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February 2015

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Market Abuse: the new European legislation

The updated regulatory framework comes along with "European" criminal sanctions

by Athina Siafarika

Executive Summary

"…trading on all platforms and of all financial instruments will now be covered by market abuse legislation…"

The initial regime set by the Market Abuse Directive 2003/6/EC ("*MAD*"), transposed into Greek Law 3340/2005, is now replaced by two new European legal texts: a pan-European "hard law" Regulation (Regulation No 596/2014 on market abuse -"*MAR*") and a new Directive (Market Abuse Directive 2014/57/EU- "*MAD II*") introducing criminal sanctions for Market Abuse.

The MAD prohibited, in brief:

- "Insider dealing": misuse of inside information in transactions in financial instruments or relevant recommendations, as well as unlawful disclosure of inside information.

  and

- "Market manipulation": the conducting of transaction activity or other related in such instruments with a fictitious effect on market prices and volumes including also spreading of false information or rumors for the issuers and markets concerned.

However, a number of issues, as identified by the European Commission, had to be further addressed including: gaps in regulation of commodities and commodities derivatives (e.g. in the energy markets), increased globalization of financial markets giving rise to new trading platforms and technologies not covered by MAD (e.g. OTC trading), highly divergent national regimes, costly administrative burdens for SMEs and others. Thus, MAD is now replaced by the new MAR and MAD II on criminal sanctions for market abuse.

What's new!

The new MAR and MAD II extend the scope of EU legislation to financial instruments traded only on multilateral trading facilities (MTFs), other organized trading facilities (OTFs) and OTC trading, so that trading on all platforms and of all financial instruments which can impact on them will now be covered by market abuse legislation. Specifically, MAD II brings changes regarding:

- An extension of the definitions of insider dealing and market manipulation encompassing any financial instrument admitted to trading on MTF, OTF and OTC. The new regime introduces more specific provisions on insider information with respect to commodity derivatives considering their impact to relevant spot markets and vise versa.
- A new regime for SMEs relating to their disclosure obligations in a simple market-specific way. In the MIFID II (Markets in Financial Instruments Directive II- 2014/65/EU), SMEs are defined as companies that had an average market capitalisation of less than EUR 200,000,000 on the basis of end-year quotes for the previous three calendar years, while according to the EU recommendation 2003/361 SMEs generally present the following figures: <250 employees, ≤ € 50m turnover, ≤ € 43m total balance sheet.
- The supervisory regime between the financial regulators and commodity regulators and the

strengthening of their cooperation and exchange of information and data for the effective regulation and supervision of both markets.

Moreover, an indicative list points out which high frequency trading (HFT) strategies should be considered as market manipulation, such as "quote stuffing". The scope of the legislation is also extended to both commodity and related derivative markets.

Towards a "Europeanization" of criminal sanctions in financial services?

During the LIBOR scandal, serious concerns were raised about the manipulation of benchmarks which can result in significant losses for consumers and investors or distortion of the real economy. According to Michel Barnier, Internal Market and Services Commissioner, European Commission Press Release of 25 July 2012, "*The international investigations underway into the manipulation of LIBOR have revealed yet another example of scandalous behavior by the banks. I wanted to make sure that our legislative proposals on market abuse fully prohibit such outrages. That is why I have discussed this with the European Parliament and acted quickly to amend our proposals, to ensure that manipulation of benchmarks is clearly illegal and is subject to criminal sanctions in all countries*". Moreover, under the previous regime, investors trading on insider information and/or manipulating markets by spreading false or misleading information could avoid sanctions by taking advantage of differences in national laws (regulatory arbitrage). Thus, MAD II introduced common minimum rules on criminal offences for market abuse, their definition and minimum sanctions (for example, Article 7 of the MAD II provides for a maximum term of imprisonment of at least 4 years in case of insider dealing and market manipulation, as well as a maximum term of imprisonment of at least 2 years in case of unlawful disclosure of inside information). The MAD II is also part of a wider European policy envisaging the introduction of criminal sanctions for the most serious violations of financial services legislation, as presented in the Commission's Communication on "Reinforcing sanctioning regimes in the financial services sector" of 8 December 2010.

