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Review of the Prospectus Directive: Position regarding the proposals of the European Commission and the Council for a revision of the Prospectus Directive

The European Structured Investment Products Association (eusipa) is the voice of the structured investment products industry in Europe. eusipa today represents the major financial institutions active in the sector across Europe organized through its national member or affiliated organizations in Austria, the Baltic countries and Finland, France, Germany, Italy, Sweden, Switzerland and the UK.

Members of eusipa have a close interest in ensuring the Prospectus Directive achieves its core objectives of ensuring investor protection and market efficiency in the public offer and listing of securities in the EU. Members rely on the proper functioning of the Directive for the issuance of retail structured products on a pan-European basis. They make full use of the passporting opportunities afforded by the Directive, seeking prospectus approvals for issuance programmes across multiple Member States.

1. General

eusipa strongly welcomes the thorough review of the Prospectus Directive conducted by the European Commission before coming forward with its proposal. The Commission's proposal published at the end of September takes up most of the deficiencies and weaknesses of the Directive that have become apparent in its practical application since 2005, including a number of points not yet included in the Commission's Consultation Paper from January this year.

However, though we agree with the Commission's proposal to a large extent, we would like to comment on some of the proposed points (under 2. below).

In addition, the version of the Directive proposed by the **Council** (following the discussions of its working group in October and November) rejects some of the useful amendments proposed by the European Commission, and proposes some further amendments which from our perspective would not be in line with the objectives behind the review process (as set out under 3. below).

Finally, in order to fully reach the objectives behind the review process, there is, in a limited number of points, a need for further amendments not contained in the Commission's proposal (under 4. below).

2. Comments regarding the Commission's proposal

a. Proposed changes to the summary regime (Art 5 and 6)

The Commission's proposal includes changes within Art 5 and 6 of the Directive regarding content of, and liability for, the prospectus summary. In short, the new rules would require the summary to contain "key information in order to enable investors to take informed investment decisions and to compare the securities with other investment products", and would extent the liability for the summary accordingly.

These amendments would effectively require each summary to contain the necessary contents of a Key Information Document (KID), the introduction of which has been envisaged by the Commission's Communication on Packaged Retail Investor Products (PRIPs). However, some of the securities covered by the Prospectus Directive will almost certainly not be treated as PRIPs, and made subject to the requirement to prepare a KID. This is the case notably for shares, but also for "plain vanilla" bonds. In addition, the requirement for the production of KIDs is meant to be restricted to products offered to retail investors, whilst some of the securities for which a prospectus summary is made are distributed solely to professional investors. Accordingly, the scope of the rules on prospectus summaries, and that of a future KID requirement, are not identical, but differ substantially.

Even in the cases where a KID will have to be produced in future, it seems highly questionable if this could be combined with the summary, if this should have been the intention behind the proposed amendments. For example, it currently seems unclear if the KID, which is meant to provide investors with the key features and risks of a product, will contain sufficient information on the issuer of the respective security to comply with the necessary content of a summary in so far. On the other hand, if combining the two formats should not have been the intention, the proposed amendments would result in nothing more than a duplication of the new requirements proposed within the PRIPs Communication, without any recognizable benefit to investors.

Given the current stage of the PRIPs discussion, it currently seems impossible to assess how the requirement for the production of KID will impact prospectus summaries, so that any amendments to Art 5 and 6 on this basis would be premature. **Accordingly, the proposed amendments within Art 5 and 6 should not be taken over into the Prospectus Directive.**

However, in case the key information concept for the summary were **maintained**, it would be of paramount importance to draft the new rules in a way that does not result in inconsistencies with other provisions and impractical requirements and is sufficiently clear as to its meaning.

In the version adopted by the Council, there is a particular risk that the summary would be made subject to the same basic content requirement as the full prospectus, in that the proposed definition of "key information" (Art. 2(l) (e) - *"…essential … information which is to be provided to investors with a view to enable them to understand the nature and the risks of the securities …and … to take investment decisions on an informed basis …*") would provide for a standard very similar to that applying to the prospectus as a whole (Art. 5(l), first sentence – "*… the prospectus shall contain all information which … is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer …, and of the rights attaching to such securities*.")

Making the summary subject to effectively the same requirement as the full prospectus would not only turn the concept of a summary on its head, it would also inevitably result in the summaries getting even longer and more complex than under the current Prospectus Directive - a result that would be completely at odds with the concept of the KID under the PRIPs initiative, as a document with a predetermined structure and maximum length. The specific points mentioned at the end of the proposed definition of "key information" would, given their generality and vagueness, not take away this risk.

