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JAC Response to European Commission Consultation Document: "Review of the Prospectus Directive "

This letter is a response to the European Commission's consultation document published on 18 February 2015 relating to the review of the Prospectus Directive and the Prospectus Regulation (the "**Consultation Paper**"). The Consultation Paper seeks to identify the needs of market users with regard to prospectuses concerning scope, form, content, comparability, the approval process, liability and sanctions. In addition, interested parties should provide feedback about the aspects which unduly hinder access to capital markets for issuers, and which, if amended, could reduce administrative burden without undermining investor protection.

The Joint Associations Committee on Retail Structured Products (the "**JAC**") welcomes the opportunity for a public discussion of the matters raised in the Consultation Paper. The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved in the creation, manufacturing and distribution within the EU of structured products that are distributed to retail investors. The JAC is therefore well positioned to comment on the subject matter of the Consultation Paper and the issues it raises.

The members of the JAC have not prepared a response to each of the questions raised in the Consultation Paper. We have addressed our responses to those questions in the Consultation Paper which we feel are particularly relevant to the JAC and the concerns of its members: being, **questions 7-11, 23, 27-30, 33, 40, 42, 48** and **question 50**.

This letter is submitted in addition to JAC's responses to the Prospectus Directive review questions on the European Commission's website. We set out in Annex 1 additional explanation or detail for the answers submitted to the Prospectus Directive review questions on the European Commission's website.

Yours faithfully,

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Chairman – Joint Associations Committee on Retail Structured Products

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ANNEX 1

Additional information in response to certain survey questions

Question no. 9 (Secondary issuances)

The exemption in Article 4(2)(a) of the PD regarding secondary issuances being admitted to trading on the same regulated market is currently limited to shares of the same class already admitted on such market. Consequently, if the exemption in Article 4(2)(a) of the PD is to be amended to apply to all categories of fungible securities, certain amendments appear appropriate in the context of issuances of structured securities. JAC does not express any view as to whether an upper limit should be retained in the context of secondary issuances of shares but see no rationale why an upper limit should apply for structured securities. Secondly, such exemption should not refer to the 'same class of securities' but rather relate to securities that are fully fungible with the securities already admitted to trading.

In addition, the exemption in Article 4(2)(h) of the PD has not been identified as a workable tool when an issuer wishes to list several issuances of structured securities on *another* regulated market, whether in the context of a dual listing, a desire to shift between regulated markets and/or to concentrate certain issuances to certain regulated market(s), e.g. depending on investor preferences or market conditions. Given the changes in requirements during the evolution of the prospectus regime, e.g. the requirements relating to summary sections in base prospectuses and issue-specific summaries attached to final terms, among other things, it can be difficult for issuers to document secondary issuances and/or admission to trading on another regulated market under their existing valid base prospectuses. We note from question no. 10 below that a maximum time frame between the original prospectus and the secondary issuance is being considered. Among the numerous conditions in Article 4.2(h) there is currently instead a requirement to have a minimum period of 18 months. Given the ongoing obligations to disclose and publish regulatory information under MAD and TOD, there are no apparent reasons why secondary issuances on the same regulated market should be treated differently than an admission to trading of the same securities on another regulated market (potentially with the exception of compliance with the applicable language requirements under the PD).

Question no. 11 (MTFs)

The existing optionality between regulated markets and MTFs has been well received by investors and issuers alike. The number of MTFs which have evolved during a limited period of time support this conclusion. Where targeted investors have expressed a preference for, or are likely to prefer, an admission to trading on a regulated market for disclosure, legal, regulatory, tax or any other reasons, an issuer wishing to extend an attractive investment proposition to such investors can benefit from the status of an admission to trading a regulated market. Where investors do not value the benefits associated with an admission to trading on a regulated market but still seek an admission to trading on an MTF, the issuers are currently able to accommodate such preference. In such case the full costs associated with an admission to trading on a regulated market do not burden the investment proposition which is to the benefit of issuers and investors. The introduction of an obligation to publish a prospectus may result in a substantial decrease in the number of non-equity admitted to trading on MTFs *de facto* resulting in a lower level of investor protection available for investors not seeking an admission to trading on a regulated market. The recent developments of MAR and MIFID II should be sufficient to address any concerns for potential market failures.