Offences subject to criminal sanctions and exceptions

The MAD II defines that the following offences: insider dealing, recommending or inducing another person to engage in insider dealing, unlawful disclosure and market manipulation should be regarded as criminal offences by Member States at least when they are serious and committed intentionally. These offences shall be deemed serious when the impact on the integrity of the market, the actual or potential profit derived or loss avoided, or the damaged caused to the market is high.

The MAD II also required Member States to criminalize inciting, aiding and abetting insider dealing, unlawful disclosure of inside information and market manipulation, as well as attempts of insider dealing and marker manipulation.

Liability will also be extended to legal persons, which will be punishable by effective criminal or non-criminal sanctions.

Transactions such as buy-backs and stabilization programs, monetary/exchange rate and debt management policy actions fall, in principle, outside the scope of the new regime ("safe harbor"), if certain conditions and procedures are complied with.

What about administrative sanctions?

The new legislation provides for both administrative and criminal sanctions. More specifically, according to the Commission's view, initially, it is crucial that insider dealing and market manipulation is criminalized in all Member States when committed intentionally. Then, a "corresponding" offence should

exist in national laws at least for serious cases and the Member States should decide which type of sanction to impose. It is important to underline, here, that Member States should put all their efforts to avoid the "double incrimination", imposing both administrative and criminal sanctions for the same act (see the recent Decision of the *European Court of Human Rights* in "Grande Stevens and others v. Italy" case).

Greek transposition in progress

The MAD II is currently going through a transposition process into the Greek legal order, lead by a special parliamentary commission. This transposition refers exclusively to the implementation of the criminal sanctions. The Greek law has two options in order to abide by the MAD II: it has to adopt either the common minimum rules and sanctions for criminal offences set by the MAD II or an even stricter regime. At the same time, for the adoption of any implementing regulations on all other parts of MAR legislation the European Securities and Markets Authority (ESMA: http://www.esma.europa.eu/) in Paris and the European Commission in Brussels will be the competent authorities from now on, rather than the national authorities.

ATHEXClear Rulebook

The new Rulebook of the ATHEX Securities Markets

by Viktoria Chatzara

The new Rulebook under EMIR

On the 16th February 2015, the new Rulebook for Clearing of Transferable Securities Transactions in Book Entry Form of ATHEXClear ("Rulebook"), came into force, concerning securities traded in the regulated ATHEX Securities Markets, including both the Regulated Market in Securities and the multilateral trading facility "Alternative Market" (EN.A.) of ATHEX (*EN.A. is a multilateral trading facility in the sense of MiFID Directive and L.3606/2007, a multilateral system operated by ATHEX, which brings together multiple third- party buying and selling interests in transferable securities. EN.A. has been authorized by Decision No 4/443/6.9.2007 of the Hellenic Capital Markets Commission (HCMC) and operates under the applicable legal and regulatory provisions and its Rules of Operation.*). The Rulebook implements in the ATHEX Securities Markets the provisions of Regulation No 648/2012, commonly known as "EMIR Regulation", and provides for a series of new obligations for the Clearing Members and the Members (Market Members) of the ATHEX Securities Markets as well.

In its general concept, the clearing procedure of ATHEXClear refers to the process of establishing positions, which includes the calculation of the net obligations, and of ensuring that the adequate means (financial instruments, cash, or both) are available for the cover of any exposure arising from such positions. As this procedure covers the clearing of all transactions in all products that are carried out in the ATHEX Securities Markets, it reasonably impacts the whole spectrum of Greek capital markets, including not only the main actors of clearing, i.e. ATHEXClear and its Clearing Members, but also the Market Members, the issuers and the end-users of all related services (investors) as well.

