AFG-ASFFI

BR/EP-n°1053/Div.

M. Fabrice Demarigny
Secretary General
Committee of European Securities Regulators
11/13 Avenue de Friedland
75008 Paris
France

28 February 2003

Dear Sirs

**Comments of the French Asset Management Association (AFG-ASFFI) on the second call for evidence of CESR on the market abuse directive**

We are grateful to you for giving us the opportunity to comment on the second call for evidence on the market abuse directive.

AFG-ASFFI represents the French asset management industry. The latter manages nearly € 1,400 billion of assets (4th in the world) representing approximately the French GDP including € 860 billion through collective investment schemes and the balance in the form of discretionary portfolio management.

Our members are particularly interested in implementing measures related to the definition of 'Accepted market practices' because, if those definitions are not sufficiently wide and clear, many transactions carried out by our members that are currently considered to be legitimate may be curtailed because of fears that they may be illegal. This could have a major negative impact on the ability of the asset management industry to function effectively in the interests of its clients.

We have been therefore pleased to note, in paragraph 46 of CESR's Advice on Level 2 Implementing Measures for the proposed Market Abuse Directive, that:

> CESR is aware of the fact that the proposed directive lays down a 'defence' in the part of the definition on market manipulation regarding the transactions or orders to trade discussed in part 1 of this part of the paper. The defence implies that the transactions or orders to trade in question will not be regarded as manipulative behaviour if "…the person who entered into the transactions or issued the orders to trade establishes that his reasons for so doing are legitimate and that these transactions or orders to trade conform to accepted market practices on the regulated market concerned."

We believe that there are three basic types of situation where asset managers trying to act in the best interests of their clients will be worried that transactions in the interests of their clients may be inappropriately interpreted as market manipulation. These are:

1) Asset managers seeking to achieve best execution on behalf of clients – see Appendix 1 for examples

2) Asset managers obliged to effect a transaction in a security without any regard to likely price changes - see Appendix 2 for examples

3) Asset managers seeking to fairly value client portfolios - see Appendix 3 for example

***We therefore strongly urge CESR to include the examples given in Appendices 1, 2 and 3 as examples of legitimate reasons and accepted methods of operation that may be invoked by market participants. We emphasise, however, that the examples given in Appendices 1, 2 and 3 are not intended to be exhaustive and we strongly believe that any examples specified in the CESR guidelines should not be considered to be exhaustive.***

We believe these examples to be fully within the terms of the mandate given to the Committee of European Securities Regulators by the European Commission and consider that it would be helpful if they were included in the consultation paper that CESR intends to publish in April.

We remain at your disposal for any additional information which might prove useful to you.

Yours faithfully,

Eric PAGNIEZ
Délégué général adjoint
AFG-ASFFI

**APPENDIX 1**

**Examples of situations where asset managers seek to achieve best execution on behalf of clients**

(i) If an asset manager expects the price of a security in which clients have a large holding to fall he may decide to decrease the holding substantially. He will not be achieving a good price if he instructs the broker to sell it all as soon as possible. Indeed, unless he has confidence in the broker's ability to keep information confidential, he may prefer not to disclose the full size of the intended order even to the broker. The ability to give partial orders is a vital element of "best execution" as currently understood. It may, however, be considered as giving a misleading signal to the market and thus prohibited under the proposed directive unless such behaviour is defined as an accepted method of operation in the proposed guidelines. The same point applies to the acquisition of large holdings for clients.

(ii) If an asset manager wishes to acquire or sell a substantial amount of a security on behalf of a client he may divide the transaction into several small orders and buy/sell in smaller quantities at different times in different markets in order not to move the price against the investor. We believe that an asset management company has a duty to their client (the investor) to try to ensure that the price does not move against the investor and that such "tactics", which do not mislead the market but do not give the whole picture, are legitimate. We therefore suggest such behaviour is defined as an accepted method of operation in the proposed guidelines.

(iii) If a security trades in two different markets or if two closely related securities, or a derivative and its underlying security, trade in two different markets, it may be possible for an asset manager to maintain a client's effective exposure to a security and obtain a benefit for the client. Such arbitrage is a useful means of enhancing client returns. Indeed for some types of funds it is an important part of their investment strategy. Such arbitrage might be prohibited under the proposed directive unless such behaviour is defined as an accepted method of operation in the proposed guidelines.

## APPENDIX 2

**Examples of situations where asset managers may be obliged to effect a transaction in a security without any regard to likely price changes**

(i) Index funds are obliged under the terms of their mandate or fund prospectus to track a specified index. Changes in the composition of the index therefore necessitate purchases or sales in the fund regardless of price expectations.

(ii) UCITS are subject to "risk dispersal" limits as regards the proportion of a portfolio that may be invested in a single security (currently 5% with member states having the right to raise the limits to a certain extent in certain circumstances). Price increases in a security may therefore necessitate partial reduction of a holding regardless of price expectations.

(iii) Risk control limits imposed by the client or as an integral part of the asset manager's risk management process may oblige an asset manager to reduce or increase the holding of a security regardless of price expectations.

(iv) Tax considerations may have a significant impact on the total net returns of a portfolio. It may be imperative for an asset manager to realise a capital gain before a particular date in order to enable his client to benefit from tax allowances or loss relief. Such tax related transactions may be effected with little consideration of likely price movements, especially if the intention is to repurchase the security soon afterwards at a similar price to that at which it was sold.

(v) An asset manager may have agreed with clients to run all portfolios under management closely in line with each other or the asset manager may have a policy of keeping all portfolios under management closely aligned in order to be able to control them better ("good housekeeping"). When the asset management company wins a mandate from a new client, transactions may be effected for the new client's portfolios that have no regard to likely price movements.

## APPENDIX 3

**Asset managers seeking to fairly value client portfolios**

If an asset manager wishes to fairly value an illiquid security in a client portfolio but considers the last quoted market price as unrealistic he may try to execute a small transaction in order to stimulate the price formation process to generate a more realistic price. In such cases there is no genuine buying or selling intention. If the directive prohibited such behaviour it could lead to unrealistic pricing of securities in client portfolios, especially small company funds.