Market Abuse Regulation: Investment Recommendations
An ICMA Q&A

Q. What is Market Abuse Regulation?

A. The EU Market Abuse Regulation (MAR), replaces the 2003 Market Abuse Directive (MAD), and has been developed in parallel with other EU and international post-crisis initiatives to regulate financial markets and instruments, in particular MiFID II/R, with which MAR has a degree of interdependence. MAR is designed to cover a broad range of potential market abuses, including market manipulation (including benchmark manipulation), unauthorized disclosure of inside information, suspicious transactions, irregular directors' dealings, and conflicts of interest.

Q. What is the scope of MAR?

A. Whereas MAD broadly captures financial instruments admitted to trading on a regulated market, MAR captures financial instruments traded on a much wider range of trading venues, including multilateral trading facilities (MTFs) and organized trading facilities (OTFs). It also covers instruments which may not be admitted to trading on a regulated market, MTF, or OTF, where the price or value of those instruments effect the price or value of instruments that are admitted to trading on a regulated market, MTF, or OTF (such as credit default swaps).

Q. What are the MAR provisions for investment recommendations?

A. Supplementing MAR is a delegated act outlining *regulatory technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy and for disclosure of particular interests or indications of conflicts of interest.* Essentially, the regulation sets out harmonized standards with respect to investment recommendations to ensure that information is objectively presented and interests or conflicts of interest are effectively disclosed. This in effect means that any investment recommendation must be accompanied by appropriate disclosures including (although not limited to):

- the identity, job title, and relevant competent authority of the person making the recommendation;
- the distinction between facts and interpretations, estimates, opinions, and other types of non-factual information;
- sources of information, and the extent of their reliability;
- the labelling of all projections., forecasts, and price targets, along with any material assumptions underlying these;
- a summary of any basis of valuation or methodology and the underlying assumptions;
- an indication of the place where detailed information about the valuation or methodology is directly and easily accessible;
- the meaning of any recommendation, such as 'buy', 'sell', or 'hold', the recommended length of time for the investment, and an adequate explanation of the related risk including a sensitivity analysis of the assumptions;
- the planned frequency of updates to the recommendation;

- where the recommendation differs from a previous recommendation concerning the same instrument or issuer that has been disseminated in the preceding 12-month period, the change(s) and date of the previous recommendation;
- a list of all recommendations relating to the relevant instrument or issuer from the previous 12-months, along with the date of dissemination, price target, the price at the time of the recommendation, the direction of the recommendation, the recommended time period of the recommended investment, and the price target, along with the identity of the person(s) who made the recommendation;
- disclosure of any interests or conflicts of interest of the person(s) or legal entity making the recommendation, including whether they hold a meaningful position in the security, if they are a market maker or liquidity provider, or were a lead manager or co-lead manager over the previous 12-mnths of any publicly disclosed offer of financial instruments of the relevant issuer.

Q. What constitutes an investment recommendation?

A. An investment recommendation is defined as: *"information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers, including any opinion as to the present or future value or price of such instruments."* [MAR L1 Art 3(1)(35)]

<u>In practice, this would seem to include any buy, sell, or relative value recommendation, for any in-scope instrument, regardless of whether any time horizon for the trade is specified and irrespective of whether there is a specific price target</u>.

Q. What constitutes a distribution channel?

A. MAD defines a distribution channel as 'a channel through which information is, or is likely to become, publicly available'. Such channels could include a Regulatory Information System, media specializing in disseminating information (news agency, news provider, a newspaper, etc.), or the website of the producer of the recommendation.

In addition, MAR takes the view that an investment recommendation is intended for distribution channels or for the public not only when it is intended or expected to be made available to the public in general, but also when it is intended or expected to be distributed to clients or to a specific segment of clients, whatever their number, as a non-personal recommendation, i.e. without the provision of the investment service of investment advice. <u>The implication here is that investment recommendations are in scope of MAR where they are disseminated to more than one client</u>.

Q. When do MAR provisions for investment recommendations come into force?

A. The MAR final draft regulatory technical standards for investment recommendations were submitted by ESMA to the European Commission in September 2015, and adopted by the European Commission in March 2016. Following approval by the European Council and European Parliament in the coming months, the regulation is intended to come into force from **July 3rd 2016**.

Q. What are the practical implications of MAR disclosure obligations for investment recommendations?

A. Whereas MAD disclosures were designed to cover the more traditional, standardized, equity market 'buy/hold/sell' research template, the extension of MAR to include less standardized sales recommendations, which could include relative value plays between different securities, vastly increases the disclosure obligations of investment firms and their investment professionals. In particular, investment firms and their employees will have to record every single investment recommendation at the security and issuer level, and make the last twelve months of this data available whenever making new recommendations.

Given these onerous disclosure demands, it is reasonable to assume that this will not only impact the extent of investment recommendations firms provide to their clients (likely to be a significant reduction), but also the form in which they are made (via electronic media as opposed to voice). Furthermore, compliance with the regulation is likely to require significant investment in information technology as well as a high level of staff training. Particularly where investment firms are not already recording every investment recommendation, they may struggle to comply with new obligations when they come into force in July of 2016.

Links:

Draft regulatory technical standards (investment recommendations) [March 2016]
MAR: draft regulatory technical standards [September 2015]
Market Abuse Regulation (EU) No 596/2014 [April 2014]

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