



The market soundings regime under the Market Abuse Regulation

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Introduction

The Market Abuse Regulation (596/2014) (“MAR”), which came into force across the EU on 4 July 2016, introduced a new regime for market soundings. A market sounding is a communication of information prior to the announcement of a transaction in order to gauge the interest of potential investors in a potential transaction and the conditions relating to it such as its possible size or pricing.

The recitals to MAR recognise that market soundings are a highly valuable tool to assess the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned. However, it is also noted that conducting a market sounding may involve the disclosure of inside information to potential investors.

Under MAR, it is unlawful to disclose inside information other than in the normal exercise of a person’s employment, profession or duties. However, MAR provides a specific safe harbour so that, where market soundings are made by certain persons who follow a prescribed process, any disclosure of inside information as part of that process will be deemed lawful.

Whilst MAR specifies many of the conditions that a person making a market sounding must comply with to gain the benefit of this safe harbour, the detailed arrangements, systems and procedures (including certain prescribed form templates) are contained within Technical Standards.

It is not only the person making the disclosure who needs to comply with certain procedures. There is a separate set of guidelines issued by the European Securities and Markets Authority (“ESMA”) for recipients of market soundings.

This note explains who can make a market sounding and the procedures and processes they will need to follow and have in place under MAR. It also outlines how a person may elect whether or not to receive a market sounding and what they need to do if they decide to receive them. Whilst MAR has direct effect in all EU member states, this note is based on the operation of MAR in the UK.





Background

What is a market sounding?

Article 11 of MAR provides that a market sounding comprises the communication of information, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as its potential size or pricing, to one or more potential investors.

Examples of market soundings include situations in which:

- a sell-side firm has been in discussions with an issuer about a potential transaction, and it has decided to gauge potential investor interest in order to determine the terms that will make up a transaction;
- an issuer intends to announce a debt issuance or additional equity offering and key investors are contacted by a sell-side firm and given the full terms of the deal to obtain a financial commitment to participate in the transaction; or
- a sell-side is seeking to sell a large amount of securities on behalf of an investor and wants to gauge potential interest in those securities from other potential investors.

Who can make a market sounding?

Under MAR, market soundings may only be made by certain people known as a disclosing market participant (“**DMP**”). A DMP may be:

- (a) an issuer;
- (b) a secondary offeror of a financial instrument, in such quantity or value that the transaction is distinct from ordinary trading and involves a selling method based on the prior assessment of potential interest from potential investors;
- (c) an emission allowance market participant (but this provision does not apply until 3 January 2018); or
- (d) a third party acting on behalf, or on the account, of a person referred to in (a), (b) or (c) above.

In addition, MAR provides that on a takeover or merger a disclosure of inside information by an offeror to the holders of target securities will also constitute a market sounding provided that:

- (a) the information is necessary to enable the holders of target securities to form an opinion on their willingness to accept the offer; and
- (b) the willingness of holders of target securities to accept the offer is reasonably required for the decision to make the offer,

so that such an offeror is also a DMP for the purposes of MAR.

The safe harbour

Under MAR, a disclosure of inside information other than in the normal exercise of a person's employment, profession or duties is unlawful. Where a disclosure occurs as part of market sounding, Article 11(4) of MAR provides that it will be deemed to be made in the normal exercise of a person's employment, profession or duties provided that the DMP complies with certain provisions. In this way, if inside information is imparted in the course of a market sounding, the DMP will not be making an unlawful disclosure.

The principal obligations that a DMP must comply with to gain the protection of the safe harbour are contained in Articles 11(3) and 11(5) of MAR, but these are supplemented by further provisions set out in the following Technical Standards:

- Commission delegated regulation 2016/960 – the Regulatory Technical Standards which set out the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings (the “**RTS**”); and
- Commission delegated regulation 2016/959 – the Implementing Technical Standards which detail the systems and notification templates to be used by disclosing market participants and the format of records (the “**ITS**”).

While compliance with these procedures will result in any related disclosure of inside information being deemed to be lawful, there is no presumption that

market participants who do not comply will have unlawfully disclosed inside information. A DMP that does not comply with the procedures (see “The MSR process” below), or a person who is not a DMP under MAR (see “Who can make a market sounding”, page 4), may still be able to demonstrate that a disclosure of inside information occurred in the normal exercise of employment, profession or duties. Whether or not there has been a breach will need to be analysed in light of all relevant provisions of MAR.

