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Die Deutsche Kreditwirtschaft

Comments

ESMA Consultation on the Guidelines on supplements which introduce new securities to a base prospectus (ESMA32-1953674026-5808)

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Contact:
René Lorenz
Director
Telephone: +49 30 1663-3350
E-Mail: rene.lorenz@bdb.de

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Coordinator:
Bundesverband deutscher Banken e. V.
Burgstraße 28 | 10178 Berlin | Germany
Telephone: +49 30 1663-0
https://die-dk.de
www.german-banking-industry.org

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Q1: Do you agree with draft Guideline 1 proposed by ESMA and ESMA's reasoning? If not, please explain why.

We welcome in principle the aim of Guideline 1 to create a uniform understanding of the conditions under which a supplement is permissible and when a new prospectus is required. However, in practical terms, the distinction made by ESMA appears too **restrictive** and **inconsistent** in some areas. Such a narrow interpretation of Article 23(4a) of the Prospectus Regulation (PR) would in many cases prevent **prospectuses being amended without undue bureaucracy by means of a supplement** and instead force businesses to prepare a completely new prospectus at great additional cost and time. This would run counter to the current practice where supplements are created as a flexible instrument to efficiently reflect changes during the offer period without unnecessarily hindering the issuer in its issuing activities. We would therefore recommend retaining the required flexibility if the basic structure of a product is clearly set out in the base prospectus and provided it is not changed by a later supplement.

We would like to highlight the following points in detail:

- Point 12 of the draft Guidelines lists examples of cases in which a supplement should not be permissible – including the introduction of a new fixed-to-variable **interest payment clause** or a new gradual increase/decrease in **interest payments**. We consider this example too restrictive. This kind of amendment to the interest structure does not represent a fundamentally new type of security; it merely modifies the conditions for calculating interest. Minor or technical adjustments to the interest rate structure, such as a change from a fixed to a variable interest rate or the introduction of a step-up/step-down mechanism, can be explained clearly and comprehensibly in a supplement without the need for a completely new prospectus. On the contrary: A supplement that clearly presents such interest rate changes promotes transparency, while the publication of a new prospectus merely for a modified interest rate would be **disproportionate**. In addition, the general ban on such interest structure changes by means of a supplement contradicts Guideline 2 (point 16), which expressly recognises that it should be possible to issue limited adjustments to existing repayment or interest calculation formulae in a supplement. This highlights how the current wording of Guideline 1 is too strict. It should be consistently permitted to amend **interest-related contractual clauses** by way of a supplement, as long as this does **not result** in a **completely new risk profile** of the security and the amendment is added to the prospectus in a way that is transparent to the investor.
- Point 12 of the draft ESMA Guidelines states that **a new guarantee may not be introduced** in a supplement. However, this restriction is not plausible either. The subsequent inclusion of a guarantee for securities already issued is **solely advantageous** from the investor's point of view, particularly if the security was previously unsecured. The guarantor assumes an additional legal obligation, which strengthens the investor's position. There is no objective reason why such a step, which is favourable to the interests of investors, should not be included in a supplement. Although the introduction of a new guarantor requires additional information (e.g. on the guarantor's creditworthiness) to be included in the prospectus. However, this can be presented as fully and verifiably in a supplement as it can in a new prospectus.

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A new guarantee can be considered and accordingly described as a "significant new factor" within the meaning of Article 23(1) PR. The fact that the investor is entitled to more extensive protection in the future in no way justifies the additional cost and effort of issuing a new prospectus, especially since the latter would not provide any additional knowledge for investors but would only be of a formal nature. The same applies to changes to the scope of an existing guarantee. It should therefore be possible to subsequently extend or strengthen a guarantee already described in the prospectus, provided that the additional information is clearly disclosed in the supplement. In general, we are in favour of always permitting **supplements with amendments that are advantageous to the investor**. A ban on supplements in such cases would amount to pure formalism, which serves neither the interests of the investor nor does it make the capital market more efficient.

