

EUROPEAN PROSPECTUSES: A STEP FORWARD?

Summary. The creation of a true Single Passport for Issuers would be an important instrument for the integration of European capital markets. The current EU prospectus regime does not achieve this. The goal of the Commission's proposal for a new directive on European Prospectuses is to create such a single passport, enabling prospectuses to be approved by only one member state authority and then accepted throughout the EU for public offer and/or admission to trading on regulated markets. This aim is generally supported, but industry and others have expressed serious concerns about the approach adopted in the proposal. Concerns include: the requirement that issuers from EU Member States must have their prospectuses scrutinised and approved by the competent authority of their country of registration, thus denying issuers the choice of where to have this service provided; the implication that issuers whose securities are only to be offered abroad may still be required to submit a prospectus in their national language; the proposal to concentrate the responsibility for prospectus approval in one central administrative authority per Member State; and the scope left to national authorities to impose additional requirements. Other concerns raised relate to: a 'one-size-fits-all' approach for all types of securities, offers, and issuers; and the exemption from the rules of securities issued by a Member State or one of its regional or local authorities. Many of these and other points are being raised in the European Parliament, and the Commission has accepted that some changes to the proposal are appropriate. Industry is hoping that Parliament will play an important role in ensuring that this time there is success in establishing a European passport, without in the process damaging European markets.

Capital Raising in Europe

The creation of a true Single Passport for Issuers would be an important instrument for the integration of European capital markets. Public offers of securities, in particular to retail investors, remain purely national due to costs and delays of accommodating national practices and restrictions into one single offering document, even after two European Directives. This obviously limits the ability of European investors to diversify their portfolio investment, and of issuers to expand their shareholder base and their debt financing activities in a cost-efficient and timely way.

Capital raising activities are very different depending on the type of product (equity, debt, convertibles, warrants, asset-backed securities), the type of investor (professional or retail), the type of issuer (start-up, SME, blue chip, government) and the type of market (national or European). There are also differences between a public offer with no subsequent admission to trading on a regulated market and therefore less exposure to market reactions, and public offers including admission to trading on a regulated market with obvious continuous public disclosure obligations. Finally, capital-raising activities can be conducted through private placements (negotiations between the issuer and a number of professional investors), or public offers, or through a combination of both. The challenge is how to combine in one piece of legislation this array of differences in the sophisticated and innovative world of capital markets.

If the objective of a Single Passport for Issuers is to be achieved (in particular after the failure of the two present European Directives), legislation should accommodate present appropriate and efficient market practices, eliminate current national restrictions that prevent issuers reaching European investors, and improve the level of disclosure in Europe.

The Commission's Proposal for a Prospectus Directive

Securities Prospectuses, i.e. the disclosure documents in the context of a public offer of securities and/or of an admission of these securities to trading on a market, are designed to fulfil two important functions in today's financial markets:

- from the viewpoint of the investor, the prospectus should furnish information enabling a correct assessment of the strategic position and financial situation of the issuer, as well as the prospects of the issuer and the rights derived from the securities offered;
- at the same time, the prospectus should enable the issuer to broadly access the capital markets, to offer its securities publicly and/or to have them traded on a quality market.

If European legislation in the area of prospectuses is to contribute to improving the functioning of EU financial markets, with the wider aim of promoting the competitiveness of the European economy as a whole (the "Lisbon target"), legislators have to take into account these two basic functions of prospectuses.

The current prospectus regime in the Union is unsatisfactory and is rightly criticized in the Financial Services Action Plan. The failure to provide a true single passport for issuers has indeed been identified as one of the major problems of the present situation. Moreover, the Prospectus Directives of 1980 and 1989 are clearly out of date, and the separate legal instruments for Public Offers Prospectuses and for Listing Particulars are often regarded as impractical and confusing.

Indeed, the retail market for offers remains mainly national due to the multitude of requirements (translation and additional information) that issuers have to comply with to make their offers acceptable in different countries.

Does the Draft Directive improve the quality of information in prospectuses?

In the Commission Draft, a uniform prospectus scheme is proposed which will in principle apply to all types of securities, all types of offers, and all sorts of issuers. The development of "models" for different types of securities and of issuers is delegated to the European Securities Committee under the Lamfalussy procedures. These models are to lean heavily on the IOSCO Disclosure Standards. It has to be noted that these IOSCO Standards were expressly developed for cross-border offerings of equity and are therefore inappropriate for other securities such as debt, convertibles and warrants. **The EP rapporteur and the Belgian Presidency are proposing amendments to ensure that these differences are taken into consideration.**

The Draft Directive excludes – as in the past – securities issued by a Member State or one of its regional or local authorities; issues from authorities in other countries will follow the general disclosure rules. In view of the divergence in credit ratings among today's Member States (and even more in respect of the accession candidate countries), and in view of the inclusion of local authorities, it is questionable whether such a broad exemption is justified. **The EP rapporteur is proposing a deletion of this exemption.**

Does the Draft Directive provide for a true Single Passport for Issuers?

The Commission proposal aims to ensure that prospectuses are indeed passportable throughout the Union, so that issuers can use one prospectus document for offers in all EU countries, without needing to obtain separate authorisations in each of the countries where they wish to raise capital. In order to do that, the Directive proposes to centralise approval in just one member state competent authority (home), and to ensure that all other EU competent authorities (host) have enough confidence in the scrutiny process and the approval of the prospectus by the home authority of the issuer (the proverbial "rubber stamp").

However, industry has questioned whether the level of harmonisation necessary to create this general atmosphere of confidence among regulators can only be achieved through a rigid and uniform regime of competencies as proposed by the Commission.