We see no evidence that the current absence of any obligation to publish a prospectus in conjunction with an admission to trading on an MTF has led to any investor detriment.

To the extent there are any material investor protection concerns related to SME growth markets which are appropriately addressed through the introduction of an obligation to publish a prospectus when securities are admitted to trading on an MTF, such obligation should only be introduced for equity securities admitted to trading on SME growth markets. We see no evidence of any market failure or other investor detriment in relation to non-equity related securities, such as structured securities, issued by non-SME issuers and admitted to trading on MTFs.

Question no. 23 (Incorporation by reference)

The prospectus can be - but does not have to be - contained in a single physical document. Essentially, a prospectus is a compilation of information and not a single physical document. The issuer shall prepare a prospectus to meet the criteria in Article 5 of the PD, allowing investors to make an informed investment decision. NCAs shall vet the prospectus to see if the prospectus meets the criteria regarding comprehensibility and the minimum information requirements stipulated in the applicable provisions in the PD and the PR. Following the NCAs' approval, the prospectus shall be published in the required manner. Any parts of a prospectus which have not already been published must be published following approval of the prospectus.

Information which has been published and is available to NCAs and potential investors when a prospectus is published following approval, (a) allows NCAs to duly consider such information for the purpose of their review and approval processes and (b) allows investors to read and duly consider the incorporated information when forming an investment decision. The same applies for information which has not previously been published but which is made available to the NCAs for the purposes of their review and approval process regarding the relevant prospectus, provided that such incorporated information is published not later than simultaneously with the publication of the main prospectus document following the approval. Again this allows NCAs and investors full access to the relevant information in sufficient time.

There is no investor detriment stemming from the nature of the document in which the incorporated information is contained. Provided NCAs and investors have access to such information at the relevant moment in time and that NCAs have concluded that the prospectus meets the criteria regarding comprehensibility among other things, we see no justification for limiting the mechanism to only certain categories of documents from which information may be incorporated. Any such limit would by necessity limit the flexibility of the mechanism. Any concerns relating potential investor detriment appear to be based on the existence on the mechanism as such rather than the category of sources from where information is incorporated.

We refer to JAC's response dated 18 December 2014 to ESMA's consultation paper, dated 25 September 2014, "Draft Regulatory Standards on prospectus related issues under the Omnibus II Directive" as regards the views of our members regarding the position under the current regime. Many of the views expressed in our response are also relevant in the context of a recalibrated regime. The response is available via the following link: http://www.icmagroup.org/assets/documents/Events/JAC-response-to-ESMA-CP-on-Omnibus-II-prospectus-related-issues.pdf.

Question no. 27 (Summary requirements)

We agree with the comments in the Consultation Document that the summary has not achieved its purposes, at least in connection with structured securities: (i) given its technical prescriptive format and its length, it is not a short, simple clear and easy to understand document which can be a key source of information for retail investors and (ii) given the diversity of interpretation as between the NCA's of the summary content requirements and the general unwieldiness of the document, it does not appear to be a useful document in order to facilitate comparisons as between products. Further, there is confusion as to whether the summary in a base prospectus should be limited to a pro forma issue specific summary to be attached to final terms or whether it should also play a role as the general summary of the base prospectus (so that there are two levels of disclosure in parts of it). For these reasons, it is clear that the summary needs to be fundamentally reconsidered.

The solution is to replace the summary with the KID. The KID has been specifically designed (including with the benefit of comprehensive consumer testing) to satisfy the first two objective above. We therefore see no reason whatsoever to retain the issue specific summary in relation to any product for which a KID is available.

Further, we suggest that for those products for which a KID is not required under the PRIIPs Directive, a summary under the Prospectus Directive is not necessary or effective (for the reasons given above), and should be abolished.

Finally, we suggest that the concept of a specific summary for a base prospectus should be re-introduced. While the Prospectus Directive of course does cater for the concept of a base prospectus, certain parts of the legislation – such as the summary requirement – need refinement in relation to the base prospectus regime. A base prospectus summary should summarise the various issuers and guarantors (if more than one) and types of securities and related features and risks under the base prospectus, in order to assist the reader to understand the scope of the document – essentially the summary as it was prior to Directive 2010/73/EU.

