# Response to CESR's Call for Evidence – Report on the Supervisory Functioning of the Prospectus Directive and Regulation

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## Introduction

Deutsches Aktieninstitut e.V. is the association of German exchange-listed stock corporations and other companies and institutions which are engaged in the capital markets development. Its most important tasks include supporting the relevant institutional and legal framework of the German capital market and the development of a harmonised European capital market, enhancing corporate financing in Germany and promoting the acceptance of equity among investors and companies.

The BDI is the umbrella organisation of German industry and industry-related service providers. It represents 35 industrial sector federations and has 15 regional offices in the German Länder. BDI speaks for more than 100,000 private enterprises employing around 8 million people.

## A. General Comments

The Prospectus regime (Prospectus Directive, 2003/71/EG, and Prospectus Regulation, (EC) 809/2004) has been an important step on the way to an integrated European financial market. There has been the need for a unification of the regulatory conditions for the raising of capital by European companies in order to increase transparency in the European capital market. Such a harmonisation, combined with the introduction of a genuine European passport for securities issuers in terms of notification processes, has represented a fundamental step towards an integrated European capital market.

Now, after one and a half years of application of the Directive and the related implementation measures CESR intends to assess whether it is really working on the ground, and in particular whether it is contributing to the development of the single market for securities. We welcome this intention. There are indeed many issues that in our view have to be addressed if examining the Prospectus regime and its application. Especially differing interpretations among competent authorities of the provisions of the prospectus regime do not help to fulfil the European market efficiency. Some Member States respectively

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Regulators demand requirements additionally to the provisions of the Prospectus regime. As we regard the Prospectus Directive as a directive of maximum harmonisation, additional requirements are in our view an infringement of the Prospectus Directive. We will give examples. Not all our comments might be related to "level 3". Still, we think that they should be mentioned nevertheless as serious practical problems have occurred.

The catalogue of frequently asked questions containing the common positions agreed by CESR Members published in July 2006 was very helpful for market participants. Although there were also dissenting opinions by regulators and an agreement was not achieved on some issues, at least issuers can get the information on differing applications of the Prospectus regime as an overview in a single document. We were pleased to hear on CESR's open hearing in Paris on 16 January 2007, that there is yet more to come.

**B. Details**

**Article 3**

1. A very important subject for issuers is the definition of the "public offer". It should be clarified by an agreed interpretation of CESR what a public offer is and when it ends.

2. In general, we notice that there is an increasing use of the exemption for offers of securities with a denomination above EUR 50,000 (Art. 3 (2)) that leads to a limited availability of retail bonds in Germany and also the UK. As to a statistic of the Börse Stuttgart, in 2006 42 % of the bonds listed there had a denomination of EUR 50,000 while in 2005 it was 8 %. If this development proceeds, retail investors as the ones to be protected by the Prospectus regime will be excluded from the bond market. The reasons for issuers to prevent their offers to be under the scope of the Prospectus regime is not their desire to exclude retail investors but are legal uncertainties and the concern about the right for investors to withdraw in Art. 16 (2). So one can state that the range of investment opportunities for private investors has decreased as a result of the Prospectus Directive.

3. Debt securities issuers who want to address above all institutional investors have the option to offer their securities to investors who acquire securities for a total consideration (Art. 3 (2)(c)) or at a denomination of at least EUR 50,000 (Art. 3 (2)(d)), as mentioned before. The latter is less attractive for issuers because the market demands also for other, flexible, units (EUR 51,000, 52,000 etc.). In the Prospectus Regulation a differentiated content of prospectuses is invented for debt and derivative securities aimed at those investors who purchase debt or derivative securities with a denomination per unit of at least EUR 50,000. According to Recital 14 of the Regulation the reason is that wholesale investors should be able to make their investment decision on other elements than those taken into consideration by retail investors. The exemp-

tion from the obligation to draw up a prospectus in Art. 3 (2)(c) was inserted in the Prospectus Directive on the same grounds. So, this exemption should be applied everywhere in the Prospectus Regulation where the exemption of Art. 3 (2)(d) is allowed for, e.g. Art. 7 of the Regulation.

