Santander
GLOBAL BANKING & MARKETS

Response to ESMA's Consultation Paper

From James Hart
Santander Global Banking & Markets, Legal

Date 15 July 2011

Subject **ESMA Consultation paper**

Dear Sirs,

SGBM UK response to ESMA Consultation Paper regarding possible delegated acts concerning the Prospectus Directive, as amended by Directive 2010/73/EU

Santander Global Banking & Markets forms one of the core business divisions of the Santander group, which itself, has more than 90 million customers and over 14,000 branches worldwide.

Comments contained in this paper are limited to the views expressed by Santander Global Banking & Markets, UK (**SGBM UK**) as a provider of structured notes and warrants. SGBM UK is committed to supporting the broader European agenda to provide for a sound regulatory environment for financial services and to ensure that investors' interests are appropriately safeguarded.

We therefore welcome the opportunity to respond to ESMA's consultation regarding ESMA's technical advice on possible delegated acts concerning Directive 2003/71/EC, as amended by the Directive 2010/73/EU (the **Consultation Paper**). Due to the short consultation period we have set out broad comments on certain aspects of the Consultation Paper, which we believe will have a significant detrimental impact on our business, the financial services market and on investors. We are at your disposal should you wish to discuss any of the points raised.

Introduction

SGBM UK thoroughly supports the need to enhance investor protection. Measures taken to ensure key information are disclosed and delivered in a manner that is understood by the relevant investor are essential to bring confidence back to the financial markets. Careful consideration must therefore be given to ensure that such measures are proportionate to achieving that objective. If such measures are disproportionate, the impact can be equally damaging to investors and to the marketplace. This may be in the form of a less competitive market, more expensive products and reduced consumer choice.

Unfortunately, SGBM UK believes that certain proposals set out in the Consultation Paper are disproportionate to achieving the objective of enhancing investor protection. Not only will the proposals miss the target of improving consumer understanding but the fundamental principles that drove the implementation of Directive 2003/71/EC, as amended by Directive 2010/73/EU (the **Prospectus Directive**) will be compromised.

Key Principles

Before we provide our comments on the proposals set out in the Consultation Paper, it is important to keep in mind the fundamental principles of the Prospectus Directive. These principles are enshrined within Recital 41 of the Prospectus Directive. Some of the key principles are:

- **Principle 1 -** The need to ensure confidence in financial markets among small investors…by promoting high standards of transparency in financial markets;
- **Principle 2 -** The need to provide investors with a wide range of competing investment opportunities and level of disclosure and protection tailored to their circumstances;
- **Principle 3 -** The need to ensure that independent regulatory authorities enforce the rules consistently..;
- **Principle 5 -** The need to encourage innovation in financial markets if they are to be dynamic and efficient;
- **Principle 6 –** The need to ensure systemic stability of the financial system by close and reactive monitoring of financial innovation;
- **Principle 7 -** The importance of reducing the cost of, and increasing access, to capital;
- **Principle 8 -** The need to balance, on a long-term basis, the costs and benefits to market participants…of any implementing measures;
- **Principle 9 -** The need to foster the international competitiveness of the Community's financial markets without prejudice to a much-needed extension of international co-operation;
- **Principle 10 -** The need to achieve a level playing field for all market participants for all market participants by establishing Community legislation every time it is appropriate; and
- **Principle 12 -** The need to ensure coherence with other Community legislation in this area, as imbalances in information and a lack of transparency may jeopardise the operation of the markets and above all harm consumers and small investors.

Headline points

1. Final Terms

1.1 Consumer protection aims are targeted at the wrong disclosure document

SGBM UK welcomes the European Commission's aim to enhance consumer protection methods within the EEA. However, it is important to understand whether increasing the disclosure obligations of issuers and dealers under prospectuses, final terms and any attendant summary (**Prospectus Documents**) will meet the objective of improving consumer understanding and comparability of securities. It is our submission that it will not. There are many reasons for this. These include:

- ✘ When making an investment decision, investors predominantly rely on the point of sale document (**POS Document**). The POS Document is prepared by and provided to investors by the final intermediary / distributor, who invariably will not be involved in preparation of the Prospectus Documents[1].
- ✘ For privately placed securities, the POS Document is prepared *prior* to an investment decision being made. The Final Terms and any attendant Summary will invariably be prepared on the basis of the POS Document but nevertheless *after* the initial investment decision is made. Consequently, enhanced disclosures through the Prospectus Documents will have little impact on investors' decision making.
- ✘ For publicly offered securities, the Prospectus Documents must be available *prior* to an investment decision being made. However, it is our submission that investors tend to look to the POS Document, due its short and concise format[2].
- ✘ Comparability of products will only be worthwhile for investment products wrapped in a security format. Comparability will not be achieved for investment products that are offered in a non-security format (e.g. insurance policies, funds, other contractual wrappers, etc). The proposals pose a potential risk of regulatory arbitrage.

