



AFM Market Watch

Prevention and detection of market abuse:
an important role for market participants

September 2021, Edition 4

Editor's note

Dear reader, we are pleased to present the fourth edition of our recurring newsletter, the AFM Market Watch. It covers capital market related topics such as MAR, MiFID II and transaction reporting.

The newsletter consists of two parts: (i) a lead article tackling a current capital market related topic, supported by (data) analyses; and (ii) a recurring short facts and figures section tracking developments in the market.

The AFM Market Watch will be published on a regular basis and sent to subscribers (click [here](#) to subscribe). This fourth edition covers the topic 'Prevention and detection of market abuse: an important role for market participants' (pp. 1-6), followed by facts and figures on European Union Allowances (EUAs) trading on ICE Endex Markets B.V. in the Netherlands (p.7).

Introduction

Trust and integrity are essential to the proper and orderly functioning of capital markets. Investors should be able to rely on a fair and transparent execution of their transactions. Market abuse can impair the proper and orderly functioning of capital markets.

Therefore, preventing and detecting market abuse, such as market manipulation and insider trading, is a top priority for the AFM. To prevent and detect market abuse, the AFM performs data-driven multi-asset-class surveillance on trading on the markets under its supervision, both in real-time and on a T+x basis.

Market participants play an essential role in preventing and detecting market manipulation and insider trading, by submitting Suspicious Transaction and Order Reports (**STORs**). After all, banks, brokers, investment firms, trading venues and proprietary traders are the first line of

defence and benefit from fair and orderly financial markets.

The AFM, and at the European level [ESMA](#), call for steps to strengthen the detection of potential market manipulation and insider trading and the reporting of STORs by market participants, by increasing the effectiveness of their surveillance.

This edition of the AFM Market Watch provides detailed information on the detection of potential market abuse and the reporting of STORs. It gives insight into the received STORs and notifications, follow-up actions by the AFM (in many cases non-public) and points of attention for market participants to improve the effectiveness of surveillance and the quality and quantity of STORs. This helps both the market participants and the AFM to continue to contribute to fair and transparent capital markets.

1. Tackling market abuse: it takes two to tango

The AFM and market participants have a common interest to keep markets trustworthy and free from market abuse. Preventing and detecting market manipulation and insider trading helps to achieve this goal.

Market participants are essential

Market participants are the first line of defence. Article 16 of the [Market Abuse Regulation \(MAR\)](#) applies to market operators or investment firms operating a trading venue and every person arranging or conducting transactions concerning financial instruments in a professional capacity (such as banks and investment firms) (all three hereafter jointly: market participants). They shall establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions.

This is a multi-asset class effort that places a large responsibility on market participants:

- Market participants must ensure that their surveillance systems can detect and respond to potential abusive trading behaviour and are updated regularly.
- They must consider the characteristics of the financial instruments concerned, markets they operate in and the clients they serve.
- They are legally obliged to notify the AFM immediately by submitting a STOR if a reasonable suspicion arises that an order and/or transaction in a financial instrument could constitute (attempted) insider dealing or market manipulation.
- Market participants should also ensure that their arrangements, surveillance systems and procedures are regularly assessed, at minimum through an annual audit and internal review, and updated when necessary.

Data-driven surveillance by the AFM

The AFM has access to order and transaction data on transactions in financial instruments. On average, almost 190 million transactions per month are reported to the AFM. This data is used to flag suspicious trading in various ways, including by using sophisticated algorithms, professional surveillance tools and dedicated personnel. The AFM also increasingly focuses on cross-product and cross-market behaviour.

Where suspicious market activity is observed, the AFM can intervene promptly by contacting the parties involved and initiate other follow-up actions that can result in additional measures.

2. More STORs but room for improvement

The AFM expects market participants to remain vigilant and be proactive in preventing and responding to market abuse.

Due to its professional secrecy, the AFM cannot elaborate on its follow-up actions in specific cases. In this Market Watch the AFM

will share its observations about received STORs and follow-up actions in a general manner.

Rising number of STORs...

STORs are key to the AFM’s market supervision. The number of STORs received by the AFM has increased in recent years (by 9% in 2020 to over 500). In the first half of 2021, the number of STORs increased further (+30%). This is partly due to Brexit, as several trading venues shifted their activities from London to Amsterdam.

