LSEG Response to Consultation Paper: ESMA's technical advice on possible delegated acts concerning the Prospectus Directive 2010/73/EU

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Executive Summary

1. We support ESMA's proposals in respect of Level II of the Prospectus Directive in principle, in particular the amendments to introduce:

    - a proportionate prospectus regime for pre-emptive offers by issuers on regulated markets and MTFs that have appropriate disclosure and market abuse requirements; and

    - a proportionate prospectus regime for offers by SMEs and issuers with reduced market capitalisation on a per market basis and not as part of a tiered regime within markets.

2. We believe these amendments, combined with the increase in thresholds that trigger the requirement to produce a prospectus to €5m consideration and 150 persons, are a move in the right direction to help facilitate access to finance for smaller companies.

3. However, we remain concerned that these changes alone do not tackle the core issue of extending the base of investors that are readily able and willing to invest in SMEs. There is a need increase investor interest in smaller companies through the regulatory framework **whilst ensuring that standards of transparency and investor protection are NOT reduced**.

4. We note questions 36 and 40 refer specifically to quantification of costs of the prospectus. The focus should not simply be on attempting to alleviate costs by reducing transparency and disclosure. The costs of being a public company and/or of undertaking an offer to the public only become a barrier to issuers if they exceed the benefits of being on market. Issuers assess the benefits of being public / making public offers based on the level of investor interest, measured through the level of trading in their securities, and ultimately their cost of capital.

5. We therefore believe that any measures proposed under PD for smaller companies / MTFs that cater for smaller companies should take the ongoing review of MiFID and MAD into consideration, as referred to in the consultation document.

6. A separate regime under MiFID for markets that cater for smaller companies, distinct from the regulated market structure would, if implemented correctly, attract investor interest as investors in smaller companies require a robust regulatory regime that provides appropriate protection over their investments. This increased investor interest and confidence would help reduce the cost of capital for issuers over the longer term.

7. However, if not correctly implemented, (for example, by introducing excessively restrictive definitions of smaller companies or not allowing for appropriate tailoring by discretions allowed to Competent Authorities or market operators), a specific regime for SMEs could have the reverse effect of reducing investor and issuer confidence and reducing available investment, thereby inadvertently increasing the cost of capital for issuers.

8. This issue is particularly important in the context of the current economic cycle and the need for the growth out of recession to be driven by growth in the economy. We therefore believe there could be benefits of introducing a new definition of 'SME market' that would better enable Europe's growth businesses to access growth capital at a reasonable cost without compromising investor protection principles.

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Introduction

The London Stock Exchange Group (LSEG) welcomes the opportunity to respond to ESMA's Public Consultation on possible delegated acts concerning the Prospectus Directive ("Consultation Paper").

During the review of Level I of the Prospectus Directive ("PD") last year, the London Stock Exchange Group ("LSEG") welcomed the Commission's efforts to increase the efficiency of the prospectus regime and to reduce the administrative burdens for companies, particularly smaller companies, when raising capital in the European securities markets. Our position remains in support of these objectives.

The Consultation Paper and the issues it raises are of vital importance to the effective and efficient operation of the financial markets of the EU and we are keen to play our part in assisting ESMA in preparing its technical advice to the Commission on possible delegated Acts.

In writing this response, we have drawn on our experience of operating Europe's largest growth market for SMEs, AIM and AIM Italia. The LSEG has significant experience of operating neutral, well regulated, fair and efficient markets in these areas.

This submission represents the views and experience of London Stock Exchange plc, Borsa Italiana, and other market operators and investment firms within the LSEG.

LSEG operates equity, fixed income and derivatives markets in the UK and Italy. Apart from its equity markets, the non-equity markets include, MTS, ORB, IDEM (specialising in Italian equity derivatives), IDEX (offering Italian energy contracts) and EDX (which offers trading in Russian and Norwegian equity derivatives products). LSEG also provides Post Trade services, including Cassa di Compensazione e Garanzia (CC&G), a clearing house and central counterparty and Monte Titoli, the Italian Central Securities Depositary. It operates Turquoise, an MTF trading pan-European equities.

Part 1 contains our detailed responses to the individual questions, whilst Appendix A is a briefing on the importance of the EU's growth markets to EU economy, which includes an explanation of the regulatory framework governing growth markets, specifically AIM and AIM Italia.

We confirm that we acknowledge that this Response may be published by the Commission.

RESPONSES TO INDIVIDUAL QUESTIONS

1. Format of the final terms to the base prospectus (Article 5(5)) [Questions 1 to 7]

1.1 We agree that it is virtually impossible to develop a fixed format/list of items to be included in the final terms of the prospectus.

