

## Chapter V - Market surveillance and discipline

The Commission des Opérations de Bourse (COB) and the Conseil des Marchés Financiers (CMF), combined as the Autorité des marchés financiers (AMF) since 24 November 2003, take assertive action to ensure that investments in financial instruments are secure, that investors are treated equally, that material information is transparently disclosed, and that financial instruments markets operate smoothly.

- Until 24 November 2003, the **supervisory and investigative** divisions of the CMF and the COB operated separately, each in their own domain, in accordance with their respective remits. The COB pursued its market surveillance activities to detect trading anomalies that might warrant investigation. It also conducted off-site and on-site inspections of asset managers to fulfil its role of oversight in the investment management industry. The CMF was responsible for the oversight of other investment service providers and market infrastructure operators, likewise by means of off-site and on-site audits.

Inspections performed by the COB and the CMF until 24 November 2003, then continued by the AMF

	<b>2003</b>
Market situations examined (COB)	1,469
Investigations opened (COB)	85
Inspections of asset managers (COB)	64
Inspections of investment service providers (CMF)	74

Beginning in 2004, the audit and investigation staffs were reorganised into two functional divisions, one responsible for supervision of investment service providers (ISPs) and infrastructure operators and the other for market surveillance and investigations. Details of the new organisation are presented at the end of this chapter.

- Each of the three regulatory authorities that were amalgamated to form the AMF had its own **disciplinary powers**. Between 1 January and 24 November 2003, the COB, the CMF and the Conseil de Discipline de la Gestion Financière (CDGF) issued 33 decisions imposing disciplinary sanctions on 61 individuals and legal entities.

<b>2003</b>	<b>COB</b>	<b>CMF</b>	<b>CDGF</b>	<b>TOTAL</b>
Number of sanction decisions	17	6	10	33
Number of persons sanctioned	24	16	21	61

When it came into being in late November 2003, the AMF inherited 14 disciplinary proceedings initiated by its predecessors. It was consequently able to issue its first sanction decisions very soon thereafter. The first three decisions of 2004 are described in this chapter. Between 24 November 2003 and late March 2004, the AMF opened 23 disciplinary proceedings.

## **I - Market surveillance in 2003**

The COB and the CMF were equipped with tools that gave them in-depth knowledge of the market. Using retrieval systems available on a large number of workstations, they could display at will the details of transactions in all securities quoted on French markets, regulated and non-regulated.

### **A - SURVEILLANCE ACTIVITIES OF THE CMF**

To detect market anomalies and organise investigations involving service providers and infrastructure operators, the CMF's inspectors use a proprietary system called SCAN (Système de Collecte et d'Analyse, for Data Collation and Analysis System). SCAN stores information on all trades made by ISPs operating in France in financial instruments admitted to trading on a regulated French market, including off-exchange transactions. When irregularities are detected, the inspector conducts a more detailed examination, either by requesting information from the provider or by launching an on-site inspection.

SCAN's online database contains historical observations for a rolling twelve-month period. At year-end 2003 the database held information on 138 million orders and 76 million trades transmitted by the market operator as well as 12 million transactions declared by 302 investment service providers (82 acting directly and 220 acting under mandate) via RDT, a direct reporting system.

SCAN is used primarily for two purposes:

- As an investigative aid, to search the entire database in order to gain an overall understanding of the activity of an ISP. By analysing the ISP's activity in terms of instruments and trading patterns, the audit can be oriented towards systematic behaviours – even if the individual incidents are small in scale – rather than towards accidental, isolated anomalies.
- As a surveillance tool, for ongoing refinement of sets of audit checks and for statistical compilation.

For routine checks of filed documents, SCAN-sourced data are used to verify compliance with regulations, for example:

- the provisions of Title V of the CMF's General Regulations, notably during public tender offers;
- the order concentration rules set forth in Articles 4.1.32 and 4.1.33 of those regulations;
- the requirement that the market operator verify member firms' compliance with its rules, for example, by checking the Euronext order book to ensure that order parameters are consistent and liquidity providers are present;
- the justification of prices of off-exchange trades, to check compliance with Article 3.4.2 of the CMF's General Regulations;
- the price movements observed in closing auctions on Euronext and the price volatility in electricity contracts traded on the system operated by Powernext, notably during the heatwave of August 2003.

