

UKLA Technical Note

Final Terms

Ref: UKLA / TN / 629.23 – Guidance Consultation

PD Regulations
Article 22, 24,
26; PR 2.2.9R;
PR Appendix
3 Annex XX,
XXI; ESMA
Questions and
Answers on
Prospectuses
(Q&As)

What information can I include in the final terms?

Article 22.4 of Prospectus Directive Regulations (PD Regs) states that final terms can only contain the following: (1) Category B and C information as set in the Annex XX; (2) information set out in Annex XXI; and (3) the replication of any options specified within the base prospectus. Information that does not fall within these categories cannot be included in the final terms. As such, drafting notes to aid the individual completing the final terms at the point of issuance should not be included in the final terms, nor should miscellaneous disclosure obligations be addressed in the final terms.

We note that before the amendment of the PD Regs in July 2012, market practitioners used final terms as a method to address disclosure obligations such as those under MiFID and from the European Central Bank. As this information is not specified in Article 22.4, this information will now need to be disseminated by an alternative method rather than in the final terms.

What information from the base prospectus can I include in the final terms?

Article 26(5) of the PD Regs prohibits the general reproduction of base prospectus items in the final terms unless there are different options within the base prospectus that can be selected for inclusion within the final terms (Article 22.4(c) PD Regs). This means that if the base prospectus contains different options that could be applicable to a security, then the final terms can include the relevant information from the base prospectus.

Do I have to include the formula for structured securities in the base prospectus?

Yes. The formulae can be presented algebraically in the base prospectus. The description contained within the base prospectus addressing how the return on a derivative security takes place and how the value of the investment is affected by the value of the underlying instrument needs to be clearly presented so that it is understandable and comprehensible to an investor. For retail denominated securities the description should not be legalistic, or overly mathematical. For complex derivative securities, Recital 18 PD Regs suggests the use of examples might be the most effective way to explain complex securities.

The final terms may then contain the formula with the issuance specific details inserted. As stated in paragraph 49 of The ESMA Consultation Paper (15 June 2011) providing technical advice on the delegated acts of the Prospectus Directive (PD); the pay out formulae for derivative and structured securities should be reviewed by a competent authority and new payment formulae should not be included in final terms. Additional features should not be added to the formulae

via the final terms as this would constitute a new formula and would therefore need to be in a base prospectus or prospectus.

What is the appropriate yield formula to include in a retail base prospectus?

The yield disclosure requirement for retail bonds is set out in the PD Regs Annex V para 4.9. This provision requires a description of the method used to calculate the yield. We believe this requirement can be satisfied by including a simple a yield formula (i.e. current yield).

Can notes exempt from Prospectus Directive (PD exempt notes) be issued from a base prospectus?

PD exempt notes can be issued from a document that includes a prospectus so long as it is clear that the PD exempt notes are not issued from the approved prospectus. This is consistent with ESMA Q&A 49, which states that a document should not be called a 'prospectus' if the document is not being used in the capacity of a prospectus (as defined by the PD), unless it clearly states that it is not a prospectus for the purposes of the PD.

Retail investors: To make the distinction clear to retail investors, PD exempt notes should be issued from a combined document containing a base prospectus and another document such as an offering memorandum. This combined document should ensure that all the information that is not part of the base prospectus is included in a single section within the document, which would be clearly marked as not forming part of the base prospectus and as not having been reviewed or approved by the UKLA.

The combined document must contain final terms (for use with the base prospectus) and a pricing supplement (for use with the offering memorandum in relation to PD exempt notes). The pricing supplement should include language in prominent bold text to make it clear that it does not form part of the base prospectus approved by the UKLA. We believe this language will ensure that retail investors are not misled and what is covered by the prospectus will be made clear to them.

Wholesale investors: We recognise that a wholesale investor will be more knowledgeable in investment matters. Accordingly, for wholesale documents, the base prospectus must include a clear statement that the PD exempt notes do not form part of the base prospectus approved by the UKLA. The base prospectus should also include a pricing supplement for use when issuing PD exempt notes. The pricing supplement should include language in prominent bold text to make it clear that it does not form part of the base prospectus approved by the UKLA.

Do I include the issuance-specific summary in the base prospectus or in the final terms?

We are of the view that the intention behind Article 24 of the PD Reg is for the summary included in the base prospectus to have place holders that are intentionally left blank for the later insertion of issuance specific information from the final terms at the time of issue. The issuance-specific summary should not be included as a separate section in the base prospectus. The relevant information from the summary included within the base prospectus (i.e. the summary relevant for the security being issued) should be attached to the final terms to form the summary specific to the securities being issued.

If a base prospectus has been approved for the issuance of both retail and wholesale securities, do the final terms have to include an issuance specific summary?

Although Article 26.8 of the PD Regs contemplates that a single document can constitute multiple base prospectuses, the requirement for an issuance-specific summary depends on the nature of the base prospectus.

If a single document comprises both a retail base prospectus and a wholesale base prospectus and it is clear which parts of the document comprise which base prospectus, then only the retail final terms will require an issuance-specific summary. Where a single document comprises both a retail base prospectus and wholesale base prospectus, we would expect it to have a 'summary' specific to the retail base prospectus and an 'overview' specific to the wholesale base prospectus.

If the document does not comprise a retail base prospectus and a wholesale base prospectus but instead the document is one base prospectus approved for the issuance of both retail and wholesale securities, then an issuance-specific summary is required both retail and wholesale final terms.

Passported base prospectus – filing of final terms

~~The requirement for filing final terms is in PR 2.2.9R(1), while PR 1.1.1R limits the application of PR 2.2.9R to instances where the UK is the Home State. So where the prospectus has been 'passported' to another Member State, the final terms should nevertheless be filed with the competent authority of the Home State.~~

~~The ESMA Q&A 1(b) recommended that issuers also send the final terms to the competent authority of the Host State, which might not require, but might nevertheless expect to see, this information. However, this position has been clarified by the Prospectus Directive (PD) (as amended). Under Article 5.4 of the PD, issuers must now communicate final terms to the competent authority of the Host State.~~

Expired base prospectus

ESMA Q&A 8 provides guidance on 'incorporation by reference of information contained in a former base prospectus that is no longer valid'.

The guidance in this Q&A advocates the preparation of a new prospectus or base prospectus where final terms make reference to terms and conditions from an expired base prospectus. The specific example in the ESMA Q&A relates to a tap issue, but the same principle could be extended to other situations where final terms make reference to terms from an expired document. This might include where securities issued under a previous (and expired) base prospectus are being admitted to trading during the current programme period.

We ask all issuers to consider the effect of this Q&A on the usual documentation relating to their programme issues. In many cases it may be necessary to include or incorporate by reference, terms and conditions from expired base prospectuses into the current base prospectus.

We will challenge final terms that do not conform to the guidance in this ESMA Q&A.