The EU Market Abuse Regime – is it fit for purpose?

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Abstract

The implementation of EU Market Abuse Regulation is the latest key development in a long history of piecemeal reform of the law relating to insider dealing and market manipulation. In an effort to respond to the considerable challenges posed by fragmentation of financial markets, the rise of high frequency and algorithmic trading and a succession of market conduct scandals, the legislation has lost sight of the underlying policy rationale for insider dealing and market manipulation prohibitions. As a result, the regime is under considerable strain in coping with changing market structures, is unable to provide clear answers to basic questions and is a source of ever increasing ambiguity for market participants. The future requires a re-think of the underlying policy rationale for regulating insider trading and market manipulation and a re-balancing of market conduct prohibitions and regulation of market structure. The focus should be not on seeking to "future proof" the market conduct regime to deal with the myriad of challenges that market innovation will present over the coming years. Instead a fundamental re-examination is required of why we regulate the use of inside information in modern financial markets and what should be the preserve of market manipulation offences rather than structural market regulation.

A. Current developments in the market abuse regime

1. The implementation of the EU Market Abuse Regulation last year effected a further expansion in the scope of insider trading and market manipulation prohibitions in order to respond to the changing nature and structure of financial markets. It also imposed new obligations on investment firms in order to assist in the prevention and detection of market abuse, whether through more prescriptive requirements in respect of the management of inside information within issuers (through insider lists etc), new rules on "market soundings" to control the information provided to potential investors in advance of the announcement of significant transactions, controls on investment recommendations and more onerous requirements on firms to monitor their own and their clients trading activities to detect suspicion of market abuse.

2. A number of drivers lay beneath these reforms[1]:
   - A desire further to harmonise standards across the EU through the use of Regulation rather than Directive.
   - The fragmentation of financial markets and the proliferation of alternative trading venues has led to concern that insider trading and market manipulation prohibitions should be extended well beyond their original intent, which was largely focussed on protecting the integrity of markets in exchange-traded financial instruments.
   - The increased focus on fixed income and commodity markets and related benchmarks in the wake of the financial crisis and a succession of scandals in markets previously untouched by insider dealing, and arguably, market manipulation laws (foreign exchange, LIBOR etc)

[1] See *Proposal for a Regulation on insider dealing and market manipulation* COM/2011/0651

- The challenges presented by electronic trading, direct market access, "high frequency" trading, and algorithmic trading.
- Closer scrutiny of the privileged access to issuer information afforded to institutional investors and how investment banks and other intermediaries manage the conflicting duties owed in respect of such information.
- Continued focus on the challenges prosecutors face in enforcing the market abuse regime.

3. What has emerged is a piecemeal rather than principled response to some of these challenges – expanding the scope of the market abuse regime into new markets and to address perceived gaps in relation to specific wrongs.

4. At the same time the focus of regulators around the globe, including in particular the UK, on the prosecution of market abuse cases (whether through the criminal or civil courts or administrative penalties) has continued[2]. Successful prosecutions of those accused of using or improperly disclosing inside information have risen while cases have also been brought concerning manipulation or attempted manipulation of financial markets (including some concerning the abuse of electronic trading systems) and of financial benchmarks (LIBOR). Meanwhile, serious allegations concerning possible market misconduct in the foreign exchange markets have been pursued, although many of them resulting in broad allegations of misconduct said to be "market abuse like" while not strictly contravening prohibitions on market manipulation or insider trading[3].

5. The damage done to the reputation of, and public trust in, financial markets by this succession of scandals has been significant. Financial institutions, in particular investment banks, are now more focussed than ever on the risk of misconduct arising from their wholesale market trading operations[4]. As regulators seek to legislate against some of the perceived gaps and weaknesses in the regulatory regime, so regulated institutions are reconsidering their business practices and, in some cases, their business models in the light of the regulatory and reputation risks and the increased costs of managing them: Communications between market participants are being restricted, or subject to more prescriptive controls, surveillance activities within financial institutions are increasing and, in areas such index administration, businesses are being sold[5].

