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## CHAPTER V – MARKET SURVEILLANCE AND DISCIPLINE

Investor protection requires vigilant action on a daily basis to ensure that markets remain fair and orderly, that investors are treated equally, and that the information they receive is transparent.

In 2004, the AMF pursued its mission of overseeing markets in French financial instruments and all persons who trade on those markets. For this purpose, the AMF has effective resources of its own and coordinates its efforts with the other authorities responsible for supervising the banking and financial professions.<sup>1</sup>

As part of this oversight role, the AMF conducts inspections and investigations under the authority of its Secretary General. For these purposes, the AMF relies on three staff departments that perform:

- market surveillance: monitoring of trading and trader behaviour to detect market anomalies;
- off-site and on-site audits of investment services providers (ISPs), including asset management companies, to ensure that they comply with the rules of their profession;
- investigations, which typically focus on infringements of laws or regulations.

For these tasks, in addition to its own staff resources, the AMF may draw on external audit bodies: the market operator, the central depository, the Commission Bancaire and auditing firms.

This chapter describes the oversight activities conducted by the AMF in 2004.

### Market surveillance and discipline in 2004

|  |       |
|--|-------|
| Market situations examined                           | 1,560 |
| On-site inspections of investment services providers | 125   |
| Investigations opened                                | 83    |

Source: AMF

## I – RECASTING OF THE REGULATIONS

Book VI of the AMF's General Regulation deals with market abuse. As noted in Chapter III, issuers' public disclosure obligations are covered in Book II.

Book VI is essentially a transposition of the market abuse directives of the European Union (EU). To facilitate cross-border transactions, the AMF has chosen to depart as little as possible from the wording of the French versions of the directives. This approach reduces the legal risk inherent in a transposition that might be more faithful to the spirit than to the letter of the EU directives.

In addition, some of the content of Regulations 90-04, 90-08 and 98-07 of the Commission des Opérations de Bourse (COB) has been incorporated in Book VI, either to make clear that the rules of that Book apply to all persons and legal entities, barring special provisions to the contrary, or to specify "closed periods", pursuant to the EU rule for share buy-backs, or to retain the broad scope of the offence of providing false information in connection with public offers of securities.

Some new provisions have been added to take account of practices specific to French investors (e.g. reference to the opening price) and methods of trading in certain securities (call auction only).

Book VI comprises three Titles:

Title I consists of general provisions regarding scope (Article 611-1) and accepted market practices (Articles 612-1 to 612-4). The scope of insider offences extends to all financial instruments admitted to trading on a regulated market and to any other instrument whose value depends on such listed instrument. The scope of price manipulation offences extends only to instruments in the first category. Title I sets forth minimum criteria that the regulator must take into consideration in assessing market practices and specifies the procedure the regulator must follow to institute and retain those practices that it deems acceptable. That procedure entails national and international consultation, reasoned explanation, publication and periodic revision.

<sup>1</sup> Banque de France, banking commission (Commission Bancaire), commission on credit institutions and investment firms (Comité des Établissements de Crédit et des Entreprises d'Investissement, CECEI) and the insurance control commission (Commission de Contrôle des Assurances, des Mutuelles et des Institutions de Prévoyance, CCAMIP).

Title II covers insider transactions. Chapter 1 defines inside information as information that is privileged by virtue of being precise, non-public and likely to have significant impact on market prices. It then adapts this definition for commodity derivatives and for intermediaries responsible for executing orders (Articles 621-1 to 621-3). Chapter 2 addresses abstention obligations, i.e., prohibitions against taking advantage of privileged information, and the persons to whom they apply, specifying by characteristics and position those persons who must meet these obligations (Articles 622-1 et 622-2).

Chapter 1 of Title III covers price manipulation. Article 631-1 spells out the practices that constitute manipulation. Articles 631-2 and 631-3 list some of the criteria that the regulator can use to determine whether manipulation has occurred. Article 631-4 states that the AMF may request, as part of an inspection or investigation, public justification of any order transmitted to the market.

Articles 631-5 to 631-10 deal with exceptions to the abstention obligations, i.e., situations in which actions are allowed that would otherwise be considered manipulative, in connection with share buy-back or price stabilisation programmes.

