



# Market Surveillance and Enforcement Program: Training Plan

The Egypt Capital Markets Development Project

## **MARKET SURVEILLANCE AND ENFORCEMENT PROGRAM**

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### **Training Plan for the CMA and CASE**

#### **A. Introduction**

This training plan — developed by the Egypt Capital Markets Development (CMD) project with the assistance of short-term advisor Molly Bayley — results from an assessment of the surveillance function at both the Capital Market Authority (CMA) and the Cairo and Alexandria Stock Exchange (CASE). Both organizations currently play a role in market surveillance and enforcement. The training plan corresponds to CMD’s comprehensive recommendation in the report titled “Capital Market Authority: Surveillance and Enforcement Program” (January 2001).

How surveillance work is shared or divided between the CMA and CASE depends on jurisdiction, available staff, and expertise. What is important is the ability of the two organizations to work closely together to create an effective market surveillance program taken as a whole. The CMA should conduct active oversight of the CASE market surveillance program.

#### **B. Assessment**

The assessment of the CMA and CASE surveillance training is as follows:

- The CMA and CASE presently operate separate market surveillance programs
- Both the CMA and CASE are adequately staffed with competent, motivated surveillance analysts
- The CMA and CASE market surveillance analysts require training to recognize market abuses and to conduct inquiries and investigations
- The CMA market surveillance analysts need to develop background or legal expertise to prepare cases for disciplinary action or prosecution
- The CMA and CASE need to develop written procedures for conducting inquiries and investigations.

The analysts were given one-on-one training in monitoring and investigative techniques by a former CMD advisor. Since this training was informal and targeted to the individual needs of each staff member, it is impossible to document what was covered in these sessions.

Selected members of the CMA and CASE surveillance staffs have attended training in market surveillance during the first two iterations of a program titled “Surveillance Practices in Stock Exchanges,” funded by the Development and Training Two (DT2) project. This was an overseas study tour to U.S. stock exchanges. The third iteration of this program has yet to be scheduled.

In November 2000, two CMA employees attended the U.S. Securities and Exchange Commission (SEC) International Training Institute for Securities Enforcement and Oversight. Prior to that point, none of the CMA or CASE staff had attended this institute. From September 1998 to date, none of the analysts at the CMA and CASE have attended the SEC International Institute for Securities Market Development, held in April each year.

### **C. Recommendations**

In order to enhance the CMA and CASE's market surveillance and enforcement capabilities, the training recommendations are:

#### 1. Conducting online and offline reviews and investigations

CMA and CASE analysts should be given basic training in recognizing market abuses and in conducting online and offline reviews and investigations. This training should cover what fraudulent activity to look for (e.g. manipulation, insider trading, etc.), how to find it, how to conduct inquiries and investigations, how to prove it, and how to document findings.

Attorneys at CASE and in the Legal Department at the CMA who will be preparing market surveillance cases for disciplinary action and prosecution may also want to attend this training. This would further develop their background or provide the legal expertise to prepare, document, and build cases for disciplinary action and prosecution.

The training should be conducted in Cairo for several reasons. It would enable all the CMA and CASE analysts to attend the same course, thereby facilitating communication between the two groups and establishing a common base of knowledge for working together. In addition to the cost-effectiveness of Cairo-based training, knowledge of what has been covered in the course will enable CASE and the CMA supervisors to incorporate the training materials into the procedures manual and to hold the analysts accountable for benefiting from the training. Since the trainers are likely to be English-speaking market surveillance experts and not all participants will be fluent in English, some arrangement should be made to assist these participants in understanding the material covered during the training.

A sample agenda for a basic market surveillance training course is included in Appendix A. This formal classroom training program could be followed-up within a few weeks by hands-on, one-on-one support for each analyst. Working directly with each analyst, the trainer will review investigations conducted by the analyst since the classroom training to ascertain whether the analyst is following the approach outlined in the training and to provide assistance and further guidance where needed. This kind of reinforcing follow-up support by the trainer will enhance the learning of each participant and will help identify where additional formal training may be needed.

#### 2. Regulatory oversight

Since the CMA will conduct oversight of CASE's online surveillance activities, the CMA staff responsible for oversight inspections should attend the training as well.