[1] The POS Documents may refer to or make available the Prospectus Documents. Nevertheless, greater prominence will be given to the POS Documents in the investment decision making process because it summarises the key features of the product in a manner that will be easily comprehensible for investors.

[2] This trend is exhibiting itself in jurisdictions such as Germany, Italy and Portugal which each impose a short form product summary to be made available to investors at the point of sale.

To represent this diagrammatically:

Disclosure documents	Responsibility for preparation	Investment Decision	Regulation
Prospectus Documents	Issuer / Dealer	Made by Financial Intermediary	Prospectus Directive (Maximum harmonisation)
POS Documents	Financial Intermediary	Made by investor	Host state (Practices and disclosure standards vary)

Key principles undermined: Principles 1 and 12

Solution

It is our submission that greater regulatory focus should be given to the POS Document where pre-contractual product disclosures are required.

We understand that such consideration is already being given in connection with the Packaged Retail Investment Products (**PRIPs**) initiative and through the Key Investor Information Document (**KIID**). We believe that this represents a more appropriate means of regulatory oversight to enhance investor protection.

1.2 Form and content of Final Terms

1.2.1 *Diverging standards*

We acknowledge ESMA's concerns regarding the divergence of market practice in relation to the form of presentation and content of the Final Terms. From our perspective however, this concern takes secondary precedence to ensuring that the Final Terms provide clear, fair and not misleading disclosure to investors. Provided, this primary consideration is met, the divergence between financial institutions in how they document the payment features of the security is of minimal consequence.

Furthermore, ESMA appears to support the view that diverging practices in the form of presentation and content of the Final Terms is acceptable as comparability of the products should be made at Summary level rather than at Final Terms level[3]. Our contention however, is that comparability of information should be made within the document that the end investor is most likely to read. In our experience, this is the POS Document.

Key principles undermined: Principles 1 and 12

1.2.2 *Limitation of Final Terms to economic menu*

In paragraph 15 of the Consultation Paper, the Prospectus Level 2 Task Force found that the Final Terms still contains information which needs to be vetted by competent authorities. Such information includes material changes to risk factors, redemption structures and terms and conditions approved in the base prospectus to which the Final Terms relate and new information which ESMA considers to be significant pursuant to Article 16 of the Prospectus Directive.

What role will the Final Terms then play? The restrictive categorisation of information adopted by ESMA within the building blocks and schedules to the Prospectus Regulation will render the Final Terms format limited to a simple economic menu. The Final Terms document will therefore only be useful for settlement and listing purposes and will be akin to an electronic confirmation of the trade.

This development would significantly conflict with the accepted market practice adopted in a number of EEA member states to provide for a consolidated Final Terms where the securities are

[3] Paragraph 39 of the Consultation Paper.

publicly offered pursuant to a programme where general principles of the product offering are contained. In these circumstances, institutions provide a summarised disclosure of the issuer and guarantor (if any), the product, the offering and the key risks. The purpose behind such development is to provide key information in one document that can be provided to investors and to assist intermediaries in their preparation of their own POS Document.

Key principles undermined: Principles 1 and 12

2. The requirement for an issue specific Summary

The proposal under paragraph 27 of the Consultation Paper to append issue specific summaries to Final Terms for securities bearing denominations per unit of less than €100,000[4], will significantly impact both the wholesale and retail markets.

2.1 Comparability of products

As alluded to in paragraph 1.1 above, the comparability of Summaries will be of minimal benefit to investors that predominantly rely on disclosures contained in the POS Document. However, as it currently stands, the POS Document remains subject to local law regulation of varying standards. Consequently, investors in one jurisdiction will be making investment decisions based on the level of disclosure contained in a POS Document that is acceptable in one member state, which may not necessarily be acceptable in another member state. An uneven playing field is therefore created across EEA member states.