Question no. 29 (Length limit)

Key drivers behind the length of base prospectuses for structured securities are, among other factors:

1) A firm desire to treat investors fairly by introducing pre-determined valuation and fall-back mechanisms, e.g. in the context of market disruptions, rather than relying on broad discretionary powers for issuers at the potential detriment for investors;

2) A firm desire to treat investors fairly by adding information in addition to the minimum requirements in the PD and PR, e.g. questions and answers sections to facilitate for investors, in particular retail investors, to digest relevant information;

3) Requirements under the PD/PR and/or from NCAs to hardwire issue-specific options and information in summary sections and form of final terms;

4) Requirements under the PD/PR and/or from NCAs to provide specific and concrete risk disclosure in respect of a variety of risks that may be relevant for a specific issuance of structured securities that may be issued under the relevant base prospectus; and

5) Ensuring adequate disclosure of all relevant terms is provided for contractual and liability purposes.

A recalibrated prospectus regime that would focus the prospectus content to the key information only but simultaneously allow for multi-jurisdictional legal certainty in respect of (i) full and detailed contractual terms; (ii) prospectus liability and (iii) investor understanding of the nature and scope of the prospectus disclosure, could potentially result in significantly shorter prospectuses. This presupposes that very precise requirements can be introduced as regards what constitutes the relevant required key information for prospectus disclosure purposes and simultaneously allow issuer to provide full disclosure on contractual terms and conditions and create legal certainty for issuers and investors alike. A recalibrated incorporation by reference mechanism could be utilised to allow issuers to publish the full terms and conditions on their respective websites.

Question 33 (Absence of harmonisation)

The proper functioning of ESMA should enable NCA(s) to reach sufficient degree of harmonisation without any need for adopting the most restrictive approach when constructing the position under Level 1 and Level 2 provisions.

Recent experience of JAC's members include the following examples of material differences in approach by different NCAs:

Choice of Home Member State

- Varying approaches of NCA(s) to the determination of Home Member State under Article 2.1(m) in the context of derivative securities, including which types of non-equity securities can be considered

Secondary issuances

- Varying approaches of NCA(s) as to whether or not admission to trading of a tap offer or admission to trading on a dual or replacing regulated market require publication of a prospectus/final terms

Summaries

- Varying approaches of NCA(s) in whether to allow base prospectus summary sections to defer to information in final terms

- Varying approaches of NCA(s) in whether to insist on issue-specific summaries to be attached to final terms where exempt offers (>100,000 EUR) are made under base prospectuses that also allow for non-exempt offers

- Varying approaches of NCA(s) in whether or onto to have "base prospectus level" summary disclosure

Incorporation by reference

- Varying approaches of NCA(s) in whether or not to allow entire documents to be incorporated by reference, and whether or not to allow so-called "daisy-chaining"

- Certain NCA(s) insisting that interim financial reports are attached to prospectus supplements rather than to be incorporated by reference

- Certain NCA(s) not allowing incorporation of a registration document into base prospectus despite the statements to the contrary within ESMA's recent opinion regarding the use of tri-partite regime in base prospectuses

Supplements

- Varying approaches of NCA(s) in whether or not to allow prospectus supplements where there is no obligation to prepare a supplement under article 16 of the PD

- Member state(s) stipulating withdrawal rights also in the context of supplements in the event of a prospectus solely for the admission to trading

- Certain NCA(s) insisting on disclosure of the authority's matter number on prospectus supplement front page

Languages

- Certain NCA(s) introducing varying numerical limits to the number of languages used in a prospectus

- Certain NCA(s) not allowing parts of a prospectus, e.g. financial reports, in the official language of the relevant NCA's member state where other parts prospectus has been drafted in a language customary in the sphere of international finance

- NCA(s) taking varying approaches to the permissibility to use a language customary in the sphere of international finance where offers to the public and/or admission to trading is to take place within more than one Member State

Content / comprehensibility

- NCA(s) not allowing information to be included unless is not mandatory pursuant to Prospectus Directive and Prospectus Regulation with reference to the provisions in the Prospectus Regulation regarding the order information must be presented

- NCA(s) not allowing selling restrictions and other important information required in other jurisdictions to be included before the table of content with reference to the provisions in the Prospectus Regulation regarding the order information must be presented

