

**EALIC's ANSWER
TO
CESR'S CALL FOR EVIDENCE
OF 13 NOVEMBER 2006
ON THE SUPERVISORY FUNCTIONING OF THE PROSPECTUS DIRECTIVE AND
REGULATION**

1 February 2007

EALIC welcomes CESR's call for evidence on the supervisory functioning of the Directive 2003/71/EC (the "Prospectus Directive") and Regulation (EC) No. 809/2004 of 29th April 2004 (the "Regulation"). In this respect, please find below the comments we received from our members, with particular reference to the following areas:

- Obstacles to the fluid functioning of the passport and/or divergent practices in Member States that pose a risk to the proper functioning of the single market.
- Range of investment opportunities and level of disclosure and protection that the Prospectus regime is providing to investors.
- Usefulness of CESR Q&A on prospectuses.

1. Obstacles to the fluid functioning of the passport and/or divergent practices in Member States that pose a risk to the proper functioning of the single market.

1.1. Lack of a harmonised practical implementation in the Member States

The aim of the Lamfalussy procedure – which governs the Prospectus Directive and Regulation – is to create a higher level of harmonisation among Member States in the field of securities regulation and supervision. However, despite the increased level of pan-European legislative convergence (Lamfalussy Level 1 and Level 2), many cross-border differences still persist in the practical implementation of the new regulatory regime provided for the prospectus. The reasons for such a situation are manifold.

(1) As shown below, in areas covered by the Prospectus Directive and Regulation, national competent authorities adopt different standards. In many cases, this seems to be due to a sort of path-dependence mechanism, according to which supervisors tend to maintain their habits. For instance, when the Prospectus Directive lays down obligations, it rarely says whether compliance with such obligations is not only necessary but also sufficient. The fact that the Prospectus Directive and Regulation are a "maximum harmonization" directive and regulation should be clearly underlined with national regulators. Alternatively, national regulators could be encouraged to stick with the Directive and Regulation by making competition between national regulators possible, for instance by disconnecting the supervisory authority competent for an issuer from the seat of incorporation of such issuer. We believe that this connection could indeed be a major flaw in the EU legislation on prospectuses and deserves closer and further examination.

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(2) Not every lack of harmonization in the functioning of the Prospectus Directive and Regulation is a sign of a detrimental path-dependence. In some cases, indeed, it might be the answer to stakeholders' needs, a sort of market-driven regulatory result. The only solution to this kind of regulatory divergence lays in the drafting of better-devised rules, also through a revision of rules already in force, when they are proving to bring more costs than benefits.

1.2. Burdensome regulatory environment

Certain rules provided for by the Prospectus Directive and Regulation, even if equally applied throughout Europe, are not satisfying. Again, the reasons are manifold:

(3) Rules may impose costs which are excessive and not proportional to the benefits they are supposed to bring. An effective regulatory framework foresees a detailed impact assessment to be run before any regulatory change, but assessments are based on forecasts which have to be checked when the legislation is in force. In addition, only the Commission proposals are subject to impact assessments and not the eventually adopted legislation.

(4) In some cases, informal EU processes influence the final output of the Prospectus Directive: official texts in different languages sometimes diverge in relevant aspects (often because of misprints); Transposition Meetings held at the Commission provide in some cases interpretations in contrast with the text approved by the Council and the Parliament (e.g. 4th Informal meeting on Prospectus Transposition dated 8th March 2005 on article 4 of the Prospectus Directive).

Examples of (1), (2), (3) and (4) may be found in the following areas covered by the Prospectus Directive and Regulation:

(a) Scope and definitions (articles 1 and 2):

The Prospectus Directive concerns transferable securities. In this respect, there is no harmonization between Member States where different definitions of transferable securities are found (e.g. definition of preference shares).

(b) Obligation to publish a prospectus (article 3 section 1 and 3):

The principle that every offer of securities made to the public needs a prospectus is too burdensome for companies that already comply with applicable notification obligations and publish current reports. In our opinion, companies that already offered their securities during, for example, the last 18 months and comply with notification obligations without any reservations from the local authority, should be excluded from the obligation to publish a prospectus. In these cases the introductory document should only mention the conditions of the offer and aim of the issue, indicating a place where the reports which investors need to evaluate the company, are published.

