# General Paper

## Prospectus Regulation Level 2 Measures

12 June 2017

### Introduction

The final text of the Prospectus Regulation (PR) is due to be published in July 2017 and the European Commission's request to ESMA for technical advice on possible delegated acts was published on 28 February 2017.

AFME has set out in this paper a series of recommendations to the Commission and ESMA for their consideration.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. It advocates stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

### Minimum information and format of the prospectus (Article 13)

Background

The PR introduces a revised disclosure test in Article 6. In particular, the test now states that the necessary information which is material to an investor making an informed assessment may vary depending on the type of securities and whether or not the target investors are solely qualified investors.

Recommendations

1. The current disclosure annexes are understood by the market and are generally functioning well. AFME recommends that the general approach taken is to retain the current disclosure annexes in their existing form, but only require disclosure of a specific item to the extent that it is relevant to the Article 6 disclosure test for the relevant type of security.

2. The annexes could benefit from certain changes. AFME recommends considering the following changes:

    a) removing the requirement for a selected financial information section and the capitalisation and indebtedness table, which duplicate information contained elsewhere in the prospectus, including in the summary financial information. To the extent that this is not feasible, consideration should be given to clarifying that the capitalisation and indebtedness table should only be required to set out IFRS balance sheet items; and

    b) clarifying that it is only movements in the material line items (or material changes in other line items on the face of the income statement) that need to be discussed in the OFR, not movements in any line item. This would improve the quality of the OFR disclosure.

**Disclosure regime for certain secondary issuances (Article 14)/Incorporation by Reference (Article 18)**

Background

The existing proportionate disclosure regime under the Prospectus Directive has been little used for secondary or other equity issuance.

The PR seeks to address this for secondary issuances by providing that the disclosure standard in Article 6 is modified (as set out in Article 14(2)) to create a "simplified disclosure regime for secondary issuances".

The simplified disclosure standard requires disclosure of the information which is necessary for investors to understand: (a) the prospects of the issuer and significant changes in the issuer's business and financial position since the last financial year end; (b) the rights attaching to the securities; and (c) the reasons for the issue and the use of proceeds of the issue. This is on the basis that a secondary issuance prospectus "shall" take into account information previously published under the issuer's continuing obligations under the EU Market Abuse Regulation (MAR) and the EU Transparency Directive (TD) ("MAR and TD Information").

It follows that only additional information specific to the issue or offering being made (both legal, such as the details of disapplication of pre-emption rights and commercial such as information relating to a linked acquisition or details of how the money raised is to be used) and other information necessary to supplement or update previously published MAR and TD Information would need to be disclosed in a secondary issuance prospectus.

Recital 40 of the PR summarises this overall concept: 'A simplified prospectus should therefore be available… and its content should be alleviated compared to the normal regime, taking into account the information already disclosed. Still, investors need to be provided with consolidated and well-structured information, especially where such information is not required to be disclosed on an ongoing basis under [the TD or MAR].'

Recommendations

1. Retention of the current Level 2 disclosure annexes, but only requiring disclosure of each individual item if it is relevant to the overriding Article 14 disclosure standard for a secondary issuance prospectus. This approach would reduce the potential for the introduction of the simplified disclosure regime to confuse investors or increase transaction costs since the market is already familiar with the existing disclosure annexes.

2. The Commission and ESMA should also have regard to the disclosure requirements of US Securities and Exchange Commission in respect of secondary issuances, which we believe supports this approach. Many larger issuers have a significant US investor base that they need to access when undertaking a secondary issuance. A proportionate disclosure regime which does not take account of the US disclosure requirements would not be used by issuers seeking to access US investors, as the proportionate disclosure prospectus would only be suitable for domestic issuance.

   A short list of recommended areas of focus is set out in the Appendix.

   In addition, to make it clear that issuers are able to disclose on a voluntary basis matters that they consider to be relevant or material to investors (which may include US disclosure requirements) but which do not fall within the simplified disclosure standard, we would recommend that ESMA insert the following text in the Level 2 RTS setting out the detailed disclosure requirements applicable to an Article 14 prospectus: "*This disclosure annex sets a minimum threshold which the prospectus content must meet. However, an issuer may exceed the terms of this annex in its prospectus disclosure if desired, whether to meet additional disclosure requirements or practices of a third country or otherwise".*

3. With respect to MAR and TD Information, the delegated acts under Article 14(3) should:

   a) avoid characterising an issuer's recent TD and MAR disclosures as part of the issuer's prospectus (and therefore part of the basis for an investor's investment decision) unless they are specifically

incorporated by reference in the prospectus. Otherwise, issuers will need to prepare all TD and MAR disclosures and to prospectus standard, which would increase costs for issuers;

b) provide that any such information that is specifically incorporated by reference in the prospectus must have been prepared to a prospectus standard. The incorporation by reference should not be automatic.

4. While recognising the mandatory nature of the items listed in Article 14(3)(a) to (e), to provide meaningful investor protection, the delegated acts should provide that issuers should be allowed to indicate to investors which previously published information is of particular relevance to the offering and (subject to the items listed in Article 14(3)(a) to (e)) expressly to exclude previously published information which is not relevant.

