Financial Markets Law Committee

c/o Bank of England
Threadneedle Street
London
EC2R 8AH

Fax: (+44) (0)20 7601 5226

Email: fmlc@bankofengland.co.uk

Website: www.fmlc.org

25 September 2007

Mr Jorgen Holmquist
Director General, DG Internal Market & Services
European Commission
C107 5/32
B-1049 Brussels
Belgium

Dear Mr Holmquist

FMLC ISSUE 103: PROSPECTUS DIRECTIVE – "OFFER TO THE PUBLIC"

The Financial Markets Law Committee ("FMLC") established a working group in 2005 to look at issuers' offers of securities to intermediaries and the way in which these securities might ultimately reach a wider retail or wholesale market. The work undertaken by this group disclosed a number of uncertainties in the application of the Prospectus Directive (2003/71/EC) to such offers which have the potential to affect, or even undermine, the securities markets. Some of these uncertainties will, I am given to understand, be investigated and dealt with by the Committee of European Securities Regulators in October and I am writing independently to Fabrice Demarigny in this regard. However, a number of the uncertainties identified do not fall to be considered under CESR's treatment of "retail cascades". On these matters, in particular, the FMLC would be grateful for guidance from the European Commission. Paragraphs below provide details of four issues that are of particular concern. In each case I have indicated whether the issue is one which is simultaneously being brought to the attention of CESR or whether it is one which is being raised exclusively with DG Markt.

Pre-sales communications

There is some uncertainty as to whether pre-sales communications, which are intended to garner the interest of those intermediaries who the issuer or distributor regards as prospective subscribers to an offer by providing supplementary investment information or research, are caught by the definition of "offer of securities to the public" under Article 2(1)(d) of the

Prospectus Directive and thus whether they trigger the requirement for a prospectus under Article 3(2). It is important to clarify whether or not this is the case because such communications are part of an established market practice which aims to inform prospective subscribers without automatically providing the detailed information which is necessarily required when a sale or subscription is firmly within the parties' common intention.

The FMLC is firmly of the opinion that a communication on its own should not be treated as an "offer of securities to the public", entailing the publication of a prospectus. It believes that only those communications which occur in the context of sale negotiations and, ultimately, the execution of a sale, should amount to an offer. In the view of the Committee, this is the treatment of pre-sales communications, which is most consistent with the natural meaning of "offer" as the term is used within the definition of "offer of securities to the public" in the Prospectus Directive. An "offer" is the invitation or communication which is capable of being accepted by the counterparty, giving rise to a contractual agreement. A pre-sales communication, however, is not designed to give rise directly to a sale and is likely to state that any reference to the price of securities (existing or expected) cannot be relied upon. It will certainly contain a disclaimer to the effect that it is not a public offer or an offer to sell securities (or any advice or recommendation to buy) such securities.

There is already European legislation covering many types of material which fall within the concept of pre-sales communications. In particular, Article 25 of the Markets in Financial Instruments Implementing Directive (2006/73/EC) prescribes detailed requirements for research communications which are not practically consistent with the requirements of the Prospectus Directive. It is unnecessary and undesirable to have overlapping legislative regimes in respect of research communications which are intended to garner the interest of intermediaries with a view to their ultimately subscribing to the issue.

The FMLC would be grateful for confirmation that

1. **pre-sales communications which are not directly accompanied by any contractual offer for sale or subscription and which contain an appropriate disclaimer;[1] and**

2. **investment research communications**

are not within the definition of "offer of securities to the public" and will not trigger the requirement of a prospectus under Article 3(2) of the Prospectus Directive.

Listings, screen prices etc

[1] To the effect that a) the document does not constitute an offer of securities for sale, b) securities may not be sold on the basis of the document, and c) any future offer of the securities will contain detailed information as required by the Prospectus Directive.

I have been given to understand that the London Stock Exchange has received a letter from the European Commission confirming that secondary market activity via the screen-based trading of securities that are admitted to trading on a market should not be treated as a separate offer of those securities to the public and that it does not, therefore, trigger the requirement for a prospectus under Article 3(2) of the Prospectus Directive. The FMLC believes that such confirmation, where given, is extremely useful. T**he FMLC would be grateful if you could confirm that the Commission is of the view that secondary market activity in securities that are already admitted to trading does not trigger the requirement for a prospectus and in particular that the publication of the prices at which securities can be traded without more information, does not amount to an "offer of securities to the public".**

A parallel concern which has been identified by the Committee relates to the standard market practice by investment firms of listing securities which are available for purchase, without further details, for the benefit of customers. The practice is to make available the price of the securities and the terms and conditions of their purchase once the investor's interest in purchasing them has been established. The FMLC believes that statements and lists of this kind should not constitute an independent "offer of securities to the public" within Article 2(1)(d) of the Prospectus Directive because "sufficient information" which is a necessary component of an "offer" under the sub-paragraph is not provided by the provider of the list. **The FMLC would be grateful for confirmation that it has correctly interpreted the requirement of "sufficient information" and that lists of securities available for purchase, which do not comprise further substantive information, are not to be treated as a separate offer of those securities to the public and do not trigger the requirement for a prospectus under Article 3(2) of the Prospectus Directive.**