1.2 However, we believe that the ESMA's approach is helpful as it clearly identifies the information items that can be or cannot be included in the final terms. This clarifies the respective roles and contents of base prospectus and final terms, stating when a supplement is necessary and when it is not. This approach is important also for clearly understanding the scope of the scrutiny by the competent authorities

1.3 We agree that final terms should not be used as a kind of short form prospectus, nor should it be used to disclose information that was not known at the time of the approval of the base prospectus. However we have some concerns that this could lead to an increased number of supplements, slowing down the process in relation to specific issuances.

1.4 For example, market conditions at the time of the offer, is one of the key factors that determines the country in which particular securities issued under a base prospectus are offered or admitted to trading.

1.5 Also the identity of the offeror is another specific item of the list of additional information labelled as CAT A that, according to the best practice adopted at European level, is often provided only in the final terms. Therefore, it might be useful to consider that information as CAT B, in order to ensure more flexibility to the issuer and to streamline the whole process.

2. Format of the summary of the prospectus and detailed content and specific form of the key information to be included in the summary (Article 5(5)) [Questions 8 to 15]

2.1 We reiterate our support for the principle of greater comparability between prospectus summaries and therefore we welcome the efforts to facilitate comparability of one prospectus summary to the next, provided that the information is presented clearly and in easily understandable language.

2.2 We understand ESMA's concerns about the alignment of the contents of the summary towards the PRIPs initiative. However, we believe that this alignment - even if difficult - should be promoted by ESMA in the context of the prospectus consultation. If the template for the KIID requires items that are not to be disclosed in a prospectus, this does not mean that new disclosure have to be introduced in the prospectus. It would be easier to consider those items of the KIID that are not applicable to the summary which are not disclosed in a prospectus

3. Proportionate disclosure regime (Article 7)

Proportionate disclosure regime regarding rights issues [Questions 16 to 36]

Q16: *Do you agree with the proposal to consider that "near identical rights" should have the same characteristics than pre-emption rights? Do you agree with the definition given in paragraph 117? Are there any other characteristics which should be taken into account?*

3.1 Yes this clarification is welcome as it will allow companies to benefit from the proportionate disclosure regime and increase harmonisation across Member States in the context of pre-emptive offers.

Q17: *Do you agree that there should be only one single proportionate regime and not two separate regimes, one for regulated markets and one for MTFs?*

3.2 Yes, we agree there should only be one regime for pre-emptive offers carried out by issuers on regulated markets and MTFs.

3.3 Currently the same PD regime, i.e. the requirement to produce a full prospectus, applies to all offers made to the public regardless of whether the issuer is listed on a regulated market or MTF or is unlisted. This approach of consistent disclosure helps provide investor clarity. We believe one regime for pre-emptive offers by issuers on regulated markets and those on MTFs will maintain this approach, reducing complexity and risk of investor confusion.

3.4 We believe that an approach that results in too many tiers or standards of regulation would cause confusion and could ultimately result in investors withdrawing funding from SMEs admitted to MTFs because a reduced standard or lower tier of regulation could increase the perceived risk of investing in SMEs.

Q18: *Do you agree with the proposal to consider that appropriate disclosures requirements for MTFs would include, as a minimum, obligations to publish:*

- *annual financial statements and audit reports within 6 months after the end of each financial year,*
- *half-yearly financial statements within a limited deadline after the end of the first six months of each financial year, and*
- *inside information?*

3.5 We agree with the suggested minimum disclosures. Of these, the requirement to disclose inside information on a timely basis is the most critical as it underpins the principles of prevention of market abuse. Given that this requirement would capture any price sensitive information in the context of a company's financials as well, we do not have any objection to the suggested reporting deadlines for annual and half-yearly financials for issuers on MTFs.

Q19: *What should be the maximum deadline for publishing half-yearly financial statements?*

3.6 No comment. See answer to Q18.

Q20: *For issuers listed on MTFs where there are no disclosure requirements on board practices and remuneration, do you agree that this information should be included in the prospectus?*

3.7 We believe that there should be one regime for pre-emptive offers by issuers on regulated markets and MTFs; therefore there should be no additional items for issuers on MTFs.

3.8 LSEG's SME markets, AIM and AIM Italia, operate under regulatory frameworks that are based on the principles of the directives that form FSAP. They have specific rule books, regulatory and monitoring functions, direct relationships with issuers and the ability to take disciplinary action and impose sanctions.

3.9 In 2010, in order to ensure that investors have access to relevant information about each AIM company, the AIM rules were amended so that companies with securities admitted to AIM are now required to disclose in their annual accounts details of the remuneration of each director for the financial year in question.

