BANKING, FINANCE AND INSURANCE COMMISSION

Communication CBFA_2010_29 of 20/12/2010

Public offers of corporate bonds

Scope:

The "good practices" set out below apply to public offers of corporate bonds in Belgium.

Summary/Objectives:

On the occasion of certain recent public offers of corporate bonds, the CBFA was informed of problems realting to the offer process, which include, principally, the receipt of orders before the official opening of the public offer; the impossibility for individual investors to subscribe at the premises of the members of the distributing syndicate, although the prospectus stated that the offer was open to the public without any restriction; non-compliance with the legal deadline for making the prospectus available; and the use of the notice, as referred to in Commission Regulation (EC) No 809/2004 implementing Directive 2003/71/EC (hereafter “Regulation 809/2004”) for promotional purposes. The CBFA decided therefore to issue a set of “good practices” in order to resolve the problems that have been identified.

Dear Madam,
Dear Sir,

1. *Introduction*

On the occasion of certain recent public offers of corporate bonds, the CBA was informed of problems relating to the offer process, which include, principally, the receipt of orders before the official opening of the public offer; the impossibility for individual investors to subscribe at the premises of the members of the distributing syndicate, although the prospectus stated that the offer was open to the public without any restriction; non-compliance with the legal deadline for making the prospectus available; and the use of the notice referred to in Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC (hereafter “Regulation 809/2004”) for promotional purposes.

The CBFA therefore decided to issue a number of "good practices" in order to resolve the problems that have been identified. Compliance with these “good practices” will be subject to regular evaluation.

These “good practices” followed upon a consultation conducted with the principal financial intermediaries active in this sector in Belgium.

The CBFA also refers to the provisions of the Law of 16 June 2006 on public offers of investment instruments and on the admission of investment instruments to trading on regulated markets (hereafter "the Law of 16 June 2006") and to the Royal Decree of 17 May 2007 on primary market practices (hereafter "the Royal Decree of 17 May 2007 "), which apply to public offers of bonds.

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Finally, it should be remembered that banks and investment firms are required to manage any conflicts of interest that may arise within their ranks with respect to public offers[1] as well as, when providing investment services to clients, to comply with all the rules of conduct laid down in Belgian law. This means, among other things, that they must, pursuant to Article 27, § 1, of the Law of 2 August 2002 on the supervision of the financial sector and on financial services (hereafter "the Law of 2 August 2002"), act honestly and fairly and with the necessary competence in the best interests of the aforesaid clients. This is a general duty of diligence that is to guide banks and investment firms in their contacts with their clients.

2. ***"Pre-subscriptions" received before the official opening of the public offer and before the prospectus has been made available, resulting in an early closing of the offer after a very short time.***

In the course of certain public offers of bonds, individual investors have complained that they were unable to acquire bonds when arriving at the branch of a bank belonging to the distributing syndicate first thing on the day the offer opened. Moreover, certain offers were closed early, a few hours after the official opening.

According to the explanations provided by the financial intermediaries consulted, it seems that the banks allowed clients to make known their intention to subscribe to the offer by email, sms or telephone a few days before the opening of the offer, that is, right after the publication of the announcement of the offer in the press or following the receipt of advertisements relating to the offer. Such "pre-subscriptions" cannot, however, be introduced into the system before the opening of the offer and are therefore encoded by the staff of the branch as soon as the offer is opened. This may explain why clients who arrive at the branches or offices of members of the distributing syndicate on the morning of the opening of the offer are unable to acquire any of the securities.

The CBFA considers that this system of "pre-subscriptions" must in fact be considered equivalent to receiving subscriptions outside the offer period, and often when the prospectus is not yet available; such a practice constitutes an irregular offer.

This rush to subscribe to such investments, relatively rare and often appreciated by investors, seems to result in part from the method for allotting bonds, which provides that subscriptions are filled in the order in which they arrive (the "first come, first served" allotment method).

The CBFA notes that marketing campaigns carried out ahead of the offer further accentuate the problem of pre-subscriptions. These are authorised by the Prospectus Directive and the Law of 16 June 2006 on condition that the information provided is compatible with the information that must appear in the prospectus if the latter is published subsequently (Article 58 of the Law of 16 June 2006), and that the prospectus is made available to the public in reasonable time.

For this reason, the CBFA recommends that intermediaries adopt allotment rules that will help them avoid problems relating to the "first come, first served" method as presently applied, and that will place all potential investors on an equal footing.

The CBFA considers that an allotment method based on a system of proportional reduction of orders in the event of oversubscription will make it possible to meet these concerns.

