FSA 2002/38

MARKET CONDUCT SOURCEBOOK (SPECIALIST TOPICS AND FREQUENTLY ASKED QUESTIONS) INSTRUMENT 2002

Powers Exercised

A. The Financial Services Authority alters the Market Conduct sourcebook in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000 (Guidance).

Commencement

B. This instrument comes into force on 1 August 2002.

Amendments to MAR 1 (The Code of Market Conduct)

C. MAR 1 is amended in accordance with Annex A to this instrument.

Amendments to MAR 2 (Price stabilising rules)

D. MAR 2 is amended in accordance with Annex B to this instrument.

Citation

E. This instrument may be cited as Market Conduct Sourcebook (Specialist Topics and Frequently Asked Questions) Instrument 2002.

By order of the Board
20 June 2002

Annex A

Amendments to MAR 1 (The Code of Market Conduct)

In this Annex, underlining indicates new text, except in the case of the two new Annexes to MAR 1, when the place that they go is indicated, but the new text is not underlined.

MAR 1.1.3G(3)	the *behaviour* must be likely to be regarded by a *regular user* of the market as a failure on the part of the *person* concerned to observe the standard of *behaviour* reasonably expected of a *person* in the position of the *person* in question. (see *MAR* 1.2 and *MAR* 1 Ann 4G (Frequently asked questions))
MAR 1.2.8G	It may … and the *SARs*. (See *MAR* 1 Ann 4G (Frequently asked questions))
MAR 1.2.11G	The FSA … be relevant. (See *MAR* 1 Ann 4G (Frequently asked questions))
MAR 1.8.2G	For the … *required or encouraged*. (See *MAR* 1 Ann 4G (Frequently asked questions))
MAR 1.8.8G	Where the … *market abuse*. (See *MAR* 1 Ann 4G (Frequently asked questions))
MAR 1.11.1G	Section 118(1) of the *Act* defines *market abuse* as *behaviour* which amongst other things: "occurs in relation to qualifying investments traded on a market to which this section applies". (See *MAR* 1 Ann 4G (Frequently asked questions))

Insert the following two Annexes after MAR 1 Ann 2G:

MAR 1 Annex 3G

Specialist topics

Scope of the market abuse regime
Scope of the market abuse regime for bonds
If a *qualifying investment* ("QI"), for example a *security,* trades on a *prescribed market,* it falls within the scope of the regime (see *MAR* 1.11.1G). Any other *behaviour* "in relation to qualifying investments" traded on a *prescribed market* also falls within the scope of the *market abuse regime* (see *MAR* 1.11.1G). For example, bonds "traded on", or traded subject to the rules of, Coredeal MTS or the London Stock Exchange (see *MAR* 1.11.3G(2)) are QIs traded on a *prescribed market*. Eurobonds which have at no time traded on an *RIE* do not fall within the scope of the regime. Bonds admitted to trading on a *prescribed market* but traded subject to the rules of a non-*prescribed market* may fall within the scope of the regime if they have previously traded on the *prescribed market*. However, if there is no ongoing market for a QI on a *prescribed market*, market participants are unlikely to rely on the *prescribed market* for price discovery. Equally, if there is no continuing market for the QI on the *prescribed market*, *behaviour* is unlikely to damage confidence in the *prescribed market* for that QI (*MAR* 1.11.4G).