These articles are to be interpreted in the light of Regulation (EC) No 2273/2003, which establishes the allowable objectives and means. Thus, the objective of a share buy-back programme must be to cancel the shares bought back, or to provide shares to cover stock option plans or convertible securities, or to achieve some other specific purpose that is part of an accepted market practice. Furthermore, such programmes must meet certain conditions as to price, volume, timetable (closed periods are not allowed) and issuer behaviour (issuers may not sell their own shares directly and may not trade on undisclosed privileged information).

In two decisions dated 22 March 2005, the AMF recognised the following as accepted market practices: (i) repurchase of the issuer's own shares with a view to holding them and using them subsequently as consideration in a merger or acquisition, and (ii) liquidity provider contracts drawn up in accordance with the new code of conduct of the French Association of Investment Firms (AFEI) and published in the legal gazette on 1 April 2005.

As well as requiring disclosure of the main characteristics of a share buy-back programme prior to implementation, the EU regulation introduces a new requirement to disclose detailed data on transactions under the programme no later than seven trading days following execution.

Chapter 2 of Title III consists of a single Article (632-1) on breaches of disclosure obligations. The actions prohibited by the Article are (i) communicating and (ii) knowingly disseminating information that is likely to convey inaccurate, imprecise or misleading indications to the market.

Two special cases are addressed: (i) persons who take positions in a financial instrument, then issue an opinion on it and stand to profit from the ensuing change in its price, without revealing the conflict of interest inherent in their actions; and (ii) journalists. Journalists are subject to the prohibitions of the article whenever they personally stand to profit or gain advantage from the information they convey. Where this is not the case, journalists' communication or dissemination of information is to be judged against the rules of professional conduct that apply to the profession. The nature and content of those rules is the subject of a consultation between the public authorities and media industry representatives.

## **II – MARKET SURVEILLANCE IN 2004**

Staffed by fifteen market experts, the market surveillance department is responsible for automated monitoring of trader behaviour and detection of market anomalies that might result from prohibited actions such as dissemination of false information, insider trading, price manipulation, failure to report major holdings, fraud involving fixed-income products, and so on. Anomalies that are spotted are analysed and may be pursued further in an investigation or an audit. The department monitors more than one-thousand listed companies, a comparable number of investment services providers, and all financial instruments traded in the Paris markets.

In 2004 the department maintained a brisk pace of surveillance activity and, at the same time, reorganised the support tools needed to perform its mission.

On the technical side, the AMF's predecessors, the COB and the Conseil des Marchés Financiers (CMF), were equipped with data systems – SMF<sup>2</sup> and SCAN<sup>3</sup>, respectively – that gave them in-depth knowledge of the market. Using retrieval tools available on a large number of workstations, these systems are able to display transaction details for all securities quoted on French markets, whether regulated or non-regulated.

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<sup>2</sup> *Système des Marchés Financiers*

<sup>3</sup> *Système de Collecte et d'Analyse*

SCAN's online database contains data sets for a rolling twelve-month period. At year-end 2004 the database held information on 194 million orders and 51 million trades transmitted by the market operator as well as 13 million transactions reported by 322 investment services providers (92 acting directly and 230 acting under mandate) via RDT, a direct reporting system.

SMF's database holds information on all trades executed since 1991 in the equity and derivatives markets as well as settlement system data since 1999. An integrated statistical module allows SMF to perform off-line audits. The module uses a set of 72 tests to provide daily alerts to the market surveillance team.

Much of 2004 was devoted to preparing the launch of a new shared application, SESAM,<sup>4</sup> which combines the functions of SCAN and SMF.

Several compelling reasons prompted the SESAM project:

- *functional*: The merged application will make it possible to run the numerous statistical tests inherited from SMF on the broader spectrum of SCAN data (which include OTC trades, for example) and thereby detect more infringements.
- *strategic*: The objective is to have an efficient system in place for implementation of the Markets in Financial Instruments Directive (MiFID).<sup>5</sup> MiFID will revolutionise market surveillance by eliminating the order concentration requirements on regulated markets.
- *economic*: With two-thirds of the data in each system common to both, maintaining two different applications entails a significant cost. The savings made possible by the merger of the COB and the CMF stand to be considerable.
- *logistical*: Currently, the AMF's data suppliers, Euronext, Clearnet and Euroclear France, must each send two data feeds. When SESAM is operational, they will each send only one feed, to a single regulatory authority.

## **A – Surveillance of ISP activity**

System development work has been completed to automate the monitoring of ISPs and thereby detect instances of non-compliant behaviour. Surveillance of individual providers, which used to be the responsibility of the CMF, is thus performed alongside surveillance of individual securities, which was one of the primary missions of the COB.