Greater regulatory focus should therefore be given to the POS Document to ensure comparability of products, in both a security and non-security format. Duplication of efforts by the product provider preparing both the Summary and the KID under PRIPs will lead to confusion and potential inconsistencies between the two documents. Investors will not benefit from such confusion.

Key principles undermined: Principles 1 and 12

2.2 Potential uncertainty and liability created

The prohibition in paragraph 105 of the Consultation Paper to cross-refer to the risk factor headings in the prospectus or to reproduce *long tracts from the risk factors section* in which the prospectus was originally drawn up runs contrary to Article 5.2 of the Prospectus Directive.

The requirement to prepare an issue specific Summary in a format that cannot cross-refer back or replicate information contained in the prospectus opens up the scope for such Summary to be prepared in a manner that could be construed as misleading, inaccurate or inconsistent when read together with others part of the Prospectus (*Articles 5.2(d) and 6.2, clause 2 of the Prospectus Directive*).

As civil liability is not harmonised for all Member States under the Prospectus Directive, issuers may be deterred from conducting pan-European offerings or offerings in particular Member States where host state competent authorities impose stringent penalties and liability on the issuer or its administrative, management or supervisory bodies (*Article 6.1 of the Prospectus Directive).* This significantly undermines the effectiveness of the regime under the Prospectus Directive, as liability is governed solely by national law (*Article 13.6 of the Prospectus Directive).*

Furthermore, as civil liability attaches to the summary, issuers will be incentivised to lengthen the summary to such an extent that all potential risks that may apply in connection with the issuer, the guarantor (if any), the market and the securities are presented. Such penalty therefore runs contrary to ESMA's objective to provide short and concise disclosure to investors.

Key principles undermined: Principles 1, 10 and 12

[4] The denomination of €100,000 per unit applies following the implementation of Directive 2010/73/EU in each EEA member state.

2.3 Increased costs and timeframes

Pursuant to Articles 5.2(d) and 19 of the Prospectus Directive, each Summary may be required to be translated into another language where a public offering or admission to trading is sought on the regulated market in another member state.

For omnibus base prospectuses, the translation requirement for the Summary was conducted once each year. The proposals by ESMA to prepare a Summary for each and every security that bear denominations per unit of less than €100,000 will escalate costs per issue and increase timelines for trades, jeopardising listing and settlement deadlines whilst also subjecting market participants to greater market risk due to volatilities in the relevant underlying market.

Furthermore, as there will be a disparity between translation requirements for Final Terms and the appended Summary, there will inevitably be a shift in market practice whereby Final Terms will also be required to be translated, thereby escalating costs. This is already witnessed in some member states.

Finally, such translation requirements will apply irrespective of whether:

- the securities are targeted to the wholesale market or the retail market; and
- the securities are subject to a technical listing requirement or are exchange traded with an active market in the securities anticipated.

Depending on the length of the summary, we estimate translation costs to be in the region of €2,000 - €8,000 per eligible security. Please note that where legal translators prepare the translation, the summary may be technically correct but may not be in a form that is easily comprehensible or understood by retail investors. As the issuer will not be sufficiently resourced or able to understand the meaning of the literal translation of the Summary, the issuer should not be disadvantaged by its reliance on external firms to translate issue specific summaries.

Key principles undermined: Principles 7 and 8

2.4 Format of the summary

SGBM UK welcomes ESMA's recommendation to provide a specific format of the Summary. Nevertheless, certain recommendations such as the Summary be written in a manner as "it formed the body of a letter from the chair, or managing board of the issuer, offeror, or person seeking admission to trading, to investors and the market" runs significantly away from the format of the KID for UCITS products and also the proposed format of the KID under PRIPs.

Consequently, comparability of summaries will only be applicable for products contained within a security format. Such a change in approach does little to assist harmonisation of similar regimes across Europe.

Key principles undermined: Principles 1 and 12

2.5 Utility of Base Prospectus

ESMA's recommendation to append an issue specific Summary to each Final Terms for eligible securities could potentially drive investors towards reliance on the Final Terms and Summary alone. The consequence would be to ignore the disclosures required in accordance with the Prospectus Directive, including the financial accounts of the issuer and guarantor (if any).

