

27 September 2002

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Dear M Demarigny

## CESR CONSULTATION ON MARKET ABUSE DIRECTIVE – Stabilisation

The International Primary Market Association (IPMA) welcomes the opportunity to respond to CESR's Consultation on possible implementing measures of the proposed Market Abuse Directive in relation to implementation of the stabilisation safe harbour.

IPMA is the association which represents banks and financial institutions in the international primary markets in their capacity as arrangers and underwriters of debt and equity securities of private and public issuers. A list of IPMA's members is attached as Annex 1.

### General

We are pleased to note that the proposals are substantially based on CESR's April 2002 paper on Stabilisation and Allotment. We congratulate CESR on its earlier work and early consultation with the market in this area, which have greatly assisted the development of proposals which acknowledge and address key issues. In this paper we give a number of practical examples of issues where further clarification or changes would be beneficial. We hope that this is helpful.

In response to **question 29**, we agree with CESR's approach of establishing straightforward requirements at Level 2 relating to time limits and price, and dealing with other relevant issues at Level 3, but not as a condition to the safe harbour. It is important, however, that Member States cannot impose more restrictive requirements to obtain the benefit of the safe harbour through

Level 3 measures than are contemplated in the Market Abuse Directive and in Level 2 implementing measures.

In response to **question 38**, we agree in principle with CESR's position set out in paragraphs 141 to 145. We address some of the specifics of the Level 3 proposals, and the question of mutual recognition and Level 3 convergence in more detail below.

## **Level 2 advice**

### Over-allotment, greenshoes and ancillary devices

Stabilisation normally refers to a range of activities undertaken by managers of an offering in furtherance of the overall objective of supporting the price of securities in the market. This may involve over-allotment of securities, exercise of a greenshoe option, if one is available, from the issuer (or selling shareholder), short selling and other ancillary devices, such as the use of derivatives. CESR's April 2002 paper on Stabilisation and Allotment acknowledges this. We acknowledge that Article 8 of the Directive refers to 'the stabilisation of a financial instrument'. However, we do not believe that this precludes CESR from making the safe harbour available to cover closely linked activities which are preparatory to the making of stabilising bids and purchases. In addition, we believe it is essential that CESR's proposals do not leave open the question of whether ancillary activity of this kind might amount to market abuse within the meaning of the Directive.

One suggestion would be for the Level 2 measures to extend the safe harbour to cover actions preparatory or ancillary to stabilisation. This should be coupled with Level 3 agreement among regulators that action taken to close out or liquidate positions created during stabilisation (such as exercising a green shoe option, selling or otherwise liquidating a long position or buying securities or otherwise closing out a short position created with a view to stabilising action) should not, in itself, amount to market abuse within the definition set out in the Directive (and to make clear that the price limits do not apply to any such buying activity).

### *Proposed changes:*

*Add to the level 2 advice in paragraph 148 (at the end): "The safe harbour shall also apply to over-allotments of Relevant Securities, sales of Relevant Securities and Associated Securities and the use of derivatives to achieve an equivalent result where such ancillary stabilisation activity is taken in that context with a view to or in order to facilitate Stabilisation."*

Alternatively, if CESR does not extend the safe harbour, CESR's Members should make clear, by Level 3 measures, that ancillary stabilisation activity of this kind does not amount to market abuse within the meaning of the Directive, merely because it is taken with a view to subsequent stabilisation.

## Non- EU Securities

Stabilisation activities in non-EU securities are potentially brought within the Market Abuse Directive, because of the broad scope of the Directive and the international nature of the business conducted from and within the EU. Denying the benefit of the stabilisation safe harbour in these circumstances would be detrimental to issuers and the competitiveness of EU markets, and would have the effect of discouraging third country issuers from raising capital in the EU. We give examples and suggest some language changes below.

### a) When-issued trading

Paragraph 149 1 (a) suggests that, in the case of an IPO, the stabilising manager will only be able to engage in stabilising trades in the "when-issued" market (and benefit from the safe harbour) if it executes those trades under the rules of a regulated market (and if certain other conditions are met). However, this will preclude when-issued stabilisation activity in a number of common new issue structures.

For example:

- A European company is undertaking an IPO. Its shares are to be listed (and admitted to trading) on a European stock exchange and outside the EU e.g. in the US. A stabilising manager may engage in "when-issued" stabilising trades in the shares on the non-EU exchange or engage in off-exchange transactions in the foreign market in accordance with locally applicable law. Under CESR's proposal, those transactions would fall outside the safe harbour (and yet they would potentially be within the scope of the Market Abuse Directive since application has been made for the admission to trading of the shares on an EU regulated market).
- A European company is undertaking an IPO. Its shares are to be listed (and admitted to trading) on a European stock exchange and depositary receipts on those shares are to be listed outside the EU, e.g., in the US. (In the terminology of CESR's proposed advice, the shares will be the "Relevant Securities" and the depositary receipts are, or at least should be, treated as "Associated Securities" as they confer rights to acquire Relevant Securities - see comment below.) A stabilising manager may engage in "when-issued" stabilising trades in the depositary receipts on the non-EU exchange or engage in off-exchange transactions in the foreign market in accordance with locally applicable law. Under CESR's proposal, those transactions would fall outside the safe harbour (and yet it appears that they would potentially be within the scope of the Market Abuse Directive since those transactions may have an effect on the market for the shares).
- An emerging market issuer is undertaking an IPO. Its shares are to be listed on a non-EU exchange and depositary receipts on those shares are to be listed (and admitted to trading) on an EU regulated market. (In the terminology of CESR's proposed advice, the depositary receipts will be the "Relevant Securities" and the underlying shares are, or should be, treated as "Associated Securities" - see comment below.) The stabilising manager may engage in when-issued trading in the underlying shares on the non-EU exchange or engage in off-exchange transactions in the foreign market in accordance with locally applicable law. Under CESR's proposal, those transactions would fall outside the safe harbour (and yet it appears