The banks have identified that a potential problem of an allotment system involving a proportional reduction of orders is the risk that clients may inflate their orders so as to be sure to obtain the amount of securities desired. The risk of this happening should not be overestimated: in share offers, where this problem arose at the beginning of this decade, self-regulation took place. Moreover, it is up to intermediaries to draw the attention of their clients to the risk of receiving a position that is disproportionate to the size of their portfolio. Finally, one might suggest asking clients to pay at the time of subscription, in order to avoid inflated orders, as was the case for certain share offers.

Certain intermediaries deem that the size of the denominations, which is generally EUR 1000, runs the risk of preventing total flexibility in the proportional reduction. Nevertheless, the denomination size would not seem to be an obstacle to a proportional reduction, given, on the one hand, that the orders are generally for quite a high amount in this sort of offer and, on the other hand, that one could provide for a

1 Articles 20*bis*, § 2, of the Law of 22 March 1993 on the legal status and supervision of credit institutions and 62*bis*, § 2, of the Law of 6 April 1995 on the legal status and supervision of investment firms.

minimum allotment of EUR 1000 or a multiple of EUR 1000. In addition, providing for a minimum allotment would also have the advantage of limiting any risk of positions being too small in the event of proportional reduction.

Others deplore the fact that intermediaries who are not members of the distributing syndicate are not bound by the allotment rules of the prospectus.

The CBFA recognizes that an allotment method based on a system of proportional reduction is not completely devoid of disadvantages, but these disadvantages seem less serious as regards the protection of investors than those presented by the "first come, first served" system. A proportional allotment makes it possible:

- to give investors more time to become informed and to take a fully informed decision;
- to treat all clients of one and the same bank fairly, in line with Article 27, § 1 of the Law of 2 August 2002;
- to avoid irregular offers made without a prospectus.

Regardless of the choice of allotment method, the public should be informed of the manner in which the allotment will be made, in order to ensure a degree of predictability. Thus it is important to ensure that the prospectus is very clear as to the allotment method and the way in which it will be applied in practice, without necessarily having to make known all the details that by nature cannot be determined without seeing the results of the offer.

The results of the offer and the distribution methods used should also be published, in order to guarantee the transparency of the allotment process.

The CBFA is aware that moving from a "first come, first served" allotment method to one that involves a proportional reduction of the orders may require adjustments in terms of organisation among the intermediaries concerned. It expects, however, that these intermediaries take all the necessary measures as soon as possible, and at any event within a reasonable time.

Recommendation:

The CBFA recommends that intermediaries adopt allotment rules that will enable them to avoid the problems relating to the "first come, first served" method as presently applied. More specifically, a method should be adopted that does not lead to situations where irregular offers without prospectus are made and that allows for a fair treatment of clients both in terms of access to information and of access to the offer.

The CBFA considers that an allotment method based on a system of proportional reduction of orders in the event of oversubscription will make it possible to meet these concerns. This type of allotment method can, where appropriate, be adjusted in order to improve its efficacy (for example by providing for a minimum allotment in order to take into account the size of the denominations offered or in order to allow for an allotment of sufficient size to each investor in order to avoid excessively small holdings). Moreover, in order to avoid all risk of an inflation of orders by clients who fear a reduction, the CBFA recommends that intermediaries draw the attention of their clients to the risk of receiving a position that is disproportionate to the size of their portfolio or their financial means. Intermediaries could also envisage asking their clients to pay at the time of subscription, in order to limit this risk.

If the allotment must nonetheless be made in the order of subscriptions received, for instance in the case of an offer with an international dimension, the solution would be not to accept subscriptions or expressions of interest that are the equivalent of a subscription before the offer has been opened and the prospectus made available. The legal provisions concerning the making available of a prospectus and placing all potential investors on an equal footing should be respected.

Regardless of the choice of allotment method, the public should be informed of the manner in which the allotment will be made, in order to ensure a degree of predictability. Thus it is important to ensure that the prospectus is very clear as to the allotment method and the way in which it will be applied in practice, without necessarily having to make known all the details that by nature cannot be determined without seeing the results of the offer.

With a view to transparency, the CBFA also recommends that the results of the offer and the method of distribution chosen be made public, in order to enable investors to understand the allotment process.

Finally, the CBFA wishes to recall that while marketing campaigns made prior to the offer are certainly allowed under the Prospectus Directive and the Law of 16 June 2006 provided the authority with competence to approve the prospectus has received a request for approval (Article 64 of the Law of 16 June 2006), this is on condition that the information provided is compatible with the information that must appear in the prospectus if the latter is published subsequently (Article 58 of the Law of 16 June 2006), and that the prospectus be made available to the public in reasonable time.