Q21: *Are there any other disclosure requirements not listed above which should be required for MTFs?*

3.10 No.

Q22: *Regarding the appropriate rules on market abuse, do you agree that there should be provisions in order to prevent insider trading and market manipulation? Do you consider it necessary to require that the rules of the MTFs fully comply with the provisions of the Market Abuse Directive?*

3.11 As mentioned above, we believe the requirement to disclose inside information on a timely basis is the most important requirement under market abuse rules. We agree that there should be provisions to prevent insider trading and market manipulation. However, we do not consider it necessary to require that the rules of MTFs fully comply with the provisions of the Market Abuse Directive ('MAD'), for example maintaining of insider lists.

3.12 MTFs that would benefit from the proportionate prospectus regime for pre-emptive offers are those that also have a primary market offering catering for smaller companies, such as AIM, AIM Italia, Alternext, Entry Standard, First North and New Connect. These markets, which play a vital role in providing European SMEs access to capital, currently apply the principles of the FSAP directives, including MAD, but do not necessarily comply with all the specific requirements such as the unnecessary burden of requiring SMEs to maintain insider lists. Requiring these MTFs to fully comply with the implementing measures of MAD would disenfranchise them from the proportionate prospectus regime.

3.13 We believe that it should be sufficient for the MTF to apply the high-level principles of market abuse prevention (such as those contained in Articles 1 to 5 of the Market Abuse Directive) to benefit from the proportionate regime for pre-emptive offers.

3.14 We are also aware that the ongoing review of MAD is considering extending the directive to MTFs. This review should consider a separate and appropriate regime for primary market MTFs that cater for SMEs. This distinct regime would also help clarify the requirements on an MTF to benefit from the proportionate prospectus regime for pre-emptive offers.

Q23: *Are there any other EU Directive or Regulation not listed in paragraph 122 which should be taken into account?*

3.15 No.

Q24: *As regards MTFs with appropriate disclosure requirements and market abuse rules, do you agree that in order to benefit from the proportionate prospectus, issuers should be required to make available their periodic and ongoing disclosures in a way that facilitates access to information by posting them on their websites?*

3.16 We agree that issuers should make available their periodic and ongoing disclosures to the wider public; posting them on their website is one mechanism for this. All issuers when incorporating by reference should clearly state where the relevant information is available from.

Q25: *Do you agree with the approach proposed in order to determine which items to delete from Annexes I and III of the Prospectus Regulation?*

No comments.

Q26: *Do you agree with the proposed items which could be deleted from Annex I (Minimum Disclosure Requirements for the Share Registration Document) and Annex III (Minimum Disclosure Requirements for the Share Securities Note) of the Prospectus Regulation?*

3.17 Yes.

Q27: *Do you consider that the language regime could be a concern in terms of investor protection in case of passporting? Do you consider that the proportionate disclosure regime should be conditional upon compliance with the language requirements of Article 19 of the Prospectus Directive?*

3.18 No comment.

Q28: *In case of issuers listed on regulated markets, do you consider that disclosures on remunerations required by item 15 of Annex I of the Prospectus Regulation are redundant with information already made available to shareholders and the public in general and could therefore be deleted from the proportionate prospectus for rights issues?*

3.19 Yes, we agree.

Q29: *Considering the objective to enhance investor protection, do you agree that information regarding the issuer's activities and markets and historical financial information can not be omitted?*

3.20 We disagree with this. Given that issuers are already subject to the requirement to disclose all price-sensitive information on a timely basis, such information will already be in the public domain and can therefore be omitted.

Q30: *Do you consider that, in order to reduce administrative burden, incorporation by reference could be a solution? Do you have any suggestions to improve the incorporation mechanism?*

3.21 Information required under the proportionate regime should be restricted to that which relates to the offer itself, or information not previously in the public domain.

3.22 Incorporation by reference could be a solution. Issuers should be required to ensure the information is easily accessible, for example through their website, and clearly state how to access the information and from where.

Q31: *Do you agree with the proposals to require basic and updated information regarding the issuer's principal activities and markets?*

3.23 No. Given that issuers are already subject to the requirement to disclose all price-sensitive information on a timely basis, such information will already be in the public domain and can therefore be omitted.