The obligation to make a prospectus should be limited to the following instances: (i) changing the market of issuing (ii) spreading the offer of securities on new markets.

(c) Exemptions from the application of the Prospectus Directive (article 1) and from the obligation to publish a prospectus (article 4):

The list of exemptions gives rise to certain inconsistencies and inefficiencies. In this respect, the Prospectus Directive makes very difficult and expensive extraordinary corporate transactions which may be of vital importance for the issuer (e.g. shares offerings to employees of non listed companies with more than one hundred employees; rights issues to existing shareholders inside and outside the Home Member State of the issuer; admission to trading of share representing, over 12 months, more than 10% of shares of the same class already admitted to trading).

(e) Responsibility for a prospectus (article 6):

This issue is left to the national legislation with the result that there are different rules in every Member State. This could give rise to a liability arbitrage. It is useful to clarify which responsibility regime applies in case of cross border offerings in the foreign Member State.

(f) The retail cascade (article 3, paragraph 2):

The provision concerned causes uncertainty: there is not a clear distinction between “subsequent resale” and “final placement”; the responsibility of publishing a prospectus is allocated to different persons depending on the national provision (e.g. financial intermediary and/or qualified investor). Therefore, it is appropriate to

- (i) clearly identify the financial instruments potentially subject to the provision at issue;
- (ii) make clear that in no event the issuer choosing not to carry out an offer to the public has to run the risk to publish a prospectus or to supply information to the intermediary.

(g) Validity of the Prospectus (article 9):

In spite of the validity period for the prospectus of 12 months foreseen by article 9.4 of the Prospectus Directive, the validity of the prospectus is also linked to the validity of the financial statements included in such document. Indeed, if the issuer wishes to use a registration document that includes financial statements more than 15 months old to make an offering of securities, such issuer will be required to update such registration document so as to include its most recent annual financial statements. There is a discrepancy between articles 9.4. and 10.1. (which subjects the 12 months validity of the registration document to an annual up-date of the relevant information, including the financial statement) and the provisions set forth in Annex I- 20.5.1. according to which the last year of audited financial information may not be older than 15 months from the date of the registration document if such document includes non audited interim financial statements. The provisions of Annex I- 20.5.1. should prevail so that no updating of the registration document including a 15 months financial statement should be required.

(h) Time lines (article 13):

According to the Prospectus Directive, the approval is the positive act at the outcome of the scrutiny of the completeness of the prospectus by the Home Member State's competent authority including the consistency of the information given and its comprehensibility (article 2, para. 1, (a)). The terms for the approval are strictly set forth by article 13 which does not subject them to any particular condition. This means that the national competent authority is not allowed to subject the terms of approval to any particular condition which is not required by the Prospectus Directive: if the terms set forth by the Prospectus Directive are not complied with due to any additional condition, this would imply a breach of the EU rules. Again, it seems necessary to make it understood by all that the Prospectus Directive is a "maximum harmonisation" directive .

In this respect, it should also be noted that many national authorities do not cope with the time lines set forth by the Prospectus Directive which does not provide for peremptory terms and sanctions in case of failure of compliance. It is necessary to provide for clear and certain time lines which could ensure the success of the launch of many securities offers which are often subject to certain market conditions. Clear time lines are also essential for carrying out preparatory activities (e.g. marketing, road shows, advertising). It should also be considered that unpredictable time lines may affect the nature of the offer (from public to institutional): qualified investors are usually preferred to retail investors due to the time needed for preparing individual marketing materials. In addition, the review procedure carried out by supervisory authorities may vary substantially from one Member State to another. Some supervisory authorities perform a fairly technical and objective revision of the document, verifying its completeness and compliance with the applicable requirements, but other supervisory authorities interfere with what should be the only responsibility of the issuer and even provide comments to the concrete wording used in the prospectus, which increases the complexity of the procedure and the time lines for approval.

(i) Approval of the prospectuses (article 13):

In case of a securities' offering, the authority in charge of the approval of the prospectus is the one of the Home Member State where the issuer has its registered office. This rule also applies in case the offer is carried out exclusively in a different Member State. Therefore it causes lack of regulatory competition.

