Five years of market abuse supervision

a European regime in development

The Netherlands Authority for the Financial Markets

The AFM promotes fairness and transparency within financial markets. We are the independent supervisory authority for the savings, lending, investment and insurance markets. The AFM promotes the conscientious provision of financial services to consumers and supervises the honest and efficient operation of the capital markets. Our aim is to improve consumers' and the business sector's confidence in the financial markets, both in the Netherlands and abroad. In performing this task the AFM contributes to the prosperity and economic reputation of the Netherlands.

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Summary

The supervision conducted by the AFM in order to prevent market abuse includes the prohibition of insider trading, the prohibition of market manipulation, the timely publication of price-sensitive information and the obligation to disclose substantial holdings. Much has been achieved since the introduction of the Market Abuse Directive on 1 October 2005. In the first years of supervision, the emphasis was on explaining the legal provisions by means of regular contacts with market participants, and presentations for and meetings with companies. Besides this active approach to the market participants, the AFM has also published guidelines on various occasions over the years. Supervision to ensure that price-sensitive information is published without delay has contributed to a greater fairness of the market: there is now less opportunity to trade with inside information. Press releases are published more promptly and more frequently, and trading in advance of press releases dealing with mergers and acquisitions has become 'cleaner'. This was also the conclusion of the AFM's 2007 research report on the effects of a change in market abuse regulation on stock prices and volumes.

Supervision by the AFM

The AFM actively tracks price and volume movements on trading venues, and requests information from listed companies. By holding seminars and publishing information brochures, it communicates a clear message regarding the obligation to publish price-sensitive information without delay. In cases where it is suspected that this obligation has not been met, the AFM requests the company concerned to provide an explanation, before any enforcement action might be taken. If necessary, the AFM will suspend the trading in financial instruments. The AFM's intention is to ensure that investors and other market participants are informed simultaneously, promptly and in a manner that is accessible to them. The AFM has suspended trading on more than 30 occasions in the last five years, and conducted more than 250 investigations into potential market abuse.

The financial markets have become more international, so that the AFM's supervision is no longer limited to the national borders. The AFM has cooperated closely with its fellow European regulators regarding several large acquisitions, in which rising share prices in advance of takeover bids were grounds for investigation. Investigations against the parties involved were indeed submitted to the Public Prosecutor in various countries. These cases demonstrate that international and in particular European cooperation is essential for proper supervision. The AFM therefore supports further integration and harmonisation of European supervision of market abuse.

The introduction of the Markets in Financial Instruments Directive (MiFID) has led to a proliferation of trading venues and international fragmentation of trading. To conduct its supervision more efficiently and in a more focused manner, and to reduce the time needed to investigate instances of market abuse, the AFM supports the introduction of a mandatory client-ID. Individual trading patterns would be more easily traceable, and conspicuous trading patterns could be more effectively attributed to the market participant or person responsible. The introduction of the client-ID would shorten the information retrieval procedure in the event of an investigation. The investigation could also be more efficiently conducted if the AFM also had access to 'print lists' from the telecommunications providers. This would give the AFM information on the persons who had been in contact with an insider prior to the execution of the suspect transaction. The AFM welcomes the recent statement by the Minister of Finance supporting the (rapid) introduction of the client-ID.

Technological innovation, combined with the increase in the number of trading venues, makes it necessary for the AFM to use an electronic detection & analysis system to indentify suspicious transactions. Using models, daily alerts are generated that indicate possible market manipulation or insider trading. This enables the AFM to trace certain types of market abuse in a targeted way. In the future, the AFM will focus more on the statistical analysis of transactions and price movements, and use algorithms to conduct searches of reported transactions (data mining).

In the coming period, the AFM will continue to draw close attention to the risks that are created if many insiders gain access to price-sensitive information prior to publication. In order to prevent leaks of price-sensitive information, it is important that the circle of insiders is kept as small as possible.

The collaboration with the Public Prosecutor and FIOD (Dutch Fiscal Intelligence and Investigation Service) is satisfactory, and contributes to the enforcement of the legislation against market abuse. Nonetheless, the AFM would like to see additional capacity being made available for settlement of market abuse cases in the criminal courts. The AFM would also prefer to see publication of all penalties imposed by the Public Prosecutor in settlement with suspects, similar to the administrative-law obligation for the AFM pursuant to the Act on Financial Supervision [*Wft*]. Publication of all penalties would increase the visibility of supervision to prevent market abuse.

Transaction information

Competition between the trading venues has led to the decentralisation of information on the supply and demand for financial instruments. This has consequences for the daily monitoring of securities transactions. Due to the increase in competition, an increasing number of trading venues have to be covered by the supervision. In order to be able to collect and synthesize information, investment firms in Europe are obliged to report transactions to their relevant securities regulator. The regulators, on their part, are responsible for sharing this transaction data with their European colleagues. The quality and consistency of these transaction data in the Transaction Reporting System (TRS) are crucial elements in the supervision of market abuse. The AFM also uses these data as input for the detection system it uses to trace patterns of market abuse.

Market developments

Technological innovations and significant changes to the structure of the European market landscape have contributed to a rapidly increasing presence of High Frequency Trading (HFT) on European trading venues. HFT is a means of optimally executing certain complex trading strategies using automated systems. As is the case for more traditional trading techniques, HFT presents opportunities for abuse and market manipulation. In this context, the AFM pays particular attention to all new techniques, including HFT.

The equity and fixed-income markets were highly unstable in the period between 2008 and 2010. The extraordinary circumstances during the credit crisis forced the AFM to take measures against the short selling of shares of financial institutions, partly due to the risk of price manipulation. The AFM has recently published a report on the operation of the fixed-income market and the formation of government bond prices. The AFM found no evidence that market participants manipulated the bond market. The developments in the market were a reaction to the problems in Greece and other countries; they were not the cause of the problems. The AFM nonetheless supports harmonised European regulation and supervision, to improve the transparency, infrastructure and supervision of

the government bond market and to ensure consistency in these areas. The AFM is closely involved in these regulatory initiatives at European level.

Notifications

Lastly, the regime applying to disclosure of substantial holdings has been amended with the introduction of the Decree on the Disclosure of Major Holdings and Capital Interests in Issuing Institutions [*Wmz* 2006]. The AFM also reviewed its policy regarding securities lending in early 2009. The AFM takes the view that the obligation to disclose substantial holdings should be extended to include economic long positions that put the holder in a position to acquire a holding in the issuing institution. The AFM also supports additional transparency with regard to short selling positions, as recently proposed by the European Commission on the advice of CESR, the Committee of European Securities Regulators.

1 Introduction

Why do we need supervision to prevent market abuse in the financial markets? How does the AFM fulfil its role as the supervisory authority? What does the AFM supervise? What are the challenges for the future? These and other questions are the basis of this report on five years of supervision of market abuse by the AFM.

The integrity of the market is essential for confidence, and therefore for the proper operation of the markets for financial instruments and for the protection of investors. If confidence is lacking, this can mean that investors and those seeking to raise capital will no longer be prepared to actively trade in these markets.

The Market Abuse Directive became Dutch law on 1 October 2005 through inclusion in the Dutch Securities Transactions Supervision Act [*Wet toezicht effectenverkeer* 1995] and in the Market Abuse Decree [*Besluit marktmisbruik*] (included in Section 5.4 of the Act on Financial Supervision since 1 January 2007, whereby the provisions relating to immediate publication of price-sensitive information were transferred to Section 5.1a with the implementation of the Transparency Directive on 1 January 2009).

The implementation of the Market Abuse Directive brought a number of new orders and prohibitions under the supervision of the AFM. The two most important changes were 1) extension of the prohibition of market manipulation and 2) the AFM's supervision of immediate publication of price-sensitive information. The changes tightened and expanded the existing European regime of market abuse supervision, and introduced some harmonisation. The intention of the Directive is to improve the protection of market integrity on the various trading venues in Europe.

In the early years of the market abuse supervision, the emphasis was mainly on explaining the legal provisions by means of regular contacts with market participants. Over the past years, the AFM has published several information brochures and guidance, such as the guideline on manipulative trading practices[1], on the AFM's interpretation of the prohibition of market manipulation and how it applies this interpretation in practice. There have also been legal rulings regarding the interpretation of the legal provisions.

The importance of equal information for investors has been a central priority for the AFM over the last five years. Much attention has been devoted to creating a level playing field in which price-sensitive information is made public as quickly as possible. Making price-sensitive information generally available reduces the chance that opportunities to trade with inside information will arise, and assists investors in making well-founded decisions. The AFM has further elaborated the criteria for the timely publication of price-sensitive information over the last five years. In 2010, the discussions with market participants mainly concern the interpretation of specific technical aspects.

The AFM has taken punitive action against companies that failed to publish price-sensitive information promptly, against investors who traded with inside information, and against those obliged

[1] The guideline on manipulative trading practices (in Dutch) can be found at: *http://www.afm.nl/nl/professionals/afm-actueel/nieuws/2009/feb/leidraad-handelspatronen.aspx.*

to disclose their transactions to the AFM who failed to do so in a timely manner. The AFM has thereby provided additional clarity regarding the standards that apply in this respect.

At the time of writing, the European Union is about to review the Market Abuse Directive. Much has changed in the market over the last five years, among other things because of the increased number of trading venues and the speed at which transactions can be executed. Partly due to these developments, changes to the legislation are necessary. This report is a review of progress so far, but also offers an opportunity to look ahead. It therefore discusses how the AFM continues to conduct its supervision, as well as expressing its objectives and challenges for the future.

Section 2 describes a number of market developments that are having an important effect on the AFM's market abuse supervision. Section 3 describes the methods used by the AFM in its supervision. Section 4 deals with the regulation, duties and process of evaluation for each type of market abuse. The report closes with a general conclusion.

This report presents a summary of the events of the last five years and is intended to provide information. No rights may be derived from it. The report does not pretend to be exhaustive, nor is it intended to provide guidance regarding legislation and regulation. The relevant legislation and brochures on market abuse can be found at www.afm.nl.

2 Market developments in the last five years

The AFM was given responsibility for the supervision of market abuse in October 2005. Until that time, it was only responsible for the monitoring of potential insider trading. The consequences of the implementation of the Market Abuse Directive included an extension of the prohibition of market manipulation and a transfer of the supervision of the publication of price-sensitive information by listed companies from Euronext Amsterdam to the AFM (previously established in article 28h of the Listing and Issuing Rules for Euronext).

The financial markets have become increasingly international, and have changed significantly, from the limitation of protective constructions in favour of shareholder power to the introduction of the Markets in Financial Instruments Directive (MiFID) which was intended to encourage increased competition between trading venues. Securitisation, the breaking up and repackaging of debt on the basis of expected creditworthiness, has contributed to the interrelatedness and complexity of the financial world. After the bankruptcy of Lehman Brothers in 2008, it quickly became clear that the US credit crisis would affect Europe as well.

The turbulence in the financial markets continued in the second half of 2008. Bad news on an international scale, in particular with regard to financial institutions, led to disquiet among investors and proved to be a breeding ground for rumours. It appeared that more false and incorrect information was being intentionally disseminated in the market. In the exceptional circumstances at the end of 2008, the AFM decided to treat trading methods that were designed to cause the prices of financial securities to fall as prohibited market manipulation. The AFM initiated several investigations in which international cooperation and exchange of information turned out to be essential. Not only are businesses operating more internationally, but the dissemination of rumours and distribution of price-sensitive information are also no longer limited to national borders. The AFM thus collaborates closely with its fellow regulators in other countries.

This section discusses the market developments that affect the supervision of market abuse, such as dealing with new trading venues, High Frequency Trading (HFT), the role of shareholders, mergers and acquisitions and the short selling of both equities and government bonds.

2.1 The advent of a new generation of organised trading systems

The advent of the MiFID in November 2007 changed the legal framework for trading venues. The MiFID took account of a new generation of organised trading systems that had developed in parallel to the regulated markets, such as Multilateral Trading Facilities (MTFs). The MiFID boosted the development of this new generation of trading venues by giving it formal legal status. At the same time, the MiFID set additional requirements for the MTFs. The intention of the MiFID is to encourage competition between the various trading venues (regulated markets and MTFs).

