Financial Conduct Authority

Financial Conduct Authority's response to European Commission Consultation on the Review of the Prospectus Directive

Introduction

The Financial Conduct Authority (FCA) welcomes the Commission's review of the Prospectus Directive (PD) and in particular the opportunity, in light of the Commission's Capital Markets Union (CMU) initiative, to reconsider this important piece of legislation in a fundamental way.

In this response we advocate a relatively significant re-structuring of the directive and we highlight how these ideas would support the objectives of CMU. We base our response on the premise that appropriate, well-designed investor protection fosters market confidence, attracting investment and issuers into a virtuous circle that benefits all participants. We also recognise that too much or poorly designed investor protection deters issuers – to the detriment of investors. These ideas work towards:

- Deep liquid capital markets fit for their purpose of matching investors with corporates and sovereigns that require capital.
- Clearer, simpler, well-designed systems which investors and issuers can understand and follow easily.
- Core European principles being observed – freedom of movement, consumer (not producer) focus, subsidiarity.

In this response we have focused on design principles and other high level matters and have avoided going into technical detail, although we have sought to answer specific questions where we can. This is consistent with our view that the legislation should be reviewed in a fundamental way. We are very happy to work with the Commission to further elaborate these proposals as the review goes forward.

Q1. Fundamental principle

We see the regulation of admission to trading and offerings of securities as matters which should be considered separately.

CMU focuses on the role of capital markets in financing the real economy. The Commission rightly sees the re-working of the PD so that it is fit for this purpose as key to the delivery of CMU. However, in practice the PD has a wider function. It also facilitates the pan-European offering of securities that are not corporate finance instruments but serve other purposes. For example it facilitates the pan-European offering of securities that are effectively structured financial products in security form.

We recommend that the PD is re-worked to focus on securities admitted to trading on stock markets. The new PD would be better integrated with the Transparency Directive (TD) and they would be designed to work together to make Europe's stock markets function better and achieve their purpose of matching enterprises that need finance with investors that want investment opportunities. The existing PD's other function, the regulation of public offerings of other (i.e. unquoted) securities, should be dealt with in separate EU regulation more suited and adapted to that very different purpose (see our response to Q7 on the scope of the PD).

This would require consideration of a number of different instances where securities are offered to the public, with different approaches adopted depending on the situation. We would be very happy to work with the Commission to elaborate on this further, and our answers to other questions address many of these instances.

This approach offers three important advantages. First, it allows policy makers to consider stock market regulation as an overall designed package. The opportunity to make considerable de-regulatory changes in the new PD would then exist as policy makers could reduce regulation in certain areas in the knowledge that other measures are in place to safeguard the position of investors.

Secondly, it makes European securities regulation simpler. It offers the opportunity to remove the overlap between the PD and much of the newer regulation, that has been created in the decade since the PD has been in force, addressing the pan-European offering of various asset management products.

Thirdly, and crucially, it makes it possible to implement a major reform of the existing cross-border offering arrangements for companies admitted to trading which could yield significant benefits to issuers and investors alike.

The existing PD passporting arrangements are modelled on those that apply in other financial services. Most financial services are bilateral arrangements between a buyer and seller or producer and consumer. So cross-border arrangements can only consider the location of the buyer and the location of the seller.

Stock markets are different however. These are (conceptually) places where buyers and sellers meet to trade, so the location of stock market provides a third venue. While the PD's passporting regime allows issuers to make offers into other Member States, it has not led to pan-European offers. In many initial public offering (IPO) situations, issuers restrict offerings to select jurisdictions. This is not just because currently they have to go through the PD passporting procedure and in many cases translate the summary of their prospectus. It is also, we believe, because an issuer is unlikely to sink cost into due-diligencing a smaller jurisdiction with which it has little historic connection unless it is certain there will be demand there. This is a significant hurdle to CMU. It denies investors in those Member States the opportunity to participate fully in the single market. It also means these issuers are not reaching the single market in its entirety.

We therefore believe two major changes to the public offering arrangements for companies admitted to trading should be considered:

- First, having securities admitted to a regulated market should carry with it a right to make public offerings of those securities across the single market. (This would also apply to IPOs where the offer is conditional on admission occurring.) Prospectuses would only be triggered when, as now, an issuer requests admission to trading on a regulated market. Exemptions would continue to apply to certain deals.

- Second, whenever a regulated market issuer makes a public offering of securities, that offer, and any resultant bargains struck between the issuer and investors under it, should be deemed in EU law to be occurring in the jurisdiction where the stock market is located. The Member State where the exchange is located would be the home competent authority for the purposes of the PD. For example, if a Cypriot company's shares are bought by Spanish investors in an IPO on a Dutch stock exchange those deals should be deemed to have occurred in the Netherlands, and not Cyprus or Spain.

Under this system issuers would not be 'offering into' (as the current jargon goes) any one jurisdiction. They would be offering into the entire single market at once. This is capital markets union in a meaningful sense. If the Commission were to make this change to the PD, issuers would still have to do due diligence for their stock market admission, but they would not have to do it for every jurisdiction across the Union. It would also mean that investors in smaller jurisdictions would not be denied the chance to participate in primary market offerings. This is a strengthening of the single market and in particular the concept of freedom of service: the investor would have the freedom to go to another member state (whether remotely or virtually) to obtain a service if it wished.

We are of the view that investors would be better off because this system is clearer, intuitive and simpler. They will be better protected by Member State authorities with simpler, clearer lines of accountability. EU principles on equal treatment of citizens will apply: it will be the responsibility of the authorities in the Member State where the stock market is located to protect all investors equally, irrespective of where they come from. In this sense, this reform aims to make the virtual space of European stock markets resemble physical European space.

