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Plenary 2

**Misconduct across Jurisdictions – The Enforcement
Challenge**

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<p>MISCONDUCT ACROSS JURISDICTIONS THE ENFORCEMENT CHALLENGE</p>
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Ladies and Gentlemen,

Not so long ago, financial market globalisation – like any economic globalisation process – was expected and eagerly awaited. At the same time it was feared on account of the possible dangers for unsophisticated investors.

That process is now under way. And although it is not yet complete, it has advanced to a greater or lesser extent across the continents. It will continue to gather momentum in the years ahead.

Globalisation creates challenges, both for market operators and for supervisory and regulatory authorities.

Some of the challenges are technical: The implementation of harmonised platforms for trading, clearing and settlement allow market participants, regardless of nationality or geographic location, to do business together over vast networks and systems that deliver substantial increases in:

- speed and volume of financial and economic interaction
- liquidity

Some of the challenges are regulatory: Obviously, the implementation of common cross-border systems demands a harmonised legal framework that prevents "regulation shopping", whereby operators gravitate towards areas with less stringent regulatory controls and constraints.

Other challenges affect market participants, forcing them to rationalise their international organisations by confining their market access points (and hence their membership) to exchanges,

clearing houses and settlement organisations that allow them to operate through a single access point, with ever-declining costs.

Against this backdrop, I want to take a few minutes to share with you the conclusions we have been able to draw from the creation of Euronext, the first pan-European market operator. Euronext was born from the consolidation of the exchanges of Paris, Amsterdam, Brussels, Lisbon and Porto, along with the London-based derivatives exchange LIFFE, acquired in late 2001.

I will first explain exactly what Euronext is and how it measures up in European and worldwide terms (1). I will then try to show how we solved the thorny issue of enforcement across markets governed by different regulations, in terms of controls as well as of procedures and disciplinary measures (2).

I/ A unique international concept

The uniqueness of Euronext stems from a simple observation made by its founders, namely that no financial centre wants to organise its own demise when, at the same time, investors and their intermediaries are seeking a broad, deep market with lower access costs, technically efficient platforms and a single set of rules and regulations.

A priori, investors' desires conflict with those of any single marketplace or even its regulatory and supervisory authorities.

And yet, that is exactly what the Euronext concept delivers. Let me explain how.

- 1) Euronext is a totally integrated group composed of a holding company, Euronext NV, which went public in July 2001. Managed by a supervisory committee and an executive board, Euronext NV has five wholly-owned subsidiaries:
 - Euronext Paris
 - Euronext Amsterdam
 - Euronext Brussels
 - Euronext Lisbon
 - London International Financial Futures and Options Exchange (LIFFE)

These five companies are market operators, in other words they run markets – some of them regulated – that are based in different countries and whose "regulated market" status depends on different jurisdictions.

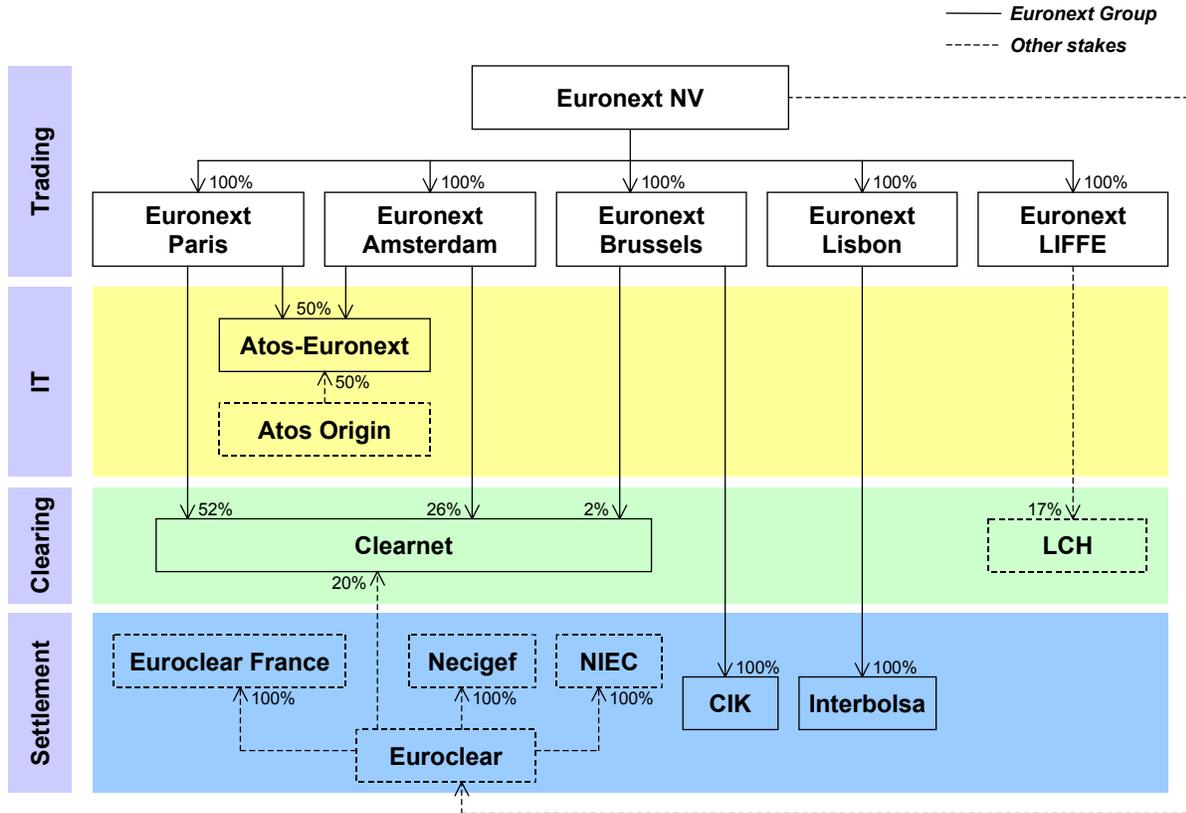
Two other important companies belong to the group:

- Clearnet is the group's single clearing house, formed from the merger of clearing activities of Euronext's founder countries. Clearnet is based in Paris and operates under French law. (Note

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that LIFFE is still cleared by London Clearing House and that the clearing operations of Euronext Lisbon, which only joined the group at the beginning of this year, will not be integrated until next year.)

- Atos-Euronext is equally owned by Euronext and the IT group Atos Origin. The company handles IT development and operations for the entire group.



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	Regulated Markets					Unregulated Markets
Paris	Premier Marché Second Marché		Nouveau Marché	MATIF MONEP		Marché Libre
	Cash			Derivatives		
Amsterdam	Euronext Amsterdam Stock Market		Euronext Amsterdam Derivatives Markets		Euronext Amsterdam Commodity Markets	Public Auctions
	Cash		Derivatives			
Brussels	Premier Marché	Second Marché	Nouveau Marché	Belgian Trading Segment	Belfox	Dutch Trading Platform
	Cash				Derivatives	
Lisbon	Official Market	Second Market	New Market	MEOG	Derivatives Market	Unlisted Market
	Cash				Derivatives	

Note : LIFFE not represented

2) Euronext uses integrated platforms

- . All Euronext cash markets use the NSC trading system developed by the Paris Bourse (Euronext Lisbon will be connected in 2003).
- . All Euronext derivatives markets will eventually migrate to LIFFE's system, LIFFE CONNECT, according to a pre-arranged schedule.
- . As the clearing house for the entire group, Clearnet is the only central counterparty in Europe that uses the Clearing 21 system, which permits multilateral netting of cash, derivatives and OTC trades.

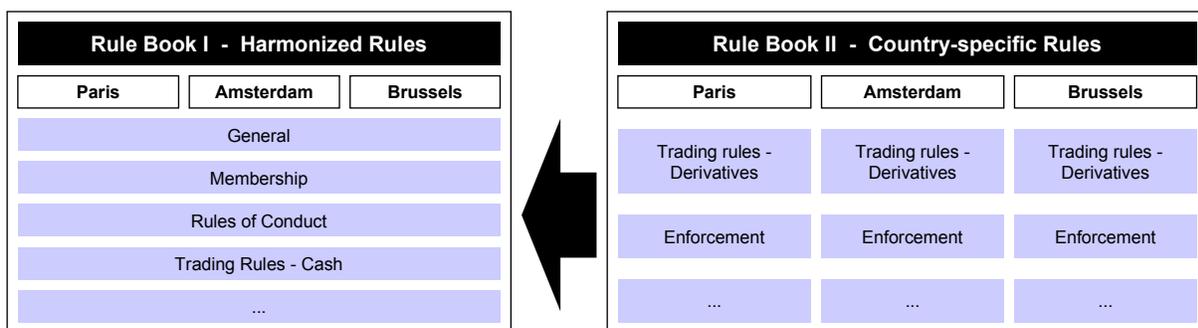
	Cash	Derivatives	
	Paris, Amsterdam, Brussels, Lisbon	Paris, Amsterdam, Brussels, Lisbon	LIFFE
Trading	NSC	LIFFE CONNECT	
Clearing	CLEARNET (CLEARING 21)		LCH

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For settlement and custody, Euronext has selected the Euroclear group as its preferred settlement organisation. This means that Euroclear is wholly responsible for settlement operations. Euronext holds a 4.75% stake in Euroclear and sits on the boards of Euroclear plc and Euroclear Bank.

