Response of Deutsches Aktieninstitut to ESMA's Consultation Paper in Regard of ESMA's Technical Advice on Possible Delegated Acts Concerning the Prospectus Directive (2003/71/EC) as Amended by the Directive 2010/73/EU – "Retail Cascade"

6 January 2012

A. Introduction

Deutsches Aktieninstitut e.V. (ID Ref: 38064081304-25) 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.

B. General Comments

Deutsches Aktieninstitut is very concerned about the tight timeframe in which ESMA starts the present consultation with its far reaching proposals. In regard of much more important issues concerning the economic crisis we would suggest to postpone the coming into force of the Amending Directive 2010/73/EU (AD) for half a year so these issues can be elaborated more carefully.

Also, we would like to draw attention to the fact that subsequent offers of securities that have already been admitted to trading on a regulated market considerably touch the topics of the relation of 'primary market', 'secondary market' and 'public offer' which the EU Commission is asked to clarify in Recital 11 of the AD: "In order to allow for the efficient application of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (2), Directive 2003/71/EC and Directive 2004/109/EC and to clarify underlying problems of differentiation and overlaps, the Commission should put forward a definition for each of the terms 'primary market', 'secondary market' and 'public offer'". **So, in our opinion, the "retail cascade" cannot be dealt with terminally without fulfilling the task of Recital 11 of the AD.**

We are especially concerned about the way the issue "retail cascade" is finally dealt with. Issuers and intermediaries actually started the discussion about the cascade about five years ago – and it was a rather theoretical discussion, no scandals, etc., had happened. It was the interest of issuers to know for how long their prospectus was being used in the secondary market, and the inter-

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mediaries wanted to have legal certainty about when the initial prospectus could be used and when a new prospectus was needed. In terms of investor protection this topic was already dealt with by the Prospectus Directive (PD) because of the consequences of a public offer without prospectus. There has never been a regulatory gap in the sense of investor protection under the PD because of the relationship between investor and offeror as a starting point for possible claims. So, the retail cascade has in our understanding actually never been an investor protection topic. This also seems to be the view of the EU Commission in its proposal: *"However the lack of clarity in Article 3(2) seems to be causing problems for issuers in some markets where securities are distributed by <<retail cascade>>",* 5.3.4 COM(2009) 491 final, 23.9.2009, p. 6.

Now, it seems this topic is dealt with by ESMA with a complete different understanding. ESMA wants additional details to be made public, some in the prospectus itself, as if until now sufficient information had not been provided for investors.

Also, ESMA reintroduces something that has been discussed thoroughly and finally found no consensus during the legislative process of the AD: ESMA proposes to include the consent to use the prospectus into the prospectus itself. We strictly oppose this for the reasons given below.

C. Details

1. The consent to use a prospectus in a retail cascade (Articles 3 and 7)

1.1. Concept of retail cascades

1.1.1 Investor protection

As already mentioned above, the retail cascade has in our understanding never been an investor topic, as there hasn't been an investor protections gap.

1.1.2 Contractual relationships and intermediary chains

ESMA seems to assume that offerors of securities always act "in association with" the issuer and have contractual relationships with the issuer. This is not the case. The distribution of plain vanilla debt securities generally includes several layers of financial institutions. In the first step the securities are sold by the issuer to the banks underwriting the debt issuance after a bookbuilding process. In a second step such banks sell the securities to other financial intermediaries (third parties) that generally have no contractual relationship with the issuer or are even known to him. In the German practice, which is one of the biggest corporate debt markets of Europe, the underwriting banks buy the securities for own account and the further resale is no sale on commission. Also the point in time of the resale is up to the very own judgment of the banks. So the wording "acting in association with the issuer" is not correct but rather misleading fur such constellations. Intermediaries may in a third step further sell the securities they bought on their own account to other financial intermediaries and/or also to retail investors.

