Acceptance by the Autorité des Marchés Financiers on 22 March 2005 of a market practice related to share buy back programs : Liquidity contracts on Euronext (France)

Description of the National AMP:

A company (the issuer) - which shares are admitted to trading on a regulated market - can conclude a commercial agreement (Liquidity contract) with an Investment Services Provider (ISP) by means of which the issuer has allowed an amount of money and/or a number of shares to the ISP in order to purchase and sell shares on behalf of the issuer. The objectives of the Liquidity contract are to foster the liquidity of trades, to enable regular quotations and to avoid price fluctuations not warranted by market trends.

The Liquidity contract must abide by the principles set forth in the Code of conduct enclosed in appendix 1. For each category of shares the issuer can conclude only one Liquidity contract.

Reference to this practice was found in COB's April 2001 Instruction pursuant to COB Regulation n°90 – 04 which has been repealed since the publication of the new AMF General Regulation. The provisions of COB Regulation n°90-04 as regard Liquidity contracts will be replaced by the present AMP.

Trades carried out under a Liquidity contract do not comply with the trading conditions and restrictions of articles 5 and 6 and are not publicly disclosed pursuant to article 4(4) of Regulation (EC) n°2273/2003.

Block trades are authorized under this practice. Trades performed under this practice by the ISP must not lead the issuer to hold at any time more than 10% of its shareholder equity.

The issuer must publish before the implementation of the Liquidity contract a press release with details about the identity of the ISP, the amount of cash or shares granted to the contract, the shares 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 shares) available. Any significant changes in the characteristics of the Liquidity contract mentioned above must be disclosed.

The press releases must be posted on the AMF and the issuer's web sites.

For information: Liquidity contracts should not be confused with Euronext Liquidity providers (LP). LP are members of Euronext who have entered into a specific agreement with Euronext whereby they 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 manipulation

This practice cannot benefit from the exemption of the prohibitions of Directive 2003/6/EC as provided for by Article 8 since its objective doesn't meet the conditions set forth by Regulation (EC) n°2273/2003.

[refer to article 1(2) (a) of Directive 2003/6/EC]

<u>List of Factors</u>

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>Conclusion regulator:</u>

An issuer entering into a Liquidity contract with an ISP must publish before the implementation of the contract a press release with details such as the identity of the ISP and the amount of cash or shares granted to the contract. The issuer must also publish, every six months or when the contract is terminated, a report on the implementation of the contract and the resources (cash and/or shares) available.

The press releases mentioned above must be posted on the AMF and the issuer's web sites. These obligations guarantee the transparency of the practice.

- 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)

<u>Conclusion regulator:</u>

This practice does not inhibit the interaction of supply and demand. Trades carried out by an ISP under this practice are reactions to orders, which, considering the volumes and size of the market, create an imbalance between supply and demand. 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 otherwise illiquid share 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)

<u>Conclusion regulator:</u>

The objective of this practice is to improve market liquidity and efficiency.

- 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)).

<u>Conclusion regulator:</u>

When trading shares under a Liquidity contract, ISP must abide by all Euronext rules. All trades are carried out on regulated markets and within opening hours.

- 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>Conclusion regulator:</u>

An issuer entering into a Liquidity contract must notify the AMF. The AMF can require a copy of the contract.

Liquidity contracts must respect a set of principles (Code of conduct) elaborated by the professional association of investment firms (Association Française des Entreprises d'Investissement). Pursuant to this code, the ISP makes its trading decisions in relation to the issuer's shares independently of, and without influence by, the issuer with regard to the timing of the purchases.

The ISP must have the appropriate means and organization in order to ensure the independence of the person in charge of the Liquidity contract. ISP who are members of Euronext must abide by Euronext rules. Finally, resources granted to the ISP by the issuer are not sufficient enough to hinder a market trend.

All transactions are reported to the regulator on a regular basis. The AMF can therefore undertake any market investigations that it would deem necessary.

- 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))

Conclusion regulator: There haven't been any adverse results of any investigation that might question this practice.

- 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))

Conclusion regulator: This practice concerns only equities traded on cash regulated markets where retail investors involvement may be significant. Nevertheless the involvement of retail investors does not represent a risk since this practice enables retail investors to buy and sell shares within reasonable conditions of liquidity. This practice is therefore favourable to retail investors.

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 are a long established practice on French regulated markets. As of March 2004, around 160 contracts had been notified to the AMF. This practice mostly involves small and medium companies – to which Liquidity contracts represent a key factor in the development of secondary market liquidity and in the access to the markets by retail orders.

