THE FORUM OF EUROPEAN SECURITIES COMMISSIONS

Date: June 2001
Ref.: Fesco/01-085

RE: COVER NOTE – SECOND CONSULTATION OF THE PAPER "STABILISATION AND ALLOTMENT - A EUROPEAN SUPERVISORY APPROACH" (REF. FESCO/01-037B)

During its last meeting in Paris, held on 6 March 2001, FESCO members agreed to publish for a second round of consultation the paper "Stabilisation and Allotment - A European Supervisory Approach" (ref. FESCO/00-099d). This cover note accompanies the revised draft of the paper, it explains how the paper has been amended to address the comments received in the first consultation and also provides some information on the past and coming consultation rounds. It provides a summary of those areas where the consultation revealed a significant need for change in FESCO's proposals.

General Remarks

The consultation of the first draft of the paper was undertaken at the European and international level by the Secretariat of FESCO and at the national level by each FESCO member between September and November 2000. Responses were obtained from a significant number of associations, firms and individuals from all jurisdictions involved as well as from a number of non EEA jurisdictions.

There was a disappointingly low response from consumer and investor associations. This fact is of considerable concern to the group as the matters of allotment, but also stabilisation, are particularly significant for retail investors. Consequently, it is a primary goal of the second round of consultation to obtain a significantly higher level of response from such associations.

The second round of consultation will be carried out from 11 June 2001 to 3 September 2001. As before, the secretariat of FESCO will undertake the consultation at European and international level while each member is responsible for undertaking the consultation at the national level. It is intended that the group should present a final paper, taking into account the comments received in the second round of consultation, to the December 2001 meeting of FESCO.

The comments received were more detailed with regard to the stabilisation section and more fundamental with regard to the allotment section. A number of comments raised process points such as the mode of consultation or the absence of a cost benefit analysis. In reaction to certain concerns relating to the consultation process, the period for the second round of consultation was extended to a full three months. In relation to the second point, it seems noteworthy that this was raised only by UK responders and that the UK is the only jurisdiction with a statutory requirement for a cost benefit analysis. As FESCO has not undertaken a cost benefit analysis in its other papers before, it was the sense of the group that if such analysis would be introduced, it should be done consistently for all FESCO papers and not just for one paper.

Stabilisation

On Stabilisation, the most significant change concerns the proposals on transparency of stabilisation transactions to the market (labelling of orders). The proposal for real-time labelling has been dropped, as it met with almost universal opposition and the group was convinced by the argument that this would be self - defeating. Nevertheless, given that the safe harbour allows an activity that under normal circumstances would very likely constitute market abuse, it is important for investors and for the market to have at least some degree of transparency. To provide this, the majority of the group is in favour of a proposal for limited public disclosure of stabilisation activity to be provided after the stabilisation period. The present requirement was drafted to allow investors to have an idea of how much stabilisation was done without forcing the stabilisation manager to reveal his position.

The proposed scope has been enlarged with regard to the securities covered, and it now conforms to the currently discussed informal proposals at the European level on market abuse with regard to markets covered. An issue remains for some jurisdictions where market manipulation provisions, and the permitted scope for stabilisation, go beyond this. Respondents are invited to comment on how this might be handled in the final paper, and in particular on how the eurobond market might best be handled.

On the stabilisation period, following requests from a number of jurisdictions, the group has decided that the proposals should allow stabilisation before the commencement of regular trading. Such stabilisation in when issued trading would, however, only be allowed in a very limited form as the group was not convinced, that stabilisation in when issued trading merits the protection of the safe harbour in every instance. Where such trading is not transparent or restricted to certain participants only, this could foster manipulation and abuse. Also, retail investors could legitimately argue that the scales were already tipped against them before they had had any possibility to act in the market. Therefore, stabilisation in when issued trading is permitted only where such trading takes place on a regulated market and with proper transparency and regulatory oversight.

Following concerns that the price limit of the “last independent transaction” would be nearly impossible to monitor in multi - market stabilisation and that in such cases, the safe harbour protection would be called into question because of very slight delays in market data transmission, this price limit is now described as the indicative upper limit. It should be stressed though that the underlying rationale of allowing only price support up to the current trading price is not affected by this change. It would also be an option to provide for the last independent transaction *in the principal market* as the upper limit of stabilisation transactions.

Clarifying changes were made to the provisions dealing with liquidation of stabilisation transactions, with the role of the stabilisation manager and with prospectus disclosure. In the last provision, the requirement to also state any other material information with regard to stabilisation was maintained despite comments calling this into question. The reason for this requirement is that all relevant information on stabilisation should be contained in one section. This will allow investors to be fully informed on all matters regarding stabilisation when reading that section alone. That purpose would not be served if information on stabilisation that fell under the materiality concept would be included elsewhere in the prospectus.