6. As a result of reform largely unrelated to market misconduct issues, banks are being forced to "ring-fence" or abandon proprietary trading activities. Their focus is increasingly on competing on the quality, speed and efficiency with which they execute client orders, where margins are tight and the effective use of technology is critical. This includes not only execution on traditional regulated markets but also the provision of alternative platforms for client trading, many of which involve financial institution offering facilities traditionally provided by

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[2] *Trends in Regulatory Enforcement in the UK Financial Markets 2015/16 Mid-Year Report*, Patton and Pruski
http://www.nera.com/content/dam/nera/publications/2015/PUB_UK_Regulatory_Trends_A4_Sat-3_1015.pdf

[3] See for example the FCA Final Notice in respect of Barclays Bank plc, 20 May 2015, which used a finding of breach of Principle 3 of the FCA Principles for Business to address control failings which allowed attempts to manipulation FX rates, attempts to trigger client "stop loss" orders and inappropriate sharing of confidential information concerning client orders. Principle 3 is the only breach cited – no explanation is provided in the FCA's decision as to the legal or regulatory basis for determining that the underlying misconduct that the control failings had allowed was prohibited, although a number of industry codes of practice are cited in the annexe to the Notice.

[4] *Risk culture in financial organisations* Power et al

[5] *Bloomberg buys Barclays' benchmarking business* Financial Times, 16 December 2016

investment exchanges[6]. As a result, liquidity and price formation are being spread over an increasingly fragmented and diverse collection of trading venues, presenting real challenges in terms of market transparency and delivering best execution, which measures such as MIFID II and MIFIR are designed to address. By apparently logical extension, the Market Abuse Regulation expands the protection of insider trading and market manipulation across such venues.

B. Stresses and strains: applying insider dealing and market manipulation prohibitions in the context of changing market structures

7. The extension of market abuse regulation in the manner described above gives rise to a number of significant tensions which have policy, legal and operational aspects. A comprehensive survey is beyond the scope of this paper. Instead I focus on the following themes and examples:

<u>Definitional problems – inside information and disclosure regimes</u>

8. The EU regime for insider trading is somewhat lacking in clear underlying policy rationale. To the extent that a policy rationale can be discerned, the EU regime (under both the previous Market Abuse Directive and MAR) is based on an "equality of information" rationale for prohibiting the use or improper disclosure of information that is not generally available to the market. This is in stark contrast to the way in which insider trading law has developed in the US where the focus is on breach of trust and whether or not the alleged insider trader was in breach of some fiduciary or quasi-fiduciary obligation in respect of the information. The roots of US insider trading lie in the notion that corporate insiders should be prevented from earning secret profits by exploiting the value of information which they have for the benefit of the company and its shareholders. The "equality of information" rationale holds that the question of what duty is owed in respect of the information is largely irrelevant. The MAD/MAR regime proceeds on the basis that issuers in securities markets should be subject to obligations to disclose inside information in order to provide equal access to such information for all investors and that, therefore, those who have privileged advance access to such information should be prevented from dealing on the basis of it lest this undermine the confidence of investors that they are trading on a market where price sensitive information is subject to public disclosure.

9. This rationale comes under strain, however, in a number of areas: Once the concept is extended to the commodity futures markets it becomes readily apparent that the premise that all inside information is the subject of public disclosure does is not hold. This is explicitly recognised by MAR which applies a different definition of inside information in respect of commodity markets and seeks to regulate only the use or disclosure of information which market participants reasonably expect to receive on an equal basis (given that there are no "issuers" and no general obligations to make public such inside information on such markets)[7]. However, the extension of MAR to other trading venues has the capacity to capture trading in unlisted financial instruments where the scope of the disclosure obligations imposed on "issuers" (if indeed the term "issuer" has any meaningful application in respect of some instruments) is unclear or very limited and yet the MAR would seek to regulate insider trading in such markets in the same way as listed securities markets.

10. The scope of the obligation to publish inside information applies to issuers who have approved trading of their financial instruments on an MTF or an OTF or have requested

[6] *Wholesale & Investment Banking Outlook – Reshaping the Model* Morgan Stanley/Oliver Wyman, March 2011 http://www.morganstanley.com/views/perspectives/Banking_Outlook.pdf
[7] Article 7.1(b) MAR

admission to trading of their financial instruments on an MTF in a Member State[8]. This has the potential to extend continuous disclosure obligations in relation to unlisted issuers whose securities that are traded on MTFs or OTFs. It is not clear what the underlying policy rationale for this is. It must be assumed that the legislators regard any organised secondary market in unlisted securities operated by investment firms as requiring the same levels of disclosure as that traditionally required in respect of listed securities but it is unclear that the implications of this for small business fundraising might be given the additional costs that such disclosure regimes incur[9]. Moreover, to the extent that financial instruments related to such unlisted issuers are traded on alternative trading venues without their request or approval, there will be no continuous public disclosure obligation and it is not clear why the full force of insider dealing regulation should be imposed.

