

04 April 2022

Circular on the Market Abuse Regulation (EU) 596/2014 ('MAR' or the 'Regulation'): Article 16 of MAR - Prevention and Detection of Market Abuse

This circular is being addressed to persons professionally arranging or executing transactions; and to market operators¹ and investment firms² that operate a trading venue.

This circular should be read in conjunction with the circular issued by the Authority on 29 April 2020 relating to general findings emanating from onsite compliance meetings with investment firms.

Without prejudice, the circular provides recommendations of what are considered to be the best practices for market operators and investment firms operating a trading venue, as well as persons professionally arranging and executing transactions ('the relevant legal persons') to seek to adhere to their legal obligations under MAR, particularly those emanating from Article 16.

Please note that such recommendations are only aimed to provide guidance and should not be in any way construed as legal advice and/or interpretation. The obligation to ensure that the relevant legal persons satisfy the requirements of the applicable laws and that its policies and procedures are kept up-to-date, rests solely with the directors of the relevant legal persons. Furthermore, this circular provides the MFSA's position as at the date of publication and is subject to any clarifications which ESMA might issue from time to time.

¹ Article 4(1)(18) of Directive 2014/65/EU defines a market operator as a person or persons who manages and/or operates the business of a regulated market and may be the regulated market itself.

² Article 4(1)(1) of Directive 2014/65/EU defines an investment firm as any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.

1.0 General Obligation to Maintain Effective Arrangements, Systems and Procedures in Place and to Notify Suspicious Orders and/or Transactions

1.1 Who is obliged to notify suspicion of market abuse through a Suspicious Transaction and Order Report ('STOR')?

- *Market Operators and Investment Firms Operating a Trading Venue*

According to Article 16(1) of MAR, market operators (such as the Malta Stock Exchange Plc) and investment firms that operate a trading venue shall establish and maintain effective arrangements, systems and procedures aimed at preventing and detecting insider dealing and market manipulation (i.e. market abuse), as well as attempted insider dealing and market manipulation.

Market operators and investment firms are also required to notify the Malta Financial Services Authority ('MFSA') in its capacity as competent authority about orders and transactions, as well as any cancellations or modifications thereof, that could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation without delay.

- *Persons Professionally Arranging and Executing Transactions*

Furthermore, in accordance with Article 16(2) of MAR, every person that professionally arranges or executes transactions in financial instruments must establish and maintain effective arrangements, systems and procedures to detect and notify suspicious orders and transactions. Where such a person has a reasonable suspicion that an order and/or transaction in any financial instrument, whether placed or executed on or outside a trading venue, could constitute insider dealing, market manipulation, or attempted³ insider dealing or market manipulation, the person is obliged to notify the MFSA without delay.

1.2 Obligations to Maintain Effective Arrangements, Systems and Procedures for the Prevention and Detection of Market Abuse

Pursuant to Article 2(5) of Commission Delegated Regulation (EU) 2016/957 (hereinafter referred to as the 'Delegated Regulation'), persons professionally arranging or executing transactions, market operators and investment firms operating a trading venue shall ensure that the arrangements, systems and procedures are:

- Appropriate and proportionate in relation to the scale, size and nature of their business activity;

³ Attempted market abuse can be described as situations in which an activity was started but not finished, although this is not the only possibility of attempted market abuse. By way of example, there could be an intervention, technical problem or non-executed order.

- Regularly assessed, at least through an annually conducted audit and internal review, and updated when necessary;
- Clearly documented in writing, including any changes or updates to them, for the purposes of complying with this Regulation, and that the documented information is maintained for a period of five years.

Furthermore, in terms of Article 3(1) of the Delegated Regulation, the arrangements, systems and procedures shall:

- Allow for the analysis, individually and comparatively, of each and every transaction executed and order placed, modified, cancelled or rejected in the systems of the trading venue and, in the case of persons professionally arranging or executing transactions, also outside a trading venue;
- Produce alerts indicating activities requiring further analysis for the purposes of detecting potential insider dealing or market manipulation or attempted insider dealing or market manipulation; and
- Cover the full range of trading activities undertaken by the persons concerned.