Until a few years ago, in some European countries all transactions had to take place on the stock exchange. All transactions by private investors in listed companies had to be executed on a stock exchange, and therefore most transactions were executed on the trading venues provided by the operators of the traditional stock markets in Europe (such as NYSE Euronext, London Stock Exchange and Deutsche Börse). European legislation has brought an end to this obligation.

New forms of trading were developed, especially in London, whereby transactions were executed on non-regulated markets.

In addition to transactions by private investors, there are also investment firms that execute equity orders for the account of clients. Some of them took the view that orders could be executed at lower costs if they were directed to a trading venue that they themselves operated. Various investment firms applied for a licence to do this.

There was also a need, mainly from institutional investors, for a venue where large equity orders could be executed discreetly and without too much impact on the price of the stock in question. All these factors led to rapid growth in the number of MTFs. According to the MiFID database of the Committee of European Securities Regulators (CESR)[2] consulted on 19 October 2010, there are 92 regulated markets and 139 MTFs operating in the European Union. On 1 November 2007 these figures were 93 and 84 respectively. The number of MTFs in the European Union is thus significantly increasing.

In order to prevent a situation in which – due to the number of venues – investors can no longer see if they are getting a reasonable price for their securities, the MiFID includes the 'best execution' rule. This rule obliges investment firms to take all reasonable measures to ensure the best possible result when executing orders for the account of their clients. At the same time, the obligation to make a comparison of the places of execution available helps to stimulate competition between the trading venues.

The most important MTFs for trading in Dutch equities are Chi-X, BATS Trading Europe, Turquoise and NYSE Arca Europe. A licence was moreover granted to TOM to operate as an MTF in 2010. Before March 2007, when Chi-X was established, the lion's share of transactions was executed on Euronext Amsterdam. This proportion fell to approximately two-thirds in 2010. The turnover on MTFs in the early months of 2010 accounted for approximately 25% of the total turnover on European trading venues. Before the MiFID came into effect, trading took largely place on the regulated markets.

The fragmentation of the market in financial instruments is continuing unabated. The increase in the number of venues has practical consequences for the supervision of market abuse. In 2005, the regulator could adequately meet its responsibilities by supervising the transactions executed on NYSE Euronext Amsterdam. Now that trading has become fragmented, a multitude of venues have to be monitored. To streamline the decentralisation of trading, all investment firms are obliged to report their transactions to their relevant regulator. The international cooperation between securities regulators regarding the transaction reporting obligation and the way in which investment firms must observe this requirement are described in Section 3.5.

2.2 High Frequency Trading

Technological innovations and significant changes to the structure of the European market landscape have contributed to a rapidly increasing presence of HFT on European trading venues in recent years. The arrival of MTFs has encouraged HFT and algorithmic trading.

[2] *http://mifiddatabase.cesr.eu/.*

The impression is that HFT has led to an increase in liquidity, although the exact quality of this liquidity is a matter of debate. The number of transactions and orders has grown exponentially, but at the same time the transaction size has fallen sharply. A debate is ongoing regarding the net result of these developments. The AFM devotes further attention to HFT in the separate report *High Frequency Trading: The application of advanced trading technology in the European marketplace*.[3]

HFT is not a strategy in itself; it is a means of optimising, implementing and executing certain complex trading strategies through the use of automation. As a means for executing certain trading strategies, HFT can also be misused to manipulate the market. In this respect, the AFM is devoting special attention to HFT, albeit in the realisation that in itself HFT is a legitimate technique that does not involve market abuse under normal circumstances. The features of market manipulation are discussed in more detail in Section 4.3.

2.3 The role of shareholders

In the corporate governance debate, a more active role by shareholders is seen as the way to improve the system of checks and balances at companies. In the period from 2005 to 2008, the hedge funds were particularly active as shareholders. They contributed in practice what the Tabaksblat Committee expected shareholders to contribute: they called the management board and supervisory board to account, and exercised pressure to change the corporate governance structure.

Under certain circumstances, the actions of shareholders can create price-sensitive information, especially if the matter concerns shareholders working together on a sustainable basis who wish to change the strategic course of the company. This kind of action was a relatively new phenomenon in the Netherlands that also involved regulatory risks. To identify these risks, the AFM conducted analyses in 2006 and held consultations with companies, shareholders and legal experts. There was also contact with (major) shareholders in writing and by telephone to point out the risk of manipulation.

If investors make statements that are factually incorrect or incomplete, fail to disclose substantial holdings in listed companies, or hint that they may be making a (competitive) public takeover bid, this influences the public and there is a reasonable chance that the public will be misled. This report deals with these aspects in further detail in Sections 3 and 4. In actual cases of known actions by (major) shareholders the AFM conducted a further investigation to verify that the legal provisions relating to market manipulation, disclosure and/or offers had been met, and that the claims made were based on reality. In the case of anonymous and factually incorrect statements in the media, however, it proved to be difficult to establish who had actually originated them.

2.4 Developments in mergers and acquisitions

Since 2006 there has been a relatively large number of public takeover bids issued without the support or approval of the management of the listed company that was the target of the bid. In addition to these hostile public takeover bids, there was a visible increase in the number of competitive bids whereby several parties were bidding for the same target company. These

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[3] The AFM report on High Frequency Trading can be found at:
http://www.afm.nl/en/professionals/afm-actueel/rapporten/2010/hft-rapport.aspx

developments led to calls for a takeover panel to be appointed as a new, independent supervisory authority for aspects of securities law and the corporate-law aspects of a public takeover bid. There were also calls for changes to the legal provisions of the existing system of the judiciary and the regulatory institutions.

At the same time, the public takeover rules were amended in order to incorporate the Takeover Directive[4] into Dutch law. Since then, press releases relating to public takeover bids no longer have to be submitted to the AFM for evaluation in advance. Since the intention of issuing a public takeover bid can constitute price-sensitive information, the legal provisions state that the press release must be sent to the AFM at the time of publication. The so-called mandatory bid was also introduced in the Netherlands and the ban on bids without previous notice[5] was lifted, so that it became possible to announce a hostile bid without any prior contact with the target company.

2007 not only saw an increase in hostile and competitive bids and shareholder activism, there was also an absolute increase in the number of public takeover bids to more than 20, compared to an average of 10 to 12 in other years. Examples of hostile and/or competitive bids were those for ABN AMRO, Hagemeyer and Tele Atlas. Since 2009, the incidence of public takeover bids has clearly been affected by the credit crisis; there has been a significant decline in activity since that time, and the situation has not changed in the initial quarters of 2010.

The 'takeover panel question' was also debated in the Lower House of the Dutch Parliament. After consultation with the market regarding the desirability of appointing a takeover panel, it was decided that this would not happen. The Ministry of Finance did however put forward recommendations for amendments to the public takeover bid rules.[6] The Ministry subsequently issued a proposed amendment to the public takeover bid rules for consultation in the summer of 2010. The new rules will most likely take effect in the first half of 2011.

2.5 The credit crisis: measures against short selling of equities, transparency in the government bond markets

After the bankruptcy of Lehman Brothers in September 2008, the regulators in the major capital markets introduced measures against the short selling of equities issue by (listed) financial institutions. Short selling is the selling of securities that the seller does not own with the intention of making a profit from a fall in the market price. The AFM also implemented such emergency measures for the duration of the credit crisis.

Short selling is in principle a legitimate activity that can have positive consequences for investors and trading. In exceptional market conditions however, short selling can have a negative effect on the proper operation (and therefore the stability) of the financial market. There is also a risk of market manipulation. The exceptional market conditions that occurred during the credit crisis increased the risks associated with short selling. In the autumn of 2008 the share prices of financial institutions were under heavy pressure as a result of the deteriorating situation, and were extremely vulnerable to bad

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4 Directive 2004/25/EC concerning public takeover bids.

5 A public takeover bid whereby the bidder is not obliged to give prior notice or enter into consultation.

6 The results of the consultation on the takeover panel (in Dutch) can be found at:

http://www.rijksoverheid.nl/documenten-en-publicaties/kamerstukken/2009/09/15/uitkomsten-consultatie-marktmeester.html

news. In these circumstances the AFM decided to intervene because it could not allow a disruption to orderly and transparent financial market processes to lead to financial instability. The AFM therefore implemented temporary measures to limit the short selling of equities issued by Dutch financial institutions and to increase transparency.

Short selling is possible in the fixed-income market, as well as in the equity market. In the second quarter of 2010 there was a crisis in the market for European government bonds in reaction to the deterioration in the financial position of certain eurozone governments. High national debts, weak budgetary discipline and an economic recession have led to doubts about the sustainability of government finances, for example in Greece. At the request of the Minister of Finance, the AFM conducted an investigation of the role of speculation in the crisis in the European government bond market[7], pursuant to requests from the Lower House to the Minister for such action. The AFM found no evidence that market participants had manipulated the bond market. The developments in the market were a reaction to the problems in Greece and other countries; they were not the cause of the problems.

The government bond market is however not a perfect market. The prices at which bonds are traded are only visible to a certain extent, since much of the trading occurs over-the-counter. Market participants cannot always make a good estimate of the price they should pay for a bond. Credit default swap (CDS) prices are sometimes used to determine bond prices, but this can give a distorted picture of the underlying security and the risks in the bond market.

For the supervisory authority, as well, only limited insight into the market is provided. The AFM currently has no information on the positions and strategies of market participants, and therefore can only assess the cause of market movements afterwards and can only then decide whether intervention is necessary. Lastly, it is not easy for market participants to assess and manage the risks to which they are exposed as a result of holding credit default swaps or other derivative instruments.

Given the imperfections of the government bond market, the AFM's view is that European legislation is necessary to improve the transparency, infrastructure and supervision of the government bond market. The AFM does not favour restrictive measures against short selling or the purchase of unhedged credit default swaps. Such measures are said to restrict speculation, but would also impede price formation and the possibilities available for hedging risks. It is more important that international regulation is put in place that is consistent and provides transparency for investors, in both the equity and the fixed-income markets. This legislation should also increase the information on the size of significant short positions available to the securities regulator, and encourage centralised trading.

[7] The AFM report 'The government bond market in a European perspective' can be found at:
http://www.afm.nl/en/professionals/afm-actueel/nieuws/2010/sep/maatregelen-staatsobligaties.aspx

3 How the AFM conducts its supervision

This section describes how the AFM deals with signals of market abuse by describing the investigation process, the obligation to report suspicious transactions, the disclosure of substantial holdings and the obligation to report transactions.

3.1 The identification of potential market abuse

The AFM looks for signs of possible market abuse using the professional skills of its supervisors, who have previous experience as analysts, traders, asset managers, IT specialists or stock exchange employees. They use their knowledge and experience to monitor price and volume movements in connection with news from many sources, such as:

- press releases sent by issuers to the market (and the AFM);
- economic and other news from data vendors such as Thomson/Reuters and Bloomberg, Internet and Internet forums, newspapers, TV and radio, etc.;
- real-time trading information from the stock exchange enabling the AFM to monitor which member or trader is trading.

The combination of all this information generates signals of possible market abuse. These signals are initially investigated further for explainable or unexplainable developments that are either permitted or not. Any further action is then taken on this basis. If necessary, the AFM contacts market participants in real time in the case of potential infringements.

BOX 3.1: Real-time supervision

The real-time supervision for market abuse that was previously conducted by Euronext Amsterdam was taken over by the AFM in 2005. The AFM was given certain powers by the legislator in this respect to enable it to enforce the relevant legal provisions in real time. These powers involve the giving of an instruction to a trading venue subject to supervision in relation to:

- the delaying or suspension of trading in a financial instrument if there is suspicion of a leak of price-sensitive information, of insider trading or of market manipulation;
- the cancellation of transactions in financial instruments executed for the purpose of market manipulation.

The AFM can also issue an instruction to an issuing institution in relation to:

- the publication of price-sensitive information without delay.

The AFM began its real-time supervision for market abuse in order to maintain the confidence of investors in the financial market. One of the ways in which this is achieved is to ensure that investors are immediately and simultaneously made aware of price-sensitive information by issuing institutions. For the AFM, in practice this means that a trading measure must be taken quickly and for good reason, and that a decision must be communicated to or imposed on a trading venue, issuer, investment firm and/or the public without delay.