This reform can only work if admission to trading is addressed separately from the offerings of unquoted securities. Cross-border offerings of unquoted securities must clearly be dealt with in either the jurisdiction of the buyer or seller; there is no neutral location available.

We also believe that there will be other benefits, some considerable, from our proposals:

- the responsibilities of regulators in various Member States would be re-aligned with the expectations of the public, who would expect the authorities in their jurisdiction to oversee transactions done on the stock market in their jurisdiction.
- the need for a passporting mechanism is dispensed with under this system.
- retail cascades would no longer need to be provided for in the PD (though they may be required in other legislation that deals with offerings of unquoted securities).
- large offers of in-issue shares which are already admitted to trading could be offered to the public without a prospectus, removing at once the practical problem of how offerors fulfil their obligations to produce a prospectus and the intellectual problem of what these prospectuses are actually for.

Q2-3. Costs

Other stakeholders are better placed to comment on costs. Our review of fees for prospectus approval and listing are publicly available on our website and will represent, in all but the most exceptional case, a fraction of a percentage of total fees on any one deal. For example, our vetting fees range from £550 to £50,000, with most equity prospectuses being charged a fee of £6,250 and most debt prospectuses being charged £2,750.

We comment on the cost and benefits of the passporting system (Q3) above where we observe that in practice corporates seeking admission to markets often restrict offerings to select jurisdictions. We would urge the Commission to reflect on the marginal cost of extending an offer cross-border when considering cost/benefit issues. Issuers do not incur the cost of a prospectus because they want to passport; they incur it because they want to access the capital markets.

Part A: When a prospectus is needed

Q4-5. Thresholds

We are broadly comfortable when considering cost/benefit issues with the existing thresholds. We do not favour the €5 million threshold being harmonised at a lower level.

Q6. The range of securities in scope

There is a need to consider exchange-traded commodities[1] (ETCs) in European securities regulation. Large numbers of these securities are publicly offered in the EU using a structure designed to make them offerable under the PD as debt securities. Consistent with the holistic approach we advocate in this response, we suggest that ETCs should be considered alongside exchange-traded funds (ETFs). ETFs are currently dealt with under UCITS (and are therefore outside the scope of the PD).

However, if that approach is not followed, we favour amendment of the PD to recognise ETCs specifically. The detail should be elaborated at Level 2.

Q7. Scope

As we note in our response to Q1, we favour a fundamental re-casting of the scope of the directive so it focuses on admissions to trading. Its other function – facilitating the offering of unquoted securities – should be dealt with separately with different categories of such offers being dealt with on their merits.

We believe this approach can remove overlap in some areas of EU securities regulation, reducing complexity.

The principal categories of investment we think should be dealt with outside the PD are:

- **Offerings of securities by special purpose vehicles (SPVs) with structured investments which are, in effect, structured financial products in the form of a security.** A new basis for regulating the offering of these types of securities should be developed. Whilst we recognise this is a significant undertaking, the PRIIPs framework already exists as a starting point. It could be significantly expanded to address this category of instrument fully and holistically. Whatever solution is arrived at, it will need to carefully consider the substance of these instruments. For the avoidance of doubt we are not referring to closed-end funds (i.e. actively managed investment companies) admitted to trading on a regulated market (see below).

- **Offerings of securities in vehicles subject to various existing EU asset management directives and regulations** (AIFMD, EuVCA etc). As we say in our response to Q13, the perimeter between the PD and in particular the newer asset management directives should be clarified. We think public offers of securities in these vehicles, where they are not to be admitted to trading, should be dealt with solely under the marketing provisions of those directives/regulations. However, where they are to be admitted to trading, we think the PD should apply and the marketing provisions of the various asset management directives should not apply. Our response to Q13 sets out further detail.

- **Offers of shares in private companies.** While on its face the ability for such companies to make pan-European offerings provides scope for growth finance for small and medium sized enterprises (SME), we are sceptical that in practice such cross-border offerings could raise meaningful amounts of capital for companies in a way

[1] By this we mean debt instruments issued typically through an SPV that provide exposure, whether directly to a commodity or a commodity index.

which would protect the interests of investors. Unquoted private companies represent an entirely separate category of risk for investors. Where there is a lack of capital for such companies, it might be better to explore what can be done to foster more investment from institutional rather than retail investors.

However, we also recognise that practice differs across the European Union and there may be places where the offering of shares in private companies to broad investor bases is entrenched and working well. We recommend retention of the right of Member States to make laws facilitating such practices on a domestic basis.

Also, the Commission should note that in our answer to Q48 we identify three possible changes to the definition of public offer (i.e. offerings to employees, to a company's own shareholders and of consideration shares to existing shareholders of companies) which are essential to making our proposals, as set out in Q1, work as they address instances when companies outside the regulated markets framework commonly make offers.

Q8-10. IPOs and secondary offerings

We strongly agree that a company being admitted to a stock market for the first time requires a full prospectus.

We also agree that the prospectus content in relation to further issuances could be significantly reduced. Companies that are already admitted to a stock market are known to markets and do not need the same level of disclosure as when they are first admitted.

However, we strongly oppose the obligation to publish a prospectus when there is a further issuance being completely lifted (Q8). Buy-side investors are clear that some level of disclosure and – importantly – process remains essential to protect their interests. Some of the most controversial capital markets transactions in European markets in the last decade have been further issues, not IPOs. For example, the financial crisis saw a number of further issues which raised investor protection concerns. Without proper process, it would be too easy for issuers to issue new capital without good cause and value could be destroyed. We believe buy-side investors would probably be sceptical of any move to significantly reduce transparency and due diligence on further issues. However, if the right balance is struck, we believe there would be strong support for a reduction in the disclosure obligations in further issue prospectuses.

