

Amsterdam, 16 December 2004

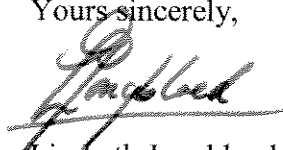
CESR - Secretariat
11 – 13 Avenue de Friedland
75008 Paris
France

Reference: Comments on the Level 3 – preliminary CESR guidance

Dear Sirs,

Please find enclosed the comments of the Netherlands Bankers' Association (NVB) Compliance Working Group on the consultation paper on Market Abuse Directive (MAD), Level 3 – preliminary CESR guidance and information on the common operation on the Directive.

Yours sincerely,



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Secretary Legal Affairs

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Comments on the Level 3 – preliminary CESR guidance and information on the common operation of the Directive

On 28 October 2004, CESR published a consultation paper on Market Abuse Directive (MAD), Level 3 – preliminary CESR guidance and information on the common operation on the Directive. CESR requests comments on its proposal by 31 January 2005. The Netherlands Bankers' Association Compliance Working Group welcomes this initiative and appreciates CESR's consultation process.

II and III Accepted Market Practices and Format of the table for assessing AMP's

Section II of the paper deals with Accepted Markets Practices (AMP's). Section III provides for a non-exhaustive list of factors to be taken into account by Competent Authorities/local regulators when assessing particular practices. One of the factors mentioned is the risk inherent in the relevant practice for the integrity of related markets in the relevant financial instrument within the whole Community.

In general, when reviewing relevant Market Practices (MP's), the local regulators should analyse the impact of the relevant MP and the possible acceptance of an AMP for cross-border consequences. Would an AMP in one country lead to problems for market practitioners in other jurisdictions? Will the level playing field be jeopardized?

Paragraph 2.6 seems to introduce a double test: the defence against an alleged infringement of the prohibition of market manipulation does not only require that a certain MP may be considered as an AMP, but in addition thereto there should be a legitimate purpose for making use of the AMP. Neither the definition of market manipulation nor the definition of accepted market practices as included in the Market Abuse Directive does allow the introduction of the requirement that there should be a legitimate purpose for making use of the AMP. Furthermore, such requirement would not contribute to legal certainty.

Paragraph 2.9 mentions that an AMP may apply to one or more jurisdictions. In the opinion of the Netherlands Bankers' Association Compliance Working Group, once a MP is accepted, in order to avoid cross-border issues, an AMP should, where appropriate, be accepted across the EU. More specifically, the AMP's set forth in Annex 1 (A) until and including (C) are related to MP's, which may also occur in other EU-Member States. We can not conceive any reason whatsoever, why these MP's would not be legitimate in other EU-Member States. This would enhance the endeavour of a single European market.

With regard to what is stated in paragraph 2.12, we note that it should be beyond any doubt that in case a market party is acting in full compliance with the rules and regulations of a regulated market (which is subject to the supervision of a competent authority) this should create a safe harbour.

IV Market manipulation

This section provides for examples of market manipulation that, in the view of CESR members, would breach the prohibitions on market manipulation contained in the MAD. Although such examples in itself may be very helpful for market participants in determining if certain practices are acceptable or not, paragraph 4.3 mentions ‘Therefore some unacceptable conduct set out in the examples may not actually be feasible in all market environments across Europe and therefore should not be read as universally applicable. Again, in order to safeguard consistency and a level playing field across Europe, it would be helpful to provide market practitioners with examples that are universally applicable (in any case applicable across the EU). The examples mentioned in paragraphs 4.11 – 4.14 could all be seen as universally applicable examples of unacceptable conduct by using wording such as: ‘give the impression, deliberately, colluding, exploiting, improperly, excessive etc.’. The addition in paragraph 4.10 ‘...although it is acknowledged that in some cases a practice may, in particular circumstances, have a legitimate purpose...’ is sufficient.

In response to what is stated in paragraph 4.14, it should be noted that the failure to properly disclose a price sensitive piece of information, which should be disclosed in a timely fashion already constitutes an infringement of article 6 of the Market Abuse Directive (as implemented by the relevant EU-member state). The dissemination of false and misleading information as included in the definition of market manipulation of the Market Abuse Directive assumes an act (opposed to an omission). Consequently, the mere failure to properly disclose a price sensitive piece of information should as such not be considered as the dissemination of false and misleading information.

V possible signals of suspected insider dealing or market manipulation transactions

Article 6.9 of the MAD requires ‘any person professionally arranging transactions in financial instruments who reasonably suspects that a transaction might constitute insider dealing or market manipulation shall notify the competent authority without delay’.

