

FREQUENTLY ASKED QUESTIONS ABOUT EUROPEAN SECURITIES LEGISLATION

Who is affected by European securities legislation?

European securities legislation applies not only to European issuers of securities, but also affects:

- issuers from outside Europe that raise capital in Europe through institutional and/or retail offerings;
- issuers with Euro MTN Programs (see “Frequently Asked Questions - European Medium Term Note Programs”) or Euro commercial paper programs; and
- issuers of securities listed on a European exchange, such as the London Stock Exchange, the Irish Stock Exchange and the Luxembourg Stock Exchange.

What is the framework for European securities legislation?

The EU’s Financial Services Action Plan was drafted with the intention of creating a single European wholesale capital market which issuers could access effectively and which would harmonize prudential rules and supervision in European financial services. Forty-two separate legislative measures were planned,

of which almost all have now been implemented in the European Economic Area (“EEA”).

What are the core pieces of European securities legislation?

Under the Financial Services Action Plan, the most important European legislative provisions in respect of the securities market are the Prospectus Directive, the Market Abuse Directive, the Transparency Directive and the Markets in Financial Instruments Directive.

What does the Prospectus Directive do?

The Prospectus Directive creates a single EU-wide regime governing the content, format, approval and publication requirements for disclosure and offering documents in respect of securities offerings in the EEA, including the ability to “passport” a prospectus approval from one EEA member state to another. (For details of the provisions of the Prospectus Directive, see “Frequently Asked Questions - European Medium Term Note Programs.”)

What does the Market Abuse Directive do?

The Market Abuse Directive (“MAD”) establishes rules prohibiting insider dealing and market manipulation. MAD applies in respect to all financial instruments (as

defined below) which are under the auspices of a “competent authority” of an EU member state (such as the UK’s Financial Services Authority, in the case of securities listed on the London Stock Exchange).

MAD is a minimum harmonization directive, meaning that it provides minimum standards of conduct in respect to financial instruments. Each EEA member state is free to implement provisions into its national law which are additional to, or more stringent than, the provisions of MAD. For example, the UK has used this feature to retain additional market abuse provisions that already existed under UK law before MAD.

What are “financial instruments” in this context?

“Financial instruments” include securities which are negotiable on the capital markets, units in collective investment undertakings, money-market instruments, financial futures contracts (including equivalent cash-settled instruments), forward interest-rate agreements, interest-rate, currency and equity swaps, options to acquire or dispose of any of the foregoing (including equivalent cash-settled instruments), commodity derivatives and any other instrument admitted to trading on a regulated market in the EEA. This is a broader category than “securities” which are subject to the insider trading prohibition under Rule 10b-5 of the US Securities and Exchange Act of 1934. Since MAD is a minimum harmonization directive, individual states are free to adopt an even broader definition of financial instruments.

The term “regulated market” is defined by statute and each EEA member state is required to publish a list of the regulated markets operating in its jurisdiction. The UK regulated markets currently include the London Stock Exchange – Regulated Market, LIFFE, EDX,

London Metal Exchange, ICE Futures Europe, SWX Europe Limited and the PLUS-listed market operated by PLUS Markets plc.

What is the European definition of “insider dealing”?

The insider dealing regime under MAD prohibits:

- dealing or attempting to deal in financial instruments on the basis of inside information;
- disclosing inside information other than in the proper course of such person’s duties (regardless of whether it leads to a trade); and
- recommending or inducing another person to do any of the above.

In this context, for the behaviour to be prohibited, it is not necessary for the relevant person to know that the information is inside information, and the relevant behaviour need not itself be on a regulated market or a non-regulated market.

What is the definition of “inside information”?

“Inside information” is defined as follows:

“information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and, which, if made public, would be likely to have a significant effect on the price of those financial instruments or on the price of related derivative financial instruments.”