In 2003 the CMF kept the SCAN production system current by adapting RDT to comply with Decision 2002-02, connecting two new data streams from Euroclear Bank and Clearstream, modifying data collection to handle changes in satellite-borne data streams from Euronext, and enhancing user access to data. Development work was required to accommodate the integration and transfer of Euronext's Matif and Monep markets, which were moved onto the Liffe-Connect system.

Application development focused primarily on analysis of transactions in fixed-income securities in order to refine the complex data reconciliation routines needed to monitor trading that takes place largely off-exchange.

## **B - SURVEILLANCE ACTIVITIES OF THE COB**

An automated off-line anomaly detection system has been in operation for thirteen years. The system runs an array of statistical tests with 70 criteria and triggers alerts that indicate which securities are displaying anomalies and should therefore be analysed first.

Using these tools as a basis, an analysis of the market, the press and online financial forums is made daily. In 2003, 1,469 market situations were examined, an increase of 5% from the year before. When no explanation can be found for a detected anomaly and it appears that an infringement may have been committed, a proposal to open an investigation is submitted to the general director of the COB (and, since 24 November 2003, to the chief executive of the AMF).

In 2003 the market monitoring staff continued to enhance the performance of its tests, in particular those relating to ISP behaviour on each security listed on Euronext Paris.

In addition, considerable work was done on the monitoring of bond trades. The AMF now has powerful tools at its disposal to spot abuses in this market, which is inherently more difficult to monitor because most of the trading is done off-exchange.

The Internet surveillance unit finalised the development of its semantic search and analysis tool. This state-of-the-art application makes it possible to perform intelligent automated scrutiny of the large volumes of information available on financial forums.

## **II - Supervision of investment service providers in 2003**

To fulfil their supervisory responsibilities in respect of investment service providers, the CMF and the COB conducted both off-site and on-site audits.

Article L. 622-9 of the Monetary and Financial Code and Decree 98-1016 of 9 November 1998 permitted the CMF to make use of external audit staff to supplement its own resources. The CMF had entered into agreements for this purpose with the market operator (Euronext), the central depository (Euroclear France), the general secretariat of the Commission Bancaire and various audit firms.

### **A – CMF SUPERVISION**

#### **1 - Off-site audits**

The main supervisory actions of the CMF took the following forms.

##### a) Annual reports

Investment services providers, the market operator, the clearing house and the central depository were required to submit reports to the CMF each April on the supervision of investment services during the previous year. The reports reviewed the current situation and provided guidance for on-site inspections.

For the 2002 annual report, the CMF again provided a form containing a reference table of the main regulatory points to be addressed in each ISP's submission. Systematic use of this questionnaire made it possible to standardise the responses, thereby facilitating analysis and permitting statistical monitoring of the supervisory work declared by ISPs. For each of the legal or regulatory provisions, the 2002 form asked whether authorised providers had established an internal first-level control procedure. The CMF was thus able to assess how effectively investment services had been supervised internally.

The steady year-to-year decrease in the rate of non-compliance and non-response suggests that in practice, this reporting format provides ISPs' investment services supervisors with both a working method and a plan.

According to the responses received, the investment services and related services most widely offered by ISPs are reception and transmission of orders (89% of authorised providers), followed by custody account-keeping (65%). Many providers do not utilise all of the authorisations they have been granted.

## b) Special reports

The CMF asked ISPs' investment services supervisors to submit a special report in September 2003 on their control procedures for provisions on client accounts and for margining of clients' positions and commitments.

The 2002 special reports dealt with procedures for establishing business relationships with clients. Review of the responses revealed difficulties of interpretation in three areas: the extent of the obligation to verify the client's identity, the categories of clients for which evaluation of professional skills is required, and, regarding provision of appropriate information, the scope of relations that must be governed by an account agreement or service agreement. The CMF's study of these reports therefore sought to clarify ISPs' responsibilities for verifying client identity and the means by which this should be done, the CMF's expectations regarding evaluation of client skills, and the requirements for formalising client relations in a contract.

Another questionnaire was sent to all ISPs in order to learn more about their financial analysis services and evaluate the measures they had taken to comply with CMF Decision 2002-01. In addition, those ISPs offering an order reception/transmission or order execution service via the Internet were invited to describe to the CMF what steps they had taken to meet the requirements set forth in CMF Decision 1999-07, in particular concerning identification of unusual transactions and verification of order consistency.

