

## Market Newsletter 1/2023

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## Wash trades prohibited as market manipulation

**The Financial Supervisory Authority (FIN-FSA) wishes to draw the attention of traders to the types of transactions that may be wash trades and meet the identifying characteristics of market manipulation. Surveillance of wash trades is one of the priorities of the FIN-FSA's market abuse supervision in 2023.**

### What is a wash trade?

A wash trade refers to, for example, a situation in which a trader trades with themselves at a trading venue, such as the Helsinki Stock Exchange. In such cases, the buy and sell orders placed by the trader are executed at the trading venue as a trade, either in whole or in part. In addition, a wash trade refers to a situation in which the same person is the investment decision-maker on both the buying and selling sides of the executed trade. Thus, for example, situations in which a person makes the investment decision in a trade on behalf of both themselves and a company they own, or on behalf of a family member by power of attorney, may be wash trades.

### Regulation of wash trades

The purpose of the regulation of market manipulation is to promote market transparency and strengthen investors' confidence in the securities markets and the parties operating in them, as well as to ensure that market participants can act on the same terms and based on the same information. Market manipulation is defined in Article 12 of the Market Abuse Regulation (EU No 596/2014) and prohibited in Article 15.

Market manipulation means, among other things, placing trades or orders that give, or are likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument. Annex I of the Market Abuse Regulation lists a number of illustrative indicators to be taken into account when assessing whether trading is misleading.<sup>1</sup>

### Misleading nature of wash trades

The misleading nature of wash trades arises from the fact that other market participants assume that the trades are between two unrelated parties who have made their investment decisions separately. In wash trades, this has not actually happened. Market participants must be able to trust that the information available from the market and the trades executed there are true and genuine.

Wash trades artificially increase the trading volume of a financial instrument, creating a misleading picture of supply and demand, which is particularly evident with thinly traded financial instruments. Wash trades may also affect the price of a financial instrument, but price change is not a prerequisite for the identifying characteristics of market manipulation to be met.

### Care must be taken when placing orders

The FIN-FSA emphasises that Market Abuse Regulation's prohibition on market manipulation applies to all entities operating in the securities market, irrespective of whether an entity operating professionally or a private individual engaged in investment activity is involved.

Before placing a buy or sell order, traders must always make sure that an order placed will not be even partially executed on the trading venue with another one of their orders. To avoid trading with themselves, traders should pay attention to their existing orders and exercise care when placing new orders, for example by taking into account the limit prices of orders.

The FIN-FSA reminds traders that they should primarily contact their own broker if they have any questions or doubts with regard to trading.

### What may be the consequences of wash trades?

Supervision of securities market trading is extensive, involving not only the FIN-FSA but also, among others, trading venues and investment service providers that transmit and execute orders. Highly automated surveillance systems are comprehensively and effectively used in monitoring trading. Surveillance of wash trades is one of the priorities of the FIN-FSA's market abuse supervision in 2023.

The FIN-FSA may impose an administrative penalty payment for wash trades or submit a request for investigation to the police. Market manipulation is punishable under the Penal Code. Attempted market manipulation is also punishable. The criminal penalty may be a fine or up to two years' imprisonment or, in the case of aggravated market manipulation, up to four years' imprisonment.

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<sup>1</sup> With regard to wash trades, particularly indicator c)

*"whether transactions undertaken lead to no change in beneficial ownership of a financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances;"*

Annex II to Commission Delegated Regulation (EU) 2016/522 specifies indicator (c) of Annex I to the Market Abuse Regulation with, among other things, the following (point 3) a) practice

*"Entering into arrangements for the sale or purchase of a financial instrument, a related spot commodity contract, or an auctioned product based on emission allowances, where there is no change in beneficial interests or market risk or where beneficial interest or market risk is transferred between parties who are acting in concert or collusion — usually known as 'wash trades'."*

### More on this topic

- ❖ [Market Abuse Regulation \(EU No 596/2014\)](#)
- ❖ [Commission Delegated Regulation \(EU\) 2016/522](#)

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## Financial Supervisory Authority reminds entities: ensure EMIR reporting of derivatives

As of 12 February 2014, the EU's European Market Infrastructure Regulation (EMIR)<sup>2</sup> has required parties to derivatives contracts to report their derivatives contracts to a trade repository (EMIR reporting). The data on derivative contracts in trade repositories are made available to the FIN-FSA and other authorities for supervision of the derivatives market. Data from trade repositories is increasingly used in supervision as different authorities move towards a more data-driven approach to supervision, and therefore more attention is also being paid in supervision to the high quality of data<sup>3</sup>. In its recent supervisory practice, the FIN-FSA has observed some significant inadequacies<sup>4</sup> in EMIR reporting and therefore further reminds Finnish entities separately of their EMIR reporting obligations.

