



THE FORUM OF EUROPEAN SECURITIES COMMISSIONS

MARKET CONDUCT STANDARDS
FOR PARTICIPANTS IN AN OFFERING

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I. INTRODUCTION

The single market in financial services

1. The adoption of the Investment Services Directive (ISD) marked a decisive step in the establishment of a single market in financial services. Investment firms authorised in one Member State may now more easily become members of regulated markets and provide investment services in the Member States of the European Economic Area (EEA). The introduction of the Euro in 11 Member States of the European Union (EU) from 1 January 1999 is likely to strengthen the development of the single market.
2. The efficient development of the single market warrants a common approach from securities regulators in the EEA to issues affecting market integrity. In the view of the members of the Forum of European Securities Commissions (FESCO)⁽¹⁾ market integrity is an absolute prerequisite in maintaining investor confidence.
3. An important feature in the development of the single market in financial services is likely to be an increase in the number and frequency of securities offerings – both primary and secondary – involving a cross-border element. A considerable body of EU and national legislation already addresses this area – specific legislation relating to prospectuses (Public Offers Directive 89/298) and listing (Admission to Listing Directive 79/279), the conduct of investment business (Investment Services Directive 93/22), insider trading (Insider Dealing Directive 89/592) and market manipulation (national legislation). To the extent that there are issues not fully or explicitly covered by the directives or member state legislation, FESCO considers it important to develop standards that will support the effective and consistent implementation of the high-level investor protection and market integrity objectives of the main directives in this area.

The standards

4. In drawing up market conduct standards for Participants in an offering (the issuer, managers of the offering, underwriters and other investment firms involved), FESCO members:
 - have taken into account the need to ensure that any regulation should be enforceable but not unreasonably onerous on Participants in an offering;
 - were aware of the need to take into account the role played by associated third party professionals (which might, for example, include auditors, consultants, appraisers, accountants and advisers) in any offering;

⁽¹⁾ The Forum of European Securities Commissions (FESCO) assembles the following 17 Statutory Securities Commissions of the European Economic Area (EEA): Bundes-Wertpapieraufsicht (Austria); Commission bancaire et financière/Commissie voor het Bank- en Financiewezen/ Kommission für das Bank- und Finanzwesen (Belgium); Finanstillsynet (Denmark); Rahoitustarkastus (Finland); Commission des opérations de bourse (France); Bundesaufsichtsamt für den Wertpapierhandel (Germany); ΕΠΙΤΡΟΠΗ ΚΕΦΑΛΑΙΑΓΟΡΑΣ / Capital Market Commission (Greece); Financial Supervisory Authority (Iceland); Central Bank of Ireland; Commissione Nazionale per le Società e la Borsa (Italy); Commission de surveillance du secteur financier (Luxembourg); Stichting Toezicht Effectenverkeer (Netherlands); Kredittilsynet (Norway); Comissão do Mercado de Valores Mobiliários (Portugal); Comisión Nacional del Mercado de Valores (Spain); Finansinspektionen (Sweden); Financial Services Authority (United Kingdom). The European Commission attends FESCO meetings as an observer. The Chairman of the IOSCO European Regional Committee is also invited as an observer. FESCO is chaired by Georg Wittich, Chairman of the Bundesaufsichtsamt für den Wertpapierhandel (Germany).

- have sought to strike an appropriate balance between the need for maintaining the integrity of markets while, at the same time, not unduly restricting their breadth and liquidity;
 - consulted the European trade associations covering banking, financial analysts, employers, fund managers and the Federation of European Stock Exchanges (FESE).
5. FESCO is concerned, in particular, that issuers and those who manage or are otherwise employed in the offering process should ensure that:
- all information published in respect of an issue is accurate, complete and fairly presented;
 - adequate arrangements are in place within firms to ensure that material information relevant to an offer is not misused;
 - they do nothing which might result in investors being misled as to the value of the securities being offered or which may create a false market in those securities.
6. Offerings normally involve not only investment firms but also third party professionals from outside the securities industry, whose involvement in an offering and whose access to material information about it varies according to their specific roles. The scope and nature of the codes of conduct of such professionals also varies (ranging from strictly binding rules to broad guidelines). To underpin market integrity, it is therefore equally important that both issuers and regulated firms involved in public offers take reasonable steps to ensure that third party professionals also are committed to high standards of conduct.