## c) Complaints from individual investors

The CMF received complaints from individual investors about financial intermediaries, the market operator and the central depository. In 2003 the CMF's enforcement division received some thirty written complaints of this nature. Most of them concerned disputes relating to transmission of orders, monitoring of positions or pricing of services. A few concerned more specific issues such as non-dematerialised securities or the proportion of total orders at the time of an initial public offering. As agreed between the COB and the CMF, these complainants were invited to take their concerns to the COB's ombudsman, even if the CMF's enforcement division was performing an audit of the matter.

## d) Surveillance of market infrastructure operators

Market oversight was enhanced by holding regular monthly meetings with the investment services supervisors of Euronext Paris, Clearnet and Euroclear France. The points monitored with Euronext included, among others:

- monitoring of utilisation in the different trading categories (proprietary, client account, liquidity provider)
- oversight of market members
- technical developments related to the order and transaction reports
- examination of market incidents

The CMF's enforcement division worked jointly with the COB's in cooperating with foreign authorities on oversight of Euronext markets. The authorities with supervisory responsibility for Euronext compared their methods of supervising the market operator by conducting studies to verify that investment firms operating in Euronext's several national markets were applying the best-execution rule. They also decided to coordinate their supervisory and investigative efforts.

The CMF met with Clearnet and Euroclear every two months to scrutinise the securities settlement fails recorded by clearing members as well as the data system incidents logged by the clearing house and the central depository. The CMF paid particular attention to Clearnet members with a relatively high percentage of fails and to Clearnet's own fails. The special problem of trades with exchange-traded funds (ETFs) was studied with a view to reducing their incidence. Based on information provided by Euroclear, the enforcement division performed audits of six custodian members whose proprietary position accounts showed fails. These audits showed that the custodians had adopted procedures to limit failed settlement and had made arrangements to borrow securities, but sometimes liquidity in the desired financial instrument was insufficient to avoid a fail. A request for explanation and a reprimand was sent to any custody account-keeper that appeared not to have implemented a requirement of Article 6.3.3 of the CMF's General Regulations, namely that there be separate entries for fund assets in custody, other clients' assets and the custodian's own assets in the books of all central depositories of which that custodian is a member.

## **2 - On-site inspections**

In 2003 the CMF completed 12 inspection missions initiated in 2002 and opened 73 new ones. The chief executive of the AMF opened one further inspection in late 2003. The schedule established at the beginning of the year was met.

Two-thirds of these missions were entrusted to external auditors: 23 to audit firms, 14 to Euronext and 10 to the Commission Bancaire. When the CMF previously, and the AMF currently, engages outside auditors to work on its behalf, these agents enjoy all the prerogatives accorded by law to the regulator, which means that information may not be withheld from them on grounds of professional secrecy. The regulator is liable to third parties for its agents' compliance with law and regulations during these missions and in any proceedings stemming from them.

Among the 74 inspection missions launched in 2003, five examined bond dealing and later gave rise to an article that was added to the rules of conduct applicable to that activity. Ten looked at compliance with the rules regarding financial analysis and assessed how CMF Decision 2002-01 was being implemented. Twenty-four missions checked authorised providers' compliance with the transaction reporting requirements of CMF Decision 2002-02 and Euronext rules. Eleven ISPs that had received authorisation in the past twelve months were inspected to ensure that the resources available to perform investment services were consistent with the providers' programmes of operations as approved by the CMF. Two missions looked at custody account-keeping by credit institutions designated by their group to perform this activity centrally as agent of the group's other custody account-keepers. One mission was initiated subsequent to a complaint from an ISP. Five reports issued in 2003 by the CMF's enforcement division led to the opening of disciplinary proceedings by the CMF, and two reports resulted in notification of charges by the chairman of the AMF Board following examination by its specialised commission.

The CMF also performed examinations based on 28 cases referred by the Commission Bancaire or the COB involving acts that might constitute violations of CMF rules. Three of these referrals led to disciplinary proceedings. Evidence provided by the Commission Bancaire identified problems in the division of account-keeping responsibilities between brokers and the multiple clearers and gave rise to an article in the CMF's monthly review clarifying the rules applicable to each of these parties.

## **B – COB SUPERVISION OF ASSET MANAGERS**

### **1 - Monitoring of the investment management industry**

Relying on off-site audits and on-site inspections, the COB regularly monitored portfolio management companies, collective management companies, investment service providers providing related portfolio management services, and fund custodians.

Supervision consists in verifying that the activities of such entities comply with the declarations on which the regulatory authority based its authorisation of the firm or its approval of their programme of operations. It also includes making sure that they have adequate resources at all times and are complying with the conduct-of-business rules.

