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Toughening EU rules on market abuse

Responding to the economic crisis and recent scandals in financial institutions, the European Commission (EC) has proposed to strengthen the financial-market abuse framework.

Undermining market integrity

Banks have been struggling to recover from the 2008 financial crisis and trying to lose their negative image, but recent market abuse scandals (e.g. Libor manipulation and investment bankers' behaviour) have slowed the pace of this recovery. Market abuse occurs when the integrity of financial markets is intentionally harmed, leading to a loss of investor confidence, and generally consists of insider dealing or market manipulation.

With insider dealing, investors benefit from trading based on information not yet available to other investors, and therefore not integrated in market prices. Manipulation concerns either influencing price-setting mechanisms (e.g. "wash trades", in which trading volumes are artificially driven up by the same person), or providing the market with misleading information (e.g. "bear raids" with rumours spread to drive down prices).

Tackling financial market abuse

Whilst regulators review financial legislation, the EC identified several issues in regard to the current EU anti-market-abuse framework (the Market Abuse Directive, MAD). They include the insufficiency of the legislation in addressing new markets and certain types of trading, its scope excluding commodities or their derivatives, the lack of clarity of the regime and its effective enforcement, and heavy administrative burdens.

In response to the challenges, the EC on 20 October 2011 presented proposals to review the legislation. A first pillar would be the replacement of the MAD with a regulation on insider dealing and market manipulation (MAR). This regulation would broaden the scope, review definitions of insider dealing and market manipulation, clarify procedures for handling inside information, and widen national authorities' responsibilities. MAD was accompanied by a proposed directive on criminal sanctions for insider dealing and market manipulation (CSMAD), seeking to establish a criminal-law regime for market abuse. CSMAD proposes to treat certain forms of insider dealing as criminal offences and Member States (MS) would be required to sanction them accordingly, with minimum sanctions fixed at EU level. With criminal law central to MS' sovereignty, this would be only the second set of criminal penalties in EU law.

Challenges

Although most analysts agree criminalisation of market abuse is justified, some doubt its efficiency. It would enable MS to impose tougher punishments, but with heavy burdens of proof required. This adds to financial markets' technical complexity with which regulators will have to deal, as well as the potential reach of market abuse beyond EU borders. As a result, it is possible that financial transactions will have to be documented more extensively, driving up costs and conflicting with the drive for efficiency. Finally, some observers doubt legislation can keep pace with rapid innovation in financial instruments. As for alternative solutions to market abuse, some critics propose a clear-cut separation on entity level, to avoid contamination of commercial banks with investment banks' culture.

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On 9 October 2012, the EP's Economic Affairs Committee (ECON) adopted reports on the MAR and the CSMAD. MEPs decided maximum prison sentences should not be below five years for the most serious infringements, whilst less serious cases would be subject to a two-year minimum. The Committee also called for intention (reckless, attempted or committed) to be disregarded when it comes to punishments and for public naming of fraudsters. Trilogue negotiations concluded in June 2013, and on 26 June, the Council confirmed its provisional agreement on the compromise text.

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