The scope

7. The purpose of this paper is to set out appropriate standards for use by FESCO members. The paper focuses on offerings in securities either listed on or admitted to (or to be listed on or admitted to) an EEA regulated market or equivalent market outside the EEA (whether of new shares – a primary offering - or of shares from existing major shareholders – a secondary offering). Certain principles set out in this paper, notably those relating to secondary market price manipulation and other market abuse as set out in part B of the standards, are not applicable to initial public offerings (IPOs).
8. The paper confines itself to conduct during the so called “Sensitive Period”. This broadly ranges from when the initial arrangements are entered into between the issuer and potential managers or underwriters of the offering until the prospectus has been published and the final prices and all other material conditions of the offering have been made public, the subscription period has been definitively closed and the relevant securities have been allotted. The Sensitive Period itself incorporates two key phases – the initial phase during which the public is unaware of the offer and the subsequent phase when the public is aware.

Definitions

For the purpose of this paper, the following definitions should be considered:

9. **Material information:** In defining material information, Members of FESCO have taken note, in particular, of appropriate definitions in the Insider Dealing Directive and the Admission to Listing Directive. Material information includes:
- inside information as defined in the Insider Dealing Directive;
 - additional information on any major developments in an issuer’s sphere of activity which is not public knowledge and which may have substantial effect on the issuer’s assets and liabilities, financial position or general course of its business;

- and, in the case of an offering, examples of additional information would include the state of the order book and forecasts of the likely level of demand and allotment policy.
10. *Offering*: An offering of securities by means of a public offer, including an offer in which existing holders or other investors may have preferential rights. This would include an offering in ordinary shares, preference shares, convertibles, warrants for shares and securities with similar characteristics.
 11. *Relevant Securities*: Refers to the securities being offered and to all securities, including derivatives, whose value is closely linked to that of the securities being offered.
 12. *Participant in an offering*: The issuer or any authorised firm providing investment services as defined in the Investment Services Directive and acting as lead manager, manager, underwriter or in any other capacity with regard to the offering. Any parent, affiliate or subsidiary of a Participant in an offering is to be included in the definition.
 13. *Research*: Covers all circulars issued to clients by Participants in an offering that provide information about the issuer and/or the offering. This information can be factual and/or contain opinions on the investment merits of the offering.

Implementation

14. The members of FESCO recognise that while these standards deal with information dissemination and certain trading issues, there are a number of issues related to offerings that are not covered in this paper but which warrant further study to establish more comprehensive common standards. The areas concerned include:
 - the grey market
 - the allotment of securities
 - stabilisation practices
15. FESCO recognises that different approaches can contribute to the attainment of the regulatory objectives set out above. Taking into account the individual characteristics of their domestic market structures and regulatory environments, each member of FESCO has agreed to use its best endeavours to implement, or encourage implementation of, the appropriate supervisory controls in this area, based on the preventative measures set out in this paper, in support of the stated objectives.

II. THE STANDARDS

A) Information Dissemination Issues

A.1) INFORMATION DISCLOSURE TO THE MARKET

- *Where Participants in an offering, including in a cross-border offering, issue material information in circumstances where there is to be a primary or secondary offering of the company's relevant securities, they must ensure that:*
 - a) *such information is accurate and complete in relation to all aspects of the offer and does not mislead investors;*
 - b) *such information is made publicly available in an effective and timely fashion;*
 - c) *all investors are treated fairly;*
 - d) *the existence and nature of any material interest which they or their affiliates may have in the offering are disclosed to investors.*
- *Where a Participant in an offering issues research relating to the securities to be offered, it should ensure that the material has been prepared to a high standard of due diligence, is fairly presented, discloses the interest of the firm in the offering, and, in the case of an offering where the relevant securities are already listed or admitted on a regulated market, indicates and explains any change in recommendation from that contained in the most recent research preceding the announcement of the offering.*
- *During the initial phase of the Sensitive Period, Participants in an offering should only disseminate material information to third party professionals and potential investors when necessary for the purposes of the offer and draw attention to the fact that material information is being provided and to their duty of secrecy/confidentiality.*

