

TO: CESR
Committee of European Securities
Regulators
11-13 Avenue de Friedland
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Milan, 2nd February 2007

ANASF COMMENTS ON

“Market Abuse Directive Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market

ANASF (Associazione nazionale promotori finanziari) is the main professional association which represents the Italian financial advisors (promotori finanziari) and has about 12.000 members.

ANASF welcomes the opportunity to participate to the Public Consultation on the Market Abuse Directive and to submit its comments about the draft guidance “Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market”.

There is one major theme that Anasf would like to comment: *when information conveyed by a client and related to a client order is considered “inside information”*.

According to article 1.1 par. 3 of Directive 2003/6/EC (and Italian law “Testo unico delle disposizioni in materia di intermediazione finanziaria, D.Lgs. 24 febbraio 1998, n. 58 article 181, par. 5 as modified with L. 18 aprile 2005, n. 62, art. 9)

“For persons charged with the execution of orders concerning financial instruments, ‘inside information’ shall also mean information conveyed by a client and related to the client's pending orders”

Information conveyed by a client and related to the client's pending orders is inside information when:

- a. *it “ is of a precise nature”,*
- b. *it “ relates directly or indirectly to one or more issuers of financial instruments or to one or more financial instruments”,*

- c. “ if it were made public, it would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments”.

The practices of

- acquiring or disposing of, or trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates
- disclosing that information to any other person unless such disclosure is made in the normal course of the exercise of his employment, profession or duties;
- recommending or inducing another person, on the basis of that information, to acquire or dispose of financial instruments to which that information relates

are forbidden and commonly known as “front running”.

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According to CESR Market Abuse Directive - Level 3 - first set of CESR guidance and information on the common operation of the Directive 5.9 Article 5.9. 2 f) a possible signal of insider dealing occurs when:

“employees' own account transactions and related orders (are) timed just before clients' transactions and related orders in the same financial instrument” (see also Italian Consob Comunicazione n. DME/5078692, 29 November 2005, Section B, Part I, lett. f).

That guidance was clearly inadequate to determine whether there could have been an illegal use of inside information related to client pending orders.

It is welcome a new set of guidance to clarify the subject.

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The declared scope of the second set of guidance is to amplify the definitions and descriptions in the Level 1 and 2 Directives/Regulations and accompanying recitals: in particular the guidance explicit purpose is to clarify when are met the conditions on the precise nature and on the price sensitivity to determine that the client's pending order is inside information.

In Italy the practice of *front running* is actually unusual: Consob annual report for 2005 informing about the types of inside information in the reports transmitted to the judicial authorities on suspected cases of insider trading affirms that in the period 1997 – 2005 there have been seven cases of suspected front running practices (1997: 0; 1998: 0; 1999: 0; 2000: 1; 2001: 2; 2002: 1; 2003: 2; 2004: 0; 2005: 1).

And the illegal practice danger should be highly reduced with the implementation of MiFID Directive.

MiFID requires an investment firm to take all reasonable steps not to misuse information related to pending client orders^{1 2}. On the other side MiFID indicates that the

¹ Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for

legitimate business of buying and selling financial instruments would not in itself constitute a misuse of information³.

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To determine when a pending client order could be inside information (and buying and selling of financial instruments become misuse of information) CESR suggests that the relevant elements are related to:

- orders parameters (price, quantity, execution timing, identity of the client),
- market microstructure,
- market impact of the order (mainly market liquidity)

About **price sensitivity** CESR assumes that it is likely to be influenced by many elements

- in a way that the greater the size of the order as compared with the average size of

investment firms and defined terms for the purposes of that Directive – Section 6 – Client order handling – Article 47 (Articles 22(1) and 19(1) of Directive 2004/39/EC) General principles

1. Member States shall require investment firms to satisfy the following conditions when carrying out client orders:

(a) they must ensure that orders executed on behalf of clients are promptly and accurately recorded and allocated;

(b) they must carry out otherwise comparable client orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this impracticable, or the interests of the client require otherwise;

(c) they must inform a retail client about any material difficulty relevant to the proper carrying out of orders promptly upon becoming aware of the difficulty.

