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Market Abuse Directive

Level 3 – first set of CESR guidance and information on the common operation of the Directive



Index

I Executive Summary

II Accepted Market Practices (AMP's)

III Format of the table for assessing AMP's

IV **Market Manipulation:** Types of practice that CESR members would consider to constitute Market Manipulation

V Common format and added guidance for reporting suspicious transactions



I. Executive Summary

- 1.1 CESR's first set of guidance at level 3 concentrates on three market facing issues that CESR members consider to be priorities. The priority areas cover accepted market practices in relation to market manipulation, guidance on what CESR members consider to constitute market manipulation and guidance and a common reporting format for reporting suspicious transactions.
- 1.2 Chapter two sets out the key issues facing CESR members when operating the Accepted Market Practices (AMPs) regime established in the directive. In chapter three, CESR has established a common format for the analysis of AMPs which will facilitate the consultation obligations placed upon CESR members.
- 1.3 Chapter four provides guidance to the market on types of practices that CESR members would consider to constitute Market Manipulation. They are described in non-legal terms and they are not intended to affect the scope of interpretation of the relevant directives and regulation.
- 1.4 Chapter five concludes the paper with guidance and a common format for reporting suspicious transactions. CESR's aim is to ensure that the directive obligation on reporting such transactions operates in a proportionate and effective manner.

II. Accepted Market Practices

- 2.1 In undertaking its level 3 work, CESR has been particularly mindful of the need to focus its energy on ensuring the proper operation of the regime for accepted market practices (AMPs) in relation to market manipulation. This is dealt with in this section of the paper.
- 2.2 It should be noted that the concept of accepted market practices also applies to the information which users of commodity derivatives markets would expect to be made public concerning commodity derivatives. This aspect of the Directive is not dealt with in this paper. However, CESR confirms that it is mindful of the need to ensure the smooth operation of AMPs in this field and will keep this under review.

Guidance Provided by the Directive and Level 2 Advice

- 2.3 Preamble 20 of the Directive 2003/6/EC states that "a person who enters into transactions or issues orders to trade, which are constitutive of market manipulation may be able to establish that the reasons for entering into such transaction or issuing orders to trade were legitimate and that the transactions and orders to trade were in conformity with accepted practice on the regulated market concerned."
- 2.4 Article 1(5) of the Directive 2003/6/EC defines Accepted Market Practices as practices "that are reasonably expected in one or more financial markets and are accepted by the competent authority in accordance with guidelines adopted by the Commission...".
- 2.5 These guidelines have now been set out in level 2 implementing measures in Directive 2004/72/EC. In article 2 of that Directive, competent authorities need to assess a particular market practice before accepting it against a non-exhaustive list of factors. Article 3 then sets out the process that the competent authority must follow which includes consultation and disclosure of the decisions.
- 2.6 It should be emphasised that accepted market practices in no way constitute safe harbours similar to those provided by Articles 7 and 8 of the Directive (which deal with share buy-backs and stabilisation). The intention of the accepted market practice concept is to avoid the penalising of behaviours which would constitute market manipulation under the effect based definition of market manipulation in Article 1(2)(a) of Directive 2003/6/EC, as under certain conditions such behaviours might be justified. However, to benefit from the defence provided, in addition to the transaction/order to trade conforming with an accepted market practice, the person who entered into the transaction or issued the order to trade must establish that their reasons for so doing are legitimate. In the absence of a legitimate purpose the accepted market practice defence would not be available.

Operational issues raised by the legal framework

- 2.7 The legal framework applicable to accepted market practices raises a number of operational issues that need to be dealt with by CESR and its members.