A.2) INFORMATION FLOW WITHIN ORGANISATIONS

- *Participants in an offering must have adequate written and enforceable policies and procedures in place, appropriate to the nature of their business, to segment effectively the flow of material information between clearly identified business areas in order to prevent the misuse of material information. These policies and procedures are normally collectively known as "Chinese Walls".*
- *If adequate policies and procedures are not in place or are not complied with, the material information must be deemed to be held by the whole firm.*

B) Trading Issues

- *In order to be able to undertake proprietary trading and/or solicit orders from third parties in the relevant securities during the sensitive period, a Participant in an offering must be able to demonstrate that it has in place Chinese Walls in accordance with Standard A2 above. Furthermore, the firm must be able to demonstrate that staff making investment decisions or giving investment advice has no access to material information about the offering.*

- *Participants in an offering must neither engage in proprietary trading nor solicit trading in the relevant security during the sensitive period, with a view to influencing the price of the securities subject to the offering except under and to the extent allowed by stabilisation and similar rules approved by the regulator.*
- *All Participants in an offering should be able to make available routinely or upon request to the competent authority information on their proprietary and solicited trades in the relevant securities on a regular basis.*

III. MARKET CONDUCT STANDARDS

16. The members of FESCO have identified two groups of issues of specific regulatory concern because of their threat to the integrity of the markets during the Sensitive Period. They are:

- A) Information Dissemination issues, and
- B) Trading issues relating to insider dealing and market manipulation.

A) Information Dissemination Issues

A.1) INFORMATION DISCLOSURE TO THE MARKET

- *Objective*

- 17. The efficiency of regulated markets depends on investor awareness of all information potentially relevant to the price of securities traded on those markets. Full and accurate information is fundamental to investors' ability to make a full assessment of the value of securities, and hence to the integrity of the price formation process.
- 18. During the Sensitive Period, Participants in an offering routinely disseminate material information to the public. The potential value to investors of full and accurate information may be significantly reduced, however, if that information is not disseminated in a timely and efficient fashion. Delays in disseminating material information both reduce the time available to investors to consider it fully and increase the risk that it will leak or be misused.
- 19. It is also important to maintaining confidence in the offer process that investors have equitable access to material information. It is important, therefore, that such information is not disseminated selectively (except in instances where the recipients of information are to be made "insiders").
- 20. Of special significance to investors is information relating to the issuer's recent business and financial performance, projections on its future performance, and information about the offering itself, including the underwriting and book building arrangements and forecasts of the likely level of demand and allotment policy. It is crucial that, when such information is provided, it is both accurate and complete.

- *Standard*

- *Where Participants in an offering, including in a cross-border offering, issue material information in circumstances where there is to be a primary or secondary offering of the company's shares or relevant securities, they must ensure that:*
 - a) *such information is accurate and complete in relation to all aspects of the offer and does not mislead investors;*
 - b) *such information is made publicly available in an effective and timely fashion;*
 - c) *all investors are treated fairly;*
 - d) *the existence and nature of any material interest which they or their affiliates may have in the offering are disclosed to investors;*

- *Where a Participant in an offering issues research relating to the securities to be offered, it should ensure that the material has been prepared to a high standard of due diligence, is fairly presented, discloses the interest of the firm in the offering, and, in the case of an offering where the relevant securities are already listed or admitted on a regulated market, indicates and explains any change in recommendation from that contained in the most recent research preceding the announcement of the offering.*
- *During the initial phase of the Sensitive Period, Participants in an offering should only disseminate material information to third party professionals and potential investors when necessary for the purposes of the offer and draw attention to the fact that material information is being provided and to their duty of secrecy/confidentiality.*

- *Preventative Measures*

21. To ensure that the material information they provide in connection with an offering is publicly available, accurate, complete, timely, and that all classes of investor are being treated fairly, Participants in an offering should adopt, where relevant, the following non-exhaustive list of measures in respect of material information under their control:

- i) Not furnish or omit any piece of information which they would not have furnished or omitted if they had not been Participants in the offering except as required in point (x) below (material interest).
- ii) At all times take all reasonable and appropriate steps both to ensure the accuracy of information provided and to prevent any misleading impression being created by (a) figures or statements quoted out of context, (b) omission of information, (c) failure to state the basis of assumptions, (d) use of unverified facts or figures, or (e) inappropriate comparisons.
- iii) Ensure that all material information arising after the issue of the approval visa of the prospectus that differs from the information contained in the prospectus or otherwise affects the context of the offer is subject to the visa of the competent authority through an additional prospectus and promptly disseminated.
- iv) Not alter, except when beneficial to investors' interest, the manner, form, frequency and timing of the release of information including research when compared with their practices before the Sensitive Period.
- v) Ensure that potential investors have a reasonable time following the public release of the prospectus (or, in the case of book-building, the preliminary – i.e. with no fixed price mentioned - prospectus) to make a proper assessment of the securities being offered before needing to decide whether or not to subscribe to the offer.
- vi) Refer to the existence of the prospectus and state where such prospectus is available to the public. If it is made available on the internet, specifically state the web address.
- vii) Arrange for the dissemination of new material information as soon as possible after it becomes available.
- viii) Identify clearly in the prospectus or other relevant document whether, and to what extent, an offering is subject to any price stabilisation régime or price ceiling (especially for private investors) to be fixed by reference to the market (and, if so, the maximum price).

- ix) Ensure that all material information to be disclosed in any road-shows or meetings with researchers, shareholders or investors has previously been or is simultaneously properly disseminated to the market.
 - x) Disclose the existence and nature of any material interest which they or their affiliates may have in the offering.
22. The disclosure of selective information relating to demand for an offer may be potentially misleading. Participants in an offering can choose either to disclose promptly and regularly demand for an offering or choose to remain silent. Should an offering be structured in various tranches and sub-tranches, any information released to the public about the current status of demand in those tranches should not be selective or likely to create a misleading impression of overall demand.
23. Investors should also be provided with information about the procedures to be used for allotting securities in the event of over-subscription. Following allotment, Participants in the offering should publish the results and basis on which allotments were determined.
24. The issuer should take steps promptly to respond to any false or misleading information emanating from any source which could affect the offer price. Regulators should press Participants in an offering for a statement where the absence of such a statement is creating a disorderly market.
25. In a cross-border offering, the issuer and lead manager in particular should take reasonable steps to ensure that material information released in each jurisdiction is identical in substance and released on a basis that will not afford market users in one jurisdiction advantage over those in another.
26. To avoid the dissemination of material information during the initial phase of the Sensitive Period, third party professionals and potential investors to whom material information is provided (which should occur only when, and to the extent necessary, for the purpose of the offering, e.g. market testing during the initial phase of the Sensitive Period) should be made aware that they have been given material information and of their duty of secrecy. Whether or not a recipient of material information is informed by the Participant, they remain subject to the applicable laws on insider dealing and rules of conduct.
27. Furthermore, to maintain control over the unauthorised disclosure of material information, Participants in an offering should, at least, implement the following confidentiality measures:
- Limit the number of material information recipients on a need to know basis.
 - Keep a record of all material information recipients, including the time at which the information was given.
 - Strictly protect any relevant document or information system against uncontrolled access.
28. If any Participant becomes aware of an unauthorised disclosure of material information and/or has an indication that confidentiality is not being maintained, the information should be immediately disclosed, and/or other appropriate action should be implemented, such as suspension of trading if there is a likelihood of a disorderly market.

29. Where a Participant in an Offering issues research, that research should be based on objective and professional analysis and the firm's normal standards of research should be maintained during an offering. In any research, analysts must make clear the basis on which interpretations and judgements are reached as well as any forecasts made. Any alteration in the recommendation relating to the offered securities compared with that prior to the offer announcement must be indicated and explained. Any analyst "brought over the wall" and made privy to material information during an offer should be precluded from disseminating research related to the offering.