This would be particularly dangerous given the proposed new liability rules (Art. 6(l), second subparagraph) which attach liability to any summary which does not provide key information (the further restriction "…when read together with the other parts of the prospectus…" would not help in so far, as the information contained in the full prospectus is just the natural point of reference for the question if a summary or key information is complete).

Accordingly, even if the key information requirement were maintained, the relevant provisions should be worded in such way as to mirror the concept of the KID under the PRIPs initiative, and thus provide for fully and precisely predefined information items within a document of maximum size, without an abstract requirement for complete information measured against a certain standard. Also, no liability should be attached to this; Art 6(II) should remain as in the current version of the Prospectus Directive. - It should be noted that even for the Key Investor Information document introduced by the revised UCITs Directive, liability is limited to cases where this document is misleading, inaccurate or inconsistent with the relevant parts of the prospectus (Art. 79 (II)), a standard which corresponds to the current rule under Art 6(II).

b. Clarification of the relevant period (Art 16 (I))

The Commission proposes an amendment to Art 16 (I) which would clarify that it is the earlier of the two events mentioned here (closing of the offer or start of trading on a regulated market) that ends the period of mandatory supplements. In contrast to this, the version of the Council contains a clarification for the later of the two events to be decisive.

However, the Council's proposal would simply be disproportional. In practice, the later event will always be the end of the offer, as ending an offer before the security is listed would not make much sense. To require amendments for a continuing offer even after trading of the relevant security has started would however go further than needed by the underlying investor protection purposes. It would effectively extend primary market obligations into the secondary market, as investors who have acquired a security traded on a regulated market are protected by the ongoing informational obligations of the Transparency Directive. Accordingly, the Commission's proposal in this point should be upheld.

However, if it should not be upheld, it should at least be clarified for the – according to the proposal of the Council - "decoupled" right to withdraw in paragraph 2 that this right cannot be used any more once trading of the security on a regulated market has started. In this case, the wording of the proposed amendment at the end of Art 16 (II), first sentence, could be amended as follows: "…, provided that the new factor, mistake or inaccuracy referred to in paragraph 1 did arise before trading on a regulated market has begun, or otherwise before the final closing of the offer to the public and the delivery of the securities."

c. Retail cascades (Art 3 (II))

The Commission proposes to introduce a provision at the end of Art 3 (II) to clarify the treatment of so-called *retail cascades*. According to this, no additional prospectus would be required in these cases, provided a valid prospectus is available and the issuer or the person responsible for drawing up the prospectus consents to its use.

We support the intention to clarify the treatment of this case. It does not make sense to have several, possibly differing prospectuses for one set of securities being distributed in a continuous cascade of re-sales.
We believe, however, that the newly introduced consent solution, which is based on the continued use of an earlier prospectus, would create new and unnecessary uncertainties possibly neutralizing the intended benefit. Consent implies liability of some sort and raises difficult questions about who is responsible to keep a prospectus updated for how long, what are the liability consequences for the person giving the consent, who is allowed to 'use' a prospectus and who will be implicated by that use.

We therefore strongly recommend going one step further by creating an express, additional exemption in Art 3 (II) from the obligation to produce a prospectus for a public offer where a prospectus regarding the same securities has already been published.

Alternatively, if the proposed amendment should remain in its current place, the requirement for the issuer or other responsible person to consent to the use of the prospectus should, for the reasons set out above, be deleted.
At least, however, the additional amendment to this amendment proposed by the Council – according to which there would have to be an explicit statement in the prospectus regarding the consent – should not be taken over into the final version of the Directive. This kind of information would not be helpful in any way for investors; at the same time, such requirement would lead to substantial practical difficulties: Very often, at the time the prospectus is published, it would not be possible yet to specify the individual entities which would be covered by the consent. Similar difficulties would arise regarding possible restrictions of the consent as regards the timing of any subsequent offers in the cascade.

d. Home member state for non-equity securities (Art 2 (I) m) (ii))

The Commission proposes to do away with the current Euro 1.000 threshold applying for the determination of the home member state for non-equity securities. This proposal has not been taken over into the version of the Council.
From a practical point of view, the current limit is completely arbitrary. In particular, there are no investor protection reasons speaking for this, as the nature and risks of a security are not linked to its denomination. Further, format and content of a prospectus have been completely harmonized across all European Union member states with the Prospectus Directive and the Prospectus Regulation, so that there is no danger that investors receive less information because of the authority chosen. In addition, the current limit has led to practical difficulties, especially in the use of base prospectuses and for derivative securities, most of which do not have a denomination and for which the current specific exemption has led to diverging interpretations.