(j) Publication of notices on prospectuses (article 14, paragraph 3):

The precise content of the notices is foreseen by the Regulation (article 31). Any practice used by the national competent authorities requiring elements which have not been foreseen by the Regulation (e.g. the risk factors) has to be considered as an evident breach of the Prospectus Directive and Regulation.

With reference to the means of publication foreseen by the Prospectus Directive, a cost benefit analysis would be useful in order to ascertain if certain means are expensive, time consuming and disproportionate to the purposes of the rules at issue (which seems to be the case of publication in the newspapers).

(k) Supplements to a prospectus (article 16):

As far as supplements are concerned, we believe that further clarification and harmonisation is needed. Currently, issuers (and even their advisors) do not have a clear understanding of when a supplement is necessary. It is very difficult to judge if a new factor is capable or not of affecting the assessment of the securities offered. There should be a better coordination of the different disclosure obligations at European level. In this sense, there should be no need to register and publish supplements to prospectuses when issuers are already disclosing all relevant information (periodic financial information, inside information, etc.) under Directive 2003/6/CE and Directive 2004/109/EC. Otherwise, companies whose shares are admitted to trading on a regulated market, would risk to have to make notifications twice; once as a current report informing the market immediately (during 24 hours) about the event and once as an annex which needs to be approved by the competent authority within 7 days. Such can lead to delay an offer (after the approval of the annex the issuer has to be given adequate time to be able to withdraw a subscription).

(1) Historical financial information and pro forma data:

In spite of the fact that the Regulation foresees precise and exhaustive provisions, national competent authorities still provide for additional rules. This should not be allowed.

2. Range of investment opportunities and level of disclosure and protection that the Prospectus regime is providing to investors.

Although the Prospectus Directive and Regulation cover different financial instruments, their provisions are mainly tailored for shares. The form of prospectuses for financial instruments other than shares, are based upon the form of prospectuses for shares. This method could give rise to inconsistencies (e.g. several corporate information regarding the issuer with reference to units of closed-end investment undertakings). The information and provisions applicable to different types of financial instruments should be clearly set forth.

From the investor protection perspective, the schemes of prospectuses provided for by the Prospectus Directive and Regulation do not increase the level of disclosure and protection. On the contrary, it should be considered that under the current regime the ordinary prospectuses (generally used for the offer of securities) are at least five hundred pages long; investors, both qualified and retail, can hardly deal with this excess of information and are not capable to catch the relevant information.

One reason why the Prospectus Directive and Regulation fails in its purpose to increase disclosure and the protection of investors, lies in the mechanistic, tick-the-box exercise that is often made due to a formalistic application of the EU schemes by the national authorities. At the same time they remain free to go beyond certain requirements laid down by the Prospectus Directive and Regulation, with the only proviso however that such goldplating does not adversely impact the smooth functioning of the internal market.

3. Usefulness of CESR Q&A on prospectuses

EALIC strongly supports the use of the Q&A as a useful and flexible tool for the correct interpretation and application of the Prospectus Directive and Regulation, providing issuers and other market participation with a direct procedure to submit their questions to CESR. Such Q&A should provide a prompt answer to the questions of general interest and should obviously be periodically up-dated.

Possible topics which might need further clarification are the need to register supplemental information or the inclusion of information regarding forecasts and estimates.

Moreover, EALIC suggests that CESR provides similar tools in order to ensure a wide knowledge of its positions on the prospectuses (e.g. monthly newsletter) or at least some sort of concept releases or common position letters –as the SEC does).. The use of such tools, including the Q&A, could be extended to other subject matters, e.g. Market Abuse, MIFID,

Finally, we would like to propose the following changes to Regulation 809/2004:

1. Annex I (6.2) (business overview) : product separating in connection with income can be very burdensome and contain important information for a competitor, while not of material importance for investors.
 2. Annex II (19) (related party transactions): the criterion of significance needs to be applied to transactions that are to be described in a prospectus. At present, a description is required for all related party transactions during the period covered by historical financial information.
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