Process, consultation and disclosure

- 2.8 The decision as to whether a process constitutes an AMP or not, is a matter of national discretion. AMPs, therefore, are the responsibility of individual CESR members and so a practice which one competent authority considers is an AMP, may not be viewed as such by another. However, each member has a duty to consult, both nationally and with other competent authorities, and to disclose any market practices that they have accepted. There is also an obligation on CESR to publish the AMPs on its website. These will be published in the standard CESR format and a link provided to the national legal text.
- 2.9 In order to facilitate the implementation of the Directive, CESR members have, during the course of working on this paper, exchanged views on AMPs. It has been decided not to

publish the AMPs which are currently under consideration or have been agreed, as an annex to this paper. Instead, AMPs, once they have been recognised and have undergone the requisite national and European consultation process, are to be published on CESR's website. This means that information upon them can remain contemporaneous as would not be the case if they were published as a static annex. In the future, CESR through CESR-Pol, will exchange views on both existing and emerging AMPs to ensure that European market integrity is maintained.

Market practices versus activities

- 2.10 CESR has consistently made a distinction between practices and activities carried out in financial markets. The implementing measures at level 2 were based on advice CESR submitted to the Commission in August 2003 (CESR/03-212c). In paragraph 5 of that advice CESR stated that 'Activities' "would cover different types of operations or strategies that may be undertaken such as arbitrage, hedging and short selling. On the other hand, market 'practices' would cover the way these activities are handled and executed in the market."
- 2.11 In the view of CESR members, 'activities' are considered to be too broad to qualify for the status of accepted market practices. An 'activity' such as short selling or hedging could be undertaken in many different ways. If the activity is carried out in a way which does not constitute market manipulation, then the question of giving it accepted market practice status does not arise. On the other hand, if the 'activity' is carried out in a way which would constitute market manipulation, it is unlikely that a competent authority would be prepared to accept it as an accepted market practice. Hence to give an activity a blanket accepted market practice status would neither be meaningful nor desirable.
- 2.12 CESR members also considered the issues of whether certain more specific practices, such as crossing/pre-arranged trades, should be given accepted market practice status, subject to the condition that these practices should be undertaken according to the rules of the relevant regulated market applicable to their conduct. However, CESR members came to the conclusion that, in most of the cases considered, conduct of the practice in conformity with the rules of the relevant regulated market would be sufficient in itself to promote market integrity and therefore the question of giving the practice accepted market practice status would not arise.

Common format for assessing AMPs

- 2.13 CESR members have devised a common format for assessing AMPs. This is set out in accordance with the Directive 2004/72/EC and is designed to facilitate the consultation and disclosure processes. The form is set out in Section III of this guidance.

III. Format of the table for assessing AMP's

<p>Description of the National AMP:</p>
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<p>Rationale for why the practice would constitute manipulation</p>
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[refer to article 1(2) (a) of Directive 2003/6/EC]

List of Factors

Commission Directive 2004/72/EC Article 2

Non-exhaustive list of factors to be taken into account by Competent Authorities when assessing particular practices whether they occur on a regulated market or an OTC market:

- The level of transparency of the relevant market practice to the whole market(art 2(1) (a))

Transparency of market practices by market participants is crucial for considering whether a particular market practice can be accepted by competent authorities. The less transparent a practice is, the more likely it is not to be accepted. However, practices on non regulated markets might for structural reasons be less transparent than similar practices on regulated markets. Such practices should not be in themselves considered as unacceptable by competent authorities. (preamble 2)

<p><u>Conclusion regulator:</u></p> <p>[fill in the rationale for this factor]</p>
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- the need to safeguard the operation of market forces and the proper interplay of the forces of supply and demand; (art 2(1) (b))

Market practices inhibiting the interaction of supply and demand by limiting the opportunities for other market participants to respond to transactions can create higher risks for market integrity and are, therefore, less likely to be accepted by competent authorities. (preamble 1)

<p><u>Conclusion regulator:</u></p> <p>[fill in the rationale for this factor]</p>
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- the degree to which the relevant market practice has an impact on market liquidity and efficiency. (art 2(1) (c))

Market practices which enhance liquidity and efficiency are more likely to be accepted than those reducing them. (Preamble 1)

Conclusion regulator:

[fill in the rationale for this factor]

- the degree to which the relevant practice takes into account the trading mechanism of the relevant market and enables market participants to react properly and in a timely manner to the new market situation created by that practice(art 2(1) (d)).