According to Article 3(8) of the Delegated Regulation, as part of the arrangements, systems and procedures, persons professionally arranging or executing transactions and market operators and investment firms operating a trading venue shall maintain for a period of five years the information documenting the analysis carried out with regard to orders and transactions that could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation which have been examined and the reasons for submitting or not submitting a STOR. That information shall be provided to the MFSA upon request.

2.0 Best Practices, Recommendations and Reminders to Maintain Effective Arrangements, Systems and Procedures in Place and to Notify Suspicious Orders and/or Transactions

The MFSA has between 2018 and 2020 held a number of onsite compliance meetings relating to MAR with investment firms falling within the scope of MAR. The purpose of the onsite compliance meetings was to verify the extent of implementation of the Regulation by investment firms and to assess the relevant systems, arrangements, policies and procedures which investment firms are required to have in place in order to detect and report suspicious orders and transactions in accordance with Article 16 of MAR.

Following a number of onsite compliance meetings held with investment firms, the Authority had on 29 April 2020 issued a circular presenting the MFSA's findings relating to how investment firms control the risk of financial market abuse. The circular also provided

recommendations of what are considered to be best practices for investment firms to seek to adhere to their legal obligations under MAR.

Given that the Regulation has been in force since 2016, and taking into consideration the number of onsite compliance meetings held with market participants, through the Circular the Authority also made clear its expectations for investment firms to be compliant with all the applicable requirements under MAR. Furthermore, it communicated the Authority's intention to proceed with carrying out supervisory inspections (rather than onsite compliance meetings), whereby entities would be required and expected to prove proper and full adherence to the respective requirements emanating from MAR and its delegated and implementing regulations.

The scope of this circular is therefore to provide market participants with additional guidance, best practices and recommendations identified throughout the Authority's supervisory work, particularly in the context of Article 16 of MAR.

2.1 'Reasonable Suspicion'

Although since the coming into force of the Regulation, the submission of STORs to the Authority by market operators and investment firms has significantly improved, the Authority has noted that STORs were for the most part submitted by the same investment firms or market operator. Hence, the Authority notes that generally there is still a high degree of under-reporting of suspicious orders and transactions among persons professionally arranging or executing transactions. Such under-reporting of STORs appears to be the result of the relevant legal persons having inadequate or ineffective systems and arrangements, not fit for the purpose of preventing and detecting market abuse.

Apart from inadequate and/or ineffective systems and arrangements, the thresholds of the 'reasonable suspicion' test are commonly too stringent resulting in each and every suspicion being discarded on the basis of a high threshold being set for the 'reasonable suspicion' test.

Although relevant legal persons should not resort to 'defensive reporting' and be overly cautious, they should also avoid submitting STORs only if a high degree of certainty that an order or transaction constitutes market abuse exists. A STOR should not be interpreted as being a notification of market abusive behaviour but rather, as the name implies, a notification of suspected market abuse. In other words, the submission of a STOR does not imply market abuse in itself.

Following the submission of a STOR it would then be the duty of the MFSA to investigate further and determine whether the suspicion raised through the STOR is in fact legitimate or otherwise. Generally, the Authority has much more information at its disposal, allowing it to analyse such suspicious transactions more efficiently and effectively.

Another typical deterrent for submitting STORs to the MFSA would be the availability of limited information. Typically, the persons notifying STORs on behalf of relevant legal

persons (often compliance officers of organisations) are not always in a position to determine or assess whether transactions and/or orders are suspicious. For example, the compliance officer might be aware that the broker is not the only intermediary that the client is using to carry out transactions. In turn, some information (i.e. that relating to transactions carried out with other brokers) might not be available to the compliance officer. Despite not having access to all the information relating to the particular investor's trading activity, however, a STOR should still be submitted if a reasonable suspicion exists through the information available to the particular broker. There might also be situations where a reasonable suspicion exists but the person making the notification is not fully certain that the order or transaction constitutes market abuse. This uncertainty, however, must not be the reason for failing to submit a STOR. Hence, ensuring that STORs are not overly discounted is crucial.