A prospectus would not be necessary in the first step (primary market) as there are only institutional investors involved, but if the further sale to retail

investors by third parties is envisaged (certain intermediaries may only buy the securities in such case) a prospectus is set up for the further public offer to retail investors or for the listing on a stock exchange. So, issuers that are interested in the sale grant their consent in order to realise the sale to retail investors. Especially in the financial crisis in times of restricted bank loans retail investors have been and still are of great significance for corporate issuer financing.

1.2 Requirement to include consent to use the prospectus in the prospectus

In # 29 ESMA takes the view that the consent to use the prospectus should be included in the prospectus or the base prospectus/final terms, as the case may be. **We would like to point out, that there has been a proposal by the Council to require the consent to be stated in the prospectus itself in 2009 and this has explicitly declined by the European Parliament and finally was not included in the AD:**

Proposal for a recital 8: *"Therefore, financial intermediaries placing or subsequently reselling the securities should be entitled to rely upon the initial prospectus published by the issuer or the person responsible for drawing up the prospectus (...) as long as this is valid and duly supplemented in accordance with Article 9 and Article 16 of Directive 2003/71/EC and the issuer or the (...) person responsible for drawing up such prospectus consents to its use. The consent, including any conditions attached thereto, should be explicitly stated in the initial prospectus, enabling assessment by relevant parties whether the resale or final placement of securities complies with the prospectus. In this case no other prospectus should be required and the issuer or the person responsible for drawing up the initial prospectus should be liable for the information stated therein and, in case of a base prospectus, for providing and filing final terms. However, in case the issuer or the (...) person responsible for drawing up such initial prospectus does not consent to its use, the financial intermediary should be required to publish a new prospectus. In that case, the financial intermediary should be liable for the information in the prospectus, including all information incorporated by reference and, in case of a base prospectus, final terms."*

Proposal for Article 3 para 2: *"Member States shall not require another prospectus in any such subsequent resale of securities or final placement of securities through financial intermediaries as long as a valid prospectus is available in accordance with Article 9 and the issuer or the person responsible for drawing up such prospectus consents to its use as explicitly stated in the prospectus"*, Council Document 2009/0132 (COD), 17451/09 of 9 December 2009.

So, ESMA's proposal reintroduces something that has found no consensus in the legislating process.

If the consent was inserted in the prospectus relevant changes to it could require a supplement and could therefore trigger a right to withdrawal which ESMA also does not consider to be appropriate (see # 44 of the Consultation paper). In case of a base prospectus, the financial intermediaries are not known to the issuer at the time when the base prospectus is approved. This could hinder new consents for more intermediaries after the publication of the prospectus and we do not see any reasonable justification for accepting

such effect. Additionally, please note that there are issuance programmes which do not provide a dealer panel. The additional requirements proposed by ESMA are likely to influence issuers to withdraw from the retail market. This would cause retail investors to loose investment opportunities and the loss of investors may increase issuer's costs for the raising of debt capital in such difficult times.

Instead, we would propose to continue what had been proposed in CESR's FAQs, because if there is a public offer investors of course have a contact person to address: in the prospectus a bold notice could be inserted in a suitable place informing investors that they should verify with the offeror whether or not the offeror is acting in association with the issuer or, we would suggest to add, has the consensus to use the prospectus. This has become good practice and does not have to be changed due to the new AD.

2. Review of the provisions of the Prospectus Regulation (Articles 5 and 7)

2.1: 4.IV of the Consultation Paper – Profit Forecast and Estimate

We do not agree with ESMA`s proposal to keep the current requirement to produce a report for profit forecasts.

Transparency requirements in the secondary market do not require such a report. So the withdrawal of a profit forecast by an ad-hoc announcement will not require such a report. Also interim financial statement may confirm forecasts without a report. The issuer has a high interest in the proper preparation of a profit forecast in a prospectus because of its prospectus liability. Because of a possible liability on the side of the auditors the required report is burdensome, expensive and time consuming and can therefore hinder the use of time critical issuance windows. Also we doubt that such a report by auditors is of high relevance and added value for investors because in our view the auditor cannot confirm the probability of a forecast in a way that gives assurance to investors.

