

## **Proposal for a Prospectus Regulation – Recommendations to put good ideas into practice**

Position Paper of Deutsches Aktieninstitut [Transparency Reg. 38064081304-25] regarding the EU Commissions proposal for a prospectus regulation replacing the current prospectus directive and entire prospectus regime [COM(2015) 583 v. 30.11.2015], February 22<sup>nd</sup> 2016.

## Executive Summary

We appreciate the original intention of the EU Commission to facilitate the prospectus regime and thereby capital markets finance. The overwhelming amount of prospectuses to be approved are concerning the issuance of non-equity securities like corporate bonds and other debt instruments which is why the EU Commission's Capital Markets Union is preliminary dedicated to enhance the debt funding. Vice versa this enhancement should serve retail investors as offering alternative wealth building instruments like corporate bonds.

In our opinion, it is strongly necessary, to retain but also to amend several provisions of the EU Commission's proposal in order to really achieve the goal of enhancing capital market finance.

**Among others we recommend the following:**

### ***The crucial decisions have to be made on level 1***

The current draft of a new prospectus regulation (draft PR) includes 32 different empowerments of the EU Commission and ESMA to concretise the requirements of the draft PR. However, the EU bodies should by no means remove their own possibility to decide how the prospectus regulation should look like in the future and to achieve the important objective of the Capital Markets Union, to gain better access to capital markets.

Thus, we recommend urgently to reduce the number of delegations significantly. Specifications in the field of secondary issuances and of risk factors are of such fundamental importance for a functioning Capital Markets Union that decisions about their actual content should be made on level 1. Furthermore, some concretisations are without added value like the RTS to supplements (Delegated act (EU) No. 382/2014) and the unpublished RTS for the approval and publication of prospectuses from November 2015. Moreover, the application period has to be prolonged to at least 24 months while delegated acts have to enter into force at least after 12 months to give market participants sufficient time to adopt the new requirements.

### ***Art. 1 para. 3 and Art. 13 draft PR should foresee 100k bond alleviations***

The EU Commission proposed to remove the most commonly used prospectus exemption by bond issuers for offers of non-equity securities, whose denomination per unit amounts to at least 100,000 euros ("100k bonds"). Consequently, we expect no useful alleviations in Art. 13 para. 1 draft PR for 100k bonds during the determination of prospectus contents on level 2 ("wholesale facilitations"). However, the proposed abolishment is not appropriate to achieve this goal which is why the 100k exemption and the wholesale facilitations should remain.

Most of the EU Commission's assumptions are not valid. Even today, investment-grade bonds with a denomination per unit of 1,000 euros are issued, giving access to retail investors. Liquidity will not be enhanced. The typical corporate bond investor follows a buy and hold-strategy and trades in amounts between 200,000 and 500,000 euros. If there were a high demand on 1,000 euros bonds from retail investors the agency banks would recommend to issue a pursuant amount. Besides, the exemption is a legally certain exemption and facilitates capital markets finance on MTFs especially for SMEs.

### ***Higher flexibility of summaries***

The maximum number of 6 pages is too short to give a brief overview of all relevant information. The restriction to 6 pages does not reflect appropriately the different types of securities, whose description scope varies considerably. Additionally, by determining a maximum length of 6 pages, the commission apparently forgot to take into account a possible guarantor, who should increase the acceptable page number.

### ***Base prospectus regime – status quo should at least remain***

The base prospectus regime is common and works. To follow the initial objective of the Capital Markets Union, capital markets finance should be facilitated and not hampered. This is why at least the status quo should be retained.

### ***Make a secondary issuances system work***

We explicitly welcome the intention of the EU Commission to create alleviations for secondary issuances. Issuers, whose securities are already admitted to trading on a regulated market and are therefore subject to the Transparency Directive and the Market Abuse Regulation, should not be obliged to continuously repeat already published information in prospectuses.

Therefore, it has to be made clear that the term "class of securities" only differentiates between equity and non-equity securities and that guarantors are included. The information level should be clearly reduced on level 1 by determining that only a document instead of a prospectus is necessary which encompasses a securities note and, in the case of a public offer, the recent developments since the last regular report.

### ***No risk categories and no selection of risk factors in the summary***

Risk factors are dynamic. It is uncertain to which probability they could materialise. To mention the risk factor of nature catastrophes might seem to be too generic but how should one estimate the consequences of Fukushima in advance? Moreover,

to classify risk factors does not mean to reduce them. Additionally, risk factors classified as low risks are likely to not be considered as material. Therefore, a retail investor would not take it into account.