Conclusion regulator:

[fill in the rationale for this factor]

- the risk inherent in the relevant practice for the integrity of, directly or indirectly, related markets, whether regulated or not, in the relevant financial instrument within the whole Community. (art 2(1) (e))

Particular market practices in a given market should not put at risk market integrity of other, directly or indirectly, related markets throughout the Community, whether those markets be regulated or not. Therefore, the higher the risk for market integrity on such a related market is within the Community, the less those practices are likely to be accepted by competent authorities. (Preamble 3)

Conclusion regulator:

[fill in the rationale for this factor]

- the outcome of any investigation of the relevant market practice by any competent authority or other authority mentioned in Article 12(1) of Directive 2003/6/EC, in particular whether the relevant market practice breached rules or regulations designed to prevent market abuse, or codes of conduct, be it on the market in question or on directly or indirectly related markets within the Community; (art 2(1) (f))

Conclusion regulator:

[fill in the rationale for this factor]

- the structural characteristics of the relevant market including whether it is regulated or not, the types of financial instrument traded and the type of market participants, including the extent of retail investors participation in the relevant market; (art 2(1) (g))

Conclusion regulator:

[fill in the rationale for this factor]

Overriding Principles

Overriding principles to be observed by Competent Authorities to ensure that accepted market practices do not undermine market integrity, while fostering innovation and the continued dynamic development of financial markets:

- new or emerging accepted market practices should not be assumed to be unacceptable by the Competent Authority simply because they have not been previously accepted by it;
- Practising fairness and efficiency by market participants is required in order not to create prejudice to normal market activity and market integrity.
- Competent Authorities should analyse the impact of the relevant market practice against the main market parameters such as weighted average price of a single session, daily closing price, specific market conditions, before carrying out the relevant market practice.

Conditional elements

In this final section, you should comment on any conditions relating to legitimate reasons and proper execution.

IV. Types of practice that CESR members would consider to constitute Market Manipulation

Introduction

- 4.1 The work in this area is aimed at providing the competent authorities and market participants with examples of types of market manipulation which have occurred in recent years and which, in the view of CESR members, would breach the prohibitions on market manipulation contained in the Market Abuse Directive. The guidance and accompanying examples are intended to help the development of a common understanding of what constitutes market manipulation.
- 4.2 The guidance and examples could also facilitate the identification of relevant variables (diagnostic flags or signals of market manipulation) that could be monitored by competent authorities and by market participants within the limits of their sphere of activity in order to detect or avoid engaging in market manipulation. The examples may also be useful in helping the relevant market practitioners to meet the requirement to notify suspicious transactions to competent authorities.
- 4.3 Market manipulation can often be avoided by implementing adequate market microstructure measures by explicit rules that forbid specific behaviours or by preventative measures set up by market participants. Therefore some unacceptable conduct set out in the following guidance and examples may not actually be feasible in all market environments across Europe and therefore should not necessarily be read as universally applicable.

Disclaimer

- 4.4 **The examples of types of practice set out in this paper are deliberately described in non-legal technical terms and it is emphasised that the descriptions are not intended to affect the scope of interpretation of market abuse directives and regulations.**

Directive Definition of Market Manipulation

- 4.5 The Market Abuse Directive defines market manipulation as meaning:-
- a. Transactions or orders to trade:-
 - which give, or are likely to give, false and misleading signals as to the supply of, demand for or price of financial instruments [for ease of reference this might be termed "false or misleading transactions"]; or
 - which secure by a person or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial level ["price positioning"]unless the transaction/order to trade had a legitimate reason and conforms to accepted market practices on the regulated market concerned.
 - b. Transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance ["fictitious devices"].
 - c. Dissemination of information through the media... which gives or is likely to give false and misleading signals as to financial instruments ... where the person who made the dissemination knew, or ought to have known, that the information was false or misleading... ["false or misleading information"]