The scope of the regime for 'grey market' or 'when issued' trading (equities and bonds)
'Grey market' or 'when issued' trading in a *qualifying investment* on a *prescribed market* will usually be within the scope of the regime. Where a *prescribed market* has rules for 'when issued' trading in a *security* or *derivative* of that *security,* and trading in that *security* or *derivative* is subject to the rules of the *prescribed market*, it will also fall within the scope of the regime. This trading will fall within the "traded on" concept as this includes traded subject to the rules of a prescribed market (*MAR* 1.11.3G(2)). This will include 'when issued' trading on the London Stock Exchange in shares and on LIFFE in equity options. Where there is 'grey market' trading which is not subject to the rules of a *prescribed market*, the *behaviour* may be "in relation to the *qualifying investment*" when it is ultimately "traded on" the *prescribed market*. *Behaviour* which occurs "in relation to a qualifying investment" traded on a *prescribed market* falls within the scope of the regime. This would include further offerings of *shares* by an issuer that has already issued *shares* which "trade on" a *prescribed market* (that is, an existing tranche is already traded on a *prescribed market*). For bonds, *behaviour* in relation to a bond being tapped which trades on a *prescribed market* would also be *behaviour* "in relation to a qualifying investment" traded on a *prescribed market*. Any *behaviour* whose effect persists until the *security* is traded on an exchange will be *behaviour* in relation to that *security*. New issues by a previously unlisted issuer (for example, initial public offers ("IPOs")) will not be "traded on" a *prescribed market* ahead of the issue, however they will fall within the scope of the regime if information which is disclosed about them before the *security* trades on a *prescribed market*, for example, in a prospectus, is false or misleading. So, if a false or misleading impression persists if and when the instrument is actually traded and thereby falls within the scope of the regime, that *behaviour* would fall within the scope of the regime. *Market abuse* may therefore be said to occur when the *security* trades on the *prescribed market*. Note too that if the price is false at the start of trading, and the *stabilising manager* knows or ought reasonably to know this, the *price stabilising rules* safe harbour may not be available (*MAR* 2.2.2G, *MAR* 2.3.8R).

MAR 1 Annex 4G

Frequently asked questions on the Code of Market Conduct

<table>
<tr><td colspan="2">Structure of the Code</td></tr>
<tr><td>Q1</td><td>Is behaviour in relation to share options and contracts for differences within the scope of the regime?</td></tr>
<tr><td colspan="2">Behaviour in relation to share options falls within the scope of the regime if the subject matter of the share options is shares which trade on a prescribed market (see MAR 1.11.2G). Behaviour in relation to contracts for differences will also fall within the scope of the regime where that behaviour is in relation to a qualifying investment. (See MAR 1.11.6G to MAR 1.11.11G.)</td></tr>
<tr><td>Q2</td><td>How are the safe harbours (the ‘C ’provisions) in the Code applied? What status does the guidance in the Code have?</td></tr>
<tr><td colspan="2">The safe harbour provisions denoted as ‘C’ are conclusive and are descriptions of behaviour that does not amount to market abuse (section 118(8), section 119(2)(b) and section 122(1) of the Act). If a person behaves in a way that is described in the Code as behaviour that does not amount to market abuse, his behaviour will not amount to market abuse. The descriptions in the Code of behaviour which amounts to market abuse carry evidential weight and are denoted as ‘E’ (s119(2)(c) and s122(2) of the Act), that is they may be relied on in so far as they indicate whether or not that behaviour should be taken to amount to market abuse.

The guidance provisions in the Code denoted as ‘G’ are issued under section 157 of the Act. Wherever guidance is used, it is not binding on those to whom the Act (and in this case the Code) applies, nor does it have evidential effect. It need not be followed to comply with a particular requirement. (See paragraphs 28 to 31 of the Reader’s Guide to the Handbook for a fuller discussion.)</td></tr>
<tr><td>Q3</td><td>If the FSA is not the regular user, who is, and how will you establish what the regular user expects?</td></tr>
<tr><td colspan="2">The regular user is neither a real person nor a group of real people. One does not establish the expectation of the regular user by taking a survey of actual market users. The test operates as an objective standard: just because ‘everyone does it’ does not necessarily make a particular practice acceptable. In practice, we may well speak to people from a market background to gauge what they as market participants consider the regular user’s expected standards would be, in a particular context. Initially we will have to form our own view about whether particular behaviour is acceptable. We are not the regular user but we do have to give guidance on the standards the regular user is likely to expect. Ultimately, the Tribunal will decide the standards the regular user expects.</td></tr>
</table>

Q4	**Why are so many Listing rules and Takeover Panel rules 'safe harboured' in the Code when only one exchange rule receives the same treatment?**

Our overall philosophy for granting safe harbours has been to identify those rules that require or expressly permit certain *behaviours* or embody certain standards of care which, absent the safe harbour, could amount to *market abuse*. *MAR* 1.2.8G explains how the *regular user* would be likely to take into account compliance with the rules of *prescribed markets*, the *FSA* and the *Takeover Panel* in deciding whether a *person* observed the standard of *behaviour* expected in his or her position in relation to the market. *MAR* 1.5.25C is a safe harbour covering required reporting or disclosure to *prescribed markets*.