- 3) Through a system of full and automatic cross-membership, any member of a Euronext-integrated cash or derivatives market has full access to all the equivalent markets (cash or derivatives) operated by the group.
- 4) This system of automatic access via a single technical platform requires compliance with a single and fully harmonised body of regulations. It should be noted that the instigators of Euronext worked hand in hand with their domestic authorities to draft a common body of rules known as Rule Book I, which so far comprises five chapters:
 - General Provisions
 - Membership
 - Rules of Conduct
 - Trading Rules for Securities
 - Special Rules for the Next Economy and Next Prime Segments

Rule Book I coexists with a set of country-specific rules – Rule Book II – covering topics that have not yet been harmonised. It is important to stress that Rule Book I allows members to operate through unified platforms because, whatever the point of market access, the regulations are identical. A closer look at Rule Book I shows that it contains regulations that have been approved by different supervisory authorities. The only common characteristic – and this is Euronext's key contribution – is that these regulations are totally identical. Each regulatory authority has approved an identical set of rules.



- 5) The order book is entirely centralised. This means, for example, that all stocks listed on the cash markets in Amsterdam, Brussels, Lisbon or Paris are available for trading through the same order book. This is obviously an advantage for investors, because the market is broader, deeper and more liquid.

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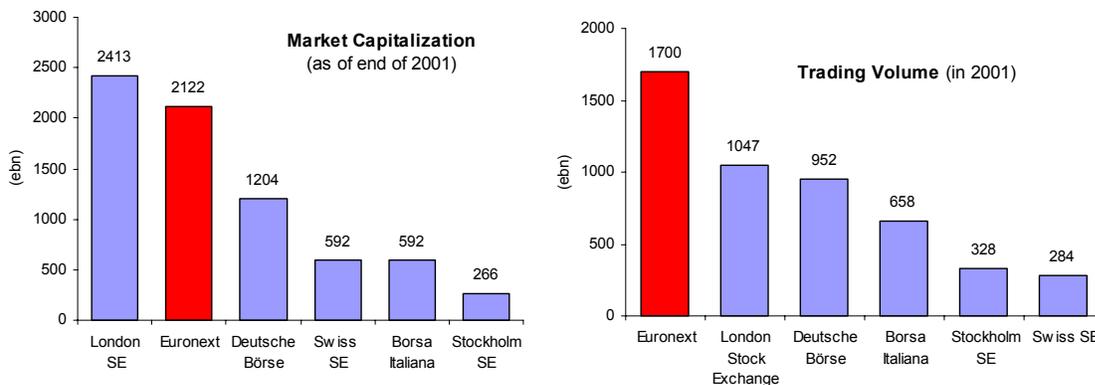
In short, Euronext members can log onto a central order book containing all the stocks (or financial contracts) admitted to trading across our markets. They have a single access point that allows them to operate on a single technical platform, while complying with a single set of regulations.

For members, intermediaries and investors, this means a single exchange incorporated into a single corporate group, whereas in fact they are dealing with regulated markets of different nationalities coming under different jurisdictions. This is what makes Euronext unique.

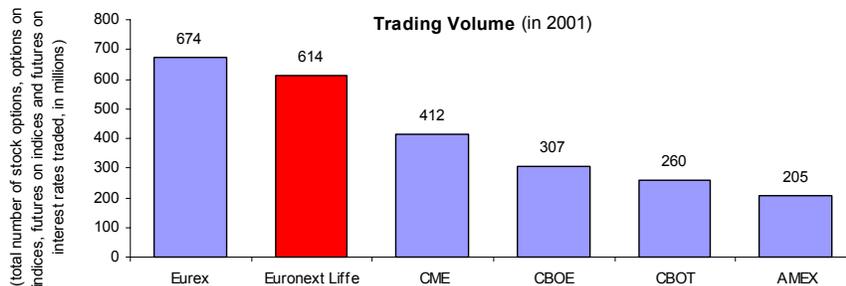
Euronext has turned what might have been a weakness into a strength. Relying on locally based subsidiaries, it is able to maintain grass-roots relationships with members, investors and issuers (listed companies, too, can choose their market access point). Those relationships form cornerstone of a pace-setting market in Europe.