The detail will need to be elaborated at Level 2. However, financial information is the obvious place to start reducing the disclosure burden for further issues. Such companies will already be subject to, among other things, the TD. So there should be no need to reproduce in prospectuses historical financial information already published in accordance with the TD.

In relation to some of the specific points raised in the consultation document:

- On the question of revising the 10% exemption threshold (Q9), we believe that further evidence would be needed to support any change. We are concerned about how a change to the threshold might impact on pre-emption rights and we recommend that the Commission should look carefully at this issue.

- If SME Growth Markets are to be brought into the PD framework then the thresholds should be considered alongside SME Growth Markets (see Q20-22).

- We do not recommend an exemption for secondary issuances based on timing since first issuance (Q10). We are supportive of reduced prospectus content for secondary issuances. We also understand the need therefore for a definition of a secondary issuance. However, we would not recommend this is arrived at through reference to the approval of a 'full prospectus' at some point in the past. We are of the view that the reason investors are comfortable with a lower disclosure threshold for secondary issuances is because a company is familiar to the market having been subject to continuing reporting and disclosure obligations, not because it previously published a prospectus.

Q11-12. MTFs

We do not favour the extension of the PD such that it requires a prospectus for admissions to MTFs, as we think the PD should clearly embody high standards of investor protection that are appropriate for regulated markets.

If the Commission does decide to extend the PD to MTFs, we would urge it do so in a way that has regard to market structure as a whole and to consider the burdens on issuers and the protections for investors as a whole package. This means considering the overall package for MTF issuers relative to the overall package for regulated markets issuers. In this regard we think a market structure in which there are different tiers of markets, each having different levels of obligations, could have significant advantages as the tiers could form the basis for clear labels which would allow investors to understand what they are exposed to. It would also allow companies to raise funds in a flexible, efficient manner. Regulated Markets should have the highest disclosure standards; MTFs should have fit for purpose disclosure standards that balance consumer protection and issuer needs, but are clearly signposted as subject to a different standard.

However, for this idea to work the Commission needs to clarify its vision for the relative positioning of the different types of markets in European regulation. The creation of the SME Growth Market format has had the indirect effect of creating three categories of stock exchange: regulated markets, SME Growth Markets, and what might be referred to as 'non-SME Growth Market primary MTFs'. We think it is essential the Commission articulates what role these three categories of stock exchange are intended to fulfil.

We address SME Growth Markets below in Q20-22. In relation to 'non-SME Growth Market primary MTFs' we would suggest, based on an assumption that these exchanges remain a relatively mainstream feature of the overall EU market structure, that companies on, or seeking admission to, such platforms should be permitted (as now) to make offers to the public provided they comply with the PD. (In other words, these companies could be permitted to 'opt-in' to the PD). Elsewhere in this response (Q48) we set out the view that irrespective of whether our recommendation that the PD is significantly restructured, the definition of public offer should exclude offers by a company to its own shareholders. We advocate this should also apply to MTF issuers and this would mean that rights issues and open offers would not be public offers.

Q13. Closed-ended funds / ELTIFs

The Commission highlights that closed-ended investment companies are obliged to comply with overlapping requirements under European directives. We agree that this overlap should be reviewed, but whilst the Commission asks whether the burden could be reduced for ELTIFs and others schemes which are subject to special regimes, we are of the view that a reduction in regulation could also be achieved for other closed-ended funds without reducing consumer protection.

However, we would not advocate opting all closed-ended funds out of the PD. In line with our overall proposals, we would suggest that closed-ended funds admitted to trading on a regulated market should continue to produce a PD prospectus, but be exempt from the equivalent marketing documents under other regulation. Unquoted funds on the other hand should be taken out of the PD and produce disclosure documents under other applicable legislation e.g. AIFMD. For the avoidance of doubt we are not advocating wholesale exemption from AIFMD or other regulations but from duplicate disclosure documents only.

Even if our overarching proposals are not accepted, we would advocate that careful consideration should be given to whether the PD prospectus would be a more appropriate vehicle than the AIFMD marketing document in certain circumstances. Anecdotal evidence suggests that the latter (and its related passporting regime) has proven an impediment to the movement of capital, and the Commission may want to seek further evidence in relation to this.

In addition, if the Commission wishes to foster investment in closed-ended investment companies admitted to trading on a regulated market that can provide long-term capital to SMEs etc, we would suggest there also needs to a be a recognition in regulation that neither the fund issuing the securities, nor its manager, is likely to have any information about buyers in the secondary market and as such cannot provide the assurances about the ultimate investor in the issuer. Requirements such as Art 24 of the ELTIF Regulation will limit issuers that are genuinely traded on capital markets from taking up ELTIF or similar schemes.

Q14. Employee share schemes

We believe that employees should not be considered to be the 'public' when considering regulation around the public offering of securities. We believe that a participant in an employee share scheme is in an entirely different position from the mainstream investing public and that the investor protection provided by the PD regime is not likely to be relevant. Extending the regulation that applies to public offerings of securities (in whatever form it ends up following review of the PD) will only have the effect of deterring third country employers from including their EU employees in share ownership schemes. In our experience a small number of a few very large third country companies are prepared to incur the expense of preparing a prospectus, but we see very few medium or even large companies do this.

Q15. Bond market liquidity

We strongly favour the removal of the dual-standard of disclosure in bond prospectuses and, more generally, an emphasis in EU bond markets policy on the identification and removal of barriers to liquidity and on overall market structure.

The current PD requires more disclosure for issuances of bonds with a denomination per unit below €100,000 than for bonds with a denomination at or above that threshold. The measure is intended to be a retail investor protection measure. Its impact, however, is on all market participants. Its effect is to create an incentive to issue high denomination bonds. For example, 78% of UK-listed bonds issued in 2014 were denominated in amounts over €100,000.[2] In our opinion, this is an impediment to liquidity. We would urge the Commission to adopt a single standard for bond disclosure, with the existing wholesale disclosure annexes from the PD Regulation as a starting point.