#### 3. Evidence gathering

The CMA and CASE staff who conduct on-site inspections of broker/dealers should be trained to gather evidence to support market surveillance investigations.

#### 4. Best practices

The CMD/DT2 training, “Surveillance Practices in Stock Exchanges,” should be expanded to include as many of the CMA and CASE analysts as is feasible. In order to ensure that analysts who do not attend this training get some benefit from their colleagues’ attendance, attendees should be required, upon their return to Cairo, to provide a workshop on what they learned. All materials handed out during the training should be incorporated into the procedures manual and made available to all analysts for reference purposes. In addition to fluency in English, an equally important criteria for selection of candidates for such overseas training should be a willingness to share what they have learned with their colleagues.

#### 5. Enforcement practices

Analysts should attend one or both of the U.S. SEC institutes in order to expand their understanding of effective surveillance and enforcement. As noted earlier, attendees to any U.S. SEC institute should be required to provide a workshop in Cairo for their colleagues upon their return. In addition, all training materials received during the institutes should become an active part of the procedures manual and reference manual.

#### 6. English knowledge

English is the universal language of the global financial markets. The ability to speak, read, and understand English may not be important in the day to day function of a the CMA analyst. However, knowledge of English is critical in order to 1) take advantage of training opportunities at exchanges and financial institutions throughout the world and 2) to stay current in international developments in enforcement by reading documents, such as those published by the International Organization of Securities Commissions (IOSCO).

All analysts currently assigned to Market Surveillance should attend classes in Cairo in English until they are sufficiently fluent to pass the English exam required for participation in international training opportunities.

#### 7. Computer skills

Analysts should be trained in Microsoft Word and encouraged to compose their investigation reports on their PCs. This training should take place in Cairo and be conducted in Arabic.

### **D. Implementing Training**

The entity responsible for implementing the recommendation is noted. In some cases, there is more than one entity involved. For example, the notation (CMA/CMD) indicates that the CMA and CMD are both responsible for implementing the recommendation.

#### **Phase One (November 2000 – March 2001)**

Initial steps in implementation

- Plan agendas and materials for training courses (this report, and on-going sourcing of other training through USAID/DT2).

### **Phase Two (April – June 2001)**

Training of the CMA and CASE staff, introduction of written procedures, and enhancement of systems and facilities

- Present a Cairo-based NASDR training course in (online and offline) market surveillance for all the CMA and CASE analysts and attorneys. The CMA oversight staff should also attend this training (CMD).

A total of six-person-weeks of training – four- person-weeks of classroom training followed by two-person-weeks of on-the-job, one-on-one follow up should complete this task. This approach may be varied because the staff from both organizations may not be able to be away from their desks simultaneously, and the NASDR trainer(s) may not be available for the entire duration of the course in one visit.

#### **Training in Market Surveillance Offline Investigations**

- For whom: market surveillance analysts at the CMA — 4  
THE CMA attorneys in legal department who handle market surveillance cases.
- Location: Cairo
- Format: classroom style — workshop setting
- Trainer: one U.S.-based short-term consultant with market surveillance/enforcement expertise
- Length of course: two weeks
- Content: How to use the CMA database of training activity to:
  - a) Support an investigation
  - b) Conduct an investigation into insider trading, market manipulation and other fraudulent activities
  - c) Request information documents from brokers and others
  - d) Examine and establish evidence
  - e) Take testimony from witnesses
  - f) Manage documents and investigation files
  - g) Prepare memoranda for enforcement

### **Training in Market Surveillance Online Inquiries**

- For whom: CASE Market Surveillance Analysts – 4  
CMA Staff who will oversee CASE market surveillance program – 2
- Location: Cairo
- Format: classroom style – workshop setting
- Trainer: one U.S.-based short term consultant with expertise in online surveillance
- Length of course: two weeks
- Content: how to use the CASE online surveillance system to select stocks with activity worthy of review, what to look for (manipulation, insider trading, other fraud), how to conduct online review, how to use the CASE database to research trading activity, how to document an inquiry, how to interview brokers to gather information, how to request information from listed companies, and preparing memoranda for referral to the CMA
- Provide access to classes in English for all analysts who must be more fluent in English in order to pass the USAID English exam (CMA/CASE).