<u>Use of order-flow information</u>

11. The very broad concept of inside information under MAD/MAR also has the capacity to capture information which has nothing to do with the fundamentals of an issuer but which solely concerns investors' trading intentions which may impact supply/demand in the secondary market. Like MAD before it, MAR defines inside information broadly to include "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, and which, if it was to be 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"[10]. Although this definition is sufficiently broad to capture it in any event, MAR goes on also to specify that "for persons charged with the execution of orders concerning financial instrument, it also means information conveyed by a client and relating to the client's pending orders in financial instruments" which also meets the test of price sensitivity in relation to either those financial instruments or the price of related spot commodity contracts[11]. It is wholly unclear from the text whether the intention is to capture any sufficiently precise, price sensitive information regarding an investor's trading intentions under the general definition of inside information or only to capture information relating to "pending client orders" held by intermediaries charged with executing those orders.

12. This has important potential implications for the day to day functioning of financial markets. Is information concerning an investors desire to dispose of a large holding in a particular instrument inside information? If s/he approaches an intermediary who then approaches potential purchasers to test their interest in purchasing some or all of that holding are the intermediary and the potential purchasers then fixed with inside information? If so when? On the initial information concerning the likelihood of such an order being placed or only once the seller has actually placed the order? What impact does the intermediary's possession of the information have on their ability to arrange sales or purchases in the same security on behalf of other clients? Is the potential purchaser prevented from trading in the instrument until the potential sale is transacted and reported? If the sale/purchase goes ahead, are all parties prevented from undertaking other trades in the same financial instrument until such time as the sale/purchase is reported to the market? What if the sale is effected through a series of transactions with different purchasers? Is the seller obliged to announce their intention to sell their entire holding (thereby damaging the price they are likely to obtain)? Does the capacity in which the intermediary acts – whether he acts as agent or principal in respect of the transaction – matter?

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[8] Article 17.1 MAR
[9] See Schwartz, *The Law and Economics of Scaled Equity Market Regulation,* Journal of Corporation Law, Vol. 39, pp. 347-394, 2014
[10] Article 7.1(a) MAR
[11] Article 7.1(d) MAR

13. That these rather basic questions are not capable of straightforward answer by reference to either MAD or MAR is concerning and indicative of a confusion within legislation of the concept of insider dealing, which may be viewed as a wrong on the market, and "front running" of client orders, which should be viewed as a wrong on the client. The distinction is crucial as a matter of policy and principle: If the information the intermediary has is "inside information" he may not disclose or use that information regardless of whether it is in the best interests of his client do so or whether his client consents. If the information is not to be regarded as inside information, then the only questions concern whether the way in which the intermediary uses or discloses the information is consistent with the professional obligations owed to clients. The distinction is also important in a practical sense: intermediaries who bring together potential sellers and purchasers (whether on an agency basis or as principal traders) perform a critical role in sourcing liquidity and price formation – they are essential to the efficient functioning of the market. If the insider dealing regime unnecessarily inhibits their activities then there must be a risk that this will impair rather than enhance market efficiency and integrity.

14. MAD and MAR both recognise this by providing "safe harbours" from accusations of insider dealing on the basis of an acquisition or disposal for "market makers" and other "persons authorised to act as counterparty" where the acquisition or disposal to which the inside information relates is made legitimately "in the normal course of the exercise of its functions as market maker or as counterparty for that financial instrument". Similar protection is available for intermediaries who execute orders on an agency basis provided the acquisition or disposal is to carry out an order "legitimately in the normal course of that person's employment profession or duties"[12].