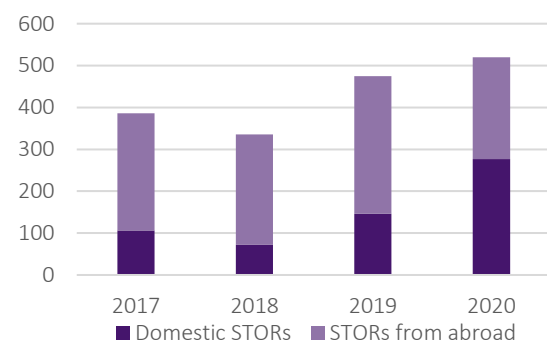


Figure 1 Number of STORs received

Most STORs submitted to the AFM by Dutch market participants are submitted by brokers (59% in 2020), banks (28%) and trading venues (8%).

Since Brexit, the share of STORs received from trading venues has increased from around 8% of the total in 2020 to one third in the first half of 2021, as more trading venues are now reporting suspicious activities to the AFM.

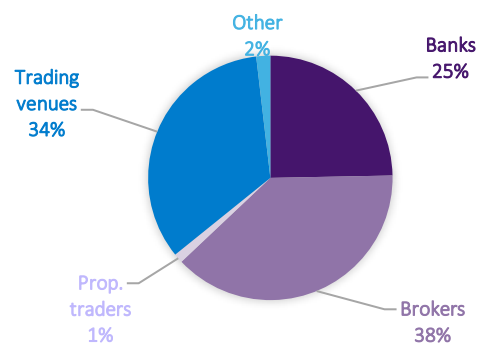


Figure 2 Source of domestic STORs in 2021H1

...but there is still room for improvement

However, there is still room for improvement in the number and the quality of STORs submitted by market participants. For instance, for some ongoing AFM investigations into market manipulation, the AFM did not receive a STOR or other notification. These cases were only detected by AFM’s surveillance. In these cases, the AFM would also have expected the suspicious behaviour to be detected by market participants involved. In these instances, the AFM will contact the relevant market participant to investigate whether the parameters for detection are off or whether they have made a different judgement on the relevant behaviour based on good grounds.

More STORs about insider trading than manipulation

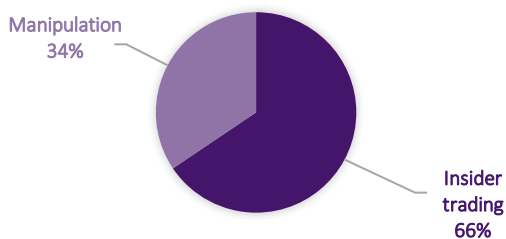


Figure 3 STORs by type of market abuse in 2020

Last year, and in the first half of 2021, around two thirds of the STORs received related to insider trading. As discussed in the second edition of the [AFM Market Watch](#), market participants should equally focus their detection on potential market manipulation.

Most STORs received about equity

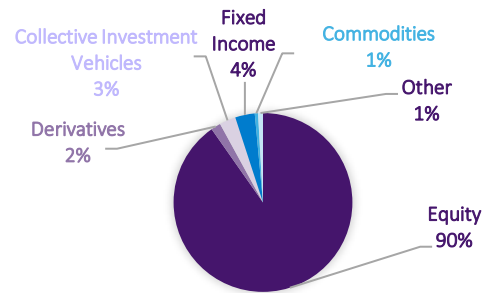


Figure 4 STORs by asset class in 2021H1

Most STORs (90% in the first half of 2021) concern equity. The number of STORs on fixed income (4%), collective investment vehicles (3%) and derivatives (2%) is much lower, and the AFM received only a handful of STORs on other asset classes. Since Brexit, several large fixed income trading venues operate from Amsterdam. Subsequently, June 2021 saw the start of secondary trading in European Union allowances (EUAs) in Amsterdam. Therefore, more notifications from trading in these asset classes are expected from market participants.