3. Greater complexity within base prospectuses

3.1 "Knowable" information

Paragraph 28 of the Consultation Paper states that the base prospectus must include *all* information that is "knowable" at the time the base prospectus is approved.

This goes beyond the requirement in Article 5.1 of the Prospectus Directive, which requires information that is necessary to enable investors to make an informed assessment of the asset and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities. Disclosure should therefore be focused on the individual category of investor and their level of expertise and understanding.

This proposal moves in the opposite direction of the concept of "shelf" registration in the United States, where much of the Prospectus Directive programme requirements were originally modelled upon. An issuer filing a shelf registration statement is only required to include in the base prospectus filed and reviewed by the SEC a general description of the securities that may be offered in order to provide maximum flexibility. At the time of an issue of securities or, in the case of an MTN programme, at the time the program is established, the issuer files a prospectus supplement describing the terms of the securities to be offered and provides the base prospectus and supplement to prospective investors. The Securities and Exchange Commission is not required to take any action with respect to the filing of the supplement or the pricing supplement in the case of an MTN programme. [5]

In sharp contrast, the consequences of paragraph 28 of the Consultation Paper are to cause needless and excessive supplementing of base prospectuses (subject to review) and the filing of stand alone prospectuses without any clear benefit to potential investors. Given the market inefficiencies created, increased borrower costs and additional regulatory resources required, the existing requirements regarding the content of base prospectuses that is consistent with Article 5.1 of the Prospectus Directive should not be changed without any clear evidence of enhanced investor protection,

Key principles undermined: Principles 1, 2, 5, 7, 8, 9 and 12

3.2 Payment formulae

3.2.1 *Issuance programmes impacted* - Issuers of structured products, whether in the wholesale or retail market, use dedicated issuance platforms (e.g. MTN programmes). This allows multiple issues to be conducted through the medium of Final Terms, as much of the disclosure required pursuant to Article 5.1 of the Prospectus Directive will be the same for each issue and will be contained in the over-arching base prospectus. Such flexibility has the following benefits:

- ✓ cost efficiencies are generated by allowing multiple issues to be conducted under one over-arching prospectus, thereby translating into cost benefits for investors;
- ✓ the time taken for the product to reach the market is relatively quick as the Final Terms does not require the pre-approval of the competent authorities;
- ✓ the short execution and issuance timeframes reduces market risk for market counterparties thereby creating more certainty with regard to pricing;
- ✓ as more products can be brought to the market relatively quickly, greater choice is offered to investors encouraging greater competition amongst distributors and providers;
- ✓ greater competition also translates into more competitive pricing for products;
- ✓ greater volumes translate into greater funding to financial institutions and in turn more business being generated within the European economy;
- ✓ providers and distributors alike can be more responsive to changing market sentiment and investor requirements; and

[5] In the case of a supplement describing an issue of new ("novel or unique") securities, the SEC has requested issuer to submit in advance a draft of the supplement for its review in order to avoid a post-issue review by the SEC.

- ✓ private investors have greater opportunities to direct market participants to structure products individually tailored to their risk profile or to provide exposure to opportunities that arise in the prevailing market climate due to the flexibility afforded under the current regime.

However, the proposals under paragraphs 44 (Category A information) and 49 will pose significant limitations on issuers of structured products that use dedicated issuance platforms. The requirement for prescriptive prospectuses will significantly curtail flexibility within the market to adapt to investor requirements. It is not possible for issuers to predict and document in advance the products that they are likely issue or be asked to issue by investors in the next 12 months. Products and pay-outs will invariably be determined on a "reverse enquiry" basis from dealers and intermediaries depending on prevailing market environment and investor sentiment. For example, certain products may be designed for investors who are willing to take a bullish view on a particular underlying or structure within that particular market cycle, which may not have existed at the time the prospectus was initially approved. Furthermore, hybrids or combinations of existing products may be required to satisfy particular investor appetite. These may not be captured in the original prospectus requiring these changes, even if requested by the investor themselves, to be pre-approved by the relevant competent authority.

Key principles undermined: Principles 1, 2, 3, 5, 7, 8, 9 and 10

(a) *Illustrations of potential consequences* - The consequences of the proposals under paragraphs 44 (Category A information) and 49 are manifold and are briefly set out below.

