German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the Consultation Paper “ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU” (ESMA/2011/444)

Contact:
Stefanie Heun
Division Manager
Telephone: +49 30 1663-3380
Fax: +49 30 1663-3399
E-Mail: stefanie.heun@bdb.de

Berlin, 22 December 2011

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,200 banks.

Coordinator:
Association of German Banks
Burgstraße 28 | 10178 Berlin | Germany
Telephone: +49 30 1663-1204
Telefax: +49 30 1663-1298
www.die-deutsche-kreditwirtschaft.de

Comments on the on the Consultation Paper “ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU” (ESMA/2011/444)

A. General remarks

I. Consultation period much too short

The consultation period set out by ESMA is much too short. The German Banking Industry Committee is operated by the central associations of the German banking industry, which represent more than 2,200 banks. Against this background it is obvious that we need to communicate and consult with our members, before we can contribute a position paper. This communication process takes more than three and a half week during Christmas holidays, where most contact persons are out of the office. Therefore the following comments are meant as a preliminary view.

II. Retail cascade

- **Distribution of securities via retail cascade – distributors usually unknown**

The description of a retail cascade used in the consultation paper does not cover an important, maybe the most relevant aspect of the phenomenon. **It is based on the incorrect assumption that the distributors of particular securities are generally known to the issuer and in direct contact with it.** However, this is not the case in the most relevant types of distribution chains. **Accordingly, we are very concerned about the fact that ESMA appears to be unaware of the relevant underlying distribution models, whose analysis has to be the starting point for developing appropriate technical rules pertaining to retail cascades.**

In particular, in the **“classical” bond distribution scheme**, debt securities of an issuer are distributed via many layers of financial intermediaries (hence the term 'cascade'). In a first step the issuer offers the debt securities via underwriting financial intermediaries (the contractual distributors) to a group of institutional buyers. Under debt issuance programmes the contractual distributor is named permanent dealer. At this stage a prospectus would not even be necessary as all buyers are qualified investors. These investors purchase from the underwriting financial intermediaries and have no contractual relationship with the issuer. Some of these institutional buyers, however, are financial intermediaries themselves and distribute (as distributors “in fact”) the debt securities in a second step to retail investors and possibly in further steps to yet other financial intermediaries (more distributors “in fact”) who in turn sell to retail investors, and so on. The issuer does not and cannot plan this process in detail, but accepts its advantages, namely the possibility to procure larger amount of financing. As it is unknown how many retail investors these debt securities are offered to, the issuer prudently produces a prospectus for this distribution. Whilst it is not clear that the distributors “in fact” would really be regarded as financial intermediaries in the sense of the retail cascade provision in the amended Prospectus Regulation, there is no legal certainty in this regard.

A similar problem arises in connection with the **distribution of structured securities** to retail investors. For this, the distribution method substantially differs from the classical bond model in so far as the issuer does typically not appoint a contractual distributor or permanent dealer as described above but manages the distribution of the securities itself.

The decisive question that follows from the above-mentioned distribution models is how to enable participating distributors, who are not in direct contact with the issuer, to make their offers to retail investors in compliance with the EU prospectus regime**. A possible solution appears to be for the issuer to include a wide written consent into the prospectus. For this to work, it needs to be allowed to omit the names of those distributors from the prospectus, because they are and remain unknown to the issuer and can, therefore, not be specified in the prospectus.** In particular, the distributors "in fact" described above do not act in association with the issuer, but need to rely on ("make use of") the prospectus prepared by the issuer, due to the fact that they could not or would prudently not dare to produce a prospectus themselves without the cooperation of the issuer.

- **It is not possible to name the distributors**

As mentioned, in the classical bond distribution model as well as in the distribution models for structured securities, it is not possible to name the distributors which are not in direct contact with the issuer at the time of issuance of the securities. Accordingly, it should at least be possible to provide the required disclosure regarding intermediaries separately from prospectus and final terms, i.e. on a specific website.

- **Terms of the offer are best presented by the offeror**

The prospectus is a good source of information on the offered product (including information on the risks, the issuer and the terms of the securities), but the terms of the offer are best presented by the actual distributor. Information on the distributor and the price are best delivered by the distributor itself; they also are part of the investment advice given by the distributor to the retail investor. Possible exemptions to omit this type of information in the prospectus created at the beginning of the distribution cascade should, therefore, be extensively applied.

B. Replies to questions/comments on proposals

I. Retail Cascade

Q1: In practice, for what types of securities are retail cascades used? In ESMA FAQ No. 56 it was assumed that retail cascades are only used for distribution of debt securities. However, the regulation introduced by the Amending Directive in Article 3.2 Prospectus Directive does not differentiate between equity securities and debt securities in this regard but applies to all kind of securities.

In our view, retail cascades are indeed mainly relevant for the distribution of simple and structured debt securities. Retail cascades in the original narrower sense, as described in the General remarks above, are only used for large syndicated offerings of plain vanilla debt securities, i.e. fixed rate or maybe floating rate notes.

It is also possible that similar problems arise while equities are distributed via retail cascade. This issue should be examined further.

Comments on the on the Consultation Paper "ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU" (ESMA/2011/444)

Q2: Please describe situations in which a retail cascade is normally used, how a retail cascade may be structured and the modalities of such retail cascade. What different models of retail cascades are used in practice?

Please see under General remarks above for a description of a true retail cascade. In the wider sense used in the definition of this consultation almost every distribution of debt securities via financial intermediaries that lasts for more than a few days is captured.

Q3: Do you agree with ESMA's understanding of retail cascades and in particular that the terms and conditions of the offer by the intermediaries may not differ from the terms and conditions in the prospectus or final terms? If not, please specify which terms and conditions may differ from those stated in the prospectus or final terms and who would be responsible and liable for such information.