The presentation of only five risk factors in the summary is likely to lull especially retail investors in a false sense. He would assume only those five risk factors as relevant for his investment decision.

How the allocation shall happen is moreover uncertain. Neither ESMA nor the EU Commission should be allowed to develop any further rules. If any, the EU legislators have to decide on this crucial point. But note, diverging provisions how to assess risk factors could cause differences to US prospectuses or the management report. In both cases, the accusation of misleading information could raise.

As an issue can currently be conducted within 1 to 2 hours, the difficulties to classify and graduate risk factors are likely to prolong the issuances of debt securities under current base prospectuses.

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## Acronyms used

draft PR	=	Proposal for a Regulation of the European Parliament and of the Council on the prospectuses to be published when securities are offered to the public or admitted to trading COM(2015) 583, November 30 <sup>th</sup> 2015
PD II	=	Prospectus Directive (2003/71/EC)
PR	=	Prospectus Regulation (EC) No. 809/2004
TD	=	Transparency Directive 2004/109/EC
SME	=	Small and medium sized enterprises
CMU	=	Capital Markets Union

## 1 Crucial decisions have to be made on level 1

As far as we can see, the current draft of a new prospectus regulation (draft PR) includes 32 different empowerments of the EU Commission and the ESMA to concretise the requirements of the draft PR. Among others it shall be decided on level 2 which information the prospectus has to contain, which information the new regime for secondary issuances requires and how to present risk factors in future. Without concretisation of these three points on level 2, the issue on how prospectuses would be like in future is uncertain. This in turn means that issuers and market participants can only adjust their systems, when these specific requirements have been determined. Only then it will also become clear, if the draft PR actually creates alleviations or if preparing a prospectus has even become more unattractive.

The EU bodies should by no means remove their own possibility to decide how the prospectus regulation should look like in the future and to achieve the important objective of the Capital Markets Union, to gain better access to capital markets.

In this context, the number of empowerments is quite problematic, when also considering the short application period of 12 months in Art. 47 draft PR. We consider it as almost impossible that all, and especially the delegated acts, will be adopted and implemented 12 months after the draft PR will have been put into force. Not to mention that issuers and their advisors need enough time to adapt these new requirements. Rules, which are generated under such time pressure, are likely to be subject to inconsistencies and discrepancies, which have been identified as obstacles to a well-functioning integrated capital market by the EU Commission in its Capital Markets Union Action Plan.

### Thus we recommend urgently:

- To reduce the number of delegations significantly. Specifications in the field of secondary issuances and of risk factors are of such fundamental importance for a functioning Capital Markets Union that decisions about their actual content should be made on level 1 (see further examples in the specific chapters of this position paper).
- Furthermore, the experience has proven that certain delegations and empowerments, which are included again, had not brought any added value. Herewith, we particularly address the RTS to supplements (Delegated act (EU) No. 382/2014) and the unpublished RTS for the approval and publication of prospectuses from the 30<sup>th</sup> of November 2015. The consultation and application of the results costs ESMA, all national authorities as well market participants a lot of time. At the end only common market practises were adopted and no added value was created for the market since controversial topics have been left unanswered. Thus, Art. 22 para. 6 draft PR will be useless. If the empowerments and delegations in Art. 19 para. 10 and 11 draft PR will add value, is at least quite doubtful.

- In addition, the application period has to be prolonged to at least 24 months to give market participants sufficient time to adopt the new requirements, especially for the new structure of the prospectus content.
- Delegated acts should be at latest adopted and entered into force after 12 months in order to give market participants at least 12 months to implement the new requirements.

## 2 Art. 1 para. 3 and Art. 13 para. 1 – Retain the “100k exemption” and “wholesale facilitations”

*The EU Commission proposed to remove the most commonly used prospectus exemption of bond issuers for offers of non-equity securities, whose denomination per unit amounts to at least 100,000 euros (“100k bonds”). Consequently, we expect no alleviations in Art. 13 para. 1 draft PR for 100k bonds like today by determining prospectus contents on level 2 (“wholesale facilitations”)<sup>1</sup>. Therefore, our arguments are concerning these two aspects. That way the EU Commission intends to give retail investors the opportunity to acquire investment-grade corporate bonds and to increase the liquidity in the corporate bonds market. However, the proposed abolishment and implicit abolishment of the wholesale facilitations will not achieve this goal.*