### **Phase Three (June – September 2001)**

Allocation of prime responsibilities for market surveillance between the CMA and CASE, continued skill building, and further enhancement of procedures and resources.

- Provide follow-up training for two weeks on a one-on-one basis to reinforce the earlier classroom training in market surveillance, with NASDR trainers on a subsequent visit, possibly in Phase 3 (CMD).

### **Follow-up Training in Market Surveillance Offline Investigations**

- For whom: for the participants in the CMA offline market surveillance investigations training – 4 staff members
- Location: Cairo
- Format: one-on-one
- Trainer: same as formal classroom training
- Length of course: one week
- Content: Trainer will review with analyst, on a one-on-one basis, actual investigations conducted by that analyst subsequent to the formal training class. The trainer will provide feedback on how the analyst could improve his/her skills. The one-on-one support will reinforce the material covered in the classroom training.

### **Follow-up Training in Market Surveillance Online Inquiries**

- For whom: for the participants online surveillance training – 4 staff members
- Location: Cairo
- Format: one-on-one
- Trainer: same as formal classroom training
- Length of course: one week
- Contents: Trainer will review with analyst on a one-on-one basis actual reviews conducted by that analyst subsequent to the formal training class. The trainer will provide feedback on how the analyst could improve his/her skills. The one-on-one support will reinforce the material covered in the classroom training.
- Delegate to CASE the responsibility to carry out online surveillance, with some input, from short-term expatriate advisor Molly Bayley, on the draft of the instrument utilized to delegate the responsibility (CMA/CMD)
- Send the CMA and CASE analysts to CMD-sponsored overseas training “Surveillance Practices in Stock Exchanges” (CMD)
- Train the CMA and CASE staff responsible for on-site inspections, with a one week workshop in gathering evidence to support market surveillance investigations (CMD)

### **Training in Gathering Evidence for Investigations During Onsite Inspections**

- For whom: the CMA inspection staff – TBD
- Location: Cairo
- Format: workshop setting – On-site broker/dealer inspection experience
- Trainer: one U.S.-based short term consultant with broker/dealer inspection experience
- Length of course: one week
- Contents: Examining broker/dealer books and records for evidence of possible manipulation, insider trading, or other fraudulent activities, gathering specific information supporting a market surveillance investigations, documenting findings, handling evidence, and providing testimony.
  - Send analysts from both the CMA and CASE to the U.S. SEC Institute for Securities Market Development in April (CMD)
  - Train analysts in Microsoft Word and encourage them to compose their investigation reports on their PCs (CMD)

#### **Phase Four (October – December 2001)**

Initial The CMA oversight exam of CASE and strengthening of enforcement. The exact specifications for this phase will be developed with the CASE and The CMA senior management during the third phase.

- On-the-job training in conducting an evaluation of the fully implemented CASE stock watch system to determine whether it provides all of the functionality required to support an effective market surveillance program

This will be provided by two short-term expatriate advisors, one to evaluate the software from a market perspective, one to evaluate the technical aspects of the software (CMA/CMD)

- On-the-job training in conducting an oversight exam of the CASE market surveillance program, focusing on whether the CASE stock-watch system identifies all unusual market activity, whether initial inquiries are opened when appropriate, whether CASE follows its written procedures, that CASE properly documents its reviews and investigations, that it follows the agreed upon procedure for referrals to the CMA, and that the penalties levied against members are appropriate. A CMD short-term consultant will participate for a week in this first oversight review and for another week to draft procedures to be followed in the future by the CMA oversight staff (CMA/CMD).

### **Training in conducting an Oversight Examination**

- For whom: The CMA staff responsible for conducting oversight examinations of CASE market surveillance - 2
- Location: Cairo
- Format: informal workshop
- Trainer: one U.S.-based short term consultant with expertise in either on-line market surveillance or oversight exams
- Length of course: one week, including accompanying The CMA staff on an oversight exam of CASE
- Content: discussion of purpose and objectives of oversight exams, procedures and process to be followed, documents to be examined, what to look for, questions to ask, documenting the findings, exit interview, and follow-up process.

Following the informal workshop, the trainer will accompany the oversight staff in conducting an actual oversight exam of CASE market surveillance.