In order to be able to use its powers effectively, the AFM needs to act without delay. Intervention in trading after the event or too late, or intervention on the basis of incomplete or incorrect observations, is not in the interest of investors or the proper operation of the securities markets. Since trading nowadays occurs increasingly at high speed and using automated systems, the effects of market abuse on the market will be accelerated and amplified. Rapid and correct trading measures are necessary to limit the damage. This can only happen if the market is monitored in real-time.

In 2005, with the acceptance of its new supervisory tasks, the AFM set up a monitoring room and took over the monitoring system used by Euronext in order to monitor the trading on Euronext Amsterdam in real-time. Based on order and transaction data from investment firms and their clients that are not anonymous and that are visible in the monitoring system in real-time, the AFM can quickly form an impression of the normal and abnormal trading patterns of market participants occurring in the financial instruments traded on the venue of Euronext Amsterdam. These data enable the AFM to actively monitor for signs of market abuse.

In the past five years, this monitoring system has enabled the AFM, when necessary, to intervene in trading quickly and efficiently, and to prevent (further) damage as a result of market abuse. For example, the suspension of trading in the shares of Numico N.V. and Vedior N.V., which the AFM imposed in 2007 on suspicion of trading on the basis of leaked price-sensitive information, demonstrated that the AFM's awareness of the trading behaviour of individual investment firms enabled it to more rapidly conclude that such trading was probably occurring. The AFM indeed imposed various measures in these cases.

The information from the monitoring system has significantly accelerated the process whereby a decision to impose a trading measure in respect of financial instruments is taken. If the AFM is informed that an issuing institution is about to publish price-sensitive information, the AFM puts the financial instruments concerned on a watch list. The trading behaviour of investment firms in these instruments is given special attention, in order to identify any possible premature leakage of price-sensitive information. The AFM uses automatically generated alerts to immediately identify abnormal trading behaviour, and can intervene without delay if necessary.

The AFM has also intervened in the market on various occasions in cases of market manipulation when its monitoring system gave reason to suspect that a client of or trader at an investment firm was attempting to artificially influence the price of or volume traded in a financial instrument. The AFM contacts those concerned by telephone to establish the motive for the trading behaviour and prevent market manipulation without delay, so that any (further) damage to the market can be avoided. The information on clients of or traders at investment firms needed for such interventions is also generated from the non-anonymous trading data in the monitoring system.

In addition to its real-time supervision, the AFM has a detection & analysis system. Transactions and orders on NYSE Euronext and transactions in Dutch instruments or derivatives thereof reported by investment firms and our fellow regulators are recorded in the detection & analysis system. Using certain models, the system generates daily alerts of indications of potential market abuse, especially with regard to market manipulation and insider trading.

The AFM then analyses the alerts generated by the detection & analysis system, enabling it to actively trace certain forms of market abuse. The system also makes it easier to identify potential market abuse in liquid stocks. The detection & analysis system has already generated a number of useful signals for further investigation.

3.2 The investigation process

After an initial analysis, the investigation department of the AFM reassesses each signal of potential market abuse to establish whether indeed the behaviour in question could constitute an infringement of the legal provisions. In this process the AFM considers the trading behaviour of individual parties and relevant public sources of information, as well as the general movement of the market. In order to use the available resources efficiently, an estimate is made of the likelihood that an investigation will be worthwhile.

Every investigation initiated concerns either the potential infringement of the prohibition of insider trading, the failure to publish price-sensitive information without delay, the prohibition of market manipulation, or a combination of the above. During the course of the investigation, the scope may be extended to include offences relating to the prohibition of communicating inside information, the prohibition of recommending to others that they execute transactions in the financial instruments concerned [*tipverbod* in Dutch] and/or the failure to report a suspicious transaction or insider transaction or the failure to disclose a substantial holding. In cases where an outsider has traded with inside information, the information may have originated from an insider who has breached the prohibition of communicating inside information or the prohibition of recommending to others that they execute transactions in the financial instruments concerned. The investigation may also reveal that the investment firm in whose name the suspicious transactions were executed has failed to notify the AFM when it should have done so. Once the investigation hypothesis is established, it is decided which infringements will be investigated further and which parties will be approached for relevant information.

The AFM requests transaction data from investment firms in the Netherlands and abroad. In the case of data from abroad, this is only possible through the relevant foreign securities regulator. The AFM's intention is to discover the accountholder for whom the investment firm has traded during a certain period. If the investigation gives grounds for doing so, more detailed information is requested from a specific client of the investment firm that has showed abnormal trading behaviour. In such cases the AFM is looking for information in the form of securities portfolio statements and the 'know-your-client' information. This allows the AFM to assess whether a particular transaction or pattern of transactions is part of the client's normal trading activity.

The retrieval of information is not only time-consuming for both the investment firm and the AFM, it also means that investigations are of lengthy duration. The retrieval of information relating to transactions executed by investment firms in the Netherlands generally involves two requests. The retrieval of information relating to transactions executed by investment firms outside the Netherlands generally involves three or four requests. The waiting time before receipt of the information can last from three to nine weeks. In particular, international requests for information can be very time-consuming. A mandatory client-ID is necessary for the purpose of investigation. This would make it immediately clear who is trading, and would significantly reduce the period needed for information retrieval. How the client-ID would work and its usefulness is explained further in Section 4.2.

When information is requested from listed companies, the focus is on:

- chronological statements - what preceded the publication of a price-sensitive press release;
- lists of insiders – who was aware of the information prior to publication;
- minutes of the meetings of the management board and the supervisory board – when were the decisions taken;
- e-mail correspondence of those involved - what was communicated to others.

The AFM may, for instance, ask institutional or private investors to give their reasons for executing certain transactions, their relationship with certain insiders or statements of securities portfolios.

In view of the development of the market structure, electronic supervision is becoming increasingly important. In future, the AFM will therefore focus more on the statistical analysis of transactions and price movements, and use algorithms to conduct searches of reported transactions. The AFM is currently working on increasing the effectiveness of its insider trading investigations using data mining techniques. This involves the identification of connections by conducting electronic searches of available information. These connections may be between:

- trading parties themselves;
- trading parties and insiders at an issuing institution; or
- trading parties and the external advisers of issuing institutions.

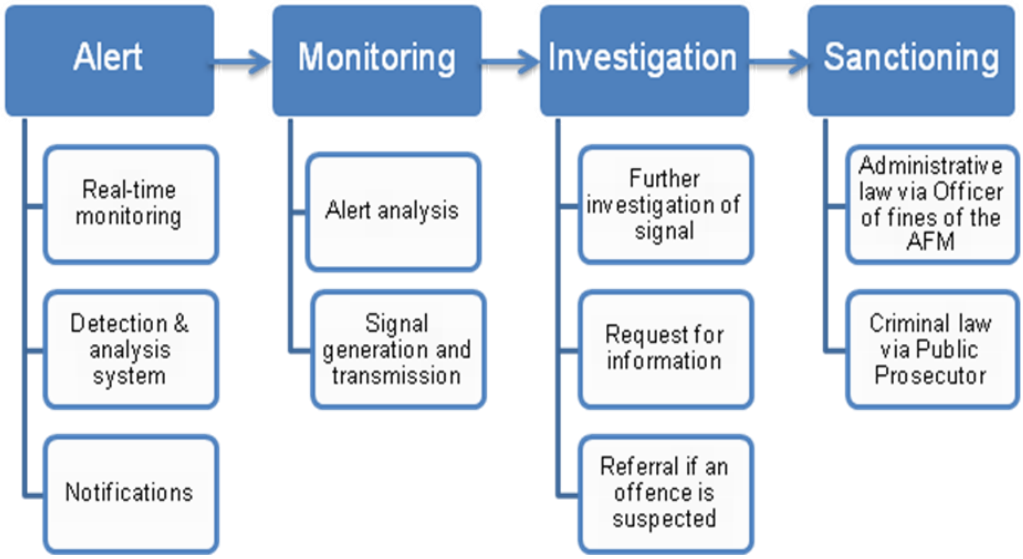
The connections relate to a longer period of time and may be used in different investigations.

The offences investigated by the AFM can be dealt with either under administrative law or under criminal law, but not both. Once a suspected infringement is identified (and it is established that the case can be prosecuted under both criminal law and administrative law) the AFM has to decide whether to submit a report to the Public Prosecutor or impose an administrative fine itself. The situation is different in some of our neighbouring countries, Belgium and France for example, where the regulator can itself impose an administrative fine and, for the same offence, submit a report to the Public Prosecutor in the country concerned.

The AFM decides whether to impose an administrative fine or submit a report in consultation with the Public Prosecutor and FIOD (Dutch Fiscal Intelligence and Investigation Service). The decision depends on the seriousness of the offence and the amount of the realised gain, or in the situation of a repeat offence, the specific knowledge and powers and available capacity at the various institutions.

The collaboration with the Public Prosecutor and FIOD is satisfactory, and contributes to the enforcement of the legislation against market abuse. Nonetheless, the AFM would like to see additional capacity being made available for those instances where market abuse cases must be dealt with in the criminal courts. The AFM would also prefer to see publication of all penalties imposed in relation to settlements made by the PPS with suspected offenders, in parallel with the administrative-law settlement whereby the AFM already has this general publication requirement pursuant to the Act on Financial Supervision. Publication of all penalties, thus in cases of administrative-law as well as criminal-law settlements, would promote the visibility of the market abuse supervision.

In simplified form, the process from alert to sanctioning is as shown below:



If it is decided that a case will be dealt with under administrative law, the AFM sends a draft investigation report to the market participant suspected of committing the offence. If the market participant concerned does not provide a response that gives grounds for revising the imposition of an administrative fine, a final investigation report is prepared. This final report with supporting documentation is then transferred to the AFM's Officer of fines (who acts independently from the investigators) with a proposal that an administrative fine be imposed.

The Officer of fines takes over the investigation file and sends a notice of intention to impose an administrative fine (this is not the fine itself) to the market participant considered by the AFM to have committed the offence. The offending party is then given a further opportunity to respond to the notice of intention. The independent Officer of fines will then send a recommendation to the Executive Board of the AFM as to whether an administrative fine should be imposed or not. The AFM Executive Board then makes a final decision on the basis of this recommendation.

The offender can object to the AFM against the imposition of an administrative fine. If this is rejected, the offender can appeal to the District Court of Rotterdam. As a last resort, a higher appeal against the ruling of the District Court in Rotterdam can be made to the Appeals Board for Industry [*College van Beroep voor het bedrijfsleven*, or CBb]. The option of appealing to the CBb is available to both the offender and the AFM. Once the AFM imposes a public warning, an administrative fine or an order subject to a penalty for non-compliance, the decision is published together with a press release from which any confidential information has been removed.

If a decision is made for a criminal prosecution, the AFM refers the case to the Public Prosecutor and takes no further part in the investigation.

BOX 3.2: Harm-Jan de Kluiver, secretary of the *Vereniging van beursgenoteerde ondernemingen*, or VEUO ["Listed Companies Association"]

Companies, markets and abuse: Is sufficient account taken of dilemmas in legislation and practice?

The legal provisions regarding market abuse and the provision of price-sensitive information are among the most difficult issues facing listed companies in everyday practice. The problems do not so much concern the obvious questions such as how to determine when or whether trading is permissible, or how to determine whether a situation of inside information has arisen. With a certain degree of prudence, companies can find their way, also with the assistance of the guidance provided by the AFM. The much more difficult issues include (i) the question of when information has to be made public, (ii) what information may be shared with certain shareholders and under what conditions (the so-called 'one-on-ones') and (iii) the interaction with the AFM once the AFM is considering an administrative fine ruling.