In a situation where a chain of market participants is involved in the execution of an order and/or transaction, each relevant legal person that is subject to MAR is obliged to notify suspicions of market abuse. By way of example where an order is received by investment firm A, subsequently transmitted to investment firm B for execution on the trading venue operated by market operator C – just because the market operator C in the chain report its suspicions, does not absolve the other market participants, namely investment firms A and B, from the obligation to report their own suspicions of market abuse concerning the same or related transactions and/or orders.

2.2 Streamlining the Analysis

Streamlining the analysis of signals of potential market abuse as much as possible allows different persons within the organisation to analyse and compare order and transaction developments in a uniform manner. The development of a scoring methodology is an example of how analysis may be streamlined. Consistent analysis is important. In addition, "professional judgement" is an essential factor for judging and qualifying certain conduct as market abuse or an attempt thereof. Hence, it is important that employees stay alert, undergo training and, therefore, do not rely solely on the signals generated by the (automated) monitoring and surveillance systems.

2.3 Proper Risk Management

The efforts of relevant legal persons must not be entirely focused on detecting suspicious transactions. As will be seen in a later section, in certain cases, the orders themselves may very well indicate ill intent to carry out market abuse or an attempt thereof.

In order to minimize risk and to ensure that market abuse or attempts thereof are detected effectively, the relevant person must have in place adequate pre- and post-trade controls.

By applying strict pre-trade controls, such as preventing an employee or a client from placing an unusual number of orders in a "penny stock", market abuse carried out by the employees of the relevant legal persons (e.g. front running) or clients can be prevented.

It is also important to note that although the risk of market abuse in the local context may be greater due to market characteristics, relevant legal persons are still required to maintain arrangements, systems and procedures that ensure effective and ongoing monitoring of all orders received and transmitted and all transactions executed, including those relating to foreign instruments. In the event that relevant legal persons note suspicious orders and/or transactions placed or executed in foreign instruments, the relevant legal persons would also be under the obligation to file STORs with the MFSA, which in turn would be transmitted to the relevant national competent authority in view of the MFSA's obligation under Article 25 of MAR to cooperate with other NCAs.

2.4 Alert Models

Adding generic elements to the surveillance model is considered a best practice. Examples of generic elements include, but are not limited to – realised profit, impact on the price of the financial instruments, volume developments, volatility developments, etc. The conduct of an investor who wants to manipulate the market is often aimed at the creation of movement in price or spread of a financial instrument. A person trading on the basis of inside information is eager to build a position before the event is made public. Quickly transferring realised profits to another account can also be a possible indication. Generic elements are a valuable addition in recognising and signalling possible market abuse.

The following sections, although not exhaustive, will indicate a number of circumstances where the submission of a STOR may be warranted.

2.5 Pre and Post Publication of News Events Checks

Prior to and during the publication of important news events, such as a public takeover bid, mergers and acquisitions, profit warnings, etc. the risk of information asymmetry in the market exists due to possible unlawful disclosure of inside information. The MFSA advises all relevant persons to analyse orders and/or transactions of clients prior to – and after the publication of an important company announcement, press or media releases in order to identify possible insider dealing or attempts thereof.

2.6 Confidentiality (versus tipping-off)

It is prohibited to inform the persons that the STOR relates to, or anybody who does not need to know about it, that a STOR was/will be submitted. This also applies to requests for information on the persons that the STOR relates to, in order to fill in certain fields. Assuring the above requires procedures to be implemented. The purpose of confidentiality is to prevent the integrity of an investigation from being compromised.

3.0 Practical Guidance on Different Market Abuse Practices

3.1 Insider Dealing

According to Article 8(1) of MAR, insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates. The use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates where the order was placed before the person concerned possessed the inside information, shall also be considered to be insider dealing.

Furthermore, Article 8(2) of MAR states that insider dealing could also arise where a person recommends that on the basis of inside information, another person acquires or disposes of financial instruments or cancels or amends an order concerning a financial instrument to which that information relates or induces that person to make such an acquisition or disposal or cancellation or amendment.

Examples:

- i. A Chief Executive Officer ('CEO') of a Company becomes aware of some negative, non-public information within the Company's mid-year report. This particular piece of information, once published, is expected to impact the Company's financials and its share price significantly. The CEO recommends to family members to dispose of their holdings in the Company, who in turn instruct their broker to sell their shares in the Company. In such a case, the family members would be in breach of Article 14(a) of MAR, whereas the CEO would be in breach of Article 14(b) of MAR, since he/she would be passing information and recommending his/her family members to sell their holdings.