Accordingly, the Commission's proposal should become part of the ultimate revision.

e. Validity period (Art 9)

The Commission proposes to extend the validity of prospectuses from 12 to 24 months. In the version of the Council, the validity period is left at 12 months.
However, this amendment, which had been proposed by ESME as well, is one of the central proposals made by the Commission for the aim of reducing administrative burdens and abolishing unnecessary inefficiencies. Given the time needed for redrafting a prospectus by the issuer and receiving approval by the competent authority, preparation of an update under the current 12 month period has to start nine months after the publication of the previous prospectus. However, it is usually only the issuer information which needs to be updated, and for this a supplement according to Art 16 could be used under a 24 month validity period.
With the proposed increase of the validity time span of one year, the number of supplements to be expected would also still remain limited, so that the prospectus with its amendments would not become too complex for investors.

The Commission's proposal should therefore be taken over into the Prospectus Directive.

Alternatively, there should at least be an extension of the validity for base prospectuses (Art 9 (II). The description of the relevant securities to be issued under a programme does not have a "natural" expiry date as regards its accuracy and completeness over time. Accordingly Art 9(3) already exempts securities described under Art 5(4)(b) from the general validity period.

3. Comments regarding the Council's proposal

a. Final terms (Art 5 (IV))

The Council's version contains additional provisions on final terms (Art. 5 (IV, last subparagraph)).

On the one hand, the current flexibility of issuers would be substantially restricted by the proposed requirement for final terms to be made available to investors, and communicated to the competent authority of the home **as well as all host member states**, **prior** to the start of the offer or admission to trading (Art. 5 (IV), last subparagraph). Currently, final terms have to be provided to investors and filed only with the competent authority of the home member state "when each public offer is made as soon as practicable and if possible in advance of the beginning of the offer". The current standard of "practicability" in the timing provides for a reasonable balance between the interests of investors and authorities and those of issuers: Under normal conditions, final terms have to be made available before or at least parallel to the start of the offer; however, when the nature of the offer does not allow otherwise, the final terms can be provided after the start of the offer. This well-balanced standard should be maintained; otherwise the flexibility of the concerned markets will be reduced, with no substantial gains for the investors or authorities involved.

On the other hand, there is no reason why, in contrast to the current legal status, issuers should have to directly provide the authorities of all host member states with final terms. Such requirement would give up the standard created by the European Passport – that issuers only need to deal with the competent authority of their home Member State – in an area where it is particularly needed, namely for frequent issuers using a base prospectus. Given the thousands of final terms issued by some issuers per year and the number of host authorities involved, this requirement would also render the use of base prospectuses on a cross-border basis all but impracticable. Accordingly, the amendments proposed by the Council on this point should not be taken over into the final version of the Directive.

b. Prospectus exemption for offers with a minimum denomination or offer size (Art 3(II), first subparagraph, points (c) and (d))

The Council proposes to raise the current threshold for the prospectus exemption available for offers with a minimum denomination or offer size from 50.000 to 100.000 Euros.

Such increase would in our view not be justified. It would not lead to an effective enhancement of investor protection, as the number of private investors which can afford to invest 50.000 Euros into a single security is small. On the other hand, for the group of investors who are able to afford this kind of investment – normally wealthy individuals or families -, raising the threshold to 100.000 Euros would in most cases not put up an effective barrier. At the same time, for such kinds of private investors – including wealthy families, as mentioned – as well as for professional investors, the increased threshold would make investments more difficult in practice: In all likelihood, this would result in the standard denomination of securities offered to such investors being raised to 100.000 Euros, which would make it even more difficult than today later to dispose of a part, but not the whole of the initial investment (for which there often is a need some time after the investment – for example where a security has been acquired on behalf of a family, but the holding later on needs to be split up between family members) . Accordingly, there is a danger that the demand for securities by such investors would be reduced.

In addition, the proposed increase would force wealthy private and professional investors which are determined to invest into a certain prospectus exempt security to concentrate their investments stronger than currently, by putting more money into a single security, and would thus result in greater concentration risks.
This amendment should therefore not be taken over into the final version of the Directive.

However, if it were maintained, it would be crucially important to provide for grandfathering rules for securities firstly offered before the new Directive comes into force.

4. Necessary additional amendments

In its response to the Consultation on the review of the Prospectus Directive, eusipa had pointed to two core areas not covered by the original Commission's proposal from January this year: the Registration Document regime and the rules on prospectus supplements. eusipa notes with great satisfaction that for each of these areas, one of its proposals has been taken up by the Commission.