4. As to an issue of securities according to Art. 3 (2), especially lit. (c), it should be clarified that the further resale of the securities to retail investors through intermediaries following the initial issue does not qualify as a public offer of the initial issuer as it is beyond its control ("retail cascade").

This is the only possible interpretation of the exemptions of Art. 3 (2) that lives up to the expectations of the Prospectus Directive and is not misleading for issuers. If a secondary offer by a third party triggered the requirement of a prospectus of the initial issuer, none of the exemptions of Art. 3 (2) of the Prospectus Directive apart from lit. (d) could be made use of in a legally secure way. This cannot be the intention of the Prospectus Directive.

**Article 4**

Deutsches Aktieninstitut and BDI see the need to remove obstacles for developing the financial participation of employees in Europe. It is important to foster this in order to analyse and to reduce obstacles that balk the implementation of financial participation across Europe by companies established in several countries. The EU Commission has already adopted a communication in July 2002 with the intention to promote greater use of employee financial participation systems. Thereafter a European Commission experts group chaired by Jean-Baptiste de Foucault elaborated a report and submitted it in July 2004.

Financial participation of employees in Europe is an important factor in group motivation and cohesion. It helps to increase a feeling of affiliation towards the company regardless of the country where employees carry out their activity.

Obstacles concerning employee financial participation systems are not only a European topic in regard for international global corporate groups. Nevertheless, a start would be made by removing obstacles at EU level. These obstacles are not only caused by the diversity of the legal, fiscal and social framework in force in the various countries but also by EU legislation, like the Prospectus Directive. The Prospectus Directive allows a derogation from the obligation to publish a prospectus concerning securities offered to employees by their employer who has securities already admitted to trading on a regulated market or by an affiliated undertaking provided that a document is made available containing information on the number and nature of the securities and the reasons for and details of the offer. So companies with more than 100 employees, whose shares are not listed on a regulated market, can offer secu-

rities to employees under a program of financial participation only when drawing up a prospectus. As this is burdensome this prerequisite might deter especially small and mid caps that are not trading shares on a regulated market from offering such programs.

Therefore, to remove an obstacle under EU legislative would be an amendment of the Prospectus directive. It should release companies from having to draw up a prospectus and enable them to offer an information document.

Also, in our view, the Prospectus Directive leaves room for interpretation. This should be fully utilised by regulators when applying the law. The exemption for offers with a total consideration of EUR 2,5 million in Art. 1 (2)(h) respectively the threshold of EUR 100,000 in Art. 3 (2)(e), e.g., should be calculated on a national, not EFA-wide basis. The German competent authority, the BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht), for example, regards the offer of securities to employees in principle as a public offer, except the offerees are known to the offerer, are chosen selectively, are addressed due to individual consideration and the information requirements of the offerees do not demand a prospectus. It is not clear in which constellation the latter is fulfilled. In our view employees cannot be compared with investors outside the company, anyway. Their level of understanding of the company is very different. It is not to be considered as a public offer.

**Article 5**

1. In order to reflect the need for market efficiency and flexibility which is addressed in Recitals 10 and 24 of the Prospectus Directive a base prospectus can be drawn up. It is not clear what information can be included in final terms and when a supplement is required.

It should be at least clarified that "final terms of the offer" do not refer only to the items set forth in no. 5 of Annex XII under the heading "terms and conditions of the offer" which would be only the amount, time period of offer, method of payment for the securities, pricing, names and addresses. A broader understanding of final terms providing for market efficiency and flexibility is supported by Art. 22 (2) and (4) of the Prospectus Regulation where it is referred to as "information items from the securities note schedules which are not known at the time of approval of the base prospectus and can only be determined at the time the public offer takes place" and where the additional words "of the offer" do not appear.