In the event, however, that the CEO does not recommend that family members acquire, dispose, cancel or amend orders and/or transactions but divulges to them the inside information on the basis of which they dispose of their shares in the Company; the family members would still be in breach of Article 14(a) but the CEO in this case would be in breach of the prohibition of unlawfully disclosing inside information contained in Article 14 (c) of MAR.

- ii. An employee of a Company becomes aware, through his/her employment, that the Company is about to enter into a new joint venture agreement with another Company that will potentially be very lucrative for the Company. Before the joint venture is disclosed to the public, the employee buys shares of the Company based on his expectations that the price would rise significantly once the new joint venture is announced. Here the employee is trading on the basis of precise and price sensitive information which is yet to be disclosed to the public i.e. inside information, therefore the employee is in breach of the prohibition contained in Article 14(a) of MAR, regardless of whether he/she manages to lock in a realised

profit through a subsequent sale or whether it would be an indirect profit obtained through an increase in the value of his/her portfolio of holdings in that security.

Determining whether an individual is trading on the basis of inside information is very challenging, especially at the order placement stage. Nevertheless, certain behaviours may be very strong indicators of possible market abuse. One such indicator is a change in trading patterns, such as a dramatic increase in the size of orders placed; an increased urgency in getting the order executed or a sudden change in the trading activity e.g. an investor always trades in bonds and suddenly insists on investing a significant amount in a particular security, regardless of any advice or recommendations which may be provided by the investment advisor.

3.2 Market Manipulation

Recital 7 of MAR outlines that market manipulation prevents full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets. Put simply, market manipulation is a conduct in financial markets designed to deceive investors by controlling or artificially affecting the price of financial instruments. Market manipulation may also involve factually false statements. However, the underlying intent would always be to seek to influence prices in order to mislead other market participants. Having said that, **Article 12 of MAR** provides a detailed definition of market manipulation, which all relevant persons are urged to consult in performing their duties to prevent and detect market abuse. One might also wish to refer to **Annex I of MAR**, which provides a list of indicators of manipulative behaviour, and **Annex II of Commission Delegated Regulation (EU) 2016/522**, which includes a list of indicators of manipulative behaviour relating to false or misleading signals and to price securing.

Market manipulation comes in various forms. Nevertheless, with adequate systems, relevant persons should be able to detect and report such suspicious behaviour to the Authority. The following section provides some practical examples to better explain the common types of Market Manipulation and their indicators:

3.2.1 *False or misleading transactions*

- i. **Wash trades:** A sale or purchase of a qualifying investment where there is no change in beneficial interest or market risk, or where the transfer of beneficial interest or market risk is only between parties acting in concert or collusion, other than for legitimate reasons.

Through a wash trade, a trader attempts to feed the market false information about supply and demand for a particular security, mainly by placing buy and sell orders for the same security simultaneously that leaves their actual economic interest in the trade.

If the investor places the buy and sell orders through the same broker, the latter should easily identify such suspicious behaviour, as the ultimate beneficiary would

be the same and visible to the broker. Even in cases where the broker suspects that the individual is attempting to place a wash trade but due to market conditions such transaction is not executed, the attempt should also be notified to the MFSA through a STOR. In cases where investors are acting in concert, on the other hand, such attempts at wash trading may be identified through the timing of orders placed, especially in the case of illiquid securities, as orders would be placed simultaneously. A wash trade between parties acting in collusion or in concert would be identified in scenarios where the units primarily disposed of by an investor ultimately end up with the same investor.

By way of example;

Party A disposes 500 units which are acquired by Party B. In turn, Party B disposes 500 units which are acquired by Party C who consequently disposes of the 500 units which are bought back by Party A.

Even though there were a number of transactions which the market can interpret as demand and supply for the instrument in question, such activity would be artificial since ultimately there was no change in beneficial ownership of the units initially held by Party A, since the units ultimately ended up back at Party A.

- ii. **Painting the tape:** Entering into a series of transactions that are shown on a public display for the purpose of giving the impression of activity or price movement in a qualifying investment. This attracts other traders, who in turn push up the price further.

