



ADVICE TO ESMA

ESMA's Consultation Paper - Draft Guidelines on Disclosure Requirements under the Prospectus Regulation (ESMA31-62-1239, 12 July 2019)

I. The role of the SMSG

The Securities and Markets Stakeholder Group (SMSG) advises ESMA on all regulatory and supervision matters. In compliance with EU Law, it is composed of expert representatives of financial market participants operating in the Union, of their employees, of consumers, of users of financial services and of independent top-ranking academics.

II. Background

The SMSG wishes to address a number of issues raised in ESMA's Consultation Paper - Draft Guidelines on Disclosure Requirements under the Prospectus Regulation (ESMA31-62-1239, 12 July 2019). It notes that the Draft Guidelines are based on CESR recommendations which were originally adopted in 2005, reissued by ESMA in 2011 and updated in 2013.¹ The Draft Guidelines update the CESR recommendations to take into account the Prospectus Regulation² and subsequent developments in the capital markets. In addition, by converting the CESR recommendations into guidelines, the comply-or-explain mechanism will apply.

The stated aims of the Draft Guidelines are: to ensure that market participants, especially the persons responsible for the prospectus, have a uniform understanding of the relevant disclosure requirements set out in the various annexes included in the Commission Delegated Regulation³; to assist the assessment by competent authorities of the completeness, comprehensibility and consistency of information in prospectuses; and to promote consistency across the EU in the way that the annexes are interpreted. In addition, they seek to ensure that information which is not material in the context of the issuer or the securities or which is repetitious will not be included in the prospectus. These aims set the criteria against which the SMSG has assessed the Draft Guidelines.

While a number of new guidelines and new explanatory texts have been included in the Draft Guidelines, they generally follow the content of the CESR Recommendations as applicable to the Prospectus Regulation. It was noted however that the CESR recommendations relating to specialist issuers set out in Annex 29 of

¹ ESMA update of the CESR recommendations for the consistent implementation of the Commission Regulation (EC) No 809/2004, ESMA/2013/319 | 20 March 2013.

² Regulation (EU) 2017/1129, OJ L 168, 30.06.2017, p. 12-82.

³ Commission Delegated Regulation (EU) 2019/980, OJ L 166, 21.06.2019, p. 26-176.

the Commission Delegated Regulation have not yet been included and are the subject of further consideration.

III. General Comment

In general, the SMSG welcomes the draft Guidelines. This is the case in particular with reference to the changes introduced to Guidelines 23 and 24 (Q.17), Guideline 31 (Q.21), Guidelines 34 and 35 (Q.23 and Q.24) and Guideline 39 (Q.29 and Q.30).

IV. Overarching Principles of the Operating and Financial Review (OFR) - Guideline 2

Guideline 2 sets out the overarching principles that should be used by the persons responsible for the prospectus in compiling information for the OFR. These are: audience, time-frame, reliability and comparability.

In respect of the audience criterion, paragraph 18 of the Explanatory Memorandum states that the persons responsible for the prospectus should not assume that investors have detailed prior knowledge of the business or the significant features of its operating environment. We consider that the reference to “qualified investors” which follows is not necessary and may cause confusion.

In respect of the comparability criterion, paragraph 21 of the Explanatory Memorandum states that the persons responsible for the prospectus should ensure that investors can “compare the information in the OFR with similar information provided elsewhere”. As indicated in paragraph 25 of guideline 3, we understand that the comparability of the OFR should be appreciated with similar information provided elsewhere in the prospectus. However, in order to avoid any confusion on the scope of this requirement, it would be useful to provide further information on its scope and in particular on the nature and reliability of the comparable information.

V. Content of the OFR - Guideline 3

Guideline 3 provides that the OFR should include details on returns to shareholders and information to allow investors to assess the sustainability of future earnings and cash flow. The Consultation notes that the only change to the CESR Recommendations relates to ESG disclosures. The SMSG welcomes the requirement in the Explanatory Memorandum that the persons responsible for the prospectus discuss performance in the context of the issuer’s long-term objectives (paragraph 23).

The OFR is designed to provide a fair review of the development and performance of the issuer’s business and of its position for each period for which historical financial information is required. Annex 1 (equity securities) Item 7.1 of Commission Delegated Regulation states “To the extent necessary for an understanding of the issuer’s development, performance or position, the analysis shall include both financial and, where appropriate, non-financial Key Performance Indicators relevant to the particular business.” Annex 24 (EU

Growth Prospectus) Item 2.5 is similar but refers specifically to “environmental and employee matters” as information which might be included in the analysis of non-financial KPIs.

