ACCEPTED MARKET PRACTICE ON LIQUIDITY CONTRACTS FOR BONDS

Acceptance by AMF - on 10 May 2012

Description of the national AMP:

The proposed accepted market practice is a Liquidity contract for bonds. Any issuer – whose bonds are admitted to trading on a regulated market or on a multilateral trading facility (MTF) approved by the AMF – may conclude a commercial agreement (Liquidity contract) with an investment firm pursuant to which the issuer allocates an amount of money and/or a number of bonds to the investment firm for it to purchase and sell bonds on behalf of the issuer. The objectives of the Liquidity contract are to foster the liquidity of trades and to enable regular quotations.

The secondary bond market (which involves purchases and sales by investors, as opposed to the primary market, where participants issue new bonds), involves other investment firms and large institutions in a decentralized, over-the-counter (OTC) market. However, a large number of bonds, primarily corporate, are listed on exchanges. The number of transactions on regulated markets or MTFs is expected to increase in the coming years, in particular due to new MTFs for bonds recently created by the market operator Euronext (MTF NYSE Bondmatch) and by the investment firm Galaxy (and by any other MTFs which could be approved by the AMF in the future). The rules for Euronext and Galaxy have been approved by the AMF (the French Regulator). Those MTFs have been built to meet the "Expression of Needs" drawn up by representatives of the European bond market community and released by the Cassiopeia Committee. The objective of those MTFs is to provide liquidity and transparency to the secondary bond market through an order book with firm orders, pre- and post-trade reporting and clearing and settlement solutions.

The Liquidity contract must abide by the principles set forth in the Code of conduct enclosed in appendix 1 [Code of conduct /Charte de déontologie de Paris Europlace].

Liquidity contracts for shares have existed in France for many years and the AMF approved such liquidity contracts as accepted market practices on March 22th 2005. However, no Liquidity contract for bonds has been introduced in France before. The aim is, thus, to accept a new market practice pursuant to article 2(2) of Directive 2004/72/EC : *"Member States shall ensure that practices, in particular new or emerging market practices are not assumed to be unacceptable by the competent authority simply because they have not been previously accepted by it.*"

Trades performed under this practice by the investment firm must not lead the issuer to hold at any time more than 15% of its bonds. Moreover, block trades are authorized under this practice.

Before the implementation of the Liquidity contract, the issuer must publish a press release with details about the identity of the investment firm which will act as the liquidity provider, the amount of cash or bonds available and authorised under the contract, the bonds and the market concerned by the practice. Every six months or when the contract is terminated, the issuer must publish a report on the implementation of the contract and the resources (cash and/or bonds) that remain available to it. Any significant change in the terms of the Liquidity contract must be disclosed (the disclosure must take place before the change is implemented). Press releases must be posted on the issuer's web sites.

For information:

An investment firm that provides Liquidity contracts should not be confused with Euronext Liquidity providers (LPs).

LPs are members of Euronext that have entered into a specific agreement with Euronext whereby they, for their own account (as opposed to on behalf of issuers), undertake to quote two-way bid and offer prices, with a minimum volume size and within a maximum price range or spread.

Rationale for why the practice would constitute market manipulation

First of all, this practice cannot benefit from the exemptions provided by Article 8 of Directive 2003/6/EC, as it does not meet the conditions set forth by Regulation (EC) n°2273/2003.

Providing liquidity without any regulatory framework could be construed as the giving of misleading signals, in particular with reference to the level of supply and demand, while the dampening effect of transactions executed under the contract, on the price movements of the bonds in question could be considered to be an attempt to maintain an artificial price level.

Also a Liquidity contract on bonds allows an investment firm to purchase and sell bonds on behalf of the issuer, while the issuer may be in possession of privileged information at the time of the transaction. The AMP provides for conditions aimed at preventing any insider dealing by the issuer.

Therefore, if this market practice is not exempted from the prohibition, the implementation of such liquidity agreements might be deemed to constitute market manipulation. In order to ensure that transactions executed in the context of a Liquidity contract are not considered as market manipulation, the Liquidity contract contains provisions with which an issuer and an investment firm must comply at all times. [please refer to article 1(2) (a) of Directive 2003/6/EC]-

Factors to be taken into account when considering market practice

Commission Directive 2004/72/EC Article 2

Non-exhaustive list of factors to be taken into account by competent authorities when assessing particular practices whether they occur on a regulated market or an OTC market:

• **The level of transparency of the relevant market practice to the whole market (Art. 2(1) (a))** Transparency of market practices by market participants is crucial for considering whether a particular market practice can be accepted by competent authorities. The less transparent a practice is, the more likely it is not to be accepted. However, practices on non regulated markets might, for structural reasons, be less transparent than similar practices on regulated markets. Such practices should not be in themselves considered as unacceptable by competent authorities. (preamble 2)

<u>AMF conclusion:</u>

An issuer entering into a Liquidity contract with an investment firm must publish before the implementation of the contract a press release with details such as the identity of the investment firm involved and the amount of cash or bonds available under the contract. The issuer must also publish every six months or upon the termination of the contract, a report on its implementation and the resources (cash and/or bonds) that remain available to it.