**Thus, the prospectus exemption for 100k bonds should be kept. Art. 13 para. 1 draft PR should define that the current wholesale facilitations for 100k bonds will continue to exist.**

- **Most of the EU Commission’s assumptions are not valid.** Even today, investment-grade bonds with a denomination per unit of 1,000 euros are issued, giving access to retail investors. Even the companies mentioned in the Impact Assessment do so. The German automobile manufacturer Daimler has issued approximately 64 percent of its corporate bond volume in 1,000 euro denominated non-equity securities in the last five years.
- Retail investors can acquire investment-grade 100k bonds through funds.
- Liquidity will not be enhanced. The typical corporate bond investor follows a buy and hold-strategy and trades in amounts between 200,000 and 500,000 euros.
- If there were a high demand on 1,000 euros bonds from retail investors the agency banks would recommend to issue a pursuant amount.
- The prospectus regime is not capable to solve the detriments of the banking regulation and is especially not capable to compensate the bank’s role as liquidity provider.
- **The exemption should therefore remain at place.** It is a legal certain exemption and facilitates capital market finance on MTFs especially for SMEs.
- **Likewise, on level 1 should be stipulated that the current wholesale facilitations have to be remained.** They are of benefit for SMEs, large companies and non-european issuers because they facilitate the placement of bonds at instiutional investors.

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<sup>1</sup> As indicated on page 17 of the EU Commission’s text.

## 2.1 Excursus: Prospectus exemption for public offers

The current PD II includes different exemptions, so that a public offering or the admission of securities to the regulated market does not require a prospectus. For example an exemption for security issues up to 5 million euros can already be found in Art. 1 Para. 2 h) PD II and other exemptions in Art. 3 or Art. 4 PD II.

Art. 3 Para. 2 PD II states that a prospectus is not required for public offers to a) only qualified investors (e.g. institutional investors) or to b) less than 150 non-qualified investors (e.g. retail investors) in one member state. Moreover, there is no obligation to publish a prospectus, if c) investors can only acquire securities for a total consideration of at least 100,000 euros, d) for securities, whose denomination per unit amounts to at least 100,000 euros or e) the offer for all securities is below 100,000 euros.

Exemption d), a minimum denomination per unit of at least 100,000 euros, is the most commonly used prospectus exemption in bond issues. It is also used by bond issuers in private placements although, no comparable exemption for the mere admission to the regulated market like in Art. 3 Para. 2 d) PD II exists.

Assuming that retail investors are not interested in purchasing 100k bonds, lower information requirements apply to these so-called wholesale facilitations. These are among others reduced information requirements in the prospectus according to Annex IX and XIII PR. For example, there are alleviations in regard of accounting which allows some non-European companies to issue bonds in the EU without adjusting their accounting standards. In addition, a summary, targeting especially retail investors, does not have to be prepared, Art. 5 para. 2 subpara. 3 PD II.

The EU Commission views the application of this prospectus exemption by larger companies (so-called Blue Chips) and the wholesale facilitations very critical. In its opinion, this exemption would cause a significant share of bonds issued by investment-grade companies inaccessible to retail investors. Thus, limiting their opportunities for saving and investing money. Furthermore, the EU Commission believes that removing this prospectus exemption would increase liquidity in the corporate bond market and therefore would reduce the likelihood of future turbulences. However, as we will show subsequently, little support for these two assumptions can be found. In contrast, removing these exemptions would even lead to higher legal uncertainties.

## 2.2 Retail investors have access to corporate bonds

The EU Commission assumes that removing the exemption for 100k bonds in Art. 3 Para. 2 d) PD II would induce large issuers to choose smaller denominations. This assumption is based on the Impact Assessment to the draft PR<sup>2</sup>. In this assessment five large bond issuers (McDonald's Corp., Walgreens Boots, Bat Intl. Finance,

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<sup>2</sup> Commission Staff Working Document, Impact Assessment, SWD(2015) 255, from 30/11/2015 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015SC0255&from=DE>.

