CLIFFORD CHANCE

LIMITED LIABILITY PARTNERSHIP

MEMORANDUM

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Market Abuse Directive: towards a workable EU-wide safe harbour for stabilisation action

The new EU stabilisation regime[1] provides a significant opportunity to create a workable EU-wide "safe harbour" allowing the stabilisation of securities offerings in a way that will benefit issuers and investors alike. However, the European Commission regulation establishing the new regime raises a number of issues which legislators, regulators and market participants need to address in a flexible and constructive way. For the most part, except where indicated, these issues mainly arise in relation to offerings of debt and other fixed income securities, because of market structures and the timing demands of fixed income markets. This note aims to highlight these concerns and to propose possible methods of resolving them for discussion and comment.

EXECUTIVE SUMMARY

	Issue	Possible resolution
1	The Commission regulation only applies where the distribution involves EU listed securities.[2] The regulation will not provide a safe harbour for stabilising action taken in respect of distributions of other securities, even though some member state laws on market manipulation or insider dealing could apply to such action.	Where member states retain or adopt market abuse or similar laws that are broader in scope than required by the MAD, they should provide an appropriate, separate safe harbour for stabilisation action taken in respect of offerings of securities covered by those laws.
2	In the case of a new issue of securities, the Commission regulation only provides a safe harbour for stabilisation action that occurs after application has been made to list the securities on an EU exchange. However, issues of EU listed debt securities are frequently launched on very short notice and the listing application will only be submitted after the launch of the offering, i.e. after the time when bonds have been priced, trading has begun on a "when	Issuers should be allowed to use email to submit a preliminary application for the admission of the securities to trading on the relevant market, with the formal application for admission following at a later time.

[1] Commission Regulation (EC) No. 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments.

[2] For the sake of brevity, this memorandum refers to listing of securities in the EU (or on an EU exchange), rather than the admission of securities to trading on an EU regulated market, the technical terms used in the Commission regulation and the Market Abuse Directive.

	Issue	Possible resolution
	issued" basis and the stabilisation manager has effected some stabilisation transactions in the market.	
3.	The Commission regulation only provides a safe harbour for stabilisation action taken during the period beginning on the date of "adequate public disclosure" of terms of an offering, i.e. disclosure made in accordance with the procedure laid down in Community law for issuers' ad hoc disclosures of significant developments. Similarly, there must be "adequate public disclosure" of information concerning proposed stabilisation before "the opening of the offer period" of the relevant securities. It may be difficult for issuers or lead managers to make an announcement in accordance with these procedures in a timely manner so as to allow stabilisation action to begin immediately after launch of the offering (as is required in order for it to be effective), particularly in the context of the issue of debt securities and where the competent authority requires relevant announcements to be made by means of newspaper announcements or using a specific mechanism.	• Member states should amend their existing rules to allow the required disclosures under the Commission regulation to be made by other means, ideally by screen announcement or at least using press agencies or other service providers. • To the extent that the rules do not allow for the use of screen announcements, lead managers may need to consider arranging for an appropriate announcement (where necessary, by the issuer) on the day of launch containing the required disclosure (and, where this is required, for a copy to be sent to the competent authority - as to which see below).
4.	The Commission regulation requires adequate public disclosure of certain information in accordance with the CARD (or eventually TOD) requirements but member states have implemented (and will implement) those requirements in differing ways. It is not clear whose rules apply (and which competent authority is the relevant competent authority) when determining how to make adequate public disclosure or otherwise comply with the Commission regulation.	Regulators should accept that there is adequate public disclosure if disclosure is made in accordance with the regime in force in the Member State where the relevant securities are or are to be listed (and that the competent authority of that Member State is the competent authority of the relevant market for the purposes of the Commission regulation). However, it may be necessary to reconsider this issue on the implementation of the TOD.

	Issue	Possible resolution
5	The Commission regulation and the regulation implementing the Prospectus Directive contemplate that certain information regarding the proposed stabilisation should be either the subject of "adequate public disclosure" or, after 1 July 2005, included in the prospectus. However, they do not specify an acceptable form for the disclosure and do not address how adequate public disclosure could be made, in the period prior to the removal of this requirement, using screen announcements (if this is permitted) given the space constraints of screens.	Regulators should accept disclosure along the lines of the standard form specified in this note.