Behaviour under the Code

Q5	**What examples are there where accepted practice is unacceptable? What will the FSA do when it identifies an accepted practice that falls below expected standards?**

Please refer to *MAR* 1.2.11G.

Q6	**What is the position of an intermediary who executes an abusive transaction? When applying the market abuse regime to electronic broking and order-routing mechanisms, including voice brokers, are the standards expected of each type of intermediary equivalent?**

Our main focus will be on the client who originated the transaction. The *regular user* is likely to consider a client who submits an abusive trade to an intermediary for execution as engaging in *market abuse*. But, in addition, the client may have *required or encouraged* the intermediary to engage in *market abuse* or the intermediary may have participated in the abuse (see *MAR* 1.8.2G(1)). The intermediary's *behaviour* in executing the transaction for the client will not amount to either *requiring or encouraging* or *market abuse* (see *MAR* 1.8.8G) unless the intermediary knew or ought reasonably to have known that the originator of the transaction was engaging in *market abuse* (see *MAR* 1.1.3G(3) and *MAR* 1.8.8G).

The *market abuse regime* does not impose any new positive obligations on intermediaries. They are already expected to comply with the applicable rules (such as the *Principles* and the *RIE* rules). The *regular user's* assessment of *behaviour* by an intermediary would likely take into account compliance with applicable rules. So, the *regular user* would recognise differences in the standards of behaviour expected of different kinds of intermediaries.

Operational issues

Q7	**When will the FSA investigate market abuse on a prescribed market and when will the operator of a prescribed market do it?**

We expect that the operator of a *prescribed market* will investigate and take enforcement action where:

- the misconduct is limited to the *prescribed market*;
- they have jurisdiction over all the *persons* concerned; and
- the operator's enforcement powers are sufficient to deal with the misconduct.

The operators of *prescribed markets* clearly have a continuing essential role as front-line regulators. We are not seeking to take over their role. It is likely that we will work together with the operators on some cases. In other cases, we will conduct the investigation and any subsequent enforcement action. We have a close working relationship with the operators and will discuss matters on a case-by-case basis, to decide which body is best placed to take each case forward. As we made clear in the Enforcement manual, we will co-ordinate action with the operators to ensure cases are dealt with effectively and fairly. The *FSA* and the operators published operating arrangement guidelines on 20 November 2001 which are available at www.fsa.gov.uk/pubs/other/market_conduct/index.html#mc (see also *ENF* 14.9 (Action involving other UK regulatory authorities)).

Q8	**When will the FSA investigate market misconduct during a takeover bid?**

We recognise the importance of minimising disruption to the takeover bid process and expect parties to use all of the procedures for complaint to the *Takeover Panel* ("Panel"). We also expect that the Panel will investigate and take action, save in exceptional circumstances, during the course of a takeover bid (for full details see the Operating Guidelines document on www.fsa.gov.uk/pubs/other/market_conduct/index.html#mc). The exceptional circumstances in which we will consider action during the course of a takeover bid are:

- where the Panel asks us to use our powers to impose penalties, or our powers of injunction or restitution;
- where the suspected misconduct falls within the misuse of information prohibition under the *market abuse regime* (section 118(2)(a) of the *Act*) or Part V of the Criminal Justice Act 1993 (insider dealing);
- where the Panel is unable to investigate properly due to a lack of co-operation by the relevant *person*;
- where a *person* has deliberately or recklessly failed to comply with a Panel ruling;
- where the suspected misconduct extends to *securities* or a class of *securities* which may be outside the Panel's jurisdiction;
- where the suspected misconduct threatens or has threatened the stability of the financial system.

There is general *guidance* on the interaction between the *FSA* and other *UK* regulatory authorities, including the Panel, in the *Handbook* at *ENF* 14.9 (Action involving other UK regulatory authorities).

