



The voice of banking
& financial services

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Response of the Joint Associations Committee to the European Commission following ESMA's technical advice on possible delegated acts concerning the Prospectus Directive

1. Introduction

- 1.1 The Joint Associations Committee (the "**JAC**") comprises most of the major firms (both financial institutions and law firms) involved in the creation of structured investment products within the European Union¹.
- 1.2 We are writing to share our views with the European Commission (the "**Commission**") in relation to the proposals from ESMA (the "**ESMA Proposals**") set forth in its final report (the "**Final Report**") providing technical advice on possible delegated acts concerning the Prospectus Directive (the "**PD**") as amended by Directive 2010/73/EU (the "**Amending Directive**"). We refer to the response to the consultation on the Amending Directive earlier in the year which was sent by the International Capital Market Association ("**ICMA**") dated 15 July 2011. ICMA is a member of the JAC and both organisations have been closely following and seeking to engage with regulators and legislators in the ongoing development of the PD.

Yours sincerely,

Timothy R Hailes
Chairman, Joint Associations Committee

¹ The JAC is sponsored by multiple associations with an interest in structured products. In the first instance, queries may be addressed to ajacobs@isda.org.

2. General comments

2.1 The JAC supports the aims of the European Parliament and the Commission with regard to the Amending Directive and the process laid out by the Commission to be considered by ESMA in relation to the delegated acts, including:

(a) the objectives of the Amending Directive:

"The Amending Directive has three main objectives: (i) increasing efficiency in the prospectus regime, (ii) reducing administrative burdens for companies when raising capital in the European securities markets, and (iii) enhancing investor protection."²

(b) each of the principles laid down by the Commission for ESMA to take into account in formulating its advice on the delegated acts, including:

"- The high level of investor protection that is the guiding principle of the Prospectus Directive.

- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objective of the Amended Directive. It should be simple and avoid creating excessive administrative or procedural burdens for issuers, in particular SMEs, and the national competent authorities."³

(c) the specific goals identified by ESMA in its Final Report, including:

- making changes as "necessary to satisfy an adequate level of investor protection which ensures confidence in EU regulated markets"⁴
- providing "issuers with clarity and legal certainty of what can be included in final terms"⁵
- ensuring that competent authorities are provided with all relevant information in order to scrutinise prospectuses "in accordance with the comprehensibility, consistency and completeness criteria set out under Article 2 of the Prospectus Directive"⁶

2.2 Particularly with regard to the last two points above, the JAC notes the comments of ESMA as to market participants having "taken advantage of the lack of regulation of the current base prospectus system to disclose information in the final terms which needs to be vetted by the competent authorities"⁷ and of the need to "prevent any further excesses in the use of final terms as well as to strengthen and harmonize supervisory practices".⁸ The JAC agrees that there is considerable legal uncertainty under the current rules as to what information may and may not be included in final terms and that practice of market participants can vary widely as to the scope of the information that has been provided in final terms. The JAC therefore welcomes the aim of providing greater legal certainty as to the permitted content of final terms, and wishes to express its support in line with ESMA

² EU Formal Request to ESMA For Technical Advice on Possible Delegated Acts Concerning the Amended Prospectus Directive (2003/71/EC), as set forth in Annex I of the Final Report, section 1.1, p. 145.

³ As per note 2, section 1.2, page 146.

⁴ Final Report, section III.I, paragraph 6, page 10.

⁵ Final Report, section III.I, paragraph 4, page 9

⁶ Final Report, section III.I, paragraph 5, page 9.

⁷ Final Report, section III.I, paragraph 5, page 9.

⁸ Final Report, section III.I, paragraph 5, page 9.

that all information that is resolved that should be vetted by competent authorities is indeed set out in a prospectus or prospectus supplement and not in final terms.

2.3 In considering the ESMA Proposals in light of the broad objectives of the Amending Directive and the principles as laid down by the Commission, we believe that, if implemented in their current form, the ESMA Proposals:

- (a) will place a heavy burden on providers of structured investment products in terms of increased costs and delays in getting products to market, with consequent loss of business;
- (b) risk driving a significant portion of the structured investment products business outside of the EU, particularly in respect of securities which are not being publicly offered but which need to be listed on an exchange; and
- (c) will reduce the universe of potential investment products otherwise available to EU investors.