#### a) Off-site audits by the COB

Checks of this kind were made on all management companies and funds and on the majority of other investment service providers. In 2003 the off-site audits concerning primarily the following:

- Capital adequacy: 47 management companies were found to have insufficient equity capital to meet regulatory requirements, which would be grounds for automatic withdrawal of authorisation by the regulator. By year-end 2003 all these companies had rectified the situation by raising fresh capital, arranging shareholder loans, reducing dividend pay-outs or other means.
- Annual financial statements and information filings. All management companies and other ISPs authorised to provide a portfolio management service are required to file these documents with the regulator. The COB's first action was to obtain documents that had not been filed on time. An exhaustive analysis of their contents was then performed to detect sensitive disclosures that might warrant special monitoring. Subsequently, targeted actions were taken to ensure that the company's managers put their house in order on several points.

#### b) On-site audits by the COB

The COB inspected 64 management companies and investment service providers in 2003.

The purpose of the on-site audits was to ensure that the resources, organisation and operating procedures of the companies visited were in compliance with laws and regulations and consistent with the filings made when they sought authorisation.

An on-site audit takes place over a period of a several days. In the great majority of cases, the regulator then sends a letter of observations identifying the irregularities found during the audit and requesting that the company rectify the situation. The COB follows up on these requests to

ensure that appropriate action has been taken. In 2003 all such situations were rectified within one to five months.

When management companies applied to the COB for extension of an authorisation, COB staff made an on-site inspection to verify that the company was operating in compliance with the rules then in force. Irregularities detected at that time had to be corrected before the Commission would consider the request for extension.

The irregularities most frequently identified in 2003 related to the following issues.

#### Organisation of asset managers, notably in respect of human resources, conflicts of interest and incompatibilities of functions

Twenty-two companies audited in 2003 no longer met the minimum resource requirements and were required to revise their programme of operations.

The COB reminded these management companies that the effective running of the company had to be performed by at least two executive officers, one full-time, and also that the company had to have at least two full-time managers with appropriate experience and qualifications. The COB saw to it that this situation was rectified.

In 11% of companies audited, a financial manager invested simultaneously for the company's account and for the accounts of its clients. The COB asked these ISPs to alter their organisational structures to ensure strict separation between investment management on behalf of clients and investment management on behalf of the company itself.

Lastly, the COB asked companies to put an end to incompatibilities it had observed between the functions of financial manager and internal supervisor or compliance officer. Persons tasked with supervisory responsibilities may not perform other operating activities, especially if those activities would be under their own supervision. Incompatibilities of this kind were found in 17% of companies audited.

#### Programmes of operations

In 2003 the COB asked management companies to show that the resources called for in their programmes of operations were adequate for and consistent with the management service they intended to provide. A detailed description in both qualitative terms (e.g., risk assessment, hard-to-price financial instruments) and quantitative terms (e.g., number of accounts) was requested in order to measure consistency.

The COB had to remind companies of the need to have prior-assignment rules for omnibus orders in order to respect the principle of equal treatment of investors. Providers were asked to submit such rules for evaluation by the regulator, notably as part of the review of their programme of operations.

#### Internal control

Twenty-three of the management companies visited in 2003 did not have a manual of control procedures, and more than half showed controls that were insufficient in relation to their activities. Under the terms of the regulations, management companies must have in place the

resources and procedures needed to audit their own activities and those of their intermediaries and custodians. The necessary rectifications were made.

Having a system of internal control, under the supervision of person within the institution designated by name for this purpose, is key to ensuring the reliability of and compliance with procedures, preventing operational risk, and ultimately, enhancing security of the business.

The COB reminded companies that documents attesting to the checks they had carried out for internal control purposes had to be kept on the premises. Only with traceability of this kind can it be shown that internal control is in fact being performed.

In 2003, on a case-by-case basis, COB allowed management companies to engage an external provider to perform the requisite internal controls. In such case, the engagement must be formalised in an agreement specifying a detailed audit programme and audit frequency. This document must be submitted for review by the AMF before it is signed.

### Compliance

Twenty-one of the management companies audited in 2003 were not controlling compliance with ethical rules.

In the interest of transparency, IPSs must establish a mechanism for controlling own-account trades made by persons engaged in asset management activities, regardless of where their securities account is domiciled. Documentation proving that such mechanisms are in place must be drawn up and retained.