5. The delegated acts should provide for a cut-off date for the date of MAR and TD Information not incorporated by reference to give certainty as to which information investors are expected to have reference to in making their investment decision and ensure that investors are not required to review a large quantity of information, much of which will be outdated. This approach would also ensure investors have access to a proportionate and calibrated record of previously published information, as contemplated in Article 14(3).

**Supplementary prospectuses in equity offerings (Article 23)**

Background

In the context of an equity offering to retail investors a practice has developed that an issuer should publish a supplement if the final price is below the price range, or if the number of securities to be offered is increased or reduced, so that retail investors have a right to withdraw. However, this can delay the closing of a transaction or in some cases can cause the transaction to fail, and therefore provides a disincentive to issuers to make an offering to retail investors.

Recommendation

AFME recommends that the regulatory technical standards made under Article 23 specify that withdrawal rights are not applicable to exempt offerings to qualified investors where a prospectus is produced solely in relation to admission of securities to a regulated market. This interpretation is consistent with the opening wording of Article 23(2) and current practice. Where the prospectus is not being used for a public offer, the imposition of statutory withdrawal rights, which are available principally to protect retail investors, is not appropriate.

**The Prospectus Summary (Article7)**

Background

In the case of equity issuance, investors rarely make a direct comparison between one investment and another (as each company's business, growth prospects and likely future dividends are, to an extent, unique).

Recommendation

AFME recommends that the regulatory technical standards to be made under Article 7(11) should specify the format and headings for the summary, tailored for equity, given that the Commission has confirmed that such a summary is not required to be in the format contemplated by the KID required under the PRIIPs Regulation.

**Definition of "Advertisement" (Article 21(6) and Article 2(1)(k))**

The definition of "advertisement" has been amended from the definition used in the (existing) Prospectus Directive from "an announcement……" to a "communication……..". However, we understand that it is the Commission's view that this change in the definition at Level 1 does not significantly alter the scope of the advertisements regime.

Recommendation

To ensure that the advertisements regime continues to be interpreted in a manner consistent with its purpose, AFME recommends clarification at Level 2 or 3:

a) that the scope of a "communication" which is subject to the regime is restricted to those announcements that are made public or otherwise broadly disseminated; and

b) that analysts' research reports are not advertisements.

**Risk Factors (Article 16)**

Background

Article 16(1) states that the risk factors in a prospectus shall be limited to risks which are specific to the issuer and/or the securities and are material for taking an informed investment decision, as corroborated by the content of the registration document and the securities note. Also risk factors shall be presented in a limited number of categories depending on their nature and the most material shall be mentioned first.

Recommendations

1. AFME recommends that Level 2 or 3 guidance as to the categories of risk factors should be grouped into broad themes. Risk factors for equity securities could be split into two categories:

   - risk factors specific to the issuer and its industry; and
   - risk factors that are material to the securities in order to assess the market risk associated with these securities.

   The wording for such categories is included in the existing Prospectus Directive annexes for securities registration documents and securities notes. This wording should be retained because it focuses on the information that investors need to know in the context of an investment decision in equity securities. Issuers could then choose whether to impose any further division within these headline categories, for example to isolate risk factors relating to financial information. However, there should be no requirement to group or categorise risk factors based on their expected importance or the possible magnitude of the damage should the risk materialise.

2. AFME recommends that, in the Level 2 or 3 provisions, the phrase "corroborated by the content of the registration document and the securities note" is clarified, as meaning that the risk factors should relate to risks relevant to the issuer's business and the securities being offered or listed, as described elsewhere in the registration document or securities note.

Andrew Brooke andrew.brooke@afme.eu

+44 (0)20 3828 2758

# Appendix

Recommended areas of focus:

- Risk Factors – SEC guidance and US practice in respect of risk factor disclosure requires the risk factors to be succinct (without extensive factual background, which can be cross-referred to), to focus only on the risk presented (without mitigants, which can be presented elsewhere in the document, without being cross-referred to)

- Forward-Looking Statements – US statutory safe harbours precludes civil liability for material mis-statements or omissions in such statements if, among other things, they are identified as forward-looking statements and are accompanied by meaningful cautionary statements – this drives certain US practice in respect of cautionary language and disclaimers around the use of all information in a prospectus which does not speak strictly to present or historical facts

- OFR – an extensive body of specific SEC guidance in respect of financial disclosure requires the OFR discussion to be formulated in a certain style and to a level of detail in certain respects above and beyond what is required in the PD. In particular, disclosure on the key factors impacting the issuer's financial results, the comparative results of operations disclosure, coverage of the issuer's critical accounting policies and of liquidity and cash flows are all typically drafted according to US practice {note – it may also be preferable to align the EU Accounting Directive requirements with the PD III rules)

- Pro forma and stand alone financial statements of acquired companies – Regulation S-X governs the use of pro forma and stand alone financial statements in SEC registered disclosure, and is applied to assess Rule 144A / 10b-5 disclosure requirements outside the United States. The standards applied by regulation S-X to require pro forma and stand alone financial statements vary in certain cases from those required in the equivalent situation in a PD-governed prospectus, and the US thresholds are generally applied in a 144A / 10b-5 disclosure document

- Industry Guides – in respect of certain industries (e.g. banks, mineral extraction companies) the SEC has certain industry-specific disclosure requirements which are made reference to in Rule 144A / 10b-5 disclosure practice even outside the context of SEC registered transactions.