15. However, these safe harbours are narrowly drawn. They only protect the intermediary in respect of the execution of particular transaction to which the inside information relates. They leave unanswered the question as to whether or not the market maker, for example, is free to take account of information concerning a proposed significant disposal in the prices that he offers on other transactions in the same instrument and/or for risk management purposes? Similarly, is the agency broker able to execute other orders in the same instrument from other clients once fixed with inside information on the large disposal? MAR suggests only in relation to orders placed before he came into possession of the inside information. This may seem logical but it raises the question of how a market maker or broker deals with being fixed with inside information concerning potentially significant market moving trades while at the same time continuing to offer two-way prices on the same financial instrument or accept new client orders. Clearly the extent that the broker owes obligations to his client in respect of best execution or the confidentiality of the information he has concerning the potential market moving trade those obligations must be observed and any potential conflicts managed, But insider dealing prohibitions are not (in the EU at least) rooted in such obligations but in a principle that trading on the basis of such information should be prohibited until the information becomes available to the market at large. It is unclear, as a matter of policy, why such prohibitions should apply only in organised financial markets regulated by MIFID/MAR and not, for example, in the spot foreign exchange markets, where the use of information that is confidential to a client can only be analysed as a potential breach of duties owed to the client and not to the market as a whole.

16. The uncertainty as to the reach of insider dealing prohibitions in this area is compounded when one considers the potential significance of aggregated order-flow information that is available to intermediaries. Where a market maker or broker has non-public information

[12] Article 9.2 MAR

concerning not one individual transaction but aggregated order flow information which enables them to deduce or predict potentially significant short term price movements they have non-public information which may be both precise and price sensitive and the safe harbours outlined above are of little assistance. Yet the role of intermediaries in the price formation process surely depends on their ability to reflect such aggregated order flow information in the prices they offer to investors before such information is available to the rest of the market. In the context of an electronic trading environment where the intermediary offers direct market access to clients/counterparties the use of such order flow information may be embedded in algorithms.

Market manipulation and market disruption

17. Such definitional issues as challenge the practical application of insider dealing prohibitions pale in comparison to those surrounding "market manipulation". Classic market manipulation involves the making of misleading statements to induce others to trade, or the use of deceptive or contrived devices to give a misleading impression in the market. These are akin to fraud and have long been reflected in criminal offences requiring proof of dishonest intent or at least reckless deceit[13]. However, as now reflected in the MAR, the concept of "market manipulation" in the context of civil or administrative regimes has steadily been expanded to encompass not only deliberate or reckless misleading or distortion of the market but also unintentional market disruption. MAR prohibits orders or transactions or other behaviour that either-
    a. gives, or is likely to give, "false or misleading signals" as to the supply of, or demand for, or price; or
    b. secures, or is likely to secure, the price at an "abnormal or artificial level";
    unless
    c. the person establishes that the behaviour was for "legitimate reasons" and conforms with accepted market practices which must be established and approved by regulators in accordance with a process mandated by the Regulation and overseen by ESMA.

    In addition, orders, transactions or other behaviour which affects or is likely to affect the price and which employs "a fictitious device or any other form of deception or contrivance" are prohibited[14].

18. At first blush these prohibitions seem to be attacking self-evidently bad behaviour. However, there is a notable and deliberate omission of any requirement to prove wrongful intent – indeed the wording suggests these acts could be committed inadvertently or negligently. That this is the case is brought home in the provisions which follow which appear to deem "market manipulation" not only attempts at price fixing or misleading investors in the market but also behaviours such as "placing orders to a trading venue which has the effect of …[securing the price at an abnormal level] … by disrupting or delaying the functioning of the trading system of the trading venue or being likely to do so [or] making it more difficult for other persons to identify genuine orders on the trading system of a trading venue or being likely to do so, including by entering orders which result in the overloading or destabilisation of the order book"[15].

19. The delegated legislation that provides further "indicators" of market manipulation is helpful in focussing on more specific examples of market manipulation[16]. The recurrence of the phrase "in order to" in many of the examples provided is striking: "buying of positions …on the

[13] See sections 89 and 90 Financial Services Act 2012
[14] Article 12.1 MAR
[15] Article 12.2(c) MAR
[16] Regulation 2016/522/EU Annex II

secondary market, after the allocation in the primary market in order to post the price to an artificial level and generate interest from other investors"; "executing orders to trade…in order to uncover orders of other participants, and then entering an order to trade to take advantage of the information obtained"; "undertaking trading or entering orders to trade in one trading venue ….with a view to improperly influencing the price of the same financial instrument on another trading venue".