Management companies authorised to run venture capital funds were reminded that they, too, had to establish controls of this nature. When they take equity stakes, they may come into possession of confidential information on the strategy of listed companies, and the funds they manage may end up holding securities listed on regulated markets.

### Prevention of money laundering

Thirty-two of the management companies audited had taken no special measures in this regard. Either they had not designated a correspondent to liaise with France's national financial intelligence unit (TRACFIN), or they had made no effort to verify the identity of their client, believing this task to be the responsibility of the fund distributor.

Although most of the shortcomings in this area were found among general management companies, two-thirds of the venture capital firms visited could not demonstrate vigilance with regard to money laundering.

Pursuant to Article 18 of COB Regulation 96-03, providers of management services must implement procedures and organisational structures enabling them to comply with the vigilance and disclosure requirements for the prevention of money laundering.

Companies were reminded that before any transaction is made on behalf of a client, either that person's identity must be verified or, if the client is not acting for his own account, the identity of the end client must be known.

## Client relationships

Twenty-one of the management companies audited did not have agency agreements that conformed to current regulations. Half of them did not make the disclosures to investors required by the rules, such as indicating how total fees and commissions are split between the various intermediaries and whether the group's proprietary funds are used in managing the portfolio, even though information of this kind must be mentioned in the annual report of the fund and/or the annual management report of the asset manager. These shortcomings were remedied.

Relations with discretionary clients and holders of fund units or shares regularly draw observations regarding companies' compliance with Article 12 of COB Regulation 96-02 and Articles 8, 22 and 23 of COB Regulation 96-03.

Holders of fund units or shares must also be informed of the asset managers' policy on exercising voting rights at annual general meetings.

## Relations with the AMF

It became apparent during the course of these audits that the provisions of Article 16 of COB Regulation 96-02 were frequently being ignored. More than two-thirds of the management companies audited in 2003 had not performed the necessary checks.

Management companies were reminded that they must inform the AMF immediately of any change in characteristics with respect to the key elements of the initial application for authorisation.

Management companies must also provide the AMF with copies of their balance sheet, income statement, notes to the financial statements, annual management report and attachments, and the general and special reports of their statutory auditors within six months from the end of the year. For the annual fund data sheet, the filing deadline is four months.

## **2 - Audits of institutions providing custodial services to collective investment schemes**

In 2003, the 87 fund custodians in active operation submitted updated performance specifications to the COB. To gather further information on a voluntary basis regarding developments in the field, the COB drew up a questionnaire that was sent to a representative sample of twenty of them, asking about their fund custody operations.

Five fund custodians were visited by COB staff. The purpose of these visits was to verify that the firms in question were complying with the legal requirements set forth in the COB's November 1993 instruction on responsibilities and resources of fund custodians.

The COB then sent letters of observation to these institutions pointing out the irregularities that had been found. These included:

- shortcomings in the rules governing the custodian's independence and oversight;
- absence of control over persons in authority;

- insufficient knowledge of COB regulations on regulatory ratios, the specific investment rules set out in the prospectus and the rules on capital adequacy for investment undertakings;
- lack of annual control of custodial functions by the statutory auditors, including checks of the accounts opened in the books of the custodian on behalf of the fund.

Whereas the law establishes the fundamental principles of operation of a fund custodian and spells out its responsibilities, the COB's November 1993 instruction is more of a practical guide to drawing up performance specifications. Those specifications cannot be limited to a mere listing of the provisions of the COB's rules. Rather, each custodian's specifications must state and describe, without limitation:

- its procedures for accepting and maintaining custodial responsibilities;
- its control procedures, specifically for monitoring net asset values (calculation, ratios, liabilities) and the lawfulness of management companies' decisions;
- its procedures for dealing with irregularities;
- the consequences of checks made previously as part of the annual control programme (where applicable);
- the systems used to exchange information with management companies;
- the human and technical resources used by the custodian's auditor.

### III - Investigations by the COB in 2003

The general director of the COB decided to open 75 investigations in 2003. The chief executive of the AMF opened a further 10 investigations between 24 November and 31 December 2003.

	<b>2001</b>	<b>2002</b>	<b>2003</b>
Investigations opened by the COB	90	80	85

#### A - ORIGIN AND CLASSIFICATION

One-half of the investigations were initiated on the basis of proposals submitted by the market surveillance teams. These involved mainly “classic” market offences and misconduct, such as insider trading, false information and price manipulation. Others were initiated in response to indications forwarded by other COB divisions in contact with investment service providers and issuers.