FESCO

Greenshoe

In the section dealing with the greenshoe, the discussion of the naked short was shortened and clarified. The point to be made here, which was misunderstood widely in the first draft, is that transaction to cover a naked short can only benefit from the safe harbour if stabilisation rules are followed.

On the definition of overallotment, it became apparent in discussions that this term was understood differently. A number of jurisdictions understand that an overallotment does not require allotment of all of the securities originally offered. To provide an example: In an offer where 100.000 shares are offered with an additional 15.000 shares for overallotment, an overallotment could be undertaken even if the 100.000 shares had not all been allotted in the first place. An allotment of 100.000 shares total could in the view of these jurisdictions be composed of 85.000 shares from the original offer and 15.000 shares from the overallotment. A number of other jurisdictions, without having explicit regulation on this matters, were of the view that an overallotment would only be possible after and in excess of allotment of the original offer. To stay in the example, any overallotment could only be undertaken once the base of 100.000 shares had been allotted. Comments are invited on this question of definition.

Allotment

In line with the number and significance of comments received, the allotment section has been substantially redrafted. The amendments concern first the introduction, which now provides a more detailed consideration of problems encountered in relation to allotment.

Also, the entire section has been refocused to apply to public offers, which excludes offers involving professional investors only. This restriction reflects the agreement of the group not to deal with the significant problems with regard to allotments only between professionals encountered in some jurisdictions, as no agreement could be reached on this point. However, it is important to stress that this only means that the issue of allotments between professionals is not covered in this present paper. It would be unwarranted to infer from the present standard any judgement as to the regulatory treatment of the allotments between professionals.

The pre-allotment disclosure requirements were materially maintained with one important change which concerns the mode of publication of pre-allotment disclosure. The information should be contained in the prospectus in every case, as this is a precondition of the proper functioning of the European passport for issuers currently under discussion at the European level. In addition, in cases where the prospectus is not available early enough to allow investors to review such information before the investment decision, it must also be published in another adequate manner.

There has been no material change with regard to the information on the basic structure of the allotment, such as the division between the various tranches. Even though a number of consultees criticised this requirement as too rigid, the group is convinced that this information constitutes the minimum of what retail investors need and that such information can be provided without causing undue damage to the allotment process or the issue. Indeed it would appear that this is part of the basic issue scenario that any issue would require. The required flexibility is provided for by the possibility of a claw back, i.e. the re-weighting of the various tranches. With regard to the exercise of the claw back, the newly introduced requirement that this device should not be used to the detriment of retail

investors is exemplified in two requirements. First, the maximum size of the claw back as disclosed cannot be exceeded. Secondly, where the retail tranche is fully subscribed or oversubscribed, the claw back cannot affect the minimum size of the retail tranche as disclosed. In cases where the institutional tranche is undersubscribed, similar considerations with respect to the retail tranche would apply. Given that the requirements apply to issues with retail participation only, the last requirement was not seen as too burdensome.

In the responses to the question raised in the first consultation about the favourable treatment of subscriptions based on which firm they are made through or by, no clear picture emerged. Rather, it became apparent that this is normal business practice in some jurisdictions, while it is frowned upon in others. The group has opted for an information - based approach, requiring that investors are informed about the way in which this will be handled in an issue. That may in some cases entail informing investors about what they know already, however this would not seem to be overly burdensome given that in other cases, this information is relevant for an investor's decision where to subscribe.

The section on post allotment disclosure was redrafted and reordered. It now covers public disclosure of the result of the allotment, disclosure of the demand situation, information to the investor and data to be recorded and disclosed to the regulator.

Public disclosure of the result of the allotment must be provided in every instance. This information broadly corresponds to the requirements for pre-allotment disclosure. This is designed to allow investors to judge the success of the issue. The proposed requirement for information to investors has been maintained. The proposed recordkeeping requirement has been materially maintained, however, it now applies to each individual investment services firm involved in the allotment process, and the same applies to information to be disclosed to the regulator on request.

With regard to information on the demand situation, such information is not mandatory. Where it is provided, it may not be misleading. Even though this would appear to be obvious, the often observed practice of stating that an issue is x-times oversubscribed even though many such subscriptions may have been made at price levels below the final offer price is clearly inconsistent with this requirement. Some members of the group were of the view that in addition to the above, information on the demand situation should be mandatory in every case to avoid distortions in the market, however, no agreement could be found on this point.

Note for responses in the second round of consultation

For the second round of consultation, respondents are asked to consider in particular whether:

- they agree with the changes made to the paper in the light of the explanations set forth above;
- the paper and this cover note adequately address the concerns that were voiced in the first round of consultations; and
- any new concerns arise from this redraft of the paper.