Pepsico Inc. and BP Capital PLC) with three bonds in euros, pounds or dollars are listed. Bonds on euros and pounds were denominated in 100,000 units, while dollar bonds were denominated in 1,000 euros units.<sup>3</sup> Based on this analysis, the EU Commission assumes that issuers would choose smaller denominations, if the advantage of a 100k denomination were neutralized.<sup>4</sup>

### 2.2.1 No automatism – 1,000 units bonds are already issued

Beforehand we have to note that removing the exemption will not oblige issuers to issue bonds with smaller denominations. It would still be allowed to issue 100k bonds, e.g. in order to keep the investor base easily manageable to exclude retail investors.

Moreover, the exemption for minimum offers of 100,000 euros in total will remain. Choosing a denomination of 100,000 euros will meet this requirement – if offered at nominal value -- for sure.

In addition, the depiction of the EU Commission creates a wrong image. In its Impact Assessment the EU-Commission states that – according to OECD data – 70 percent of all “listed” corporate bonds have a denomination per unit above 100,000 euros. It uses the example of the five companies mentioned above which issued bonds with a denomination of 1,000 units in US dollars but 100k bonds in euros and pounds to support its theory. Implying that these companies – presented as representing the Blue Chip companies in a whole – did not issue bonds with a denomination of 1,000 euros but would do this, if the facilitations for 100k bonds were abolished. However, this is not true.

First of all, taking US companies as representatives for issuers of the European capital market is misleading. We don't know why these noneuropean companies have issued 100k bonds instead of 1,000 bonds. Actually, there are many Blue Chips, especially from Germany, issuing both 100k and 1,000 euros bonds. For example, the automobile manufacturer Daimler has issued 64 percent of its bonds volume in 1,000 euros units in the last five years under its EMTN programme. The remaining 36 percent were bonds with variable interest rates and bonds of foreign financing subsidiaries, which have no IFRS financial statements and thus need the wholesale alleviations in Annex IX PR.

Besides that, the currency is not relevant for the application of prospectus requirements. European issuers could also issue bonds with a minimum denomination in dollars.

Moreover, it has to be mentioned that the OECD data does not distinguish between the regulated market and MTFs. Hence, it is probable that these listed bonds also include issuances of special MTFs for institutional investors like the Luxembourg Euro MTF or the British Professional Securities Market. The OECD paper mentions these market segment as well, which supports the assumption that they have been

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<sup>3</sup> s. fn. 1, p. 31.

<sup>4</sup> s. fn. 1, p. 30.

counted, too.<sup>5</sup> On these MTFs typically 100k bonds are traded. Furthermore, the investors involved anyway trade units of 200,000 or 500,000 euros. The proportion of 100k bonds in market segments accessible by retail investors have not been quantified by the OECD data.

### 2.2.2 100k bonds due to the Transparency Directive

In the case that the issuer uses the exemption in Art. 8(1)(b) TD, he is even forced to issue 100k bonds. This article exempts issuers from the TD, if they only issue 100k bonds.

### 2.2.3 Retail investors have access to 100k bonds through funds

The Impact Assessment as well as the argumentation und justification of the draft PR neglect the fact that retail investors less frequently invest directly in corporate bonds but use funds for indirect investments in corporate bonds.<sup>6</sup> A 100k denomination is not important to funds. Thus, to allege that retail investors cannot invest in 100k bonds of Blue Chips is misleading.

## 2.3 Liquidity cannot be increased by that

In addition, we are pretty convinced that removing the prospectus exemption for 100k bonds will not lead to higher liquidity in the corporate bonds market. That is why the IOSCO has also not identified a less denomination of bonds as solution to create more liquidity in corporate bond markets.<sup>7</sup>

### 2.3.1 Typical corporate bonds investor holds bonds till maturity

Corporate bonds are often used to secure portfolios and thus to balance volatile investments. Meaning that the typical corporate bonds investor follows a buy-and-hold strategy. In the current low interest rate environment selling bonds is quite unattractive due to a lack of saving opportunities. Therefore, smaller denomination values would not induce investors to trade more.

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<sup>5</sup> vgl. Celik/Demirtas/Isaksson(2015), Corporate Bonds, Bondholders and Corporate Governance, OECD Corporate Governance Working Papers, No. 16, S. 41 <http://www.oecd-ilibrary.org/docserver/download/5js69lj4hvnw.pdf?expires=1453282440&id=id&accname=guest&checksum=3F2033F98C984A9871FDBE93BD6A4CFA>.

<sup>6</sup> OICV-IOSCO Staff Working Paper [SWP/2014], Corporate Bond Markets: A Global Perspective, p. 46 ff.

<sup>7</sup> OICV-IOSCO Staff Working Paper [SWP/2014], Corporate Bond Markets: A Global Perspective.