- NCA(s) insisting newly established special purpose issuers include audited financial statements in accordance with IFRS despite such not being required pursuant to paragraph 136 of ESMA's Prospectus Guidelines (ESMA/2013/319)

- Varying approaches of NCA(s) in whether or not to allow drafting notes in pro forma final terms in the base prospectus

- "Gold-plating" approach of certain NCA's as to their particular interpretation of comprehensibility – eg UKLA Technical Note 632.1 as "Worked Examples" section and retail navigation aids

- Certain NCA(s) insisting that a table of contents must not exceed one page in length which appear to be at odds with other NCA(s) requests for retail navigation aids

Question no. 40 (Base prospectus facility)

While the JAC believes the fundamental features of the base prospectus facility do not require changes, certain modifications would be beneficial for issuers without reducing investor protection. The existing limitation of a base prospectus validity to one year does however cause certain practical difficulties.

The members of JAC issue a large number of structured securities on a regular and frequent basis. Such issuances are often offered to the public in various member states and/or admitted to trading on regulated markets. Under the current regime most Member States do not allow an offer to the public to extend beyond the expiry of the validity of the base prospectus regardless of whether the original base prospectus is immediately replaced by a new base prospectus from the same issuer. Similarly, some Member States do not allow an admission to trading on a regulated market to take place on the basis of final terms published under a base prospectus which has expired at the time of admission to trading. This gives rise to two main problems for issuers and investors:

1) Offers to the public and/or admission to trading are scheduled to accommodate for the expiry and replacement of a base prospectus with a new base prospectus. This means that issuance and investment activities are not undertaken at the moment in time when issuers' and investors' interests coincide given ever changing market conditions. Instead, the issuers' issuances and, consequently, also the investors' investments are planned with reference to the anniversary of the relevant base prospectuses. From a pure issuance and investment perspective such date is irrelevant and arbitrary; and

2) Practical problems may, despite well-considered planning, occur due to a wide range of factors, e.g. delayed caused by market disruptions, operational risks, delayed payments by investors, delay in obtaining approvals from listing authorities and/or clearing systems etc. Where such delays occur in close proximity of the anniversary of the relevant base prospectus, practical difficulties result from the inability to straddle the anniversary.

For these reasons a mechanism should be introduced to accommodate for offers to the public and admission to trading to extend across the anniversary of the base prospectus validity. In order to ensure the level of investor protection is not impaired such mechanism could entail withdrawal rights for investors in scenarios where a withdrawal right would have been triggered pursuant to article 16 of the PD. For example, a mechanism could be introduced to allow issuers to supplement the 'expiring' base prospectus for a limited period of time with the new issuer disclosure published in the new base prospectus. Alternatively, issuers could be allowed to designated 'ongoing offers' to be covered by the new base prospectus (possibly combined with withdrawal rights being triggered for the investors who have already subscribed in such 'ongoing offers' at the time of the anniversary).

We see no reason why it should not be possible to passport a registration document. A duly approved registration document should be regarded as fully compliant with all applicable requirements and hence there is no reason why the passporting mechanism should not be available for such documents.

Question no. 48 (Exchange Traded Products)

JAC: The terminology regarding "offers of securities to the public", "primary market" and "secondary market" should be better defined in the context of exchange traded products ("**ETPs**"). ETPs are structured securities which are continuously sold and purchased over the trading system of an exchange or other regulated market. There is no initial subscription period whereby external investors are able to subscribe followed by a subsequent admission to trading. Instead, ETPs are admitted to trading and the ETPs are held in inventory by the relevant market maker(s). The market maker(s) provide bid and offer prices on the regulated market and investors wanting to purchase any such ETP at the prevailing market price will do so over the trading system of the relevant regulated market. The market maker(s) may be another legal entity than the issuer of the relevant ETPs.

We see no evidence that any investor detriment has been identified as regards ETPs and prospectus related aspects.

Issuers, market makers and investors alike would benefit from improved legal certainty that such trading activities do not constitute a continuous "offer of securities to the public" and consequently would not be caught by any implications relating to anniversary of the issuer's base prospectus, publication of prospectus supplements etc.

Further any future prospectus regime distinguishing between primary and secondary markets for the purposes of triggering the obligation to publish a prospectus should take into account, and cater for, such trading activities of ETPs.