Q32: *Do you agree with the proposal to require only the issuer's historical financial information relating to the last financial year?*

3.24 This can be incorporated by reference, given that this information will already be in the public domain.

Q33: *Do you agree with the proposal to redraft certain items of Annexes I and III of the Prospectus Regulation as proposed in paragraphs 132 to 134? Are there any other items which should be redrafted?*

3.25 No comment

Q34: *Do you agree with the proposal to include a statement in the proportionate prospectus drawing attention to the specific regime and level of disclosure applicable to rights issues?*

3.26 Yes.

Q35: *Do you agree with the schedule for rights issues presented in Annex 2 of this consultation paper?*

3.27 Yes

Q36: *What are the costs for drawing up a full prospectus? What are the most burdensome disclosure requirements?*

Can you provide any data? Can you assess the costs that the proposed proportionate prospectus will allow issuers to save?

3.28 No comment

Proportionate disclosure regime regarding SMEs and issuers with reduced market capitalisation [Questions 37 to 45]

Q37: *Do you agree that a full prospectus should always be required for an IPO and for initial admission to a regulated market (as described in paragraph 141 above)?*

3.29 Yes. We believe that introducing a proportionate regime is appropriate only in the case of further pre-emptive issues by companies that are already on the market.

3.30 The introduction otherwise of a proportionate regime for SMEs and companies with reduced market capitalisation would create a tier within regulated markets, causing investor confusion and we do not support this.

Q38: *Do you agree with the proposal summarized in the table in paragraph 141?*

3.31 We agree with the proposal in principle but emphasise the need for further clarification on the following points:

- The proportionate prospectus in the context of issuers on MTFs and unlisted issuers will only be available to SMEs, given the definition of 'companies with reduced market capitalisation' by default refers to companies on regulated markets only.

- Companies other than SMEs, even if they are not on a regulated market, must comply with the full prospectus regime when making an offer to the public.
- The term 'OTC' has different meanings across Member States, similarly the use of the term 'listed' varies and should be clarified.

Q39: *Do you agree that there should be only one schedule for a proportionate prospectus for both unlisted and listed SMEs and Small Caps or do you believe that further consideration should be given to having a separate regime for unlisted companies, dealt with under the proposed revision to MiFID?*

3.32 We would agree there should be only one schedule for a proportionate prospectus for smaller companies on regulated markets and those that are not on regulated markets.

3.33 However, we do consider it would be appropriate to incorporate any proposals in relation to a separate regime for SME markets currently being considered under the MiFID review. The focus should not simply be on attempting to alleviate costs by reducing transparency and disclosure. The costs of being a public company and/or of undertaking an offer to the public only become a barrier to issuers if they exceed the benefits of being on market. Issuers assess the benefits of being public / making public offers based on the level of investor interest, measured through the level of trading in their securities, and ultimately their cost of capital. We believe the MiFID review is very important and would allow for a more complete review of regulatory requirements for smaller companies.

3.34 Furthermore, MiFID provides a valuable opportunity for a wider cross-Directorate approach to introduce a range of measures to stimulate investment in SMEs and improve the exit environment in Europe fro the venture capital industry. In this regard we welcome the initiatives being undertaken by the SME Finance Forum, DG Enterprise and DG Research & Innovation.

Q40: *Can you provide data on the average costs for SMEs and Small Caps to draw up a prospectus? What are the most burdensome parts of a prospectus to produce?*

3.35 No comment

Q41: *Do you consider that the three items identified in paragraph 147 (the OFR and the requirements to include a statement of changes in equity and a cash flow statement when the audited financial statements are prepared according to national accounting standards and to produce interim financial statements when the registration document is dated more than nine months after the end of the last audited financial year) could be omitted without lowering investor protection?*

3.36 Yes, we believe these items can be omitted without lowering investor protection.

Q42: *Do you agree with the items ESMA proposes to delete and to redraft listed in Annex 4 and the proportionate schedule for the share registration document presented in Annex 5?*

3.37 We believe that as the proposals stand there does not appear to be that much difference between the proportionate regime and the full prospectus.

3.38 We believe that that this issue is better served within the SME framework part of the review and we no not believe that a tiered proportionate regime is appropriate for the reasons given in Q39 above.

Q43: *Are there any other items which could be deleted or redrafted? Please justify any suggestions, including, if possible, the costs that would be saved and the impact on investor protection.*

3.39 Please see our response to Q42

Q44: *Taking into account the items which ESMA proposes to delete or redraft as per Annex 4, do you consider the proportionate disclosure regime for SMEs/Small Caps could strike the right balance between investor protection, the amount of information already disclosed to the markets and the size of the issuers?*

3.40 Please see our response to Q42

Q45: *Given the number and nature of the items ESMA proposes to delete and to redraft listed in Annex 4, do you consider the proposal would suppose a significant reduction of the costs to access financial markets for SMEs and Small Caps? Can you estimate the costs that the proposed proportionate prospectus will allow SMEs and Small Caps to save?*

3.41 Please refer to our response to Question 42

Proportionate disclosure regime regarding credit institutions and other issuers [Questions 46 & 47]

3.42 No comments.

Appendix A

2.1 Funding SME growth, innovation and jobs

The availability of funding is particularly important in the current economic environment As we plan for the recovery of the EU economy, it is clear that SMEs will drive growth, innovation and job creation and the PD Review should be viewed as an opportunity to support and nurture these companies at this critical time.