Q9	**Will market participants have to wait for an enforcement action to find out if a behaviour is unacceptable?**

Please refer to *MAR* 1.2.11G.

Annex B

Amendments to MAR 2 (Price stabilising rules)

Insert the following new Annex after MAR 2 Ann 2G:

MAR 2 Annex 3G

Frequently asked questions on the price stabilising rules

<table>
<tr><td colspan="2">Application</td></tr>
<tr><td>Q1</td><td>What does the sentence in MAR 2.1.4G "Other offers that may be regarded as public are offers to a section of the public, placements that are not essentially private and distributions” mean? If, for example, a public offer of shares is made in another jurisdiction and a private placement of GDRs is made in the United Kingdom, how could that placement of GDRs be "...not essentially private"?</td></tr>
<tr><td colspan="2">The policy intends to exclude block trades of securities already in issue, not to limit genuine offers for the purposes of capital raising. The guidance given in the MAR 2 sets this out. There is no universally accepted definition of “public offer”, nor is it possible or desirable to give exact guidance on how many investors would be required to make an offer “public”. It is clear from MAR 2.1.3R(5) that the public announcement element is critical; stabilisation of placements is only allowed after they are announced. If firms have concerns about a particular issue structure, they may wish to approach us for individual guidance.</td></tr>
<tr><td>Q2</td><td>The rules state that the stabilisation safe harbour is available for offers of £15 million or more. Are there circumstances when the safe harbour would be available for offers smaller than £15 million? First, if the overallotment option raised the value above £15 million, would stabilisation be permitted? Secondly, if there are two offers of relevant securities, one of which is below £15 million, can they be combined for stabilisation purposes?</td></tr>
<tr><td colspan="2">MAR 2.1.3R(4) sets the limit at £15 million, and this replicates the limit under the Financial Services Act 1986. This refers to the amount to be raised and available for offer. MAR 2.1.3R and MAR 2.4.2R(1) state that an overallotment relates to securities that are not among those offered and so are not included in the £15 million limit. So the offer itself, distinct from the overallotment option, should indicate the value and the overallotment is clearly not included in this amount.

If there is more than one offer of the same relevant or associated securities they will only be able to be combined for stabilisation purposes (that is, treated as a single offer) if one of the offers is for more than £15 million and if they are issued simultaneously or almost simultaneously. In these circumstances, all of the securities will be able to be supported by price stabilising action, provided that this is undertaken pursuant to the price stabilising rules in the case of all the securities subject to the offer (including all required disclosures). Firms should seek individual guidance on the ability to combine offers that are made almost simultaneously and the applicable stabilising period for each of the offers.</td></tr>
</table>

Record keeping: Territorial application

Q3	**The territorial application at MAR 2.1.6R(2) is for a firm's business when "carried on from an establishment in the United Kingdom". Under MAR 2.2.4R the safe harbour is available only if proper records are kept. The record-keeping requirement is a general rule, applicable only to authorised firms. Where does this leave passported firms operating out of, for example, Paris? Do they have to follow the record-keeping rules in MAR 2.7?**

MAR 2.2.4R only imposes the record-keeping requirement in *MAR* 2.3.2R on those *stabilising managers* that are obliged to keep those records. *MAR* 2.3.2R(3) makes it clear that only those *persons* to which *MAR* 2.7 applies have to meet the register requirements in *MAR* 2.7. The *rules* in *MAR* 2.7 (and the *rules* in *MAR* 2.6) are general *rules* made under section 138 of the *Act*. So, only a *firm* carrying on business from an establishment in the *United Kingdom* has to meet the requirements in the *rules* in *MAR* 2.6 and *MAR* 2.7 (see *MAR* 2.1.6R(2)). An *incoming EEA firm* must comply with these *rules* where this activity is undertaken in the *United Kingdom*, but if the activity is undertaken in its *Home State*, local record keeping rules apply. An *incoming EEA firm* that is carrying on stabilising activity, but only from an establishment abroad, does not have to meet the requirements in *MAR* 2.7 to get the safe harbour defences referred to in *MAR* 2.1.2G (see *MAR* 2.1.8G). So *MAR* 2.2.4R(2) and *MAR* 2.3.2R(3) are not only about whether the *person* concerned is *authorised*, but also whether, in the circumstances, the *person* is obliged to comply with the *rule*.