There are also a number of other more detailed issues on which it would be helpful if there were consensus as to how the Commission regulation should be applied in practice by regulators and market participants.

THE ISSUES DISCUSSED

1. The Commission regulation only applies where the distribution involves EU listed securities.[3] The regulation will not provide a safe harbour for stabilising action taken in respect of distributions of other securities, even though some member state laws on market manipulation or insider dealing could apply to such action.

For example, it is common for an initial public offering of shares in a US company being listed on the New York Stock Exchange or NASDAQ to involve a distribution to investors in Europe effected through the managers' EU-based affiliates. In connection with the distribution, the managers may undertake stabilisation action in the US or their affiliates may undertake stabilisation action in the EU.

Similarly, EU-based banks often act as stabilisation managers (or as agents on behalf of stabilisation managers) in relation to distributions of bonds being listed on exchanges outside the EU and being sold to EU based investors. Also, they may act to stabilise offerings of some securities which are to be traded on second tier or other markets for securities within EU (such as, in the UK, AIM) which are not "regulated markets" for the purposes of the Market Abuse Directive (MAD).

Member state laws on market manipulation or insider dealing may apply to stabilising action in relation to distributions of such securities even though this is not required by the MAD. For example, the UK criminal law on market manipulation applies to manipulative conduct in relation to any securities (whether listed or unlisted) if the conduct has an effect in the UK, including conduct taking place outside the UK. In addition, the UK market abuse regime applies to manipulative conduct in relation to securities traded on certain UK markets which are not regulated markets (such as, in the example given above, US equities which are traded on the London Stock Exchange's international equity market or securities traded on AIM). The current

[3] See the definition of "relevant securities" in article 2(6) of the Commission regulation and see note 2 above.

UK safe harbour has a broader scope than the Commission regulation, in that it also applies in relation to distributions of securities listed on other exchanges, as well as of securities traded under the rules of the International Securities Markets Association.

Similarly, the German law on market manipulation may apply in relation to offerings of securities included in the "free market" (*Freiverkehr*) even though this is not a regulated market.

Possible resolution: Where member states retain or adopt market abuse or similar laws that are broader in scope than required by the MAD, they should provide an appropriate, separate safe harbour for stabilisation action taken in respect of offerings of securities covered by those laws.

For example, the UK should retain its current safe harbour for stabilisation action taking place outside the UK which conforms to recognised third country stabilisation rules (at present, Hong Kong, Japanese and US rules are recognised for this purpose). In addition, the UK should retain a safe harbour for other stabilisation action that might be restricted by UK rules (e.g. the conduct in the EU or outside the EU in relation to the bond example given above).

Notes:

- Where separate safe harbours exist, member states should seek to ensure that their terms are consistent with the terms of the EU safe harbour. However, it may not be sufficient simply to adopt national rules extending the Commission regulation so that it applies to stabilisation action in relation to the wider range of securities covered by the relevant national law. Many of the provisions of that regulation are designed to apply in relation to EU listed securities and it will be necessary to adapt those provisions when applying them to circumstances not covered by the MAD (for example, the requirements for "adequate public disclosure" may not be appropriate in relation to offerings of securities not covered by EU directive requirements). In addition, it would be open to member states to apply less burdensome requirements under any separate safe harbour in cases where the requirements of the regulation are unnecessarily burdensome.

- Additional issues may arise because of the limited scope of the Commission regulation. For example, an EU issuer might offer convertible debt securities where the debt securities are not themselves to be listed in the EU but are convertible into the issuer's shares, which are listed on an EU exchange. In such a case, the Commission regulation will not provide a safe harbour for stabilisation action taken in relation to the underlying shares (because, in the absence of an EU listing, the debt securities are not "relevant securities"), even though that action could fall within the scope of the MAD (because the shares are listed in the EU).

2. In the case of a new issue of securities, the Commission regulation only provides a safe harbour for stabilisation action that occurs after application has been made to list the securities on an EU exchange.[4] However, issues of EU listed debt securities are frequently launched on very short notice and the formal listing application will often only be submitted after the launch of the offering, i.e. after the time when bonds have been priced, trading has begun on a "when issued" basis and the stabilisation manager has effected some stabilisation transactions in the market.

