the **Act** also seeks to ensure that the MFSA and the market have access to a proper flow of information, to ensure transparency.

With the purpose of ensuring that the MFSA has the required information to detect and control market abuse and other forms of market misconduct, the **Act** together with the Legal Notices imposes a number of requirements on certain relevant persons including issuers of financial instruments, persons involved with such issuers and persons professionally arranging transactions, such as investment services licence holders.

B.1. Issuers of financial instruments - [Art 9 of Act and Reg 4, 5, 6, & 7 of L.N. 108 of 2005]

Issuers of financial instruments admitted to a regulated market (in the local context meaning issuers of financial instruments traded on the MSE), hereinafter referred to as '**Issuers**' are required to:

(i) **Disclose inside information:** which directly concerns the said issuer, to the general public by way of a public announcement in the form of a notice.

Such disclosure must be made **promptly** and in a fashion which is as **synchronised** as possible on the **internet site of the Issuer** and be published in one or more **newspapers widely distributed** in Malta and, if applicable, in any other Member State or EEA State or States Concerned and cannot be combined, in a manner likely to be misleading, with the marketing of the Issuer's activities;

Disclosure of inside information may be delayed by Issuers to protect their legitimate interests (such as during the course of negotiations), provided that the confidentiality of the information can be ensured during the delay and provided that such delay would not be likely to mislead the public. In such situations, the Issuer is required to promptly inform the MFSA Securities Unit in writing of its decision to delay the public disclosure of inside information, together with its reasons.

(ii) **List of insiders**: Insiders are required to draw up a list of those persons working for them, under a contract of employment or otherwise who have access to inside information. This list must be regularly updated and must be provided to the MFSA Securities Unit upon request. In this regard:

(a) Issuers who are already listed on an RIE on the 1st October 2005 are required to submit such list to the MFSA Securities Unit by the 1st November

2005 ;

(b) Issuers who are given admissibility to listing after the 1st October 2005, are required to submit such list to the MFSA Securities Unit within one month from the date when the said Issuer has been given admissibility to listing.

(c) MFSA Securities Unit should be immediately notified each time the said list is updated.

The list of insiders to be submitted to the MFSA Securities Unit should be prepared in the form set out in the relevant Schedule of L.N. 108 of 2005, and submitted in the manner set out by the MFSA from time to time.

B.2. <u>Persons discharging managerial responsibilities within an issuer of financial instruments registered in Malta</u> - [Art 10 of <u>Act</u> and Reg 8 and 10 of L.N. 108 of 2005]

The disclosure of management transactions is intended as a means of increasing transparency of information. Such disclosure provides investors with additional qualitative insight with regard to their investment decision.

The **<u>Act</u>** requires persons discharging managerial responsibilities within an issuer of financial instruments registered in Malta and whose financial instruments have been admitted to trading on a Regulated Market and persons closely related to them, to notify the MFSA Securities Unit of the existence of transactions conducted on their own account relating to shares of the said issuer or to derivatives or other financial instruments linked to them. The manner of notification to the MFSA is prescribed in L.N. 108 of 2005.

Upon request MFSA is required to provide, a member of the public with information concerning transactions by persons discharging managerial responsibilities within an issuer of financial instruments registered in Malta.

(a) <u>Guidance on some important definitions:</u>

<u>Definition of the term *'Persons discharging managerial responsibilities within an issuer'*</u>:

The Act defines the term *'Persons discharging managerial responsibilities within an issuer'* as a member of the administrative, management, or supervisory bodies of the issuer or a senior executive having a regular access to inside information relating, directly or indirectly, to the issuer, and to the power to make managerial decisions affecting the future developments and business prospects of the issuer. For example the following boards/committees would be considered as falling within the abovementioned categories of persons:

- Board of Directors;

- Executive Committee;
- Management Committee;
- Audit Committee;
- Remuneration Committee.

Non exhaustive list of who may be considered as a '*person closely associated with a person discharging managerial responsibilities within an issuer*' based on definition in the Act:

- spouse or equivalent to the spouse;
- dependent children;
- other relatives who have shared the same household, for at least one year on the date of the transaction concerned.

(b) Threshold for notification: In terms of L.N. 108 of 2005, no notification is required, until the total amount of transactions of a person discharging managerial responsibilities within an issuer and those of persons closely associated to him/her has reached the equivalent of Lm 2,400 at the end of a calendar year.