Lastly, some investigations were prompted by sources external to the COB. These include complaints from individuals, requests for advice from judicial authorities in prosecutions relating to public companies or offences committed in connection with securities offerings, revelations received from other French administrative authorities, and requests from foreign authorities with regulatory powers analogous to the COB’s.

The grounds for the 85 investigations opened in 2003 were as follows:

	<b>COB</b>	<b>AMF</b>	<b>TOTAL</b>
Market-related (insider behaviour or deceitful conduct impeding fair and orderly operation of the market)	28	3	31
Financial disclosure	14	0	14
Improper acts committed in performing asset management	9	0	9
Improper solicitation	1	0	1
International cooperation	23	7	30

As in past years, a significant proportion of the investigations in 2003 concerned behaviour that represented possible insider abuses, impairment of fair and orderly markets or shortcomings in financial disclosure.

The investigations followed a procedure designed to ensure that personal rights were respected. Investigations that were not completed at the time of the AMF’s formation were continued under the newly applicable legal and regulatory framework.

## B - INTERNATIONAL COOPERATION

The COB continued to cooperate with foreign regulators on matters of surveillance and investigation of markets and financial intermediaries. In 2003, 30 investigations were opened at the request of foreign authorities, primarily concerning transactions made by intermediaries in France in securities listed on foreign markets.

The table below summarises the requests for assistance received by the COB from foreign authorities and made by the COB to foreign authorities.

### Requests for assistance, by country

Country	2002		2003	
	Received	Sent	Received	Sent
Bahamas	1	5	3	0
Belgium	3	10	14	13
Bermuda	1	0	0	2
Brazil	0	0	1	0
Canada	0	1	0	3
Cayman Islands	0	2	0	2
Egypt	0	0	1	0
Finland	0	0	1	0
Germany	5	6	2	13
Greece	0	0	1	0
Guernsey	4	0	5	0
Hong Kong	4	3	1	1
Ireland	4	2	1	3
Italy	2	4	1	5
Japan	1	0	0	3
Jersey	0	1	0	0
Luxembourg	9	9	11	14
Monaco	1	6	0	2
Morocco	0	0	0	1
Netherlands	3	9	1	4
Poland	1	0	1	0
Singapore	0	1	0	3
South Africa	0	0	1	0
Spain	4	4	1	3
Sweden	2	2	2	0
Switzerland	0	73	3	39
United Kingdom	5	66	7	52
United States	4	22	7	33
Other	3	4	3	1
<b>Total</b>	<b>58</b>	<b>230</b>	<b>68</b>	<b>197</b>

Requests for assistance served a variety of needs, as shown in the table below.

Requests for assistance, by type

<b>Type of request</b>	<b>2002</b>		<b>2003</b>	
	<b>Received</b>	<b>Sent</b>	<b>Received</b>	<b>Sent</b>
<i>Authorisation</i> Transmission of information on intermediaries	27	30	26	63
<i>Surveillance</i> Market information requests	2	3	1	1
Transmission of information on intermediaries/transactions/legislation	10	3	1	1
<i>Investigation of infractions</i> Use of inside information	14	160	24	102
Dissemination of misinformation	2	5	2	15
Infractions involving tender offers	0	0	3	1
Price manipulation	0	19	5	10
Improper financial solicitation	3	2	1	2
Infractions involving the Internet	0	6	2	1
Other	0	2	3	1
<b>Total</b>	<b>58</b>	<b>230</b>	<b>68</b>	<b>197</b>

The most numerous requests calling for international cooperation remain those relating to suspected insider trading.

The CMF also exchanged information with foreign regulatory authorities (one in 2001, four in 2002 and five in 2003) in connection with its monitoring or enforcement actions.

## **IV - Cases referred to other authorities in 2003**

When the COB or the CMF found evidence of acts that could fall under the jurisdiction of other judicial, administrative or professional authorities, they transmitted their findings or reports so that those authorities could take appropriate action. The AMF has been given jurisdiction over the same matters as its predecessors.

### **A - REFERRALS TO ADMINISTRATIVE OR SELF-REGULATORY AUTHORITIES**

During 2003 the COB transmitted ten reports to other French authorities, notably the CMF and the CDGF. The CMF transmitted 29 reports to other French authorities, notably the COB and the Commission Bancaire.