Date: June 2001
Ref: Fesco/01-037b

STABILISATION AND ALLOTMENT

A EUROPEAN SUPERVISORY APPROACH

Second Consultative Document

Table of Contents

I. Introduction 3

II. Definitions 6

III. The Standards 7

IV. Stabilisation 8

1. Stabilisation - the Regulatory Regime 8

2. FESCO European Standards for Stabilisation 9

V. Overallotment Facility and Greenshoe 11

VI. Allotment 13

1. Allotment - the Regulatory Regime 13

2. FESCO European Standards on Allotment 15

I. Introduction

The continuing development of the Single Market in financial services, in particular following the introduction of the Euro, is likely to generate a progressive increase in the number of cross-border offerings of securities. For the efficiency of the market and protection of investors, it is desirable that FESCO members develop common approaches to key elements of the offering process.

According to the FESCO charter, the objectives of protecting investors and ensuring the integrity and transparency of markets are fundamental to achieving and maintaining sound and stable financial markets.

FESCO has already published "Market Conduct Standards for Participants in an Offering" (99-FESCO-B; "Market Conduct Standards"). These standards deal with the control and dissemination of information and certain aspects of trading activity. The purpose of this present paper is to address those issues that were not covered in the Market Conduct Standards and where there is a need for harmonisation. These are stabilisation practices, including the operation of greenshoes, and the allotment of securities. The standards set forth in this paper complement and add detail to the Market Conduct Standards for certain areas. However, they are not intended to alter the scope of application of the FESCO Market Conduct Standards.

Furthermore, the experts group on market abuse has sent to the European Commission a paper on "Market Abuse; FESCO's response to the call for views from the Securities Regulators under the EU's Action Plan for Financial Services COM(1999)232" (FESCO-99-096l, the "Market Abuse Paper") providing input for a future harmonisation of the legal framework against market abuse at the European level. The current discussions on a possible legal instrument at the European level reflect such input.

Likewise, the experts group on European public offers has sent its proposals for a notification - based, automatic recognition of prospectuses (A European Passport for Issuers, FESCO/00-138b, the "European Passport Paper") to the European Commission. This paper is also reflected in the current discussions of a new legal framework for the mutual recognition of prospectuses in the EEA.

The standards on stabilisation set forth in this paper are applicable to both debt and equity securities, since both types of security are the subject either of existing market abuse regimes, or will be covered under FESCO's proposals as mentioned above. The section on allotment standards, however, is applicable only to equity issues. This reflects the fact that regulatory issues in relation to allotment have arisen almost exclusively in respect of equity issues.

In all three sections of the paper, the scope extends to securities to be admitted to trading or already admitted to trading on a regulated market within the meaning of the Investment Services Directive (Directive 93/22/EEC, the "ISD"). This corresponds to the proposed scope of application of a future European regime on market abuse. However, the Market Abuse Paper does also propose to broaden the concept of a regulated market in the forthcoming revision to the ISD. Should this happen, the scope of application of this paper would broaden accordingly.

On stabilisation the aim of this paper is to provide clear and coherent regulatory standards that can be implemented in national rules. For cross-border issues of securities effected within EEA - member states, all involved parties should be able to rely on substantially the

same safe harbour rules with regard to stabilisation. Within the EEA - member states, this goal should be achieved through a mutual recognition of national stabilisation rules that implement the standards set forth in this paper. FESCO members will seek to obtain such Europe-wide recognition for their national rules and to grant similar recognition to the rules of other FESCO members.

For cross-border issues involving entities and markets of EEA and non - EEA jurisdictions it is important to have harmonised safe harbour legislation. FESCO members will also seek recognition of their national rules by non - EEA authorities and to recognise relevant foreign stabilisation rules.

This paper does not seek to address the issue of the competent authority with regard to stabilisation regulations in cross border issues of securities. As a result of FESCO's commitment to strive for a mutual recognition and harmonisation of respective national stabilisation rules, the matter of designating a competent authority becomes less relevant.

The standards on stabilisation set forth in this present paper are designed to provide a safe harbour against charges of market abuse, both criminal and administrative under both current national laws, and under the future harmonised European framework. This safe harbour provides a defence against charges of market abuse in cases where the standards on stabilisation as implemented by the national authority were followed. Cases where the standards have not been adhered to do not automatically constitute market abuse. In such cases, however, no defence of legitimate stabilisation can be raised. The concept that stabilisation is a legitimate form of potential market distortion is already contained for cases of insider trading in the 12th recital of the Insider Directive (89/592/EEC). It is expanded in this paper for the different types of market abuse as defined in the FESCO Market Abuse Paper, which are: insider trading, market manipulation and the dissemination of false and misleading information.

The objective of this paper as regards allotment is to provide common standards on disclosure and the fair treatment of retail investors. In addition, against the background of the notification - based, automatic recognition of prospectuses which FESCO is proposing, it is particularly important that the approach with regard to information on the allotment process is broadly similar across the EEA.

As this system of automatic recognition of prospectuses effectively entails a shift of regulatory responsibility to the home country authority, the even and consistent enforcement of the applicable requirements becomes even more important. FESCO has recognised this issue in Nos. 16 and 17 of the European Passport Paper and those considerations apply equally in the context of allotment disclosure as treated in this paper.

