

INTERNATIONAL PRIMARY MARKET ASSOCIATION

Response to HM Treasury Consultation of October 2004 on implementation of the Prospectus Directive

1 Introduction

The International Primary Market Association (IPMA) is pleased to respond to HM Treasury's Consultation Paper on the UK implementation of the Prospectus Directive 2003/71/EC. IPMA is the organisation which represents the managers of debt and equity securities' issuer in the international capital market.

We have prepared our response with the help of a working group of our Members and capital markets' lawyers. In Section 2 we respond to the questions raised in the consultation. In Section 3 we raise some additional points. We also attach a copy of our response to the UK Listing Authority's consultation on their proposed implementation of the Prospectus Directive.

2 Responses to Questions raised

We set out below our responses to the questions raised in the consultation.

2.1 *Question 1 Do you agree that the Directive definition of public offer benefits from this clarification?*

We agree that the definition of "public offer" in the Directive is so broad as to require clarification. The exemption proposed for Section 103(2) is helpful. However:

2.1.1 there appears to be some confusion between the text of the definition in the draft Regulations and the explanation set out in paragraph 4.11 of the Consultation Paper. Paragraph 4.11 says that the definition "does not include a communication in connection with *screen trading* on" the specified markets, whereas the draft regulation uses the phrase "in connection with *trading* on" the markets. The latter phrase is much broader than "screen trading", because the UK Listing Authority's rules treat any transaction effected by means of the facilities of, or governed by the rules of, a regulated market as being "on-exchange" (see the definition of "on-exchange" in the UK Listing Authority's Handbook). This broader interpretation is much preferable, because there are likely to be transactions that are not the result of offers made on a screen. We therefore suggest that you leave the suggested implementation wording as it currently stands in the draft Regulations.

2.1.2 we are unclear as to the intended meaning of the phrase "in connection with" in the proposed definition. Does it mean that the communication has to expressly refer to the on-market transaction? Or does it mean that any communication that eventually results in an on-market transaction is exempt? The former interpretation would limit the scope of the exemption to communications such as the bid

offer on the market's screen. The latter view would expand the exemption to include, for example, letters to clients describing the securities that are to be offered.

- 2.1.3 the inclusion of this specific exemption highlights the broad nature of the definition in the Directive. By implication, if screen trading on the specified markets needs an exemption, screen trading (and a very wide range of other communications) on all other markets (or, indeed, off-market) will require the production of a prospectus. It will, therefore, be very important to exempt all communications that may inadvertently be caught by implication. As markets are innovative and dynamic, it will also be important to include in the legislation a power for the Treasury to change the definition quickly, to take account of new developments. We are not certain that the power reserved in the proposed section 103(2)(iii) is sufficient for this purpose, because it is tied to the market abuse regime under section 118. Markets that will be prescribed for the purposes of section 118 are not necessarily the same as those that need to be exempt from the public offer regime.
- 2.1.4 it will be important to limit the jurisdictional scope of the definition (and thereby, of the prohibition). Article 3.1 of the Directive requires Member States to prohibit any offer of securities to the public *within their territories* without the prior publication of a prospectus. However, it is unclear under proposed section 85(1)(a) whether the prohibition relates to the making of an offer in the United Kingdom; or to the making of an offer to members of the public who are in the United Kingdom. The former interpretation would catch offers made from the United Kingdom to non-exempt persons in other countries (whether within or outside the EU). We do not believe that this is (or indeed should be) the intention. The ambiguity could be removed by inserting the words "in the United Kingdom" after "any person" in line two of the proposed section 103(2)(a).
- 2.1.5 we believe that it would be both helpful and possible for the UK to make it clear that, before the prohibition can bite, there must be an offer in the contractual sense. While the language of Article 2.1(d) of the Directive is broad, it does talk of the communication containing "sufficient information on the terms of the offer". Under English law, this could be implemented so that there has to be an offer with sufficient certainty as to its terms to be capable of acceptance so as to form a contract; or an invitation to someone to make such an offer. Implementation of the Directive on this basis would remove considerable uncertainty as to when a prospectus is required. It is also important to note that such implementation would not create a loophole in English law, because non-contractual inducements to investors tempting them to buy securities would continue to be controlled by the financial promotion regime under section 21 of FSMA.
- 2.1.6 we do not believe that the Directive requires the publication of a prospectus unless the person making the communication in question

actually has securities to sell as a result of someone responding to the communication, or is acting at the behest or in collusion with such a person. The wording of Article 3.1 of the Directive prohibits the *making* of an offer, implying that the “maker” of the offer must have securities to sell. A person cannot be deemed to be making an offer when the subject matter of the offer does not belong to him and he has no intention of acquiring and selling the property, even if someone asks him to. So, for example, financial journalists should not have to produce a prospectus before making a report about a new issue. It is important that the press should be able to continue reporting such new issues, including issues which are offered only to wholesale investors, even though the wholesale investor exemption will not be available to them, thanks to their wide readership.