It should be noted that the MAD determination of what constitutes “inside information” differs from the determination of “inside information” under US securities laws. The MAD analysis focuses only on the price sensitivity; whereas under the US analysis, the potential effect on price is only one of a variety of

factors that may be considered when determining whether non-public information constitutes “material” non-public information. In practice, US and European lawyers often analyze these issues in a relatively fact-specific manner, as the impact of the public dissemination of information upon the market price of a security cannot be known for certain prior to disclosure.

As noted above, individual EEA member states are free to adopt more far-reaching definitions of “inside information” and “financial instruments,” so the exact scope of obligations of an insider or a related person would be decided by the laws of the relevant EEA member states.

What is “market manipulation”?

The MAD prohibitions on market manipulation include the following behaviour:

- effecting transactions or orders to trade which give or are likely to give a false or misleading impression of the supply of, demand for, or price of financial instruments;
- effecting transactions which secure the price of financial instruments at an abnormal or artificial level (in each case, unless the relevant person demonstrates that there were legitimate reasons for such behaviour and the behaviour conformed to accepted practice on the relevant market);
- effecting transactions or orders to trade using fictitious devices or other forms of deception;
- dissemination of information giving a false or misleading impression (including rumours) as to financial instruments where the disseminator knew or should have known that the information was false or misleading;

- requiring or encouraging another to do any of the above.

Are there any specific exemptions from MAD?

MAD expressly provides that the prohibitions contained on insider dealing and market manipulation do not apply (a) to dealing in one’s own shares under a buy-back programme or (b) to the stabilisation of a financial instrument where such stabilisation complies with the Buy-back and Stabilisation Regulation.

This Regulation specifies particular periods in which stabilisation action can take place, limitations on the price at which securities can be offered as part of the stabilisation action, a maximum proportion (15%) that a greenshoe option may constitute of the original offer, and a maximum proportion (5%) that any other over-allotment (not including a greenshoe option) may constitute of the original offer.

Failure of stabilisation action to comply with the conditions set forth in this Regulation will not automatically mean that the action will constitute market abuse. However, full compliance with the Regulation does provide a “safe harbour” defence to any market abuse allegations.

What other obligations are imposed by MAD?

MAD emphasizes the need for prompt public disclosure and, prior to disclosure, control of inside information. In particular, it requires the public disclosure by issuers of inside information as soon as possible. (By comparison, a public company in the US is generally only subject to an affirmative obligation to disclose material developments when required under stock exchange rules, when a Form 10-K, 10-Q or 8-K must be filed, or when conducting an offering.) An issuer may

delay public disclosure so as not to prejudice its legitimate interests, but only if the delay does not mislead the public and the issuer is able to ensure the confidentiality of that information. In this context, where market rumours have begun to circulate, a failure to disclose information may mislead investors. Member states may require issuers to inform the relevant competent authority without delay of any decision to delay public disclosure of inside information.

Wherever an issuer, or a person acting on the issuer's behalf, discloses any inside information to any third party in the normal exercise of such person's employment, profession or duties, he must also make a complete and effective public disclosure of that information. This public disclosure must be made simultaneously, in the case of an intentional disclosure, or promptly, in the case of a non-intentional disclosure (as is the case with respect to the timing of disclosures under US Regulation FD).

However, public disclosure is not required if it would breach a duty of confidentiality (whether based in law or in contract).

In addition, MAD requires that the issuer maintain a list of "insiders", *i.e.*, those in possession of inside information. The insiders list must include:

- the identity of any person having access to inside information;
- the reason why any such person is on the list; and
- the date at which the list of insiders was first created and last updated.

Issuers must promptly update the list of insiders and provide it to the competent authority upon request. The

insider list must be updated on a regular basis and kept for five years after being prepared.

Are there any specific categories of information that are required by MAD to be disclosed?

MAD specifically requires that any senior executives or persons discharging managerial responsibility must notify the relevant competent authority of dealings in the company's shares, or other securities or derivatives related to the shares, through a Regulatory Information Service ("RIS") approved by the FSA.