The press releases mentioned above must be posted on the issuer's web sites.

Besides and in addition to these disclosure requirements, the new AMP also imposes the investment firm to report the details of completed exchange trades to the issuer every month to allow it to forward them to the AMF.

• the need to safeguard the operation of market forces and the proper interplay of the forces of supply and demand (Art. 2(1) (b))

Market practices inhibiting the interaction of supply and demand by limiting the opportunities for other market participants to respond to transactions can create higher risks for market integrity and are, therefore, less likely to be accepted by competent authorities. (preamble 1)

AMF conclusion:

At the present time, most bond trades are conducted OTC (where the AMP has no influence) for which there is no pre-trade, nor post-trade reporting of transactions and there are usually no executable orders in the order book. Therefore, this practice does not inhibit the interaction of supply and demand. On the contrary, trades carried out by an investment firm under this practice are designed to improve the liquidity of the bonds market when the related bonds are traded on a regulated market or an MTF (although listed on exchanges, they are not actively traded on such exchanges; most transactions take place outside exchanges). Liquidity contracts help and may even be a key factor in the interaction of supply and demand since they aim to ensure regular quotations for an illiquid bond and to avoid price fluctuations that do not correspond to a market trend.

• the degree to which the relevant market practice has an impact on market liquidity and efficiency (Art. 2(1) (c))

Market practices which enhance liquidity and efficiency are more likely to be accepted than those reducing them. (Preamble 1)

AMF conclusion:

The objective of this practice is to improve market liquidity and efficiency in particular, in the context where bonds trading platforms are developing.

• the degree to which the relevant practice takes into account the trading mechanism of the relevant market and enables market participants to react properly and in a timely manner to the new market situation created by that practice (Art. 2(1) (d))

AMF conclusion:

The practice is designed to have a positive effect on market efficiency as it will facilitate the evaluation of fair and actual prices on a market for which most of the trades are conducted OTC. The aim is to impact favourably the liquidity of bonds which are traded on a regulated market or an MTF. Besides, when trading bonds under a Liquidity contract, investment firms must abide by Euronext rules (on Nyse Bondmatch MTF) or by Galaxy rules (on Galaxy MTF), or any other MTFs which could be approved by the AMF in the future.

Furthermore, there are differences between this activity and the activity of designated sponsors and market makers on exchanges; whereas stock exchange sponsors and market makers buy and sell bonds for their own account and at their own risk, an investment firm having entered into a Liquidity contract acts on behalf of the issuer and consequently the losses or profits related to the performance of the Liquidity contract will be the issuer's.

Last, referring to the issue of stabilisation, it must be noted that liquidity contracts and stabilisation are mutually exclusive. Stabilisation is an activity which EC Regulation 2273/2003 confines to the primary market of a bond; a liquidity contract may only be performed on the secondary market once stabilisation of the bond in question has ceased. If stabilisation is resumed, for what ever reason, then the performance of the liquidity contract must be suspended.

• the risk inherent in the relevant practice for the integrity of, directly or indirectly, related markets, whether regulated or not, in the relevant financial instrument within the whole Community (Art. 2(1) (e))

Particular market practices in a given market should not put at risk market integrity of other, directly or indirectly, related markets throughout the Community, whether those markets be regulated or not. Therefore, the higher the risk for market integrity on such a related market is within the Community, the less those practices are likely to be accepted by competent authorities. (Preamble 3).

<u>AMF conclusion:</u>

Any issuer entering into a Liquidity contract must notify the AMF beforehand. The AMF may require a copy of the contract at any time.

Liquidity contracts must respect a set of principles (i.e. the Code of conduct) established by Paris Europlace, a non-for-profit organisation which represents companies, financial institutions, law and accounting firms and undertakes to promote and develop the Paris financial market. Pursuant to this code, the investment firm makes its trading decisions in relation to the issuer's bonds independently of, and without influence by, the issuer with regard to the timing of the purchases. In this regard, the investment firm must have the appropriate means and organization in order to ensure the independence of the person in charge of the Liquidity contract.