- 4.6 It is noted that the acceptable market practice defence can only be available in respect of the first two categories ("false and misleading transactions" and "price positioning"). No such defence is available in respect of the other categories.
- 4.7 The Directive itself gives three particular instances of market manipulation:-
- i. Conduct by a person, or persons acting in collaboration, to secure a dominant position over the supply of or demand for a financial instrument which has the effect of fixing, directly or indirectly, purchase or sale price or creating other unfair trading conditions;
 - ii. The buying or selling of financial instruments at the close of the market with the effect of misleading investors acting on the basis of closing prices;
 - iii. Taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a financial instrument (or indirectly about its issue) while having previously taken positions on that financial instrument and profiting subsequently from the impact of the opinions voiced on the price of that instrument, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way.

Possible Signals of Market Manipulation

- 4.8 Article 4 of implementing Directive 2003/124/EC sets out the following non-exhaustive signals of false or misleading transactions or price positioning transactions, which should not necessarily be deemed in themselves to constitute market manipulation.
- a. The extent to which orders to trade given or transactions undertaken represent a significant proportion of the daily volume or transactions in the relevant financial instrument on the regulated market concerned, in particular when these activities lead to a significant change in the price of the financial instruments;
 - b. The extent to which orders to trade given or transactions undertaken by persons with a significant buying or selling position in a financial instrument lead to significant changes in the price of the financial instrument or related derivative or underlying asset admitted to trading on a regulated market;
 - c. Whether transactions undertaken lead to no change in beneficial ownership of a financial instrument admitted to trading on a regulated market;
 - d. The extent to which orders to trade given or transactions undertaken include position reversals in a short period and represent a significant proportion of the daily volume or transactions in the relevant financial instrument on the regulated market concerned, and might be associated with significant changes in the price of a financial instrument admitted to trading on a regulated market;
 - e. The extent to which orders to trade given or transactions undertaken are concentrated within a short time span in the trading session and lead to a price change which is subsequently reversed;
 - f. The extent to which orders to trade given change the representation of the best bid or offer prices in a financial instrument admitted to trading on a regulated market, or more generally the representation of the order book available to market participants, and are removed before they are executed;
 - g. The extent to which orders to trade are given or transactions are undertaken at or around a specific time when reference prices, settlement prices and valuations are calculated and lead to price changes which have an effect on such prices and valuations.

4.9 Article 5 of the same Directive sets out the following non-exhaustive signals of transactions employing fictitious devices:

- a. Whether orders to trade given or transactions undertaken by persons are preceded or followed by dissemination of false or misleading information by the same persons or persons linked with them;
- b. Whether orders to trade are given or transactions are undertaken by persons before or after the same persons or persons linked to them produce or disseminate research or investment recommendations which are erroneous or biased or demonstrably influenced by material interest.

Again, these signals should not necessarily be deemed in themselves to constitute market manipulation.

Examples of the various types of practice which would constitute market manipulation

4.10 The following guidance gives examples of types of practice which, in the view of CESR members, would contravene the prohibition on market manipulation as defined by the Directive, although it is acknowledged that in some cases a practice may, in particular circumstances, have a legitimate purpose. The examples are categorised according to which element of market manipulation as defined by the Directive they relate to. However, it should be noted that there can be some overlap: a practice may involve a number of types of market manipulation according to how it is used.