B.3. Persons professionally arranging transactions in financial instruments - [Art 11 of Act and Reg 9 and 11 of L.N. 108 of 2005]

3.1 The Requirement and duty of confidentiality

In terms of the **Act** persons professionally arranging transactions (investment firms and credit institutions) are required to notify the MFSA Securities Unit in the manner specified in L.N. 108 of 2005 of any suspicious transactions which might constitute market abuse. In the local context this rule applies to all investment services licence holders, and branches of credit institutions and investment firms operating in Malta. On the other hand Recognised Investment Exchanges ('RIEs') are required, in terms of the General Notification Directives Applicable to RIEs, to give the MFSA notice of any evidence tending to suggest that a person may have committed, has committed or is likely in the circumstances to commit an offence in terms of the **Act.**

Persons professionally arranging transactions notifying the MFSA Securities Unit, have a duty of confidentiality and are required not to inform any other person, in particular the persons on behalf of whom the transactions have been carried out or parties related to those persons, of this notification.

This section is intended to provide those persons professionally arranging transactions and RIEs with guidance as to indications of transactions which may involve insider dealing or market manipulation.

3.2 Suspicious transactions

The Act and the Legal Notices do not deal with the steps which persons subject to this requirement need to take to identify such transactions. In fact the notification regime laid down in the **Act** requires that persons subject to it decide on a case-by-case basis

where there are reasonable grounds for suspicion concerning the relevant transaction.

It is important to note that as explained in the recital to the MAD, notification of suspicious transactions requires sufficient indications that the transactions might constitute market abuse. Certain transactions by themselves may seem completely void of anything suspicious, but might deliver such indications of possible market abuse, when seen in perspective with other transactions, certain behaviour or other information. Persons professionally arranging transactions and RIEs should therefore not only notify transactions which they consider are suspicious at the time the transaction is carried out but also any transactions of which, in the light of subsequent events/information (for example publication of financial results, profits warnings or announcement of a takeover bids in relation to the security in question), they might retrospectively become suspicious. However, this does not mean that they are required to go back and retroactively review transactions in the run-up to that event or development.

What follows is a description of a number of indications which should serve as a starting point of whether a transaction is suspicious. The indications given below are however neither exhaustive (a particular transaction may be suspicious even if it matches none of the indications) nor determinative (a transaction may not necessarily be suspicious simply because it matches one or more of the indications). Persons professionally arranging transactions and RIEs need to exercise their judgement and consider the particular circumstances of the case before deciding whether or not to report.

3.2.1 <u>Possible signals of Insider Dealing or Market Manipulation:</u>

(i) An unusual concentration of transactions in a particular security (for example, with one or more institutional investors known to be affiliated with the issuer or a party with a particular interest in the issuer such as a bidder/potential bidder);

(ii) An unusual repetition of a transaction among a small number of clients over a certain period of time;

(iii) Unusual concentration of transactions and/or orders with only one client; or with the different securities accounts of one client; or with a limited number of clients (especially if the clients are related to one another).

3.2.2 <u>Possible signals of Insider Dealing</u>

(i) The client opens an account and immediately gives an order to conduct a significant transaction or, in the case of a wholesale client, unexpectedly large or unusual orders in a particular security - especially if the client is insistent that the order is carried out very urgently or must be conducted before a particular time specified by the client;

(ii) The client's requested transaction or investment behaviour is significantly out of

character with the client's previous investment behaviour. (e.g. type of security; amount invested; size of order; duration of holding). One case reported by a CESR member involved a client wanting to sell his whole portfolio and immediately invest the proceeds in the securities of a specific company. Others have involved a client who had previously invested only in mutual funds suddenly requesting the purchase of the securities of a single company or a client who had previously only invested in 'blue chip' stocks who made a sudden switch into illiquid securities. In a further case a 'buy and hold' client suddenly conducted a purchase and then sale of a particular security just before the announcement of inside information and the sale directly after the announcement;

(iii) The client specifically requests immediate execution of an order regardless of the price at which the order would be executed (this indicator pre-supposes more than the simple placing of a 'market order' by the client);

(iv) Significant trading by major shareholders or other insiders before the announcement of important corporate events.

(v) Unusual trading in the shares of a company before the announcement of price sensitive information relating to the company; transactions resulting in sudden and unusual changes in the volume of orders and shares prices before public announcements regarding the security in question;

(vi) Employees' own account transactions and related orders timed just before clients' transactions and related orders in the same financial instrument.

3.2.3 <u>Possible signals of false or misleading transactions or price positioning (Market Manipulation) [Reg 6 of L.N. 107 of 2005]</u>

(i) The extent to which orders to trade given or transactions undertaken represent a significant proportion of the daily volume or transactions in the relevant financial instrument on the regulated market concerned, in particular when these activities lead to a significant change in the price of the financial instruments;

(ii) The extent to which orders to trade given or transactions undertaken by persons with a significant buying or selling position in a financial instrument lead to significant changes in the price of the financial instrument or related derivative or underlying asset admitted to trading on a regulated market;

(iii) Whether transactions undertaken lead to no change in beneficial ownership of a financial instrument admitted to trading on a regulated market;