### 2.3.2 Demand of retail investors is relatively low

As mentioned in 2.2.1, Blue Chips also issue bonds with a minimum denomination per unit of 1,000 euros. Therefore the current alleviations for 100k bonds does not imply the avoidance of 1,000 euros bonds. The amount of 1,000 euros bonds is depending on the recommendations of the agency banks. The higher they recognise a demand on 1,000k bonds the higher the amount of 1,000k bonds would be. The assumption of the EU Commission, that there is a high but unfulfilled demand, is not comprehensible.

### 2.3.3 Typical bond investors trade larger units

An increase in liquidity is seldomly caused by retail investors. If the objective is to reduce risks, in a situation where investors would like to sell large units of corporate bonds, a sufficient number of institutional investors, able and willing to buy these large amounts, is crucial. However, for them a 100k denomination is not essential, as they mostly trade units of 200k or 500k euros.

### 2.3.4 The prospectus regulation cannot compensate the banking regulation

A lack of liquidity providers in narrow market situations cannot be blamed on 100k denominations but is primarily attributable to regulatory restrictions for credit and financial institutions. The interaction of higher capital requirements for banks, e.g. liquidity or leverage ratios, has led to tremendous reductions of portfolios in trading books. The decrease in market making activities can be blamed on this development. Removing the 100k exemption cannot compensate for this.<sup>8</sup> In fact, the EU Commission should analyse to what extent an adjustment of capital requirements would increase market liquidity.

## 2.4 Keep the 100k exemption and determine wholesale facilitations on level 1

### 2.4.1 This exemption is the most certain legal exemption

As already explained, other exemptions exist besides Art. 3 Para. 2 PD II, such as c) a minimum offer of 100,000 euros. The minimum 100k denomination is typically chosen due to a simple reason. Art. 3 Para. 2 d) PD II offers a reliable method to be sure that a public offer does not imply the obligation to publish a prospectus. A minimum offer of 100,000 euros cannot ensure this, especially if the consortiums banks or investors partially consist of banks with retail business. If these banks distribute parts of the bond at a lower price to their customers, legal uncertainties

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<sup>8</sup> Compare position paper of Deutsches Aktieninstitut, of May 13<sup>th</sup> 2015, p. 20 f. [https://www.dai.de/files/dai\\_usercontent/dokumente/positionspapiere/2015-05-13%20Position%20of%20Deutsches%20Aktieninstitut%20to%20the%20consultation%20of%20the%20Prospectus%20Directive%20with%20answered%20survey.pdf](https://www.dai.de/files/dai_usercontent/dokumente/positionspapiere/2015-05-13%20Position%20of%20Deutsches%20Aktieninstitut%20to%20the%20consultation%20of%20the%20Prospectus%20Directive%20with%20answered%20survey.pdf).

arise, if the issuer is responsible for this contribution to retail investors and therefore had to publish a prospectus from the beginning of the offer. This is caused by the formulation of Art. 5(1) S. 2 draft PR, which focuses on “final placements”, thus poses the question, if transmission to retail investors is a final placement by the issuer. In order to avoid such interpretation issues, the easily conductible exemption for 100k bonds should be kept.

#### **2.4.2 Simple exemption for SMEs**

The intention of the EU Commission is to facilitate raising funds especially for SMEs. To remove this legally certain method which eases capital market finance for SMEs, contradicts the objectives of the Capital Markets Union. In addition, the wholesale facilitations offer a less costly entry into the regulated market for SMEs.

#### **2.4.3 Conclusion**

As explained before, removing the exemption will bring no real advantage for retail investors and no increase in liquidity in the bond market. In contrast, it will lead to higher regulatory risks when applying prospectus exemptions. Therefore, the current exemption for 100k bonds in Art. 3 Para. 2 d) PD II should be transferred to the draft PR and the existing wholesale facilitations should be provided in Art. 13 draft PR in order to avoid the same discussion on level 2.