Providing harmonised disclosure standards for allotment will also contribute to the provision of a broadly similar level of investor information across the EEA. This need is particularly pressing for allotment, as this is an area, where the interests of participants can and often do diverge. In an offering of securities, issuers expect to be able to achieve an efficient allotment of their securities and raising of funds, while investors expect to be treated fairly and to receive an allotment based on clear and documented criteria. In many instances, however, investors have complained about a lack of reliable information about the allotment process. This often results in investors receiving allotments that do not correspond with their reasonable expectations. FESCO is committed to provide a framework which is consistent with the requirements of effective disclosure and fair treatment of investors. A more detailed consideration of the problems that have been encountered with regard to allotment is set forth in Section VI. of this paper.

Most Member States have legislation and/or regulation addressing the issues of stabilisation and allotment. A limited survey of the existing national regulation in this area was undertaken which indicated that these vary greatly in scope and specificity and that there is significant diversity across the EEA. There is, with the exception of indirect references (see above), no European law in the areas covered in this paper.

FESCO members will seek to implement the standards set out in this paper in their regulatory objectives and, where possible, in their respective rules. If a FESCO member does not have the authority to implement certain standards, it will commend these to its government and/or to the responsible regulatory authority. This commitment is underpinned by the disclosure mechanism agreed upon by FESCO members. This provides for regular disclosure by FESCO, how far the implementation of FESCO standards has progressed in each member's jurisdiction.

II. Definitions

Stabilisation - any purchase or the offer to purchase the Relevant Securities or transactions in Associated Securities equivalent thereto which is undertaken

(1) by an Investment Services Firm involved in or undertaking a public offering of Relevant Securities, and

(2) in order to support the market price of the Relevant Securities.

Relevant Securities – shares, as well as securities equivalent to shares (such as depository receipts) and for purposes of sections IV. and V. of this paper also debt securities including convertible and exchangeable debt securities as well as securities equivalent thereto (such as depository receipts) which are offered to the public in the European Economic Area and which are admitted or going to be admitted to trading on a Regulated Market, including securities identical thereto which are already admitted to trading on a Regulated Market.

Associated Securities – Associated Securities shall mean the following financial instruments provided that they are negotiable on the capital market

(1) contracts or rights to subscribe for, acquire or dispose of Relevant Securities,

(2) financial derivatives on Relevant Securities, and

(3) where the Relevant Securities are convertible or exchangeable debt securities, the securities into which such convertible or exchangeable debt securities may be converted or exchanged.

Overallotment – allotment to investors of a greater number of the Relevant Securities than originally offered.

Overallotment Facility - clause in the underwriting agreement authorising such Overallotment.

Greenshoe Option / Overallotment Option – option granted by the Offeror in favour of the Investment Services Firm(s) involved in the offering, providing that for a certain period of time after the offer of the Relevant Securities this firm(s) may purchase up to a certain amount of Relevant Securities at the offer price.

Offeror - the shareholder(s) who were prior holders of or the entity issuing the Relevant Securities being offered to the public.

Free Retention - a contingent of Relevant Securities (normally below 5% of the offer) put at the disposal of certain members of the consortium for free distribution, *i.e.* distribution outside pre-determined and disclosed allotment methods.

Regulated Market - the markets as defined in Article 1 No. 13 of the Investment Services Directive (Directive 93/22/EEC).

Investment Services Firms - investment firms and credits institutions as defined in Article 1 Nos. 2 and 3 of the Investment Services Directive (Directive 93/22/EEC).

III. The Standards

Stabilisation

1. Stabilisation may only be undertaken with regard to Relevant Securities offered to the public in the context of an initial or secondary offering to support the price of such Relevant Securities in the secondary market for a limited period of time beginning with the commencement of trading of such Relevant Securities on a Regulated Market.

2. The responsibility for Stabilisation must be borne by one entity within the offering consortium (the "Stabilisation Manager").

3. The possibility of Stabilisation must be disclosed in the offering or listing prospectus. Stabilisation activity must be disclosed and recorded in an appropriate manner.

Overallotment

4. The Greenshoe may only be exercised in connection with an Overallotment of securities. The Overallotment Facility and the Greenshoe must be disclosed in the prospectus.

Allotment

5. In the allotment of securities, investors must be treated fairly by the involved Investment Services Firms. Disclosure of the proposed allotment process must be made in the prospectus. The result of the allotment must be disclosed in an appropriate manner.

FESCO

IV. Stabilisation

1. Stabilisation - the Regulatory Regime

This section deals with the requirements applicable to Stabilisation transactions in general. Stabilisation is an optional activity undertaken by Investment Services Firm(s) involved in a public offering of securities. The main conditions of the Stabilisation process are agreed between the Offeror and such firm or firms.