(iv) The extent to which orders to trade given or transactions undertaken include position reversals in a short period and represent a significant proportion of the daily volume or transactions in the relevant financial instrument on the regulated market concerned, and might be associated with significant changes in the price of a financial instrument admitted to trading on a regulated

market;

(v) The extent to which orders to trade given or transactions undertaken are concentrated within a short time span in the trading session and lead to a price change which is subsequently reversed;

(vi) The extent to which orders to trade given change the representation of the best bid or offer prices in a financial instrument admitted to trading on a regulated market, or more generally the representation of the order book available to market participants, and are removed before they are executed;

(vii) The extent to which orders to trade are given or transactions are undertaken at or around a specific time when reference prices, settlement prices and valuations are calculated and lead to price changes which have an effect on such prices and valuations.

3.2.4 Possible signals of false or misleading transactions or price positioning (Market Manipulation) [Reg 7 of L.N. 107 of 2005]

(i) Whether orders to trade given or transactions undertaken by persons are preceded or followed by dissemination of false or misleading information by the same persons or persons linked with them;

(ii) Whether orders to trade are given or transactions are undertaken by persons before or after the same persons or persons linked to them produce or disseminate research or investment recommendations which are erroneous or biased or demonstrably influenced by material interest.

3.2.5 Additional possible signals of Market Manipulation:

(i) Transactions with no other apparent justification than to increase/decrease the price of or to increase the volume of trading in a financial instrument. Particular attention might be given to orders of this kind which result in the execution of transactions near to a reference point during the trading day – e.g. near the close;

(ii) The client submits orders which, because of their size in relation to the market in that security, will clearly have a significant impact on the supply of or demand for or the price or value of the security. Again, particular attention might be given to orders of this kind which result in the execution of transactions near to a reference point during the trading day – e.g. near the close;

(iii) Transactions which appear to have the purpose of increasing the price of a financial instrument during the days preceding the issue of a related derivative/convertible;

(iv) Transactions which appear to have the purpose of maintaining the price of a financial instrument during the days preceding the issue of a related derivative/convertible when the market trend is downward;

(v) Transactions which appear to be seeking to modify the valuation of a position while

not decreasing/increasing the size of that position;

(vi) Transactions which appear to be seeking to increase/decrease the weighted average price of the day or of a period during the session;

(vii) Transactions which appear to be seeking to set a market price when the liquidity of the financial instrument is not sufficient to fix a price within the session (unless the rules or regulation of the regulated market explicitly allow such operations);

(viii) Transactions which appear to be seeking to bypass the trading safeguards of the market (e.g. as regards volume limits; bid/offer spread parameters; etc);

(ix) When a transaction is to be concluded/executed, changing the bid-ask prices (as computed by the trading system) when this spread is a factor in the determination of the price of that transaction;

(x) Entering significant orders in the central order book of the trading system a few minutes before the price determination phase of the auction and cancelling these orders a few seconds before the order book is frozen for computing the auction price so that the theoretical opening price might look higher or lower than it otherwise would do;

(xi) Transactions which appear to be seeking to maintain the price of the underlying financial instrument below the strike price of a related derivative at expiration date;

(xii) Transactions which appear to be aimed at modifying the price of the underlying financial instrument so that it crosses over the strike price of a related derivative at expiration date;

(xiii) Transactions which appear to be seeking to modify the settlement price of a financial instrument when this price is used as a reference/determinant in the calculation of margins requirements.

B.4. Duties of Producers of Recommendations [Art 12 of Act and L.N. 106 of 2005]

The Act and the L.N. 106 of 2005 also stipulate certain requirements which affect persons involved in producing recommendations. These requirements have the purpose of ensuring that recommendations with respect to financial instruments are fairly presented and disclose any possible conflicts of interests. Before giving a brief outline of these requirements it is very important to highlight the meaning of the term recommendation.

Definition of *'recommendation'*: A recommendation is defined by L.N. 106 of 2005 as being *'research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public.'*

The Requirements: LN 106 of 2005 subjects producers of recommendations to rules which *inter alia* set:

(i) disclosure requirements with respect to the identity of the producers of recommendations;

(ii) standards and obligations with respect to the fair presentation of recommendation and for the disclosure of conflicts of interest;

(iii) standards for the dissemination of recommendations by third parties.

In the local context the above-mentioned rules mainly affect Investment Services Licence Holders as well as EU/EEA based investment firms and credit institutions providing investment services in Malta in terms of pass porting provisions.

Persons falling within the above category of persons should make sure that they are aware of all these detailed requirements.

B.5. Administrative sanctions:

In terms of the **Act,** a person who does not satisfy his duties as stipulated by the Act, the Legal Notices or rules issued by the Competent Authority thereunder, may be subject to a fine sanctioned by the MFSA which may not exceed Lm 40,000.