2. (...).

3. An investment firm shall not misuse information relating to pending client orders, and shall take all reasonable steps to prevent the misuse of such information by any of its relevant persons.

² See also “whereas 78” of *Commission Directive 2006/73/EC*: For the purposes of the provisions of this Directive concerning client order handling, the reallocation of transactions should be considered as detrimental to a client if, as an effect of that reallocation, unfair precedence is given to the investment firm or to any particular client

³ See “whereas 78” of *Commission Directive 2006/73/EC*: Without prejudice to Directive 2003/6/EC, for the purposes of the provisions of this Directive concerning client order handling, client orders should not be treated as otherwise comparable if they are received by different media and it would not be practicable for them to be treated sequentially. For the further purposes of those provisions, any use by an investment firm of information relating to a pending client order in order to deal on own account in the financial instruments to which the client order relates, or in related financial instruments, should be considered a misuse of that information. However, the mere fact that market makers or bodies authorised to act as counterparties confine themselves to pursuing their legitimate business of buying and selling financial instruments, or that persons authorised to execute orders on behalf of third parties confine themselves to carrying out an order dutifully, should not in itself be deemed to constitute a misuse of information

orders in that market, the more likely it is to have influence on the price of the financial instrument;

- the liquidity of the market;
- in a way that the wider the bid-ask spread the more likely that an order may have an impact on the price (and the relationship with price limit for the order);
- in a way that the quicker the client wants the order executed the more likely there is to be a price impact (and the relationship with relevant or reference prices);
- the identity of the client;
- whether the order is likely to influence the behaviour of other market participants.

About **precise nature** CESR assumes the test is more likely to be satisfied

- the more defined are the order's, price limit and execution period;
- the more predictable the pattern of the trading behaviour of a client the more precise will be the nature of a particular order from that client.

Even if CESR remarks that an analysis can be made only on a case by case basis and emphasises that the guidance is indicative and not exhaustive, the risks of the guidance – related to the unspecificity of the suggested parameters- could be to deem as suspected cases of the illegal practice of front running, conducts otherwise (or until now) considered legitimate.

For example the dimension/size of the order, relevant with other parameters to judge the pending client order as inside information, could be determined when involving at least a certain amount of shares (or other financial instruments)⁴ with a certain market value, or when is exceeded a ratio between order dimension (and/or value) and average volume.

Alternatively it is possible to consider pending client orders inside information only when they can be treated as suspicious transactions according to CESR first set of guidance.

According to CESR *“unexpectedly large or unusual orders in a particular security – especially if the client is insistent that the order is carried out very urgently or must be conducted before a particular time specified by the client-”* are suspicious transactions ⁵.

CESR could clarify that only suspicious pending client orders (for example large and unusual orders) could be treated as inside information.

Similar consideration is possible about the price (a suspicious transaction occurs when *“the client specifically requests immediate execution of an order regardless of the price at which the order would be executed”*).

On the other side it seems overvalued the importance of the client identity –if not better explained-.

⁴ Nasd (United States National Association of Securities Dealers) considers in its Conduct Rules –IM-2110-3- Front Running Policy considers a quantitative approach relating to block transactions i.e. transactions involving 10,000 shares or more of an underlying security, or options or security futures covering such number of shares is generally deemed to be a block transaction

⁵ CESR – THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS – Market Abuse Directive – Level 3 – first set of CESR guidance and information on the common operation of the Directive, article 5.9. a)

Remembering cited past CESR guidance about suspicious transactions, the suggested test about the predictability of the trading behaviour of a client could qualify the pending client order as inside information when the requested transaction is significantly out of character with the client's previous investment behaviour.

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Concluding ANASF believes that more detailed guidance can help market transparency without affecting markets efficiency.

ANASF hopes that CESR will find these comments useful and remains at disposal for clarification.



The Chairman
Elio Conti Nibali