3. ***Impossibility for retail clients to subscribe at the branches or offices of members of the syndicate, although the prospectus states that the offer is open to the public without restriction - Identification of the "target" public***

It has been noted in the case of certain offers that private banking retail clients of members of the distributing syndicate generally have privileged access to certain bond offers classified as "public" offers, and that it is often very difficult, if not impossible, for other retail clients to obtain bonds.

In this regard, the CBFA recalls that the prospectus and advertisements must clearly designate the public that is the target of the offer. Thus, for example, if the offer is reserved to certain categories of investors, this should be stated in the prospectus.

The majority of intermediaries consulted consider, however, that it is generally preferable not to indicate in the prospectus that an offer is reserved to private banking clients. Since it is difficult to anticipate the level of their interest in a given offer, it is not always desirable to indicate that all or part of the offer is reserved to private banking, in order to be able to place the bonds with other categories of investors as well, if necessary.

Moreover, the concept of "private banking" varies from one bank to the next, and this may present an additional obstacle to a mention in the prospectus.

However, the way in which distribution takes place at present is unacceptable, as it seems that the "first come, first served" allotment rule which prevails on public offers of bonds is not applied to private banking clients with the same degree of rigour as to other retail clients. This is problematic as regards equality of treatment. Intermediaries are required to ensure fair treatment of their clients[2.]

The CBFA considers therefore that if the offer is a public one and the prospectus makes no a distinction between different categories of investors, members of the distributing syndicate should adopt measures that do in fact allow for the public offer to be open to all investors without distinction.

The CBFA notes that at the present time, the "first come, first served" allotment method does not always make it possible to attain this objective.

By contrast, an allotment method based on a system of proportional reduction of orders in the event of oversubscription, combined with a longer subscription period, should enable retail clients who are not private banking clients to receive better information about the offer, to enter their subscription in reasonable time and to obtain bonds under the terms of the allotment.

Recommendation:

The CBFA recommends that intermediaries take care to ensure that an offer described as "public", for which the prospectus does not reserve any portion to a specific category of investors, should be open to all investors on the same conditions without discrimination and that the securities should be allotted fairly.

The CBFA notes that the "first come, first served" allotment method as it is currently applied does not make it possible to attain these objectives.

The CBFA therefore recommends that an allotment method based on a system of proportional reduction of orders in the event of oversubscription be adopted, combined with a longer subscription period. This should allow all retail clients, including those who do are not clients of private banking, sufficient time to be informed of the conditions of the offer, to enter their subscription in reasonable time and to have the

[2] Art. 27, § 1, of the Law of 2 August 2002.

opportunity to obtain the securities through the allotment system. Intermediaries are indeed required to ensure fair treatment of their clients[3].

If, however, a portion of the offer is reserved to certain categories of investors, or if some investors have priority in allotment, this should be stated in the prospectus.

4. ***Non-compliance with the legal deadline for making the prospectus available (Art. 21, § 1, paragraph 1ter of the Law of 16 June 2006).***

Article 14 of the Prospectus Directive provides that the prospectus must be made available at a reasonable time before the opening of the offer, and specifies that this period is a minimum of six working days before the end of the offer in the case of an initial public offer (IPO). Taking the lead from the Belgian legislation in force before the transposition of the Prospectus Directive, the Belgian legislators have chosen a period of three working days before the closing of the offer as a reasonable deadline for offers other than IPOs.

In fact, however, it has been noted that in the most recent bond offers the prospectus was rarely available three working days before the end of the offer. By way of example, if the price is determined on a Thursday, the notice announcing the offer, including the price, is published in the press on Saturday and the prospectus made available to the public on Monday. In some cases, where the offer is entirely subscribed after only a few hours, the intermediaries wish to close it without delay on Monday. Given an allotment method of bonds based on a "first come, first served" fulfilment of subscriptions, there is indeed no interest in keeping the offer open. It should be noted that in the case of certain operations, however, it was announced that the offer would remain open, in compliance with the requirements of Article 21, § 1, paragraph 1*ter* of the Law, but no further subscription would be accepted. This is clearly not a satisfactory solution.

Under the current legislation, the CBFA can only insist that the legally stipulated deadline for making the prospectus available be observed, a requirement that should be possible if a few adjustments are made to current practices.

Recommendation:

The CBFA reminds intermediaries that the legal deadline for making the prospectus available, namely three working days before the end of the offer, must be complied with. As a consequence, in cases where the prospectus is not available before the opening of the offer, the offer must remain open for three working days and it should be possible for subscriptions to be entered validly during three working days. This means that subscriptions entered during the entire period of the offer must be taken into account when allotting the securities.