20. Although subtly expressed and buried in the delegated legislation, these words suggest a degree of purposeful conduct is often a key indicator of market manipulation. Indeed, in practice, it may be the only thing that distinguishes manipulative conduct from an otherwise legitimate pattern of trading. And yet no reference is made to this in the main definition of market manipulation and the "indicators" in the Delegated Regulation are of course non-exhaustive. Moreover, similar indicators in the UK FSA guidance on what constitutes market abuse have not persuaded the court that there is any requirement to demonstrate purposeful conduct in order to prove alleged market abuse[17].

21. This reflects both a concern with the difficulties of proving purpose or intent, and a desire to ensure that the definition of market manipulation is sufficiently flexible to address the perceived risks of distortion or disruption to financial markets that may flow from innovative, fast-moving markets. High speed, high volume trading of the kind that can be generated through electronic and algorithmic trading, for example, is widely regarded as having the capacity to distort or disrupt financial markets even if that is not its purpose[18].

22. However, an objective "effects-based" test for market manipulation also injects considerable uncertainty as to where the line between unacceptable market manipulation and legitimate trading (which may on occasion result in market disruption or disorder) should be drawn. It also suggests a lack of clarity and confidence on the part of regulators and legislators as to the effectiveness of structural market regulation and its ability to safeguard and manage the orderliness of financial markets across multiple trading venues.

23. Provision is made in MIFID and MIFIR to seek to ensure that trading venues themselves have in place structural arrangements to guard against market disruption and disorder[19]. But there is of course a massive difference between engaging in a course of trading that triggers a "circuit breaker" and one that results in public penalties for "market manipulation". The apparently objective and very broad definition of market manipulation, exposes market participants to allegations of market manipulation wherever their trading has the effect of significantly disrupting or distorting markets, whether or not that is the purpose of the trading, and whether or not such a course of trading was permitted on the trading venue in question.

"Price discovery"

24. The MAR also does little to resolve vexed questions concerning the difference between market manipulation and "legitimate price discovery": In the context of algorithmic trading the question arises as to the extent to which it is legitimate for market participants who are able to deduce, from their own expertise and analysis, the strategy that is being traded by an algorithm and thereby predict the way in which it will behave in certain market conditions and

[17] *Winterflood Securities Ltd & Ors v Financial Services Authority* [2010] EWCA Civ 423
[18] See for example the US SEC order in re Athena Capital Research LLC https://www.sec.gov/litigation/admin/2014/34-73369.pdf Although the concern that speed and/or sheer volume of order submission and execution can disrupt or distort markets pre-dates the significant growth in algorithmic trading: see UK Financial Services Authority Final Notice against Citigroup Global Markets Ltd, 28 June 2005 https://www.fca.org.uk/publication/final-notices/cgml_28jun05.pdf
[19] See for example Article 48 MIFID on systems resilience, circuit breakers and electronic trading

to trade on the basis of that knowledge. Should this situation be treated any differently in principle from any other situation where one investor (using only their own expertise rather than any improperly acquired commercially sensitive information) is able accurately to predict the likely trading strategy of another investor and to use that information to his own advantage in responding to market conditions? How far, if at all, is it possible for an investor to go about testing the market through small trades in order to obtain information that may be relevant to deducing the other investor's trading strategy? Even if it is acceptable for one investor to use their own expertise and market analysis accurately to predict the trading intentions of another investor, is it acceptable for the first investor to the set out to trade in a way that creates the market conditions which he predicts will trigger a significant change in position by the second investor and then seek to profit from that change? It seems relatively clear (but by no means beyond argument) that the answer to the last question is that such conduct would (and should) be regarded as market manipulation[20]. The answer to the first two questions is very unclear.

C. The future for market abuse regulation

25. Market structures are changing and becoming more fragmented. Technological innovation has quickly transformed financial markets where a substantial proportion of trading is now driven by algorithmic trading[21]. These include both algorithms designed to pursue institutional investors' proprietary trading strategies and those designed by intermediaries/liquidity providers to deliver best execution to investors.