However, two other proposals for each of the mentioned core areas are not included in the Commission's proposal or in the version of the Council. In our view, this would mean that the Registration Document could still not realise its full potential to facilitate the offering or listing of securities on a frequent basis, and would result in the requirement for supplements, and the right of investors to withdraw in the case of a supplement, going further than needed and justifiable.

Accordingly, we think that the following further amendments should be made in the Prospectus Directive:

a. Registration document regime

i. Tripartite format for base prospectuses

The possibility for a tripartite prospectus, comprising the registration document, securities note and summary, was created to ensure frequent issuers of securities had the possibility of the highest levels of efficiency in their prospectus obligations and its implementation has served issuers and investors well.

However, according to the predominant interpretation of the current text of the Directive, only stand alone prospectuses can be prepared on the basis of a three-part prospectus. Thus, issuers engaged in multiple issuance programmes using the base prospectus, which practically are the most frequent issuers of securities, have no possibility to make use of the tripartite format.

The absence of the tripartite disclosure regime thus leads to significant inefficiencies for issuers. The possibility to incorporate a registration document by reference does not provide the same degree of efficiency, as issuers are obliged to update their references each time the registration document is amended or substituted.

We would therefore suggest the following amendment of the Prospectus Directive: *Art 5 (3): Deletion of the wording "Subject to paragraph 4" at the beginning of the paragraph.*

ii. Passporting of the registration document

A further inefficiency in connection with the Registration Document is caused by the fact that the rules on passporting (Art 17) currently do not specify that the passport also applies at the level of the registration document as a stand alone document itself. Thus, most competent authorities do not accept the exclusive passporting of a registration document.

Accordingly, issuers that want to make use of the tripartite format and which are having securities approved in more than one EU member states generally have to have a separate registration document in all these countries, which results in unnecessary duplication of work, and has the potential to cause prospectus liability claims from investors in case the different authorities involved require diverging issuer descriptions.

Art 17 (1) of the Prospectus Directive should therefore be supplemented as follows: *Without prejudice to Article 23, where an offer to the public or admission to trading on a regulated market is provided for in one or more Member States, or in a Member State other than the home Member State, the prospectus,* ***in the form of a single document or separate documents including the registration document and forming part of a prospectus in accordance with Article 5(3),*** *approved by the home Member State and any supplements thereto shall be valid for the public offer or the admission to trading in any number of host Member States, provided that the competent authority of each host Member State is notified in accordance with Article 18. Competent authorities of host Member States shall not undertake any approval or administrative procedures relating to prospectuses* ***in the form of a single document or relating to separate documents including the registration document and forming part of a prospectus in accordance with Article 5(3)****.*

b. Supplementary information regime

i. Addressing duplication with Transparency Directive

The supplementary information obligations under Art 16 of the Directive in many cases today duplicate reporting obligations under the Transparency Directive. This is the case notably for interim reports and insider information published by the respective issuer. For this kind of information, there is no need for the process prescribed by Art 16 (I), i. e filing with the competent authority and approval by this before publication, to apply, as this information is published anyhow according to the rules of the Transparency Directive, and is therefore made known to investors without a supplement according to the Prospectus Directive.

Removal of these duplicate requirements from the Prospectus Directive will significantly increase efficiency for issuers while maintaining the same level of public disclosure.

Accordingly, the following sentence should be added at the end of Art 16 (I): *The obligation to file a supplement shall not apply if the issuer has published information under Directive 2004/109/EC that comprehensively describes the new factor that is relevant for the offer; in such case the issuer shall publish the information in accordance with at least the same arrangements as were applied when the original prospectus was published including a reference to the withdrawal right under Article 16(2).*

ii. Clarification of investor's right of withdrawal

The wording of Art 16 (II) currently does not limit the investor's right to withdrawal in case of a supplement to cases where the information detrimentally affects the assessment of the issuer and the securities.

Accordingly, investors could use events positively affecting the issuer's and the securities' assessment, like results which are better than expected by the markets, to withdraw for reasons completely unrelated to the information constituting the object of the supplement. This would almost be comparable to widening prospectus liability to circumstances having a positive impact on the market value of the securities.

Accordingly, Art 16 (II) should be replaced by the following: *2. Investors who have already agreed to purchase or subscribe for the securities before the supplement is published shall have the right, exercisable within two working days after the publication of the supplement, to withdraw their acceptances* ***if the information contained in the supplement is detrimental to the assessment of the issuer and the securities which are the subject of the offer or the admission to trading on a regulated market or multilateral trading facility as defined by Council Directive 2004/39/EC. In the case of the publication of information under Article 16(1) last sentence the withdrawal right shall apply accordingly.***