The main purpose of these transactions is to provide some support for the price of the new issue if it falls as a consequence of initial pressure from selling orders. Stabilisation can under certain circumstances be beneficial by alleviating sales pressure generated largely by short term investors (so called flippers). Stabilisation facilitates the distribution process for new issues by giving the involved Investment Services Firms a safe harbour for certain activities within a regulatory framework that sets appropriate controls on these activities.

The benefits to the markets to be gained through Stabilisation can be considerable. New, particularly small and medium sized companies are encouraged to access the capital market and established issuers will be more comfortable raising funds from the securities market through capital increases if they know there will be some support for the price of their offer. Stabilisation may also contribute to a lower cost of funding for the issuer. Investors may feel more confident making an investment, where there is an expectation, that at least for a limited period of time, the price of the new issue is being actively supported. They must always be aware, however, that there is no guarantee, that Stabilisation will be undertaken. Investors should therefore not base an investment decision on the assumption that the involved Investment Services Firms will actually undertake Stabilisation.

Stabilisation also poses some risks to the market. Generally, there is a risk that Stabilisation activity could conceal the true market demand by sustaining a price for too long a time at a potentially artificial level. Taking into account that furthermore:

- Stabilisation transactions are undertaken to affect the market price of the Relevant Securities (potential of market manipulation); and
- the entity undertaking Stabilisation may have insider information (within the meaning of Directive 89/592/EEC) (potential of insider trading); and
- the fact that Stabilisation may be undertaken is material to the market price of the Relevant Securities (potential dissemination of false or misleading information);

Stabilisation must be conducted according to specific rules if it is to have the benefit of the safe harbour.

Stabilisation rules therefore must deal with permissible stabilisation transactions (i.e. time and price rules), market transparency safeguards and investor information requirements. The rules set out below are drafted to confine Stabilisation transactions narrowly to certain time periods (usually between 30 and 60 days) and certain prices. Moreover, they provide for disclosure of Stabilisation arrangements to investors as well as for limited public disclosure after the end of the stabilisation period. With these requirements, the potential risks associated with Stabilisation are, if not counterbalanced, at least contained.

For regulatory purposes, it is also important to establish a clear accountability obligation. To achieve this, Standard No. 2 prescribes that one entity within the offering consortium should be accountable to the relevant national authority with regard to the Stabilisation

activity. This obligation of accountability requires it to act as central point of inquiry for any regulatory intervention. In case of stabilisation in multiple jurisdictions one entity must fulfil the accountability obligations for Stabilisation activity in each jurisdiction.

The question of proprietary trading (*i.e.* own - account transactions undertaken in the normal course of business without a Stabilisation purpose) of the Stabilisation Manager and other consortium members, although closely connected to stabilisation is not treated in the Stabilisation rules. The Stabilisation rules in their entirety constitute a safe harbour against charges of market abuse for Stabilisation transactions. It follows, that other transactions, undertaken in the course of normal proprietary trading are not included in this safe harbour.

2. FESCO European Standards for Stabilisation

Stabilisation may only be undertaken with regard to Relevant Securities offered to the public in the context of an initial or secondary offering to support the price of such Relevant Securities in the secondary market for a limited period of time beginning with the commencement of trading of such Relevant Securities on a Regulated Market.

a. Stabilisation Period

(1) Stabilisation shall be permitted only during a defined period beginning with:

- the commencement of trading of the Relevant Securities on a Regulated Market; or
- prior to that with the pricing of the Relevant Securities for equity securities and the announcement of the offer of Relevant Securities for debt securities provided that any such trading prior to the commencement of regular trading of the Relevant Securities on a Regulated Market (*i.e.* when issued trading) takes place on a Regulated Market and subject to trade reporting requirements and an appropriate level of regulatory supervision and monitoring

(2) The Stabilisation period must be disclosed to the market in advance.

b. Stabilisation Price

(1) Equity Securities

Stabilisation transactions may only be undertaken to support the current trading price of the Relevant Securities and in any case may not be executed above the offering price. Where the Relevant Securities trade below the offering price, the last independent transaction (where there is one) is the indicative upper limit for Stabilisation transactions.

(2) Debt Securities

Stabilisation transactions may only be executed for the purpose of price support.

c. Liquidation of Stabilisation transactions

The Relevant Securities bought by the Stabilisation manager during the Stabilisation period may be used to cover any Overallotment. If Relevant Securities acquired in excess of that are disposed of in the market, this must happen in an orderly way.

The responsibility for Stabilisation must be borne by one entity within the offering consortium (the "Stabilisation Manager").

d. The Stabilisation manager

Vis à vis each relevant competent national authority, one entity within the consortium must be accountable for regulatory purposes, in order to act as central point of inquiry for any regulatory intervention. There must be adequate co-ordination between all entities undertaking Stabilisation.