### **B - REFERRALS TO JUDICIAL AUTHORITIES**

The legal basis for referral to the judicial authority is the obligation of any constituted authority, public officer or civil servant who acquires knowledge of a crime or offence to notify the public prosecutor. Referral can also be founded on a request for advice from the judicial authorities in court cases relating to public companies or offences committed in connection with public offerings, or on the mere fact that a judicial inquiry has been opened on the same acts.

In 2003 the CMF transmitted 7 investigative reports to the public prosecutor.

The COB transmitted 17 reports involving possibly criminal acts. Twelve of them have led (or could lead in 2004) to the opening of a disciplinary proceeding by the COB (or the AMF) and thus cannot be commented upon here. The remaining five involve situations in which the AMF's investigation must be supplemented by police intervention to obtain proof of the facts and enable valid imposition of a penalty.

The facts at issue in two investigative reports concern use of inside information, dissemination of false information and deceitful acts intended to impede a fair and orderly market in a financial instrument by causing others to act in error, both on Euronext Paris and on foreign markets. Another investigative report concerns the dissemination or use of inside information. Lastly, one report concerns misinformation released on the Internet by an employee.

In other situations, the observed acts do not fall under the jurisdiction of the market regulators. Thus, the report implicating an employee for spreading false information on the Internet was also transmitted to the public prosecutor because the employee in question refused to attend a hearing, thereby obstructing an audit or investigation by the AMF. An investigative report was transmitted to the prosecutor's office in a case in which a company's statutory auditors appeared to have failed to exercise due care in ensuring compliance with the financial communication and public disclosure rules and may thus have made themselves liable to disciplinary action.

Summary of cases referred by the COB and the CMF

	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>Cases referred by the COB:</b>			
- administrative and self-regulatory authorities	11	15	10
- judicial authorities	19	23	17
	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>Cases referred by the CMF:</b>			
- administrative and self-regulatory authorities	23	45	29
- judicial authorities	28	7	7

## **V - Sanctions imposed by the COB, the CMF and the CDGF in 2003**

<b>2003</b>	<b>COB</b>	<b>CMF</b>	<b>CDGF</b>	<b>TOTAL</b>
Number of sanction decisions	17	6	10	33
Number of persons sanctioned	24	16	21	61

### **A - DISCIPLINARY MEASURES TAKEN BY THE CMF**

In 2003 the CMF issued one warning and imposed six disciplinary sanctions on four legal entities and 12 individuals.

### **B - ADMINISTRATIVE SANCTIONS IMPOSED BY THE COB**

Since the reform of the COB's administrative sanction procedure in August 2000, 49 proceedings have been opened.

The apparent decrease in the number of proceedings opened by the COB in 2003 is not due to any slackening in the activity of the investigation and surveillance teams, which continued at a brisk pace. Rather, it is attributable to the formation of the AMF: numerous cases were referred to the Authority's specialised commissions and Disciplinary Commission during the first weeks of their existence. At this writing, 37 cases had been referred to the Disciplinary Commission.

<b>Disciplinary proceedings opened by the COB</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Number of proceedings	20	16	7
Number of individuals or legal entities concerned	30	28	12

In 2003 the COB imposed 24 sanctions. Appeals against six of them have been filed with the Paris Court of Appeal; at this writing, judgments had been rendered in only three.

<b>Administrative sanctions imposed by the COB</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
• Number of sanction decisions	4	7	17
• Number of persons penalised	7	9	24
<b>Disciplinary sanctions imposed by the COB</b>	0	3	0

## **C - DISCIPLINARY SANCTIONS IMPOSED BY THE CDGF**

In 2003 the Conseil de Discipline de la Gestion Financière (CDGF) issued 10 decisions imposing sanctions on 21 individual and legal entities.

## **VI - First sanctions imposed by the AMF**

### **1 - Against GSD Gestion and Mr Jacques Gautier, decision of 16 March 2004**

The Disciplinary Commission of the AMF found that GSD Gestion had violated the conditions of authorisation for management companies established by COB Regulation 96-02 as well as the rules of conduct set forth in COB Regulation 96-03.

Firstly, the Commission found that GSD Gestion had contravened Article 8 of COB Regulation 96-02 by not having two experienced managers as executive officers in 1999 and 2000. The curriculum vitae of Mr Thierry Gautier, son of the chairman of GSD Gestion, showed that he could not have performed the function of managing director of the company from June 1998 because he was enrolled as a student at that time.