We recognise that the current €100,000 threshold is intended to act as an investor protection measure. We would support efforts to develop new ideas to give an appropriate level of protection to retail investors accessing bond markets. However, we also recognise that this is not easy. As a starting point, we suggest they should be designed to address the targeted group rather than all investors and should where possible avoid market distortions. They

[2] By number of issues. Source: Official List.

should also aim to ensure that where retail investors do access markets, they do so (again to the extent possible) on the same terms as other investors. We think information plays an important role in investor protection, but we think consideration should also be given to comprehensibility and how information is disseminated.

We also believe that the requirement for significant amounts of additional information to be provided to retail investors is not an effective retail protection measure. We would argue that retail investors require better, clearer disclosures, not greater volumes of information.

Any new Prospectus Directive regime should be designed in a manner that allows the efficient production of documents for wholesale investors, and requirements for retail investors that are not so onerous as to entirely disincentivise issuers from seeking retail participation in their offerings.

The current PD disclosures for wholesale bonds could be maintained (with some improvements – see Q40). These disclosure requirements should apply to securities regardless of their denomination. But there should be an additional disclosure requirement to oblige an issuer to explain how it or its agents intend to sell the securities. Such disclosure need not be particularly onerous, but should be sufficient to enable the target investor base (and whether that investor base is wholesale or retail) to be clearly identified.

Where securities will be sold directly to retail, or will be placed with retail intermediaries, there should be a requirement to produce a summary. In addition to the general summary requirements, the summary should set out in language adapted to the target investor group how the security generates its return, and a summary of the most relevant key investment risks described in the full prospectus.

This proposal would allow issuers to issue wholesale securities in the form they currently do, but simply add a retail summary where applicable. The summary could allow (but should not require) the inclusion of additional information that may be required in line with national product marketing regulations as long as the information is consistent with the prospectus.

We believe this proposal would provide a balanced approach between the desire of wholesale issuers to issue debt in an efficient manner, and the need to protect retail investors.

If the Commission seeks to further reduce the burden on wholesale only issuances, limited scrutiny or no scrutiny of prospectuses targeting only wholesale investors could be proposed. We recognise, however, that, even if the current incentive to issue at the €100,000 denomination threshold is removed, if the regime for wholesale issues is in other ways substantially less onerous than for retail, this will continue to embed an incentive to avoid the additional burden of retail issues.

We would note in this context that we disagree with the view put forward by some market participants that no tailored disclosure is required for retail investors in primary markets, and that instead greater intermediation should be encouraged. We are of the view that whether or not a sale is intermediated, an investor should be provided with information about the security purchased. Where such takes place pursuant to a primary issuance, that information should be provided by the issuer. The issuer is after all the entity that can describe itself, and the issued security, most accurately.

We support the CMU goal of fostering vigorous private placement markets. We believe that, provided participation is restricted to suitably sophisticated investors, vigorous private placement markets would be a useful corollary in the development of liquid on-exchange regulated markets in which a wide range of investors participate. We observe however that the current effect of tax legislation is that many issuers opt-in to listing, and with it the PD, in order to achieve a favourable tax treatment.

More generally, we would say that realising ambitions for CMU is a more challenging prospect in bond markets than in equity markets. A commonly cited ambition is to reverse the ratio of bank to non-bank finance of enterprises from 80:20 to 20:80. To do so we must find policies that attract different sources of capital and new investments. The scale of this challenge is significant. New sources of capital may be found and attracted into bond markets by greater liquidity and more investible assets. Issuers may be attracted to bond markets by deeper more liquid pools of capital. However, although a virtuous circle is to be hoped for, how it gets started remains a significant question. There are no instant solutions to these significant challenges but we would nonetheless recommend ways of working to address them:

- policy makers should seek a market structure that does not assume investors are of any one type and challenge market structures that seek to silo capital.
- policy makers cannot make investors trade bonds and have to recognise that many investors in bonds are buy and hold investors. However, they can prioritise the identification and elimination of impediments to liquidity. Whether a measure inhibits liquidity should be an important policy consideration as bond markets are developed.

Part B. The information a prospectus should contain

Q16-19. Proportionate disclosure regime

We agree with the Commission's observation that the proportionate disclosure regime (PDR) has not been widely used since its introduction in 2012.

The PDR allows issuers to disclose less information in a PDR prospectus than the PD otherwise requires. We agree that it is sensible that an issuer which is already admitted to trading on a regulated market, and which is therefore making periodic and episodic disclosures to the market in accordance with the Market Abuse Directive/Market Abuse Regulation (MAD/MAR) and TD, need not always produce a full prospectus. However, we strongly favour issuers having to publish a full prospectus when seeking admission to a regulated market for the first time. We discuss this in our answers to Q8-10 above where we argue that the prospectus content in relation to secondary issuances should be significantly reduced. In the context of PDR for further issues, the information which may be omitted is similar to information which may be incorporated by reference, and so PDR provides little benefit.

Other reasons why PDR is not used as much as hoped might include: (1) that if an offer might go into the US, the issuer will want to meet the high US disclosure requirements; and (2) an issuer using a PDR prospectus may be advised that the necessary information test in Art 5 PD requires additional 'necessary information' beyond the items in the PDR annexes.

The current PDR has added to the complexity of the PD regime and introduced a wider variety of prospectuses for similar issuers doing similar issues. This does not help investors gain a clear understanding of what the various prospectuses are trying to achieve with their varying disclosure requirements.