4.11 False/Misleading Transactions

- a) Wash trades. This is the practice of entering into arrangements for the sale or purchase of a financial instrument where there is no change in beneficial interests or market risk or where the transfer of beneficial interest or market risk is only between parties who are acting in concert or collusion. (Repo transactions and stock lending/borrowing or other transactions involving transfer of securities as collateral do not constitute wash trades.)
- b) Painting the tape. This practice involves engaging in a transaction or series of transactions which are shown on a public display facility to give the impression of activity or price movement in a financial instrument.
- c) Improper matched orders. These are transactions where both buy and sell orders are entered at or nearly at the same time, with the same price and quantity by different but colluding parties, unless the transactions are legitimate trades carried out in conformity with the rules of the relevant trading platform (e.g. crossing trades).
- d) Placing orders with no intention of executing them. This involves the entering of orders, especially into electronic trading systems, which are higher/lower than the previous bid/offer. The intention is not to execute the order but to give a misleading impression that there is demand for or supply of the financial instrument at that price. The orders are then withdrawn from the market before they are executed. (A variant on this type of market manipulation is to place a small order to move the bid/offer price of the financial instrument and being prepared for that order to be executed if it cannot be withdrawn in time.)

4.12 Price Positioning

- a) Marking the close. This practice involves deliberately buying or selling securities or derivatives contracts at the close of the market in an effort to alter the closing price of the security or derivatives contract. This practice may take place on any individual trading day but is particularly associated with dates such as future/option expiry dates or quarterly/annual portfolio or index reference/valuation points.

- b) Colluding in the after market of an Initial Public Offer. This practice is particularly associated with Initial Public Offers of securities immediately after trading in the security begins. Parties which have been allocated stock in the primary offering collude to purchase further tranches of stock when trading begins in order to force the price of the security to an artificial level and generate interest from other investors – at which point they sell their holdings.
- c) Abusive squeeze. This involves a party or parties with a significant influence over the supply of, or demand for, or delivery mechanisms for a financial instrument and/or the underlying product of a derivative contract exploiting a dominant position in order materially to distort the price at which others have to deliver, take delivery or defer delivery of the instrument/product in order to satisfy their obligations. (It should be noted that the proper interaction of supply and demand can and often does lead to market tightness but that this is not of itself market manipulation. Nor does having a significant influence over the supply of, demand for, or delivery mechanisms for an investment/product by itself constitute market manipulation.)
- d) Creation of a floor in the price pattern. This practice is usually carried out by issuers or other entities which control them, and involves transactions or orders to trade employed in such a way that obstacles are created to the share prices falling below a certain level, mainly in order to avoid negative consequences for their share or credit ratings. This needs to be distinguished from legitimate trading in shares as part of "buy-back" programmes or the stabilisation of financial instruments.
- e) Excessive bid-ask spreads. This conduct is carried out by intermediaries which have market power – such as specialists or market makers acting in cooperation – in such a way intentionally to move the bid-ask spread to and/or to maintain it at artificial levels and far from fair values, by abusing of their market power, i.e. the absence of other competitors.
- f) Trading on one market to improperly position the price of a financial instrument on a related market. This practice involves undertaking trading in one market with a view to improperly influencing the price of the same or a related financial instrument in another market. Examples might be conducting trades in an equity to position the price of its derivative traded on another market at a distorted level or trading in the underlying product of a commodity derivative to distort the price of the derivative contract. (Transactions to take legitimate advantage of differences in the prices of financial instruments or underlying products as traded in different locations would not constitute manipulation.)

4.13 Transactions involving fictitious devices/deception

- a) Concealing ownership. This is a transaction or series of transactions which is designed to conceal the ownership of a financial instrument via the breach of disclosure requirements through the holding of the instrument in the name of a colluding party (or parties). The disclosures are misleading in respect of the true underlying holding of the instrument. (This practice does not cover cases where there are legitimate reasons for financial instruments to be held in the name of a party other than the beneficial owner – e.g. nominee holdings. Nor do all failures to make a required disclosure necessarily constitute market manipulation.)
- b) Dissemination of false or misleading market information through media, including the internet, or by any other means (in some jurisdictions this is known as 'scalping'). This is done with the intention of moving the price of a security, a derivative contract or the underlying asset in a direction that is favourable to the position held or a transaction planned by the person disseminating the information.