that they would potentially be within the scope of the Market Abuse Directive since those transactions may have an effect on the market for the depositary receipts).

*Proposed change: Delete the proviso to the third indent of paragraph 149.1 (a) of the proposed advice.*

*Alternatively, at a minimum, the advice should allow stabilising transactions to benefit from the "safe harbour" when they are undertaken subject to/under the rules of a third country stock exchange or regulatory body recognised by the relevant competent authorities. When-issued trading could be subject to transaction reporting rather than trade reporting requirements.*

As a small drafting point, the wording of the advice might suggest that the stabilising manager loses the benefit of the safe harbour if there is "any [when-issued] trading" by anyone (even if unconnected with the offering) which is off-exchange or which otherwise does not fulfil the stated conditions.

*Proposed change: If the proviso to the third indent of paragraph a) is retained, replace the proviso with the following wording: "provided that any stabilisation which takes place prior to the commencement of trading on a Regulated Market fulfils the following conditions:"*

#### b) Definition of "Associated Securities"

The proposed definition states that other financial instruments will only be "Associated Securities" if they are themselves admitted to trading on a regulated market. However, this unduly limits the scope of the safe harbour. In particular, trading in securities which are not themselves admitted to trading on a regulated market may fall within the scope of the proposed Market Abuse Directive, for example:

- Where the trading in those instruments has an effect, of the kind indicated in article 1(2)(a) of the proposed Directive, on the market in other financial instruments which are admitted to trading on a regulated market; and
- Where the value of those instruments "depends on" the value of other financial instruments which are admitted to trading on a regulated market (see the second paragraph of article 9 of the proposed Directive).

This can be illustrated by the second and third examples given above under 'When-issued trading'. It is also illustrated by the following examples:

- A non-EU issuer is planning an issue of bonds convertible into its own shares. Its shares are listed on an exchange in that non-EU country but are not admitted to trading on an EU regulated market. The bonds are to be listed (and admitted to trading) on an EU exchange. Under CESR's proposal, the underlying shares would not qualify as "Associated Securities" since they are not admitted to trading on a regulated market. Accordingly, stabilisation transactions in those shares would not benefit from the safe harbour but may be within the scope of the Market Abuse Directive because they may have an effect on the price of the bonds.
- An EU issuer is undertaking an issue of (non-convertible or exchangeable) bonds which are to be listed (and admitted to trading) on an EU exchange. The stabilising manager purchases an over-the-counter cash-settled call option on the bonds with a view to supporting the price of the bonds. Under CESR's proposal, that call option would not qualify as an "Associated Security" since it is not admitted to trading on a regulated market. Accordingly, that stabilisation transaction would not benefit from the safe

harbour but may be within the scope of the Market Abuse Directive because it has an effect on the price of the bonds.

*Proposed change: Delete the words "which are admitted to trading on a Regulated Market or for which a request for admission to trading on such market has been made".*

The proposed definition does not adequately deal with the position of depositary receipts representing underlying securities.

For example:

- A non-EU issuer is planning an issue of convertible bonds which are to be listed (and admitted to trading) on an EU regulated market. The issuer's shares are listed on a stock exchange in its home country. There is an American Depositary Receipt (ADRs) programme in relation to those shares. Neither the shares nor the ADRs are listed or admitted to trading in the EU. Under CESR's proposal, it seems that only the shares, and not the ADRs, would be treated as "Associated Securities".

*Proposed change: Add the words "(or securities equivalent to those securities, such as depositary receipts)" at the end of paragraph (3) of the definition. For consistency, add the words "(and securities equivalent to those Relevant Securities, such as depositary receipts)" at the end of paragraph (1) of the definition.*

We propose below changes to the definition of "Relevant Securities" to address the question of whether stabilising action can be taken in respect of securities which will become fungible with the securities being offered. However, in the debt markets, in particular, a new issue may be closely linked in terms of price and other market behaviour with another existing series of securities without being (or becoming) fungible with it. In those circumstances, the trading patterns of the two series may be closely linked.

For example, a subsidiary finance company may have issued a previous bond which is guaranteed by the parent company. Another subsidiary finance company may plan a second issue, also guaranteed by the same parent company, where the terms of the new bond (and guarantee) are similar to those of the earlier bond. For practical purposes, the two series of bonds may trade as one series, because the market looks to the credit of the parent guarantor, even though the two series are not technically fungible with one another because they have different issuers. However, the stabilising manager may wish to make stabilising purchases of the first bond in order to stabilise the issue of the second.