Q20-22. SME Growth Markets

Improving the access of SMEs to the single market is a core objective of CMU. Many stakeholders assume this should be achieved by lowering the regulatory burden on SMEs.

However, the SME category includes many early stage companies which may carry additional risk and the regulatory burden may include many measures investors value as important investor protection measures. It is important therefore to get the balance right between access to markets and investor protection.

In Q11-12 we argue the PD should not be extended to MTFs. For the avoidance of doubt, this view also applies to the new SME Growth Markets sub-category. As we suggest for other primary MTFs above, SME Growth Market issuers could be allowed to 'opt-in' to the PD if they wish to make a cross-border offering. Our recommendation on changing the definition of public offers to exclude a company's own shareholders would apply to rights issues and open offers these companies make. If however the Commission does decide to extend the PD to SME Growth Markets it should do so in a way that ensures the SME Growth Market format is developed alongside the regulated market format so the differences between the two are understood and clear. The UK has addressed problems of the higher risk early stage companies in capital markets with what is in effect a labelling strategy. This could be a model that would also work in wider European markets. The SME Growth Markets format, if well designed, would be understood by investors to carry with it certain additional risks associated with smaller, faster growing companies. This would not remove the risks, but it would manage expectations. Thus the regime could deliver a lower regulatory burden without misleading investors as to the risks they are taking.

Assuming the PD is reformed along the lines we suggest above in Q1, if the Commission does decide to extend the PD to SME Growth Markets, the same ideas that apply to the main regulated market segment could apply to SME Growth Markets. Admission to an SME Growth Market would be on the basis of a harmonised admission document (which could be called a prospectus) which would have lighter content than regulated (main) market prospectuses and would be adapted for SMEs. Again, there could be lighter prospectus disclosure for further issues, with no replication of already-published financials necessary. Prospectuses (or admission documents) would be required on admission to trading but not on a public offering. Admission to an EU SME Growth Market could give the right to make public offers anywhere in the EU. The Member State where the exchange is located would be the home competent authority for the purposes of the PD.

Irrespective of these choices, it will also be necessary to consider accounting standards in the design of these markets. As we say in our response to the Commission's CMU consultation, as a securities regulator we believe that convergence in accounting standards brings benefits in consistency and comparability across issuers and there could be much to be gained from exploring the possibility of aligning current national accounting standards already used on various trading venues with IFRS. We recommend that accounting standards are considered further as CMU is developed and the appropriate accounting bodies are fully engaged. However, we do not consider that a mandatory common EU level accounting standard for SMEs admitted to SME Growth Markets (or MTFs) should be required even if such a standard were available. It would be preferable to allow operators of SME Growth Markets some flexibility in the accounting standards they require for the issuers on their markets. This is consistent with the approach we support for operators of SME Growth Markets within the context of MiFID 2.

Finally, we would recommend avoiding the creation of special treatments for SMEs within the regulated market format. This would be confusing for both investors and issuers alike as there would be ambiguity as to whether the issuer did or did not meet the definition of SME. We would anticipate this would cause category disputes and additional cost and complexity. If an issuer is defined as an SME by virtue of being admitted to trading on an SME Growth Market then there would be no such ambiguity.

Q23-24. Incorporation by reference / Transparency Directive

We are generally supportive of the Commission's desire to reduce the burden on issuers. However, the Commission could consider going even further. One of the main themes of the Commission's PD Review is identifying what can be done to reduce the burden on issuers preparing prospectuses. Incorporation by reference is relevant to that question. We are of the view that items of information which are not important enough to be included in the body of the document, and which can instead be incorporated by reference, could be candidates for removal from the list of mandatory prospectus content.

In our responses to Q8-10 we suggest that historical financial information should not be required in prospectuses published in respect of secondary issuances.

Q25-26. Interaction of the market abuse and prospectus regimes

We share the desire for a better system for supplementing prospectuses; particularly base prospectuses. The majority of supplements we approve are supplements to base prospectuses. However, in determining whether the Market Abuse Directive / Regulation (MAD/MAR) is a suitable candidate for such an update mechanism, the Commission should consider whether the information disclosed to the market under MAD/MAR, which will be information deemed by the issuer to meet the 'inside information' test, captures the same information (or a reasonable proportion of the information) as that which would be disclosed under the PD's supplementary prospectus regime test.

Q27. Summaries

We recommend that the requirements for summaries in prospectuses should be reassessed and issuers should be free to draft a narrative they think is a fair summary of the prospectus. The existing requirements for summaries require tabular presentation of specific information and has been driven by a desire to make the information in summaries highly comparable between prospectuses. This has been at the expense of their use and readability for the investor.

The changes made in July 2012 to the summaries regime set out its disclosure requirements under five section headings: (A) Introduction and warnings; (B) Issuer and any guarantor; (C) Securities; (D) Risks; and (E) Offer. If a detailed requirement for summaries were to be kept then they should go no further than setting out these section headings. We would, however, advocate that summaries would be improved with a short opening paragraph explaining why the prospectus is being published.

In addition we would make two smaller points:

- Recital 27 of the PD Amending Directive [2010/73/EU] required the Commission to align to the greatest extent possible the content and form of the prospectus summary with what is to become the PRIIPs KID. This should be pursued to ensure that the overlap between the two regimes do not create duplications or conflicts.
- The existing Prospectus Regulation was not amended in 2012 to set out summary requirements for proportionate disclosure regime prospectuses and this should be corrected, if no other amendment were to be made.

Q28. Overlap of PRIIPs

Our proposal to restructure the PD regime significantly would see the elimination of the overlap between the PRIIPs regime.

Q29-30. Prospectus length

We recognise the problem of ever longer prospectuses. Longer prospectuses do not serve the interests of investors. Rather, they are a tool used in the management of issuers' legal liability.

