

Response to CESR's consultation on Market Abuse, Level 3 – preliminary CESR guidance and information on the common operation of the Directive

Dear M. Demarigny,

Market Abuse Directive: Level 3 - Preliminary CESR guidance and information on the common operation of the Directive

The International Swaps and Derivatives Association ("ISDA") welcomes the opportunity to comment on the paper published by the Committee of European Securities Regulators ("CESR") under the title 'Market Abuse Directive: Level 3 - Preliminary CESR guidance and information on the common operation of the Directive' (Ref: CESR/04-505).

Accepted market practices

We agree with CESR that it is correct to focus on practices rather than activities. In addition, we agree that it is only necessary to address specific practices which, unless recognised as an accepted market practice, would fulfil the definition of market manipulation.

We note that CESR has only identified a limited number of practices for consideration as accepted market practices. We presume that this recognises that the definition of market manipulation is not as broad or all encompassing as some previous remarks by CESR might have suggested. In particular, as the examples of market manipulation show, it is important to take into account the purpose of the transaction when seeking to assess whether it in fact gives false or misleading signals or secures prices at abnormal or artificial levels. For example, it is difficult for an order placed for a legitimate investment purpose to create false or misleading signals as to supply or demand or price; the order is part of the prevailing supply and demand mix.

Market manipulation

As CESR will be aware, the "signals" set out in the implementing measures also describe many legitimate practices which do not constitute market manipulation. Therefore, it is essential that the descriptive examples of market manipulation only cover behaviours that unequivocally constitute manipulation.

For example, the description of wash trades should, like the other examples in that section, make clear that it covers transactions entered into in order to give the impression of activity or price movement. For example, it is not enough just to exclude

repos and stock loans. A party may transfer securities as collateral in other transactions as well.

Paragraph 4.14(b) appears to go beyond the scope of article 1(2)(c) of the directive which only covers the dissemination of information. This paragraph appears to cover activities which only indirectly lead to the dissemination of information, perhaps by third parties.

Possible signals of suspected market abuse

We welcome the introduction of a standard reporting format. CESR members should seek to introduce arrangements so that firms can use the same form to make associated reports for anti-money laundering purposes, in cases where the suspicions of market abuse also indicate criminal activity.

We agree that firms should have appropriate systems and controls. However, CESR should make clear that firms are not required to put in place systems to detect market abuse or to combine information held in different parts of the firm which, collectively, might indicate that particular activities amount to market abuse. This would be unduly burdensome, especially in large firms. For example, it would be unduly burdensome if firms had to monitor all their clients' transactions with a view to determining whether there is any unusual concentration among a small number of clients (paragraph 5.8(b)). A firm might happen to notice this; it should not be required actively to identify it. Similarly, firms should not be required to have systems which retrospectively review trading patterns before corporate announcements (paragraph 5.9(d)). Exchanges and other centralised authorities are best placed to monitor and initiate investigations of these behaviours.

In addition, CESR should confirm that the firm's duties only extend to reporting transactions executed or arranged by the firm itself. Firms are not obliged to review or report on transactions observed by them in the market and executed or arranged by others, even if they consider that they might be suspicious. The duty falls on the executing or arranging firm.

CESR rightly recognises that the proposed "signals" are not determinative and that a transaction may not necessarily be suspicious simply because it matches one or more of the indications. This should be emphasised in any final paper.

We hope that this letter is of assistance and would be pleased to discuss any comments which CESR or its members may have on it.