To answer the question of when information has to be made public, one must first determine whether a situation of inside information has arisen. The next crucial consideration is the provision for delay contained in Section 5:25i Wft. Regarding the first question, the long-established practice used to be that an assessment had to be made as to whether publication would have a 'significant influence' on the share price. It should certainly be possible for people to make a reasonable estimate of the extent of this influence. However the AFM appears to have shifted the focus to the determination of what a 'reasonably acting investor' would be likely to consider relevant to their investment decision. This definition is so broad and open that it is difficult for companies to estimate this in advance. The situation is further complicated by the scarcity of specific conditions whereby publication can be delayed. The conditions for delay that are known are (a) that there is a legitimate interest, (b) that the delay is unlikely to deceive the public and (c) that confidentiality can be guaranteed. These conditions are not clearly defined, and require explanation and elaboration. The explanation and elaboration that have been provided still give listed companies the impression that the AFM has little sympathy for or understanding of the dilemmas that companies face in the complex reality of everyday practice. Some of the AFM's decisions confirm the impression that the AFM interprets these conditions in a very restrictive light, and does not give listed companies a reasonable benefit of the doubt in its assessments.

Also in the case of 'one-on-ones', the AFM should – in the view of Dutch listed companies – take more account of practical considerations in the underlying development of its thinking with regard to corporate governance. Simply put, what this comes down to is that in certain circumstances both the major shareholders and the courts demand that the company must discuss its concerns and wishes with its (major) shareholders. The relevant interpretations of the AFM with regard to the sharing of confidential information restrict this possibility to crucial proposals with regard to takeovers or the issuance or reissuance of financial instruments. However these days it is increasingly the case that a company board cannot afford not to look for support from its major shareholders in other areas as well.

Finally, there is the question of the procedure and progress of affairs once the AFM has formed the intention of imposing an administrative fine in relation to this legal provision. Listed companies do not always have the impression that the AFM is prepared to enter into reasonable consultation. This certainly applies to the objection phase, which is not experienced as very encouraging. The composition of the complaints committee is regularly rather one-sided, and there is little confidence

that the case will be considered objectively. As a result, there is even a tendency among companies to actually avoid attending the hearings of the complaints committee.

Constructive contact is made even less likely once the AFM engages (external) legal counsel and further contacts take place via this route. Given the status and powers of the AFM, listed companies find it extraordinary that the AFM can in this way avoid direct contact and direct consultation with the company which is subject to the exercise of the legal powers the AFM has.

With all respect for the integrity which undoubtedly forms the basis of the AFM's exercise of its duties, listed companies take the view that there is nevertheless room for improvement. As stated above, the impression at these companies is that the AFM does not adequately take account of the dilemmas and dynamics with which a listed company is confronted in everyday practice. Listed companies would like to see an improvement in the AFM's sympathy for and understanding of the practical issues they face. That should become an agenda item for the AFM for the next five years.

3.3 The reporting requirement for suspicious transactions

The requirement for investment firms to report reasonable suspicions of market abuse is an important means for supervision by the AFM. The reporting requirement for suspicious transactions obliges an investment firm, that has reasonable suspicion that a transaction or order to execute a transaction is in conflict with the prohibition of insider trading or the prohibition of market manipulation, to report its suspicions to the AFM without delay. Any other institution or person that sees a suspicious transaction or suspicious behaviour in the market may at all times report their suspicions to the AFM on a voluntary basis.

Informative meetings regarding the reporting requirement were organised for a number of investment firms in 2006, at which meetings the AFM obtained feedback on its supervision. The AFM has added a list of FAQs to its website in an attempt to respond to this feedback. A further information session was organised in 2007 for a number of small and medium-sized investment firms which had not submitted any reports. The objective was to bring the reporting requirement to the attention of these parties and give them the opportunity to express their opinion of the reporting requirement. Through this meeting the AFM also gained additional information regarding the reasons why these investment firms had submitted few or no reports.

Despite efforts to draw attention to the reporting requirement, the number of reports received by the AFM has gradually declined since 2006, in which year nearly forty reports were received. In 2009 this had declined to around fifteen reports. Only fourteen (approximately 5%) of the active investment firms submitted a report to the AFM between 2005 and 2010, and only ten of these investment firms submitted a report on more than one occasion. Four (in most cases large) investment firms accounted for almost three-quarters of the reports submitted. Only a handful of reports were submitted by medium-sized and smaller investment firms. The reports mainly concerned insider trading by private investors.

In part of the European Union investment firms are obliged to actively monitor transactions. The AFM applies a passive reporting requirement: the investment firms do not have to actively search for suspicious transactions. Some countries apply active supervision focused on obtaining reports, while in other countries such as the Netherlands the regulator takes a more passive approach.

In 2010 the AFM made a comparison of the reports it had received and the reports received by other European regulators since 2007. The Netherlands was in the middle bracket in terms of the number of reports received. On average, the reports submitted in most European countries were divided equally between insider trading and market manipulation. The situation was different in the Netherlands, where the vast majority of the reports concerned insider trading. The AFM is currently looking at ways to increase the number and quality of the reports it receives. The AFM is also looking for ways to expand the area to which the reports relate, in order to receive more reports of market manipulation, for instance.

The AFM recently sent a questionnaire to the members of CESR on matters including increased enforcement of the reporting requirement. Between January 2007 and July 2010, eight of the 21 CESR countries (including the Netherlands) took measures against investment firms that had failed to comply with the reporting requirement. The measures taken varied from an administrative fine to a report to the Public Prosecutor. In 2007 the AFM imposed an administrative fine of EUR 21,781 on KopVos & Partners B.V. for the failure to report reasonable suspicions of insider trading by one of its clients in 2006.

The Portal AFM is available for the reporting of suspicious transactions. The Portal can be used for the notification of price-sensitive information, but also for the mandatory reporting of suspicious transactions by an investment firm. Users can send their messages and reports in a secure manner to the AFM by logging in to the Portal with a user name and password. By using the Portal AFM, market participants can comply with their obligation safely with a few electronic actions, and administrative costs are kept to a minimum.

3.4 The disclosure of substantial holdings

There is an obligation to disclose substantial holdings in listed companies. The proportion of votes held by shareholders is important information, as investors need to know which other parties hold large blocks of votes. To enable investors to calculate the percentage of the capital and the number of votes that they hold, the issuing institution is obliged to notify its total outstanding capital and the number of votes.

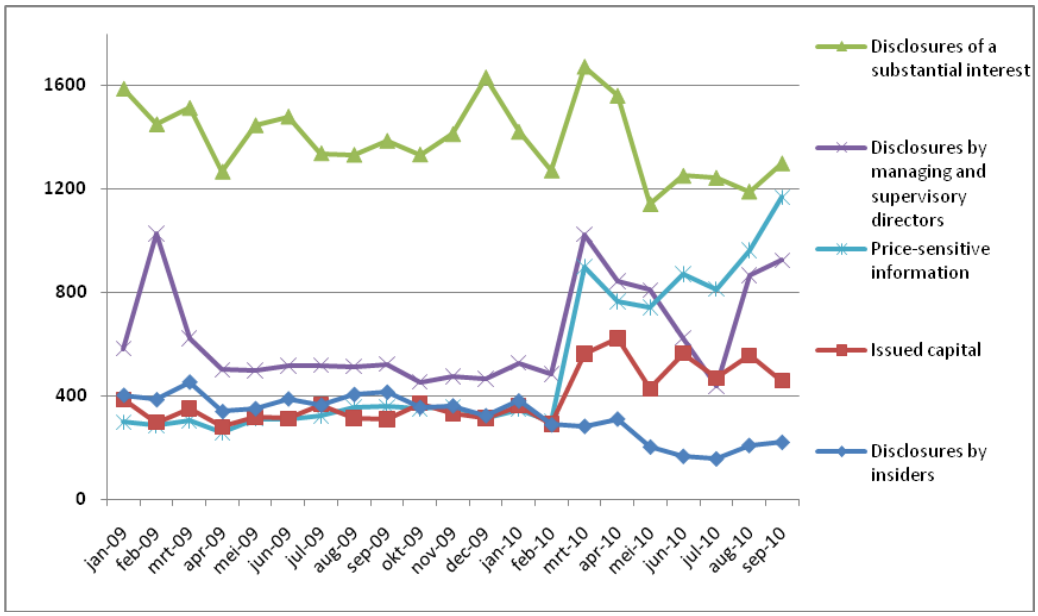
The interests of the company management are not generally the same as those of its shareholders. To harmonise these interests more closely, companies pay their directors partly in shares and share options. The number of shares that the management holds or buys can also be an indication of the confidence it has in its business. Insiders (managing and supervisory directors of an issuing institution and other insiders) are therefore required to notify the transactions they execute to the AFM.[8] The AFM then publishes these transactions via the registers on its website. Since October 2006, notifications can be made via the Loket AFM. By using the secure access, people can safely comply with the disclosure requirement with a few electronic actions and minimal administrative costs.

[8] See Wft 5:48, 5:60 and further.

Each year the AFM sends information on practical matters, by email, to the compliance departments of the issuing institutions that submit notifications on behalf of managing and supervisory directors. These matters include how certain transactions should be reported to Loket AFM, for example the unexercised expiration of staff options or the allocation of preferential subscription rights. The explanatory brochures that are provided for issuing institutions, managing and supervisory directors and holders of substantial holdings give guidance to the market on the various disclosure regulations.

A survey taken by the AFM in 2009 and 2010 of those subject to a disclosure requirement revealed that people mostly use automatic systems to disclose substantial holdings. Both the compliance and the legal department are usually involved in submitting a disclosure to the AFM. External advisers are engaged in the event of changes in legislation. Changes in legislation are communicated internally via intranet, informative meetings or by e-mail to those concerned.

The conduct of supervision of the disclosure requirements begins with a check of the accuracy and completeness of the disclosures received, and the release of this information for the AFM's registers. The registers on the AFM's website can be consulted by anyone. The figure below shows the number of unique visitors to the AFM registers per month, including the subjects they were interested in.



The disclosure registers can be searched for parameters such as date, issuing institution or person subject to the disclosure requirement. Lists of submitted disclosures are also available for download. A register update is available for those wishing to be kept up to date with changes to the registers. For example, this enables people to check whether they have become subject to the disclosure of a substantial holding requirement due to a change in the issuer's share capital. The update service, the registers and Loket AFM are generally experienced as useful and user-friendly.

For most disclosure requirements, people should notify a shareholding or change thereto to the AFM without delay. If they fail to do so promptly, the AFM requests the person subject to the disclosure requirement to give an explanation. In certain cases the AFM establishes that there has been a failure to notify substantial holdings at all, which is a serious offence.

In each case, the AFM determines the appropriate sanction on the basis of the response of the person subject to the disclosure requirement, the seriousness of the offence and the degree of culpability. The following aspects are considered:

- how late the disclosure is;
- the number and size of the transactions;
- the circumstances surrounding the transactions, such as the increase or decrease of a substantial holding;
- whether the transaction was made known to the market by other means (prospectus, press release);
- whether the case involves a repeat offence.

An additional check is made to determine whether other offences such as suspected insider trading are involved.

There is also a requirement under the 'Temporary Regulations Concerning the Notifying of Short Positions' to disclose when a short position is taken. Since 1 October 2008 the AFM has received approximately 80 notifications of short positions.[9] The majority concern daily notifications to the AFM of a short position subject to the disclosure requirement, regardless of whether a threshold value has been reached, exceeded or gone below.

The transactions that are visible via the systems of NYSE Euronext and in the transaction reports from investment firms do not, however, provide the AFM with information on the positions these parties take. The AFM therefore requests information from these parties in order to be able to assess the short selling positions of the end clients. The information requested gives information on the trading behaviour of market participants and the extent to which a party is complying with the short selling regulations. As a result, the AFM has so far initiated around seventy investigations in relation to a possible breach of the short positions regulation. The most common reason for an investigation was that parties had taken short positions that could have been subject to the disclosure requirement. As a result of some of these investigations, the AFM has sent letters with instructions regarding standards to the parties involved. So far the AFM has not encountered any serious offences.

3.5 The reporting of transactions

Competition between the trading venues has led to the decentralisation of the information on the supply and demand for financial instruments. Furthermore, much of the trading in equities is over-the-counter. In order to ensure that information can be collected and synthesised, all investment firms in Europe report transactions to their relevant regulator. The regulators in turn are responsible for sharing this transaction data with their European colleagues. The central collection of transaction data is used to trace instances of market abuse.