It is important to note that the investment firm is not required to acquire monitoring systems to detect trading patterns of possible insider dealing and market manipulation. Investment firms should use their existing systems. The monitoring process can be characterized as ‘passive monitoring’. Given the specific nature of these transactions, this notification requirement is very different from the disclosure obligation under the anti-money laundering legislation. It should be a smell test rather than an obligation to provide evidence. It is not the investment firm’s duty, nor is it equipped to act as a criminal investigation department. It is not the responsibility of the investment firm to investigate in detail if a transaction might constitute insider dealing or market manipulation. That is, after all, the responsibility of the securities regulator in the particular member state, which is also more qualified and better equipped to investigate this. The securities firm should only,

on a case-by-case basis, decide where there are reasonable grounds for suspicion concerning the relevant transaction.

As a consequence of the fact that an investment firm is not required to have active monitoring systems in place, the investment firm could only reasonably ascertain if 'a transaction might constitute insider dealing or market manipulation' in the retail market in case of so-called 'advice clients' (in which case there is communication between the client and the investment firm on the (proposed) securities order/transaction). When clients trade via execution-only media (e.g. internet banking), an investment firm is unable to ascertain if 'a transaction might constitute insider dealing or market manipulation'. The requirement to notify the regulator about suspicious transactions also does not apply to situations where transactions are arranged in a managed account agreement situation. In this case, it is the investment firm that initiates the transactions and not the client.

Paragraph 5.6 of the CESR Level 3 guidance states, inter alia, that 'investment firms should therefore not only notify transactions which they consider are suspicious at the time the transaction is carried out but also any transactions of which, in the light of subsequent events/information (for example publication of financial results, profits warnings or announcement of a take-over bids in relation to the security in question), they might retrospectively become suspicious'. Again, it should be noted that the investment firm is not required, nor equipped to actively monitor and/or investigate transactions. That's the responsibility of the securities regulator. Moreover, an associate of the investment firm receiving the order from the client is usually not aware of 'subsequent events/information'. It is not the duty of the associate to keep track of this kind of information. In addition, associates within an investment firm that do keep track of this kind of information are behind a Chinese Wall and are, in cases of non-public, price sensitive information, not allowed to share this information, in order to determine if 'a transaction might constitute insider dealing or market manipulation'.

The 'reasonable grounds for suspicion' would usually occur at the moment of communication between the client and the investment firm, in which case the associate of the investment firm becomes aware of certain information from the client that gives him/her 'reasonable grounds for suspicion'. Therefore, the instances as described in paragraph 5.6 would only in exceptional instances lead to a 'reasonable ground for suspicion'. Apart from issues regarding handling of sensitive information on a need-to-know basis within an investment firm, the regulators could not reasonably expect investment firms to combine bits of information on deals, stock prices, volumes and information about listed companies in order to ascertain if a transaction may constitute insider dealing or market manipulation.

In conclusion, investment firms should not be required to actively monitor or investigate certain transactions. After all, the securities regulator is much better equipped to investigate possible insider dealing and market manipulation and able to compare the volumes and prices of transactions in a particular security from other investment firms as well, thus getting an 'overview' of the 'possible case of insider dealing or market manipulation at hand.

Paragraph 5.9 provides some examples of indications of whether a transaction is suspicious. Although the title of paragraph 5.9 rightly mentions Possible Signals of Insider Dealing, it should be noted that some of the examples may, in certain circumstances, be considered as legitimate transactions. How should for example the situation described under 5.9 a) be distinguished from the pattern which is common practice in certain EU-Member States in case of subscription to securities issues with a member of the issue syndicate (with which not already a client relationship exists)? The same applies to the situation described under 5.9 c): how should this situation be distinguished from a normal market order?

The list of signals lacks any signal for insider dealing in financial instruments not being securities. Especially, in the area of prepositioning vis-a-vis front running in financial instruments not being securities further guidance is desirable.

Paragraph 5.8 and 5.10 rather provides guidance to the competent authority in the relevant EU-Member States than to investment firms subject to the notification requirement. The information, which is required in order to assess whether these possible signals do apply, is not available within the investment firms. Only the competent authority either disposes of or is authorized to generate with assistance of exchanges and trading platforms the information, which is required to perform the necessary assessments. In addition, some of the possible signals of market manipulation are quite likely to occur continuously in case of illiquid small and midcap funds, whereas we understand that it is not the intention that all these transactions will be reported.

The CESR guidance on suspicious transaction reporting also provides for an example of a reporting form. In this respect, it is uncertain what is meant by 'Identities of any other persons known to be involved in the transaction'? The reporting form should also provide clarification which parts of the requested information relates to the client that provides instructions to the investment firm to execute transactions in financial instruments and which information relates to the investment firm that has been instructed to execute such transactions.

Paragraph 5.1 mentions that 'any person professionally arranging transactions in financial instruments who reasonably suspects that a transaction might constitute insider dealing or market manipulation shall notify the competent authority without delay'. In practice, it makes sense to channel the reporting through the compliance officer of the investment firm. This would not only be practical for the investment firm itself, but also beneficial for the securities regulator that would have one contact person for these issues. Perhaps the possibility of reporting suspicious transactions through a certain officer within the investment firm (e.g. the compliance officer) should be mentioned in the guidance.