### What is EMIR reporting?

Article 9(1) of EMIR requires counterparties to derivative contracts to ensure that the details of any derivative contract they have concluded and of any modification or termination of the contract are reported to a trade repository. The details must be reported to a trade repository no later than the working day following the conclusion, modification or termination of the contract.

EMIR reporting applies both to financial counterparties, as separately defined in the Regulation, and to non-financial counterparties, i.e. to *all other entities* that enter into derivative contracts. It is also worth noting that details must be reported not only of over-the-counter (OTC) derivatives – such as interest rate and currency swaps – but also of listed derivatives. Details of securitised derivatives such as warrants need not be reported, however.

Details of derivative contracts are not reported to the FIN-FSA, but to a trade repository registered or recognised under the Regulation. The European Securities and Markets Authority (ESMA), which supervises trade repositories, maintains a [register](#) of such trade repositories. More detailed [information](#) of the content of the reporting is available of ESMA's website.

<sup>2</sup> Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories

<sup>3</sup> [ESMA finds data quality significantly improves under new monitoring approach \(europa.eu\)](#)

<sup>4</sup> [Administrative fine imposed on S-Bank Plc for failures in reporting on derivatives contracts](#) and [Administrative fine imposed on Bank of Åland Plc for failures in reporting on derivatives contracts](#)

## Double side reporting

EMIR reporting is double-sided, meaning that both parties to a derivative contract are obliged to ensure that they fulfil their reporting obligation on their own behalf. In practice, there is one notable exception to this double-sided approach: According to Article 9(1a) of EMIR, a financial counterparty has a reporting obligation *on behalf of both parties* when it enters into an OTC derivative contract with a non-financial counterparty that is not subject to the clearing obligation<sup>5</sup> under the Regulation. A notable feature of this exception, however, is that it is not applicable to listed derivatives.

In practice, however, parties subject to the reporting obligation are not themselves required to report the details of their derivative contracts to a trade repository. Article 9(1f) of EMIR allows a counterparty to delegate the reporting to the other party to the derivative contract or to a third party, such as a reporting service provider. Delegating EMIR reporting in this way does not, however, remove the responsibility of a party subject to the reporting obligation to ensure that the details are, in practice, correctly reported to the trade repository, as both the European Commission and ESMA have emphasised<sup>6</sup>.

## Group exception

There are no exceptions to EMIR reporting due to, for example, the low level (number or nominal value) of a party's derivative contracts. The only exception is that groups where the parent company is a non-financial counterparty may, under certain conditions, not report intra-group derivative contracts. The FIN-FSA must also be notified in advance of the use of the exception. The European Commission has, however, also proposed to remove this exception<sup>7</sup>.

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## Updates to the FIN-FSA's prospectus inspection process

The FIN-FSA is updating on its website the guidelines on prospectus applications and prospectus inspection. The updates relate to streamlining the prospectus inspection process and the use of an AI tool in prospectus inspection. Preparers of prospectuses are requested to pay attention to, among others, the following points:

### Prospectus application and comments on prospectus

- ❖ An application for the approval of a prospectus is submitted to the FIN-FSA Registry. It is considered to have arrived on the day in question when it has arrived during the Registry's opening hours, i.e. by 4.00 p.m. on weekdays (by 1.30 p.m. on Maundy Thursday and New Year's Eve). An application arriving later

<sup>5</sup> For more on EMIR, including the clearing obligation, see [EMIR - Regulatory framework - www.finanssivalvonta.fi](http://www.finanssivalvonta.fi)

<sup>6</sup> There are no specific provisions on the delegation of the reporting obligation, but the European Commission (see II.4 [EMIR: Frequently Asked Questions](#)) and ESMA (see TR Question 8 [Questions and Answers](#) Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)) have emphasised that, irrespective of delegation, the counterparty itself is still responsible for reporting.

<sup>7</sup> Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) No 648/2012, (EU) No 575/2013 and (EU) 2017/1131 as regards measures to mitigate excessive exposures to third-country central counterparties and improve the efficiency of Union clearing markets, COM/2022/697 final, [EUR-Lex - 52022PC0697 - EN - EUR-Lex \(europa.eu\)](#)

than this is considered to have arrived on the next working day. In addition to the Registry, an application may also be submitted directly to the prospectus inspectors.