<u>On-sales by intermediaries</u>

The FMLC is aware of the ongoing debate in CESR about securities distributions known as "retail cascades". These arrangements involve the issue of securities through a distribution network whereby it is intended that these securities should ultimately be offered to the public and, in particular, to the retail investor. The topic of retail cascades is discussed below. However, treatment of the subject necessarily begs the question of unintended or unauthorised distribution to the public by intermediaries. That is, the question of how the Prospectus Directive applies in the case of issues of securities which are offered to the public, whether in the wholesale or retail markets, by intermediaries but which were never intended by the issuer to be distributed in circumstances which would trigger the requirement of a prospectus under Article 3(2) of the Prospectus Directive.

Such a case may, for example, arise where the primary or initial distribution of the securities falls within one of the safe-harbour provisions listed in paragraphs (a) to (e) of Article 3(2) but where the securities are subsequently offered to the public owing to unauthorised distribution

by the original subscribers. If these on-sales by intermediaries are not within the express authorisation provided by the issuer and are, therefore, unintended and unauthorised, the FMLC believes that liability for any breach of Article 3(2) of the Prospectus Directive should be borne exclusively by the intermediary making the unauthorised offer and should not reside with the issuer.

The FMLC believes that this conclusion can be drawn from the definition of "offer of securities to the public" within Article 2(i)(d) of the Directive. Where that definition refers to the on-selling of securities by financial intermediaries, it specifies that the definition is only applicable to the "placing of securities". In the FMLC's opinion, securities cannot be said to be placed by an issuer unless the financial intermediary in question has been authorised to on-sell those securities by the issuer itself. **The FMLC expects that this question will be addressed by CESR in its treatment of "retail cascades", which will necessarily examine the question of unauthorised retail distributions, and will be writing to Fabrice Demarigny with the points outlined above. It would be grateful for support in its interpretation from the European Commission.**

Retail cascades

A closely related problem is the question of "retail cascades" and the question of how the Prospectus Directive applies in the case of an offer to the public by an intermediary which arises in the context of retail distribution but which is, in the instant case, outside the terms of the authorisation granted to that intermediary (or his predecessor) by the issuer. The FMLC believes it to be evident that unauthorised placements of this kind should not give rise to liability on the part of the issuer for failure to comply with the Prospectus Directive. Market practice in the UK has developed, the FMLC believes, in such a way that issuers will include a clear statement in their prospectuses alerting investors to the need to check with the person from whom they buy securities whether that person is authorised by the issuer to make the offer and, if not, who is responsible to the investor for the prospectus and for related purposes. In circumstances where an offeror is not authorised by the issuer to make the offer, it seems clear that only the offeror should be responsible for the prospectus and liable for any deficiencies therein.

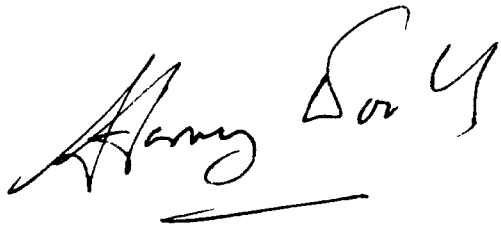
A related problem arises in the case where distributions to the retail public are authorised by the issuer but the placement will be governed by terms and conditions of which the issuer has little prior knowledge. The FMLC notes that the UK Listing Authority has concluded that an issuer may in appropriate cases rely on the derogation in Article 23(4) of the Prospectus Directive Regulation to omit information which is required by Annex V/5 (or XII/5) of the Prospectus Directive Regulation (2004/809/EC). The information must then be supplied by the retail distributors. The FMLC believes that Article 23(4) provides a valuable safe-harbour for issuers who cannot possibly know detailed information about the terms and conditions under which the securities will be offered to the retail public in advance.

The FMLC will address CESR on both these points. It would be grateful for support from the European Commission for its approach to the issue of retail cascades under the Prospectus Directive.

As a final point, I would like to add that, although the FMLC believes that it has identified the correct interpretation in each case of uncertainty outlined above and that confirmation on these points is vitally important, nevertheless the number of issues and uncertainties to which the Directive continues to give rise means that legislative amendment is appropriate.[2]

If you would like to discuss any of these matters further with members of the FMLC, Committee members would be delighted to visit you or members of your team in Brussels for that purpose.

Yours sincerely



Lord Woolf

Cc David Wright
Alberto Parenti

[2] Previous correspondence between the European Commission and the FMLC on other issues arising under the Prospectus Directive can be found at www.fmlc.org .