The CBFA thus recommends that certain allotment criteria be established that permit a fair treatment of the subscriptions received during the entire offer period. One such method would be an allotment based on a system of proportional reduction of orders in the event of oversubscription.

Where the bond allotment method provides that subscriptions be filled in the order in which they are received, the CBFA recommends that in order to fulfil the said legal requirement, intermediaries should make the prospectus available to the public at least two working days before the opening of the offer. In that case, early closing on the first day of the offer would be possible where the offer was successful. In this regard, it should be remembered that Article 27, § 1, of the Law of 16 June 2006 allows for a prospectus to be published that does not contain the price of the offer, provided it indicates the maximum price or the criteria/conditions on the basis of which the price will be determined. The definitive price must in that case be submitted to the CBFA and published in accordance with the procedures set out for the publication of the prospectus.

The CBFA also draws the attention of intermediaries to the fact that an offer made without prospectus is considered irregular, and refers in this regard also to Article 12, § 3, of the Royal Decree of 3 June 2007 laying down detailed rules on the transposition of the Directive on markets in financial instruments, according to which prior to subscribing to a public offer, an existing or potential retail client must be

[3] Art. 27, § 1, of the Law of 2 August 2002.

informed by the bank or investment firm of the manner in which the prospectus will be made available to the public; this means that the prospectus must be made available to the client in question.

5. Prohibition against subscribing for own account

Financial intermediaries are reminded that Article 7 of the Royal Decree of 17 May 2007 provides that the members of the distributing syndicate may not acquire for own account, directly or indirectly, financial instruments that are the object of a public offer where the latter is fully subscribed or oversubscribed, with the exception of financial instruments held on a firm commitment basis or with a performance guarantee.

In certain cases, it seems that the trading desk receives a position in the course of the offer when there is the expectation of a high demand for the securities being offered. This position is generally resold before the bonds are admitted to trading on the secondary market ("grey market"), in some cases at a higher price than the offer price.

This practice does not seem admissible in light of Article 7 of the Royal Decree of 17 May 2007, since this constitutes an acquisition for own account, even if the position is held for only a limited time.

The CBFA thus recalls that the prohibition made in Article 7 of the Royal Decree of 17 May 2007 also applies where the intention is to resell the investment instruments in the short term, be that before or after their admission to trading on the secondary market.

Recommendation:

The CBFA asks intermediaries to comply strictly with the provisions of the Royal Decree of 17 May 2007, and in particular with Article 7 of that Decree, which provides that members of the distributing syndicate may not acquire for own account, directly or indirectly, financial instruments that are the object of a public offer where the latter is fully subscribed or oversubscribed, with the exception of financial instruments held on a firm commitment basis or with a performance guarantee.

The CBFA recalls that this prohibition also applies where the intention is to resell the investment instruments in the short term, be that before or after their admission to trading on the secondary market.

6. Notice versus advertisement

Article 14 (3) of the Prospectus Directive provides that Member States may require publication in a newspaper of a notice stating how the prospectus will be made available and where it can be obtained by the public. Article 31 of Regulation 809/2004 defines restrictively the contents of this notice, namely, the identification of the issuer, the type, class and amount of the securities to be offered, the time schedule of the offer and a statement that a prospectus has been published and where it can be obtained.

This requirement to publish a notice in a newspaper applies only where the home Member State's legislation lays it down: it is therefore important to examine whether the law of the Member State of the authority that approved the prospectus requires issuers to publish such a notice.

In practice, it has been noted that certain intermediaries publish an insert in a newspaper to announce the offer and the publication of the prospectus, claiming that this is the notice referred to in Article 14 (3) of the Directive. This "notice" also contains more information than that provided for in Article 31 of Regulation 809/2004 (it generally contains the coupon and sometimes the price of the offer), and logos and colours are used.

Where such a notice is not required under the law of the home Member State and where the notice does not comply with Article 31 of Regulation 809/2004, the CBFA considers that this is in fact an advertisement which requires its prior approval and to which the CBFA's recommendations regarding advertisements apply.

Recommendation:

The CBFA recommends that intermediaries comply strictly with the requirements of Article 31 of Regulation 809/2004.

It therefore deems that inserts in the press may be considered to be notices within the meaning of the Prospectus Directive only if they meet the following conditions:

- their publication is required under the law of the home Member State;
- they are strictly limited to the information referred to in Article 31 of Regulation 809/2004;
- they are identified as a notice in their title;
- they are plain and cannot be confused with advertisements on account of their appearance.

Sincerely yours,

The Chairman,

Jean-Paul SERVAIS