



CHAPTER V

SUPERVISION OF SECURITIES MARKETS

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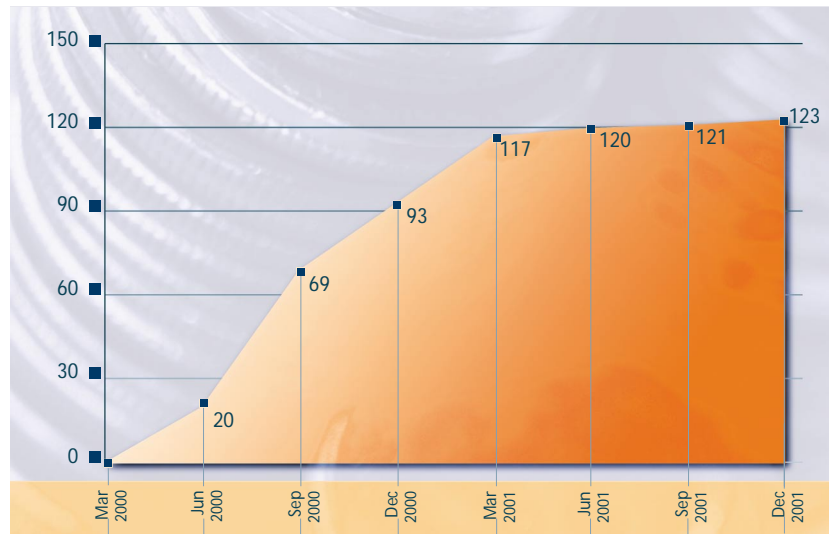
1. Reporting of transactions on financial assets (TAF)
2. Investigations conducted by the CSSF in its supervision of securities markets
3. Prudential supervisory practice

1. Reporting of transactions on financial assets (TAF)

While 2000 was devoted to the implementation of the TAF project, putting this project into effective operation marked the year 2001. In addition, first conclusions could be drawn from this project within the CSSF.

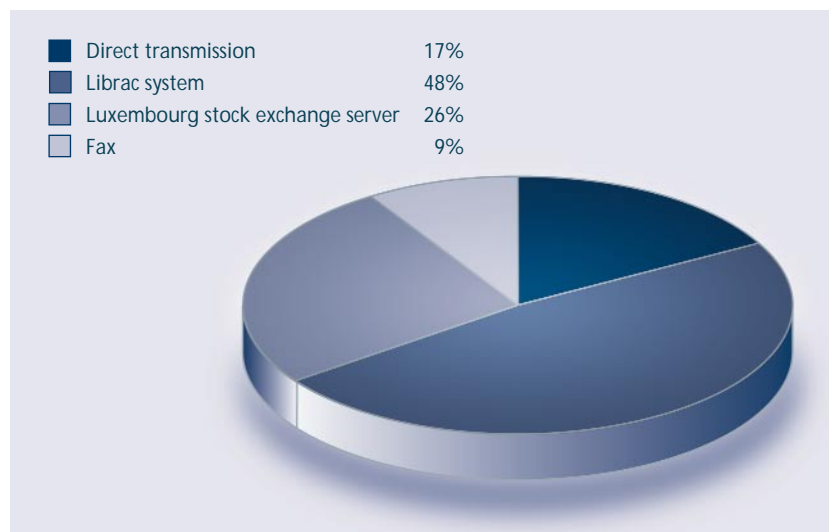
1.1. Movements in the number of connections and methods of transmission

Movements in the number of connections



During 2001 the number of connections concerning the transmission of data on financial assets in the TAF project rose from 93 investment firms at the beginning of the year to 123 at its end. Nevertheless, the total number of firms which are subject to reporting requirements fell slightly, due to the number of mergers that occurred on the Luxembourg financial market as part of the concentration movement in the international financial sector.

Transmission methods



1.2. First conclusions drawn from the TAF project

In order to allow as many investment firms as possible to adapt their reporting to the requirements laid down in Circular 99/7 on reporting to the CSSF pursuant to Articles 5 and 6 of the amended Law of 23 December 1998 on the supervision of securities markets, the TAF project team published several documents. These documents should help to clarify regulatory aspects as well as technical aspects.