The AFM receives the transaction data directly from the investment firms subject to its supervision and from the other European regulators via the transaction reporting system (TRS). The quality and consistency of these transaction data are essential for the supervision with regard to potential market abuse. The investment firms themselves are responsible for the quality of the transaction data they deliver.

[9] Reference date: 1 September 2010.

Quality of transaction data means:

- complete: TRS receives all relevant transactions;
- correct: the transactions reported correspond to reality;
- timely: transactions must be reported by the following business day, at the latest.

There was an improvement in the data quality provided in the Dutch market in 2009. There is, however, still room for improvement in the level of accuracy achieved by the investment firms.

Consistency means that all the investment firms operating in Europe report transactions in the same mutually comparable way. For this to be the case, it is important that all investment firms use the same definition of a transaction. It is also important that the investment firms report transactions not executed on a regulated market or MTF in the same way. Elements of transaction reporting which are currently not consistently provided concern the indication of whether and at what juncture a transaction forms part of a chain of transactions, and the option of entering a client-ID or not. The AFM continues to strive to achieve an improvement to the quality and consistency of data and therefore participates in the relevant CESR working group.

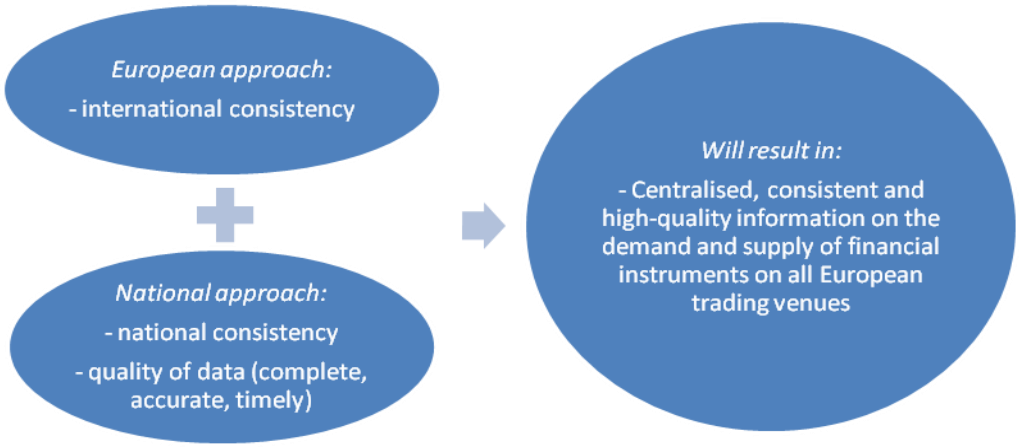


Diagram: overview of coherence of data quality of transaction reporting process in Europe.

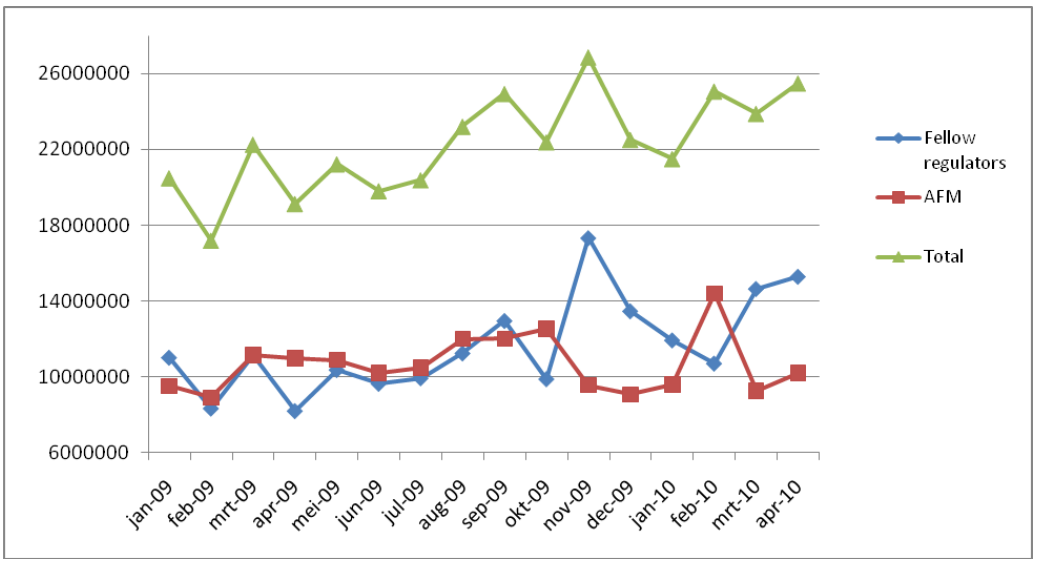
In order to encourage investment firms to manage their transaction reporting process:

- the AFM informs investment firms on a monthly basis regarding the quality of their transaction reporting process;
- the AFM conducts quality audits three times a year;
- the AFM conducts audits on site, giving the AFM information on the entire reporting process;
- the AFM compares TRS data with transaction data from trading venues and other investment firms. This provides insights into the completeness and accuracy of the transaction data in the TRS. In this way, it is possible to test whether the information on transaction time, location, size and counterparty corresponds with reality.

In the period from January 2009 to April 2010 the AFM received an average of 22 million transactions per month in TRS. On average, 10.6 million of these transactions originate from investment firms reporting directly to the AFM, and 11.6 million originate from our fellow European regulators. The majority of the transactions sent to the AFM come from the United Kingdom, Germany and France. Analysis of the transaction data shows that, with respect to the trade in financial instruments, there is

a shift to new trading venues taking place. In particular, the share of transactions executed on MTFs has increased at the expense of the traditional trading venues.

The figure below shows how many transactions TRS receives each month, subdivided into transactions reported directly to the AFM and transactions reported by other regulators.



The AFM published the Handbook Transaction Reporting in October 2010, which deals with all aspects of the transaction reporting requirement.[10] This handbook has two objectives: First, to provide clarity to investment firms, which will improve the quality and consistency of the transaction data in TRS, and second, to communicate changes, observations and European developments in a centralised manner.

[10] The handbook can be found at *www.afm.nl/handbookTRS.*

4 What does the AFM supervise?

The various forms of market abuse dealt with in this section concern the (incorrect) publication of price-sensitive information, insider trading, market manipulation and the disclosure of substantial holdings. The central issues are the regulations, interpretations and the sanctions imposed. The AFM has conducted more than 250 investigations of market abuse and has referred more than thirty cases to the Public Prosecutor in. In addition, frequent presentations are held for listed companies, and in 2010 a meeting was organised for Board members of Midcap stocks on various aspects of capital markets supervision, including market abuse supervision.

Besides this active approach to listed companies, the AFM has also published guidelines on various occasions over the years. Supervision of timely publication of price-sensitive information has contributed to a 'fairer' market: there is now less opportunity to trade with inside information. Press releases are published more promptly and more frequently, and trading in advance of press releases dealing with mergers and acquisitions has become significantly more honest. Box 4.4 deals in more details with the findings of the AFM's investigation into the 'health' of the market.

Key figures

The table below shows the figures relating to the investigation of market abuse in the last five years. With respect to the number of occasions on which the AFM initiates an investigation of market abuse, no distinction is made as to whether the case involved insider trading, market manipulation or the prompt publication of price-sensitive information. Each signal of potential market abuse is assessed to determine whether the behaviour could indeed constitute a breach of the market abuse regulations. An estimate is made of the likelihood that an investigation will lead to a successful outcome, so that the available resources are deployed efficiently.

	2005 (Q4)	2006	2007	2008	2009	2010 (Q1-3)
Number of investigations initiated	26	74	59	41	48	20
Investigations completed	10	91	56	44	45	25
Referrals of signal to foreign regulator	-	1	2	1	2	1
Number of letters sent	96	400	499	382	274	139
Letters to foreign regulators	12	70	148	126	72	45
Reports to Public Prosecutor	2	12	6	10	3	3
Administrative fines imposed	1	3	2	4	5	7
Instructive letter or consultation regarding standards	-	1	4	1	3	2

The table below shows the number of press releases published in recent years that are entered in the AFM's register, the number of contacts with issuers, the number of alerts analysed by the AFM and the number of trade suspensions.

	2005 (Q4)	2006	2007	2008	2009	2010 (Q1-2)
Press releases	1,074	3,641	4,801	4,542	3,906	1,962
Contacts	260	528	469	412	216	87
Alerts	115	413	369	169	126	41
Trade suspensions	6	7	5	6	5	2

4.1 Timely publication of price-sensitive information (section 5:25i Wft)

The AFM monitors the compliance with the obligation of listed companies to publish (make generally available) price-sensitive information without delay. It does this by monitoring news, prices and volumes in the markets, and calling listed companies if there are unexplainable developments, or if it has reason to believe that there has been a leak of information. The AFM also receives notifications of possible leaks, and monitors rumours from public sources.

Developments in the last five years

Immediately after the introduction of the legal provisions relating to price-sensitive information in 2005, the market and the AFM had to get used to each other: how should the legal provisions be interpreted and what did each side expect of the other? Partly because various actions were undertaken, including the organisation of an AFM seminar in September 2005, a number of workshops for members of the Executive and Supervisory Boards over the years, the publication of AFM brochures on the website, and extensive telephone contact with market participants, mutual understanding has greatly improved.

Good contact with listed companies continues to be an essential element of the supervision relating to price-sensitive information. Presentations are therefore organised for listed companies on a very regular basis. Sometimes this is in response to an actual question, but meetings are also organised when there are changes to a company's management or when there are new listings. An important issue to be discussed is the prevention of leaks of confidential information. This was particularly a problem during the boom in takeovers of listed companies during 2007, when – on several occasions – leaks led to notable price movements immediately prior to an acquisition. The AFM intervened in the trading process in several cases. The AFM was also regularly approached with questions about how to deal with shareholder activism and rumours. The company itself is and remains responsible for deciding whether it considers information to be price-sensitive. The general rule is: if in doubt, publish. The AFM is, of course, available for consultation.

From the end of 2007 onwards, the emphasis in discussions shifted – mainly due to the credit crisis – towards profit warnings and rights issues. During this period, many companies wanted to know when they should make information on these matters public. The AFM actively approached listed companies at that time, to inform them on ways of dealing with price-sensitive information, for example concerning (rights) issues.

Regulations and interpretations

An issuing institution is itself responsible for determining whether information is price-sensitive or not. It is, after all, in the best position to assess its internal state of affairs and the implications of the information, and whether the information is significant for (potential) investors in the company.

A frequently encountered misunderstanding is that information is only price-sensitive if it affects the share price. Price-sensitive information is defined as "information a reasonable investor would be likely to use as part of the basis of his investment decisions".[11] If a piece of information could affect the share price, this is a good indicator. If a company has doubts as to whether information should be published immediately, it should consider whether a reasonable investor would wish to have the information, and whether without this information he might reach a different decision. By objective measures it should be reasonably expected that publication of the information will cause a price reaction.

BOX 4.1: One-on-one consultations

The AFM website gives a list of FAQs on the problems relating to one-on-one consultations, showing what is permitted and what is prohibited in this respect. A brief and non-exhaustive description of the possibilities is given below.[12]

The company and an investor are free to share information in a dialogue regarding general matters, including developments (opportunities and threats) within the sector in which the company operates. An issuing institution may not share price-sensitive information with individual investors, unless the company can demonstrate that this was, within reason, indeed necessary, in order to sound out the views of certain (major) shareholders with regard to a particular proposed course of action.

Such a necessity may exist in the case of a proposal to make a public takeover bid for financial instruments or a proposal to issue or reissue financial instruments. The shareholders concerned may not trade during the period in which the price-sensitive information has not yet been made public. In addition, the shareholders may not share the price-sensitive information with third parties, or recommend transactions in the shares concerned to third parties.

Publication must be in the form of a press release, and in such a manner that enables the public to make an accurate and timely estimation of the significance of the information. The press release must be published as follows:

- in the Dutch media, and if applicable in any other EU member state in which the financial instruments of the company concerned are traded. In most cases, transmission to the major press agencies (the wires) is adequate to meet this requirement[13];
- on the company's own website;
- to the AFM, which will include the press release in the register on its website.

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11 Article 1, paragraph 2 of Commission Directive 2003/124/EC.