There are also certain procedures set out in separate guidelines issued by ESMA (the “**Guidelines**”) for a person who receives a market sounding (a market sounding recipient (“**MSR**”) to follow but, again, these are not mandatory (see “The Guidelines”, page 10).

How can a market sounding be made?

Market soundings may be made orally, in physical meetings, by audio or video telephone calls, or in writing, by mail, fax or electronic communications.

If made by telephone, recorded lines must be used where available and the MSR must consent to the recording in advance. If a recorded line is not available, written minutes or notes of the call must be drawn up. The content of those minutes/notes is prescribed by both the RTS and ITS – see “Records of communications”, page 8.

As part of its overall procedures (see next paragraph), a DMP must give effect to the above and ensure that persons working for the DMP (under a contract of employment or otherwise) only use equipment provided by the DMP to send and receive telephone calls and electronic communications for the purposes of market soundings.

Systems and procedures

The RTS expressly provides that a DMP must establish procedures for conducting market soundings that comply with MAR. These procedures must describe the manner in which market soundings are conducted and must be regularly reviewed and updated where necessary. The procedures are subject to certain record keeping requirements (see “Record keeping formalities and inspection”, page 9).

The DMP process

Assess whether the sounding contains inside information

The first thing that a DMP must do is to consider whether the market sounding will involve the disclosure of inside information. The DMP must make a written record of its conclusion and the reasons for it. This written record will have to be provided to the FCA if requested.

The obligation applies not just at the outset of a market sounding, but to each disclosure of information throughout the course of a market sounding. The DMP must therefore update its written records accordingly.

Whether the market sounding contains inside information or not will affect the procedures to be followed in respect of it. Importantly, where the sounding does include inside information, the DMP will be under an obligation to advise the MSR when that information ceases to be inside information – see “Obligation to say when information ceases to be inside”, page 8.

Notwithstanding the duty on a DMP to assess whether a sounding contains inside information, an MSR must also make its own assessment and, as part of the market sounding process prescribed by MAR, the DMP is under a duty to make the MSR aware of this responsibility – even if the DMP has concluded that the sounding does not include inside information (see item (d) of the next section). This is because the MSR may possess other

information in its own right or from other sources that, when combined with information contained in a market sounding, amounts to inside information.

Set information must be provided in a pre-determined order

The procedures that a DMP has in place must provide for set information prescribed by MAR to be provided to the MSR in a set sequence.

The DMP must determine the standard set of information for each market sounding before it is conducted. The same set of information must then be used with all persons receiving that market sounding. MAR prescribes what each standard set of information must contain and the order that it must be provided in. No more than the prescribed information can be included. The requirements differ depending on whether the market sounding includes inside information or not.

The DMP must ensure that the same level of information is communicated to each person receiving the market sounding in relation to the same market sounding.

The prescribed requirements and sequence are as follows:



	Inside information included	Inside information not included
(a)	a statement clarifying that the communication takes place for the purposes of a market sounding	
(b)	where the market sounding is conducted by recorded telephone lines, or audio or video recording is being used, a statement indicating that the conversation is recorded and the consent of the person receiving the market sounding to be recorded	
(c)	a request for and a confirmation from the contacted person that the DMP is communicating with the person entrusted by the potential investor to receive the market sounding and the reply to that request	
(d)	a statement clarifying that, if the contacted person agrees to receive the market sounding, that person will receive information that the DMP considers to be inside information and a reference to the obligation under MAR for an MSR to assess for itself whether or not it has inside information as a result of the sounding	a statement clarifying that, if the contacted person agrees to receive the market sounding, that person will receive information that the DMP does not consider to be inside information and a reference to the obligation under MAR for an MSR to assess for itself whether or not it has inside information as a result of the sounding
(e)	where possible, an estimation of when the information will cease to be inside information, the factors that may alter that estimation and, in any case, information about the manner in which the MSR will be informed of any change in such an estimation	<i>no requirement</i>
(f)	a statement informing the MSR that: <ul style="list-style-type: none"> – he is prohibited from using that information, or attempting to use that information, by acquiring or disposing of, for his own account or for the account of a third party, directly or indirectly, financial instruments relating to that information; – he is prohibited from using that information, or attempting to use that information, by cancelling or amending an order which has already been placed concerning a financial instrument to which the information relates; and – by agreeing to receive the information he is obliged to keep the information confidential <p>(whilst required by the RTS, the obligation to inform a proposed MSR of these matters before a sounding is also contained within Article 11(5) of MAR)</p>	<i>no requirement</i>
(g)	a request for the consent of the MSR to receive inside information and the reply to that request (whilst required by the RTS, the obligation to obtain consent before a sounding is also contained within Article 11(5) of MAR)	
(h)	where the consent required is given, the information being disclosed for the purposes of the market sounding, identifying the information considered by the DMP to be inside information	where the consent required is given, the information being disclosed for the purposes of the market sounding