These figures show where Euronext stands in relation to Europe and the rest of the world.

Cash markets (in Europe)



Derivatives markets (in the world)



So how does this concept permit satisfactory and harmonious enforcement of regulations, both for issuers and for members coming under different jurisdictions and subject to different regulatory frameworks in terms of admission and disciplinary oversight?

This is the second question I want to address today.

II/ Enforcement at Euronext

Euronext is clearly a highly effective catalyst for changing the intra-European regulatory framework within which markets operate and develop. In contrast to the Investment Services Directive (ISD), which seeks to iron out national obstacles hindering the activities it regulates (while allowing special laws to apply in certain cases), Euronext epitomises the increasingly assertive demand to harmonise the actual content of regulations and legislation for a business that is not simply cross-border but totally international.

Let me take a simple example. Euronext's cross-membership arrangement is not simply a possibility for members to directly access a foreign market; it entails full and simultaneous membership of several regulated markets of different nationalities using a single order book. Ultimately, therefore, the aim is to establish a single membership giving access to several markets simultaneously rather than several memberships of several markets.

Naturally, this situation has consequences for the supervision of members and the implementation of disciplinary or criminal sanctions. I would now like to discuss those consequences.

The rules governing enforcement at Euronext stem from the strongly international nature of our members' business. Naturally, the unique features of the Euronext model are reflected in the architecture of the enforcement mechanism.

This mechanism is based on three basic principles:

- 1) the relationship between the member and the market is governed by contract
- 2) the home authority has principal jurisdiction
- 3) public policy on economic matters must be respected, with the attendant consequences under criminal law

- 1) Contractual relationships

This principle is sometimes challenged because it is linked to the way the markets have changed in recent years. Put simply, there are two conflicting concepts. The first holds that the relationship between market members and the market itself, as well as the relationship between issuers and the

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market, comes within the legal ambit of public (administrative) policy, chiefly because the market is instrumental in implementing public policy on economic matters. This concept was widely accepted at a time when regulated markets enjoyed a national monopoly, not only *de facto* but frequently *de jure*. This led them to play an often crucial part in the authority responsible for supervising and disciplining members and issuers.

The second concept is that the relationship between members and the market, and between issuers and the market, is primarily contractual and therefore comes under private law (usually commercial law). This is the concept that appears to have emerged from recent developments:

- a. The companies that now run the markets are commercial enterprises which themselves offer securities to the public.
- b. The markets have totally lost their *de facto* and *de jure* monopoly. Market operators are working in an environment of out-and-out competition, both from over-the-counter markets and from other regulated markets. The ISD paved the way for competition, which may extend beyond the boundaries of Europe inasmuch as the principles of reciprocity and level playing fields are respected.
- c. The move to electronic trading has made price discovery a simple, routine mechanism; it has also showed that developing systems to implement this economic relationship is chiefly a question of investment and capital risk taking.
- d. The corollary of these trends has been emergence of independent supervisory and disciplinary authorities, whose powers have increased significantly at the same time as the markets' powers have declined.

As I mentioned before, this difference of opinion between proponents of the public and private spheres has not yet been totally settled. Let me take the case of France, where eminent legal experts are still defending radically opposing arguments. This became particularly evident in Paris during legal proceedings between "locals" and the derivatives exchanges when electronic trading was introduced. Conflicting judgements were handed down in which the administrative and legal tribunals both claimed jurisdiction over totally identical disputes, even though the objection to jurisdiction had been formulated at the outset.

Within this generally unstable legal setting, Euronext deliberately adopted the principle that the relationship with members and issuers was primarily a contractual one. There are several advantages to this solution. First, it is the only one that offers the flexibility needed to create a common framework within which members, issuers and the market operator can carry on their business. Accordingly, Euronext members – regardless of their home market – are asked to sign two contracts: the Admission Agreement and the IT Agreement. There is only one blueprint for each agreement. These have been discussed with members, who can choose to resort either to arbitration or to the courts in the event of a dispute (the choice must be formalised when the contract is signed). This is the only way to ensure that, in the event of a conflict with national public-policy rules, these will automatically take precedence over the contractual rules, without having to wait until national laws have been harmonised. Naturally, Euronext has also ensured that the contractual provisions can be easily applied as they stand.