The implementation of the requirement to report transactions on financial assets as from 1 January 2000, the practical use made of this reporting and the first on-site inspections of certain investment firms raised numerous questions. The CSSF therefore clarified several general principles and answered the most frequently asked questions in relation to Circular 99/7 by publishing a circular letter on 23 May 2001.

The Circular puts the crucial point, among other things, to the principles for the reporting of purchases and sales executed for the account of clients as well as for own account activities. Indeed, many investment firms missed to make the right distinction between transactions executed for their own account and transactions negotiated for the account of their customers. This misinterpretation brought confusion into the CSSF's data analysis, as it was not in the possession of homogeneous reports. In this context, it has been accepted that transactions carried out for client's account as well as those executed under discretionary management have to be reported for "client's account" taking into account the client's orientation of the transaction. Those initiated by the investment firm itself should be stated at the initiative of the firm.

At a technical level, the document "*Recueil d'Instructions*" was updated in May 2001 in order to consider the additional explanations given to Circular 99/7 and the principal problems encountered. The document provides further information to the communication system established between the CSSF and the investment firms in relation to the reporting requirements. The discordance of electronic exchange regarding the reporting was due, among other things, to the non-respect of the stipulated delays, to the duplication of reporting concerning the transactions that are carried out on the Luxembourg Stock Exchange, as well as to the right application within the correction of possible errors.

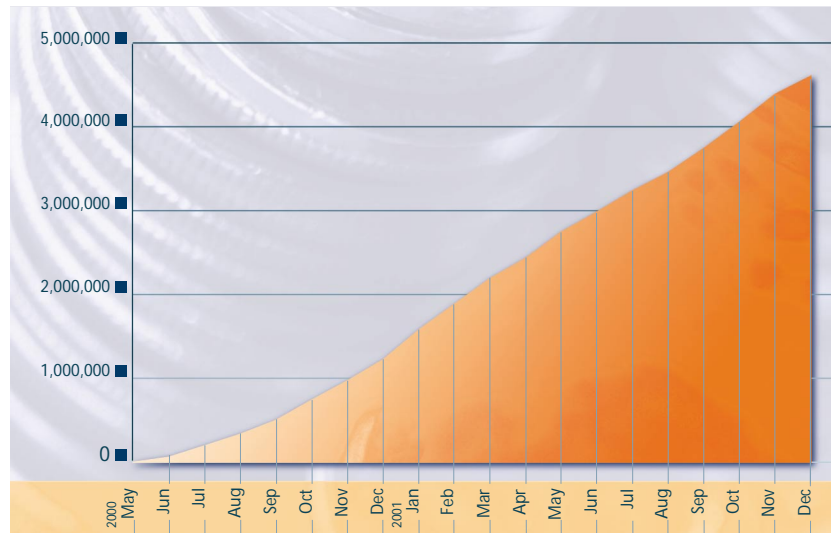
All the information relating to TAF reporting, which is continuously updated, is accessible on the CSSF website (www.cssf.lu) in the '*Reporting légal*' section under '*Reporting TAF*'.

All these efforts have been initiated in order to allow the CSSF to provide correct interpretation and analysis according to the severe requirements of the different investigations. The results of these initiatives should contribute to an effective regime of investor protection, market transparency and to the successful detection of infringements of the financial laws and regulations.

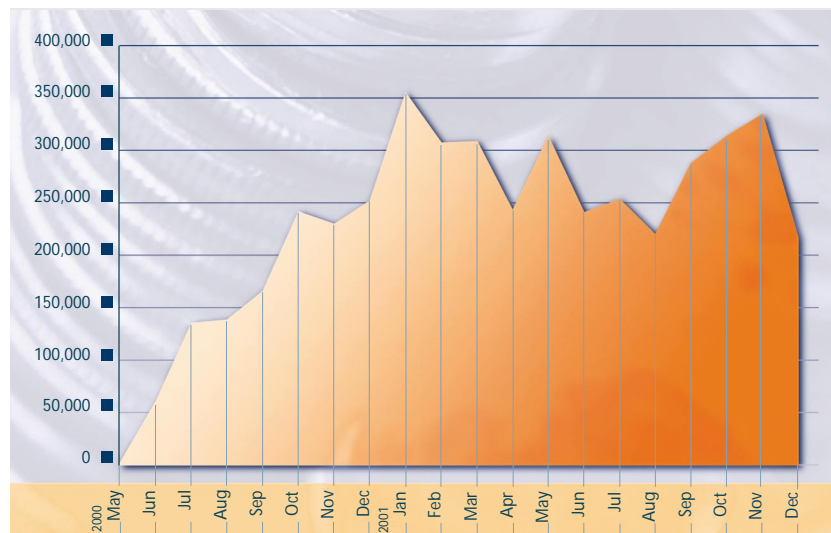
1.3. Movements in the number of trades reported