26. The challenge in applying market abuse regulation in this environment arises not from technological innovation but from a lack of clarity and certainty that has, deliberately to a large extent, been embedded in the market abuse regime. Uncertainty arises not only from a lack of prescription, which is justifiable in order to enable the regime to respond to changing market structures and practices. It arises from a lack of clarity even as to the broad principles and underlying policy rationale for prohibitions on use of inside information and market manipulation. The result is that when faced with new market structures and technological innovation, the principles by which it should be determined whether or not information advantages may or may not legitimately be exploited are unclear. The basis on which the impact of a trading strategy on market prices should be determined to be a function of the legitimate forces of supply and demand (and the periods of volatility which inevitably come with those) or, conversely, illegitimate distortion or disruption of the price formation process, lacks any principled rationale.

27. This has practical implications for compliance and for market surveillance and enforcement. Technological advances seem likely to continue apace. The potential applications of machine learning in the context of algorithmic trading suggests that the sophistication with which trading systems can respond to and potentially influence intraday market trends, or make use of insight gleaned from analysis of order flow information or other data sources, will continue to increase. Such developments have the potential significantly to improve the economic efficiency of financial markets but also pose risks in terms of potential for abuse and market disorder[22]. The absence of a clear and coherent set of principles against which to design, test

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[20] Scopino, *The (Questionable) Legality of High Speed "Pinging" and "Front Running" in the Futures Market* 47 Connecticut Law Review 607 (2015)

[21] ESMA Economic Report, *High-frequency trading activity in EU equity markets,* Number 1, 2014 https://www.esma.europa.eu/sites/default/files/library/2015/11/esma20141_-_hft_activity_in_eu_equity_markets.pdf

[22] *Crashes and High Frequency Trading: An evaluation of risks posed by high-speed algorithmic trading*, D. Sornette and S. von der Becke, August 2011

and monitor such systems for market conduct risks is a growing challenge. New skills will be required of compliance professionals and those who advise them in applying the requirements of the market abuse regime to such systems. Traditional methods of monitoring trading for suspicion will change – the traditional focus on monitoring trading around significant price movements and electronic and voice communications by traders makes little sense in relation to trading that is being effected through an algorithm with limited realtime human intervention.

28. It could well be argued that there is no realistic prospect that market abuse regulation could seek to anticipate all the market conduct risks that may emerge and that therefore retaining intentional and strategic ambiguity in the definitions of inside information and market manipulation is prudent and incentivises market participants and trading venues to develop detailed controls to avoid such risks. However, the potential downside with such an approach is that it potentially inhibits market innovations which may enhance the efficiency, integrity and stability of financial markets, and may impair the efficiency of the price formation process. The focus of compliance efforts may move towards avoiding regulatory scrutiny by reducing or managing market impact, itself distorting the legitimate forces of supply and demand. The debate that has raged over the supposed evils of short selling as a potentially manipulative act, particularly during the height of the financial crisis, is a now classic illustration of the problem: Were those shorting financial stocks corrupt speculators seeking to exploit weakness in banks' shares, forcing prices into steeper and deeper falls in order to reap profits. Or were they simply reflecting the realisation that market values were too high in the light of new information and increased uncertainty concerning the value of their assets and liabilities? Without principle to guide such debate there is a real risk that market abuse enforcement becomes an unpredictable regulatory response to public or political concern over the impact of trading in financial markets on the fortunes of high profile issuers.

29. Similarly, the drift towards expanding the scope of continuous public disclosure obligations and insider dealing restrictions beyond the scope of a listed markets may have unpredictable consequences: The costs imposed on issuers as the price of fundraising on such markets may be too great and drive increasing resort to alternative funding sources and networks which provide less transparency and less liquidity for investors.

D. Rethinking the policy rationale for regulating insider dealing and market manipulation

30. The policy rationale for regulating insider dealing and market manipulation in the EU needs to be clarified. The policy and principles to be applied are in a state of drift, leading to suspicion and regulatory scrutiny falling on any conduct which involves either the exploitation of information advantage by market participants or trading that causes or contributes to market volatility. That is not a sound basis for regulatory intervention and runs the risk of impairing rather than enhancing market efficiency and market confidence.