Records of who consents and who does not must be kept

For each market sounding conducted, the DMP must compile a list containing:

- the names of all persons to whom information has been disclosed in the course of the market sounding;
- the date and time of each communication which has taken place in the course of, or following, the market sounding; and
- the contact details of the persons receiving the market sounding for the purposes of the market sounding.

A DMP must also compile a list of any potential investors who have said they do **not** wish to receive market soundings in relation to either all potential transactions or particular types of potential transactions. The DMP must ensure that it does not communicate information for the purposes of market soundings to any such potential investor.

Obligation to say when information ceases to be inside

Under Article 11(6) of MAR, if information that has been disclosed in the course of a market sounding ceases to be inside information according to the assessment of the DMP, the DMP must inform the recipient of that fact as soon as possible. In such circumstances, the DMP is required to keep a record of the information given to the MSR and must provide it to the FCA on request. There is a prescribed template for this purpose at Annex III of the ITS.

The information that must be provided to an MSR in such circumstances is prescribed by the RTS and comprises:

- the identity of the DMP;
- an identification of the transaction subject to the market sounding;
- the date and time of the market sounding;
- the fact that the information disclosed has ceased to be inside information; and
- the date on which the information ceased to be inside information.

Notwithstanding this obligation on the DMP, MAR provides that the MSR needs to assess for itself whether it is in possession of inside information or when it ceases to be in possession of inside information (see “MSR to make own assessment”, page 11).

Records of communications

A DMP must keep records of all communications which have taken place between the DMP and all persons that received the market sounding for the purposes of the market sounding, including any documents provided by the DMP. The RTS specifies what must be kept for different methods of communication as follows:

- written communications – a copy of the correspondence;
- recorded telephone calls – the recordings of those conversations (provided that the persons to whom the information is communicated have given their consent to such a recording – see “How can a market sounding be made?”, page 5);
- meetings recorded by video or audio - the recordings of those meetings (provided that the persons to whom the information is communicated have given their consent to such a recording – see “How can a market sounding be made?”, page 5);
- unrecorded telephone calls or meetings – written minutes or notes of those calls or meetings, the detail of which is prescribed by the RTS as follows:
 - the date and time of the meeting or telephone conversation and the identity of the participants;
 - the details of all information relating to the market sounding which were exchanged between the DMP and the MSR in the course of the market sounding; and
 - any documents and materials provided by the DMP to the MSR in the course of the market sounding.

The ITS includes a prescribed template to be used for such written minutes or notes. There are two different versions depending on whether the market sounding includes inside information (Annex I) or does not (Annex II).