- We are also critical of the ban contained in the draft Guidelines on including **a new type of underlying** by means of a supplement in an already approved base prospectus (point 12). This rule appears to be **too strictly formulated**. In our opinion, the inclusion of an underlying should be possible in a supplement, insofar as the base prospectus already contains information about an(other) underlying. It is important to **consider** the **prospectus structure systematically** here: Prospectuses for structured securities must contain certain information concerning the underlying in accordance with Annex 17 CDR 2019/980. If the prospectus is compiled in accordance with these stipulations and therefore already contains information concerning at least one underlying, the introduction of an additional underlying falls **within the scope of information already covered**. In concrete terms, this means: If, for example, share indices have been described as underlyings in the prospectus, a further share index or comparable underlying can be added by means of a supplement without introducing a completely new prospectus category. The required information (e.g. on functionality, volatility and historical performance of the new underlying) follow the same structure defined in Annex 17, which is already laid out in the prospectus. A supplement can easily provide this information.

  This understanding is dogmatically based on the wording of Article 23(1) PR, according to which the supplement must refer to information that is, "*included in a prospectus*". However, "*the information included in a prospectus*" **does not mean *any* information in the prospectus, it refers only to the (minimum) information in accordance with the Annexes of the CDR 2019/980**. In other words, as long as an amendment remains within the **scope of the information already included in the base prospectus**, it can be published **as a supplement**. In contrast, a supplement would not be permissible if, for example, a base prospectus focussing exclusively on bonds (without an underlying) is supplemented for the first time by structured products with an underlying. In these cases, a new prospectus is required. This is also the result of a teleological interpretation, since the aim of Article 23(4a) PR is to prevent misuse.

Finally, we suggest a clarification for Guideline 1 that the examples given by ESMA (interest adjustment, guarantee, underlying, etc.) only concern **new** introductions, but not the **correction** of originally incorrect information. If, for example, an interest rate formula or

guarantee statement originally contained in the prospectus is factually incorrect or incomplete, a supplement to correct it must remain permissible in any case.

Q2: Do you agree with draft Guideline 2 proposed by ESMA and ESMA's reasoning? If not, please explain why.

The objective of Guideline 2 is to ensure, from the outset, that a base prospectus covers all types of securities the issuer is likely to issue during its period of validity. Although we can understand the concerns here, we would like to point out the many **practical disadvantages** this requirement would give rise to were it to be strictly implemented. Firstly, there is a risk that issuers will, in future, make their base prospectuses extremely broad and abstract – with numerous contingencies and placeholders in order to retain the necessary flexibility for future issues. The consequence of this would be considerably more extensive and unclear prospectuses. The average investor might have difficulties recognising which securities features are actually relevant and planned, and which are simply mentioned so they are covered in the brochure. This development would hardly be in line with the overarching goal of the Listing Act to reduce the scope of prospectuses and increase their comparability.

In order to counteract such a misstep, Guideline 1 should be less strictly formulated (as outlined under Q1). If supplements are permitted to a reasonable degree, then not every product variation needs to be **included in the base prospectus as a precautionary measure**. The issuers can then keep the prospectus lean and only issue supplements where required, which would serve to improve **clarity** and **comprehensibility** for investors.

Should ESMA stick to the principle of describing as many product types as possible in advance, we would suggest at least reconsidering the (*non-exhaustive*) list of the types of securities given in point 15. Such a broad list could be interpreted as meaning that each of the products mentioned must be regarded as a separate class of security and must be described separately in the base prospectus, which would effectively restrict the flexibility of supplements. In particular, the phrase "*one of the many potential types of non-equity securities*" appears problematic since it suggests that almost any differentiation constitutes a separate type of security. We would therefore urge ESMA to refrain from listing such general examples or, at least, clearly indicate that they are non-binding. Otherwise, there is a risk that issuers might feel compelled to include every category mentioned in the prospectus irrespective of its relevance, which, in turn, would lead to the document becoming bloated as outline above.

A more balanced approach under Guideline 2 would be to require issuers to carefully plan the types of securities they are likely to issue, but give them the flexibility to use supplements where appropriate, rather than including information 'just in case' from the outset. This way, ESMA could ensure that base prospectuses are **complete yet not overwhelming**.

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Q3: Do you believe draft Guideline 2 will lead to longer and less comprehensible prospectuses? If yes, please explain why and describe how you would solve this issue.

Yes, we believe that draft Guideline 2 would lead to **longer and less comprehensible prospectuses**. If issuers are required to include every potential type of product in their base prospectuses, then these documents will become bloated. In practice, this would likely lead to prospectuses describing the numerous structural features and securities categories, the majority of which may not even be issued. This makes it more difficult for investors to filter out the core of securities on offer (information overload).