Please note that, in this FAQ, when we refer to general *rules* we are referring to those *rules* made under section 138 of the *Act*. The rules in *MAR* 2.1 to *MAR* 2.5 are *price stabilising rules* made under section 144 of the *Act* (Price stabilising rules).

Stabilising managers and agents

Q4	**The rules allow a single stabilising manager. How does this approach relate to agents?**

There must be one *person* that has the sole responsibility for ensuring compliance with the *United Kingdom price stabilising rules* ("the rules"). This *person* is referred to as the *stabilising manager*. The *stabilising manager* can delegate activities to an agent or agents, including agents in other jurisdictions. However, the *stabilising manager* must still maintain overall responsibility for managing and co-ordinating the stabilisation.

This requirement stems from:

a) the definition of *stabilising manager* as "the single *person* responsible for *stabilising action* under *MAR* 2"; and

b) *MAR* 2.6.4R, which requires each bid to be made or transaction effected by the *stabilising manager* himself or a *person* appointed on specified terms to act as an agent for the *stabilising manager*.

However, the rules do not prohibit different managers for different jurisdictions. We are aware, for example, that local stabilising rules in some overseas jurisdictions may require a local manager or that local expertise may be required in meeting those local rules. For an *offer* in an overseas jurisdiction, there is no requirement for an overseas manager to follow the rules unless he wants to obtain the benefit of the safe harbour defences referred to in *MAR* 2.1.2G. In such a case, there must be compliance with *MAR* 2.1 to

MAR 2.5, or with *MAR* 2.8. Further, if the overseas manager wants to use an agent in the *United Kingdom*, he should ensure that one *person* is identified as the *stabilising manager* for the purposes of the rules. That *stabilising manager* will take responsibility for compliance with *MAR* 2.6.4R, and so will take responsibility for the actions of any agents also undertaking stabilisation in the *United Kingdom.* If the *stabilising manager* is a *firm* (that is, an *authorised person*) the agent in the *United Kingdom* will not be able to benefit from the safe harbour if he makes a bid or effects a transaction during *stabilising action* unless he is appointed on terms complying with *MAR* 2.6.4R. (Note that in this scenario we envisage that the *stabilising manager* will be a *firm* or employed by a *firm* (see *MAR* 2.6.2R), but if he is not, we suggest that individual *guidance* is sought.)

Q5	**The rules appear to impose a greater responsibility on the stabilising manager for agents' actions than those known to the normal laws of agency. If institutions cover themselves by introducing indemnity statements into contracts, would this mean the policy would be ineffective?**

We intend to ensure that responsibilities are clear but avoid setting specific *rules* in this area. In setting this policy, we envisaged that a contractual arrangement would govern the relationship between principal and agent (explicitly stating the limits of the agent). The contractual relationship between the *stabilising manager* and his agent could specify that the authority of the agent was limited to actions complying with the *rules*. However, the contract would also include the term outlined in *MAR* 2.6.4R(2)(b). This would make the *stabilising manager* as responsible to others for the acts or omissions of the agent as if they had been done by the *stabilising manager*. If the agent were to breach the *rules* then, even if it is acting outside the authority of the *stabilising manager*, the *stabilising manager* would be responsible to others for those actions. However, applying *MAR* 2.6.4R means that if the agent does, for example, breach the price limits, the *stabilising manager* will not automatically lose the safe harbour and be guilty of an offence to which the *rules* relate. The questions of whether the safe harbour has been lost and whether there has been such an offence, raise different issues. We would need to consider, for example, the steps taken by the *stabilising manager* in seeking to ensure that the agent did comply with the *rules*. Our policy here is not defeated by contractual arrangements resulting in the agent indemnifying the *stabilising manager*.