2.1.7 The final paragraph of Article 3.2 of the Directive makes it clear that, where securities have been the subject of an offer to which an exemption applies, any subsequent offer of those securities is treated as a separate offer and must either itself be exempt or be preceded by the publication of a prospectus. It seems to us that this implies that, if an offer has been made which is NOT exempt (and for which therefore a prospectus has been published), then a subsequent resale of those securities is not to be treated as a separate offer and does not require the publication of a prospectus. It would be helpful to make this clear in the definition of public offer.

2.2 ***Question 2 Do you anticipate particular issues regarding the application of the definition of a public offer in other circumstances?***

We believe that there are issues regarding the application of the definition. Examples include:

- markets that are not specified for the purposes of section 103
- depending on the scope of the exemption, it may be necessary to exempt materials that advertise listed securities – if the exemption is limited to screen offers, brokers’ circulars, for example, will not be exempt. This is an unnecessary result, given that such circulars are already controlled under the financial promotion regime and, as we say above, the Directive does not seem to us to require that brokers publish prospectuses (because they are not offerors).
- some websites that make prospectuses published in other jurisdictions available to anyone who has access to the internet.

2.3 ***Questions 3 and 4 Do you consider the 2.5 million euros threshold to be an appropriate level at which the production and approval of a prospectus is required under UK law?***

And, if not:

What form of additional UK prospectus regime should apply below the 2.5 million euros threshold?

We would not support the introduction of such a regime, because:

- it would introduce additional complexity into legislation that is already highly complex
- it would introduce greater cost into a market populated almost entirely by small or medium sized enterprises and where there is already adequate consumer protection, thanks to the financial promotion and conduct of business regimes
- securities issued as a result of such offers are unlikely to trade actively
- there are already adequate protections against the use of misleading offering materials in the general law; and adequate controls over who can offer securities and how they can be promoted, under sections 19 and 21 of FSMA.

2.4 *Question 5 Do you agree with our approach to implementing the exemption where the offer of securities is addressed to fewer than 100 persons?*

We do not agree with the proposal to require that availability of the exemption for offers to fewer than 100 persons should be determined on an aggregate basis over a 12 month period. The Directive does not contain such a requirement and, if the UK introduced it, it would be running counter to the maximum harmonisation that is intended by the Directive. Those involved in pan-EU offerings would be faced with multiple, different rules on public offers across Member States and the market would be fractured as a result. It would also affect employee share option schemes, where multiple offers may be made to employees throughout the year, so that the 100 persons limit would be quickly reached making the exemption much less useful in this context. We assume that the reason for suggesting this extension of the Directive regime is a concern to prevent the use of avoidance devices – for example, offers of the same securities to 99 people on day one and another 99 on day two, where each offer technically constitutes a separate offer. However, we wonder whether this situation is not already dealt with by the FSA’s rules. Any such offers to retail customers in the UK will be made by persons authorised under FSMA, who are therefore subject to the FSA’s Conduct of Business Rules. For example, General Principle 1 requires firms to conduct their business with integrity; and General Principle 5 requires firms to observe proper standards of market conduct.

2.5 *Question 6 Do you agree with our proposed implementation approach for attaching responsibility to the prospectus?*

We broadly agree that carrying over the existing liability regime is the correct approach. However: -

- 2.5.1 we note that, while the liability regime under section 90 of FSMA has been widened, by deeming “listing particulars” to include “prospectuses”, the same approach has not been adopted in relation to the Financial Services and Markets Act (Official Listing of Securities) Regulations 2001 (the “OLS Regulations”). As a result, it is not clear who is responsible for prospectuses. We can see no reason why the OLS Regulations should not apply to both listing

particulars and prospectuses, as indeed they currently do in relation to public offer prospectuses thanks to Regulation 10.

