Financial Markets Law Committee

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THE RT.HON. THE LORD WOOLF

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Fabrice Demarigny
Secretary General
CESR
11-13 Avenue de Friedland
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France

Dear Mr Demarigny

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 when it considers questions relating to "retail cascades" and I am writing to you in this regard. The paragraphs below provide details of two issues that are of particular concern. In each case the issue is one which is simultaneously being brought to the attention of the European Commission, DG Markt.

On-sales by intermediaries

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 would be grateful for confirmation from CESR that its interpretation on this point is correct.**

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.

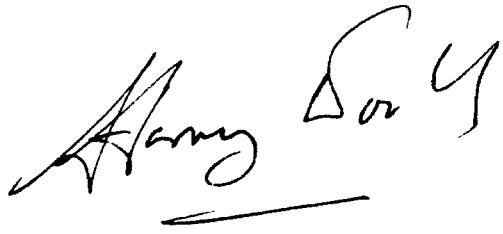
A related problem arises in the case where distributions to the retail public are authorised by the issuer but the placement will be governed by terms and conditions of which the issuer has little prior knowledge. The FMLC notes that the UK Listing Authority has concluded that an issuer may in appropriate 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 would be grateful for confirmation from CESR that its approach to the issue of retail cascades under the Prospectus Directive is the correct one.

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 committee in Paris for that purpose.

Yours sincerely



Lord Woolf

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