[4] See the definition of "relevant securities" in article 2(6) of the Commission regulation.

In a typical institutional offering of debt securities, the launch is announced to the market by a screen announcement on Reuters or Bloomberg.[5] The managers would then begin the distribution of the securities in reliance on private placement or similar exemptions (after implementation of the Prospectus Directive,[6] the initial distribution would be limited to qualified investors or otherwise qualify for exemption from the requirement for the prior publication of a prospectus under article 4(1) of that Directive). The issuer would then submit its application for listing, which would be granted simultaneously with the closing.

Possible resolution: Issuers should be allowed to use email to submit a preliminary application for the admission of the securities to trading on the relevant market, with the formal application for admission following at a later time.

Note: In some countries, it may be necessary to resolve the mechanics for submitting such an application where a listing agent or similar entity handles liaison with the exchange.

3. The Commission regulation only provides a safe harbour for stabilisation action taken during the period beginning on the date of "adequate public disclosure" of the terms of an offering,[7] i.e. disclosure made in accordance with the procedure laid down in Community law for issuers' ad hoc disclosures of significant developments. Similarly, there must be "adequate public disclosure" of information concerning the proposed stabilisation before "the opening of the offer period" of the relevant securities.[8] In many cases, it would be difficult for issuers or lead managers to make an announcement in accordance with these procedures in a timely manner so as to allow stabilisation action to begin immediately after launch of the offering (as is required in order for it to be effective), particularly in the context of the issue of debt securities and where the competent authority requires relevant announcements to be made by means of newspaper announcements or using a specific mechanism.

Under current market practice for international debt securities offerings lead managed in the UK, the stabilising manager would normally make a screen announcement of the terms of the issue, including a short form disclosure of the possibility of stabilisation (e.g. "Stabilisation/FSA"), before stabilisation action begins in relation to the securities.

The Commission regulation defines "adequate public disclosure"[9] as disclosure made in accordance with the procedure laid down in articles 102(1) and 103 of the Consolidated Admissions and Reporting Directive (CARD).[10] Those provisions envisage that a listed issuer

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[5] The screen announcement should satisfy the requirements for a public announcement imposed by virtue of the definition of "significant distribution" in article 2(9) of the Commission regulation.

[6] Directive 2003/71/EC.

[7] See article 8(2)-(5) of the Commission regulation; in an initial public offering of shares where there is to be no "when issued" trading, the stabilisation period simply begins when trading commences.

[8] See article 9(1) of the Commission regulation. Article 9(1) will cease to apply on the date of application of the measures implementing the Prospectus Directive (1 July 2005) for offers to which those measures apply. However, this does not affect the requirements of article 8(2)-(5) for "adequate public disclosure" of the terms of the issue before the stabilisation period begins.

[9] See article 2(5) of the Commission regulation.

[10] Directive 2001/34/EC.

will make "ad hoc" announcement of significant developments and other information under its continuing obligations:

- By means of a newspaper advertisement (or publication at an address previously announced using a newspaper advertisement) or by an equivalent means approved by the competent authority;
- In an official language of the member state concerned or another language customary in the sphere of finance which has been accepted by the competent authority; and
- In some cases, the issuer must simultaneously send the information to the competent authority.

There are significant differences in the member states' requirements for ad hoc disclosures. For example:

- the UK requires publication through primary information providers,
- Luxembourg generally requires a newspaper advertisement (and notification to the Stock Exchange)
- France requires publication in an official publication (the BALO, which is not published daily), after approval by the AMF; and
- Germany requires a newspaper advertisement or dissemination through an electronic information system, such as a website (and prior notification to BaFin and the stock exchange). [11]

All of these techniques could present significant challenges as to how to synchronise "adequate public disclosure" with the launch of the transaction and the beginning of stabilisation in debt offerings, especially where they require newspaper advertisement. In some cases, where stabilisation is to take place at launch, the Regulation may, in effect, require the issuer to make a prior announcement of the required information. Currently, this is not general market practice in debt securities offerings, as a new issue of debt securities will not always amount to price sensitive information in relation to the issuer's existing securities requiring immediate disclosure.[12]