- c) Pump and dump. This practice involves taking a long position in a security and then undertaking further buying activity and/or disseminating misleading positive information about the security with a view to increasing the price of the security. Other market participants are misled by the resulting effect on price and are attracted into purchasing the security. The manipulator then sells out at the inflated price
- d) 'Trash and cash'. This is the opposite of pump and dump. A party will take a short position in a security; undertake further selling activity and/or spread misleading negative information about the security with the purpose of driving down its price. The manipulator then closes their position after the price has fallen.
- e) Opening a position and closing it immediately after its public disclosure. This practice is typically carried out by portfolio managers and other large investors whose investment decisions are usually valued by market participants as relevant signals of future price dynamics. The canonical unfair conduct consists in closing the position previously acquired immediately after having publicly disclosed it putting emphasis on the long holding period of the investment. However, making a report or disclosure will not, in itself, give rise to a false or misleading impression if it was made in the way specified by any applicable legal or regulatory requirement and was expressly required or permitted by such a requirement.

4.14 Dissemination of false and misleading information

This type of market manipulation involves dissemination of false and misleading information without necessarily undertaking any accompanying transaction. This could include creating a misleading impression by failure properly to disclose a price sensitive piece of information which should be disclosed. For example, an issuer with information which would meet the Directive definition of 'inside information' fails properly to disclose that information and the result that the public is likely to be misled.

- (a) Spreading false/misleading information through the media. This involves behaviour such as posting information on an internet bulletin board or issuing a press release which contains false or misleading statements about a company whose shares are admitted to trading on a regulated market. The person spreading the information knows that it is false or misleading and is disseminating the information in order to create a false or misleading impression. Spreading false/misleading information through an officially recognised channel for disseminating information to users of a regulated market is particularly serious as it is important that market participants are able to rely on information dissemination via such official channels.
- (b) Other behaviour designed to spread false/misleading information. This type of market manipulation would cover a course of conduct designed to give false and misleading impression through means other than the media. An example might be the movement of physical commodity stocks to create a misleading impression as to the supply or demand for a commodity or the deliverable into a commodity futures contract.

V. Possible Signals of Suspected Insider Dealing or Market Manipulation Transactions

Introduction

- 5.1 Article 6.9 of the Directive 2003/6/EC 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". The Directive and its implementing measures do not deal with the steps which those persons subject to this requirement need to take to identify such transactions. Those subject to the requirement clearly need to ensure that they comply with this obligation. However, CESR does not propose in this initial guidance to prescribe how this obligation is discharged, except in respect of the form for reporting suspicious transactions.
- 5.2 This section is intended to provide those persons subject to the notification requirement with guidance as to indications of transactions which may involve insider dealing or market manipulation. Until the coming into force of the Market Abuse Directive, no Member State operated a mandatory suspicious transactions reporting regime for market abuse. However, in a number of jurisdictions, market participants had already been alerting the authorities on a voluntary basis to situations they regard as suspicious or abnormal in this context. The following guidance draws on these cases as well as the views of CESR members as to what might constitute a signal of a suspicious transaction. Annexed to this guidance is a standard reporting format which should be used by institutions to report suspicious transactions to the relevant competent authority.

The Duty to Notify Suspicious Transactions

- 5.3 It should be emphasised that the notification regime laid down by the Directive requires that persons subject to it decide on a case-by-case basis where there are reasonable grounds for suspicion concerning the relevant transaction. The indications given below are therefore neither exhaustive (a particular transaction may be suspicious even if it matches none of the indications) nor determinative (a transaction may not necessarily be suspicious simply because it matches one or more of the indications). The indications are therefore merely a starting point and firms need to exercise their judgement and consider the particular circumstances of the case before deciding whether or not to report.
- 5.4 CESR members are clear that blanket pro forma notifications to the authorities of all transactions conducted through an institution would not be in conformity with the provisions of the notification regime. Such notifications would not benefit from the protection provided by Article 11.3 of Directive 2004/72/EC against breach of restriction on disclosure obligations or other liabilities arising from the notification. This is because in the view of CESR members blanket notifications would not be in good faith. Nor would such practice conform with the requirement to consider on a case by case basis whether there were reasonable grounds for suspicion. CESR members are interested in quality not quantity of reporting and will pursue vigorously cases where firms are notifying transactions without seriously considering whether they meet the test of reasonable suspicion.