3. Adequate detection and reporting are crucial to a fair market

The STORs and other (voluntary) notifications are valuable instruments for the AFM to identify and investigate suspected insider trading and market manipulation and are thus essential to maintaining fair and orderly capital markets. The AFM reviews all STORs and other notifications received from market participants and determines the most appropriate response. For instance, in case the AFM receives various STORs about the same event, in combination with AFM’s own intelligence, this may result in a high priority case.

STORs can lead to many different supervisory actions (many of them non-public).

As shown in figure 5, this can range from:

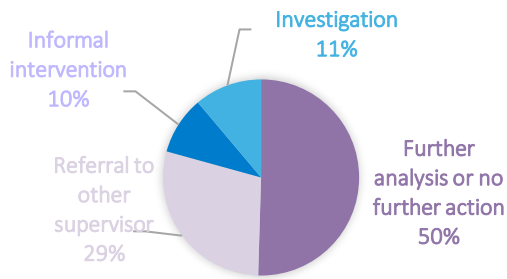


Figure 5 Follow-up actions after analysis of STORs

- Informal interventions, such as warning letters or calls. 10% of STORs in the past 2.5 years resulted in an informal intervention. The AFM has noticed that informal interventions relating to manipulation have in most cases put a stop to such behaviour.
- 11% of STORs led to the start of, or contributed to, an investigation.
- 29% of STORs were referred to other supervisory authorities abroad or to other agencies in the Netherlands.
- Almost half of the STORs required further analysis or warranted no further action at this moment. Some of these STORs subsequently became building blocks for other types of intervention, for instance when certain suspicious trading behaviour appeared to be repetitive. Another part of these STORs were cases that, after analysis, appeared not to involve market abuse.

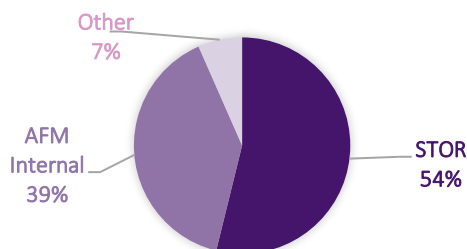


Figure 6 Source of market abuse investigations in recent years

The figure above shows that over half of the market abuse investigations started by the AFM in recent years were initiated based on STORs and 39% were based on AFM's own surveillance. This shows that both market

participants and the AFM play an important role in detecting and tackling market abuse. In addition, the AFM regularly detects trading behaviour that leads to a suspicion of market abuse but on which it did not receive a STOR or other notification from market participants concerned. Therefore, the AFM will contact market participants to emphasize their obligation to further improve their detection and reporting of potential market abuse.

Figure 7 shows a subset of market abuse investigations: those initiated on the basis of a STOR. Two thirds of these investigations triggered supervisory interventions in recent years. These interventions range from informal measures (the outcome of 41% of the investigations) to a referral to the public prosecutor (6%). In around one third of the investigations, no violation or market abuse could be established.

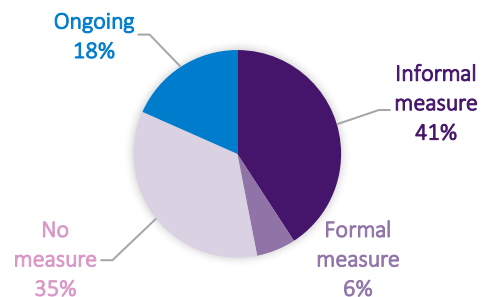


Figure 7 Outcome of STOR-initiated investigations, 2018-2021

4. How to increase detection and reporting of market abuse?

The responsibility for adequately detecting and reporting suspicious orders and transactions lies with market participants. The AFM is constantly in contact with market participants to improve their level of surveillance and the quality of their STORs.

Focus more on manipulation and non-equity

The AFM expects that market participants are committed to improving the detection of potential market abuse, in view of their thorough knowledge of the clients and markets they serve. The AFM will focus its Article 16 MAR supervision on the areas

where the level of surveillance by market participants can still improve. For instance, there will be a stronger focus on detecting manipulative behaviour, as well as on suspicious behaviour in non-equity asset classes, particularly fixed income, EUA and other commodities. Recently, the AFM started a thematic project to evaluate the level of surveillance of fixed income platforms, which is still ongoing.