It is also relevant that *MAR* 2.6.4R applies only to a *stabilising manager* which is a *firm* (that is, an *authorised person*) operating from an establishment in the *United Kingdom.* If the contract fails to include the required term, there could be disciplinary consequences for the *firm*, though breach of *MAR* 2.6.4R(2)(b) does not result in civil liability in its own right (see *MAR* 2.1.9R).

Q6	**MAR 2.6.5R prohibits stabilising managers from entering into principal trades in the relevant securities with their agent. Does the FSA mean to prohibit, for example, cases where the manager and the agent act together to short sell as part of ancillary stabilising action, but where the agent is more successful in the selling, and where the stabilising manager then covers the agent's short position? The rule suggests that this cannot now be done. Is this the intention?**

There are a number of issues to consider here.

Any *stabilising* or *ancillary action* taken by the *stabilising manager* or his agent must be taken with a view to supporting the market price of the *relevant securities* (*MAR* 2.2.3R and *MAR* 2.4.2R). By their nature, pre-arranged transactions between a principal and agent will not usually be taken with this view in mind. When drafting the *rule*, we wanted to prohibit the situation where, for example, an agent opened a short position to enable his principal to offload a net long position at less of a loss than would otherwise be the case.

In the specific example referred to in the question above, we would not consider the pre-agreed covering of a short position as prohibited behaviour where:

(a) it comes within the permitted range of *stabilising action* and is taken with a view to supporting the market price of the *relevant securities*; and

(b) it involves the agent effectively conducting transactions for the principal's book.

The *FSA* is aware that the application of *MAR* 2.6.5R(1) may raise issues for participants in the debt markets. The *FSA* is currently considering the issue and we anticipate amending this *rule* in the near future. In the meantime, we suggest that *firms* approach the *FSA* for individual *guidance* or a *waiver*.

It is also worth remembering that *MAR* 2.6.5R is a general *rule* (see *MAR* 2.1.8G). As such, *MAR* 2.6.5R is not relevant for the defences outlined in *MAR* 2.1.2G, so the transaction itself will not cause a *firm* to lose the safe harbour.

Q7	**The price stabilising rules prohibit entering into transactions with agents during the stabilising period (MAR 2.6.5R(1)). For a large firm, it would be difficult to suspend all dealings with agents as they operate on several different levels and have numerous relationships. This would severely limit market activity. Can this be avoided by using Chinese walls?**

We introduced this policy to avoid a person manipulating the price through dealings between the principal and its agent. This could arise, for example, if the agent were to sell at a price higher than the price at which another holder of the stock would be able to sell. The thrust of the policy behind the *rules* is to prevent activities inconsistent with one of the underlying concepts, which is support for the market price. This policy could be defeated if non-arms-length dealing between principal and agent were part of the process.

However, we do not intend that the policy should limit normal *market making* activities. To separate actions that are collusive from these normal *market making* activities, it is acceptable to the *FSA* for a *person* to use *Chinese walls* to maintain a separation of its activities as stabilising manager and its activities as *market maker*. *MAR* 2.6.5R(2) states that the prohibition in *MAR* 2.6.5R(1) does not apply where the stabilising manager could not have reasonably been expected to know the identity of the counterparty. The use of *Chinese walls*, to the extent that they will help keep the identity of one party from the other, will in our view enable the *market maker* to conduct its normal activities with its counterparties. It must be clear, however, that the *Chinese wall* is operated in line with the normal procedures in *COB* 2.4.4R. (This must also be the case for the agent if the agent is an *authorised person*. This may be more problematic if the agent is a small entity and if there is limited clarity of role in the relationship between the *stabilising manager* and *market maker*.)

The *firm* should ensure that it reviews its actions case by case to ensure that it is not engaging in *market abuse* and, where necessary, approach the *FSA* for individual *guidance*. Where the *stabilising manager* is limited to using agents that are affiliates of the *stabilising manager*, it should apply to us for individual *guidance* on a case by case basis.

Please note that this *rule* would usually only affect a limited number of transactions. The *rules* only apply for a limited set of conditions, that is, for dealings in *relevant* and *associated securities* during the *stabilising period*.