2.4 At the same time, we question whether the ESMA Proposals achieve the objective of meaningfully serving to enhance investor protection. In our view:

- (a) while the proposed changes to final terms will reduce legal uncertainty as to the permitted content of final terms and ensure that more information is available to competent authorities to assess comprehensibility, we feel that the ESMA Proposals are overly prescriptive and lack the flexibility required to allow disclosure to be appropriately tailored to the relevant type of product, with little benefit to investors; and
- (b) the proposed additional summary to be attached to each final terms will be of limited value as the principal source of information targeted at retail investors. Instead, a key document for retail investors will be the PRIPs KIID (for those retail investment products which are within the scope of PRIPs) – an initiative that the JAC firmly supports.

2.5 In summary, the JAC strongly supports the objectives of the Amending Directive and the delegated acts thereunder. Our concerns are broadly that (a) in a number of important areas, the ESMA Proposals are overly prescriptive and more flexibility needs to be permitted, (b) certain of the ESMA Proposals are disproportionate in that they will severely reduce the efficiency of investment offerings in the EU under the PD disclosure regime, (c) the ESMA Proposals substantially increase the administrative burden (contrary to the first two objectives of the Amending Directive cited above) and (d) the ESMA Proposals may have only limited - if any - benefit in terms of investor protection.

2.6 We believe that the consultation period for ESMA to consider industry comments was far too short - being only four weeks over the summer period - and it is therefore perhaps not surprising that ESMA did not make many substantive changes between its initial consultation paper and Final Report, notwithstanding the many comments given. We respectfully urge the Commission to consider each of the detailed points raised by us below, and we would be pleased to engage further with the Commission to help ensure that the final legislation satisfies each of the objectives set out for it, in a reasonable and proportionate way, and in a manner which enhances consumer outcomes and confidence in EU regulated markets.

3. Detailed comments

3.1 Supplements

3.1.1 A number of competent authorities interpret Article 16 under the PD restrictively such that a supplement may only be published for a significant new factor, material mistake or

inaccuracy with respect to the issuer (or guarantor) which was not known at the time that the relevant base prospectus was published, and not due to a change in the terms and conditions of securities. Indeed, some competent authorities will not permit publication of supplements in relation to a specific product offering or in relation to the terms and conditions of securities for specific types of product offerings.

- 3.1.2 If the ESMA Proposals are implemented in their current form,⁹ issuers will need to make many amendments to the base prospectus. This is because pay-out formulae are subject to constant change in accordance with market developments and the ESMA Proposals are highly restrictive as to the scope of changes to the terms and conditions and the additional information that may be included in final terms. Therefore, it is vital that supplements be permitted to be published in relation to changes to the terms and conditions of securities. It is also vital that issuers should be able to decide whether information is significant, as it is the issuer and not the competent authority which is liable for the contents of the prospectus.
- 3.1.3. ESMA has stated that it will provide guidance on the permitted content of supplements. This is to be welcomed on the assumption that it will harmonise practice between competent authorities, and hopefully resolve the concerns noted above.

⁹ We note that the ESMA Proposals state that supplements can only be used if they contain information which is "significant" - Final Report, section IV.II, paragraph 125, page 27.

3.1.4. **Summary of JAC comments: we urge that, in providing guidance on the permitted content of supplements, ESMA takes into account the following:**

- **issuers must be permitted to amend the base prospectus by way of a supplement in relation to a specific product offering and in relation to the terms and conditions of securities for specific types of product offerings;**
- **issuers (and not competent authorities) should be free to decide what information is significant and therefore requires a supplement; and**
- **such guidance should be published by ESMA as soon as possible.**