A few examples of AFM's supervisory activities in this field are listed below:

➤ *Periodic meetings*

Periodic market conduct meetings have been set up with several market participants to discuss STORs and so-called near-misses (suspicious behaviour that is not severe enough to be reported as a STOR by the market participant, e.g. because it is assessed that the behaviour fits in the normal trading pattern of a client). In these meetings the AFM also discusses, where possible, what its own surveillance has detected and what the market participant reasonably should have detected. The AFM also plans to visit market participants on-site to have a closer look at their surveillance systems and STOR procedures.

➤ *Feedback and close contact*

Due to its professional secrecy, the AFM cannot elaborate on its follow-up actions in specific cases. However, a few general conclusions and observations were already mentioned in the sections above. In addition, the AFM can and will give feedback about the quality of a STOR if needed. For instance, information about trading history can be very useful to include in the STOR. Especially in fixed income cases interconnected instruments, such as cash versus futures, or products with different durations, play an important role.

Market participants submitting a STOR are obliged to clearly indicate why certain trading behaviour is considered suspicious.

For example, the submitter may have (taped) conversations with its client or knows things about its client that are part of the reason why the behaviour is flagged up as suspicious.

➤ *Challenge with own surveillance*

The AFM's surveillance of the capital markets in the Netherlands allows it to detect suspicious trading and to help review STORs. As stated before, if the AFM detects suspicious behaviour for which no STOR was submitted, it can intervene (see below). Conversely, if a market participant submits a STOR that was not detected by the AFM's own surveillance systems, this can be used to improve the AFM's surveillance algorithms.

➤ *Risk assessment*

Market participants need to undertake adequate risk assessments to identify the market abuse risks they could be exposed to and to determine what controls are necessary to mitigate them. These risk assessments can refer to the list of indicators for fictitious devices, false or misleading signals and price securing, as specified in Annex 1 of MAR, but this list is not exhaustive.

Every business (and every market participant's client base) is unique. Therefore, relying on standard packages, such as popular 'off the shelf' alert settings and surveillance solutions, average peer group parameters and output volumes, will not necessarily satisfy MAR requirements. Each market participant is responsible for the appropriateness and proportionality of their systems in relation to the scale, size and nature of their business activity. This means, for instance, that they have to make their own decision about alert calibration. If market participants assume that because a certain calibration is appropriate for their peers, it must be appropriate for them, they risk non-compliance with the MAR.

➤ *Audits*

Market participants are obliged to conduct an annual audit of their arrangements, surveillance systems and procedures. Last year's analysis of audits requested by the AFM from several market participants revealed room for improvement. The AFM also found that merely requesting the audits already contributed to more awareness and improvement in the priority, level and quality of market surveillance by market participants.

➤ *Additional points of attention*

In addition to the above, the AFM publishes general tips on its [website](#) or through the [AFM Market Watch](#). Moreover, last year the AFM raised awareness on the provisions of Article 16 MAR by sending informative e-mails to certain groups of market participants, such as commodity traders and certain asset managers. Some general points of attention the AFM distilled from its supervision are:

- Focus not only on suspicious orders and transactions by clients but also by your own personnel.
- Trade surveillance should be an agenda item at management meetings.
- Regular training of personnel on (surveillance of) market abuse is very important.
- Adjust your surveillance systems to your own unique situations and in response to new trends and/or new types of market abuse.

International cooperation

As market abuse does not stop at the Dutch border, the AFM is in close contact with foreign supervisory authorities. As shown in figure 1, the AFM receives many STORs from other National Competent Authorities. Conversely, many STORs the AFM receives are transferred to foreign supervisory authorities, such as when trading takes place on a trading venue in another member state. Cross-border investigations are also

increasingly common. Therefore, market participants need to focus their surveillance on all trading they conduct, not just on Dutch instruments or trading venues.

AFM measures range from informal to formal

If prevention and/or detection by market participants is below par, or if they fail to report a reasonable suspicion of attempted or actual insider dealing or market manipulation, the AFM can intervene. This supervisory action can take many forms, as explained in section 3.

Whether the AFM imposes a formal or informal measure always depends on the circumstances and the weighting of the related factors involved. Usually, the AFM will first request an explanation as to why certain behaviour was not reported.