Paragraph 26 of the Explanatory Text states “If non-financial key performance indicators that are relevant to the particular issuer (i.e. key value drivers) are disclosed in the OFR, information relating to environmental, social and governance (ESG) matters should be included to the extent it is necessary for investors to understand the company’s development, performance and condition.” It is submitted that the new text requires clarification. The Consultation Paper states the Guidelines “update” previous wording related to environmental and employee matters by referencing ESG disclosure. Clearly, ESG matters are more wide-ranging than purely environmental and employee matters. While, the Commission Delegated Regulation makes no reference to governance issues or social issues other than employee matters, paragraph 26 appears to suggest that such information should be included (a) to the extent non-financial KPIs are disclosed in the OFR and (b) to the extent such information is necessary for investors to understand the company’s development, performance and condition. Yet, it might be considered that in reality ESG issues are always relevant to investors’ understanding of the company’s development, performance and condition and that information relating to them should always be included in the OFR. Alternatively, adopting a literal interpretation of the guidance, one might consider that it provides that the ESG information is only required where (a) and (b) above apply. If so, the person responsible for the prospectus might avoid including such information by not identifying it as a KPI. This would not be consistent with the wording of the Commission Delegated Regulation. The SMSG also notes that the reference in this Guideline to information “necessary for investors to understand the company’s development, performance and conditions” narrows the Level 1 text insofar as this states “necessary for an understanding of the issuer’s development, performance or position”. The SMSG suggests an amendment to the Guideline accordingly by replacing “and” by “or”. Furthermore, if the ESG issue relates to a non-financial KPI disclosed in the OFR on an environmental issue, paragraph 26 might be interpreted as suggesting that social and governance issues necessary for investors to understand the company’s development, performance or condition should also be disclosed. Paragraph 26 should be amended to remove any uncertainty.

VI. Due Care and Diligence - Guideline 9

Guideline 9 provides that “The persons responsible for the prospectus should apply due care and diligence when compiling profit forecasts and estimates to ensure that they are not misleading to investors.” This may suggest that liability for misleading statements may be avoided if the person responsible for the prospectus applied due care and diligence. To avoid such an interpretation, the phrase “to ensure” should be replaced with “and ensure”.

Paragraph 44 of the Explanatory Text clarifies that profit forecasts and estimates must be updated via a supplement or an amendment to the URD/RD. For the avoidance of doubt, the text might also note that the

principles for preparing profit forecasts and estimates in Guideline 10 (ie understandable, reliable) also apply to any such supplements or amendments.

VII. Pro Forma Financial Information: Assessments of Significant Gross Changes and Significant Financial Commitments - Guideline 18

Guideline 18 sets out three indicators of whether a transaction constitutes a variation of more than 25% to the size of the issuer's business. These are to be used in assessing whether a transaction constitutes either a significant gross change or a significant financial commitment. These size indicators are: total assets; revenue; or profit or loss.

Paragraph 83 of the Explanatory Text sets out a new approach to the 25% threshold in relation to these assessments where the issuer is involved in multiple transactions. It states that if an issuer is involved in several transactions which collectively, though not individually, constitute more than a 25% variation in the issuer's size or if an issuer is involved in more than one transaction only one of which constitutes more than a 25% variation, pro forma information should be required for all the transactions unless it is disproportionately burdensome to produce it. Currently no pro forma information would be required⁴ in such cases and this change is welcomed. However, paragraph 83 states that this determination is made by the persons responsible for the prospectus on the basis of cost and value of the information to investors. While we welcome the proportionality of the approach, we caution that in the absence of guidance at the NCA or ESMA level this could unduly limit the value of this new approach. Furthermore, the example given in paragraph 84 suggests requiring pro forma information in respect of a transaction which constitutes a 1% increase in the context of another constituting a 27% increase might be unduly burdensome compared to the potential value of the additional information to investors. This would seem to suggest that the smaller transaction would need to be of a particular percentage to justify the additional information. Care should be taken to avoid setting outright thresholds, which may be burdensome and will not always be appropriate. Ultimately the National Competent Authorities have control over this process and the objective of the Guidelines is to encourage supervisory convergence.

VIII. Accountant / Auditor Report - Guideline 25

Guideline 25 provides that the persons responsible for the prospectus must ensure that the report of the accountant or auditor under Annex 20, Section 3 of the Commission Delegated Regulation must follow the exact wording of that section. Annex 20, Section 3 requires the prospectus to include a report prepared by the independent accountants or auditors stating that in their opinion: the pro forma financial information has been properly compiled on the basis stated and that the basis referred to in (a) is consistent with the accounting policies of the issuer.

⁴ ESMA Q&A 52.



The Explanatory Text in paragraph 113 prohibits the inclusion of emphases of matter as well as qualifications on the basis that they reduce clarity and cause confusion as to the conclusion of the report. Emphases of matter paragraphs follow the opinion paragraphs and have been defined in International Standards on Auditing as referring to “a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements”. The auditors are signifying their agreement with the management on how a transaction is treated but are perhaps also indicating a degree of uncertainty about its future impact or identifying it as a matter the management should address. The SMSG accepts that this might be done in an attempt to reduce potential litigation on their part. An argument might also be made that including emphases of matter causes confusion and constitutes some sort of qualification. However, the SMSG considers that emphases of matter do provide investors with useful information and do not modify the opinions of the auditors, but merely highlight a situation that is very relevant to a correct understanding of the financial statements. A complete prohibition on their inclusion might thus prove counterproductive.

In relation to pro forma information, the SMSG also discussed the potential benefits to investors of inserting ratios and advises ESMA to consider this possibility.

IX. Related Party Transactions - Guideline 41

Guideline 41 sets out guidance on information provided under the Commission Delegated Regulation⁵ in relation to details of related party transactions that are to be disclosed when the respective standards under the IAS Regulation do not apply. The SMSG advises ESMA to add to the Guidelines that disclosure should be in line with the requirements of the Shareholders' Rights Directive⁶ in this context.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

Adopted on 3 October 2019

[signed]

Veerle Colaert

Chair

Securities and Markets Stakeholder Group

⁵ Commission Delegated Regulation (EU) 2019/980 supplementing Regulation (EU) 2017/1129.

⁶ Directive (EU) 2017/828 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.