The number of trades that have been reported rose from 1,219,000 in 2000 to 4,595,777 in 2001, representing an increase of 26%. The central system recorded an average of 14,555 TAF trades per working day.

Number of trades reported



Monthly volume of trades reported



2. Investigations conducted by the CSSF in its supervision of securities markets

A distinction should be drawn between investigations conducted into breaches of stock exchange regulations and investigations into non-compliance with the rules of conduct in the financial sector laid down in CSSF Circular 2000/15 dated 2 August 2000.

2.1. Investigations into breaches of stock exchange regulations

The CSSF is the administrative authority competent to ensure that the provisions of the Law of 3 May 1991 on insider dealing are applied to the professionals of the financial sector. The aim is twofold: to ensure fair and equal treatment of investors and protection against the illegal use of insider information.

In its supervision of securities markets, the CSSF either initiates enquiries itself or conducts them in response to a request for assistance from a foreign administrative authority within the framework of international co-operation.

2.1.1. Enquiries initiated by the CSSF

- *Enquiries concerning insider dealing*

In 2001 the CSSF initiated four enquiries into a possible breach of the Law of 3 May 1991 on insider dealing.

Based on evidence and information it received in relation to one of the enquiries, the CSSF decided to pursue this investigation internationally by requesting assistance from several European market authorities. Once the CSSF has all the information requested, both at national and international level, it will decide whether to report these on to the State Prosecutor under Article 6(2) of the Law of 3 May 1991 on insider dealing.

The evidence and information collected during two other enquiries allowed the CSSF to conclude that there were no infringements of the Law of 3 May 1991 on insider dealing.

Following the example of a number of other authorities, the CSSF reacted rapidly to the terrorist attacks of 11 September 2001 on US soil by launching an enquiry to detect insider dealing connected with the attacks. The CSSF first analysed on- and off-exchange transactions on securities of companies active in the sectors most sensitive to this type of event, notably insurance and airlines companies. The CSSF concentrated in particular on the two weeks preceding the attacks and on the day of 11 September 2001 itself. The CSSF also examined the market behaviour of each financial sector professional on an individual basis during the same period to detect anomalies and suspect validations, particularly with respect to their seasonal activity. After these investigations the CSSF concluded that it did not have information to confirm that possible insider dealing had taken place in relation to these attacks.

- *Enquiries into price manipulation*

As part of its general mission of supervising the financial markets the CSSF also opened an enquiry on market manipulation in 2001. The subject of these specific investigations was to verify whether the prices of a security officially listed on the Luxembourg Stock Exchange had been manipulated upwards. Investigations are still in progress.

2.1.2. Enquiries conducted by the CSSF at the request of a foreign administrative authority

- *Enquiries concerning insider dealing*

The number of requests for assistance from foreign authorities was much higher than in the previous year. In 2001 the CSSF processed 57 applications for enquiries into insider dealing (versus 39 in 2000), one of which was filed by a government body outside the European Economic Area.

A total of five requests from foreign authorities concerning insider dealing were referred to the CSSF in direct connection with the attacks of 11 September 2001. These enquiries focused principally on the securities of airlines, insurance and reinsurance companies.

The CSSF handled all these enquiries with the necessary diligence befitting co-operation between authorities. During these enquiries, no major issues relating to the involved financial intermediaries have been raised.