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From a formal and procedural standpoint, all Euronext members are required to comply with Chapter 9 of the common rule book, which sets out the measures that apply in case of rule violations. Without going into detail, let me simply say that Euronext has responded to the request of the regulators and made provisions to take immediate measures to protect the integrity and security of the market, if the need arises. These measures include the possibility of suspending some or all of the trading rights of any member suspected of infringing market rules. A detailed investigative procedure is then set in motion to establish whether an infringement has actually taken place, while naturally respecting the member's right to defend and explain himself.

If an infringement is established, Euronext can impose penalties. These are stipulated in the contract and range from a simple warning to comply with obligations to the withdrawal of membership status; they also include fines and temporary suspension.

Because the contractual relationship between Euronext and its members is unique – in other words, each member signs a single contract for admission to all markets – there is no question of double jeopardy. If a member fails to respect its contractual obligations, Euronext invokes only the breach of contract. It is within this expressly contractual framework that Chapter 9 applies. But what happens when we move away from a purely contractual approach and address the issue of discipline? I will now address this question briefly.

2) Principal jurisdiction for the home authority

As I mentioned earlier, Euronext's supervisory authorities (regulatory, disciplinary and oversight) have to jointly set an appropriate agenda for exercising their powers. The framework they define must preclude a build-up of constraints that would weigh too heavily on members or issuers, thus affecting the cross-border and international nature of their business.

For issuers, the question has been resolved quite simply and will be settled once and for all through European legislation, particularly the Prospectus Directive, which to all intents and purposes grants issuers a passport similar to the one granted to intermediaries under the ISD. As regards Euronext, issuers have a choice of entry point. A company can apply for admission to listing and trading through the markets of Belgium, Portugal, France or the Netherlands. It will thus comply with the initial or ongoing requirements corresponding to the legal and regulatory framework of the point of entry. But wherever that point may be, the stock will be traded through the central order book and thus enjoy the benefits of greater liquidity and a broader investor constituency.

As regards members, it was obviously necessary to avoid a situation where they would be forced, because of the cross-membership arrangement, to submit to the combined controls of the various supervisory authorities of the national exchanges integrated into Euronext. It was also necessary to avoid multiple penalties for the same rule violation. This is why the authorities adopted the principle that principal jurisdiction should lie with the home authority. Under this principle, an infringement committed by a member in the course of its business on a Euronext market would be punishable by a disciplinary measure consistent with the regulatory framework of the member's home country, that is to say its main point of access. This principle was laid down by Euronext's regulators when the exchange was created and is applied naturally in its daily operations. It

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should also be noted that as disciplinary powers are exercised in different ways, both in form and in substance depending on the national framework concerned, they may be the prerogative either of the market operator or of an independent authority. In some cases, too, sanctions for the same offence may differ, depending on the authority that imposes them. In this respect, total harmonisation will not be possible until Europe's legislative bodies have defined a totally coherent framework that assigns disciplinary powers to the same type of authority in all countries and that imposes equivalent penalties for the same type of offence. Better still, the powers may one day be transferred to a supra-national European authority.

The solutions that have been devised pragmatically by Euronext and its various supervisory authorities must be followed up with appropriate European regulations via the directives currently in the pipeline. It is only normal that Euronext should be allowed to develop within a pre-established European framework – a framework that allows markets to operate naturally – rather than having to work solely with its own regulators and define a legal framework confined to the countries whose regulated markets are integrated into Euronext.

3) Compliance with public policy on economic matters

Obviously, there are limits to the innovative solutions devised to allow Euronext to operate smoothly and develop. These are evident when it comes to complying with public economic policy at the national level, where violations are usually subject to criminal prosecution.

Broadly, it should be stressed that the principle of avoiding multiple penalties does not apply to criminal offences committed by Euronext members, especially in their capacity as intermediaries. Members will thus be required to comply with all national laws and regulations that apply to them depending on the nationality of the investor.

However, Euronext believes that the rules – particularly those on cold-calling and advertising – applicable to intermediaries in their dealings with investors, whether professional or not, should be harmonised at the European level.

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In conclusion, there is still some way to go before markets, market members, intermediaries and issuers can operate within a harmonised and flexible international framework. Nonetheless, substantial progress has been made by national supervisory authorities and supra-national authorities, notably at the European level through the numerous directives that seek to harmonise the operating framework of the various participants. Much credit is due to Euronext because, within this incomplete process, it has come up with original solutions that allow its business model to operate and develop satisfactorily. This goes to show that the consolidation of Europe's financial markets has become a reality.