Those responsible for reporting include directors and others who have regular access to inside information and the power to make decisions affecting the business or prospects of the company. They may or may not be the same persons as those included on the insider list.

What does the Transparency Directive do?

The Transparency Directive ("TD") applies to companies whose securities are listed on an EEA regulated market and their shareholders. It establishes obligations:

- on issuers to publish periodic financial reports prepared in accordance with International Financial Reporting Standards;
- on issuers regarding the manner of dissemination of regulated information;
- on shareholders to notify to issuers information regarding major holdings of listed shares.

The TD is a minimum harmonization directive, like MAD, allowing individual member states (as "home member states") to adopt additional, and more onerous, provisions in these respects than the TD itself.

Each issuer of securities listed on an EEA regulated market will have a “home member state” for TD purposes. Member states other than the home member state (“host member states”) may not impose disclosure requirements on an issuer which are more stringent than those of the issuer’s home member state.

In respect of low denomination (below €1000 or equivalent) debt securities (which do not include convertible or exchangeable securities) and shares, the relevant issuer’s home member state will be the member state where securities of the issuer were first offered to the public or where they were first admitted to trading on a regulated exchange, at the choice of the issuer, or where the issuer is incorporated in an EEA member state, that member state. For debt securities which have a minimum denomination of at least €1000 (or its equivalent), the home member state is selected by the issuer from among those EU member states in which the issuer has securities listed on a regulated market. Such choices, once made, remain valid for a three-year period.

On 27th May 2010, the EU Commission published a consultation document, for public comments by 23rd August 2010, on modernising the TD in relation to information about issuers whose securities are admitted to trading on a regulated market. The consultation covers, inter alia, a review of the current regimes for small listed companies, financial reporting and notification of major holdings of voting rights as well as a possible introduction of an EU regime for the disclosure of holdings of cash-settled derivatives. Draft legislation from the EU Commission is currently scheduled for October 2011.

What are the obligations regarding financial reporting?

The TD requires that, unless an issuer falls within one of the relevant exemptions, it must publish:

- an annual financial report no later than four months after each financial year end;
- a semi-annual financial report no later than two months after the first six months of its financial year; and
- for issuers of listed shares, an interim management statement between ten weeks after the beginning, and six weeks before the end, of each half-year period (covering the period from the beginning of the half-year until the date of the interim management statements).

The annual and semi-annual financial reports must be prepared in accordance with International Financial Reporting Standards and filed with the competent authority of the home member state.

What are the available exemptions from these requirements?

The reporting requirements above do not apply to:

- a non-EEA issuer whose home jurisdiction laws are considered “equivalent” to the TD in this regard. Certain countries have been declared to have equivalent laws in this respect, including the United States, Canada and Japan; and
- an issuer of (exclusively) high denomination (at least €50,000) debt securities.

The TD has recently been amended, among other things, to increase the above €50,000 threshold to €100,000. Member states are required to implement this,

and other changes, into their national laws by 1 July 2012.

What are the content requirements for the required periodic financial reports?

- Annual financial reports must contain:
 - audited financial statements for the financial year;
 - a management report, containing a fair review of the development and performance of the issuer's business and describing the principal risks and uncertainties faced by it;
 - a responsibility statement, which is a statement of assurance by the relevant personnel of the issuer that the financial statements give a true and fair view of the issuer's assets, liabilities, financial position and profits.
- Semi-annual financial reports must contain:
 - a condensed set of financial statements;
 - an interim management report;
 - a responsibility statement.
- Management reports must contain:
 - an indication of important events occurring in the annual or semi-annual period they cover;
 - their impact on the financial statements;
 - a description of the principal risks and uncertainties for the next financial period;
 - (for issuers of shares) details of major "related party" transactions.

What are the TD's requirements as to notification of major shareholdings?

Where a person's interest in shares, measured by control of voting rights (by virtue of acquisition or disposal of shares listed on an EEA regulated exchange and other financial instruments (including derivatives) in respect of those shares), exceeds or falls below one of the specified thresholds, that person has an obligation to notify the issuer of the changes.