Growth markets such as AIM (UK), Alternext (France), AIM Italia (Italy) and Entry Standard (Germany) are a vital part of the EU's SME funding ecosystem and key to the creation of future jobs. Growth markets enable SMEs with high growth and substantial innovation prospects to access vital capital. Often equity capital is the only viable funding option for these businesses as bank finance is not appropriate for their business models. Equity also helps companies retain key employees and secure commercial contracts that were often not available to them as private businesses.

Since its establishment in 1995, AIM has enabled smaller, growing companies across a wide range of sectors to raise over £75 billion in new and further fundraisings. Companies, such as innovative high-tech start-ups, have been able to raise core development capital, while private equity and other early stage backers have successfully used AIM as an exit. Indeed, most early stage backers – including angel investors, banks and venture capitalists – are only willing to provide funding to companies because there is a viable exit route in the public equity markets.

2.2 Briefing - AIM and AIM Italia

The London Stock Exchange Group operates AIM and AIM Italia, launched in 2008 through Borsa Italiana S.p.A., both of which cater for SMEs by providing a more flexible and cheaper model for equity fund raising.

As at 31 May 2011 there were 1335 companies on AIM, with a total market value of £57.3 billion. Of these, 805 AIM companies had their operations in the EU and an aggregate value of £39.6 billion.

The regulatory status of AIM and AIM Italia

Both AIM and AIM Italia benefit from a robust regulatory framework with the emphasis on ongoing disclosure, which preserves the integrity of the market and ensures that investors have the necessary information to make investment decisions.

Nominated advisers (Nomads), responsible for assessing a company's appropriateness at admission and on an ongoing basis, have been central to AIM's success. They provide advice to ensure companies comply with the rules and provide much needed support to help these smaller companies grow and benefit from being on a public market.

One of the strengths and vital elements of this model is that the regulator (i.e. the market operator) is close to the market and has strong, close and continuous relationships with the Nomads. This enables the regulator to respond quickly and efficiently to market developments. Furthermore, the Nomad model helps ensure

that early stage companies have an ongoing relationship with a 'trusted adviser' to help them transition successfully from being a private business to maximizing the benefits of being admitted to a public equity market.

AIM regulation and EU regulatory requirements

AIM is a market operated and regulated by the London Stock Exchange (a Recognised Investment Exchange which is itself regulated by the UK competent authority, the FSA). AIM falls within the definition of Prescribed Market under the UK's Financial Services and Markets Act 2000 (and, therefore, is under the supervision of the FSA).

AIM Italia is regulated and managed by Borsa Italiana, and is built on the same model as AIM in the UK, but adapted in a few areas to take into account the specificities of the Italian legislative framework.

As AIM and AIM Italia are not Regulated Markets under the EU directives, they are usually classified as multilateral trading facilities (MTFs) according to the definitions contained in the Markets in Financial Instruments Directive (MiFID). However, it is imperative to distinguish growth/"junior" markets which perform primary market functions - such as AIM, Alternext, AIM Italia and Entry Standard - from 'traditional' MTFs that are pan-European trading platforms (such as Chi-X, Turquoise) which purely operate in the trading of securities that are listed elsewhere.

The regulatory framework of AIM and other growth markets such as Alternext and Entry Standard is such that it incorporates the principles of EU directives while providing access to capital with the support of the advisory community.

The majority of the Market Abuse Directive, as well as the disclosure requirements under the Transparency Directive, apply to AIM securities.

In addition, in accordance with the Prospectus Directive (PD), companies on AIM and AIM Italia are required to produce a prospectus for their admission to the market where they make an initial public offer, but not otherwise (in practice, primary offers on MTFs are often made within the exemptions regime provided for by PD (i.e. by means of a private placement)).[1]

Nevertheless, such companies are required to produce an Admission Document, which is based on PD requirements and is very similar to the prospectus. A prospectus would also be required in the case of an open offer made by such companies once they are admitted to a growth market MTF, once again unless the relevant exceptions apply (i.e. offers to less than 100 persons).

[1] Please see the relevant forms for applying to admit to trading on AIM: http://www.londonstockexchange.com/companies-and-advisors/aim/publications/forms/forms.htm