- *Enquiries into price manipulation and fraudulent public offers*

The CSSF received one request for assistance from a foreign authority in connection with price manipulation and one request in connection with a fraudulent public offer of transferable securities. The CSSF replied to both requests within its legal competence.

2.2. Enquiries into non-compliance with the rules of conduct in the financial sector

CSSF Circular 2000/15 of 2 August 2000 states the specific rules of conduct to be observed by all financial sector professionals. The primary purpose of this Circular is to amplify and clarify the principles laid down in Article 37 of the amended Law of 5 April 1993 on the financial sector.

A fair number of these rules of conduct are related to the overall principle that the professional shall act honestly and fairly in conducting his business activities in the best interest of his clients and the integrity of the market. Rule 1.7., often quoted by the CSSF concerning non-compliance by financial sector professionals with these rules, is worded as follows:

‘The professional shall refrain from any behaviour liable to impair the transparency or distort the proper operation of the market. At no time shall he manipulate the market, either alone or in concert, for his own benefit or for that of a third party, by means of a single act or series of acts of whatever nature, intending actively or passively to mislead or misinterpret, without prejudice to the professional’s right to intervene in the market in order to ensure the success of an offering or to stabilise a market price’.

On six occasions the CSSF addressed letters to members of the Luxembourg Stock Exchange to make them aware of their duties to ensure compliance with the rules of conduct.

In particular the CSSF took action on so-called offsetting of operations, i.e. transactions which members of the stock exchange carry out acting themselves as counterparty. The CSSF reconsidered these operations within their regulatory context. Transactions of this category actually represent around one-third of the volume carried out on the market of the Luxembourg Stock Exchange and are subject to the same rules as transactions carried out on the central market. They thus follow the same price formation mechanisms and rules of allotting the securities available. The outcome of this analysis was that while most of these operations comply with the rules of conduct, some nevertheless do not.

As a first step, the CSSF agreed with the Luxembourg Stock Exchange to establish a specific system allowing members to report block trades executed off the order book to the stock exchange for the purpose of publication in the official price list. This system, which is in fact used by many other stock markets, allows block trades to be made public while avoiding negative interference with the market, on condition however that strict pre-defined rules are followed. The start of this specific system of reporting block trades was scheduled at the beginning of 2002. Depending on the results thereof, the CSSF will decide if and what kind of additional measures will be necessary to reach the scope of increasing market transparency while respecting market integrity.

The use made of the information collected in relation to the reporting of transactions on financial assets carried out by investment firms contributed a lot to the performance of the tasks fulfilled in 2001 with respect to enquiries. This effective tool enabled the CSSF to obtain the tangible real-time information needed to conduct its investigations throughout the year.

3. Prudential supervisory practice

In accordance with the amended Law of 23 December 1998 on the supervision of securities markets, the CSSF enlarged its activity relating to the supervision of stock exchanges, public offerings and listed Luxembourg companies.

3.1. Supervision of stock exchanges

The establishment of a stock exchange in Luxembourg is subject to a concession to be granted by grand-ducal decree. The only stock exchange currently licensed under Luxembourg Law is the "*Société de la Bourse de Luxembourg*" (the "Luxembourg Stock Exchange"). The CSSF monitors the proper functioning of the market operated by the Luxembourg Stock Exchange as well as the proper application of the related regulations. It also attends the meetings of the Luxembourg Stock Exchange authorities.

3.1.1. Regulatory changes

Developments made in 2001 in the context of the agreement on cross-membership and cross-access signed on 16 November 2000 between Euronext and the Luxembourg Stock Exchange, were the subject of several meetings of the CSSF and the Luxembourg Stock Exchange. The purpose of this discussion was to include the view of the CSSF in the underlying harmonised regulations, particularly as regards the specific of 'cross members', essential under this new form of co-operation.

In order to keep the stock exchange regulations regarding market surveillance in line with the regulatory developments at European level and the background of a fully decentralised automatic market, a Surveillance Committee was created as part of the Luxembourg Stock Exchange bodies. This Committee is in charge of supervising the members' compliance with the Rules and Regulations laid down by the Luxembourg Stock Exchange and any legal and regulatory provisions governing stock exchange trades. This supervisory committee informs the CSSF of any suspected infringements of the law.