Option 1

The issuer determines to prepare and have approved an omnibus base prospectus covering the universe of "knowable" products and underlyings

Implications

- ✘ The entire structured product industry will be required to significantly adapt their existing prospectuses at considerable cost to include the universe of potential features of products they expect to issue for the next 12 months;
- ✘ Increased costs will inevitably lead to less competitive products being made available to investors;
- ✘ Prospectuses will increase in length through the necessity to list multiple options to be elected within the individual Final Terms;
- ✘ Prospectuses and Final Terms will fail to be easily analysable and comprehensible for both wholesale and retail trades causing greater confusion to both investors and market participants;
- ✘ Multiple supplements will be required for new products and for minor alterations to existing products and pay-offs which do not mirror the terms contained in the prospectus[6] - ESMA's desire under paragraph 47 of the Consultation Paper would not therefore be achieved by requiring payment formulae in the prospectus;
- ✘ Rigid provisions being hardwired into prospectuses, which may be difficult to apply or adapt to multiple future scenarios where single underlyings are referenced, baskets of underlyings are referenced and multiple asset classes are referenced; and
- ✘ The potential for increased mistakes and manifest errors where payouts and formulas are not included in the Final Terms but in the base prospectus – an example of the obfuscation likely to be caused by this approach is illustrated below:

[6] From SGBM UK's perspective, we estimate that more than 50 supplements per annum will be required, depending on the architecture of the programme. This will lead either to increased costs being passed on to investors or a withdrawal of certain products being issued into the market.

Omnibus Base Prospectus

Option #42 (page 250)
Settlement Amount payable in respect of each certificate as determined by the Calculation Agent shall be:

(i) If on the Final Valuation Date the [Price] [Closing Price] [other] of the [Underlying] [each Basket Component] [other] is equal to or greater than A, the Settlement Amount shall be B; or

(ii) If on the [Final] Valuation Date the [Price] [Closing Price] [other] of the [Underlying] [each Basket Component] [other] is less than A, the Settlement Amount shall be C.

Option #43 (page 251)
Settlement Amount payable in respect of each certificate as determined by the Calculation Agent shall be:

(i) if A is equal to or greater than B, the Settlement Amount shall be C

(ii) if A is less than B, the Settlement Amount shall be D.

Term Sheet for Qualified Investor

Best of World Index trade

Settlement Amount =

(1) If $\text{Max}\left(\frac{CAC_F}{\text{CAC}_0}, \frac{\text{NKY}_F}{\text{NKY}_0}; \frac{\text{SX5E}_F}{\text{SX5E}_0}\right) \geq 60\%$, 100% * SD

(2) Otherwise, $\text{Max}\left(\frac{CAC_F}{\text{CAC}_0}, \frac{\text{NKY}_F}{\text{NKY}_0}; \frac{\text{SX5E}_F}{\text{SX5E}_0}\right)$ * SD

Final Terms

Settlement Amount:	Option #[?][7] A = 60% B = 100% C = Price * SD
Definitions:	**Index** = Each of CAC 40, Nikkei 225 and Eurostoxx 50 (each as further described on page 300 of the Base Prospectus). **Price** = The Best Performing Index as determined by the Calculation Agent. **Best Performing Index** = The highest integer determined by the Calculation Agent by taking the quotient of the Final Price and the Initial Price for each of the three indices. **Final Price** = The closing level of the relevant Index on the Final Valuation Date. **Initial Price** = The closing level of the relevant Index on the Initial Valuation Date. **Final Valuation Date** = 1 July 2012 **Initial Valuation Date** = 15 July 2011 **SD** = Specified Denomination

[7] Option #42 should have been selected, however this key consideration is mistakenly omitted by the Final Terms drafter. The consequence of this is that Calculation and Settlement Agents will be unable to compute the designated formula by looking at the Final Terms but will need to liaise with the issuer to understand what the formula is. Furthermore, even if the correct option is selected, it will make it difficult for counterparties to continually cross-refer to the contents of a voluminous prospectus to locate the relevant formula for the trade. The Final Terms will also be largely meaningless for investors, particularly where wholesale denominations are used.