In 2004, ISP surveillance focused on the following.

- Monitoring of tender offers: for both share purchase and share exchange offers, the surveillance department sought to verify compliance with applicable regulations regarding Chinese walls, trading by the ISP presenting the offer, and so on.
- analysis of sharp changes in securities prices caused by ISP activity that might represent price manipulation, or placement of orders inconsistent with the client's interest.
- behaviour of liquidity providers: presence in the order book, compliance with quote spread requirements, etc.
- detection of trades with no economic justification.
- justification of prices in off-market trades.

Cases of erroneous trade reporting, probable front-running,<sup>6</sup> post-trade order allocation and price manipulation of various kinds by asset managers or other ISPs are brought to the attention of the audit department. The audit department analyses these alerts in greater depth and, if warranted, decides what further action to take.

## **B – Transaction monitoring**

Using its statistical tools, the surveillance department continued to detect a significant number of market anomalies that resulted in investigations. The department was the source of more than 50% of all investigations opened by the AMF.

Instances of possible insider trading ahead of tender offers or profit warnings were detected before the events in question became public. Pro-active monitoring of this kind also turned up a few instances of substantial price variations caused by individual investors or by companies trading in their own securities.

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<sup>4</sup> *Système Expert pour le Suivi des Activités de Marchés*

<sup>5</sup> The new EU directive that will come into force in April 2006 (see Chapter II)

<sup>6</sup> Placing own-account orders before executing client orders that would affect the market price

Lastly, some anomalies on the bond market also led to in-depth investigations, providing ample justification, if any were needed, for the systems developed by the COB and the CMF to monitor fixed-income activity, too.

Of the sanctions imposed by the AMF in 2004, 70% involved anomalies flagged by the market surveillance department. Certain infringements could never have been detected without the department's monitoring tools because no publicity in any form (press article, complaint, public offer, etc.) had ever resulted from them. This was true of the price manipulation in the Provalor case and also of inadequate margining for deferred-settlement trades at several ISPs (in the Banque Transatlantique case, for example), both of which were uncovered by the AMF's effective surveillance efforts.

In 2004, 1,560 market situations were examined, up 6% on the year before. Each of these market situations represented a set of anomalies concerning a security or an ISP that necessitated analysis by the surveillance department and requests for further information.

In 2004 the market surveillance staff continued to enhance the performance of its tests and performed several back-testing simulations on actual cases to calibrate trigger levels for these tests.

The department's Internet surveillance unit also upgraded its tool for analysing investment-related online forums. Several instances of improper investment solicitation were spotted, and the AMF issued warnings to the public about them. The AMF uses this warning procedure whenever it becomes aware of an illegal offer of investment products (marketing of unauthorised products or solicitation by unlicensed persons).

As part of the cooperation between members of the Committee of European Securities Regulators (CESR) on market surveillance, the AMF regularly receives public warnings issued by other national regulators regarding persons or entities offering investment services that they are not authorised to provide or products for which regulatory approval has not been obtained.

AMF has decided to pass along all these messages by publishing both its own warnings and those of other CESR members.

In 2004 the AMF issued seven warnings and posted them all on its website.

### **III – SUPERVISION OF INVESTMENT SERVICES PROVIDERS IN 2004**

The AMF's auditing activities concerned 983 regulated entities: 501 asset management companies, 132 investment firms<sup>7</sup> (56 of which have custody account-keeper status), 345 credit institutions (317 of which have custody account-keeper status), two custody account-keepers,<sup>8</sup> and three market infrastructure operators.

To carry out its responsibilities for supervising ISPs and market infrastructure operators, the AMF had some twenty inspectors at its disposal at year-end 2004, under the authority of the head of the Inspection department.

This department is charged with ensuring regulatory compliance by providers under the jurisdiction of the AMF. It is responsible for assessing the effectiveness of providers' compliance organisations, resources and procedures and for verifying that AMF rules are properly understood.

Both off-site audits and on-site inspections are used in supervising ISPs and infrastructure operators.

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<sup>7</sup> Includes Powernext and MTF France, both of which operate multilateral trading systems. Article 521-1 of the AMF General Regulation

<sup>8</sup> Article L. 542-1 (5 of the Monetary and Financial Code)

## **A – Off-site audits**

An off-site audit consists in analysing information transmitted to the AMF, either systematically or upon request, to verify compliance with the rules. It includes checking of orders and executed trades reported to the AMF by the market operator and ISPs.