3.1.2. The market ensured by the Luxembourg Stock Exchange and its members

The CSSF is kept informed of market activities and related problems on a daily basis through an activity report provided by the Luxembourg Stock Exchange.

As far as market activities are concerned, turnover fell by 14.2% compared to 2000 to reach EUR 2.4 billion. It may be worth pointing out that trends in trading reversed from past years in favour of bonds with a total turnover representing 67% of trading compared to variable income securities, which accounted for the remaining 33%. This change was partly due to withdrawals of certain traditional shares of Luxembourg origin. The general development of markets, reinforced by the economic consequences of the 11 September attacks were some additional reasons.

At the end of 2001 the Luxembourg Stock Exchange had 85 members, 28 of which were 'cross members'.

Considering that turnover fell in 2001, the year was nevertheless marked by intense activity in new admissions to the Luxembourg Stock Exchange. A total of 7,225 new securities were admitted, an increase of some 19% in relation to the number of quotation lines, compared to an increase of 15.5% in 2000. The total number of securities admitted as at 31 December 2001 amounted to 23,438, divided into 16,447 bonds, 278 shares, 1,306 warrants and 5,407 investment funds and subfunds.

3.2. Documentation relating to public offers and listings

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Under the supervision of the CSSF, the Luxembourg Stock Exchange is entrusted with the examination of prospectuses, pursuant to the Grand Ducal regulation of 28 December 1990 on the requirements for the drawing up, scrutinising and distribution of the prospectus to be published where transferable securities are offered to the public or of listing particulars to be published for the admission of transferable securities to official stock exchange listing. Under the Grand Ducal regulation, the Luxembourg Stock Exchange approves the prospectuses to be published where transferable securities are admitted to official listing and where public offers of transferable securities are followed by a listing on the Luxembourg Stock Exchange. Prospectuses relating to public offers of transferable securities not followed by a listing are approved by the CSSF.

During the year under review, some 50 public offers of transferable securities were made in Luxembourg, 11 of which were public exchange offers in relation to securities listed on the Luxembourg Stock Exchange. The CSSF approved the documentation relating to 12 public offers that were not the subject of an application for admission to official listing.

The criteria applied by the CSSF regarding the supervision of the specific task of approval of prospectuses carried out by the Luxembourg Stock Exchange are based on close co-operation between the Stock Exchange and the supervisory authority.

During 2001 the Luxembourg Stock Exchange submitted some 20 application files drawn up for the purpose of the due examination of the public offer prospectus or listing particulars to the CSSF in order to obtain the CSSF's view on these issues. In addition, over 60 reports for a waiver from specific provisions of the regulations concerning the prospectus were referred to the CSSF by the Stock Exchange. A total of 50 of these were duly justified and thus granted.

The CSSF also clarified its position regarding issues of mortgage bonds. In fact, these issues may benefit, as from the time of their first application, from the partial exemption from the obligation to publish a prospectus provided to credit institutions issuing debt securities in a continuous or repeated manner. The prospectus shall contain information only on the persons responsible for it, on the bonds, on the admission of the bonds to the official list and on any

events of importance for the assessment of the securities concerned, that would have occurred since the end of the financial year in respect of which the last annual accounts were published. These accounts must be made available to the public.

In the absence of a legal or regulatory definition of a public offer of securities, the CSSF assesses the private or public character of offers on a pragmatic basis. It has thus always admitted that an offer of securities for subscription or sale is public when it is announced in the press or by any other means accessible to the public in general. The fact that the public can get a prospectus of a securities issue at the counters of a bank is also considered as a public offering just like information about a securities issue given by way of circular letters or tracts.

Despite its continuous efforts to clarify the essential elements to be considered when appreciating the private or public character of an offer, the CSSF had to intervene on several occasions in 2001 in connection with public offers because the document approval procedure was not carried out properly. Specific intervention proved necessary in relation to public exchange offers concerning securities listed on the Luxembourg Stock Exchange. Notices relating to the announcement of these public exchange offers should in fact be published in one or several national newspapers circulated throughout Luxembourg or widely therein. Taking into account this announcement and the distribution among the public, these exchange offers fall within the scope of the regulations in force for public offers of transferable securities.