Finally, it should be noted that resources granted to the investment firm by the issuer are generally not sufficient to hinder a market trend.

All transactions are reported to the regulator on a regular basis by the issuer. The AMF may therefore undertake any action, within its competence, that it deems necessary.

For bonds traded on a regulated market or on an MTF market, prices will be more transparent to the public when conducted through these systems, allowing market participants to react more efficiently.

• the outcome of any investigation of the relevant market practice by any competent authority or other authority mentioned in Article 12(1) of Directive 2003/6/EC, in particular whether the relevant market practice breached rules or regulations designed to prevent market abuse, or codes of conduct, be it on the market in question or on directly or indirectly related markets within the Community (Art. 2(1) (f))

<u>AMF conclusion:</u>

An AMP concerning government bond has been established by the competent authority in Austria, the FMA.

Other AMPs concerning liquidity contracts for shares have been established by the competent authority in Spain, the CNMV, the competent authority in Portugal, the CMVM, and the competent authority in the Netherlands, the AFM.

In France, a similar AMP concerning Liquidity contract for shares has also been established by the AMF, which did not observe any adverse results that might question this practice. Regarding the present AMP for bonds in France, there are no results of any investigation that might question this practice since Liquidity contracts for bonds have not been implemented before.

• the structural characteristics of the relevant market including whether it is regulated or not, the types of financial instrument traded and the type of market participants, including the extent of retail investors participation in the relevant market (Art. 2(1) (g))

AMF conclusion:

This practice relates to bonds traded on a regulated market or an MTF where retail investors involvement is not significant for the moment and where the key players are institutional investors. In other words, it is a professional market with minimal retail involvement. Nevertheless, the involvement of retail investors may grow in the years ahead. In any case, it won't represent a risk since this practice enables retail investors to buy and sell bonds under reasonable conditions of liquidity.

Overriding Principles

Overriding principles to be observed by Competent Authorities to ensure that accepted market practices do not undermine market integrity, while fostering innovation and the continued dynamic development of financial markets:

• new or emerging accepted market practices should not be assumed to be unacceptable by the Competent Authority simply because they have not been previously accepted by it;

• Practising fairness and efficiency by market participants is required in order not to create prejudice to normal market activity and market integrity.

• Competent Authorities should analyse the impact of the relevant market practice against the main market parameters such as weighted average price of a single session, daily closing price, specific market conditions, before carrying out the relevant market practice.

Conditional elements

Liquidity contracts on bonds are not the first accepted market practice on French regulated markets. However, it is the first accepted market practice relating to bonds.

The Liquidity contract is a framework agreement established by Paris Europlace in consultation with the AMF. Paris Europlace is a non-for-profit organisation which brings together a great variety of players in the financial industry that are active in the marketplace.

Liquidity contracts must comply with a set of principles (Code of conduct) established by Paris Europlace in consultation with the AMF. Pursuant to this Code, the sole purpose of a Liquidity contract is to favour the liquidity of the securities and regularity of their price. Under no circumstances may transactions effected under a Liquidity contract interfere with the orderly market operation or mislead other parties. The investment firm must make its trading decisions in relation to the issuer's bonds independently of, and without influence by, the issuer with regard to the timing of the purchases. The investment firm must have the appropriate means and organisation in order to ensure the independence of the person(s) in charge of the Liquidity contract. Finally, resources granted to the investment firm by the issuer are generally not sufficient to hinder a market trend.

Lastly, an issuer entering into a Liquidity contract must notify and send to the AMF reports on all transactions on a regular basis. The AMF may therefore undertake any market investigations that it deems necessary.

Paris Europlace, *Commission obligataire*

CODE OF CONDUCT FOR LIQUIDITY CONTRACTS RELATING TO DEBT INSTRUMENTS

Version of 26 April 2012

Preamble

Directive 2003/6/CE of the European Parliament and Council of 28 January 2003 on insider dealing and market manipulation (market abuse) provides that competent authorities may accept market practices that consequently benefit from a presumption of legitimacy with regards to the provisions of such Directive. Directive 2003/6/CE has been completed by Directive 2004/72/CE of the Commission of 29 April 2004, which sets the conditions for acceptance of such market practices. These provisions have been implemented in France by Articles 612-1 to 612-4 of the General Regulations of the *Autorité des marchés financiers*.