We agree with ESMA's proposal to exclude "preliminary statements" from the requirement to produce a report.

However an agreement from the auditors to the disclosure must not be necessary. Due to a possible liability of the auditors such an agreement may become an obstacle similar to the required report.

2.2. 4.V. of the Consultation Paper – Audited Historical Financial Information

We strongly oppose to keep the current requirement of the Prospectus Regulation to produce audited financial information covering the last three financial years. Such historical financial information is already available to the public in accordance with transparency requirements. In other words, the information is already in the market and its inclusion in the prospectus can be of very little use (if any) for investors. Especially for shares it is questionable how publicly available financial information which is older than 2 years may have an influence on an investor's decision to buy a security.

Annex: ESMA's Questions

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.

As already mentioned above, we have doubts in regard to ESMA's concept of the retail cascade in general. As we tried to explain a retail cascade is not "used" but may "develop" in different layers. This may also be the case for equity securities. For both, a book building process for the initial offer is usual where the price for the entire transaction will be fixed at the end and will be identical for all initial investors. Immediately after settlement the secondary trading starts. As from the issuers' point of view the primary market ends at this stage any obligation of the issuer to update the prospectus has to lapse. In the secondary market anongoing transparency regime may apply if the securities are listed on a stock exchange or on a trading platform with similar requirements.

In case of equity shares especially sales of existing shareholders to intermediaries for own account are imaginable where a retail cascade can develop if further sales happen. in such cases there is even less interconnection with the issuer.

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 our answer to Q1 above.

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.

No, we do not agree. After the book building period economic terms of the securities (like the coupon) are usually fixed. The prospectus or in case of programmes the final terms can contain the price of this first issuance. The terms of the further distribution, especially the price for which securities are sold, can not be provided by the issuer and do not concern the terms and conditions of the securities. The following sale prices of the intermediaries in the secondary market may vary according to market conditions. Therefore the following prices can not be described in the prospectus.

We would like to emphasise again that financial intermediaries sell securities on their own account and do not sell the securities on commission basis in retail cascades. So, the issuer cannot and will not rule into this business activity which includes especially not dictating terms and conditions for the offers (The issuer may e.g. attach a time frame to the consent itself, though).

If ESMA's concern is about investor protection in the context of the price for which the securities are sold, such concerns should be dealt with by the MIFID requirements.

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?

No, we do not see this as a change of the terms and conditions of the securities.

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 suboffer? How and when is such information communicated to the investor? Please specify and explain.

Please see our answers above. Also, if there is an offer of the intermediary it has to fulfil regulated information requirements for which the intermediary is responsible. We assume that in the future such requirements will include also in the own interest of intermediaries a statement about the consent to use the prospectus. So we do not see that the burden to verify whether or not the offeror is acting in "association" with the issuer is placed upon the investor, which ESMA wants to avoid.

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?

As the issuer will generally not be responsible for the content of information outside of the prospectus, this cannot be included in the prospectus.

Q7: Do you agree that the period for which consent to use a prospectus may be granted cannot extend beyond the validity of the prospectus and the period in which a supplement is possible according to Article 16 Prospectus Directive? If not, please specify how in particular a standalone prospectus can be kept valid once the period according to which a supplement is possible has lapsed.

We fully agree.

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?

No, we strongly disagree, see our answer to Q1.

Principles regarding disclosure requirements in relation to retail cascades in a prospectus

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?

As mentioned above only the underwriters have contractual relations with the issuer while financial intermediaries further selling the securities in the secondary market (third parties) are generally not known to the issuer.

As far as we are informed such consensuses to use the prospectus in the secondary market are not common practice yet.

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?

The agreements with the initial investors (underwriting banks) will be finalised only after the approval of the (base) prospectus at the filing of the final terms. We would like to repeat that there are no agreements with further intermediaries (third parties).