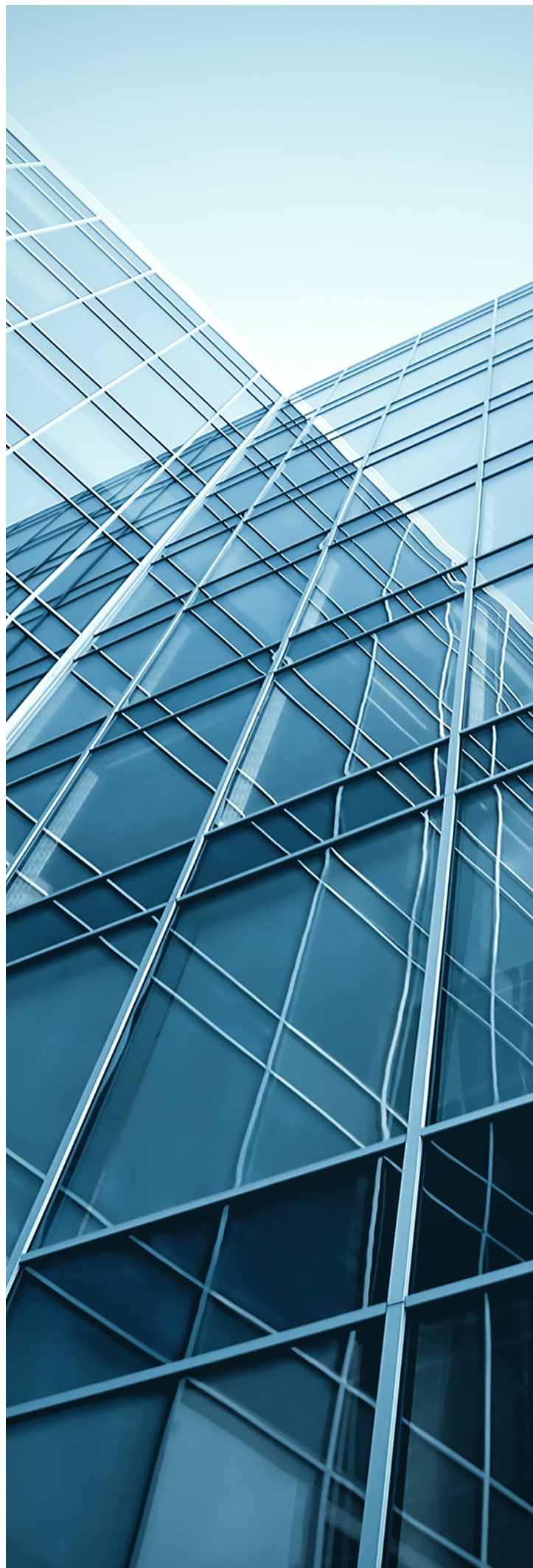
The RTS provides that the minutes or notes of any such telephone call or meeting must be drawn up by the DMP and signed by both the DMP and the MSR. If the DMP and MSR cannot reach agreement on the content of the written minutes or notes within 5 working days of the market sounding, the DMP must keep both a version signed by itself and a version signed by the MSR. If the MSR has not provided the DMP with a signed version within 5 working days of the market sounding, the DMP must keep a copy of the version signed by itself.

Record keeping formalities and inspection

All records that a DMP is required to keep in respect of market soundings must be kept on a durable medium that ensures accessibility and readability. They must be retained for 5 years and made available to the FCA on request.

The records subject to this requirement include:

- the DMP's procedures;
- the DMP's assessment of whether or not the sounding includes inside information;
- the standard set of information for each market sounding;
- the information on each person who has consented or not consented to receive market soundings;
- the records of each communication made as part of a market sounding; and
- the records relating to the assessment of when information ceases to be inside information.



The MSR process

As noted above, an MSR must also comply with certain requirements in respect of a market sounding. These obligations are set out in the Guidelines. The Guidelines themselves are not mandatory, but some of the obligations for an MSR arise directly from MAR, such as the obligation on an MSR to assess whether or not it is in possession of inside information. In other instances, the Guidelines reflect obligations created by the DMP process so that, if an MSR does not comply, a DMP would be unable to continue in respect of that MSR.

An MSR should note that, unlike in respect of a DMP, the market soundings regime does not provide a safe harbour for MSRs. If an MSR is in possession of inside information as a result of receiving a market sounding, it must not disclose that information unlawfully and must not deal in affected securities whilst in possession of that information. However, by following the Guidelines, MSRs should avoid the risk of committing a possible offence under MAR as a result of receiving market soundings which lead to their possessing inside information.

The Guidelines

MAR obliges ESMA to issue guidelines addressed to persons receiving market soundings regarding:

- the factors that such persons are to take into account when information is disclosed to them as part of a market sounding in order for them to assess whether the information amounts to inside information;
- the steps that such persons are to take if inside information has been disclosed to them in order to comply with the provisions of MAR concerning inside information and its unlawful disclosure; and
- the records that such persons are to maintain in order to demonstrate that they have complied with the provisions of MAR concerning inside information and its unlawful disclosure.