12 The full list of FAQs (in Dutch) can be found at:

http://Www.afm.nl/nl/professionals/diensten/veelgestelde-vragen/marktmisbruik/one-on-ones.aspx?perpage=10

13 There are no legal provisions regarding the media to which a press release has to be sent, only that "the issuer shall make use of media that may reasonably be assumed to guarantee a fast and effective distribution of the regulated information in all Member States".

Situations may occur in which an issuer may decide to postpone its obligation to make price-sensitive information available without delay. This is a decision for the issuer itself, and it thereby assumes responsibility for its appeal to the exception to the general requirement of publishing price-sensitive information without delay. Three cumulative conditions apply to the possibility of delay:

- the delay serves a legitimate interest of the issuer ; ***and***
- the delay is unlikely to deceive the public; ***and***
- the issuer can guarantee the confidentiality of the information.

If only one of the above conditions cannot be met, the company must publish the price-sensitive information without delay.

BOX 4.2: Ensuring confidentiality is an obligation of result

In its ruling in the case of the acquisition of Numico by Groupe Danone, the Rotterdam District Court ruled that the condition of ensuring confidentiality should not be seen as a best efforts obligation. Taking measures is not enough to mean that confidentiality is always ensured. The measures taken must also be effective. The ruling was issued in connection with an administrative fine imposed on Numico by the AFM in 2008 for failure to publish price-sensitive information in the correct manner.

The obligation with regard to immediate publication comes back into effect if the confidentiality of the information (despite the measures taken) is no longer ensured. The Court established the requirement that taking measures to ensure confidentiality is a continuing obligation, and that the conditions under which delay in publication is permitted can no longer be met if the confidentiality can no longer be ensured.

The movement in the Numico share price in combination with price-sensitive information made it, in the opinion of the Court, sufficiently likely that the confidentiality of the price-sensitive information was no longer assured. Since the case involved an exception to the general obligation to publish price-sensitive information without delay, it was Numico's responsibility to demonstrate that the exception applied in its case. According to the Court, this could only be otherwise if was explicitly shown that no price-sensitive information could have been leaked.

Given the degree of the rally in Numico's share price, the Court ruled that it had to be assumed that a larger group of people than the insiders alone had been aware of the progress of the negotiations between Groupe Danone and Numico.

The price movement in combination with existence of price-sensitive information was sufficient for the ruling that the confidentiality of the price-sensitive information was no longer assured.

Measures

On trading days, the AFM continuously monitors all the financial news in relation with price and volume developments. The AFM can decide to request a listed company to give an explanation if it identifies inconsistencies in this relationship. Usually a clear explanation is provided, in some cases accompanied by an additional press release from the listed company concerned. The AFM can also decide to suspend trading if it emerges that a listed company needs more time to prepare an (emergency) press release. This happens only occasionally, since the legislator has instructed the AFM to use this trading measure with great care. There must be a very urgent reason for trading to be suspended. The AFM assesses this on a case by case basis, but in general it will only suspend

trading in the event of an expected or actual significant price movement accompanied by a suspicion of market abuse. In recent years the AFM has suspended trading in a stock on average six times a year. The AFM has initiated an investigation into the failure to publish price-sensitive information or the failure to publish promptly on dozens of occasions in the last five years.

The AFM has imposed an administrative fine in relation to the failure to promptly publish price-sensitive information in four cases. In 2008 the AFM imposed an administrative fine on Numico B.V. of EUR 96,000. In 2009 an administrative fine of EUR 96,000 was imposed on Randstad Holding N.V. as the legal successor to Vedior N.V. The AFM imposed two administrative fines in 2010 totalling EUR 288,000 on Fortis S.A./N.V. (with registered office in Brussels) and Fortis N.V. (registered office in Utrecht) for the failure to promptly publish price-sensitive information. The AFM imposed two further administrative fines in 2010 totalling EUR 288,000 on Ageas S.A./N.V. (formerly Fortis S.A./N.V., with registered office in Brussels) and Ageas N.V. (formerly Fortis N.V., registered office in Utrecht) for the failure to promptly publish price-sensitive information.

In cases where the price movement in advance of publication of a press release gives cause to believe that price-sensitive information may have leaked, this can also lead to (civil) proceedings by shareholders and interest groups.

The future

In order to trace more efficiently a leak of price-sensitive information, and to be able to know which parties are involved, the AFM supports the introduction of an obligation for a company to notify the AFM whenever it decides to delay the publication of price-sensitive information. Currently, there is no obligation to notify the AFM of a decision to delay publication. The AFM's view is that this should be made mandatory when the Market Abuse Directive is revised. The benefit would be that the AFM could devote special attention to monitoring the prices and volumes traded of the financial instruments of the company concerned. This would not affect the situation that, even in this case, it is only *after* the event that the AFM can establish whether a company's decision to delay publication was in accordance with the legal provisions.

BOX 4.3: Jan Maarten Slagter, director of the *Vereniging van effectenbezitters*, or VEB ["Stockholders' Association"]

Leaks of price-sensitive information lead to compensation for investors

Faster enforcement by the AFM is essential

The implementation of the Market Abuse Directive was necessary, and the Directive has proved its worth over the last five years. The AFM has had to take enforcement action on a regular basis. There is also a consensus among market participants that losses due to market abuse should be compensated. But the regulatory process still needs improvement.

Civil consequences

The introduction of the prohibitions has unfortunately not led to a visible improvement in the behaviour of insiders, (directors of) listed companies, traders and investors in the market. Insider trading is still a regular occurrence, as is the leaking of price-sensitive information and the failure to publish price-sensitive information promptly. The VEB stands up for the rights of investors who are the victims of this behaviour, and has set itself up as an enforcer of the legal

provision and legislation relating to price-sensitive information in the civil courts. Briefly, the following standard regarding liability can be derived from the settlements achieved by the VEB in cases of failure to promptly publish price-sensitive information:

> *'A listed company has not succeeded in maintaining the confidentiality of existing price-sensitive information if market transactions show unusual and/or clearly aberrant price movements and/or trading volumes that cannot be explained by the information that is available.'*

This standard includes the assumption of optimal information in the market (reflected in the term "available information"), that should lead to an optimal price and a reversal of the burden of proof. Optimal information should be ensured by compliance with the obligations placed on listed companies to provide information and the disclosure requirements for insiders. An AFM decision that establishes that there has been a failure to meet these requirements fulfils this part of the standard.

The reversal of the burden of proof is clear because the listed company must ensure that the price-sensitive information is either kept confidential or released to the market in a timely manner. Maintaining the confidentiality of price-sensitive information is a result obligation for the company; if this is not successful, the company is obliged to publish without delay. Failure to do so entails a liability for losses suffered by investors.

Persons claiming to have suffered a loss in this way must be able to demonstrate that the price movements and/or trading volumes that did occur would not have occurred under normal circumstances. This can be demonstrated for example if prices have recently moved higher than in previous months, or there has been a continuous rise over several days, with high trading volumes, which is highly unusual and for which there is no explanation.

The consequence of breaching this standard is full or partial compensation for losses suffered by investors. There are various ways to measure the losses, which depend on the circumstances in individual cases.

A more prompt enforcement by the securities regulator

The standard only examines afterwards whether objectionable trading took place. The same applies to enforcement by the regulator. As a consequence, the market is not fully informed for a certain period, reprehensible behaviour that has been identified can continue for some time, the losses suffered by unwitting investors increase correspondingly, and confidence in the financial market and the securities regulator is reduced. In order to prevent these effects from occurring, the AFM should a) act more promptly where there is the suspicion of market abuse and b) make its market abuse supervision actions more visible by publishing a register with cases of market abuse that are under investigation.

a) Quicker suspension of trading in the event of large price movements and unusual trading volumes

In many cases, market abuse can be identified at an early stage through the analysis of price movements and trading volumes. If the AFM identifies a conspicuous signal that something abnormal is happening, its first action is not visible to the market. The AFM requests the listed company to explain the unusual price movements. If there is no response, the AFM issues a demand to the listed company to issue a press release. If this does not occur, trading is suspended.

Time passes between the AFM's initial contact with the listed company and the actual suspension of trading. For investors who traded during this period, the losses are the most affecting. They will wonder why the AFM had still waited after it had suspected that prohibited trading was taking place, thus giving the offenders time to make additional profits.

One possibility for suspending trading at an earlier stage could be the introduction of objective limits whereby trading would be suspended by the AFM in the event of abnormal price developments and trading volumes. The SEC for instance applies a rule that takes effect if a price changes by 10% in five minutes. NYSE Euronext applies a cooling-off period of 2 to 15 minutes if the price opens outside the thresholds or goes through certain limits. These rules allow the market to calm down when excessive price movements occur that do not realistically reflect the underlying value.

b) Register of current investigations of market abuse

If a market participant requests the enforcement of provisions in the Act on Financial Supervision, the AFM issues a confirmation of receipt. The market is only informed of the outcomes after the investigation is successfully completed. Sometimes the market never hears of the matter. This causes (legal) uncertainty. The AFM could keep interested parties informed by introducing a register of cases under investigation, in which the AFM would indicate which phase the investigation had reached. Only directly interested parties would be able to consult the register.

4.2 Prohibition of insider trading (Section 5:56 Wft)

The prompt publication of price-sensitive information is the most effective means of preventing insider trading. The AFM also takes action against persons who are in possession of inside information and have made use of it.

Developments in the last five years

Persons offending against the prohibition of insider trading are usually random offenders. Offenders who 'happen' to be aware of important, unpublished price-sensitive information, in other words inside information. This could be as a result of their employment at a company that is being taken over or they know someone employed there, or because they know that a company's earnings figures will be spectacularly out of line with expectations.

Inside information originates from an insider, but it is often difficult to establish the identity of the insider. In the cases where the identity of the person from whom the inside information originated is established, it is frequently the insider himself who has traded, or who has tipped off a friend or family member. The AFM's investigation therefore focuses on establishing a link between a market participant that has traded suspiciously and the inside knowledge itself. Inside knowledge is particularly difficult to identify and determine in a fluctuating market.

The AFM observes that investigations of insider trading are usually linked to extreme events, such as a takeover or a bankruptcy. The persons suspected of insider trading may be either institutional or private investors. Insider trading is not limited to equities and derivatives; such trading can also occur in other financial instruments, such as bonds. In an unpredictable market, however, an occurrence of possible insider trading is more difficult to detect.

BOX 4.4: Quantitative measurement

In the past, the AFM conducted a quantitative study to compare trading around the publication of price-sensitive information before and after the introduction of the Market Abuse Directive.[14] Price movements and the returns to be realised are also influenced by general market factors, as well as expectations. This means that returns that are higher than usual in the market do not occur that frequently. When they do, one can describe such returns as abnormal. In a market where there is no insider trading (in other words, a 'fair' market), abnormal returns will not occur before the publication of a press release. Press releases that are expected, for instance the publication of annual figures, are often preceded by speculative trading, even in a clean market. One method of measuring abnormal returns is to analyse the cumulative abnormal returns preceding the publication of a press release.

The results of the study in 2007 indicate that the introduction of the Market Abuse Directive has led to a somewhat cleaner and better informed market. There has been less speculation preceding the publication of price-sensitive information, and the quantity of the information available to the market has increased. Trading has become significantly cleaner, in particular before the announcement of news relating to mergers and acquisitions. Also after the introduction of the Market Abuse Directive, it is clear that the speculation in the market preceding an announcement regarding a merger or acquisition has a visible effect on prices. But at the same time, the ensuing price movements are less extensive, and they occur more immediately prior to the time of actual publication. This point suggests that in the new situation, companies are publishing price-sensitive information regarding mergers and acquisitions more promptly, or are being more successful at keeping the information confidential. Applying a distinction in the analysis regarding the size of companies and the sectors in which they operate reveals that abnormal price movements have been significantly reduced for smaller businesses and companies in the technology sector. The decline in abnormal price movements together with the additional availability of information in the market contributes to the 'health' of the market.