The possibility of Stabilisation must be disclosed in the offering or listing prospectus. Stabilisation activity must be disclosed and recorded in an appropriate manner.

e. Prospectus Disclosure

The prospectus must contain adequate disclosure on the following items in one clearly identified section:

- the possibility that Stabilisation may be undertaken and that it may be stopped at any time;
- the period during which stabilisation may occur;
- the identity of the Stabilisation Manager in each relevant jurisdiction and of any appointed agents unless this is not known at the time of publication; and
- other aspects of Stabilisation which could be material for an investor's decision to subscribe for the Relevant Securities.

f. Record keeping requirements

All Stabilisation orders entered and transactions carried out according to these Stabilisation rules must be recorded separately in a form that allows an adequate analysis of such information. The recorded information shall include for each order and transaction, at least the information set forth in Article 20 para (1) of the Investment Services Directive (93/22/EEC). This information must be at the disposal of the competent authority at all times.

g. Post Stabilisation Disclosure

Within one week after the end of the stabilisation period, the stabilisation undertaken must be adequately disclosed to the public. This disclosure has to contain at least the following information:

- the average price of Stabilisation transactions weighted by the volume of trading, and
- the total volume of Stabilisation transactions.

V. Overallotment Facility and Greenshoe

Within the context of the agreement entered into between the Offeror and the Investment Services Firms involved in the offering, an Overallotment Facility and/or a Greenshoe may be agreed. The Overallotment Facility allows an Overallotment, *i.e.* the allotment of more securities than originally planned with the same conditions as the original issue and without an increase of the size of the offer at that time. The Greenshoe permits the purchase of up to a certain amount of additional securities from the Offeror, at the offering price, within a specified time after the end of the offering period.

It is common practice to reserve securities amounting to up to 15% of the original offer for the Overallotment Facility. The period after the offer, within which the Greenshoe may be exercised to acquire these additional shares from the Offeror is usually between 30 and 60 days. For that time, a short position is established.

Two possible scenarios which may occur during that period are that:

- The market price drops below the offer price – in this case the short position could be covered with securities bought on the market;
- The market price goes up - in this case the short position could be covered through the exercise of the Greenshoe.

Both the Overallotment Facility and the Greenshoe are closely related to Stabilisation. The use of the Overallotment Facility enables the Stabilisation manager to buy back securities in the aftermarket (reducing the risk of obtaining a long-position) and thus enhancing chances to achieve a balanced market. The Greenshoe hedges the Overallotment, its exercise has a neutral market effect.

Alternatively or in addition to the Overallotment Facility, which is hedged by the Greenshoe, an Overallotment can also be undertaken without a hedging device which results in a naked short[1]. Transactions to cover such a naked short may be Stabilisation transactions which fall under the safe harbour, provided that the standards set forth in Section IV of this paper as implemented by the national regulator are followed.

Concerns that attach to the Overallotment Facility and the Greenshoe relate to investor information and protection, to market transparency and to market integrity. To alleviate these concerns, the following standards must be adhered to. Disclosure matters are also covered by the FESCO European Standards on Allotment (see below) which must be read in conjunction with these standards. It is important to stress that these standards do not allow Investment Services Firms to choose whether they want to act in accordance with the standards and consequently be able to raise the safe harbour defence, or whether they want to act outside of the standards with the risk that their actions may be prosecuted as market manipulation. These standards in their entirety must be adhered to in every instance.

[1] The creation of such a naked short is problematic under current regulatory practice in some jurisdictions

The Greenshoe may only be exercised in connection with an Overallotment of Relevant Securities. The Overallotment Facility and the Greenshoe must be disclosed in the prospectus.

a. Disclosure

The prospectus must give proper disclosure of the existence of an Overallotment Facility and a Greenshoe, including the amount or percentage of Relevant Securities available for Overallotment, the exercise period of the Greenshoe and any conditions for the use of the Overallotment Facility or exercise of the Greenshoe.

b. Market Transparency

The exercise of the Greenshoe must be communicated to the public in suitable detail.

c. Market Integrity

The Greenshoe must not be exercised where Relevant Securities have not been overalloted by the beneficiary or beneficiaries of the Greenshoe.

VI. Allotment

1. Allotment - the Regulatory Regime

FESCO members have acknowledged that, especially in times when offerings are heavily oversubscribed, it is important to ascertain the fair treatment of investors. The rules set out below concentrate primarily on disclosure, while, with regard to fair treatment of investors, they are mainly aimed at managing conflicts of interest between the involved Investment Services firms and investors.

It is important to stress that this paper cannot be read to preclude the right of the Offeror to give either preferential treatment or non-preferential treatment to certain groups of investors or individual investors.