ESMA complied with this obligation by publishing the Guidelines. The purpose of the Guidelines is to ensure a common, uniform and consistent approach in relation to the requirements that MSRs are subject to. The Guidelines aim to reduce the overall risk of the unlawful disclosure of inside information communicated during a market sounding and to provide tools for Competent Authorities in the EU to effectively conduct investigations into suspected market abuse cases.

Communicating the wish not to receive market soundings

After being approached by a DMP, the MSR should notify the DMP whether or not it wishes to receive future market soundings. This may be:

- in relation to all potential transactions; or
- only particular types of potential transactions.

Internal procedures and staff training

If an MSR wants to receive market soundings, it will need to establish, implement and maintain internal procedures to:

- ensure that, where the MSR designates a specific person or a contact point to receive market soundings, that information is communicated to the DMP;
- ensure that the information received in the course of a market sounding is only communicated internally through pre-determined reporting channels and on a need-to-know basis;
- designate the person(s) within the MSR who will be responsible for assessing whether it is in possession of inside information as a result of the market sounding, and ensure that such person(s) is/are clearly identified and properly trained for that purpose; and
- manage and control the flow of inside information arising from a market sounding within the MSR and its staff in order for the MSR and its staff to comply with the provisions of MAR concerning inside information and its unlawful disclosure.

Additionally, the MSR should ensure that its staff who receive and process the information in a market sounding are properly trained on:

- its relevant internal procedures; and
- the prohibitions against insider dealing and its unlawful disclosure under MAR.

To prevent the above obligations being disproportionately burdensome, the Guidelines usefully provides that the policies and training put in place should be appropriate and proportionate to the scale, size and nature of the MSR's business activity.

MSR to make own assessment

An important obligation on an MSR is the need for it to assess for itself whether it is in possession of inside information or when it ceases to be in possession of inside information. This obligation is contained within MAR (Article 11(7)) and a DMP is under a duty to make an MSR aware of it (even if the DMP has itself concluded that the sounding does not contain inside information). The MSR's duty is expanded on in the Guidelines.

In order to comply with this duty, an MSR must independently assess whether it is in possession of inside information as a result of the market sounding. In doing so, the MSR should take into consideration all relevant factors, including:

- the DMP's assessment; and
- all information available to the individual(s) within the MSR who will carry out the assessment including information obtained from sources other than the DMP (but not including information behind any information barrier within the MSR) – this is because, whilst the sounding itself may not include inside information, when information it does contain is combined with other information available to the MSR it may result in inside information.



For similar reasons, the Guidelines makes it clear that, when a DMP advises an MSR that inside information included in a market sounding ceases to be such, the MSR must still assess for itself whether or not it is in possession of inside information, again taking all relevant factors into account as mentioned above.

If the MSR concludes that it is in possession of inside information as a result of a market sounding, it should identify all the issuers and financial instruments to which it believes that inside information relates so that it can comply with its obligations under MAR more generally.

Written minutes or notes

If an MSR participates in an unrecorded telephone call or meeting, the DMP must draw up written minutes or notes of that call or meeting (see ‘Records of communications’, page 8). The MSR must, within five working days of receiving such minutes or notes, either:

- sign the minutes or notes if it agrees with them; or
- if does not agree with them, provide the DMP with the MSR’s alternative signed version.

Various consents required and information to be provided

Whilst not expressly referred to within the Guidelines, an MSR will need to provide a DMP with various consents and information during the course of a market sounding in order for the DMP to comply with its own obligations and, without which, the DMP would be unable to continue with the sounding in respect of that MSR – this includes the need to:

- provide the DMP with consent to receive a market sounding;
- consent to a telephone call or meeting being recorded;
- agree a written minute or notes of an unrecorded telephone call or meeting or to provide an alternative signed version;
- provide the consents/confirmations required by the DMP under the set information stage of the DMP process; and
- provide the DMP with the information it needs to comply with its obligations, such as the contact details of the individuals receiving the market sounding.

Record keeping

An MSR should keep records of:

- its internal procedures referred to above;
- the notifications as to whether or not it wishes to receive a market sounding referred to above;
- its assessment and reasoning as to whether or not it has inside information referred to above;
- its assessment of related financial instruments referred to above; and
- the persons working for the MSR (under a contract of employment or otherwise) performing tasks through which they have access to the information communicated in the course of the market soundings, listed in a chronological order for each market sounding.

These records should be kept in a durable medium that ensures accessibility and readability. They must be retained for at least five years.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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