Guidance Provided by the Directive

- 5.5 Directive 2003/6/EC and accompanying implementing Directives outline what constitutes insider dealing and market manipulation. This is supplemented by the proposed CESR guidance on practice that constitutes market manipulation (see Chapter 4 of this paper).
- 5.6 It is worth noting Recital 9 of Directive (reference) which states

"Notification of suspicious transactions by persons professionally arranging transactions in financial instruments to the competent authority requires sufficient indications that the transactions might constitute market abuse.... Certain transactions by themselves may seem completely void of anything suspicious, but might deliver such indications of possible market abuse, when seen in perspective with other transactions, certain behaviour or other information."

Investment firms and credit institutions 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 takeover bids in relation to the security in question), they might retrospectively become suspicious. However, this does not mean that they are required to go back and retroactively review transactions in the run-up to that event or development.

Indications of Possible Suspicious Transactions

5.7 It is again emphasised that these examples of indications are only a starting point for consideration of whether a transaction is suspicious and are neither conclusive nor comprehensive. Moreover, they are to be applied using judgement rather than necessarily being interpreted literally. It is recognised that transactions meeting signals may be legitimate and hence not give reasonable grounds for suspicion.

5.8 *Possible Signals of Insider Dealing or Market Manipulation*

- a) An unusual concentration of transactions in a particular security (for example, with one or more institutional investors known to be affiliated with the issuer or a party with a particular interest in the issuer such as a bidder/potential bidder);
- b) An unusual repetition of a transaction among a small number of clients over a certain period of time
- c) Unusual concentration of transactions and/or orders with only one client; or with the different securities accounts of one client; or with a limited number of clients (especially if the clients are related to one another).

5.9 *Possible Signals of Insider Dealing*

- a) The client opens an account and immediately gives an order to conduct a significant transaction or, in the case of a wholesale client, 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;
- b) The client's requested transaction or investment behaviour is significantly out of character with the client's previous investment behaviour. (e.g. type of security; amount invested; size of order; duration of holding). ¹

¹ One case reported by a CESR member involved a client wanting to sell his whole portfolio and immediately invest the proceeds in the securities of a specific company. Others have involved a client who had previously invested only in mutual funds suddenly requesting the purchase of the securities of a single company or a client who had previously only invested in 'blue chip' stocks who made a sudden switch into illiquid securities. In a further case a 'buy and hold' client suddenly conducted a purchase of a particular security just before the announcement of inside information and then a sale directly after the announcement.

- c) The client specifically requests immediate execution of an order regardless of the price at which the order would be executed (this indicator pre-supposes more than the simple placing of a 'market order' by the client);
- d) Significant trading by major shareholders or other insiders before the announcement of important corporate events.
- e) Unusual trading in the shares of a company before the announcement of price sensitive information relating to the company; transactions resulting in sudden and unusual changes in the volume of orders and shares prices before public announcements regarding the security in question;
- f) Employees' own account transactions and related orders timed just before clients' transactions and related orders in the same financial instrument.