A.2) INFORMATION FLOW WITHIN ORGANISATIONS

- *Objective*

30. The establishment of policies and procedures within organisations to segment the flow of material information - Chinese Walls - is fundamental to the prevention of information misuse. They are essential particularly, but not only, in large, integrated investment banks or other finance or credit institutions which may be among the key organisations involved in an offering. It is also of great importance that issuers take adequate precautions to segment the flow of material information. In the absence of such policies and procedures, there would be considerable potential within these organisations for sensitive information to move from, for example, the corporate finance division, which will typically have access to it in relation to an offering on which it may be advising, to the trading floor, where it could be misused.
31. Although there are many ways in which material information can reach those not entitled to receive it and be misused, internal transfers within organisations involved in an offering or other activity, such as a takeover, are a significant means. The members of FESCO believe it is important that this area is specifically addressed in developing market conduct standards for participants in an offering.
32. Chinese Walls must be designed to prevent effectively both intended and unintended transfers of material information and ensure that those making investment decisions or giving investment advice for an organisation are not doing so on the basis of material information.

- *Standard*

- *Participants in an offering must have adequate written and enforceable policies and procedures in place, appropriate to the nature of their business, to segment effectively the flow of material information between clearly identified business areas in order to prevent the misuse of material information. These policies and procedures are normally collectively known as "Chinese Walls".*
- *If adequate policies and procedures are not in place or are not complied with, the material information must be deemed to be held by the whole firm.*

- *Preventative Measures*

33. Participants in an offering should implement and enforce adequate internal policies and procedures appropriate to their business to segment flows of material information between business areas. These policies and procedures may extend to the physical separation of offices if that is an effective way to achieve this objective. In some cases, it may be appropriate for firms to establish Chinese Walls within business areas.

34. These policies and procedures should be known to and understood by directors, managers and other employees, and compliance procedures should take account of them.
35. The following measures should, inter alia, be implemented, under the responsibility of the compliance officer:
 - i) Policies and procedures which clearly identify those business areas which need to be kept isolated from each other. Of particular concern in the context of these standards are the corporate finance, research, asset management and trading departments.
 - ii) Procedures to categorise and control access to material information whether in documented or electronic form.
 - iii) The provision of instructions about information handling, safeguarding, record keeping, communication between business areas and disclosure.
 - iv) The identification to the compliance officer of those who have access to material information across a Chinese Wall or who may be brought over the wall under clearly drawn up and implemented policies and procedures. The compliance officer should be in a position to provide reports on request to the regulator.
 - v) To promote, and increase, staff awareness of the prohibition on the misuse of material information.

B) Trading Issues

- *Objective*

36. During the Sensitive Period, the risk of insider dealing and market manipulation is greatly increased. The perception that Participants in an offering exploit material information and/or trade with a view to influencing the offer price and/or change their proprietary positions is potentially damaging to the fair and efficient operation and integrity of regulated markets.
37. Participants in the offering may be potentially interested in dealing in the relevant securities with a view to:
 - (a) increasing the price of the securities traded, or
 - (b) creating the (misleading) impression of an upward-moving, and therefore desirable, security, or
 - (c) selling, whether short or from an existing holding, with a view to lowering the price (and repurchasing the securities more cheaply at a later stage), or
 - (d) dealing to establish a proprietary profit or avoid a proprietary loss.
38. FESCO recognises that the issue of stabilisation practices is closely linked to market manipulation and is committed to drafting standards at a later stage setting out where such stabilisation is acceptable.
39. During the offering process, knowledge by Participants in the offering of current demand as reflected in the order book of the offering, is considered as material information unless it is publicly disclosed. It should be noted that knowledge of this demand continues to be material information until the subscription period is definitively closed.

40. Investors rely on the market price of a security to reflect the balance of supply and demand based on full availability of material information. It is important to the integrity of the price formation process that this price is freely formed, uninfluenced by proprietary dealings of the issuer, offeror or their agents other than those that are specifically permitted by the law or regulation.