Whichever method you adopt to identify who is responsible for prospectuses, it will be important to include the concepts set out in regulation 13(2) of the Public Offer of Securities Regulations 1995. It must be made clear that the issuer is *not* a person who is responsible for a prospectus unless the issuer is the offeror or has authorised the offer.

- 2.5.2 in particular, it will be necessary to extend regulation 9 of the OLS Regulations so that it refers to prospectuses as well as listing particulars. Many non-EU issuers in the international securities markets rely on this exemption, which enables the issuer, rather than its directors, to take responsibility for listing particulars (or prospectuses). It will also be important that the UK Listing Authority's rules are extended so that prospectuses are specified for the purposes of this regulation.

2.6 *Question 7 Do you think that the UK should have a Qualified Investor regime?*

We agree that the UK should extend the definition to include natural persons and SMEs. The criteria for identifying such persons as qualified investors should depend on self-certification. It is not practical to require solicitors or accountants to provide such certifications, as they cannot readily assess if the criteria have been met. (We note that the Government response to the review of the effectiveness of the certification system under the Financial Promotion Order also concluded that self-certification is the practical way to proceed).

2.7 *Questions 8 and 9*

Do you agree that a prospectus should be made available on an issuer's website in addition to in a printed form?

Do you agree that a notice should be published stating how the prospectus has been made available and where it can be obtained from the public?

We refer you to our response to question 2 of the UKLA's consultation on the implementation of the Directive (see attached copy). By way of brief summary, we believe that:

- 2.7.1 issuers should be permitted to take such action as is necessary to avoid breach of the laws of other countries, including managing access to the prospectus
- 2.7.2 issuers should be permitted to segregate prospectuses from other material on their websites, to avoid the possibility that those accessing the website may be confused with what is, and what is not, prospectus material
- 2.7.3 in relation to publication of listing particulars for those listing on exchange-regulated markets, website publication may be inappropriate, because it may amount to a public offer (in the UK

and elsewhere in the EU) thus triggering the requirement for publication of a prospectus

- 2.7.4 any requirements for website publication should recognise that some issuers, particularly smaller issuers, such as special purpose vehicles, may not have websites
- 2.7.5 publication on the websites of others (such as financial intermediaries and paying agents) should be optional
- 2.7.6 provision should be made for the removal of prospectuses from the website after the expiry of an appropriate period.

3 Other points on the draft Regulations

3.1 Section 84(2)(b)

We believe that a reference to the Regulations made under the Directive would be more appropriate than the reference to the Prospectus Directive, as these take direct effect in English law. The Directive does not require a prospectus to be in any particular form or contain any particular information. It requires Member States to implement laws containing such requirements.

3.2 Section 85(1)(b)

We do not think that this correctly implements the Directive. Article 3.3 of the Directive makes the production of a prospectus a prerequisite to *admission* to the regulated market. It does not require a prospectus before a person *seeks* admission.

3.3 Section 85(2)

The reference should be to subsection (1)(a), because the exemptions in section 85(3)(a) to (e) (which replicate those in Article 3(2) of the Directive) are not available under the Directive when securities are to be admitted to trading on a regulated market. Paragraph (f) of section 85(3) implements Article 17 of the Directive and *does* apply both to public offers and admission to the UK's regulated markets. Accordingly, we would suggest that section 85(2) should read:

“Subsection 1(a) does not apply where any of the conditions in subsection (3)(a) to (e) is satisfied and subsection (1)(a) and (b) do not apply where the conditions in subsection (3)(f) are satisfied.”

3.4 Section 85(8)

It is very helpful to have a mechanism for determining the equivalence in other currencies of the euro amounts used in the exemptions. However, we are concerned that the method used in the draft Regulations does not create the necessary certainty required by the markets, given the serious consequences that will result if an offer falls outside the exemption. There will always be scope to argue what the “latest practicable date” before an offer is, and we do not think that investors should be able to use volatile exchange rates to argue that a prospectus should have been produced. We think that the better alternative, in terms of creating certainty, would be to specify that the relevant exchange rate is that prevailing and the time the offer

is *first* made. While it would be possible to require that there has to be appropriate equivalence throughout the offer period, we do not believe that this is the correct approach, because it would expose the offeror to the commission of a criminal offence purely due to the vagaries of exchange rates.