During a crisis, however, it is almost impossible to conduct a useful quantitative study, because a degree of normality in the market is needed to obtain measurements that are reliable. This normality was lacking due to the credit crisis. It was difficult to attribute price movements to an initial public takeover announcement or an announcement of (annual) returns. It is therefore unclear whether the significance of the average cumulative abnormal returns calculated should be attributed to the publication of price-sensitive information that was previously confidential, or to the exceptional market circumstances as a result of the financial crisis.

There have been few studies conducted in the last five years that were restricted to parties from the Netherlands, since many international market participants are active on the Dutch trading venues. Due to this internationalisation of potential offenders and the internationalisation of supervision, the AFM is regularly forced to issue several rounds of requests for information, which can increase the duration of an investigation.

[14] The report can be found at: *http://www.autoriteit-fm.org/registers/default.ashx?DocumentId=9912.*

International cooperation is becoming increasingly important in order to detect and deal with market abuse. The AFM therefore enthusiastically supports further international cooperation between securities regulators, mainly within CESR, in order to increase the effectiveness and efficiency of investigations of insider trading. As stated previously, the international component in such investigations is increasing due to the further internationalisation of trading and the distribution of transactions across different trading venues. Strong cooperation between regulators and the bundling of resources are thus essential. The AFM's view is that further improvements can be achieved in this area.

Regulations and interpretations

One of the objectives of the Market Abuse Directive is to protect the integrity of the financial markets and to increase confidence among investors. One of the factors underlying this confidence is the knowledge that investors operate on a level playing field and that they are protected against the unlawful use of inside information.

The legal provision applying to inside information is that it may not be shared; this takes the form of the prohibition against communicating inside information or advising others to execute transactions in the financial instruments concerned. In November 2005 the European Court of Justice expressed an opinion regarding the sounding out of shareholders and the relationship of this to the prohibition against advising others to execute transactions [*tipverbod* in Dutch].[15] To summarise, the Court requires there to be a close link between the information to be shared and the duties of the primary insider, and secondly that sharing the information is strictly necessary for the exercise of the primary insider's duties. In the case of an appeal for exemption on the ground that the inside information could be shared in the normal exercise of one's work, profession or duties, this ground for exemption should be interpreted restrictively.

Measures

In its investigations of insider trading, the AFM encounters lists of insiders containing a large number of people.[16] In the case of a public takeover bid, there are often many people who have or could have access to inside information. At the same time, the AFM regularly finds that many people are not included on these long lists of insiders who actually should be included, since they could have gained access to inside information. The AFM will continue to draw close attention to the risks created if many people gain access to price-sensitive information prior to publication.

It is difficult to prevent a leak of price-sensitive information, so it is important to restrict the group of persons and market participants involved as far as possible. To some extent, this makes it possible to control the dissemination of inside information. The people concerned should be fully aware of the potential implications of offending against the prohibition against insider trading or the prohibitions against communicating inside information or advising others to execute transactions in the financial instruments concerned.

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15 ECJ 22 November 2005, Knud Grøngraard and Allan Bang.

16 An insider list is a list of persons who work at or on behalf of a listed company and who regularly or occasionally could have access to inside information.

Various investigations into insider trading have been completed and referred by the AFM to the Public Prosecutor. One case involved a number of parties operating from different countries who were suspected of systematically insider trading relating to various acquisitions. These parties, who made profits from their transactions amounting to several million euros, were active in various European markets. Reports were submitted to the Public Prosecutor by several securities regulators in other countries, as well as by the AFM.

The future

In addition to public information available for instance from Internet and data vendors, in its investigations of persons with inside information the AFM can make use of data that are not publicly available, such as transaction and portfolio details. The AFM cannot currently request records of historical telecommunication traffic data from telecom providers (for example, the telephone numbers a person has called in combination with time data, known as print list). The AFM needs to be able to access this information in order to supervise insider trading. Several other European regulators already have access to such information. Access to these print lists would significantly contribute to the investigation dossiers for reports to the Public Prosecutor and administrative fines.

This information is, however, only retained for a limited period of time. Some time usually elapses between the conduct of the AFM's investigation and the eventual referral to the Public Prosecutor (which does have the power to access print lists). It can thus be the case that the print lists have already been deleted by the time the Public Prosecutor takes over the investigation.

Moreover, the duration of an investigation could be reduced if order and transaction data with a client-ID were available to the AFM in the transaction reporting process to the securities regulator. Based on information connected to the client-ID, signals could be identified, and further investigated. The client-ID would help the AFM to analyse transactions in the context of the normal trading behaviour of the client concerned.

While the client-ID would be useful for both the identification of signals and for investigation, print lists would primarily be useful for investigation. Telephone records would assist in the establishment of relationships between various people at the time the suspected offence was committed.

4.3 Prohibition of market manipulation (Section 5:58 Wft)

The trading and the prices that occur should be the result of legitimate supply and demand arising from a transparent market in which all investors have access to the same information that has not been manipulated.

Developments in the last five years

The AFM regularly organises presentations on market manipulation for market participants such as traders, banks, brokers and pension funds, and in 2009 and 2010 it visited a number of professional market participants in order to hold consultations regarding market manipulation. The AFM has encountered various forms of market manipulation in the last five years. Most cases involved forms of systematic entry of buy or sell orders, sometimes in combination with exaggerated or untrue messages on (Internet) forums. These cases involved, for example, sending a false press release to the press agencies, prior to which the originators had taken a position in options.

The AFM has also quite frequently encountered systematic attempts to manipulate the opening or closing auction prices on the market. The AFM collaborates with NYSE Euronext to take measures against this form of market manipulation. In the context of this type of manipulation, the AFM published guidance on manipulation relating to rights issues in concert with other regulators in July 2010. The guideline describes certain manipulative practices in the securities markets of NYSE Euronext that have been identified during the opening and closing auctions of subscription rights during their exercise period. In the eyes of the regulators, this form of trading is an offence.[17] On the basis of signals received from the market, discovered by the AFM, or both, the AFM can investigate certain forms of market abuse more specifically or in relationship to each other. International cooperation is highly valuable in this respect.

Regulations and interpretations

The prohibition against market manipulation applies to everyone. Four prohibitions thus apply to trading in financial instruments:

- First, the execution of transactions or placement of orders that give an incorrect or misleading signal with regard to the supply of, demand for or price of a financial instrument is prohibited. The prohibition also applies to a situation in which such a signal may be expected;
- Second, the execution of transactions or placement of orders whereby the price of a financial instrument is brought to or kept at an artificial level is prohibited;
- Third, the execution of transactions or placement of orders involving deception or misrepresentation is prohibited;
- Fourth, the dissemination of information that gives an incorrect or misleading signal regarding the supply of, demand for or price of a financial instrument if the originator is aware that the information will give such a signal is prohibited.

In addition to the legal provisions, the AFM has published explanation and guidance on the situations which are seen as involving manipulation.

Lastly, the Appeals Board for Industry [CBb] requested a preliminary ruling from the European Court of Justice regarding the treatment of the higher appeal against the administrative fine imposed on IMC in relation to possible market manipulation regarding the shares of Wereldhave. This case involved the question of whether causing price movements by performing a combination of actions with a financial instrument qualifies as ‘maintaining’ the price of such an instrument at an abnormal or artificial level, and thereby as market manipulation.

[17] The guideline on manipulative irregularities during the opening and closing auctions for subscription rights during the exercise period of rights issues (in Dutch) can be found at:
http://www.afm.nl/layouts/afm/default.aspx~/media/files/wetten-regels/leidraad/leidraad-marktmanipulatie.ashx

BOX 4.5: Exceptions to the prohibition of market manipulation and Accepted Market Practice (AMP)

There are exceptions to the prohibition of market manipulation as described below. Exceptions are also established in Section 5:58 Subsection 2 of the Act on Financial Supervision.

The AFM can advise the Minister of Finance to classify a particular market practice as AMP by means of an order in council, and thereby exempt this practice from the prohibition of market manipulation. The intention of an AMP is to provide additional certainty for market participants. This does not mean, however, that activities not classified as an AMP are by definition prohibited. For example, the AFM has advised the Ministry to exempt liquidity providers subject to certain conditions. The Ministry has consulted with the market in this respect, but this AMP has so far not been established.

Another exemption from the prohibition arises from European Directive 2273/2003. This Directive states that the repurchase of own shares and actions taken for the purpose of stabilisation do not constitute market manipulation if the plans are published promptly, if certain price and volume limits are observed, and if the number of shares that have been repurchased is published after the transaction.

Measures

In the past years the AFM has referred cases to the Public Prosecutor or has itself imposed an administrative fine on various occasions. In four instances, this led to a ruling in the courts.

In 2007 'Hercules' was fined EUR 5,000 by the Supreme Court and given a suspended prison sentence. 'Hercules' bought large volumes of the stock Cardio Control and then spread rumours that there would soon be positive developments and that a large buyer was in the market. The large buyer turned out to be 'Hercules' himself.

'KBC' was fined EUR 87,125 because orders that KBC had placed earlier were then fully or partly cancelled, thus completely or partially neutralising the effect of the orders KBC had previously placed. The AFM took the view that this constituted an incorrect or misleading signal which had brought the price to an artificial level.

A community service order was also imposed in the Versatel case, in which two people disseminated a false press release by e-mail regarding a possible takeover by Deutsche Telekom. The share price rallied as a result.

The AFM also imposed two administrative fines in 2010 totalling EUR 288,000 on Fortis S.A./N.V. (with registered office in Brussels) and Fortis N.V. (registered office in Utrecht) for the breaching the prohibition of market manipulation.

The future

In the last five years, the AFM has provided further guidance on its view of market manipulation in various ways. Now that this information has been disseminated to market participants, the focus in future will be more on enforcing compliance with the legal provisions. The fact that transactions can be executed on several different trading venues is a factor that will have to be taken into consideration.

Furthermore, increased attention will be paid to the spreading of (false) rumours via various channels, i.e. manipulation of information. This was already an important part of the AFM's activities during the credit crisis, and the AFM will continue to focus on this issue.

BOX 4.6: Joost Italianer (lawyer at NautaDutilh)

Five years of market abuse supervision

"The implementation of the Market Abuse Directive in October 2005 was also a matter of great interest for lawyers.

Already in the preliminary phase, both we and our clients had many questions regarding the scope of the new legal framework, partly due to the loosely worded explanation given by the government in the Act on the Market Abuse Directive. The new role allocated to the AFM in the supervision of the publication of price-sensitive information also raised questions from clients. The AFM therefore definitely responded to a need in the initial phase by publishing detailed brochures explaining the matter, and by organising a number of well-attended informative meetings.

In addition, the FAQs relating to numerous specific market abuse issues on the AFM's website met a need and are regularly consulted by my firm. It is moreover my impression that the AFM has now become more accessible in its communication on outstanding issues of interpretation than it was initially, when there was some question of 'cold feet'.
One of the controversial issues in the initial phase was the meaning of the term 'making use of inside information'. Is a connection now required between someone in possession of inside information and the subsequent transaction, or not? The obligation to report the suspicion of insider trading or market manipulation also raised concerns. Are bank employees personally responsible for such reports, or is this the duty of the institution? And as a director, how far can you go in a one-on-one conversation?

My impression is that most of these issues of contention from the initial phase have now been sufficiently resolved by guidance from the AFM, further legislation and case law, so that market participants can deal with them. Nevertheless, there have recently been important developments affecting legal practice and the regulator. In particular the recent court rulings on the obligation to publish in the event of rumours combined with price movements, and on presumptive evidence in relation to insider trading. Generally, my feeling is that where the Dutch legislator interprets the law too widely, the (European) courts bring it back into line, whereby we hopefully will move towards a balanced system. There will moreover be important new developments as a result of the forthcoming review of the Market Abuse Directive by the European Commission.

I do still have one question, which is: why are there so few visible results in the area of market manipulation? I have the impression that this is a frequent occurrence, although this is an unknown dark number. It may be that such cases are dealt with under administrative law without publicity, but market manipulation has a far greater effect on confidence in the financial markets than insider trading. In my view this is a challenge for the AFM over the next five years."

4.4 Disclosures by directors, disclosure of substantial holdings

The AFM receives notifications of transactions by managing directors, supervisory directors and other insiders, and notifications of substantial equity holdings. These are published in the registers on the AFM's website.