Depositary receipts	
Q8	**What is the policy reason for 'uniformity' of depositary receipts ("DRs") as set out in the definitions, especially concerning numerical uniformity?**

We introduced the principle of uniformity to prevent stabilising of DRs that are complex products or which are in the form of an index, that is, those that are non-equivalent instruments. The definition of DR in article 80 of the *Regulated Activities Order* (which is one of the group of *securities* specified in *MAR* 2.1.3R), excludes receipts conferring rights for two or more *investments* issued by different *persons.* (There is a further definition in Schedule 2 to the Criminal Justice Act 1993, for the insider dealing provisions, which defines a DR as a certificate or record issued by or on behalf of someone who holds any *relevant securities* of a particular issue.) Given these definitions, the standard operation of *MAR* 2.2.3R is that a DR can, where it is a *relevant security* (that is, it is issued as part of the *offer*), be treated as in the definition of the *Regulated Activities Order*. The *rules* do not prohibit stabilising DRs of a different size or denomination to the *securities* they represent. These are still mutually interchangeable and uniform with the underlying *security*, and fall within the scope of the *rules*.

However, where a DR is not issued as part of the offer the definition in the *Glossary* of an *associated security* (that it is "…in all material respects uniform with the *relevant security* in terms of value, size and duration") applies. So, where an *associated security* is to be stabilised, it should not differ from the *relevant security* to any material extent. In our view, a DR that is a multiple of a *relevant security* is an *associated security* because it is still the same size in all material respects, as it is based on a *security* that is the same size. However, a DR that is a multiple of a *security* that is not the same size as a *relevant security* is not an *associated security*.

Price limits	
Q9	**The pricing limits have a ceiling at the issue price, but MAR 2.4.4R allows ancillary action (under MAR 2.4.2R) which is not subject to the price limits. MAR 2.4.2R(2) allows for the closing out or liquidation of any position established under MAR 2.4.2R(1) by buying relevant or associated securities outside of the pricing rules. However, most of this ancillary action is likely in practice to take place in the grey market and most stabilising managers would be expected to obtain a greenshoe. In effect, any further action would be to close out the short, so circumventing the price limits. Is this correct? The only cases where the limits would apply would be in cases where (i) a short has not been established (that is, no overallotment) or (ii) where the short is closed out, but there is a need to stabilise further.**

A reminder of this issue was outlined in our Market Watch Newsletter No. 1 (September 2001) on our website at http://www.fsa.gov.uk/pubs/other/market_conduct/index.html#mc. Any short positions opened by a *stabilising manager* with the purpose of "circumventing" the price limits in *MAR* 2.5 would take the *stabilising manager* out of the *stabilising action* safe harbour. A short position established by short sales or an overallotment must be established "with a view to supporting the price of the *relevant securities* by action under *MAR* 2.2.3R". Action can only be taken under *MAR* 2.2.3R if certain conditions are met, including the price limits in *MAR* 2.5 (see *MAR* 2.2.2G(4)). A *stabilising manager* can only open a short position if it does so with a view to buying *relevant securities* in line with the price limits in *MAR* 2.5. In other words, at the time the short position or overallotment

position is taken, it must be taken by the *stabilising manager* with a view to taking action under *MAR* 2.2.3R (that is, purchasing *securities*) in line with the price limit *rules*.

If, at the time the short position is set up, the real intention is to circumvent the price limits, then that position is not being set up "with a view to supporting the price" of the *relevant securities*. Instead, the position is being taken with a view to avoiding the price limits.

With shorts created for price support, if it then transpires that it is not possible to cover the position in line with the price limit *rules*, the *stabilising manager* is able, without breaching the *rules*, to cover the position outside the price limits. There will also be economic pressures here given the costs of covering a short. Not applying the price limits to the covering purchases brings the covering of short positions within the safe harbour. So, the issue is: when does buying by a *stabilising manager* contrary to the price limit *rules* indicate that the *stabilising manager* did not take the position with a view to buying in line with the price limits? This would be a question of fact, to be decided in the circumstances of each case. However, an indication might be where the overallotment was so large in relation to the greenshoe facility available that it would make it probable that there might have to be closing out above the price limits.