*Proposed change: Add a new sub-paragraph "(4) where the securities are issued or guaranteed by the issuer or guarantor of the Relevant Securities and, because of the similarity of their terms, the market price of those securities is likely materially to influence the market price of the Relevant Securities."*

### c) Definition of "Relevant Securities"

In many cases, new securities being issued may not, at the outset, be fully fungible with a class of existing issued series of securities. For example, they may not carry the same rights to dividends or interest for an initial period, to reflect the different date of their issue, even though, after that initial period, they will be fully fungible with the existing class. Under the CESR proposal, it is unclear whether the existing series would be regarded as "identical" securities at the outset (when stabilising transactions are likely to take place). If the other securities of the existing class were not treated as "Relevant Securities", then they also would not be "Associated Securities". Therefore, it would not be possible to undertake stabilisation transactions in securities of the existing class.

*Proposed change: Insert the words "substantially" before the word "identical" in this definition. Alternatively, delete the words "identical thereto" and substitute "that are (or will become) fungible therewith and".*

### **Level 3 measures**

In response to **question 39**, as stated above, we do not consider that measures dealing with public, regulatory and prospectus disclosure and stabilisation managers need to be harmonised at Level 2. As a general comment, we believe that it would be appropriate for there to be distinctions made at Level 3 between provisions for equity and provisions for debt. It is also important that a failure to meet the requirements of paragraphs 154 to 158 does not affect the availability of the safe harbour.

We have the following comments and suggestions on the proposals themselves:

#### **Disclosure of stabilisation activity**

Paragraph 154: Public disclosure of stabilisation activity is of limited value to investors, because there is no particular course of action that an investor would want or expect to take with the benefit of that information. This raises the question as to whether the costs to the markets of implementing the proposals, complying with the requirements and monitoring the outcome are proportionate to the benefit that investors would obtain. We therefore ask CESR to reconsider its position on mandatory public disclosure of stabilisation activity. But if public disclosure will nevertheless be required, we ask CESR to disapply these requirements for debt, which is principally a wholesale market, and where volumes of issuance, and therefore the potential costs of compliance and monitoring, are high.

We also note that it is not meaningful to require disclosure of price range within which stabilisation for debt issues took place, as is currently provided in Paragraph 154. For similar reasons, CESR has correctly not placed restrictions on the price at which stabilising transactions can be carried out for debt issues if stabilisation is for the purposes of price support.

If public disclosure is to remain in relation to equity offerings, CESR should make clear that the price range to be disclosed is the price at which transactions were actually executed (since the definition of stabilisation includes offers to purchase).

#### **Regulatory Reporting**

Paragraph 156: We agree that a record of executed stabilising transactions should be maintained and be readily available to the relevant competent authority. This is already a regulatory requirement in several Member States, including the UK. There are currently no regulatory requirements to maintain records of stabilisation ‘orders’. We believe it is not practical and will in any event require substantial systems and operational changes to maintain records of stabilisation ‘orders’. We are particularly concerned that this will place a disproportionate burden on firms operating in those jurisdictions where most stabilising activity takes place, particularly in relation to debt. CESR should not, in any event, propose such a recommendation without a full cost-benefit analysis. In particular, this should focus on whether other, less burdensome, measures would achieve the objectives.

### Prospectus Disclosure

We note CESR’s proposals for prospectus disclosure of stabilisation activity. For consistency and ease of understanding and implementation in this technical area, it would be helpful if CESR Members could agree the indicative text of common disclosure language at Level 3. We have attached as Annex 2 an example of the kind of disclosure language which might be included in prospectuses.

### Mutual Recognition

We note the risk that Member States Level 3 measures may lead to differing, even conflicting, requirements which will impede, and may increase the costs of, cross-border offerings. At a minimum, we urge CESR to acknowledge in its advice that compliance with one relevant country’s Level 3 regulations and other relevant laws, including regulatory and legal interpretation of the Directive’s requirements, should be a defence against proceedings in another relevant EU country. This would arise, for example, if, say, an Italian regulated entity stabilises an issue which is admitted to trading on, say, a German regulated market, or if stabilisation carried out entirely in one country is deemed to have had an effect in another Member State.

We also urge CESR Members to develop a transparent mechanism for resolving disputes and regulatory differences on a timely basis so that markets can operate efficiently and with clarity.

We further note the importance of mutual recognition of appropriate third country rules, so that, for example, stabilisation carried out in the US of an issue admitted to trading in the EU, can be done according to US requirements, and does not have to comply with EU requirements. This could arise, for example, if a security has a dual listing in New York and the EU, as has been common for securities admitted to the Neuer Markt. We suggest that, at a minimum, Level 3 measures should provide for recognition of third country rules if they are consistent with the principles of the safe harbour in the Directive.

We would be pleased to discuss any aspect of our submission with you further. If you have any questions, please do not hesitate to contact Mary Hustings, Cliff Dammers or Helen Style at IPMA.

Yours sincerely

Clifford R Dammers