The proposed Transparency Obligations Directive (TOD) will repeal these provisions of the CARD and references to those repealed provisions in the Commission regulation will instead be references to the corresponding provisions of the TOD. The TOD envisages that an issuer's home member state will ensure that information disclosed under continuing obligations will be disclosed by means that ensure fast access to that information on a non-discriminatory basis

[11] See also Disclosure Regulation in the EU - the Emerging Framework: Report of a CEPS Task Force (Centre for European Policy Studies, October 2003), page 29.

[12] Announcements of new issues of debt securities under national rules implementing article 81(3) CARD (issuers "must inform the public without delay of new loan issues and in particular of any guarantee or security in respect thereof") are not typically made at launch. See e.g. paragraph 23.22(e) of the UKLA's listing rules and paragraph 9(B)(c) of the Luxembourg Stock Exchange's rules (although the Luxembourg rule only applies to non-Luxembourg listed issues). The listing process will itself involve public disclosure of the terms of the transaction but at a later stage in the process.

across the EU. The Commission may set standards for that disclosure. There will also be a somewhat different language regime. The final text of the TOD is expected to be published in the Official Journal in the autumn of this year and member states will then have two years to bring its provisions into force.

Possible resolution:

- ***Member states should amend their existing rules to allow the required disclosures under the Commission regulation to be made by other means, ideally by screen announcement or at least using press agencies or other service providers.***

- ***To the extent that the rules do not allow for the use of screen announcements, lead managers may need to consider arranging for an appropriate announcement (where necessary, by the issuer) on the day of launch[13] containing the required disclosure (and, where this is required, for a copy to be sent to the competent authority - as to which see below).***

Notes:

- Recital 16 to the Commission regulation recognises that "methods used for adequate public disclosure … should be efficient and can take into account market practices accepted by competent authorities".

- The implementation of the Prospectus Directive will (from 1 July 2005) in many cases obviate the need for adequate public disclosure of the possibility of stabilisation under the Commission regulation.[14] However, the regulation implementing the Prospectus Directive will require the inclusion of information on proposed stabilisation in prospectuses in respect of shares and depositary receipts.[15] Although these requirements do not apply to prospectuses in respect of offerings of debt or other securities, we expect that issuers will continue to include information on stabilisation in order to satisfy their general obligations of disclosure.

- The Prospectus Directive includes a broad definition of "public offer" but it is likely that, in practice, very many euromarket offerings will rely on the exemptions for offerings to qualified investors (or other exemptions), even where the securities are to be listed on an EU exchange (prior to the publication of the prospectus for the listing, the offering will have to be restricted so as to benefit from the relevant exemptions). Regulators should accept that adequate public disclosure of the terms of the transaction in order to start the stabilisation period[16] (or, for issuers with an existing listing, in order to satisfy their continuing

[13] Note that under article 8(2)-(5), the stabilisation period begins on the "date of adequate public disclosure" and thus it is arguable that the announcement does not actually have to precede the first stabilisation transaction. However, under article 9(1), the safe harbour is conditional on adequate public disclosure of the possibility of stabilisation "before the opening of the offer period of the relevant securities" (although this will cease to apply from 1 July 2005).

[14] Article 9(1) of the Commission regulation. However, this requirement will still apply in a case where no prospectus is required even though the relevant securities are admitted or to be admitted to trading on a regulated market e.g. some secondary offers of shares.

[15] See Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive.

[16] Under article 8 of the Commission regulation.

obligations to make "ad hoc" disclosure of material developments[17]) does not preclude reliance on these exemptions, so long as (in fact) the managers only offer the securities to qualified investors (or otherwise within one of the exemptions). The existence of a public announcement of this kind should not prejudice reliance on the exemptions; otherwise, it would be difficult for listed issuers to carry out exempt private placements.

- Lead managers and issuers may also wish to continue the current practice of including information about potential stabilisation of the issue in important documents, such as invitation telexes.