In our view, one approach could be to formulate the Guidelines such that not every possible change has to be included in the prospectus from the outset. If Guideline 1 were to provide more scope for supplements, Guideline 2 could be more moderately worded without compromising the goal of standardised EU-wide supervision. Then prospectuses would not have to cover every conceivable eventuality, which should make them much easier for investors to understand. So, instead of extending prospectuses as a preventive measure, **supplements** should be accepted **as tools** for making targeted and selective additions if necessary.

Q4: The explanatory text under draft Guideline 2 identifies 'green bonds' and 'sustainability-linked notes' as distinct securities for the purpose of these Guidelines. Do you agree with that, or do you think they are the same as 'regular' bonds or 'regular' structured products? To the extent you consider 'green bonds' and 'sustainability-linked notes' to be the same as 'regular' bonds or 'regular' structured products, please explain why. In particular, make clear why, for example, a currency-linked note, or index-linked note, should be treated differently to a 'sustainability-linked note' for the purpose of these Guidelines. Please also consider factors such as the oncoming Annex [21] in your response7.

No, we are **against generally identifying** 'green bonds' and 'sustainability-linked notes' as distinct securities within the meaning of Article 23(4a) PR. Both product types – depending on their design – correspond structurally to conventional bond types or structured products. They often differ only in terms of additional contractual features, such as agreements on the use of funds or interest rates linked to sustainability criteria.

For example, the difference between **green bonds (GB)** and traditional bonds is primarily that the proceeds from the issue are used for ecologically sustainable projects and that they are subject to the relevant reporting and transparency requirements of the issuer. However, these differences do **not affect the structure of the security itself**. Under the applicable legislation, issuers are already able to state in the section, "Use of proceeds" that the proceeds are set aside for certain green projects, but this does not mean the security is in a class of its own. Accordingly, a base prospectus that covers such 'ordinary' bonds should also include green bonds without the need for a separate prospectus just because of the 'green' label. Otherwise, economically identical products would be treated differently simply because of a sustainability feature.

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Similarly, **sustainability-linked notes** are a **sub-form of structured bonds**. Its only distinctive feature is its structure, which is linked to performance indicators. While, in the case of a classic, structured bond, the payments depend on an external reference value (share index, exchange rate, commodity price), the SLN links interest or repayment changes to an internal sustainability reference value (such as the issuer's CO_2 emission quota or a specific ESG rating improvement). In structural terms, this is merely a variation in the reference parameter and not a new kind of financial instrument. Any differences in the information included in the prospectus, such as the presentation of the specific ESG indicator and the resulting interest rate adjustment do not justify divergent treatment or categorising them as a separate type of security in terms of prospectus law.

In this respect, we see no objective reason – from the perspective of prospectus law – to treat these products more strictly in regulatory terms than, for example, currency-linked or index-linked notes, whose risk profile also changes due to external factors. **As long as these ESG characteristics do not change the underlying repayment structure, they should not be considered new types of securities**. However, if the ESG components determine the structure and significantly influence the repayment modalities, categorising it as a new type of security may be justified. The requirements contained in Annex 21 CDR 2019/980 do not therefore establish a new type of security; they are to be understood as a supplementary disclosure standard. Different treatment would neither be required by the risk profile of the products nor for the purpose of investor protection but would unnecessarily restrict the scope for financing in the sustainable sector. In addition, a guideline that establishes GBs and SLNs as independent categories under prospectus law would run the risk of stifling **innovation in the sustainability segment** and **hindering transformation financing**. Issuers may hesitate to introduce sustainable features if this requires publishing a new prospectus. We are therefore calling for a **flexible approach**: The Guidelines should clarify that the **sustainability features in themselves do not constitute a 'new type of security'**.