Association Française
des Entreprises d'Investissement

AFEI / 05-20-EN
14 March 2005

AFEI CODE OF CONDUCT FOR LIQUIDITY CONTRACTS

Preamble

Directive 2003/6/EC of the European Parliament and Council of 28 January 2003 on insider dealing and market manipulation (market abuse), which came into force on 12 October 2004, introduced various changes to French legislation. Some of these changes concern the conditions under which issuers are entitled to buy back their shares.

Pursuant to Directive 2004/72/EC of the European Commission of 29 April 2004, which implements the Market Abuse Directive and specifies, *inter alia*, how national authorities can recognise accepted market practices, the French securities regulator, the Autorité des Marchés Financiers (AMF), has decided to accept the use of liquidity contracts.

The AMF has established a principle whereby any issuer whose shares are admitted to trading on a regulated market can create liquidity in those shares, provided it does so through a liquidity contract that complies with a code of conduct approved by the AMF pursuant to Articles 612-1 *et seq*. of its General Regulations.

The French Association of Investment Firms (AFEI) had a code of conduct that had been approved by the AMF's predecessor, the Commission des Opérations de Bourse (COB). This allowed it to benefit from certain provisions of COB Regulation 90-04 (*COB Instruction of 10 April 2001 implementing Regulation 90-04 on price setting*). AFEI is submitting a new code of conduct so that its liquidity contracts can be recognised for use in connection with an accepted market practice recognised by the AMF.

Drafted in close consultation with the staff of the AMF and based on the previous code of conduct, the new AFEI code sets forth the principles with which liquidity contracts must now comply.

These principles are as follows:

1. – Specialisation

The sole purpose of the liquidity contract is to foster regular and liquid trading in the securities of an issuer and to avoid price swings that are unwarranted by market trends. Under no circumstances may transactions effected under a liquidity contract interfere with the orderly market operation or mislead other parties.

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2. – Independence of liquidity providers

The liquidity contract is implemented by an investment services provider, know as the "liquidity provider". The provider alone 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 provider's actions.

Liquidity providers must have an appropriate internal organisational structure to ensure that the employee responsible for trading in the market can 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 provider to generate artificial prices or volumes through its actions.

3. – Implementation on a regulated market

The liquidity contract may be implemented only on regulated markets on which the issuer’s shares are quoted, 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 feels that continuity might be compromised.

5. – Identification

Transactions effected under the liquidity contract are recorded on a special and separate account ("liquidity account").

Where parties other than the issuer give securities or cash to the liquidity provider so that it can carry out its duties, a mechanism must be established so each party's share of the liquidity account can be identified at any time.

6. – Restricted use of securities

Subject to the provisions of Principle 7, 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 unless they are used in transactions that comply with the objectives of the liquidity contract.

7. – Proportionality

The funds and securities held on the liquidity account must be commensurate with the objectives of the liquidity contract. Under no circumstances may the liquidity account be used to "park" securities.

As an exception to Principle 1, the liquidity contract establishes the conditions under which, to ensure compliance with the proportionality principle, a liquidity provider may, separately or in combination:

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

8. – Cash withdrawals

If the liquidity account is closed, for whatever reason, any securities in the credit balance that belong to the issuer must be sold.

There are two exceptions to this rule:

- when the securities are transferred to another liquidity provider charged with implementing a liquidity contract compliant with an AMF-approved code of conduct;
- when the issuer wishes to recover a number of securities equivalent, at most, to those it allocated to the liquidity contract.

9. – Procedures for exchanging information

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

The liquidity provider shall provide the issuer with the information it needs to meet its obligations to report major holdings and to keep a register of sales and purchases, as set forth in Article 185-2 of Decree 66-237 of 23 March 1967.

10. – Informing the market

Any issuer entering into a liquidity contract shall supply the market with the following information through a news release:

- prior to implementation: the signature of the liquidity contract, together with the identity of the liquidity provider, the security concerned, the market(s) on which the provider will operate and the resources assigned to the liquidity contract;

- every half-year and when the liquidity contract is terminated: the results of the liquidity contract, specifying the amounts of securities and cash on the credit side of the liquidity account compared with those provided initially;

- within fifteen trading days: any change to the information described in the first bullet point.

11. – Communication

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

The liquidity contract establishing the relationship between the issuer and the liquidity must be sent to the AMF upon request.