Option 2

The issuer determines to prepare and have approved multiple prospectuses for each "family" of products

Implications

- ✘ A reduction in investor choice with bespoke products being removed from prospectuses due to uncertainty that such products will generate sufficient interest in the forthcoming 12 months to justify the cost and time involved in obtaining approval[8];
- ✘ Increased costs of setting up multiple prospectuses[9] and uncertainty regarding depth of market for products will impact institutions raising finance in the prevailing market environment;
- ✘ Multiple supplements will still be required for new products and for minor alterations to existing products and pay-offs which do not mirror the terms contained in the prospectus;
- ✘ Potential divergences in disclosures for new products approved by different competent authorities, with some authorities requiring greater disclosure than others[10]
- ✘ Greater administrative burden being placed on competent authorities to review numerous supplements within short timeframes, which will result in bottlenecks occurring;
- ✘ Greater costs being generated for issuers to prepare multiple prospectuses and supplements – such costs being passed to investors in the form of less attractive returns;
- ✘ The requirement for supplementary prospectus extends the timeframe between the dates the securities are traded and issued, such period subjecting trading counterparties to volatile market conditions generating uncertainty over pricing and potential losses – this in turn may deter certain products being made available to investors due to the nature of the underlying and also the uncertainty of competent authority approval
- ✘ Competent authorities need to have the resources and the expertise to understand the products and the risks to ensure that disclosure of information is meaningful for investors;
- ✘ Greater administration and bureaucracy that significantly reduces cross-border offerings and listing applications being made within the EEA. The following example illustrates the myriad of logistical problems that using multiple programmes would create for issuers of structured products and end investors alike:

  Client A wishes to purchase Twin Win Certificates and publicly offer them in Country X and list them in Country Y. Prospectus #1 caters for Twin Win Certificates and is passported to Country X and separate application is made to list the Twin Win Certificates under the programme in Country Y.

  Later that month, Client A wishes to purchase Bonus Certificates and publicly offer them in Country X and list them in Country Y. Prospectus #2 caters for Bonus Certificates and will subsequently need to be passported to Country X and separate application is made to list the Bonus Certificates under the programme in Country Y.

  The following month, Client A receives feedback from investors that they are keen to purchase further Twin Win Certificates but with an income element. Since Prospectus #1 caters for Twin Win

[8] This development may further be to the detriment of retail investors who are operating in a historic low interest rate climate coupled with less provision being made by the state for pensions during retirement. The sole domain of 'protected' investments will therefore be deposits yielding below inflation rate returns. This development may trigger investors into other higher yielding or more risky asset classes, such as direct exposure to equities, funds, CFDs or spread betting.

[9] We estimate costs being €30,000 per prospectus, of which as many as 20 may exist per product family. This translates as a more than ten fold increase in costs for adopting an omnibus programme. Such costs will deter issuers from entering the market for bespoke structures and for those programmes that are made available, the costs will be priced into the products issued thereby reducing the commercial appeal of the products and in turn reducing the competitiveness of the Eurozone vis-à-vis products offered or listed outside the Euro-zone.

[10] Unless a co-ordinated effort is made by EEA regulators, it will be difficult for competent authorities to provide consistency in disclosure requirements for the universe of potential products which may each be labelled differently depending on the institution devising the structure or payout.

Certificates without an income element, the prospectus will need to be supplemented. The supplement will need to be passported to Country X and a separate application is made to list the income bearing Twin Win Certificates under the supplement in Country Y.

Consequently, there will be duplication of costs, time and effort expended on what are relatively straightforward issues that could have been documented pursuant to a Final Terms under an omnibus prospectus passported to Country X and listed in Country Y. Investor requirements cannot therefore be met in an efficient manner.

✘ There is a greater potential of offerings being inadvertently conducted in breach of the Prospectus Directive as securities governed by Prospectus #12 may be offered in a jurisdiction where such prospectus has not already been passported, but the issuer had previously publicly offered securities governed by Prospectus #5, which had previously been passported to that EEA member state.

Option 3

The issuer files and has approved a base prospectus for each type of product or the issuer determines to file a stand alone prospectus for each issuance of securities.

Implications

✘ The consequences of this approach are all of the points listed in Option 2 above, save that the effect of each is magnified; and

✘ There is a danger that investors will perceive the competent authority's approval of the individual prospectus as a form of regulatory seal of approval of the product itself.

(b) *Solutions for structured product base prospectuses*

✓ Each of the above options are unsuitable, particularly as the aim of investor protection will not necessarily be achieved by requiring inclusion of pay out formulae in the base prospectus (see further explanation in paragraph 1.1 above).