The main supervisory actions of the AMF in 2004 took the following forms.

### **1 – Asset management companies**

#### **a) Internal control reports**

In 2004 asset management companies were for the first time required to file internal control reports, as other ISPs were already required to do. The 464 companies active in this business were told to submit a report on their control programme by the end of October 2004, giving a general description of their procedures and their internal control organisation and the resources devoted to them. A checklist of regulatory provisions applicable to asset management companies and the investment services they perform was provided to them for use in their internal audits in 2004. The responses are currently being analysed by the AMF.

#### **b) Annual financial statements**

With the development of a special database containing the financial statements of asset management companies, the AMF is able to verify that the data these companies are required to transmit annually to the AMF are consistent with the financial statements certified by their external auditors.

#### **c) *Late trading/market timing***

In the wake of the autumn 2003 scandal involving late trading and market timing at US investment funds, the AMF conducted a review of collective investment schemes established under French law within the broader context of a re-examination of the regulatory framework for asset management companies and custodians. At that time, the AMF sent a questionnaire to the forty largest management companies by assets under management in the equity fund category.

The AMF then analysed 34 management companies' descriptions of their practices in valuing equity funds and booking redemption orders, with a view to detecting potential late-trading or market-timing abuses. This analysis served as the preliminary to a series of on-site inspections to examine companies' responses more closely. In July 2004, without waiting for the findings of those further investigations, the AMF Board adopted and published a series of recommendations intended to reduce the likelihood of abuses of this kind.<sup>9</sup>

Documentary audits were conducted in connection with 16 cases referred to the AMF by the Commission Bancaire and one case referred by the CCIRP, all regarding acts that may have constituted breaches of AMF regulations.

### **2 – Other authorised providers**

#### **a) Annual reports**

Investment services providers, the market operator, the clearing house and the central depository are required to submit reports to the AMF each April on their internal supervision of investment services during the previous year. These reports serve to guide the AMF's on-site inspections. Of the 505 authorised providers, 486 reported that they were engaging in the provision of investment services. The other 19 reported that they were not making use of their authorisation to do so.

As was done in the past, the AMF supplied a questionnaire for use by authorised providers in filing the 2003 annual report required by Article 312-22 of the General Regulation. This form included a reference table of the main provisions. Systematic use of the questionnaire format makes it possible to standardise the responses, allowing the AMF to analyse them more easily and to monitor statistics relating to the supervisory efforts reported by providers.

Based on the responses received, the investment services and related services most frequently offered by ISPs are reception and transmission of orders (93% of authorised providers), followed by custody account-keeping (78%). Many providers do not utilise all the authorisations they have been granted.

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<sup>9</sup> AMF monthly review, issue 5, July-August 2004

The annual reports for successive years bear witness to the implementation of internal procedures and the strengthening of controls performed by providers' investment service supervisors, making for constant improvement in the rate of regulatory compliance.<sup>10</sup>

## b) Special audits

Every year, the AMF conducts audits on a specific subject.

### - Marketing of investment services and financial products

In 2004, the AMF asked authorised providers' investment service supervisors to submit by September 2004 a special report on marketing procedures for investment services and financial products. A summary analysis of the 455 reports that were received will be published in 2005.

### - Control procedures for provisions on client accounts (for deferred-settlement orders)

The summary of the 2003 special reports on this subject<sup>11</sup> shows that rigorous automated monitoring of risks on both stocks and flows of clients' deferred settlement orders, coupled with procedures to flag irregularities, issue warnings to clients and liquidate positions, all help to ensure proper compliance with regulatory provisions.

As regards coverage of positions in exchange-traded derivatives, providers appear to be systematically applying the margining and liquidation rules to their clients. In contrast, analysis of the reports highlighted the necessity of having secure processing circuits for cash sell orders involving multiple intermediaries. The processing of "direct" orders (placed by clients directly with traders that are not also their custody account-keepers) must be improved, and client relations of this kind must be more uniformly put under contract. Procedures for monitoring debit balances in pure traders' securities accounts with their clearers must likewise be improved. Lastly, there is currently no obligation that an asset management company check for the existence of the required balance or margin when it places orders on a client's behalf.