Until the entry into force of the Rulebook, the ATHEX Securities Markets operated with ATHEXClear and its predecessors (Central Securities Depository - CSD, HELEX) as clearing houses since 2010, when "unbundling" was introduced (i.e. the separation between the clearing and the settlement functions) in order to make more effective the clearing and settlement processes and rationalize any relevant costs. From the entry of the Rulebook, ATHEXClear undertakes fully the role of the Central Counterparty (CCP), becoming the buyer to every seller and the seller to every buyer in accordance with EMIR.

Why was EMIR Regulation introduced?

EMIR Regulation was adopted by the European Parliament and the Council following the current severe economic crisis and in the context of a general attempt to strengthen the regulatory framework concerning the provision of financial services. It aims mainly at creating a safe environment for the clearing infrastructure in EU and, in this respect, at achieving all related goals, such as mitigation of systemic risk symptoms, improvement of transparency, efficiency and integrity in the financial services sector, high level of investor protection and asset segregation and level playing field for the competition between market participants. EMIR provides unified rules for the clearing procedure and other connected obligations (such as reporting obligations) in all Member States and for all the entities participating in the relevant post-trading sector. In this respect, Member States do not have the discretion to adopt divergent national measures concerning the clearing process and, thus, the field for phenomena of *forum shopping* is much more limited.

Major changes in the ATHEX Securities Markets

The most important changes the Rulebook introduces to the clearing process in the ATHEX Securities Markets refer to the following:

1. Clearing Members: According to the Rulebook, both investment firms and credit institutions may qualify as Clearing Members, provided they also fulfill further requirements described in the Rulebook, such as the own funds requirements (€ 700.000 for the Direct Clearing Members-DCM [i.e. the ones entitled to clearing exclusively their own transactions] and € 3.000.000 for the General Clearing Members -GCM [i.e. the ones which are entitled to clearing not only their own transactions]), the initial/minimum contribution to the Clearing Fund (€ 30.000. for the DCM and € 500.000 for the GCM) and other related technical and operational requirements.

   One of the most essential obligations of the Clearing Members, deriving from the provisions of the new Rulebook, is the one connected with the Margin requirements. ATHEXClear calculates the Margin requirements for a Clearing Member per each Clearing Account it maintains in the system on a daily basis in accordance with its risk management procedures based on EMIR. Should the Margin requirements for a particular Clearing Account be higher than the collateral provided to ATHEXClear for this Account, the Clearing Member is obliged to cover the deficit by providing additional collateral in favor of ATHEXClear; in the event that there is not enough coverage, the Clearing Member is prohibited from undertaking new transactions for clearing, without prejudice to the close-out netting procedures for the limitation of risk.

2. Clearing Accounts: The Rulebook reflects the respective provisions of EMIR, according to which the clearing of transactions may be effected either through an individual Client Clearing Account (individual segregated) or through a Clients Clearing Account (omnibus). Clearing Members have to offer their clients the choice between the Clients Clearing Account and the Client Clearing Account and make publicly available the segregation levels they offer, the safety level and the cost for each different choice.

   Clearing Members are obliged to maintain separate records and accounts in order to be able to separate both in the Clearing Accounts they maintain and in their own accounts their assets and positions from the assets and positions they keep on behalf of their clients or per each client, according to the segregation level chosen.

3. Collaterals: As far as the form of collaterals accepted by ATHEXClear is concerned, the Rulebook states that it may be provided either in cash or in transferable securities, whereas letters of guarantee are not acceptable as collaterals according to the new provisions (collaterals in transferable securities is under implementation).

   Under the Rulebook, Clearing Members have the right to use the collaterals given to them by their clients, in order to cover margin obligations, related to respective clients' positions, towards ATHEXClear. In order to exercise such right, Clearing Members must ensure that such clients have provided their written consent for such re-use.

   The implementation of the Clients Clearing Account has been served by the new provision of Article 11a of the DSS (Dematerialized Securities System) Regulation of the Hellenic Capital Markets Commission, which establishes the Clients (omnibus) Collaterals Account. Securities of the clients provided to the Clearing Member in accordance with their contractual agreements can be registered in this Account, which is kept in the name of the Clearing Member, and can further be used by the latter as margin in favor of ATHEXClear. This collateral re-use concept, as a re-use of collaterals in securities for margin purposes, facilitates clearing and enables the Clearing Member to fulfill its obligations to ATHEXClear in an effective manner.