✓ Allow payment formulae and descriptions of the payment conditions to be set out in the Final Terms to ensure that the industry can respond to new developments without the cost and administrative bureaucracy associated with seeking pre-approval for each new product idea and to permit investors to have all information comprehensively contained in one location. The additional benefit is that inclusion of the formulae and explanatory disclosure within the Final Terms will aid greater transparency without the need to cross-refer to the base prospectus.

✓ To ensure consistency of disclosure and for greater transparency of the rights attaching to securities, allow industry working groups to devise agreed form language acceptable by a competent authority for common products. These products can be categorised and made freely available on the ESMA website. This will set a high water mark and provide guidance to the industry as to the disclosure standards to adopt, which can also be applied for slight variations of trading ideas. This would also (a) avoid repetition of costs and time being consumed for products that have been "pre-approved" and (b) preserve the gains made since the adoption of the Prospectus Directive in establishing a pan-European market for securities.

3.2.2 *Innovation stifled* - The requirement under paragraphs 44 (Category A information) and 49 directly contradicts paragraph 23 of the Consultation Paper. The requirement to document redemption structures, payment formulas and/or description of the payment condition within the base prospectus will stymie innovation and lead to greater inflexibility within the industry. Furthermore, it will provide additional limitations on issuers to respond to investor requirements in a timely and cost efficient manner. It is also doubtful that it will significantly aid investors in their understanding of the securities or impact their decision to invest in the securities.

Key principles undermined: Principles 2, 5, 7, 8 and 9

3.2.3 *Wholesale market impacted* - Furthermore, the proposals to include payment formulae within a pre-approved prospectus take no account of the sophistication and experience of the investor. The one size fits all approach cut across both the wholesale and retail market. Any attempt to confine such proposals to a specific market will not be met by applying such proposals to denomination sizes. It is simply not true that the wholesale market only exists for securities bearing denominations of above €100,000 per unit. Many institutions require smaller denominations to allow them to split holdings internally between different funds and to rebalance portfolios by trading in units of small lots. The wholesale market therefore exists for securities with denominations below €100,000 per unit.

Key principles undermined: Principles 2, 5, 7, 8 and 9

3.2.4 *Competent authorities will need to be geared up for increased workload*

The restrictive of approach to the form and content of the Final Terms and the requirement to set out payment formulae within the pre-approved prospectus, will translate into a significant increase in the volume of prospectuses requiring approval from the competent authorities located in each of the 28 member states. As the vast majority of issuers will be congregated in principal financial centres within the EU, certain competent authorities will have a greater workload than others.

To take an example, 50 issuers may be located in the United Kingdom. Each of those issuers in any given month will require a supplement to be approved by the UK Listing Authority (**UKLA**) for 20 separate products. This translates into the UKLA being required to review and approve 1,000 supplements per month within the limited timeframes provided under the Prospectus Directive.

Furthermore, competent authorities will not only need to be sufficiently resourced to cater for the increased demand for prospectus / supplement approval, but they will also need to have ensure staff have the requisite knowledge and experience to understand the products and the payment features.

3.3 Asset backed securities

For issuance programmes where flexibility is required to provide investors with solutions to mitigate counterparty risk, information in relation to the structure of the securities will be issue specific. Such details would therefore need to be made in the Final Terms for the reasons specified in paragraph 3.2.1 above.

The implications of the proposals in paragraphs 55 and 59 will be similar to those specified in paragraphs 3.1 and 3.2 above.

Key principles undermined: Principles 2, 5, 7, 8 and 9

4. Trading away from European listing venues

The Prospectus Directive and the broader Financial Services Action Plan were initially devised to address a pressing problem. As the Lamfalussy Report stated, European stock exchanges remained significantly behind those of the U.S. and in 2000 were still roughly at only half of the size of those in the U.S[11]. By introducing a harmonised European passport for securities offerings, the Prospectus Directive maximised the economic benefits for an integrated European financial market and allowed Europe to compete globally for capital.

By way of contrast, the proposals raised in the Consultation Paper have the potential to incentivise industry participants to list their securities on non-EEA stock exchanges. The impact would be to reduce the commercial attractiveness of European listing venues and in turn see an exodus of capital to other global financial centres exhibiting more efficient and flexible regulatory regimes.