Key figures

	Number of disclosures	Number of disclosures not in time	Number of administrative fines	Number of reports to Public Prosecutor
2005 (Q4)	503	16	0	1
2006	3,582	159	1	0
2007	3,462	441	0	0
2008	2,448	161	3	0
2009	2,041	98	2	0
2010 (Q1-3)	1,790	71	2	0

Developments in the last five years

As a result of the implementation of the Market Abuse Directive in 2005, the number of categories of people obliged to disclose as insiders has been reduced (for example, the issuing institution no longer has to disclose) and disclosure is only obligatory if the total transactions (in a period of not more than one calendar year) exceeds a sum of EUR 5,000. The number of disclosures by insiders has therefore been reduced.

The number of disclosures of holdings has declined further since 2008 because the much lower market prices in 2008 and 2009 made it less attractive to exercise employee share options. Falling prices also led to fewer positions being accumulated in shares of listed companies. The fact that holdings can be disclosed by electronic means has led to greater efficiency in the processing of disclosures. Partly due to tighter monitoring of compliance with the legal provisions, the number of late disclosures also fell by more than the average. The AFM sees this as a sign that compliance with the legal provisions is improving.

In September 2009, the Ministry of Finance held a consultation on a proposal for extending the substantial holdings disclosure requirement to include economic positions. In practice there are financial instruments which offer the holder an economic value that depends on the appreciation in value of shares in a listed company (long positions), without the holder legally having a claim on the (underlying) shares. There are currently no specific disclosure requirements for these financial instruments.

The aim of the disclosure requirement in the Act on Financial Supervision can be impeded through the use of these financial instruments, because market participants are not currently aware of the economic interests involved. Economic long positions whose value depends on the value appreciation of shares or dividend rights linked to shares can in certain circumstances be used to influence the exercise of the voting rights. Economic long positions can make it easier for the holder to acquire an interest in the issuing institution than would be the case if such financial instruments were not available. For this reason, there is a proposal to extend the disclosure requirement. In the

CESR context, the AFM has prepared a recommendation to the European Commission to introduce such a measure at European level.

BOX 4.7: Porsche versus Volkswagen

In 2008 there were several cases in Europe and the US in which parties built up large economic positions in a takeover battle by means of derivatives. For instance, Porsche secretly accumulated an interest of 31.5% in Volkswagen by means of derivative instruments. The market was not aware that Porsche held a large economic position. The (subsequent) announcement of this position caused an explosive rally in Volkswagen shares.

Market participants scrambled to cover their short positions in Volkswagen while the percentage of Volkswagen shares that was still freely tradable was extremely low. This case clearly shows why the disclosure of economic interests to the regulator and the market makes an important contribution to market transparency.

Due to the turbulent developments in the financial markets, the AFM announced measures in relation to short selling in September 2008, including an obligation to disclose short positions. However, various regimes were introduced in the different European countries. The European Commission put forward a proposal for the regulation of short selling in September 2010[18], which addressed the following issues:

- increasing the transparency regarding short selling for both equities and bonds;
- reducing the risks associated with naked short selling;
- giving the national regulators powers to intervene in emergency situations;
- giving the future European regulator, the European Securities and Markets Authority (ESMA), a coordinating role in financial emergency situations.

For short positions in equities, the European Commission proposes that market participants must disclose short positions reaching a threshold value of 0.2% of an issuer's share capital, and on the attainment of each further 0.1%, to the securities regulator. Short positions amounting to 0.5% or more should be announced to the market. In financial emergencies the regulators would have the power to temporarily prohibit or limit short selling and the trading in naked Credit Default Swaps.

Regulations and interpretations

When the Decree on the Disclosure of Major Holdings and Capital Interests in Issuing Institutions [*Wmz 2006*] took effect in November 2006[19], this meant that all holdings subject to the disclosure requirement had to be reported again. The purpose of the Decree was to increase transparency regarding the governance and capital holdings in issuing institutions and to simplify the disclosure process for those subject to it with reduced administrative costs as a result.

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18 The proposal for a Regulation of the European Parliament and of the Council relating to short selling and certain aspects of credit default swaps can be found at: *http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_proposal_nl.pdf*

19 The Wmz 2006 replaced the Dutch Major Holdings Listed Companies Disclosure Act [Wet melding zeggenschap in ter beurze genoteerde vennootschappen, Wmz 1996] and also implemented the European Transparency Directive. The Wmz 2006 was subsequently included in Section 5.3 Wft as of 1 January 2007

The disclosure regime was adjusted in certain respects with the introduction of the Decree on the disclosure of Major Holdings and Capital Interests in Issuing Institutions 2006:

- more disclosure threshold values (Wmz 1996: 6 thresholds, Wmz 2006: 11 thresholds);
- extended scope: companies not incorporated under EU law but listed in the Netherlands are now also included in the regulation process;
- obligation to disclose dilution: a holding that reaches or goes below a threshold due to an increase in the capital of an issuer must also be disclosed;
- a new disclosure obligation for managers of mutual funds.

In early 2009 the AFM amended its policy with regard to the disclosure requirements in relation to securities lending.[20] Questions were raised in the market regarding the passage included in the explanatory brochure relating to the disclosure requirements for securities lending. This led to a verification and revision of the AFM's policy. One important aspect of the new policy is that borrowed shares do not have to be notified if they are re-lent within one day.

BOX 4.8: Acting in concert

The AFM clarified its policy regarding the disclosure requirement for long-term agreements to act in concert at the end of 2009. The AFM takes the view that consultation between shareholders can contribute to awareness of the corporate governance of an issuing institution. Such consultation can help shareholders to express their opinions to an issuer more effectively and clearly. These forms of consultation do not normally involve an agreement to follow a collective voting policy, and therefore do not qualify as acting in concert.

The AFM does not always know whether a long-term agreement to act in concert has been made. The AFM can request information from the parties involved if the cooperation is possibly directed at an issue that could lead to a change in the issuer's strategy, for example through the collective proposal for nomination of one or more managing or supervisory directors.

There are various facts and circumstances that can cause the AFM to suspect that a long-term agreement to act in concert has been made. The AFM can request information from parties that are suspected of collaborating in relation to a strategic issue if certain events or circumstances occur prior, during or after a general meeting of shareholders.

AFM: More permitted in contacts between companies and investors

Interview with René Maatman, member of the Executive Board of the AFM in DFT (20-11-2009)[21]

More is permitted in discussions between companies and their shareholders and between shareholders than many people realise. AFM member of the Executive Board René Maatman notes that many people are not certain what is permitted in such discussions and what is not.

[20] The revised policy on securities lending (in Dutch) can be found at:

http://www.afm.nl/nl/professionals/afm-actueel/nieuws/2009/feb/meld-regelingen-herzien.aspx

[21] The entire interview (in Dutch) can be found at:

http://www.telegraaf.nl/dft/nieuws_dft/5373023/_AFM_Meer_toegestaan_in_contact_bedrijf_beleggers_.html

"This has contributed to the atmosphere of confrontation." The uncertainty is mostly related to situations where several shareholders act together, and to the 'dialogue' between companies and their (major) shareholders.

"The AFM takes the view that consultation between shareholders can contribute to awareness of the corporate governance of an issuing institution" says the AFM in an amended explanatory brochure. "This particularly applies to the preparation of a general meeting of shareholders, where consultation can lead to the granting of voting proxies and voting instructions."

Since this does not involve a 'long-term collective voting policy', the AFM does not see this as acting in concert. This is only the case if the agreement between the shareholders applies to more than a single meeting. For example, if more fundamental proposals are involved, such as a change of strategy or the dismissal of a member of the executive board. Even then consultation is not prohibited, says Maatman, "as long as the disclosure requirement is met".

Measures

In the last five years the AFM has imposed administrative fines for offences against the substantial holdings disclosure requirement and the disclosure requirement for directors on eight occasions, with the fines varying from EUR 6,000 to EUR 120,000. This is because different fine regimes apply (Decree on the Disclosure of Major Holdings and Capital Interests in Issuing Institutions or Act on Financial Supervision), and also because in one case it was decided to mitigate the fine.

The fines related to the failure to disclose substantial holdings in one or more issuing institutions and the failure to disclose transactions by directors over a longer period. Since the introduction of the Act on Financial Supervision the fines have also been published. In one case a report was made to the Public Prosecutor for the failure to disclose transactions by a director, and this led to prosecution.

The future

The AFM is of the opinion that the level of compliance with the current legal provisions relating to the disclosure requirement for both substantial holdings and directors' transactions is good. In due course it is expected that the initial threshold for substantial holdings will be reduced to 3% instead of the current 5%. This will increase the number of disclosures, but it will not affect the way the disclosure regime operates. The AFM supports harmonisation of the disclosure regime for substantial holdings at European level, for both short positions and economic long positions.

The AFM notes that the content of the disclosures is used increasingly by journalists, analysts and others. A good example is the use of this information for estimating the so-called free float of the shares, as the percentage of the shares not firmly held can be determined. The announcement that a market participant is accumulating a shareholding can also form the basis of investment decisions, for instance when estimating the likelihood of a takeover.

5 Conclusion

The market developments in the last five years have clearly affected the way in which the AFM conducts its market abuse supervision . Since the AFM took on this responsibility in October 2005, the financial markets have become more international and have changed significantly. The fragmentation of trading as a result of the implementation of the MiFID means that the AFM has to follow activities on several international trading venues, and that effective cooperation at European level will only increase in importance. The AFM is a strong supporter of international solutions to cross-border issues in the area of market abuse. Moreover, the extraordinary circumstances during the credit crisis have forced the AFM to take measures against the short selling of shares of listed financial institutions, partly due to the risk of price manipulation. Other market developments that have influenced the monitoring for market abuse include HFT, the role of (major) shareholders, and the developments in the world of mergers and acquisitions.

The AFM monitors for possible market abuse by following price and volume developments and all kinds of news. A signal of market abuse is analysed to determine whether the behaviour identified actually constitutes an infringement of the market abuse provisions. The AFM has various systems for tracing market abuse, whether automated or not. Using data techniques, the AFM identifies patterns that indicate potential market manipulation or insider trading. Other instruments for market abuse supervision include the obligation to report suspicious transactions, the requirement to disclose substantial holdings and the transaction reporting requirement.

In the conduct of its market abuse supervision, the AFM has devoted much attention to the prompt publication of price-sensitive information. In addition to actively following activities on trading venues and requesting information from companies, the AFM has also provided clarity regarding the obligation to publish price-sensitive information without delay by means of seminars and the publication of guidelines. Good contact with companies continues to be essential for the supervision of prompt publication of price-sensitive information, so the AFM will continue to organise presentations for listed companies on a regular basis. Regarding the publication of price-sensitive information, the AFM considers it desirable that decisions to delay publication should be notified to the securities regulator. The AFM's view is that this should be made mandatory in the revision of the Market Abuse Directive.

To prevent insider trading, it is important that the number of persons who have access to price-sensitive information is limited. The AFM regularly encounters lists of insiders which contain too many people, and will continue to draw attention to these risks in future. International cooperation between securities regulators is essential in the supervision of insider trading. The complexity of cases means that investigation is a lengthy process. Investigations can be carried out more efficiently if the AFM has access to telecommunications print lists and order and transaction data that is provided with the client-ID field in the transaction reporting to the regulator.

The AFM has expressed its views regarding market manipulation to the market over the last five years. Now that this information has been disseminated to market participants, the focus in future will be more on enforcing compliance with the help of statistical analysis. Increased attention will moreover be devoted to the manipulation of information, in other words the dissemination of (false) rumours via for example (Internet) forums.

Finally, the AFM is of the opinion that there is a high level of compliance with the current legal provisions relating to the disclosure requirement for both substantial holdings and directors' transactions. A lower initial threshold for the disclosure of substantial holdings is expected to be introduced in due course. This will increase the number of disclosures, but it will not affect the operation of the disclosure regime. The AFM takes the view that the disclosure requirement should be extended to include economic long positions that give the holder the opportunity to acquire an interest in the issuing institution. The AFM furthermore supports the harmonisation of the holdings disclosure regime at European level for both short positions and economic long positions, as recently proposed by the European Commission in response to a recommendation from CESR.

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