As regards co-operation with foreign authorities concerning mutual recognition of prospectuses, the CSSF issued certificates of approval relating to 94 public offers or admission to the official stock exchange listing made simultaneously or within short interval in several Member States of the European Economic Area. These issues include in particular the public offer of securities made by Arcelor in exchange for Arbed, Aceralia and Usinor securities, an offer followed by admission to the official stock exchange listing on the Luxembourg Stock Exchange.

The special nature of the above-mentioned public exchange offer was due to the fact that four financial markets were directly affected by the underlying operation, which would certainly have repercussions, both on the markets concerned and on the companies involved. This entailed simultaneously considering the interests of shareholders and employees while complying with the regulations in force in the different countries affected by the offer and the listing. It is evident that the offer documentation and issue prospectus relating to the new securities were thoroughly examined by the competent authorities in Luxembourg, Belgium, France and Spain. Since the listing particulars, which were scrutinised by the Luxembourg Stock Exchange, were an integral part of the offer documents in the four countries, as much information as possible required under the different laws on the public offer of securities had to be included. In the framework of this transaction it should be emphasised that co-operation between the Luxembourg Stock Exchange and the CSSF, and between the four concerned supervisory authorities, was marked by a concern to protect the interests of investors by providing them, during the assessment of the option whether or not to accept the exchange offer, with the information necessary to make an informed judgement on the assets, financial position, results and prospects of the companies involved.

3.3. Luxembourg companies listed on the Luxembourg Stock Exchange

3.3.1. Monitoring of financial information and information on shareholdings

The amended Law of 23 December 1998 on the supervision of securities markets lays down the principle of monitoring the disclosure of information by companies admitted to official listing on the Luxembourg Stock Exchange (48 at 31 December 2001).

The CSSF verifies financial data submitted to it, in particular the annual and half-yearly reports published by these companies. As part of this mission the CSSF contacted companies on several occasions to obtain additional information on certain aspects of their reports. It also formulated written comments on the annual accounts of certain companies.

The CSSF systematically checks compliance with the Law of 4 December 1992 on the information to be published when a major holding in a listed company is acquired or disposed of. For this purpose, attendance registers of ordinary or extraordinary general meetings are considered. The CSSF took action with companies that did not comply with the provisions laid down.

3.3.2. The RTL Group case

At national level the exclusive offer made by Bertelsmann to GBL rekindled interest in the discussion of the principle of protection of minority shareholders. On 2 July 2001 the Belgian group GBL sold its holding of around 30% in RTL Group to Bertelsmann, which then controlled 67% of RTL Group. In return GBL received a holding in the capital of Bertelsmann. This transfer of the exclusive control of RTL Group to Bertelsmann was not followed by an offer in identical conditions to the other shareholders. This fact was vigorously contested by the minority shareholders. Alongside the legal proceedings brought by the minority shareholders, some of their representatives referred to the CSSF. In August 2001, the CSSF specified that it was not entitled to issue an order with respect to the specified case. Despite this, the CSSF referred to the European Commission Recommendation of 25 July 1977 concerning a European code of conduct relating to transactions in transferable securities. In fact, point 3 of the General Principles states that *'equality of treatment should be guaranteed to all holders of securities of the same type issued by the same company; in particular, any act resulting directly or indirectly in the transfer of a holding conferring de jure or de facto control of a company whose securities are dealt in on the market, should have regard to the right of all shareholders to be treated in the same fashion'*. Point 17 of the Supplementary Principles reads as follows: *'Any transaction resulting in the transfer of a holding conferring control in the sense referred to in general principle 3 should not be carried out in a surreptitious fashion without informing the other shareholders and the market control authorities. It is desirable that all the shareholders of the company whose control has changed hands should be offered the opportunity of disposing of their securities on identical conditions, unless they have the benefit of alternative safeguards which can be regarded as equivalent'*.

The CSSF pointed out that these provisions are very clear and that it is of the opinion that, insofar as the minority shareholders were excluded from the opportunity to have their securities repurchased or exchanged on the same conditions as those granted to GBL/Electrafina, the above-mentioned principles were not observed.