Furthermore, **disadvantaging green bonds outside the EUGBS** over GBs that fulfil the requirements of the standard (EuGBs) must be avoided. In this regard, ESMA rightly refers in its consultation document to the new regulatory requirements for ESG information in prospectuses according to the proposed **Annex 21** (sic!) CDR 2019/980. These include a range of product-specific information that is often not yet known when an issuing programme or the relevant base prospectus is being drawn up or updated. According to Article 26(1) CDR 2019/980, these are assigned to category A and must therefore be included in the base prospectus. In particular, these are items 2.1, 2.2, 2.3, 2.4 and 3.1 for GBs and 4.1.1, 4.1.3 from Annex 21 for sustainability-linked bonds. This information presupposes that the planning and documentation of the sustainability aspects of the relevant bond and of the Green Bond Framework are at a very advanced stage. In contrast, according to proposed Article 24(4a) CDR 2019/980 (CP Annex to ESMA32-117195963-1276), all the information from the GB factsheet of an EuGB is assigned to category C(!). This leads to privileged treatment of EuGBs over other green bonds (in particular GBs according to ICMA GBP). If the information from Annex 21 CDR 2019/980 on the sustainability aspects of a bond-issuing programme cannot yet be included in the base prospectus, it also cannot be included in a supplement. Nevertheless,

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EuGBs could be included in the base prospectus and the supplementary information could then be submitted later as category C information in the final terms. Against the background of the EU Commission's new strategy on transformation financing, giving EuGBs privileged treatment is hard to comprehend. The consequence of this would be that all non-EuGBs would have to be standalone issues with their own prospectuses to be approved separately. For GBs issued according to international standards (e.g. ICMA GBP), it should also be possible to include sustainability aspects in a supplement.

Q5: Is there another way to approach the subject of these Guidelines in your opinion? If yes, please explain what it is and provide arguments to support your suggested approach. Please also provide examples to illustrate the issue(s) you are solving and how your proposed approach facilitates that end.

ESMA's Guidelines should not be too strict in limiting the options for updating prospectuses with supplements. Neither the investor nor the issuer is well served if a new prospectus always needs to be prepared instead of just a supplement. Investor protection requires above all that the prospectus is up-to-date, complete and comprehensible at the time of the public offer. The question as to how this up-to-date status can be achieved (by initial completeness or by supplementation) is subordinate to the goal of protection. The benchmark for the reliability of supplements should therefore be that the prospectus and the supplement remain clear and comprehensible overall and contain all the information required. If these conditions are met there should be no reason to decline a supplement.

In concrete terms, we propose **rewording** Guideline 1 to clarify that changes introduced through a supplement are certainly permissible if the relevant information already meets the minimum information requirements of an annex included in the prospectus. Only where a change contains completely new information that was not included in the original prospectus would this qualify as introducing a new type of security and consequently a new prospectus would be required. This distinction not only ensures that supplements are not misused to circumvent the requirement to publish a prospectus for genuinely new products, it also gives issuers the required flexibility to implement variations and further developments of their securities without them needing to spend an excessive amount of effort on formalities.

In addition, it should be clarified that **supplements with purely advantageous or clarifying changes** are always possible. As outlined in our answer to Q1, these include, for example, adding a guarantee which benefits investors, extending a guarantee framework, correcting errors or including additional information about risk that gives investors a better picture. In all these cases, the strict requirement for a new prospectus would generate unnecessary work – the supervisory authority would have to review a completely new document, although the content would only contain additions that could also be presented in the existing prospectus. A more flexible and balanced approach would avoid such duplication of work.

One alternative would be to take the following **staggered, risk-base approach**:

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1. Is the product category set out in the base prospectus, at least in its basic features?
2. Do new features lead to a change in the risk structure?
3. Can the supplement be presented in a comprehensible and clear way in the overall context of the prospectus?

If the answer to these questions is yes, then it would generally be permissible to issue a supplement. This approach would allow for the rules to be applied more flexibly and would be better suited to distinguishing between misuse of product supplements and legitimate product concretisation.

Q6: Can you provide an estimation of the costs/benefits of these proposed Guidelines?

As they currently stand, the ESMA Guidelines are likely to lead to **considerable additional costs** for issuers and additional reviews for supervisory authorities without any recognisable added value for investors. Each new prospectus would require legal advice, preparation and approval costs that are significantly higher than the costs of a supplement. Typically, the preparation of a completely new prospectus is many times more expensive and time-consuming than the preparation of a supplement. Depending on the issuer and the complexity involved, these costs could be up to five figures and tie up internal resources for weeks. This would most affect **frequent issuers**, such as issuing banks, which have previously been able to act flexibly by issuing supplements. We are therefore in favour of a **teleological, functional and practice-oriented** approach that allows supplements to a reasonable extent.