3.2 Pay-out formulae and "comprehensibility"

- 3.2.1 Many commentators have already made the point that the requirement to include all pay-out formulae in the prospectus will lead to lengthy and complex bases prospectuses, many supplements (assuming supplements to amend pay-out formulae are permitted), and likely overload on the part of regulators having to vet all such documentation. The JAC strongly agrees with such views. An issuer should have the freedom to balance the convenience of offering all of its products in one document against the clarity and ease of use of that document for the investor. There should be no need for a separate prospectus for each product as long as it can be understood by investors, as ESMA has acknowledged in its Final Report.¹⁰
- 3.2.2 The JAC also queries the degree of benefit in terms of enhanced investor protection that will be derived from having pay-out formulae subject to regulatory scrutiny. If included in a base prospectus, pay-out formulae will have to be generically drafted, will include multiple options and consequently will be difficult to analyze.
- 3.2.3 The JAC suggests that the Commission should mandate ESMA to provide guidelines for competent authorities to clarify what "comprehensibility" means in the context of a prospectus, supplement and final terms. Unless the requirement is defined more clearly, this will be a significant area of uncertainty for issuers upon implementation of the relevant ESMA Proposals. Also, in the absence of published guidance, there will be broad scope for inconsistent interpretation of "comprehensibility" as between the various competent authorities. For example, it might be argued by a competent authority that including more than one pay-out formula or product in a base prospectus may reduce comprehensibility, but we believe this is the route that the ESMA Proposals envisage. The ESMA Proposals also refer to "product-specific" prospectuses and we believe ESMA has in mind the use of "product-specific" prospectuses incorporating by reference general product terms from a general base prospectus. In order to provide greater certainty for issuers, the Commission should confirm that it considers that these approaches should not affect the "comprehensibility" analysis by a competent authority.
- 3.2.4 As noted in our general comments, however, the JAC recognises the value of enhancing legal certainty on this issue and the need to ensure that any information that it is resolved that the competent authority should be vetting is indeed placed in front of it via the base prospectus.

¹⁰ At paragraph 6, page 10.

3.2.5 **JAC comments:**

- **The ESMA Proposals should be clarified such that (a) variations to existing pay-out formulae of products included in a base prospectus and (b) a combination of a number of different "features" of a product, should be permitted to be included in final terms;**
- **Given that there are many variations on pay-out formulae, the guidance to be published by ESMA will need to be very detailed (perhaps with examples) and be subject to industry comment and capable of regular update; and**
- **ESMA should publish guidelines as to the meaning of "comprehensibility" under the prospectus approval process.**

3.3 **Proprietary indices**

3.3.1 The ESMA Proposals would require that all proprietary indices be included in the prospectus, and may not be included in final terms. In its Final Report¹¹, ESMA picks up on some of the artificiality in the distinction between the treatment of indices which are composed by the issuer (proprietary indices) and those that are not. In our view, it is somewhat arbitrary that, in relation to an index comprised by the issuer, the PD requires that a description of such index must be provided; whereas, in relation to all other indices, all that is required is an indication of where information about the index can be found. Also, if the ESMA Proposals in regard to proprietary indices are implemented, the different disclosure requirements will put issuers having proprietary indices at a significant competitive disadvantage vis-a-vis third party providers. Further, there will be a strong incentive to circumvent the requirement for additional disclosure in relation to proprietary indices by simply appointing a third party to "compose" an index, or by referencing the proprietary indices of another market participant.

3.3.2 If the regulatory concern with proprietary indices is that a number of such indices offer strategies which may not be suitable for retail investors, then this should be addressed directly. It is worth noting that an index should not be considered to be unsuitable merely because the rules are complex. A proprietary index may have simple rules but pass risks to the investor, whereas a more complex proprietary index may involve no greater risk than an investment in a product linked to a mainstream equity index.

3.3.3 **JAC comment: in light of the considerations outlined above, the Commission and ESMA should engage further with the industry to develop an appropriate approach regarding proprietary indices, perhaps seeking to make a distinction between those which may be appropriate for vetting by competent authorities and those which can be treated like non-proprietary indices for such purposes. Or, ESMA could be delegated further authority to consider this matter further with a view to developing criteria by which certain types of proprietary indices could be treated in the same manner as non-proprietary indices for PD disclosure purposes.**

3.4 **Additional information in final terms**

3.4.1 ESMA has stated it will provide a list of "Additional Information" which is permitted to be included in final terms at a further stage. The JAC urges that such list be produced as soon as possible in order for market participants to consider the changes which will be required to their base prospectuses. Also, we think that such list should be regularly updated to reflect changes in market and regulatory practice.

¹¹ At paragraphs 83 – 89.