- Send analysts from both The CMA and CASE to the U.S. SEC Institute on Securities Enforcement and Oversight in November (CMD)
- Send analysts to United States for internships in online and offline market surveillance and enforcement, and to visit other exchanges' market surveillance or enforcement programs (CMD/DT2).

### **E. Other Actions To Be Taken — Ongoing**

- Subscribe to Egyptian periodicals and industry publications to enable the analysts to stay informed of events that could affect the market in CASE-listed stocks (CMA/CASE).
- Establish and maintain a market surveillance library for manuals, training materials, newspapers and periodicals, memoranda and other documents such as case reports, for reference and training purposes (CMA/CASE).

The CMD short-term expatriate advisor Molly Bayley will provide an initial list of useful materials (CMD).

- Assemble and keep up-to-date a manual of reference materials to complement the Procedures Manual and to provide additional support to investigations (CMD).

## APPENDIX A

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### **Sample Agenda for Market Surveillance Training**

#### **Course Objective:**

To gain an understanding of the techniques necessary to successfully pursue inquiries, conduct investigations and prosecute cases involving potential violations of insider trading, manipulations and other fraudulent transactions.

#### **Course Length:**

Two weeks

#### I. Investigating Insider Trading

- a) What is insider trading?
- b) What is considered “material” information?
- c) Who is an “insider”?
- d) Establishing materiality.
- e) Requesting a chronology of events from the company.
  1. Questions to ask.
  2. Documents to request.
- f) Next steps
  1. Identify time period.
  2. Obtain broker/dealer trading records, identify suspect account activity, and obtain account documents.
  3. Research relationships.
  4. Conduct interviews.
  5. Take testimony.
  6. Prosecute.
- g) Suggested background reading
- h) Discussion of significant case law
- i) Case studies
  1. Identify the news and date. Is the news material? If so, explain why.
  2. Identify the insider.
  3. Prepare a chronology of the significant events.

4. Did the insider have knowledge of the confidential information?
5. Review the trading data, including when the account was opened, the type of account, who was the beneficial owner of the account, and what was unusual about the account.
6. Prepare a chronology of events relating to the trading activity as it relates to the corporate chronology.
7. What will be the defense of the insider?
8. What is the necessary evidence: chronology, account documents, insider's motive?

## II. Investigating Manipulation

### a) What is manipulation?

1. Intentional interference with the free forces of supply and demand.
2. Conduct designed to deceive or defraud by controlling or artificially affecting securities prices and/or volume.
3. Economically irrational trading such as "wash sales" and "matched orders."
4. Definitions.

### b) Elements of a market manipulation

1. Series of transactions.
2. Manipulative effect.
  - a) Create actual or apparent value.
  - b) Raise or depress the price of the stock.
3. Manipulative purpose.
  - a) Motive (usually money).
  - b) Course of business that operates as a fraud or deceit.

### c) Proof of manipulation

1. Based on inferences drawn from circumstantial evidence (significant amount of factual detail).
2. Collapse of market when the manipulator ceases activity.
3. Evidence of a series of transactions coupled with a motive to manipulate (inferred from the person's pattern of trading).
4. The manipulator caused actual or apparent activity or a rise in market price.

## d) Characteristics of manipulations

## 1. Trading.

- a) By family, friends, and associates.
- b) In discretionary and controlled accounts.
- c) Circular flow of shares.
- d) Ghosting of orders.
- e) Wash sales.
- f) Matched orders.

## 2. Prices.

- a) Price setting or leadership.
- b) Erratic pricing.

## 3. Creation of demand.

- a) By issuer - corporate events or news.
- b) By brokers - research analysis, recommendations, discretionary account transactions.

## 4. Motive.

- a) To make trading profits or commissions.
- b) To raise value of collateral.
- c) To dress up the market for a secondary offering or other financing.
- d) To meet initial or maintenance listing requirements.
- e) To sell insider stock.
- f) Personal reasons such as pride, status, prestige, public attention.

## 5. Schemes.

- a) Blind pools, blank checks, reverse acquisitions, ponzi schemes.
- b) Box jobs, domination and control.
- c) Misrepresentations, false or misleading information, omissions of material facts.