- Lead managers that undertake stabilisation action are also required to make "adequate public disclosure" of the results of stabilisation.[18] Again, it will be important for Member States to allow a lead manager undertaking stabilisation adequate flexibility as to the means of making this disclosure without the necessity of involving the issuer (the issuer may be reluctant to announce information which it is unable directly to verify).

4. The Commission regulation requires adequate public disclosure of certain information in accordance with the CARD (or eventually TOD) requirements but member states have implemented (and will implement) those requirements in differing ways. It is not clear whose rules apply (and which competent authority is the relevant competent authority) when determining how to make adequate public disclosure or otherwise comply with the Commission regulation.

For example, a German issuer may be listing debt securities on the Luxembourg stock exchange for the first time (and thus not yet be subject to continuing disclosure obligations in that country). However, it may already be subject to continuing disclosure obligations under CARD in other member states (e.g. Germany and the UK) because it has shares or other securities listed there. After the implementation of TOD in 2006, an issuer will generally be subject to continuing disclosure obligations in one country (its home state), which may not be the same country as where it is seeking a listing for the securities in question.

Since the obligations imposed by the Commission regulation are directly linked to the listing of the relevant securities on a particular regulated market, it is logical for the relevant requirements to be those that apply under the rules of the Member State of that regulated market. Thus, in the example, on this basis, the rules for determining whether there is adequate public disclosure for the purposes of the Commission regulation would be determined in accordance with Luxembourg law (and the Luxembourg regulators would be the relevant competent authority for the purposes of the Commission regulation).

Similarly, in the example, the lead manager undertaking stabilising action would be required to report stabilisation transactions to the competent authorities in Luxembourg as "competent authority of the relevant market".[19]

Proposed resolution: Regulators should accept that there is adequate public disclosure if disclosure is made in accordance with the regime in force in the Member State where the

[17] Under article 6(1) of the MAD.

[18] Article 9(3) of the Commission regulation.

[19] Article 9(2) of the Commission regulation.

relevant securities are or are to be listed (and that the competent authority of that Member State is the competent authority of the relevant market for the purposes of the Commission regulation). However, it may be necessary to reconsider this issue on the implementation of the TOD.

5. The Commission regulation and the regulation implementing the Prospectus Directive contemplate that certain information regarding the proposed stabilisation should be either the subject of "adequate public disclosure" or, after 1 July 2005, included in the prospectus.[20] However, they do not specify an acceptable form for the disclosure and do not address how adequate public disclosure could be made, in the period prior to the removal of this requirement, using screen announcements (if this is permitted) given the space constraints of screens.

It would be helpful if regulators would agree that disclosure along the following lines should satisfy the relevant requirements for a new issue of debt securities (subject to appropriate modification where there is a greenshoe option):

> "In connection with this issue, [name of stabilising manager or managers] (or persons acting on [its/their] behalf) may overallot [Relevant Securities][21] or effect transactions with a view to supporting the price of the [Relevant Securities] at a level higher than that which might otherwise prevail. However, there is no assurance that [name of stabilising manager or managers] (or persons acting on [its/their] behalf) will undertake stabilisation action. Any stabilisation action may begin at any time after the adequate public disclosure of the final terms of the offer of the [Relevant Securities] and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the Closing Date and 60 days after the date of the allotment of the Relevant Securities.[22]"

Possible resolution: Regulators should accept disclosure along the lines of the standard form specified in this note.

Notes:

- Market participants may wish to able, for practical reasons, to continue the practice of addressing stabilisation disclosures through short form references on screen announcements

[20] See above.

[21] Until 1 July 2005, it will also be necessary in all cases to state the maximum size of the over-allotment facility (see article 9(1)(e) of the Commission regulation). Article 11(a) of the Commission regulation restricts the extent of overallotment, such that overallotments not covered by a greenshoe should not exceed 5% of the original offer. Issuers and lead managers might satisfy this disclosure requirement by including the following wording "(up to the maximum amount permitted by Commission Regulation (EC) No. 2273/2003 implementing Directive 2003/6/EC of the European Parliament and the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments)" or as an alternative, in a case where there is no greenshoe option, "(in an aggregate principal amount not exceeding 5% of the total aggregate principal amount of the [Relevant Securities] offered hereby)". The regulation implementing the Prospectus Directive does not require that the prospectus disclose information on the size of the "over-allotment facility" and therefore this additional information will not be required after 1 July 2005 in a case where the offer falls within that regulation. Typical forms of subscription agreement and agreements among managers used for euromarket offerings do not explicitly limit the amount of overallotment but may only authorise the stabilising manager to overallot securities in accordance with applicable law or to the extent permitted by applicable law.