3.4.2 **Summary of JAC comments:**

- **ESMA should publish its list of "Additional Information" as soon as possible; and**
- **There should be provision for additions and clarifications to this list (for example through the ESMA Q&A) to be made on a regular and ongoing basis to correct omissions and to respond to changes in market and regulatory practice.**

3.5 **Summary and issue-specific summary**

3.5.1 According to ESMA:

"Recital 27 AD speaks of aligning to the greatest extent possible the content and form of the summary for securities with the outcome of the PRIPs KIID and of preventing the duplication of documents and potential confusion for investors as well as minimising the costs. The Mandate requires ESMA to take into account the objective of the work on PRIPs, in particular to avoid any duplication of disclosure requirements and so any costs and liability for PRIPs' offerors.

In the CP ESMA explained that the work on PRIPs KIID was still at the Level 1 drafting stage. This has meant that there has not been any Level 2 material for ESMA to engage with and consequently it has not been possible to align the requirements for prospectus summaries with that work. [footnotes deleted]"¹²

3.5.2 ESMA has essentially thrown it back to the Commission as to how the prospectus summary should interact with the PRIPs KIID:

"ESMA has therefore undertaken this work on a standalone basis. The Commission will need to consider how best prospectus summaries and PRIPs KIID might be aligned and what role the Commission wish ESMA to play in that work."¹³

3.5.3 In the view of the JAC, the PRIPs KIID, when enacted, will be a key retail investor-focused document for those retail investment products which are within the scope of PRIPs. The PRIPs KIID should operate side-by-side with the base prospectus summary. For these reasons, the proposed requirement for an additional issue-specific summary as proposed by ESMA should be delayed, either indefinitely or at least until the outcome of the PRIPs KIID project.

3.5.4 If the issue-specific summary is retained, in order to allow an issuer to provide for a number of different options in the base prospectus, it should be clarified that as long as the issue-specific summary meets the proposed length restrictions, there is no restriction on the length of the summary in a base prospectus. If the length restriction is applied to base prospectuses (in particular, the page limit), this may have the effect of abolishing multi-issuer programmes, the existence of which is contemplated in the Prospectus Regulation (paragraph 27 of the preamble).

3.5.5 In addition, it is not clear from the Amending Directive, as currently drafted, that the summary liability provisions contained in Article 6 of the PD which apply to summaries contained in base prospectuses would cover issue-specific summaries.

¹² See the statements at paragraphs 206 - 210 of the Final Report.

¹³ Paragraph 201 of the Final Report.

3.5.6 **Summary of JAC comments:**

- **The proposed new requirement for an issue-specific summary to be attached to the final terms should be delayed, either indefinitely or at least pending the outcome of the PRIPs KIID project; and**
- **If the issue-specific summary nevertheless goes ahead, it should be clarified that:**
 - **as long as the issue-specific summary meets the proposed length restrictions, there is no restriction on the length of the summary in a base prospectus; and**
 - **the summary liability provisions included in Article 6 of the PD applicable to base prospectus summaries should also be extended to cover issue-specific summaries.**

3.6 Translations

3.6.1 The Commission should confirm that issue-specific summaries need only be translated into the languages of the jurisdictions into which a particular offer is being made.¹⁴ If ESMA intended that the issue-specific summaries should be translated into the same languages that the base prospectus summary was originally translated into then, in the view of the JAC, this would be an overly formalistic approach and would cause issuers to incur real costs and delays in making translations into jurisdictions where an offering is not being made for no investor benefit.

3.6.2 **Summary of JAC comment: The Commission should confirm that the issue-specific summary only needs to be translated into the language of each jurisdiction in which an offer is made in accordance with Article 19 of the PD.**

3.7 Grandfathering rules

3.7.1 The ESMA Proposals are clear that prospectuses approved prior to 1 July 2012 will not need to be amended to reflect the amended PD.¹⁵ This is an extremely important point for the industry, as the ESMA Proposals, if implemented in their current form, will trigger a very substantial revision to existing documentation. For example, many market participants will need to publish a number of new base prospectuses to reflect the respective product types. Obviously, such process will take considerable time, and cannot get fully underway until the new rules and accompanying detailed guidance has been published and digested by the market.