- ❖ We recommend using [secure email](#) in the prospectus process.
- ❖ The draft prospectus and cross-reference lists must be submitted at least in Word format.
- ❖ Cross-reference lists should be prepared at a sufficiently detailed level. We recommend using the cross-reference list template formats published on the FIN-FSA's website, as this streamlines the FIN-FSA's prospectus inspection process.
- ❖ The application must include contact person(s) for commenting on the prospectus and provide contact details for invoicing.
- ❖ Responses to comments of the FIN-FSA and an edited version of the prospectus must be submitted to the FIN-FSA Registry in addition to those processing the prospectus.
- ❖ The final, approved version of the prospectus is submitted to the FIN-FSA in both pdf and Word formats. The prospectus preparer must ensure that the hyperlinks to the referenced documents work correctly.
- ❖ The FIN-FSA issues prospectus approval decisions within office hours. Decisions are issued electronically signed by e-mail.
- ❖ Instructions for submitting prospectuses to the register of prospectuses can be found on the FIN-FSA's [website](#).

### Specific issues

- ❖ Please contact the FIN-FSA before filing a prospectus application so that any questions and the need for arranging a prospectus meeting can be assessed. Particularly if the prospectus concerns a merger, demerger or another corporate transaction, presents pro forma financial information or involves other special characteristics, such as a need to diverge from the language requirements for a prospectus, we request that you contact the FIN-FSA well in advance before filing an application. Companies preparing for an initial public offering typically introduce themselves to the FIN-FSA before filing a prospectus application.
- ❖ In prospectuses on share issues, please provide the justifications of the working capital statement with the application.
- ❖ When applying lighter prospectus requirements (EU Growth prospectus, wholesale prospectus and the simplified disclosure regime for secondary issuances), the justifications for the application of these requirements must also be presented.
- ❖ If the prospectus subject to the application is considerably similar to another prospectus already approved by the FIN-FSA, please provide a redline (track changes) version against the previously approved prospectus.
- ❖ When requesting notification of a prospectus, we recommend that a more precise schedule be agreed in advance.
- ❖ If a prospectus is submitted to the FIN-FSA for approval with material deficiencies, the inspection period will not begin until the prospectus has been supplemented with the missing information.

More detailed information is available on the FIN-FSA's website at [Offering of securities and prospectuses](#).

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## Financial reporting enforcement results in Europe 2022

In March 2023, the European Securities and Markets Authority (ESMA) published its annual report [2022 Corporate reporting enforcement and regulatory activities](#). The report provides an overview of the ESMA-coordinated activities in 2022 of European national accounting enforcers.

The report is clearly divided into three parts:

1. enforcement of financial reporting (including IFRS enforcement and enforcement of alternative performance measures)
2. enforcement of non-financial reporting
3. ESEF reporting.

In the report, ESMA provides companies, their audit committees and auditors with recommendations and examples of how they can improve financial reporting in the future. The recommendations are based on ESMA's assessment of how the companies have complied with IFRS standards, regulations related to non-financial information, and ESMA's guidelines and statements.

In 2022, national enforcers examined the financial statements or interim reports of 640 listed companies as part of their regular IFRS enforcement. These led to enforcement actions against 225 companies, which represents 38% of the companies reviewed. Enforcement actions related to recognition and measurement accounted for 13% of the total, while actions relating to disclosures accounted for 25%. Enforcers identified most shortcomings in the areas of accounting for financial instruments, impairment of non-financial assets, presentation of financial statements and revenue recognition. In addition, enforcement highlighted, in particular, the need to improve the disclosures of climate-related matters in financial statements. This work will continue as part of the enforcement of the European common enforcement priorities in the 2022 financial statements.

Financial reporting enforcers also examined non-financial information disclosed by 403 companies. This represents around 18% of issuers required to provide this information. Enforcement actions were taken in relation to 100 companies.

In addition, enforcers examined 521 management reports to assess compliance with ESMA's APM Guidelines. Based on these, enforcement actions were taken in relation to 89 companies, constituting an action rate of 17%.

In 2022, ESMA also promoted the development of financial reporting through many actions. These actions included:

- ❖ ESMA's [statement](#) Implications of Russia's invasion of Ukraine on half-yearly financial reports
- ❖ ESMA's [statement](#) Transparency on implementation of IFRS 17 *Insurance Contracts*
- ❖ ESMA's [assessment and statement](#) to the EU Commission on EFRAG's draft *European Sustainability Reporting Standards (ESRS) Set 1*
- ❖ [ESEF XBRL taxonomy files 2022](#) and [ESEF Reporting Manual update](#)

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## Topical matters at ESMA

On 20 March 2023, ESMA delivered to the European Parliament and Council a [letter](#) in which ESMA has raised its concerns with proposed changes to the insider list regime in the Markets Abuse Regulation.

On 28 March 2023, ESMA published a [statement](#) on the classification of derivatives on fractions of shares.

European Supervisory Authorities [invited comments](#) on a consultation paper setting out the proposed Regulatory Technical Standards related to the Sustainable Finance Disclosure Regulation.

On 10 May 2023, ESMA [announced](#) that it has decided to postpone to 2024 the amendment of the 2023 ESEF-RTS (European Single Electronic Format Regulatory Technical Standard).