If the AFM observes a violation of (one of) the obligations of Article 16 MAR or [Delegated Regulation 2016/957](#), it can take enforcement measures. The AFM may impose an [administrative fine](#), subject to a maximum of €2.5 million or 5% of the net turnover.

5. Facts & Figures

Since 7 June 2021, [European Union Allowances](#) (EUAs) derivatives are traded on ICE Endex Markets B.V. in the Netherlands. Approximately 95% of the EUA derivatives trading within the EU now takes place in the Netherlands under supervision of the AFM. EUAs are an important instrument when it comes to sustainability. Through this market instrument, the EU can achieve its own climate objectives (Paris Agreement) and those of the Kyoto Protocol. These climate goals make the instrument sensitive to political decision making as well.

Initial observations after 3 months of supervising this market:

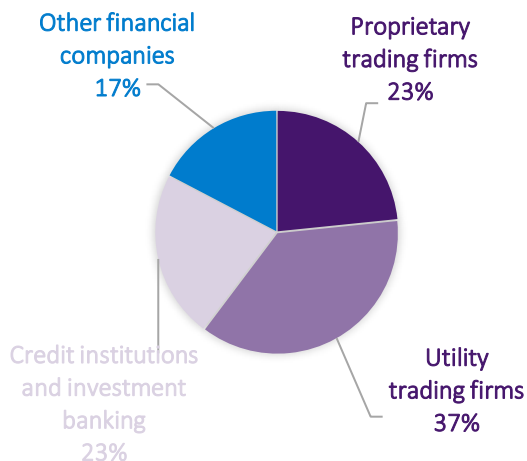


Figure 8 Distribution of traded volume in EUA futures on ICE Endex (%) by categories, based on AFM transaction reporting data

ICE Endex has 500 members with trading rights on the EUA derivatives market. The AFM has received EUA derivatives transaction reporting from 332 firms since 7 June 2021. Figure 8 and 9 show that market participants are a variety of firms and are

spread over multiple countries. Additionally, the 50 most active firms are responsible for 90% of the total volume traded.

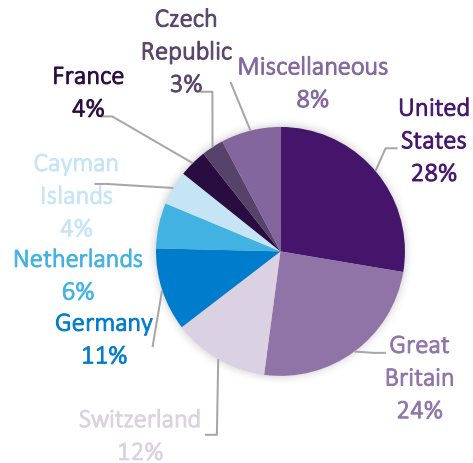


Figure 9 Traded volume (%) by firms per country in EUA futures on ICE Endex, based on AFM transaction reporting data

The past year, the price of EUAs has shown a significant increase. The AFM is the competent authority and supervises the conduct of, amongst others, the EUA derivatives market. The focus of the AFM is that the price is established through a fair and orderly market process. The price development of the most active EUA future over the past months is shown in figure 10.



Figure 10 Price development and traded volume in the most active EUA future Jun - Sept 2021 (Source: Bloomberg)

Did you know?

- More information about the obligation for regulated firms to notify the AFM of any reasonable suspicion of attempted or actual market abuse can be found [here](#).

And:

- If you have any suspicion of attempted or actual market abuse, please notify the AFM voluntarily by contacting us. [Contact the AFM](#).

Remarks

As described in this AFM Market Watch, the AFM is keen to continuously increase the overall level of supervision for all asset classes under its supervision. This is realised by continuously improving its data-driven surveillance as well as encouraging (and challenging) the financial industry to operate at a high level. This is a constant process, which develops over time. The AFM and market participants have a common interest to keep markets fair and orderly, so that true demand and supply can meet and the financial system can support the sustainable growth and development of the economy.



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Mission statement:

The AFM is committed to promoting fair and transparent financial markets.

As an independent market conduct authority, we contribute to a sustainable financial system and prosperity in the Netherlands.

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