2. As mentioned before, we regard additional requirements that are imposed on issuers especially regarding passporting issues as infringements of the Prospectus Directive. As an example the Belgian competent Authority, Commission Bancaire, Financiere et des Assurances (CBFA), requires as a host Member State authority the passporting issuer to file the final terms also with

the CBFA although Art. 5 (4) obliges only a filing with the home competent authority.

**Article 6**

Differing member state standards for prospectus liability are almost an obstacle for cross-border offers of securities. Issuers and other transaction parties are exposed to inconsistent liability regimes in other countries, e.g. the liability for the summary.

**Article 10**

If an issuer has more than one home Member State (Art. 2 (1)(m)(ii)) it has to file the annual document in all home Member States. Differing interpretations among competent authorities about e.g. the period of reference ("annually") should be avoided. This even controverts the scope of the annual document confusing the investors. A common interpretation of Art. 10 by the competent authorities should be achieved.

Such a common understanding of the application of Art. 10 should take into account that the value of the annual document has been minimized by the Transparency Directive (2001/34/EC). The Transparency Directive which was to be implemented in national law by 20 January 2007 invented a Europe-wide disclosure and storage regime of regulated information. In each Member State at least one officially appointed mechanism (OAM) for the central storage of regulated information has to be set up giving investors or whomever interested easy access to the documents. The Transparency Directive also aims at the creation of a single electronic network, or a platform of electronic networks across Member States so that the investor has one single access to the information. Thus, the same (overlapping) information is stored in the different OAMs and the website of the issuers. Also, the annual document contains information of a certain period of time. Investors visiting the website of an issuer will generally be interested in current information on the issuer, not historic information referring to a certain period of time in the past. And such information is already provided by the issuer on a voluntary basis. For offering historic information, the OAM has been invented by the Transparency Directive.

Thus, the requirements for the annual document demanded by regulators should not be burdensome. This also is a "read across" issue comparing the scopes and provision of different directives. The annual document should be deleted in an amendment of the Prospectus Directive.

**Article 11**

It should be clarified that financial statements may be incorporated by reference as Art. 28 of the Prospectus Regulation expresses explicitly. There

should not be any restricting implementation or interpretation in Member States.

**Article 14**

Art. 14 allows home Member States to require a publication of a notice stating how the prospectus has been made available and where it can be obtained.

Germany as a host Member State requires for prospectuses to be notified a publication according to German law (Sec.14 Wertpapierprospektgesetz, WpPG). So, even if the home Member State does not require a notice to be published (Art. 14 (3) Prospectus Directive), the BaFin will. This it not in accordance with Art. 17 of the Prospectus Directive that states that "the prospectus approved by the home Member State and any supplements hereto shall be valid for the public offer or the admission to trading in any number of host Member States".

The provision in Art. 14 (3) allows an unnecessary discrimination of issuers for which the Member State that has implemented the option of Art. 14 (3) is the home Member State. A level playing field is to be strived for, so Art. 14 (2) should be deleted in an amendment of the Prospectus Directive.

**Article 15**

The Belgian CBFA requires as a host Member State authority the passporting issuer to file any type of advertisements relating to an offer made in Belgium for review with the CBFA in due time prior to the beginning of the offer.

According to the idea of a European Passport for prospectuses, a prospectus that has been approved and published in the home Member State is valid for public offers or the admission to trading in any number of host Member State provided the notification procedure is followed. Art. 17 of the Prospectus Directive does not allow any additional approval requirements. So, only the competent authority of the home Member State is permitted to control advertising activity.

**Article 16**

1. Supplements to the prospectus

Supplements to the prospectus are a very important subject and have a high priority for issuers.

Some aspects need clarification here. As to supplements it is not clear what the requirement to disclose "every significant new factor" means. Especially

the relation of this obligation and the obligation in the Market Abuse Directive (2003/6/EC) concerning the disclosure of inside information should be clarified.