Under the TD, these thresholds are 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%. EEA member states can impose more stringent thresholds, and, in respect of UK issuers, the UK has imposed thresholds of 3%, 4%, 5% and each 1% thereafter.

The obligation to notify the issuer of changes to major shareholdings extends to any additional securities which entitle the holder to acquire the company's shares with voting rights, such as options, warrants and convertible securities.

The issuer thereafter has an obligation to publish such information promptly through an RIS.

Who is affected by these provisions?

Subject to the exemptions noted below, the share notification provisions are binding on any person, irrespective of whether they are located inside or outside the EEA, if they have an interest in a major holding of shares listed on an EEA regulated market.

What kinds of financial instruments on shares are covered?

Instruments such as physically-settled convertible or exchangeable bonds are covered by these provisions, as are physically settled option, forwards and other derivative instruments on such shares. Currently, as is

the case in the U.S., cash-settled derivatives on such shares are not covered – at least not unless they provide control over voting rights or any entitlement to acquire the underlying shares. However, the FSA in the UK has extended these provisions of the TD in the UK so that they also cover “pure” cash-settled derivative instruments referencing shares listed on an EEA regulated exchange, such as contracts for difference as they are known in the UK (in addition to those which are settled physically in shares).

Are there any exemptions from these notification provisions?

Member states may exempt non-EEA issuers and their shareholders from these requirements if they are already subject to similar obligations under their own laws.

The United States is one of the countries which the UK’s FSA considers to fall within this category. Accordingly, a shareholder of a US company which is publicly traded in the US and has selected the UK as its home member state would not have to make these notifications, as such shareholder would already be subject to the US requirement to file Schedule 13Ds and/or Schedule 13Gs. However, the situation is not clear in many other member states, which is one additional reason that makes it important for a non-EEA incorporated issuer to choose its home member state very carefully for purposes of the TD.

What are the TD provisions regarding dissemination of information?

Where the financial reporting requirements or major shareholding disclosure obligations apply, the TD prescribes rules relating to the methods, conditions and timing of the issuer’s disseminating such information to

the public and the competent authority of the home member state.

The most important principles outlined in the TD in this regard are timeliness of disclosure and equality of information – in respect of changes in major shareholdings, the issuer must disseminate the information within a few trading days of becoming (or being deemed to be) aware of the change.

Once again, member states may exempt issuers from countries whose laws are deemed equivalent – again rendering the choice of TD home member state an important one for non-EEA issuers.

What does MiFID do?

MiFID sets out high-level provisions governing the organizational and conduct of business requirements that should apply to financial institutions and harmonizing certain conditions governing the operation of regulated financial markets. It replaced the previous Investment Services Directive in the EEA.

The Investment Services Directive enabled firms to “passport” (*i.e.*, carry on) financial services business throughout the EEA, based on a single permission from the firm’s home state. The two main purposes of MiFID are to extend the range of services which can be included in this single “passporting” arrangement, and also to prohibit host member states from imposing additional local rules on that firm where it provides cross border services from the home member state into the host member state. However, host member states may still impose additional local rules where a firm establishes a branch in such host jurisdiction.

MiFID is a maximum harmonization directive, meaning that (with a few limited exceptions) a member-

state may not impose additional or more onerous rules than MiFID prescribes.

The following pages contain FAQs and answers in relation to MiFID in its current form. However, the EU Commission is currently considering proposing legislation which would make far-reaching changes to MiFID. Draft legislation is currently expected in October 2011.

Which firms are affected by MiFID?

MiFID affects all investment banks or financial institutions with a presence in Europe.

What are the main provisions introduced by MiFID?

MiFID has introduced new provisions concerning:

- client classification;
- suitability of advice/services/products;
- appropriateness of advice/services/products;
- best execution;
- transaction reporting;
- conflicts of interest; and
- pre-trade transparency.

What are the provisions introduced by MiFID?