Among FESCO members there have been a number of examples of different kinds of problems related to allotment. In cases when offerings are heavily oversubscribed regulators receive complaints that allotment procedures are not treating all investors fairly. Retail investors may complain that institutional investors obtain better allotments and/or that the employees of the investment firm are accorded preferential treatment. In some jurisdictions, there are also complaints that investors in the same tranche and/or category are treated differently, for example subscriptions made through syndicate members are given preference over other subscriptions or preference is given to syndicate members´ own clients, whereas in other jurisdictions, this is a normal and accepted commercial practice. Alternatively, where the issue turns out to be "cold" or a failure, there have been complaints that in some jurisdictions shares have been "dumped" on retail customers or into managed portfolios. There are also occasions of complaints of misuse of dominant positions by investment firms in cases where an investor is forced into a customer relationship with a firm in order to ensure an allotment or where the customer has to promise to give certain amount of business to the investment firm in order to get an allotment. Finally, concerns relate to the retention of funds and charging of subscription fees in cases where investors have not been allotted shares.

Many of these issues are already covered by conduct of business rules but there are wider concerns from investors who are not satisfied with the level of information on this process. This relates to the information provided before the allotment on how the allotment will be conducted, how the offering is shaped and how this can be altered. Investors are also interested in reliable information about so called friends and family programmes, i.e. programmes where preferential treatment is accorded to friends and family of the Offeror or of the involved Investment Services Firms. In order to avoid unecomically small shareholdings, the information on any minimum allotment is of significance to investors. In jurisdictions where multiple subscriptions are not admitted, investors need to know how such multiple subscriptions will be treated, i.e. whether all of several subscriptions will be deleted or whether one subscription will be maintained.

Such needs for information before the offering correspond to needs for information after the allotment. Investors require this information to be able to judge the success of the offer. This is particularly important, where the Offeror has exercised his right to reshape the allotment to respond to the demand situation. In some cases there are also complaints about misleading disclosure of the demand situation of the offer after the allotment.

Where the retail investor has an advisory relationship with the Investment Services Firm, and this is regulated, then the investor should already have a measure of protection in his dealings with the Investment Services Firm. However, where a customer relationship does

not exist between the retail investor and the Investment Services Firm, the application of these standards should ensure that the retail investor receives fair treatment in the allotment process and also receives better quality information.

Free Retention and friends and family programmes are a business practice in a number of European jurisdictions. They have been dealt with in this paper as such, and this does not constitute an endorsement of these practices which are currently prohibited in some other European jurisdictions.

The standards on allotment set out below are focused on public offers, which exclude offers involving professional investors only. This reflects the fact, that the members of FESCO were not able to agree between them what standards should be applicable to offers involving only professional investors. FESCO may at a later time revert to this question, which for the time being remains open.

The standards deal first with enhancing the information on allotment available to investors both before and after the allotment. Secondly, they impose certain fair treatment requirements. The requirement for prospectus disclosure is addressed to the Offeror, as this is the person which is responsible for prospectus disclosure under the applicable European Directives. The requirements for post-allotment disclosure and record-keeping are addressed to the Allotment Manager, as this will be the entity which is in possession of all the necessary information for making such disclosure.

The standards are to be implemented by requirements on investment firms. This recognises that FESCO members have authority over and supervise licensed investment firms. However, certain FESCO members, who have supervisory responsibility also with regard to Offerors under national legislation, could apply the allotment principles also to Offerors. It is important to note that even where the Offeror is not the subject of national regulation, this should not lead to circumvention in practice and the involved Investment Services Firms should be in a position to see to it that the standards on allotment as implemented in national law are complied with in their entirety.

The provisions dealing with the responsibility of the allotment manager have been drafted along the lines of the provision dealing with the stabilisation managers. This does not impose regulatory responsibility on the allotment manager for the actions of other consortium members. It is recognised that civil law remedies are available under the consortium agreement to the allotment manager against other consortium members. These may be less relevant in some jurisdictions, where retail allotments are carried out centrally by the allotment manager on the basis of data collected from the syndicate.

In providing these standards, FESCO members were aware of the potential conflict of interest of the involved Investment Services Firms, which may at the same time have a client relationship with the Offeror and with investors. The relationship with the Offeror has not been covered in these standards as there is a lesser need for regulatory intervention in the terms of this relationship. It was felt, that the Offeror should generally be more able to take care of its own interests in relation to the Investment Services Firms involved in the offering than are investors. It was felt that there was a demonstrable need for some protection of especially retail investors in relation to investment services firms, as typically, such retail investors would be in a disadvantaged position both where access to information and bargaining position is concerned.

In a number of jurisdictions, subscriptions must be treated in the same manner, regardless of which Investment Services Firm they are made through. However, in many other jurisdictions it seems to be current practice that subscriptions made through certain, in

particular non-syndicate Investment Services Firms, will not be allocated any securities in oversubscribed offerings. It would seem prudent to ensure that investors are informed in the prospectus in the latter case. This information is of particular importance in cases where subscription fees are charged regardless of a subsequent allotment.