ESMA's understanding of retail cascades, in our eyes, misses the most crucial part, as described under the General remarks above. The terms and conditions of offers by unknown intermediaries cannot and need not be known at the time the prospectus/final terms are drawn up. Information on the offeror and the price are best delivered by the offeror itself; they also are part of the contractual arrangement between the offeror and the retail investor. There would be no prospectus liability for that information by the issuer, because it is omitted from the prospectus.

Q4: Can you provide examples of scenarios whereby the price would differ from that set out in the prospectus? Would you deem this to be a change of the terms and conditions?

As the Consultation Paper points out, the price fluctuates constantly in accordance with the movement of the markets. This is not a change of the terms and conditions. The prospectus can always only specify the initial offer price at the minute of pricing. Holding a price steady for any length of time is not customary in this type of offer of debt securities. This notion seems to have found its way into the regulation from the equities world.

Q5: What information required according to the Prospectus Regulation cannot be provided in a prospectus or base prospectus/final terms in case of retail cascades but is only provided by the intermediary at the time of the sub-offer? How and when is such information communicated to the investor? Please specify and explain.

Most importantly the price and the name of the financial intermediary. This information does not even need to be communicated to the investor, it is obvious to the investor because he/she is in direct contact and negotiation with the offering intermediary.

Q6: Do you consider it necessary to clarify in the prospectus who is responsible for information that is provided by the intermediary to the investor?

No, that is not necessary, since the issuer is responsible for the information in the prospectus in accordance with the domestic rules and the offeror is responsible for the information/investment advice given to the investor.

Comments on the on the Consultation Paper "ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU" (ESMA/2011/444)

Q8: In relation to a standalone prospectus, do you agree that once the offer which is the subject matter of the initial prospectus has been closed, financial intermediaries subsequently offering the securities in a retail cascade should prepare a new prospectus which could incorporate by reference the issuer's initial prospectus?

Please note that there is no known case in an offer of debt securities where a prospectus was ever prepared by someone else but the issuer. The offeror just does not have access to the information needed nor can he/she rely on the publicly available information to be complete and up to date. Also, the notion that there is one big offer in a retail cascade is a fiction; in fact there is a whole series of offers. The issuer accepts this to be its offer and to produce one prospectus for the whole retail cacscade to enable the distribution of its bonds under the EU prospectus regime, specifically the final placement rule in 3.2.2 of the PD.

Q9: Is it the case that the identities of the financial intermediaries, the conditions attaching to the consent and the duration of the consent are generally known at the time of the approval of the prospectus or at the time of filing the final terms? At which stage do you generally determine the precise way of distribution including the decision of which financial intermediaries to use for a specific offer?

Please see our General remarks above. This is the central problem when trying to keep the retail cascade distribution alive. Distributors "in fact" that offer debt securities further down in the cascade may need a prospectus, but have no means to prepare it. So the issuer prepares it for them, but has no way of knowing who the distributors in "fact" are. The consent is not so problematic, as long as it can be given in a general form.

Q10: Is it common practice for agreements with financial intermediaries to be finalized following the approval of the prospectus or the filing of final terms? Can you estimate how often this would happen?

Under the current practice only the contractual distributors i.e. the initial underwriters or under a debt issuance programme the permanent dealers are known at this early stage. Later distributors in fact are not part of an agreement with the issuer.

Q11: Given the fact that in a retail cascade the responsibility of the issuer for the content of the prospectus is subject to its consent to use the prospectus such consent is crucial for the whole prospectus responsibility regime. Therefore ESMA believes that the consent to use the prospectus needs to be public, and furthermore, that it should be stated in the prospectus as is also the case for the general responsibility statement. Do you agree with ESMA's approach to include such consent in the prospectus or base prospectus/final terms?

The whole underlying assumption that the issuer's prospectus liability is subject to its consent is flawed, since it only applies to a part of the EU.

Comments on the on the Consultation Paper "ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU" (ESMA/2011/444)

Q12: If the above elements are known at the time of approval of the prospectus or the time of filing the final terms, what are the disadvantages (if any) for including this information within the prospectus or final terms?

There are no disadvantages of including information that is known at the time of filing, as long as this requirement is not used to prohibit uses of the prospectus that are not described therein, because they could not be known at the time of filing and will in part never be known.

In addition, the recommended naming of the financial intermediary with address is an important disadvantage because of harming the business interest of the issuer in a striking manner since he or she has to display the distribution structure, vis-à-vis the competitors. In our eyes, this is an overregulation going beyond the aim of the revised Prospectus Directive. This could not be intentioned since the relevant transposition would harm competition.

Q14: Do you consider a supplement necessary in relation to information on retail cascades? Please explain and justify your position, also taking into account different typical situations of retail cascades and any effect such retail cascade related information may have on the assessment of the securities.

No. The information of who offers the debt securities at what price is not material to the public. That is information that any investor will know as soon as the offer is made.

II. Requirement to indicate the tax implications of an issue

To create sufficient legal certainty for issuers, the requirement to indicate the tax implications of an issue, as referred to in Question 45 of this guide, should in particular be included in the Prospectus Regulation, as some member states do not regard CESR's Q&A guide as binding. What is meant is, as CESR/ESMA explain, not full disclosure of the tax regime in each country where the offer takes place, but information on taxes withheld at source which are directly incurred by the issuer and which are therefore known to the issuer. We would welcome a clarification about the nature of taxes. Since the entry into force of the Prospectus Regulation, questions have repeatedly been asked about how some of the contents of prospectuses are to be understood or interpreted. CESR/ESMA tried to answer these uniformly for the whole of the EU by way of a Q&A guide entitled "Frequently asked questions regarding Prospectuses: Common positions agreed by CESR Members (CESR/10-1337)" (FAQs").