The Commission also found that the company had twice failed to inform the COB of a change in portfolio manager, which is contrary to Article 16 of COB Regulation 96-02.

Secondly, the Commission found that the company's portfolio managers were part-time employees who had set up other companies that brought business to GSD Gestion and charged expenses in the form of fees that covered the salaries of the manager positions. Furthermore, some of them also provided consulting services to GSD Gestion that were not shown to be of any real substance.

These other companies were remunerated by rebates of a portion of the trading commissions charged by GSD Gestion. Those commissions represented 50% of the company's gross income in 1999 and 64% in 2000 owing to an especially high churn rate in the portfolios brought in and managed by those managers.

In the light of these facts, the Disciplinary Commission found that Mr Jacques Gautier, chairman of the GSD Gestion company, had put in place a system that enabled the companies set up by the portfolio managers to benefit from the authorisation granted by the COB to GSD Gestion in exchange for remunerating himself and the company largely on the basis of trading commissions generated by the autonomous activity of those managers.

It ruled that this mode of operation constituted several violations of the rules of conduct applicable to discretionary portfolio management:

- insufficiency of the number of managers in the employ of the company given the size of the portfolios and the schemes under management, which is contrary to the principle of management permanence, notably in the absence of one of the managers, as stated in Article L. 533-4 of the Monetary and Financial Code and paragraph 1.12 of the COB instruction of 17 December 1996;

- impossibility of having autonomous management within the meaning of Article 3 of COB Regulation 96-03, since the company had put itself in a position of dependence under the system established by its chairman;

- inadequacy of internal control, in contravention of Article L. 533-4 of the Monetary and Financial Code and Article 11 of COB Regulation 96-03, as demonstrated by the following:

- . The fact that highly disparate performance by portfolio managers with similar “dynamic” investment mandates brought no reaction from Mr Gautier, who was officially in charge of internal control, other than to ask the manager whose performance had been negative whether he had received any complaints from his clients.

- . The fact that one of the portfolio managers did not know the identity of the person in charge of internal control for the company, even though the company had few employees.

Lastly, the Commission ruled that a scant number of client complaints was not a criterion of effective internal control, and further that Mr Gautier’s liquidation of insufficiently margined client positions likewise did not demonstrate effective internal control, because strictly speaking that decision was taken in his capacity as chairman rather than as internal controller.

The Commission consequently ruled that GSD Gestion’s mode of operation was necessarily in violation of a management company’s obligation to have resources adequate to its activities at all times, as required by Article 9 of COB Regulation 96-03 and Article 10 of COB Regulation 96-02.

The Commission issued a reprimand and imposed a fine of €50,000 on GSD Gestion and Mr Jacques Gautier personally. It ordered publication of this decision in the legal gazette (BALO) as well as in the AMF’s monthly review and on its website.

At this writing, no appeal against this decision had been made to the Conseil d’État.

## **2 - Against Exane and Mr Laurent Taburet, decision of 18 March 2004**

The proceeding against Exane, a broker, related to acts resulting to wilfully excessive movements in the price of Xilam Animation shares and to transactions carried out for the purpose of misleading other market members.

The Disciplinary Commission issued a warning and imposed a fine of €30,000 on Exane on the basis of Articles 3.4.1, 3.4.7 and 3.4.10 of the CMF's General Regulations, and it issued a warning to the trader, Mr Laurent Taburet, on the basis of Articles 3-4-7 and 3-4-10 of those regulations.

It ordered publication of this decision in the BALO as well as in the AMF's monthly review and on its website.

At this writing, no appeal against this decision had been made to the Conseil d'État.

### **3 - Against Crédit Agricole Indosuez Cheuvreux and Mr Charles Fabregat, decision of 18 March 2004**

The proceeding against Crédit Agricole Indosuez Cheuvreux (CAIC) and its employee, Mr Charles Fabregat, concerned relations between a management company and an investment service provider responsible for receiving and executing orders that the management company had placed for its own account and for its clients.

CAIC was faulted for having taken orders without prior assignment to a specified account, for allocating those orders at the end of the day or the following day, and for treatment that favoured certain clients over others.

On the basis of Articles 3.1.1 and 3.3.1 of the CMF's General Regulations, the Disciplinary Commission issued a warning to CAIC and Mr Charles Fabregat and ordered publication of this decision in the BALO as well as in the AMF's monthly review and on its website.

At this writing, no appeal against this decision had been made to the Conseil d'État.