An individual carrying out transactions in this manner is likely to make several small, separate acquisitions at the same (or very similar) price within the same trading day or across the span of a few days (in the case of an illiquid security). Such trading is likely to lack a clear rationale, including a number of separate transactions which would have probably been better executed through a single order.

- iii. **Spoofing:** Entering orders into an electronic trading system, at prices which are higher than the previous bid or lower than the previous offer, and withdrawing them before they are executed, in order to give a misleading impression that there is demand for or supply of the qualifying investment at that price.

For example, during the order entry phase preceding the closing/opening price rotation, sell orders are entered with a limit price lower than the last traded price. The intention of the market participant is to make other investors believe that there is heightened selling pressure, encouraging the entry of new, legitimate sell orders at a lower price. The initiating market participant cancels its sell orders immediately prior to the auction or execution of the orders and places a buy order at the lower price to take advantage of the fall in price.

3.2.2 Price Positioning

- i. **Collusion:** Two or more parties collude to give the impression of increased market activity, influencing supply or demand.

By way of example, collusion may take place between two market participants where one party places a large buy order above the price of the public offer and the other party places a corresponding sell order. These actions could mislead other potential investors.

In such a case, the two orders are likely to be placed within a very short time span, indicating that the two investors may have been colluding.

- ii. **Marking the close:** This type of market manipulation typically involves buying but could also be selling qualifying investments at the close of the market with the effect of misleading investors who act on the basis of closing prices, other than for legitimate reasons.

A typical example of marking the close would generally involve an investor placing a purchase order (or amending an existing order) with a limit price higher than the last traded price, typically just high enough to ensure that the order is matched, towards the end of the trading day. If the order is matched and the trade is executed, the lateness of the order ensures that the increase in price is not reversed.

Someone attempting to mark the close is likely to carry out such transactions in securities which are relatively illiquid, as this decreases the chance of the price change being reversed. Such an individual is also likely to attempt such a transaction in a security in which s/he has some holding, as the aim of such behaviour is ultimately to make a profit on units held.

The strongest indicators of such manipulative behaviour are the timing and size of orders placed. Besides placing the order very late during the trading day, an individual attempting to mark the close is likely to attempt to do it very cheaply. Hence orders of this type are likely to be relatively small in size, keeping the average price paid per unit held low.

In this respect, the Authority has noted that in some cases, relevant persons discount potentially suspicious transactions solely on the basis of their small volume or value. Nevertheless, as indicated above, such low volumes or values may themselves be a good indicator of attempted market abuse.

The above-identified practices are few of the many behaviours which could constitute market abuse or an attempt thereof. In this regard, the Authority urges readers to go through Annex I of MAR and Annex II of Commission Delegated Regulation (EU) 2016/522 for further information in relation to the various manipulative mechanisms which might be used by investors.

4.0 Submission of STORs – Way Forward

Relevant persons are reminded that the STOR template is available on the MFSA's website and may be accessed either through this [link](#) or the following file path:-

Our Work/Securities and Markets Supervision/Market Oversight/Market Integrity/Regulatory Templates/Suspicious Transaction and Order Report (STOR) Form

One of the objectives of the Regulation is to ensure market integrity and investor protection. The Regulation has been in force since July 2016 and the MFSA has since held various compliance meetings and inspections as well as issued guidance to the issuers by way of circulars.

As a way forward, it is now the intention of the MFSA to proceed with engaging with relevant persons subject to the obligations contained in Article 16 of MAR to particularly question specific orders and/or transactions, where, in the Authority's opinion, such orders and/or transactions were suspicious, hence requiring the submission of a STOR, but no STOR was submitted. Consequently, relevant legal persons will be requested and expected to substantiate, with documents, their analysis with regard to such transactions and the reason/s for not submitting a STOR, to prove proper and full adherence to the respective requirements emanating from MAR and its delegated and implementing regulations.

A breach of the requirements emanating from MAR would warrant regulatory action in terms of Article 22 of the Prevention of Financial Market Abuse Act, Chapter 476 of the Laws of Malta.

5.0 Contact

Should you have any queries in relation to the above, kindly contact the Authority on pfma@mfsa.mt.