We are not clear why the section refers to the date on which “approval is granted”. It seems to us that the only reference of monetary amounts in the section is in relation to exemptions from the requirement to produce a prospectus. If the offer is exempt from the requirements of the Directive, there will be no approval. If this is intended to refer to the approval mentioned in Article 85(3)(f), it is unnecessary (because this paragraph contains no monetary amount).

Finally, we do not understand the final phrase of this subsection – “denominated wholly or partly in another currency or unit of account”. Should this not be inserted at the beginning of the subsection, after the words “an amount” in line 1?

3.5 Section 85(10)

It should be remembered in this context that the persons who might contravene section 85(1) could include non-EU sovereigns, their agents and their local and regional authorities. We believe that such issuers should be exempt for the purposes of section 85(10).

3.6 Section 85(12)

There will be some issues whose offer period straddles the implementation of the Directive. For that part of the offer period ending on 30 June 2005, there will be a valid public offer or listing prospectus under the existing regimes. But these will no longer be valid on 1 July. There will therefore be a gap from the early morning on 1 July until the new prospectus is approved during that day when the offer will be in breach of Section 85(1). We believe that there should be a provision exempting such offers, provided a compliant prospectus is approved at some stage during 1 July.

3.7 Section 86(2)

One of the requirements imposed by the Prospectus Directive is that a prospectus relating to equity or low denomination non-equity securities must be approved by the home Member State of the issuer. Accordingly, the UK Listing Authority will be the home state for UK incorporated issuers of such securities. But it will also be the home state for certain non-EU issuers. The determination of which non-EU issuers fall within the jurisdiction of the UK Listing Authority depends on Articles 2.1(m) and 30 of the Directive. Unfortunately, the interpretation of these Articles is legally ambiguous. It also depends on factual information that is likely to be outside the knowledge of the UK Listing Authority. In this context, Section 86(2) requires the UK Listing Authority to withhold approval of a prospectus unless it is satisfied that the requirements of the Directive are satisfied – including the fact that it is the home state competent authority. Failure to do so may expose the UK Listing Authority to liability, including perhaps a claim for breach of statutory duty. For these reasons, it would be desirable to provide that

approval of a prospectus once given by any competent authority in the EU is valid, notwithstanding the fact that it is subsequently found that that authority was not the home state.

3.8 Section 86(3)

3.8.1 We think that the requirement that the information be presented “in an easily analysable and comprehensible form” should be included in the Prospectus Rules of the UKLA, rather than as a statutory requirement. If they are included in the statute, they create a statutory duty, and give rise to a cause of action under section 90. It is wrong that issuers and others should be threatened with litigation where the required information is disclosed in the prospectus, but it is argued that it was difficult to understand. It is the role of the listing authority to assess whether the disclosure is understandable; and the liability regime has no useful part to play in this area. We note that, although the Combined Admissions and Reporting Directive also contains these words, they have not been carried into the corresponding statutory provision in relation to listing particulars (section 80(1)).

3.8.2 It would be helpful to include provisions equivalent to sections 80(3) (information only required if within the knowledge of persons responsible for prospectus or reasonably obtainable by making enquiries) and 80(4) (indication of factors to be taken into account when determining disclosure to be made). In the case of section 80(3), this is important, partly because it makes it clear that there is no strict liability for information in the prospectus; and partly because it gives considerable comfort to an offeror who may have no relationship with the issuer of the securities and may therefore have to rely exclusively on publicly available information. Indeed, in the latter situation, we suggest that liability of such offerors should be limited to correct extraction of publicly available information.

In the case of section 80(4), the equivalent provision for prospectuses could refer to the factors in Article 7.2 of the Directive. As these provisions would qualify liability in relation to the prospectus, and as the Directive leaves Member States free to determine their own liability regimes (under Article 6), we believe that the UK has the power to implement these changes.

3.9 Section 86(6)

This provision does not implement correctly the requirements of Article 8.1 of the Directive, which permits a prospectus either to specify the criteria or conditions for fixing the price (or to include a maximum price); or to omit both the price and such information. It is only in the latter case that the investor has the right to withdraw acceptances during a period of not less than two working days.

3.10 Section 87(1)

3.10.1 This section uses different language from that in the corresponding provision relating to listing particulars (section 81(1)). In section 81(1), the period during which supplemental listing particulars are

required ends on “the *commencement of dealings in the securities* concerned following their admission to the official list”. In section 87(1), the period for supplemental prospectuses ends on the final closing of the offer to the public or when “*trading on a regulated market begins*”. In some types of issue, most trading takes place off-market. Accordingly, neither formulation is appropriate. A better formulation would be “trading on [the relevant market] is permitted under the rules of that market”.