In order to bring more legal security for issuers, we propose that this provision is interpreted in a way that in any case no supplements are necessary if a disclosure of inside information isn't either. So, the disclosure of inside information can function as a minimum threshold. On the other hand, there should be no synchronism in a way that any ad hoc publication triggers a supplement because not every ad hoc is relevant for the assessment of (debt) securities. There also is a difference between the relevance of facts for equity securities and debt securities. While a change in the management of the issuer can affect the stock price, the assessment of debt securities is dependent on other factors. For them, the company-related risk factors that have to be taken into account for the investment decision will rather be the probability of punctual interest payments and re-payment of the principal, thus the issuer's insolvency risk. So, factors that are not relevant for equity securities are a fortiori not relevant for debt securities. It should also be understood that supplements are only required if the "significant new factors" can "negatively" affect the assessment of the securities.

2. Approval by the competent authority

Supplements have to be approved by the competent authority in a maximum of seven working days. The competent authority only checks the formal coherency and comprehensibility of the supplement. The need for and benefit from an approval of the supplement in order for the assessment of the investment to be evaluated by investors (Recital 34 of the Prospectus Directive) is not visible to us. This bureaucratic procedure leads to a loss of time which is an important factor not only for issuers when offering securities. The delay of the disclosure of the new information is even a contradiction to investor protection which is especially apparent in cases where the new factors are at the same time inside information in the sense of the Market Abuse Directive. The interest in new (material!) information will always prevail any interest of competent authorities in (formal!) examination. The lawmaker might have seen this problem when drawing up the Prospectus Directive and in order to compensate the loss of time has invented the right for investors to withdraw from their agreement to purchase or subscribe for the securities within two days after the publication of the supplement. The background might be the prevention of competent authorities from any claims for damages caused by the delay as the right to withdraw is designed independently from the concrete results caused by the publication. This, of course, is at the very expense and risk of the issuers and dealers and leads to the possibility of abuse by investors. In the case that an inside information has been published investors can subscribe in this period of time knowing about the new factors and can withdraw when the correspondent supplement is published seven days after, at no risk. Therefore, the Prospectus Directive should be amended and the ob-

ligation of the competent authority to approve the supplements to the prospectus should be deleted. On the behalf of regulators an approval of supplements within one working day should be aspired.

Also, a shelf registration regime like in the USA could be considered. There, any filing with the SEC of a "20F" (Annual Report / consolidated financial statements) or of a "6 K" (interim financial statements or ad hoc/insider publications) is directly and automatically valid as a disclosure both for the issuer's equity listing and the debt listing/registration.

3. Withdrawal

The right to withdraw should be reconsidered. The Prospectus Directive has invented a very unbalanced regulation that opens the door to abuse as mentioned before. Investors who have already agreed to purchase or subscribe for securities before the supplement are granted the right to withdraw their acceptances even if the new factors had indeed no negative effect or were known to them already.

Issuers issuing debt securities will stop launching the offer immediately when a new factor occurs due to the additional risks provided in Art. 16. Thus, the possible consequences of Art. 16 may deter issuers from taking advantage of good near-term market conditions. The delays provided in Art. 16 increase the risk of a stop of the offer in general which is neither in the issuer's nor in the investor's interest.

(a) So, the right to withdraw should be restricted or deleted in an amendment of the Prospectus Directive:

At least in cases that securities have not (i) been acquired on the basis of the prospectus, (ii) the new factors have not had any negative effect on the investment or (iii) the investor knew or in case of the dissemination of inside information according to the Transparency Directive (2004/109/EC) could have known about the new factors when acquiring the securities, a right to withdraw should be excluded.

In our view, investors do not need the right to withdraw, anyway, if the supplements do not have to be approved, as stated above. Then, supplements can be published at once without the described loss of time. So, the right to withdraw and the requirement of approval should be deleted.

(b) Art. 16 should in any case be interpreted in a restrictive way regarding "significance" and "material" as mentioned above. It should also be clarified that the withdrawal right exists only prior to the settlement of a transaction. This is what the German implementation act governs in Sec. 16 (3) WpPG. A common interpretation by European regulators in that way would be appreciated.