However, we think there are no easy solutions in this area and we would recommend the problem is not addressed through an absolute word or page limit. Such a limit would have to be set high enough to accommodate the genuinely exceptionally complex company and would legitimise excessive length for other companies. Nor do we have appetite for a graduated approach in which complex companies get a different word limit. This would add yet more complexity to the regime. Defining the categories would be too difficult and once defined there would be endless category disputes.

Based on our discussions with practitioners, we believe there are two key drivers behind the tendency toward ever greater prospectus length:

- Firstly, we are regularly informed that the extra-territorial nature of US securities regulation is a key driver of prospectus length in the EU. Many disclosures and disclaimers exist to address aspects of US securities law. We recommend the Commission starts negotiations with the US authorities aimed at ensuring US qualified investors can participate in EU regulated offers without the issuer being subject to US securities law

- Secondly, prospectuses are long because legal advisors deem the content necessary to mitigate the legal liability that may arise if material information is omitted. This determination is made in the light of the 'necessary information' test. We are open minded to suggestions of a better statement of what should be required, but have yet to arrive at one ourselves. We do however think there may be some merit in additional guidance (or similar measure) to assist the understanding of the 'necessary information' test, with issuers being allowed to have regard to the type of transaction that they are carrying out when considering what information is necessary. For example the necessary information in a bond deal would be that information that would enable an investor to assess the ability of the issuer to repay its indebtedness. The necessary information in a rights issue may have regard to the fact that the investors in the issuer are already invested in the company.

In relation to Q30 specifically we think there is merit in the suggestion of a targeted limit in the risk factors section in the summary which perhaps should only address (say) the seven most material risks. Excessive length of the risk factor section might also be addressed by given more thought to the definition of a 'risk factor' and to the purpose of requiring such a section to be included in the document. For example, we think of a risk factor as disclosure that highlights a possible detriment to the issuer based on the crystallisation of a contingency. However, many documents we review contain risk factors with no contingency and which are in effect just disclaimers.

Elsewhere in this response we have set out other ideas which will, among other things, go some way to reducing the length of prospectuses by removing unnecessary disclosure items, for example in our response in relation to secondary issuances.

Q31-32. Prospectus liability

Along with others we can see benefits in harmonising prospectus liability. However practitioners warn that this process is a significant undertaking requiring many years of work.

In Q1 above we offer the suggestion that whenever a regulated market issuer makes a public offering of securities that offer should be deemed in EU law to occur in the jurisdiction where the stock market is located. The deal should be deemed to occur on the neutral ground of the stock market rather than in the jurisdiction of either issuer or investor. This does not harmonise prospectus liability. However, looked at from the viewpoint of a prospective issuer wishing to access more areas within the single capital market at no incremental cost, it goes some way to addressing the detrimental effect of there being multiple liability regimes. These benefits could be achieved long before harmonisation of liability regimes is complete.

Finally, we would add that some practitioners highlight to us the effect that the current prospectus regime has in deterring issuers from including more forward-looking information in prospectuses. If issuers were more candid as to their views on the prospects of the company this would make prospectuses more useful, although clearly proper accountability is necessary or there would be no disincentive from making exaggerated claims as to the company's prospects. We think this issue is worthy of proper examination by the Commission.

Part C. How prospectuses are approved

Q33. Competent authority approaches

We believe that there is already a strong common understanding between national competent authorities in relation to the overall goals of the PD, and a real determination by national competent authorities to achieve the right balance between high quality disclosures to investors and ensuring issuers can access capital markets.

There will of course be low-level differences in interpretation and process arising from time to time, but we believe the existing convergence mechanisms for addressing these work well. We, like other national competent authorities, devote considerable resource (working through the auspices of ESMA) to enter into dialogue with fellow national competent authorities to resolve these points of difference. We feel this is an efficient, cost-effective mechanism that fosters good European collaboration.

It is important that if the Commission does feel that more needs to be done to bolster convergence that whatever mechanism is put in place must take account of the needs of issuers executing transactions and should not require national competent authorities to pre-consult ESMA or one another before approval of the prospectus. Rather, whatever consultation is required should occur after the approval of the document. Any requirement to consult in relation to low-level points of interpretation on a pan-European basis on a live case would bring primary markets to a standstill.

We would also emphasise that national competent authorities need to retain the ability to tailor their review processes and techniques to specific prospectuses submitted to them – taking into account the nature of the issuer, the target investors, and market conditions at the time. A targeted approach should not be misinterpreted as representing an inconsistent approach.

Q34-37. Prospectus approval procedures

We favour retention of pre-vetting of prospectuses in most cases and would caution against undermining this important investor protection measure (Q37). We understand issuers and their advisors do not like to be challenged on the completeness of their documents. However, they benefit from investor confidence that their prospectus has been subject to a thorough review. If the aim is to foster access to capital by reducing burdens on issuers there are other areas with more promising options. We would particularly caution against introducing uncertainty as to whether a prospectus will need to be scrutinised before approval, either through adopting a sample based approach to ex ante reviewing (Q37b) or some special status (e.g. whether it meets a definition of SME). In the case of a sample method, issuers' advisors would face uncertainty as to whether the document would be reviewed. In the case of a special status being used there would be uncertainty as to whether the issuer met the criteria. Advisors planning transactions need to know with certainty whether the document will need to be reviewed.

National competent authorities have an important role in ensuring that issuers do not just disclose in their prospectuses only the minimum information explicitly required under the PD Regulation annexes. National competent authority review ensures the information has been subjected to independent scrutiny and tested for coherence and consistency. This puts in place a vital balance to the structural information asymmetry between issuers and investors. Without it the only protection against poor disclosure in primary markets would be the deterrent effect of civil action. An increase in litigation would be detrimental to the effectiveness and competitiveness of EU capital markets.