3.7.2 In its Final Report, ESMA suggests that some final terms do not meet the current rules, including because they "include significant changes to redemption structures ... and terms and conditions that should have triggered the need to produce a supplement."¹⁶ We have noted above that there is considerable legal uncertainty as to the permissible content of final terms and that practice of market participants can vary widely as to the scope of the information that has been provided in final terms, but there are nevertheless legitimate differences of opinion as to what may and may not be included in final terms under the current terms of the PD. In addition, as we stated in paragraph 3.1 above, there is currently uncertainty as to how a supplement may be used with some competent authorities taking the view that a supplement may not be used to amend the terms and conditions as set out in the base prospectus. In order for the grandfathering provisions set out in the ESMA Proposals to be effective it is important for ESMA to clarify that individual

¹⁴ See paragraph 68 of the Final Report.

¹⁵ At paragraph 11 of the introduction to the Final Report, page 7.

¹⁶ At paragraph 34, page 14.

competent authorities should not change their recent and current published views and monitoring practices in response to the comments made in ESMA's Final Report in relation to issues made on or after 1 July 2012 under valid base prospectuses approved prior to such date.

3.7.3 Paragraph 12 of the introduction to ESMA's Proposals provides that "*a competent authority may passport a prospectus or base prospectus on or after 1 July 2012 even though the prospectus or base prospectus was approved before that date and that in such cases the certificate of approval should clearly indicate that the prospectus or base prospectus was approved before 1 July 2012 in accordance with the requirements of the Directive as applied at that time.*" The use of the word "may" suggests that a competent authority has discretion whether or not to passport a prospectus or base prospectus. It should be clarified that a competent authority *will* passport the prospectus under these circumstances.

3.7.4 **Summary of JAC comments:**

- **ESMA should clarify that individual competent authorities will not change their recent and current published views and monitoring practices in relation to the permitted content of final terms until base prospectuses approved prior to 1 July 2012 have lapsed;**
- **ESMA should clarify with the competent authorities that it will provide guidance on the permitted content of supplements and that competent authorities should not restrict use of supplements until instructed by ESMA. This would be welcome on the assumption that it will harmonise practice between competent authorities, and hopefully resolve the concerns noted above; and**
- **It should be clarified that a competent authority *will* passport a prospectus or base prospectus on or after 1 July 2012 where the prospectus or base prospectus was approved before that date.**

About the Joint Associations Committee

The JAC is sponsored by multiple associations with an interest in structured products, including the International Swaps and Derivatives Association (ISDA), the International Capital Market Association (ICMA), the Association for Financial Markets in Europe (AFME), the British Bankers' Association, the Asia Securities Industry & Financial Markets Association (ASIFMA), SIFMA, the Associazione Italiana Intermediari Mobiliari (ASSOSIM) and the Institute of International Finance, Inc. (IIF). The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved in the creation and, to some extent, distribution of structured securities which are distributed to retail investors.

About ISDA

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA is one of the world's largest global financial trade associations, with over 825 member institutions from 57 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

About ICMA

ICMA represents financial institutions active in the international capital markets; its members are located in 50 countries, including all the world's main financial centres. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants and regulatory authorities. For more information see: www.icmagroup.org.

About FOA

The Futures and Options Association (FOA) is the industry association for some 170 international firms and institutions that engage in the carrying on of derivatives business, particularly in relation to exchange-traded transactions. The FOA's membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector.

About UK SPA

The UK Structured Products Association (UK SPA) is an organisation established by companies that create and distribute structured products to the UK financial services market in order to provide a useful and responsive source of information, education and comment on structured products by promoting their contribution to effective financial planning.

The Association's formation is a direct response to the members' belief that structured products are sometimes misunderstood and misrepresented and that this lack of understanding can prevent structured products forming an integral part of financial planning for investors.

The UK SPA is committed to publishing research, information and educational material about structured products and so create greater acceptance about their potential.

The UK SPA is not a commercial organisation and education and research are its core activities.

About the British Bankers' Association

The BBA is the leading association for the UK banking and financial services sector, speaking for 201 banking members from 50 countries on the full range of UK and international banking issues and engaging with 55 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts for UK customers and contributing £50 billion annually to UK economic growth.