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Consob's Careful Eye on Liquidity

June 22, 2009

Consob¹ communication n. 9053316 of 8 June 2009 (the "Communication") sets out detailed disclosure requirements applicable to certain public offers and listings (in Italy) of debt securities.

In particular, the Communication is tailored to those debt issues contemplating certain undertakings to provide liquidity on the securities. It follows that, based on an initial interpretation, the Communication should not apply to: (i) debt issues where there is no such undertaking, and (ii) issues of non-equity securities other than debt (such as certificates).

The Communication has immediate application, and has an impact on the information that the issuer needs to disclose in the **prospectus**, as well as on the issuer's **ongoing reporting requirements**.

Background – The Undertaking to Provide Liquidity

The practice of entering into agreements, according to which an intermediary (so called "Price Maker") undertakes to provide liquidity in relation to debt securities and the issuer undertakes to buy the securities back from such intermediary, is now established in Italy.

Under the terms of such agreements:

- a) The Price Maker puts in bids at a price calculated at the market conditions at the time of trading;
- b) In case of a downgrading of the issuer's rating, the Price Maker still determines the above bid prices taking into account the issuer's rating at the time of issue of the securities (instead of the new, lower rating);
- c) Normally, the liquidity undertaking of the Price Maker is limited to a given percentage of the aggregate nominal value of issue; and
- d) Often, the agreement also provides for the undertaking of the issuer to buy back the securities from the Price Maker at the same conditions mentioned under a) and b) above, and up to

¹ The Italian Financial Services Authority

the maximum threshold. Beyond such amount, the Price Maker may transfer the securities to the issuer at a price which takes into account the rating at the time of trading.

Aim of The Disclosure Requirements

According to Consob, the above mentioned activity may give rise to issues concerning investors' protection and the efficiency of the market. In particular, Consob believes that, in case of downgrading of the issuer's rating, the price of the securities may be affected in a way that some investors may be penalized *vis-à-vis* other investors by the operation of such method to provide liquidity, as clarified below.

As mentioned in the Communication, in case of downgrading, if there is a Price Maker operating as outlined above, the price will likely be higher than it would be in normal circumstances and the price making activity may turn out to provide the investors with a partial "guarantee" against the price decrease when the creditworthiness of the issuer weakens. However, such "guarantee" may not benefit all investors, in the presence of the threshold described above. As a matter of fact, when the threshold is reached, the price is likely to decrease. In such a scenario, investors willing to sell may be able to do so only at less favourable conditions.

As a consequence, Consob believes that the price making activity has an impact on the profit expectations, as well as on the risk assessment carried out by investors. Therefore, such activity represents a significant factor capable of affecting the decision to invest in the securities. As such, investors should be duly informed of the existence of such mechanism and should be kept abreast of its operation when activated.

Disclosure Requirements

Based on the above and in the framework of the disclosure requirements set out by EU Regulation 809/2004, Consob requires the following specific disclosure.

Prospectus:

The following information shall be included:

- a) A description of the terms of the "price making activity";
- b) The identity, if known, of the Price Maker;
- c) A warning that the market price may be significantly influenced by the price-making activity;

- d) A warning describing the circumstances, if any, when the price-making activity may be interrupted and the circumstances when the Price Maker may be replaced; and
- e) The details of the ongoing information required on the price-making activity.

Ongoing Information:

Issuers are also requested to make public the following information without delay:

- a) The occurrence of any event (such as the downgrading of the issuer's rating) likely to result in a deviation between the bids made by the Price Maker and the prices likely to be formed in the absence thereof;
- b) The cessation of any of the events mentioned under (a) above;
- c) The purchase of securities by the Price Maker in amounts equal to 25 per cent, 50 per cent, 75 per cent and 100 per cent of the maximum amount it undertook to buy; and
- d) The identity of the Price Maker, if not included in the prospectus.

Timing and Scope

The Communication is intended to be a clarification of existing disclosure requirements (Consob expressly refers to EU Regulation 809/2004 in connection with the disclosure to be included in the prospectus) and a specification of the duty to make public price sensitive information (reference is made to article 114 of the Italian Financial Services Act); consequently, issuers should comply with it immediately.

In this respect, Consob requires that, in order for the issuer to fulfil the above mentioned requirements, specific arrangements shall be entered into between the distributor and the issuer, so that the latter will receive the necessary flow of information on the price making activity carried out by the appointed intermediary. With reference to debt securities already placed and/or admitted to listing, (in the absence of an arrangement to this effect) Consob recommends the distributors to provide the above information to the relevant issuers.

Finally, the Communication clarifies that the disclosure requirements shall apply to debt issues with the same characteristics as above, not only when the securities are listed on a regulated market, but also

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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