### - The depositary function

The AMF also analysed the content of the performance requirements of the 88 currently active fund depositaries<sup>12</sup> against the standard of the COB Instruction of November 1993. A representative sample of 18 depositaries was surveyed using a questionnaire. This review highlighted some gaps in those performance requirements. It revealed that several depositaries were not performing certain supervisory tasks relevant to their functions or did not have appropriate resources, in particular for assessing valuations of specific securities or for ensuring that the investment strategies of some of the funds to which they provide depositary services are consistent with the stated investment objectives. The AMF has set up an industry working group to modernise the regulatory framework for fund depositaries.

### - Placing orders via the Internet

The AMF also conducted an audit to determine whether the systems used by authorised providers to take orders via the Internet meet the requirements of Article 321-61 of the General Regulation, in particular as regards identifying transactions that are not usual for the client and checking orders for consistency.<sup>13</sup> The audit showed that the majority of ISPs are implementing specific routines to flag unusual orders and alert clients to them, without going so far as to design a personalised system based on each client's pattern of orders.

### - Exercise of voting rights (procedures of depositaries and custody account-keepers)

An assessment of the procedures implemented by the main fund depositaries and custody account-keepers to facilitate the exercise of voting rights by their clients showed that some of them offer personalised services for this purpose and also that wide disparities exist in their deadlines for processing voting instructions. The findings of this audit have been transmitted to the working group established by the AMF to study ways of improving shareholder participation in general meetings.

## c) Reporting obligations

Each day, authorised providers report the transactions they make in financial instruments admitted to trading on a regulated market in France. These reports are made either directly or via the market operator.

Pursuant to Book I of its General Regulation, the AMF has set forth the reporting requirements for trades in financial instruments in Instruction 2004-01. Besides maintaining the requirements established previously by the CMF, this instruction provides for reporting of transactions in debt securities admitted to trading on a regulated market but carried out off-market. It also extends the reporting requirements to foreign branches of authorised providers.

<sup>10</sup> A summary of the 2003 reports was published in the AMF monthly review, issue 9, December 2004.

<sup>11</sup> AMF monthly review, issue 11, February 2005

<sup>12</sup> AMF monthly review, issue 11, February 2005

<sup>13</sup> The results of this audit are presented in an article, "Detection and processing of unusual orders placed via the Internet (Article 9 of CMF Decision 99-07): Summary of practices". AMF monthly review, issue 5, July-August 2004

By analysing the transaction data collected in this way, the AMF has been able to assess the risk of an intra-day price change greater than the minimum margin required for securities eligible for deferred settlement.

### **3 – Surveillance of market infrastructure operators**

Market oversight is enhanced by holding regular monthly meetings with the investment services supervisors of Euronext Paris, LCH Clearnet and Euroclear France. The points monitored with Euronext in 2004 included:

- supervision of market members;
- technological developments associated with reporting of orders and transactions using the TCS Web tool;<sup>14</sup>
- implementation on the regulated market of provisions governing value-weighted average price transactions;<sup>15</sup>
- examination of the consequences of combining certain operating functions such as surveillance of derivatives markets;
- analysis of market incidents.

The AMF works in cooperation with its counterparts<sup>16</sup> on the oversight of Euronext markets. These authorities have jointly decided to coordinate their supervisory efforts by:

- drawing up an annual oversight questionnaire;
- evaluating the business continuity plan for the equity and derivatives markets;
- implementing procedures to alert the regulators in the event of market malfunction.

Every two months, the AMF met with LCH Clearnet and Euroclear to go over the fails recorded by clearing members as well as the data system incidents logged by the clearing house and the central depository. Special scrutiny was given to Clearnet members with a relatively high percentage of fails on settlement. This monitoring effort has now been extended to fails involving derivatives. Particular attention was paid to control procedures for derivatives clearing and for the risks incurred in doing. At the request of the AMF, Euroclear France began monitoring inactive accounts as part of its procedures to combat money laundering and terrorism financing.

## **B – On-site inspections**

The decision to order an on-site inspection is taken by the Secretary General of the AMF. After the inspection mission, a written report of its results is provided to the regulated entity, which is asked to submit its observations to the AMF. The report is then forwarded to the AMF Board, which decides whether there are grounds for opening a proceeding.

In 2004 the AMF completed 98 inspection missions initiated in 2003 and opened 125 new ones. The schedule established at the beginning of the year was met.

To perform inspections of authorised providers, management companies and infrastructure operators, the AMF is not limited to its own staff. Under Article 621-9-2 of the Monetary and Financial Code and Articles 11 and 13 of Decree 2003-1109 of 21 November 2003 relating to the AMF, it may also draw on external audit bodies.