4. Credit Limits – Market Members: The Rulebook lays down also provisions related to Credit Limits to which both Clearing Members and Market Members have to comply. Such Limits operate as prefunded limits to Clearing Members and Market Members respectively concerning the risk related to the entry of orders to the Trading System (OASIS) of ATHEX and the conducting of relevant transactions. ATHEXClear defines the Credit Limit as per each Clearing Account and notifies the Clearing Member respectively, which, in its turn allocates such Credit Limit to each Market Member. Market Members are obliged in their turn to respect the Credit Limits allocated to them. They are entitled to enter orders for transactions in the Trading System only up to their Credit Limit; should such Credit Limit not exist or not suffice, they are prohibited from entering such orders.

5. Clearing Fund: The Clearing Fund for the ATHEX Securities Markets as now operates in accordance with EMIR is a risk sharing fund which aims as a default waterfall measure to further mitigate risks and losses arising from a Clearing Member's default. Each Clearing Member is obliged to contribute to the Clearing Fund its initial contribution as well as any regular or extraordinary contribution, as defined in the Rulebook. The regular contribution of each Clearing Member is calculated in connection with the Margin requirements for all the Clearing

Accounts a Clearing Member maintains. The calculation period may not be greater than three months. The contributions of the Clearing Members are deposited and kept in one or more accounts in the Bank of Greece or in another central bank or other credit institution, according to a relevant decision of ATHEXClear.

6. Default waterfall: A new default procedure is established in compliance with EMIR, the so-called "default waterfall", according to which, in the event of default of a Clearing Member, ATHEXClear covers any occurred losses under the Rulebook in the following order:

   (a) By the collateral as provided as Margin in favor of ATHEXClear for the Clearing Account in default;

   (b) By the collateral of the Own Clearing Account of the Clearing Member;

   (c) By the contributions (share) of the defaulting Clearing Member to the Clearing Fund;

   (d) By the Special Own Resources of ATHEXClear (the so-called "skin in the game" under EMIR);

   (e) By the contributions of the other Clearing Members to the Clearing Fund on pro rata basis;

   (f) By ATHEXClear's other financial resources that it maintains in accordance with EMIR.

It should be noted with respect to the above that ATHEXClear may proceed with using the resources described in any of the above steps only after having fully used the resources described in the previous step and only to the extent necessary to cover any remaining damage from the default.

All in all...

The Rulebook creates a new environment for the operation of the ATHEX Securities Markets, given that clearing is a process having an impact on all market aspects and participants. In any case, Clearing Members and Market Members have to re-evaluate their models of operation, their contractual agreements and, generally, their procedures of operation, in order to ensure that they are in compliance with the new regulatory framework. In this respect, it should be taken into account that such regulatory framework depends to a significant extent from rules established on a European level, as well as from ATHEXClear decisions issued in implementation of the Rulebook. All parties in the capital markets sector should ensure that they keep track of the essential changes, in order not only to fully comply with them, but also to be able to offer to their clients innovative and competitive products and services. Especially with respect to the Clearing Members, should they be found in breach of the provisions of the Rulebook and its implementing decisions, ATHEXClear is entitled to impose certain sanctions, which vary from a written reproach, to prohibiting the Clearing Member from clearing transactions, to a suspension of the Clearing Member's status for a certain period, to imposing monetary fines between € 100 – 150.000, or even to deletion of the Clearing Member. It should be noted that ATHEXClear is bound to impose appropriate and adequate sanctions in the event of a breach, under its duties as a CCP authorized under the EMIR Regulation (and HCMC's approval based on the opinion of the College). Should ATHEXClear ascertain a breach of the provisions regulating the clearing procedure, it will notify respectively the HCMC and provide it with all necessary data and information concerning the breach. In this respect, should the above breach also constitute a breach of the general Capital Markets legislation, it could be possible that the HCMC would also take measures, within its competence, against the Clearing Member.

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