There could however be some exceptions. If, contrary to our recommendation in the Q15, the dual standard of disclosure and the €100,000 threshold for bond prospectus is retained, pre-vetting of prospectuses could be relaxed for high denomination prospectuses. Pre-vetting could also be relaxed for supplements. Finally, in our response on SME Growth Markets (Q20-22) we suggest if the Commission does decide to bring SME Growth Markets into the PD regime, it may wish to consider whether pre-vetting is necessary as part of the overall design of those markets. There are some examples of junior markets which do not feature pre-vetting as part of their investor protection package and use other methods.

In relation to the question of further streamlining of scrutiny and approval procedures (Q34), we would urge an approach that emphasises transparency and accountability of national authorities not just to ESMA and the Commission but to market participants. We would caution focusing on major restructuring of review process, certainly on a harmonised basis. Rather, we would advocate a focus on transparency as to the aims and methods of the scrutiny processes and also on authorities clarifying what participants in the scrutiny process should expect (Q35). The ordinary processes of accountability that EU public authorities should be subject to should be brought to bear here.

We sense no desire among market participants to adopt the US system of draft documents (and the reviewing authority's comments on them) being open to full public scrutiny during the marketing process (Q35). We are sceptical the transition to such a system could be achieved without stretching the scrutiny process and without a significant investment in IT systems on the part of all national competent authorities.

Regarding marketing activities (Q36), the existing regime already supports the ability for the company to be marketed to investors ahead of publication of a full prospectus in two ways. Firstly, the company can file a registration document which will contain all the information needed to understand the company's business and to open a dialogue on price and deal structure which is then later set out in the securities note. Secondly, companies use 'pathfinder' prospectuses under the PD's advertising regime to test investors' appetite for the investment during institutional book building exercises.

Q38-39. Passporting

The current passporting system is logical in the context of a regime that is not organised around the concept of admission to trading and has to be able to apply to all public offerings of securities including bilateral issuances between buyer and seller where no stock exchange is involved. On the whole it works well administratively. However, in our response to Q1 we highlight that many issuers making public offers limit their offers to select jurisdictions. We believe this is because of the high marginal cost for issuers of adding additional jurisdictions. We set out a new scheme for the PD which would mean that for regulated market offers an approved prospectus is valid for truly pan-European offers of securities; this would be a genuine CMU. This would remove the need for passporting completely from the regulated market sphere as an admission on one market in the EU would be sufficient for all public offers across the EU. Alongside this we advocate that when a regulated market issuer makes a public offering of securities, the offer should be deemed in EU law to be occurring in the jurisdiction where the stock market in located.

If the current system is retained and refined, we would urge the Commission to ensure that issuers have certainty that their passport has been given to the host authority. This is particularly important in the context of final terms.

In this context we would suggest that the latest iteration of the final terms regime, following the Omnibus II Directive, should be improved upon. In particular the Commission should look again at the arrangements for sending final terms from the issuer to the home competent authority which then send the final terms to host competent authorities and to ESMA. We argue that in a CMU a prospectus approved by one competent authority would be good for all offers across the Union. This would remove the need for passporting of base prospectuses and the final terms could be treated accordingly. If the Commission were not to follow this suggestion, we believe that there is merit in the pre-Omnibus II Directive arrangement of the issuer having control over sending its final terms to both home and host competent authorities and that this should be extended to the issuer sending the final terms to ESMA. We think that the arrangements put in place by the Omnibus II Directive from 1 January 2016 could lead to significant uncertainty for issuers as to when their final terms are delivered to host competent authorities. We think that issuers will not want to take on the legal risk that arises from making offers and seeking admission without the certainty that their final term have been delivered to the host competent authority. This will lead to delays in capital raising which would be contrary to the aims of CMU.

Q40. Base prospectuses

We would in general support efforts to lower obligations for issuers producing base prospectuses. In particular:

- We agree the life of a base prospectus should be extended beyond one year (Q40b). Provided there is a mechanism to allow issuers to update them, they could potentially be extended indefinitely.

- Alternatively (and assuming the Commission does not take forward our proposal in Q16 to remove the dual-standard of disclosure for debt securities) pre-vetting of updates to wholesale base prospectuses could be removed.

- Programme documents should not have to be supplemented immediately when a material change occurs. Rather, if a material change occurs the programme should be considered 'suspended' until such time as a supplement is published. This is how many issuers proceed already. We think this practice could be codified in the directive.

- Guarantor disclosure for issuers with multiple guarantors could be looked at and reduced. The base prospectuses for companies with multiple guarantors can be substantial. We would welcome the opportunity to discuss with the Commission how different regulatory approaches might be taken to different types of guarantees, for example, there could be different approaches where: (1) a guarantee is provided by an issuer's parent to enhance the credit quality of a security; and (2) a guarantee is provided to an issuer by its main trading subsidiaries in order to prevent investors being structurally subordinated to other creditors.

- Thought could be given to developing a variant of a base prospectus which would enable existing equity issuers already admitted to trading on a regulated market having reduced disclosure obligations, such disclosure only focusing on the additional material bond investors require (e.g. information on the security package).

In relation to the idea that different authorities could approve different component parts of a tripartite prospectus, we see this as a significant additional layer of complexity. Again, we would emphasise that the need for this would be removed by the proposal in relation to jurisdiction in Q1.

Q41. Tripartite regime

In the UK, there has been some use of the tripartite regime by issuers of debt securities. Debt issuers typically secure approval of a Registration Document in the first instance, and then prepare Securities Notes and Summaries as and when required. We have seen an increase in the use of the tripartite model by banks since the implementation of the 'PD2' reforms to the directive, which restricted issuers' ability to add new securities to a base prospectus.