Roughly three-quarters of its inspection missions in 2004 were performed by outside auditors: 60 by seven auditing firms, 16 by Euronext and 16 by the Commission Bancaire. When the AMF 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.

### **1 – Subject areas**

The main audit topics were the following.

- 12 inspections looked at fund subscription and redemption procedures to ensure that holders were being treated equally in terms of information on asset valuation and order acceptance;

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<sup>14</sup> Transaction Confirmation System

<sup>15</sup> A transaction in which a member agrees with a client or another member, in accordance with the provisions of Trading Manual, to negotiate a trade at a price within an interval of one percentage point, including the upper and lower bounds, around the average price, weighted by the value of trading in the central order book, of a specified security over a period of time in the future.

<sup>16</sup> In Belgium, the Netherlands, Portugal and the UK

- 41 inspections reviewed compliance with reporting requirements;
- 21 inspections were conducted at ISPs whose authorisation to provide investment services had been issued within the previous 18 months. These inspections reviewed the means deployed to provide such services for consistency with the CMF-approved programme of operations, in 17 cases, and with the filing package submitted to the COB, in the case of the other four;
- 30 inspections reviewed asset management companies' compliance with professional obligations and checked whether their activities were in accord with the authorisation issued to them;
- Three inspections were performed on behalf of the UCITS Supervisory Commission of the Principality of Monaco.

The problems found during inspection missions typically arise from a provider's failure to implement appropriate resources for supervising its activities. Regarding the rules of conduct on relations between providers and their clients, shortcomings are still being identified in customer due diligence procedures. The same is true of compliance with the obligation to inform, especially where the client is not a qualified investor. In this regard, ISPs with individual investor clients must pay particular attention to the way in which they market riskier financial instruments.

Regarding compliance with market disclosure obligations, the audit trail could be improved, both in terms of documentation (missing or incomplete order tickets or trade confirmations) and of consistent time-stamping. Time/date stamps are still too frequently incomplete or absent altogether, making it impossible to ensure pre-allocation of portfolio managers' orders, whether for discretionary or for collective management. ISPs should also pay special attention to checking margin for orders transmitted by clients. It would appear that the best-execution principle is being infringed by several ISPs that charge a spread in addition to the brokerage fee.

Not all ISPs have yet adopted appropriate organisational arrangements and procedures to implement the required Chinese Walls between client and proprietary activities and around investment research. This situation is likely to give rise to conflicts of interest.

During on-site inspections of authorised providers' reported transactions, auditors checked whether:

- the transactions had an economic justification;
- the transactions reported by the authorised provider were consistent with the transactions that it executed or sent to another provider for execution;
- the orders entered were consistent with the instructions it received from the client;
- the tickets were stamped with the time and date that the order was placed, so that any late allocations could be identified;
- the terms on which orders were executed matched those reported to the client, and the provider's charges were correctly calculated;
- client orders were transmitted to the market quickly and in order of arrival.

The inspection missions conducted in the past three years on custody account-keeping have focused on the following requirements:<sup>17</sup>

- double-entry bookkeeping for financial instrument accounts;
- automated reconciliation of asset holdings on the account-keeper's books with those on record at the central depository for France;
- implementation of an automatic securities loan facility in the event of mandatory provisions;
- margining of deferred-settlement orders at the time of the order and throughout the duration of the position;
- availability of own-account assets at the time of trade execution;
- supervision by the principal of the agent's transactions, when tasks are delegated to an agent;

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<sup>17</sup> AMF monthly review, issue 7, October 2004

- formalisation of relations with clearing brokers;
- existence of system backup and business continuity plans;
- formalisation by the institution's investment service supervisor of an annual audit plan for the custody account-keeping activity.

## **2 – Actions subsequent to on-site inspections**

Eight inspection reports resulted in the opening of a disciplinary proceeding by the AMF Board. These proceedings are still in progress at this time.

Two reports led the Board to issue injunctions pursuant to Article L. 621-14 I of the Monetary and Financial Code. One investment firm was enjoined to be able to prove the origin of its trading orders, to disclose to clients the total amount of rebated commissions received by the firm on their orders, and to take measures to ensure compliance with its own internal rules. A second investment firm, which offered a web-based order reception and transmission service, was ordered to produce an affidavit certified by its statutory auditor stating that a registered letter had been sent to all clients whose identity had not been checked during the account-opening procedure. In both cases, the situation at the firm in question was rectified following the injunction.