2. FESCO European Standards on Allotment

In the allotment of securities, investors must be treated fairly by the involved Investment Services Firms. Disclosure of the proposed allotment process must be made in the prospectus. The result of the allotment must be disclosed in an appropriate manner.

These Standards are applicable to public offers of Relevant Securities. The standards are not applicable to offers involving only professional investors. Compliance with these standards shall be adequately monitored by the competent authority.

1. Allotment Principles

In an allotment, all investors must be treated fairly by the involved Investment Services Firms. Investors in different tranches, categories, classes or types may be treated in a different manner.

a. Allotment Manager

Vis à vis each relevant competent authority, one entity within the consortium must be accountable for regulatory purposes, in order to act as central point of inquiry for any regulatory intervention. There must be adequate co-ordination between all entities participating in the allotment process.

b. Allotment Methods

Various methods can be used in an allotment of Relevant Securities to retail investors, such as scaling down, progressive scaling down, lottery, priority based on timing of bid/subscription. Where one or more Investment Services Firms undertakes the allotment, the same method or combination of methods should be used within a tranche, these method or methods should be used systematically, and in choosing the method or methods the individual characteristics of the offering should be considered. The same allotment methods and criteria must apply to the original tranches and any over-allotment. The claw back should not unduly be used to the detriment of the retail tranche

In order to avoid disruptions in the subscription process, it is not recommended that allocations in the retail tranche be based solely on the timing of bids.

2. Pre – Allotment Disclosure

As a minimum requirement the following information must be included in the prospectus. Where the prospectus is not available on a sufficiently timely basis to allow investors to review the information before the start of subscription, it must also be made available in another adequate manner.

- The main features of the offer which are the division between domestic and international tranches and the division between retail, institutional and issuer's employee tranches if any.
- The conditions under which the division between tranches may be changed (claw - back) the maximum size of such claw back and any applicable minimum percentages for individual tranches. For the retail tranche, a minimum percentage,

which cannot be reduced in the event that the tranche is fully subscribed or oversubscribed, must be provided.

- The allotment method or methods to be used for the retail and employee tranche in the event of an over-subscription.

- A description of any preferential treatment[2] to be accorded to certain investors or classes of investors or certain affinity groups (including employees) in the retail tranche in the allotment, the percentage of the offer reserved for such preferential treatment and the criteria for inclusion in such classes or groups.

- Whether the treatment of subscriptions or bids to subscribe in the allotment may be determined on the basis of which firm they are made through or by.

- The amount of shares reserved for Free Retention. The potential beneficiaries of allotments from such retained shares must be disclosed when investors or members of investors classes or affinity groups already receiving preferential treatment are not specifically excluded from receiving allotments of retained shares.

- A target minimum individual allotment if any within the retail tranche.

- The conditions for the suspension of the offering as well as the date on which the offering may be suspended at the earliest.

- A description of the manner and timing for refunding excess amounts paid by retail and employee subscribers, including the terms of any interest to be paid on such amounts.

- Whether or not multiple subscriptions are admitted, and where they are not, how any multiple subscriptions will be handled.

3. Disclosure of Allotment

a. Public Disclosure

The Allotment Manager must ensure that the final size of the offer and the result of the allotment together with the allocation between the various tranches - such as institutional, retail or where applicable, domestic and international or employee - and the use of the Overallotment Facility and the claw back is made public in an adequate manner as disclosed in the prospectus after the allotment. If preferential treatment, as disclosed in the prospectus has been granted the percentage of the offer used for such preferential treatment should also be disclosed.

Where public disclosure about the demand situation is made after the allotment, such disclosure may not be misleading including by omission. Any such disclosure must allow an adequate analysis of the information provided. If the level of oversubscription is indicated, this should include only demand at or above the offer price.

[2] Such as advantages in the allotment process or discounts.

b. Investor Information

Investors must be informed (in writing or by other means providing an adequate record) of their individual allotment. This information requirement also applies in the event that no allotment is obtained. In any event investors should be able to access information about the amount allotted them before dealing may begin.

c. Record keeping and Disclosure to the Regulator

The Allotment Manager and the other Investment Services Firms involved in the allotment must keep adequate records of the allotment process. Such information should be provided to the regulator on request.

This includes, in particular, information on the recipients of allotments from the Free Retention, on the beneficiaries of preferential treatment (cf. footnote 2) and on the allotments to employees of Investment Services Firms participating in the offering.

4. Consortium Allotment

Employees, managers, directors or board members of Investment Services Firms participating in an offering may subscribe for shares thus offered. Such persons may not participate in the institutional tranche. They may not be included in any group receiving preferential treatment. Their allotments must not take preference over customer allotments. Investment Services Firms participating in an offering may not subscribe for such shares.

Any firm participating in an offering must have adequate internal rules on allotments to the persons mentioned in the preceding paragraph as well as adequate compliance procedures to enforce such rules.