The proposals contained in the Consultation Paper apply in circumstances where a prospectus is required. Namely, where there is (a) a non-exempt public offering of securities or (b) the admission

[11] Lamfalussy Report, page 10

to trading of securities on any regulated market, each within an EEA member state. In the wholesale markets, these circumstances may be readily avoided if borrowers deem the consequences of compliance outweigh the benefits.

With respect to (b) above, securities may be admitted to trading on an EEA regulated market but in practice, active trading does not occur, particularly with respect to non-equity securities[12]. Many securities are listed for fiscal purposes or to meet prudential requirements by clients for listed paper. In these circumstances, such listing will represent a technical listing with no liquidity offered by the issuer or dealer. However, the proposals contained in the Consultation Paper will affect both technical listings and listings where an active exchange traded market exists in the securities.

Consequently, for primary issues where a public offer exemption is readily available (e.g. offerings to Qualified Investors) and a technical listing is only required, issuers can obviate the additional burdens of compliance and cost, by listing securities on a non-EEA regulated market. You may therefore have a scenario where medium term notes are, for example, privately placed within Luxembourg to Qualified Investors but the listing is maintained in Hong Kong, rather than Luxembourg as previously may have been the case.

Key principles undermined: Principles 7, 8 and 9

5. The success of the Prospectus Directive will be compromised

The Prospectus Directive has largely proved successful in the creation of a single European market for securities and financial services. It has improved market transparency, efficiency and competitiveness in financial services resulting in greater jobs in the financial services sector. It has also improved the attractiveness of Europe as an investment destination and as a place where innovation is encouraged[13].

The success of the Prospectus Directive in creating a pan-European market for securities is built upon the standardised rules of disclosure and efficient procedures that have been implemented across the EU. This has provided borrowers with efficient access to capital and investors with a wider degree of investment opportunities while at the same time promoting investor protection through disclosure. The consistent and flexible regime created by the Prospectus Directive has facilitated the development of new ideas and products designed to meet investors' needs and encouraged innovation. These many successes should not be diminished by the current proposals without clearly enhancing investor protection.

We firmly believe that certain proposals contained in the Consultation Paper will significantly detract from the success of the Prospectus Directive leading to a more inflexible, inefficient and illiquid marketplace for the issuance of securities within Europe. The aim for enhanced investor protection is welcome but the proposals will not achieve the objective set out for the reasons stated below. Furthermore, any perceived benefits will be more than offset by greater bureaucracy, cost escalation and reduced appeal of the Euro-zone as a territory for the issuance and trading of securities. Consequently, we feel that the costs of the proposals set out in the Consultation Paper will far outweigh the benefits.

Key principles undermined: Principles 2, 5, 7, 8, 9 and 12

[12] We understand that the rationale behind the requirement to publish a prospectus where securities are admitted to trading on a regulated market was to cover issuers that listed their securities on one exchange in an EEA member state in order to attract investors across Europe to come to the exchange. This would therefore nullify the need by the issuer to publicly offer securities in several territories. In these circumstances, an active trading market is envisaged by listing securities on an exchange.

[13] For an analysis of the improved competitiveness of the Eurobond market versus the US bond market over the past decade, see "Has the US Bond Market Lost its Edge?". S. Peristiani and J. Santos, Fed. Res. Bank of N.Y., International Review of Finance, Vol. 10, No. 2, pp. 149-283 (June 2010).

Conclusion

SGBM UK appreciates that significant thought and work has been put into ESMA's preparation of the Consultation Paper. Our comments on certain recommendations are made to express certain concerns that could detrimentally impact the financial services industry within Europe. Consequently, we ask that ESMA take into consideration the points we have raised and to assess the real value or benefits that such recommendations will bring to both investors and market participants. If the benefits to the market from such recommendations prove greater than the costs, then such regulatory approach will have added value. But if the additional regulatory costs that arise do not provide the intended benefits, it would be prudent to pare back non-value aspects of regulation before such proposals are implemented.

Given that consultation is already ongoing and further developments are intended in connection with improving disclosure standards within Europe (i.e. PRIPs Directive), we recommend that any steps made in connection with the Prospectus Directive are in alignment with the key principles enshrined within Recital 41 of the Prospectus Directive, and in particular, Principle 12.