MiFID requires that financial institutions must categorise their clients as follows:

- eligible counterparties;
- professional counterparties; and
- retail investors.

There is some overlap between eligible counterparties and professional counterparties. This is because the eligible counterparty regime is only relevant to certain

services including receiving and transmitting orders and executing orders on behalf of clients. Firms can therefore be treated as an eligible counterparty for some purposes and professional counterparties for others. It is possible for clients to opt up or down categories, subject to certain safeguards. In particular, a client that would otherwise be treated as a retail client may only be reclassified as a professional client if the firm undertakes a qualitative and quantitative assessment of the client's expertise, knowledge and experience.

What are the provisions regarding suitability?

A suitability obligation is owed wherever a firm provides investment advice or portfolio management services to a client.

The firm must obtain sufficient information in relation to the client's:

- knowledge and experience;
- financial situation; and
- investment objectives.

This suitability obligation is now owed to professional clients and eligible counterparties, except that firms can assume that:

- professional clients have the necessary knowledge and experience relevant to the type of investment or service; and
- professional clients (other than "opted up" retail clients) can financially bear the risk of loss of the investments.

What are the provisions regarding appropriateness?

Whenever a firm provides services (other than investment advice or portfolio management services) to a professional or retail client (but not an eligible

counterparty), it owes an obligation to determine the appropriateness of the services for the client. In this regard, the firm must ask the client to provide information about his or her knowledge and experience in the relevant investment field, in order to determine whether the client has the necessary experience and knowledge to understand the risks involved in relation to the product or service.

The appropriateness test is not applied to certain “non-complex” instruments (*e.g.*, shares admitted to trading on a regulated market or units in UCITS), provided certain conditions are met. In addition, the firm is entitled to assume that a professional client has the necessary knowledge and experience for those products or services for which the client has been classified as a professional client.

What are the provisions regarding best execution?

MiFID requires firms to take all reasonable steps to obtain, when executing orders, the best possible result for their clients, taking into account price, costs, speed and likelihood of execution and settlement, size, nature or other relevant considerations.

This duty is modified in relation to discretionary portfolio managers and to receivers and transmitters of orders, as they do not execute orders. It is not possible to contract out of the duty of best execution, but the duty does not apply when dealing with eligible counterparties.

What are the provisions regarding transaction reporting?

Transactions in any financial instrument admitted to trading on an EEA regulated market must be reported to the relevant competent authority, *i.e.*, the home

member state competent authority for the firm (or the branch of the firm) carrying out the transaction.

The requirements apply even if the transactions are not carried out on a regulated market.

In addition to equity and debt transactions, the reporting obligation includes transactions in commodity, interest rate and currency derivative transactions admitted to trading on EEA regulated markets.

The reporting can be made:

- directly by the firm;
- by a third party on the firm’s behalf;
- by a trade-matching or reporting system approved by the competent authority; or
- via a regulated market or multilateral trading facility (“MTF”) through whose systems the transaction was completed.

What are the provisions regarding conflicts of interest?

MiFID provides that firms must “maintain and operate effective organizational and administrative arrangements with a view to taking all the reasonable steps designed to prevent conflicts of interest from adversely affecting the interests of clients.” More specifically, firms must adopt a conflicts of interest policy which describes the arrangements that they have established to manage conflicts and, where necessary, disclose the policy to their clients. Firms are particularly encouraged to pay attention to proprietary trading as a potential conflict.

What are the provisions regarding pre-trade transparency?

MiFID states that a firm which qualifies as a “systematic internaliser” is not permitted to buy and sell shares using the existing “invitation to treat” business model, but will, instead, be required to act as a market maker. It must, therefore, hold out firm offers to buy and sell at specified prices, rather than invite clients to negotiate a deal.

A “systematic internaliser” is a firm that, on a frequent and systematic basis, deals on its own account by executing client orders in liquid shares outside of a regulated market or MTF.

The pre-trade transparency obligations only apply to firms which deal below a standard market size (which will vary depending on the liquidity of the shares in question).

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