## IV – INVESTIGATIONS

When impropriety is suspected, the Secretary General of the AMF may decide to open an investigation on possible infringements. An investigation will give rise to a report that is submitted to the AMF Board for evaluation.

A total of 83 investigations were opened in 2004. This figure is roughly the same as in previous years, whereas the proportion of investigations that subsequently result in disciplinary proceedings is on the rise.

|  | 2002 | 2003 | 2004 |
|--|------|------|------|
| Investigations opened by the AMF <sup>18</sup> | 80   | 85   | 83   |

Source: AMF

### A – Origin and classification

One-half of the investigations were initiated on the basis of anomalies detected by the market surveillance department. Most frequently, these investigations concern offences or rule violations: insider trading, dissemination of false information and price manipulations.

Others were initiated in response to indications forwarded by other AMF divisions in contact with investment services providers and issuers.

Lastly, some investigations originated from sources outside the AMF, such as investor complaints, requests for advice from judicial authorities in cases involving public companies or infringements committed during public offers,<sup>19</sup> revelations received from other French government authorities, or requests from foreign authorities with regulatory responsibilities equivalent to the AMF's.<sup>20</sup>

The 83 investigations in 2004 were opened for the following reasons.

| Reason <sup>21</sup>  | TOTAL*    |
|---|-----------|
| Market (insider behaviour or dishonest conduct impairing orderly markets) | 37        |
| Financial disclosure  | 24        |
| Improper acts related to asset management                                 | 1         |
| Unauthorised direct marketing   | 3         |
| International cooperation   | 32        |
| <b>Total*</b>   | <b>97</b> |

Source: AMF

\* *The total is greater than the number of investigations opened because 14 investigations concerned both the market in a security (price manipulation and insider trading) and financial disclosure.*

As in past years, a significant proportion of the investigations in 2004 concerned behaviour that represented possible insider abuses, impairment of fair and orderly markets or shortcomings in financial disclosure.

Ninety investigations,<sup>22</sup> were completed in 2004, an appreciable increase from previous years (75 in 2002, 79 in 2003), even though the "size" and complexity of investigations has tended to grow.

### B – International cooperation

The AMF continued to cooperate with foreign regulators on matters involving market surveillance, investigations and exchanges of information on financial intermediaries. In 2004, 32 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 AMF from foreign authorities and made by the AMF to foreign authorities.

<sup>18</sup> By the COB in 2002; by the COB and then the AMF in 2003: 75 by the COB and 10 by the AMF (from 24 November 2003)

<sup>19</sup> Article L. 466-1 of the Monetary and Financial Code

<sup>20</sup> Article L. 621-21 of the Monetary and Financial Code

<sup>21</sup> The reason indicated relates to the facts that prompted the opening of the investigation and does not prejudice the outcome thereof.

<sup>22</sup> See appendix 5

Requests for assistance, by country

| Country        | Requests 2003 |            | Requests 2004 |            |
|----------------|---------------|------------|---------------|------------|
|                | received      | made       | received      | made       |
| Austria        | 0             | 0          | 2             | 0          |
| Bahamas        | 3             | 0          | 1             | 3          |
| Belgium        | 14            | 13         | 5             | 5          |
| Bermuda        | 0             | 2          | 0             | 1          |
| Brazil         | 1             | 0          | 1             | 0          |
| Canada         | 0             | 3          | 0             | 3          |
| Cayman Islands | 0             | 2          | 0             | 0          |
| Egypt          | 1             | 0          | 0             | 0          |
| Finland        | 1             | 0          | 1             | 0          |
| Germany        | 2             | 13         | 10            | 9          |
| Greece         | 1             | 0          | 1             | 0          |
| Guernsey       | 5             | 0          | 4             | 0          |
| Hong Kong      | 1             | 1          | 1             | 0          |
| Ireland        | 1             | 3          | 1             | 2          |
| Italy          | 1             | 5          | 6             | 9          |
| Japan          | 0             | 3          | 0             | 3          |
| Jersey         | 0             | 0          | 1             | 0          |
| Luxembourg     | 11            | 14         | 7             | 6          |
| Monaco         | 0             | 2          | 0             | 1          |
| Morocco        | 0             | 1          | 0             | 1          |
| Netherlands    | 1             | 4          | 7             | 11         |
| Poland         | 1             | 0          | 2             | 0          |
| Singapore      | 0             | 3          | 2             | 1          |
| South Africa   | 1             | 0          | 0             | 0          |
| Spain          | 1             | 3          | 4             | 1          |
| Sweden         | 2             | 0          | 2             | 2          |
| Switzerland    | 3             | 39         | 1             | 21         |
| United Kingdom | 7             | 52         | 4             | 48         |
| United States  | 7             | 33         | 9             | 21         |
| Other          | 3             | 1          | 4             | 11         |
| <b>Total</b>   | <b>68</b>     | <b>197</b> | <b>76</b>     | <b>159</b> |