We note that ESMA requests clarification on the production of tripartite base prospectuses. We would add that the interaction with final terms and the existing 'ABC' regime would also have to be considered carefully

There has been only limited use of tripartite prospectuses by equity users in the UK. We are aware they are widely used in France and other EU jurisdictions. However, there is greater interest in the use of tripartite prospectuses as their use has recently been recommended by Lord Myners in a wide ranging report on UK IPO practice so their use in the UK could increase.

See also our response below (Q49-51) in relation to tripartite base prospectuses.

Q42. Home Member State status

We oppose issuers' ability to frequently change their home competent authority. It serves the purpose of allowing an issuer subject to a regulatory decision which it does not like to seek further opinions until it gets the determination it wants. This undermines solidarity between authorities. Like other competent authorities, we do not favour this arrangement.

Our proposal to restructure the PD and refocus it on admission to trading set out in Q1 provides, among other things, a new basis for determining home competent authority status. We acknowledge certain details will need to be fleshed out as the PD review continues (most notably how to determine a single competent authority where there is a dual listing) but we believe this proposal better aligns Member State authorities' accountabilities with the expectations of citizens in their jurisdiction.

Q43-45. Availability of prospectuses

We are sympathetic to proposals aimed at making prospectuses available to investors early in the marketing process and will help ensure that it is embedded in the marketing process. Early prospectus publication would also benefit producers of independent research who need timely access to reliable information about the issuer. Ensuring it is embedded in the sales process in a meaningful way may also provide a pressure to reduce length. We would urge the Commission to favour policies which foster that outcome. For example in the case of a float with no public offer, the prospectus does not have to be published until the start of dealings. We think that the directive could be modified to create a requirement that approved prospectuses should be made available to the public in good time before the admission of the securities to trading on a regulated market (i.e. before the start of dealings).

We believe that publication in a newspaper is not a commonly used or investor-friendly way of publishing a prospectus, and as such could be abolished as an option for fulfilling publication obligations (Q43). We do see value in retaining the requirement to provide paper copies free of charge, as anecdotal evidence suggests there is some demand for paper copies.

Regarding a single pan-European filing system (Q44), whilst this is a laudable aspiration, we would strongly advocate against mandating such a system in primary legislation before a proven, operable system has been delivered. For it to be a single filing system this would inevitably mean the document is filed with an EU institution (ESMA presumably) and therefore a different body from the authority which approved the document and supervises the market. This is more unnecessary complexity. We would also be concerned about the risks of failure in any IT project. If such a system is built, its essential features (Q45) would have to be that the information is filed once with the national competent authority and then shared with the centre. This is the basic concept behind the existing ESMA register.

Q46-47. Third country equivalence

This is an important and complex topic. We believe that there should be a proportionate regime recognising that third-countries present a wide variety of prospectus regimes compared to the EU's.

Q48. Definition of public offers of securities

Irrespective of whether the major restructuring of the PD we advocate in this response is adopted, we favour two amendments to the current definition of an offer to the public:

- Offerings of shares to employees, irrespective of whether the issuers are Member State or third country issuers. As we note in our answer to Q14, we do not think employees should be deemed 'the public'.
- Offerings by a company to its own shareholders. Again, we do not think a company's existing shareholders – its owners – are 'the public'. The effect of treating a company's owners the same as the rest of the public is that companies outside the regulated market framework (e.g. MTF issuers) cannot offer give their shareholders meaningful pre-emption rights without being subject to the PD.

Additionally, if the Commission takes forward our major restructuring proposals, it should consider whether the offering of consideration shares to existing holders should be deemed public offers. There are good arguments to say an offeror in a merger situation should not be barred from offering consideration shares by the notion that the offer is an offer to the public. In these cases the recipients are already invested in one company and are being the offered the opportunity to roll over that investment into the newly merged entity. So there is a case for extending the principle that a company's own shareholders are not the public to these situations even though in this case the recipients of the shares are not the existing owners of the issuer.

Q49-51. Other

We believe that the following changes should also be made to the PD:-

- **Global depositary receipts (GDRs).** GDRs are certificates representing securities (typically shares) and are treated as non-equity securities under the PD. They are considered equity investments by investors. The PD should be amended so that the disclosure regime for share issuers applies, with the only difference being that the depositary structure would also fall to be disclosed.

- **Tripartite base prospectuses**. ESMA published an Opinion in 2013 stating that prospectus may not take the form of a tripartite base prospectus[3]. The Commission should take the opportunity of the PD review to clarify the matter one way or another.

- **Final terms**. Art 5(4) PD was amended by both the PD Amending Directive and by the Omnibus II Directive. Its final paragraph mentions 'offers' three times and 'admission' just once. The text could be reviewed to better clarify how the legislation applies to offers and to admissions.

- **Partly-paid securities**. The PD allows for different disclosure for securities depending on whether they have a minimum denomination of €100,000 or more. However it is not clear how a partly-paid security with a denomination of €100,000 or more should be treated. This might be a matter for ESMA to address.

- **Risk factors**. The clarity of the risk factors section in the main body of the prospectus would be improved by dividing risks between "key" and "other" risks.

- **Waivers**. The PD allows for national competent authorities to approve requests for omission of information from prospectuses. This is an area where ESMA could assist in harmonising approaches across national competent authorities in scenarios where waivers have become routine. For the avoidance of doubt we not want this to mean there should be a requirement to consult ESMA on live transactions as this will introduce delays. Rather, a harmonisation would involve dialogue between authorities after the transaction.

[3] *Format of the base prospectus and consistent application of Article 26(4) of the Prospectus Regulation*; ESMA/2013/1944; 17 December 2013