31. The assumption that continuous public disclosure of material information on all organised secondary markets in corporate securities is a good thing should be challenged. It imposes significant costs on issuers which may not be necessary or appropriate and may drive SMEs to increased use of alternative sources of fundraising. Insider dealing regulation should be confined to those markets where there is a legitimate expectation of continuous public disclosure. Provided adequate investor protection measures are in place it should not be assumed that continuous public disclosure is necessary on all securities markets.

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289016/11-1226-dr7-crashes-and-high-frequency-trading.pdf

32. More broadly, in respect of all markets in financial instruments a more informed and principled approach is required to determining the extent to which exploiting other, novel forms of information advantage is acceptable or not.

33. This is not to suggest a return to debate over whether insider dealing is a “victimless crime” or a good from an economic efficiency perspective. But the EU legislation in particular has lost its way in terms of the underlying policy rationale for the prohibitions – justifying broad definitions (which in practice confer massive discretion on regulators and enforcers) under the slogan of “market integrity”. The US regime is clearer in terms of underlying principles but these are based on questionable foundations rooted in fraud and breach of fiduciary duty which are arguably inadequate to address the risks inherent in modern financial markets[23] and which have also been expanded so far that their underlying public policy rationale is difficult to define. A rethink is required which provides a market failure based analysis to establish which information advantages may or may not be exploited based on discerning those which enhance price formation and market efficiency and those which add little value and arguably undermine the integrity of public markets which are genuinely founded on equality of information requirements.

34. Some may be tempted to regard the prospect of UK exit from the EU as an opportunity to re-think UK regulation of market abuse as a matter of domestic law. However, in practice that may prove both challenging and misguided: The UK’s heavy influence on the EU legislation is self-evident. To a large extent MAR reflects policy first developed in the UK Treasury and the FSA/FCA. There is also a very strong likelihood that whatever the future relationship between the UK and EU, there will be a requirement to demonstrate the equivalence of UK market abuse regulation with EU law. Moreover, even if there is no legal requirement, the costs and benefits for London and a financial centre of the UK tracking a significantly different course on market abuse regulation would need very careful consideration. The greatest challenge is therefore likely to be how to continue to promote both coherent policy and harmonised implementation across the Europe in circumstances where its leading financial centre is no longer within the EU.

35. What might a more coherent future policy approach look like a decade from now, given the challenges identified above? I suggest the following propositions as a starting points for further debate:

    a. It will be accepted that unintentional market disruption and market distortion should be the focus of structural market regulation and should not form the subject matter of market manipulation offences. Market manipulation offences (even in their civil or administrative) should be preserved for morally culpable behaviour which should generally involve purposeful or at least reckless deception (whether through representation, conduct or artifice). The protection of market infrastructure from the risks of high frequency or algorithmic trading will be delivered primarily through regulatory requirements in respect of market infrastructure and the imposition of preventative measures and regulatory obligations on those who access that infrastructure. Expansive use of market manipulation offences will be regarded as a blunt tool and abandoned as it is incapable of balancing the desire to encourage technological innovation, and the increased liquidity and efficiency that it can bring to financial markets, with the need to guard against the risk of market distortions resulting.

[23] Yesha Yadav, *Insider dealing and market structure* 63 UCLA L. Rev. 968 (2016)

b. Insider dealing prohibitions would be confined to the protecting the integrity of markets in financial instruments where there is an obligation or legitimate expectation of equal access to material information among all market participants – and would only restrict dealing on the basis of that information to which there is a legitimate expectation of equal access. In practice this is most likely where issuers, other market participants or market venues themselves are required to publish material information.

c. Order-flow information, proprietary research and other insight gained by market participants through legitimate pursuit of their own interests should not be considered inside information or the subject of insider dealing prohibitions. The extent to which restrictions should be imposed on the use of such information by any party should be dictated solely by the obligations imposed to protect the interests of the "owner" of that information. In the case of "order flow" information the "owner" is the party placing the order and their interests should be protected by the fiduciary and regulatory obligations imposed on those intermediaries who act on their behalf.

d. Beyond insider dealing law, professional ethics and the law of fiduciary duties would become the correct space in which to discuss the legality or ethics of individuals exploiting for their own benefit (on the financial markets or elsewhere) other information advantages that they obtain through their work.