Firstly, issuers from EU Member States will be forced to have their prospectuses scrutinised and approved by the competent authority of their country of registration – even if their securities offer (or application for admission to trading) is not targeted at their home market. Issuers from third countries will be stuck forever with the competent authority where their securities have been admitted for the first time. For all EU-based issuers, this creates a monopoly for their respective national competent authorities. Issuers fear that their national regulators may have little experience with instruments (such as warrants, asset-backed bonds and others) that are not common within their countries, while competent authorities in other countries have developed specialised skills and already established appropriate structures and procedures.

Secondly, being tied – for better or for worse – to its national competent authority, could mean that an issuer whose securities are only to be offered abroad may still be required to submit a prospectus in its national language. The question of disclosure language is of course a complex and highly political one, but private investors' interest should not be ignored- as they would be by a language regime that was used to protect the political interests of an authority rather than the economic interests of an investor. **The EP rapporteur proposes some (limited) choice of competent authority for all issuers to reflect current market practice.** Regulators, like market operators have a paramount interest in market quality. Allowing a degree of choice will not lead to 'regulatory arbitrage' but will encourage increased cooperation between authorities, which is also desirable as a first step towards a unified system of European financial regulation.

Thirdly, the Commission draft adopts the proposal by the European regulators to concentrate the responsibility for prospectus approval in one central administrative authority per Member State. While this proposal potentially facilitates access to disclosure documents and contributes to creating the atmosphere of mutual trust among regulators as mentioned earlier, discontinuity in scrutiny and approval procedures through the transfer of responsibilities to central administrative authorities may lead, at least in the short term, to delays in the approval procedures. The arguments for leaving the final responsibility for prospectus approval with an administrative authority are strong; a delegation of some powers to other institutions under strict supervision could be a feasible option. In any case, market operators (Exchanges) argue that the commercial decision on admission of securities to trading on their markets must remain their own responsibility.

In order to make a prospectus "passportable", the Commission's proposal establishes a specific procedure for pan-European offers based on a notification from the home authority to the host authority of an approved prospectus. While representing a major improvement from the present

situation, the Commission proposals are still seen as insufficient (host authorities can still impose national requirements) to achieve **the “Community approval” that the EP rapporteur is proposing.**

Are the approaches in the Draft Directive proportionate?

Many have criticised the Draft Prospectus Directive as too rigid, too inflexible, and as fostering a "one size fits all" approach to many issues. Such "one size fits all" approaches, however, are by definition likely to fail the proportionality test. Achieving a flexible and modern legislative framework for such a variety of capital raising activities is a tremendous challenge. More extensive consultation during the drafting phase of this Directive could have resulted in a more differentiated – and thus more proportionate – regime.

An adequate differentiation between a private placement and a public offer, and a proportionate regime for exemptions from the obligation to have an approved prospectus, is one of the essential measures for flexibility and proportionality.

Private placements enable issuers to raise capital on a timely and cost-efficient basis. The draft Directive acknowledges this and defines private placements by establishing a definition of public offer, of professional investor, and describing three types of private placements (namely, offers to professional investors, to a limited number of investors, with a minimum acquisition amount of 150,000 Euro). **One of the main adjustments that the EP rapporteur proposes is to amplify the concept of private placement to adapt it to current best practice in the market, namely by considering large corporations as professional investors.**

In relation to the exemptions regime, the draft Directive has eliminated a number of exemptions that issuers are currently using either because there is already enough disclosure in the market (for example in the case of an offer of new shares that are already admitted to trading on a regulated market), because the securities offered are from strictly supervised institutions (e.g. banks), because the offer concerns products that are mainly traded among professional investors (Eurobonds), or simply because there is a continuous offer of securities based on an approved prospectus (MTN programmes). **The EP rapporteur is re-introducing these exemptions.**

The Draft Directive brings about considerable changes in disclosure requirements and procedures, which affect particularly, but not exclusively, SMEs. In the past, SMEs that only wanted to offer their securities publicly, without having them listed on an "official market", had to fulfil only the reduced disclosure requirements of the Public Offers Directive and could in some Member States potentially benefit from more flexible, often faster non-administrative scrutiny procedures. In the current Draft Directive, this distinction between public offers without admission to trading on a regulated market and those with an admission to trading is abolished. In addition, all issuers, regardless of their size and of their issuing intentions will be obliged to make use of the so-called "shelf registration system" (two separate documents) when they want their securities admitted to trading on a regulated market. If their securities are not admitted to trading, they can publish the prospectus as one single document. Under the mandatory shelf registration system in the Commission's proposal, issuers would be forced to update the so-called Registration Document (basically financial information) every year and to have these updates registered and scrutinised by the competent authority. This is in addition to other secondary market information obligations under present EU Directives for issuers listed on traditional stock exchanges. In return for updating the Registration Document on a yearly

basis, issuers will/would later only need approval of a securities note (basically the offer details) and a summary (of the Registration and Securities documents). The benefit for the issuer would lie in reduced documentation (and faster procedures) in the case of subsequent securities offers and in efficient passportability of such documentation onto other Member States.

This is where the question of proportionality is raised by many. Certain issuers may opt to decline the opportunity for easier and faster disclosure procedure in the future or they may have no intention to benefit from the passportability of a prospectus since – at least for the time being – their intentions are purely domestic (and none of these decisions need be irreversible). Estimates for the additional costs for issuers resulting from the introduction of the shelf-registration system run to tens of thousands of Euro per year. Making shelf registration optional would not change the information flow between issuer and investor, consisting of a complete prospectus whenever securities are issued, and annual reports and ongoing disclosure in the time between issues. For cross-border offers (where the passporting argument becomes valid), mandatory shelf registration could be required. **The EP rapporteur proposes optional use of the shelf registration system in his draft report.**

Briefing notes are prepared by the Industry Advisory Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Advisory Committee.

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