3.10.2 In addition, in section 87(1) it would be helpful to make it clear that the end of the period is the *later* of the two events – given that it is possible that there will be a public offer followed by admission to the regulated market.

3.10.3 Finally, it is important that a provision equivalent to that in section 81(3) is included in relation to supplemental prospectuses.

3.11 Section 87(6)

This is unnecessary and confusing, given that section 86(10) already provides that “prospectus” includes a supplementary prospectus in the whole of section 86 (except subsection (4)).

3.12 Section 87C(2)(c)

Article 5.2 of the Directive contains an exemption from the requirement to produce a summary where the securities being admitted to trading are non-equity securities in denominations of at least EUR50,000. There is a power reserved under Article 19.4 of the Directive for a Member State to choose to require in its national legislation that a summary be drawn up in its official language; but as this power is contained in an Article setting out the language (rather than the contents) regime for prospectuses, it is difficult to see how it can override Article 5.2. In any event, the UK’s proposed implementing legislation does not require a summary for securities with denominations of at least EUR50,000.

In the light of this, it is difficult to understand the words “where required by X” in Section 87C(2)(c). X here means the UK Listing Authority. It has no choice as to when a summary is required. If the securities being admitted are equity or non-equity denominated below EUR50,000, there has to be a summary. If they are other types of security, there is no requirement for a summary.

It is possible that the phrase is intended to relate to the words “including a translation” – in which case they should be included within the brackets. Otherwise they should be deleted.

3.13 Section 87E(2)(a) and (e)

There can never be a suspicion that a provision of the prospectus directive has been infringed, because the Directive has no direct effect as law. We suggest that this reference should be deleted.

3.14 Section 87E(2)(d)

Line 1 should read “require a market operator to suspend trading *in the relevant securities*”.

3.15 Section 90(11)

Under the current listing regime, certain types of issuer (such as sovereigns) can be listed in the UK by producing a document equivalent to listing particulars (see UK Listing Authority’s Listing Rules, Rule 2.6). Accordingly, Section 90 of FSMA does not apply to such issuers (because there are no listing particulars). Under the new prospectus regime, some such issuers are exempt from the requirement to produce a prospectus (see Article 1.2(d) of the Directive) although non-EU sovereigns and their regional authorities are no longer exempt.

EU Member States and their regional and local authorities have the right to produce a prospectus under the Directive on a voluntary basis. If they did so, Section 90(11) would expose them (and their officers) to the liability regime under Section 90(1). This would be a significant change, with implications both in the realm of diplomacy and of international law.

This problem could be resolved either by exempting such issuers from section 90(1); or by including an exemption in section 85(6).

The same implications arise in relation to non-EU sovereigns and their regional and local authorities; but the Directive appears to give little latitude in relation to them.

3.16 Section 90(12)

Article 6.2 of the Directive states that there is to be no civil liability solely on the basis of the summary, *including any translation thereof*. The italicised words are important, because they provide an exemption for any mistranslation in the summary. Section 90(12) does not correctly reflect this.

There is a further point in relation to a summary included in listing particulars that are produced for the purposes of listing on the London Exchange regulated market. As we understand it, the UK Listing Authority intend that a summary should be included (see proposed new listing rule 4.2.2). If this requirement is retained, it will be important to extend the exemption in section 90(12) to such listing particulars.

Finally, Section 90 (12) should provide an exemption from all civil liability rather than simply liability under Section 90. This is a requirement of Article 6.2 of the Directive – and it is difficult to see how an issuer can include in a prospectus the language required by Article 5.2 (d), unless English law is altered in this way.

3.17 Section 91(1)(c)

Section 91 gives the UK Listing Authority the power to impose sanctions for breach of the listing rules. How can such rules apply to an “offeror” (particularly where the securities being offered are not listed or admitted to a regulated market)?

The new paragraph (c) refers to “any other person to whom the prospectus directive applies”. To whom is this intended to apply (given that issuers and persons seeking admission to a regulated market are already covered)?

3.18 Section 97(1)(a) and (c)

The insertion should read “or any requirement otherwise imposed by way of implementation of the prospectus directive”.