- *Standard*

- *In order to be able to undertake proprietary trading and/or solicit orders from third parties during the sensitive period, a Participant in an offering must be able to demonstrate that it has in place Chinese Walls in accordance with Standard A2 above. Furthermore, the firm must be able to demonstrate that staff making investment decisions or giving investment advice has no access to material information about the offering.*
- *Participants in an offering must neither engage in proprietary trading nor solicit trading in the relevant security during the sensitive period, with a view to influencing the price of the securities subject to the offering except under and to the extent allowed by stabilisation and similar rules approved by the regulator.*
- *All Participants in an offering should be able to make available routinely or upon request to the competent authority information on their proprietary and solicited trades in the relevant securities on a regular basis.*

- *Preventative measures*

41. Regulatory authorities should provide guidance to Participants in an offering as to the dealings permitted during the Sensitive Period and controls which those Participants should adopt to monitor their dealings. The broad objective of such guidance should be to require Participants in an offering to refrain from proprietary dealings with a view to influencing the price of the offering. The guidance should make clear that regulators would regard dealings outside such guidance as potentially likely to create a false or misleading market in those securities.
42. Participants in an Offering should monitor transactions and price movements in the relevant securities during the Sensitive Period. Regulators should be able to obtain a list of material information recipients and to establish a list of purchasers/sellers of relevant securities, and have the capacity to cross-check such lists.
43. During the Sensitive Period, Participants in an offering should report to their regulator any suspicious or abnormal movement that they may detect in the price or volume of the relevant security. Regulators themselves should in any case monitor price movements during the Sensitive Period.
44. During the Sensitive Period, Participants in an offering should implement trade review and surveillance procedures usually known as watch lists, which permit trading in the securities on the list subject to close scrutiny by the firm's compliance department, and restricted lists, which restrict or prohibit trading in the securities on the list. Members of FESCO recognise that the use of restricted lists will not always be the appropriate response to meet the standard set out above with Participants in an offering needing to exercise judgement in their use of restricted lists.

45. Members of FESCO recognise the important role played by the compliance department during the Sensitive Period. In particular, where an employee becomes aware of material information regarding a security, that person must immediately inform the compliance officer. The compliance officer must then decide on the trading restrictions, if any, that are appropriate in the circumstances. In particular, the compliance officer must decide whether to place the security on the firm's watch list or restricted list. The compliance officer must also consider the appropriateness of any trading restrictions in the context of the firm being a member of a financial group.
46. Participants in an offering should establish adequate internal controls over the trades carried out by their managers, employees and other related persons.

IV. IMPLEMENTATION BY REGULATORS

47. Taking into account the characteristics of its domestic market structure and regulatory environment, each member of FESCO agrees to implement the market conduct standards referred to above by using a mix of appropriate approaches, of which the following are core elements:

A) A limited legislative approach

48. While recognising the relevance of the Insider Dealing Directive in addressing regulatory concerns, relying solely on the Insider Dealing Directive carries the difficulty for the Regulator of proving that trading was actually done in possession of inside information. In the same way, relying solely on national laws and regulation prohibiting market manipulation requires the Regulator to define the point at which normal trading activity becomes trading activity intended to manipulate prices. At the same time, Participants in an offering are faced with a « perception risk » that their trading activities may be considered a posteriori as based on inside information or carried out with a manipulative purpose.
49. Thus for both Regulators and Participants there is a need to rely on additional approaches aimed at preventing and sanctioning misconduct during the Sensitive Period of an offering.

B) Codes of Conduct

50. Regulators should require that Participants in an offering should implement and enforce adequate Codes of Conduct, or internal rules and procedures as described in the section on Chinese Walls, aimed at preventing and detecting flows of material information between separated business areas. These Codes, and the significance of them, should be made clear to managers and other employees. They should be properly enforced within the relevant organisation.
51. To these ends, the measures set out within section A.2 (Information flow within organisations) and paragraph 26 (informing recipients of material information) and 27 (confidentiality measures) of this report should be implemented.
52. Failure to enforce the codes of conduct should be sanctionable by the regulator.

C) The reporting approach

53. In order to facilitate the surveillance of transactions by Participants in an offering, Participants should be in a position to report to the Regulator all transactions made during the Sensitive Period for own account or solicited and executed for the account of third parties (including all related entities and funds under discretionary management). The reporting should be made upon request. It is generally considered that the prospect of having specifically to report those trades may also act as a deterrent for participants and may contribute to the prevention of potential misdemeanours.
54. Participants in an offering should be in a position to make available to the Regulator upon request the record of material information recipients including potential investors contacted during the initial phase of the Sensitive Period for « market testing » purposes.