Question no. 50 (Additional aspects)

The JAC feels that the following items should be addressed in the review:

1. **Supplements**: there are at least three issues in relation to Article 16 of the Prospectus Directive:

    a) Application to base prospectuses: certain NCAs interpret Article 16 narrowly and literally such that the amendment must relate to a specific offer or admission of securities (e.g. see UKLA Technical Note 605.2 which allows only limited exceptions to this principle). As a base prospectus has a validity of a year and provides for offerings and admissions to take place after approval and within the validity period, a base prospectus should be capable of amendment in relation to the terms and conditions for the purpose of future offerings and admission thereunder. This is particularly the case for base prospectuses of derivative securities following the passage of Directive 2010/73/EU given the practically impossible task of catering for all features and terms of offerings and admissions that an issuer may wish to undertake over the validity period of a prospectus. We suggest that either the terms of Article 16 be relaxed to facilitate such amendments for base prospectuses or that a new supplementary power be added specifically for such purpose.

    b) Amendment for matters which are not significant new factors, material mistakes or inaccuracies capable of affecting the assessment of the securities: The Prospectus Directive is silent on supplementing prospectuses for items which will not affect the assessment of the relevant securities. Item 23 of ESMA's Prospectuses Questions and Answers does not solve the issue because a notice does not amend the prospectus, but merely notifies investors. Information which is not significant within the Article 16

meaning may nevertheless be important for investors (e.g. securities codes, ambiguities in certain terms and risk factors which could be updated), and therefore there should be a permission in the Prospectus Directive for such immaterial amendments. We suggest that the scope of Article 16 be broadened to permit immaterial changes which an issuer may voluntarily wish to make.

2. **Omission of information**: for the public offering of derivative securities – particularly in certain jurisdictions – it is the practice not to specify the value of certain economic terms (e.g. interest rate or participation rate) in the initial Final Terms or drawdown prospectus, and instead to provide a range of values (and/or indicative value) and specify that the final value will be within the range (if any) and will be set on the trade date (usually the end of the public offer period) by reference to prevailing market forces at the time. Article 8 of the Prospectus Directive only caters for the omission of final offer price and amount, provided that (i) the criteria and/or conditions by which these elements will be determined and (in the case of offer price) a maximum price is disclosed and (ii) investors are afforded a two day put right after the final value is set. We suggest that Article 8 be expanded to clarify that any further economic term of the securities (in addition to final offer price and amount of the securities) may be omitted provided that (i) a range is provided which is reasonably narrow enough to ensure that investors are provided with a reasonable expectation of the ultimate value of the term and (ii) investors are afforded a two day put right after the final value is set. Restricting the issuer's ability to allow for hedging transactions to occur at a later stage is likely to result in hedging costs which could otherwise have been avoided. Such costs are likely to be passed on to investors without any increased investment potential for such investors. In other words, such restrictions under the Prospectus Directive comes at a cost for investors. Provided issuer's flexibility is not open-ended, investor protection can still be upheld.

3. Miscellaneous

a) **PD-exempt offers under a PD compliant prospectus**: the JAC would welcome clarity as to the legal position of offering and/or admitting securities under a base prospectus for which a prospectus is not required under Art.3 of the Prospectus Directive. For example, the UKLA has published detailed requirements pursuant to which such practice is prohibited unless the detailed requirements in its Technical Note 629.2 are met. In our view, the UKLA's position should be followed save that the requirements should be reduced to (i) explicitly disclosing such possibility in the base prospectus and (ii) providing that such securities will be issued under a pricing supplement (with appropriate legend under Art 34 of the Prospectus Regulation).

b) **Home Member State for non-EEA issuers**: Art 2(m)(iii) should be amended so that – including for securities described in Art 2(m)(ii) - the non-EEA issuer may elect as home Member State one of the jurisdictions where the offer is being made and/or where the securities are being listed or where the first offering and/or admission was made.

c) **Transfer of authority under Art 13(5)**: for multi-issuer bases prospectuses, competent authorities should be obliged to delegate (unconditionally) to the NCA of the jurisdiction selected by the issuer, provided that such jurisdiction corresponds to the home Member State of at least one such issuer under Art 2(m).