Source: AMF

Nearly two-thirds of all requests received or made by the AMF concerned the United Kingdom. The two other countries with which cooperation is most frequent are the USA and Switzerland. Although the number of requests received by the AMF grew by approximately 10% between 2003 and 2004, the number of requests made by it to other countries' regulators dropped significantly in 2004.

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

Requests for assistance, by type

|  | Requests 2003 |            | Requests 2004 |            |
|--|---------------|------------|---------------|------------|
|  | received      | made       | received      | made       |
| Authorisation:   |               |            |               |            |
| Requests for information on intermediaries                           | 26            | 63         | 27            | 44         |
| Surveillance:  |               |            |               |            |
| Requests for market information                                      | 1             | 1          | 0             | 0          |
| Requests for information on intermediaries/transactions/ legislation | 1             | 1          | 0             | 0          |
| Investigation of infringements:                                      |               |            |               |            |
| Use of inside information  | 24            | 102        | 23            | 79         |
| Dissemination of misinformation                                      | 2             | 15         | 7             | 13         |
| Infringements associated with public offers                          | 3             | 1          | 0             | 0          |
| Price manipulation   | 5             | 10         | 7             | 19         |
| Unauthorised direct marketing  | 1             | 2          | 0             | 1          |
| Infringements via the Internet                                       | 2             | 1          | 2             | 0          |
| Other  | 3             | 1          | 10            | 3          |
| <b>Total</b>   | <b>68</b>     | <b>197</b> | <b>76</b>     | <b>159</b> |

Source: AMF

Of the investigations calling for international cooperation, those concerning insider trading remain the most numerous.

## V – CASES REFERRED TO OTHER AUTHORITIES IN 2004

When the AMF finds evidence of acts that could fall under the jurisdiction of other judicial, administrative or self-regulatory authorities, it transmits its findings or reports to those authorities for appropriate action.

### A – Transmittals to administrative or self-regulatory authorities

During 2004, the AMF forwarded four reports to other French administrative or professional authorities: two to the Commission Bancaire, one to the higher council of the accounting profession (Conseil Supérieur des Experts Comptables) and one to a regional institute of statutory auditors (Compagnie Régionale des Commissaires aux Comptes). These figures represent a lower number of referrals than in previous years simply because of the merger of the COB, CMF and CDGF, each of which transmitted numerous audit and investigative reports to the others.

### B – Transmittals to judicial authorities

If the report of the inspection or investigation identifies possible offences, the AMF Board forwards it to the public prosecutor and may disclose to the public that it has done so. If the suspicions bear on breaches of securities law<sup>23</sup> (price manipulation, false information, insider trading), the Board transmits the report immediately to the prosecutor for the Paris Regional Court, which has sole jurisdiction in such matters. Transmittal can also be founded on a request for advice from the judicial authorities in court cases relating to public companies or

<sup>23</sup> Article L. 621-15-1 of the Monetary and Financial Code

offences committed in connection with public offerings,<sup>24</sup> and also on the fact that a judicial investigation has been opened on the same acts.

The AMF transmitted 17 reports involving possibly criminal acts. Fourteen of these reports have led, or could lead in 2005, to the opening of a disciplinary proceeding by the AMF and thus cannot be commented upon here. The remaining three 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 concern, in the first case, direct marketing of banking transactions, and in the other two cases, advertising and sale to the public of foreign financial products of uncertain legal status (second case) or in evasion of the requirement imposed by COB Regulation 98-08 to have an offering document approved by the AMF (third case).

**Summary table of inspection and investigation reports referred by the AMF in 2004**

|   |                     |
|---|---------------------|
|   | <b>AMF<br/>2004</b> |
| <b>Transmittals</b>                                 |                     |
| - to administrative and self-regulatory authorities | 4                   |
| - to judicial authorities                           | 17                  |

Source: AMF

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<sup>24</sup> Article L. 466-1 of the Monetary and Financial Code