5.10 *Possible signals of Market Manipulation*

- (a) Transactions with no other apparent justification than to increase/decrease the price of or to increase the volume of trading in a financial instrument. Particular attention might be given to orders of this kind which result in the execution of transactions near to a reference point during the trading day – e.g. near the close;
- (b) The client submits orders which, because of their size in relation to the market in that security, will clearly have a significant impact on the supply of or demand for or the price or value of the security. Again, particular attention might be given to orders of this kind which result in the execution of transactions near to a reference point during the trading day – e.g. near the close;
- (c) Transactions which appear to have the purpose of increasing the price of a financial instrument during the days preceding the issue of a related derivative/convertible;
- (d) Transactions which appear to have the purpose of maintaining the price of a financial instrument during the days preceding the issue of a related derivative/convertible when the market trend is downward;
- (e) Transactions which appear to be seeking to modify the valuation of a position while not decreasing/increasing the size of that position;
- (f) Transactions which appear to be seeking to increase/decrease the weighted average price of the day or of a period during the session;
- (g) Transactions which appear to be seeking to set a market price when the liquidity of the financial instrument is not sufficient to fix a price within the session (unless the rules or regulation of the regulated market explicitly allow such operations);
- (h) Transactions which appear to be seeking to bypass the trading safeguards of the market (e.g. as regards volume limits; bid/offer spread parameters; etc);
- (i) When a transaction is to be concluded/executed, changing the bid-ask prices (as computed by the trading system) when this spread is a factor in the determination of the price of that transaction;
- (j) Entering significant orders in the central order book of the trading system a few minutes before the price determination phase of the auction and cancelling these orders a few seconds before the order book is frozen for computing the auction price so that the theoretical opening price might look higher or lower than it otherwise would do;



- (k) Transactions which appear to be seeking to maintain the price of the underlying financial instrument below the strike price of a related derivative at expiration date;
- (l) Transactions which appear to be aimed at modifying the price of the underlying financial instrument so that it crosses over the strike price of a related derivative at expiration date;
- (m) Transactions which appear to be seeking to modify the settlement price of a financial instrument when this price is used as a reference/determinant in the calculation of margins requirements.

Method of Reporting Suspicious Transactions

5.11 Article 9 (2) of Commission Directive 2004/72/EC provides that where the information specified to be reported

"is not available at the time of notification, the notification shall include at least the reasons why the notifying persons suspect that the transactions might constitute insider dealing or market manipulation. All remaining information shall be provided to the competent authority as soon as it becomes available."

Article 10 of that Directive also provides that

"Notification to the competent authority can be by mail, electronic mail, telecopy of telephone, provided that in the latter case confirmation is notified by any written form upon request by the competent authority".

Persons making suspicious transactions reports therefore do not need to have all the required information before contacting the competent authority. If the case is one which (the persons subject to the reporting obligation consider) needs to be brought to the attention of the competent authority urgently, then CESR would urge them to make the first contact quickly. This can be by telephone if appropriate, giving the basic details and reasons for suspicion. The other information can be supplied subsequently.

Suspicious transaction reporting format

5.12 CESR considers that it will assist those subject to the obligations to report suspicious transactions if there is a standard reporting format for doing so. CESR has therefore drawn up the format below.

Description of the transaction(s)
<i>Please include details of the financial instrument(s), including the ISIN code of the instrument; the market(s) concerned; the original order's entry date/time, price and size; the times and sizes of the transaction(s); the type and characteristics of the order, etc</i>
Reasons for suspecting that the transaction(s) might constitute insider dealing/market manipulation



<p>Identities of persons carrying out transaction(s) <i>Names, address, telephone number, date of birth, account number, client identification code used by the firm, etc</i></p>
<p>Identities of any other persons known to be involved in the transaction(s) <i>Names, address, telephone number, location, date of birth, relation to person carrying out transaction; position held, role played, etc</i></p>
<p>Capacity in which the person performing the transaction(s) acts <i>e.g. broker, underwriter, agent</i></p>
<p>Further information which may be of significance (please list any accompanying material you are supplying)</p>
<p>Details of the person making notification. <i>Name of person, name of firm, position held within firm, contact details etc</i></p>
<p>Signed..... (<i>person making notification</i>)</p> <p>Dated.....(<i>Date of notification</i>)</p>