[22] It will usually be impractical to state specific dates because the relevant dates can change.

at launch of the issue, at least until 1 July 2005, after which the Commission regulation will not for most purposes require prior adequate public disclosure of stabilisation. It might be possible for regulators to agree a method by which these disclosures can be made in an abbreviated form in announcements otherwise meeting the standards for adequate public disclosure, for example, by accepting the incorporation by reference of standard form disclosures on the website of the International Primary Market Association (IPMA).

- Many forms of stabilisation legend based on US templates will not comply with the minimum requirements of the Commission regulation or the regulation implementing the Prospectus Directive (such as the requirement to state the duration of the stabilisation period, the identity of the stabilising manager and the size of any potential overallotment).

6. There are a number of other issues on which it would be helpful if there were consensus as to the practical application of the regulation.

(a) The Commission regulation requires ***adequate public disclosure of the "terms" or "final terms" of debt or convertible debt securities*** before stabilisation can begin.[23] While the key commercial terms of euromarket debt offerings are typically announced at launch, the full, detailed terms and conditions are normally only set out in the final prospectus, which is available at a later stage. Regulators should accept that the disclosure required is of the final commercial terms (including, in the case of convertible or exchangeable securities, the final conversion terms).

(b) The Commission regulation requires ***adequate public disclosure of stabilisation action*** after the end of the stabilisation period.[24] In many cases, there might be disclosure of the possibility of stabilisation action but, in the end, the stabilising manager does not in fact carry out any stabilisation action. Regulators should accept that, in those circumstances, it is unnecessary to make disclosure that there has been no stabilisation action, as (in those circumstances) the stabilisation manager does not require the protection of the safe harbour.

(c) The Commission regulation requires ***stabilisation managers to record "each stabilisation order or transaction"***.[25] Current practice is to record stabilisation transactions as such. Trading in bonds is typically on a principal to principal basis between wholesale counterparties, for which there is normally no recognisable "order" as such. Regulators should accept that it is not necessary to make records of bids or offers quoted in the course of such dealing.

(d) The Commission regulation requires the relevant competent authority to ***agree the standards of transparency relating to associated securities*** where those associated securities are not themselves admitted to trading on an EU regulated market.[26] This will be particularly relevant in relation to the stabilisation of convertible bond issues by non-EU issuers, where the bond is to be listed in the EU but the underlying shares are not. In those circumstances, the managers may need to take stabilisation action in relation to the underlying shares. Regulators should accept that the standards of transparency are adequate where the shares are listed on major third

[23] Article 8(4) and (5) of the Commission regulation.

[24] Article 9(3) of the Commission regulation.

[25] Article 9(4) of the Commission regulation.

[26] Article 2(8) of the Commission regulation.

country exchanges (at least so long as the regulator has confirmed that the applicable transparency standards meet some minimum standard).

(e) In some countries there may continue to be ***national rules regulating stabilisation***. Regulators should accept that these may continue to have a role as "accepted market practices" for the relevant national regulated market.[27]

(f) The Commission regulation makes it a condition of stabilising offerings of shares, where ***when-issued trading*** is permitted, that any such trading is carried out in compliance with the rules, if any, of the regulated market concerned, including those rules concerning public disclosure and trade reporting.[28] Regulators should apply this requirement in a manner which continues to allow stabilisation to be carried out on overseas markets, for example, where a company is offering shares which are simultaneously to be listed in the EU and in the US.

This note is intended for discussion purposes only. It does not purport to be comprehensive and does not provide legal advice. If you have any questions or comments, please contact Chris Bates or Tim Morris at Clifford Chance in London (+44 20 7006 1000; Firstname.lastname@cliffordchance.com).

[27] Article 2(2) of the MAD.

[28] Article 8(2) of the Commission regulation.