In the context of the works relating to the creation in France of a secondary market for bonds and assimilated debt instruments under French or foreign law (hereafter the "Securities") and of the possibility now provided by law for an issuer to favour the secondary market of its own Securities (Articles L.213-1A and D.213-1A of the French Monetary and Financial Code), it appeared necessary to propose to all players that liquidity contracts pursuant to which providers of financial services could intervene for the account of issuers in order to favour the liquidity of their Securities could benefit from a secured legal framework, through the acceptance by the Autorité des marches financiers (AMF) as market practice of liquidity contracts relating to debt instruments.

In this view, market players, gathered within Paris Europlace, have, in close collaboration with the AMF, elaborated this code of conduct; this code sets forth the principles with which liquidity contracts must comply in order to benefit from the above-mentioned market practice..

These principles are as follows:

1 Specialisation

The sole purpose of the liquidity contract is to favour the liquidity of the Securities and regularity of their price. Under no circumstances may transactions effected under a liquidity contract interfere with the orderly market operation or mislead other parties.

2 Independence of liquidity provider

The liquidity contract is implemented by an investment services provider (the "liquidity provider").

Only the liquidity provider decides when to trade in the market, having regard to both the purpose of the liquidity contract and its continuity. The issuer may not instruct the liquidity provider in any way that could influence the liquidity provider's actions.

The liquidity provider must have an appropriate internal organisation structure in place to ensure that the employee responsible for trading in the market will act independently.

The liquidity contract establishes the terms and conditions for the liquidity provider’s compensation, which may not compromise the principle of independence nor encourage the liquidity provider to generate artificial prices or volumes through its actions. This principle forbids in any case:

- that the compensation be fully or partly set
  - in accordance with the proportion of transactions made by the liquidity provider at the closing of the trading day or in accordance with the number of transactions made on the market; or
  - in accordance with the evolution of the trading price, unless this reference is used to assess, within a market session, the liquidity provider’s efforts to reduce the volatility of the security.
- that the variable part of the compensation exceeds fifteen per cent (15%) of the total amount of the compensation agreed with the issuer, it being noted that a significant part of this variable shall be based on non-discretionary criteria set with regards to predetermined objectives.

3 Implementation on a regulated market or on an organised multilateral trading facility within the meaning of article 524-1 of the General Regulation of the French *Autorité des Marchés Financiers* (“the AMF”)

The liquidity contract may be implemented only on regulated markets and/or on organised multilateral trading facilities within the meaning of article 524-1 of the AMF General Regulation on which the issuer’s securities are listed, in accordance with the markets' trading rules. The liquidity provider must operate during the business hours of these markets.

4 Continuity of action

The liquidity contract must be implemented with a view to ensuring continuity of action. The liquidity provider may therefore decide not to trade if it considers that trading might compromise continuity.

5 Identification

Transactions effected under the liquidity contract are recorded on special and separate accounts ("liquidity accounts"). There must be as many accounts opened as bond issues covered by the liquidity contract.

6 Restricted use of securities

Subject to the provisions of the Principle of proportionality, the securities allocated by the issuer for the implementation of the liquidity contract or acquired through transactions effected for that purpose cannot be debited from the liquidity account provided for in the liquidity contract unless they are used in transactions that comply with the objectives of the liquidity contract.

7 Proportionality

The funds and securities held on each liquidity account must be commensurate with the objectives of the liquidity contract. Under no circumstances may a liquidity account be used to "park" securities. No debit balance is allowed on the liquidity account either on its cash part or on its securities part.

As an exception to the Principle of specialisation, the liquidity contract establishes the conditions under which, to ensure compliance with the proportionality principle, a liquidity provider may, separately or cumulatively:

- buy or sell securities to ensure, in view of likely future requirements, the balance between the cash and securities available to it for each liquidity account;
- transfer cash or securities outside the liquidity account.

8 Procedures for exchanging information

The issuer shall not disclose confidential information about its situation or prospects to the liquidity provider.

The liquidity provider shall provide the issuer with the information required to meet its reporting obligations.

9 Information of the market

Any issuer entering into a liquidity contract shall inform the market through a press release, prior to implementation of a liquidity contract, of the signature of such liquidity contract, indicating the identity of the liquidity provider, the potential shareholding relations with the issuer, the security(ies) concerned, the market(s) on which the provider will intervene and the resources assigned to the liquidity contract.

The market is informed each time a new bond issue is included under the liquidity contract.

The market is also informed on a bi-annual basis of the transactions carried out under the liquidity contract pursuant to terms set forth by the AMF.

10 Communication

To comply with the present code of conduct, a liquidity contract must be reported to the AMF, along with details of the identity of the liquidity provider and of the issuer concerned.