## 6. Players.

- a) Finders and promoters.
- b) Brokers.
- c) Purchasers and sellers.
- d) Transfer agents.
- e) Issuer, its owners, officers, lawyers, accountants, underwriters, etc.

## e) Hallmarks of a classic manipulation

- 1. Up-ticking and purchasing at increasing prices despite being long the stock.
- 2. Up-ticking the firm's already high bid without executing a trade.

3. Executing many transactions away from the inside bid and offer.
4. Soaking up the floating supply to gain control of the market for the stock.
5. Dominating and controlling the market.
6. Significant trading profits (consistent profits without losses).
7. High commissions (as a percentage of the net amount of the transaction – especially if it is a pattern).
8. Brokers traded at a loss, but certain retail or institutional accounts profited.
9. Prearranged block trading, wash sales, matched orders, circular trading and ghosting of orders.
10. Patterns of trading that don't look right or make any economic sense.
  - a) Suggested background reading.
  - b) Discussion of significant case law.
  - c) Case studies.

### III. Interview Skills and Taking Testimony

- a) Definition of an interview: a structured question and answer session designed to elicit specific information.
- b) Characteristics of good interviews.
- c) Characteristics of a good interviewer.
- d) The witness' rights.
- e) The interrogation.
  1. Background questions.
    - a) Residential addresses.
    - b) Home and work telephone numbers.
    - c) Educational background.
    - d) Family members, spouse (maiden name).
    - e) Tax or other identification numbers.
    - f) Bank accounts and numbers.
    - g) Financial problems.
    - h) Previous testimony – subject or defendant in other proceeding
  2. Employment questions.
    - a) Dates and places.
    - b) Title and positions.
    - c) Organizational/authority chart.

- d) Day-to-day function and responsibilities.
  - e) Supervisory responsibilities/procedures.
  - f) Supervisory chain.
  - g) Co-workers, assistants, secretaries.
  - h) Compensation.
3. Books and records and other documents to review.
- a) Securities ledger.
  - b) Stock position.
  - c) Customer ledger.
  - d) Order slips.
  - e) Confirmations.
  - f) News and corporate events.
  - g) Broker's files required to be maintained.
  - h) Research/recommendation reports.
  - i) Chronology of events.
  - j) Corporate filings (prospectus, annual report, proxy).
  - k) Telephone records.
  - l) Payments – receipt, check, wire instructions.
  - m) Signed stock certificate.
  - n) Written correspondence.
4. Trading activity questions.
- a) Have you ever traded \_\_\_\_\_ stock before?
  - b) Personal background.
  - c) Why did you buy/sell the stock?
  - d) Who was the broker/trader?
  - e) Was the order solicited?
  - f) Names of relatives.
  - g) Names on the chronology.
  - h) Trading/investment strategy.
  - i) Timing of trades and decisions to buy or sell.
  - j) Method of payment.
5. Mock testimony exercise.
- a) Be prepared. Have thorough knowledge of the facts and documents.
  - b) Focus. Ask pertinent questions. Have an outline of questions you want to ask.
  - c) Proper coordination by the interviewing team.
  - d) Start in and try to stay in chronological order. Use previously prepared chronology of events and ask questions to fill in the gaps.
  - e) Keep to a line of questioning until the matter is exhausted, especially when questioning about trading activity.

- f) Keep asking follow-up questions: who, what, when, where, how and why?
- g) Use documents chronologically and/or by subject matter to facilitate questioning.
- h) Ask the witness to identify, if possible, persons on your list of suspect accounts.

6. Class discussion of mock testimony.

#### IV Case Organization and Document/File Maintenance

##### a) Internal documents

- 1. Trading data, news, public filings, etc.
- 2. Analyses, notations, memoranda, etc.
- 3. Request letters and other correspondence.

##### b) External documents

- 1. Receipt of documents.
  - a. Record of when, how and from whom.
  - b. Original copies (record on document index and do not mark on original documents – keep them “clean” as evidence).
  - c. Make “working” copies.
  - d. Keep external files free of notations and work products.

##### c) Organization

- 1. Files by source.
- 2. Files by subject.
- 3. Folders with headings.

##### d) Document index

- 1. Description and number of pages.
- 2. Date received.
- 3. Source (from whom, where, why, how).

##### e) Example of a large case file