### 3 Art. 1 Para. 3 d), Art. 3 Para. 2 – Raise prospectus threshold up to 20 million

Public offers with a total consideration below 100,000 euros in the European Union don't need to provide a prospectus, according to Art. 3 para. 2 e) PD II. Furthermore, Art. 1 para. 2 h) PD II entirely exempts bond offers with a total consideration below 5 million euros in the European Union from PD II. Yet, in contrast to Art. 3 para. 2 e) PD II deciding about the 5 million euros threshold is at the discretion of Member States.<sup>9</sup>

The draft PR increases the 100,000 threshold for securities offers up to 500,000 euros, Art. 1 para. 3 d) draft PR. Art. 3 para. 2 draft PR establishes a discretionary rule for Member States. However, the proposal defines changes to the current 5 million euros threshold. Firstly, the total consideration will be raised up to 10 million euros. Secondly, the threshold only applies to domestic offers in each Member State and not across the European Union.

The reason for this limitation is not clear. Neither does recital 13 give a proper explanation. The overall objective of the Capital Markets Union is to integrate capital markets in order to facilitate access to capital across borders. A regulation with national focus contradicts this objective. Especially smaller issuers with financing needs above 500,000 euros - which is not very high - would be forced to solely address domestic investors. This would decrease their possibilities to obtain capital. Hence, this rule should be valid throughout the European Union.

**We recommend a non-discretionary rule, to ensure that investors will not be confronted with different limitations in each Member State. Therefore Art. 3 para. 2 draft PR is not needed. The consideration in Art. 1 para. 3 d) draft PR should be raised to 20 million euros.<sup>10</sup>**

**At least Art. 1 (3)(d) draft PR should be increased to 2,5 million euros.** In Germany this corresponds to a typical crowdfunding exemption for investments, which currently disadvantages smaller securities issuances.

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<sup>9</sup> Germany transposed Art. 1 Para. 2 h) PD II in § 1 Abs. 2 Nr. 4 WpPG. The 5 million euros threshold is only applicable by issuers whose shares are already admitted to trading on a regulated market.

<sup>10</sup> Compare our position on 13/05/2015, p. 19.

#### 4 Art. 1 para. 4 b) – Increase up to 20 percent

We have advocated to allow capital increases up to 20 percent which is why we appreciate EU Commissions proposal. With this increase capital market finance by SMEs and other growing companies would be facilitated.

## 5 Art. 7 – Higher flexibility in the summary

*The EU Commission proposes to define exactly, which information should be included in the summary and in which order and section. Moreover, the EU Commission plans to reduce the maximum length of the summary from 15 pages or 7 percent of the prospectus to fixed 6 pages.*

**We see several problems arising from this new form of the summary, also based on liability reasons.**

- The maximum number of 6 pages is too short to give a brief overview of all relevant information.
- The restriction to 6 pages does not reflect appropriately the different types of securities, whose description scope varies considerably.
- In determining a maximum length of 6 pages, the Commission apparently forgot to take into account a possible guarantor, who would increase the page number.
- Restricting risk factors to five each gives investors the impression that they only need to consider these five risks as relevant. That way, the summary would be, together with all the other issues, misleading and contradicts the general idea of a summary to give a brief overview about all material information.

### 5.1 Art. 7 para. 3 – 6 pages restriction is too short

The summary shall not exceed 15 pages or 7 percent of the whole prospectus according to Art. 24 para. 1 subpara. 2 PR.

#### 5.1.1 Art. 7 para. 3 – Different complexity of securities

Restricting the summary to 6 pages is a substantial reduction, disregarding the different complexities of securities. Obviously, EU Commission has prepared its proposal from an equity shares view. While equity shares can be described briefly, the description of bonds, certificates etc. needs a much larger scope (e.g. because an issuer and a guarantor could be involved, the underlying of derivatives has to be described separately or the rights related to bonds are more capacious).

Issuers already have difficulties not to exceed the limitation of 15 pages or 7 percent of the prospectus. The fact that a summary for base prospectuses only has to be published with the final conditions, does not solve this problem. It only means that the description of all financing subsidiaries under one programme will

not be necessary, as the focus will only be on the corresponding issuer and the guarantor. However, this does not justify a reduction to less than half of the current number. **Contrarily, the additional space should be used to design a less dense description.**

### 5.1.2 Art. 7 para. 3 and 6 – Eventual guarantees need more pages

Frequently not the holding company, whose shares are already admitted to the regulated market, issues the bonds but a financing subsidiary. However, the holding company functions as guarantor, as investors rely on its creditworthiness and financial performance. We are surprised that the description of a guarantee and a guarantor is mandatory in Art. 7 para. 7 c) draft PR, but doesn't allow to use a higher number of pages. Although, a guarantor is to describe like an issuer.

Being obliged to give additional information about the guarantor renders the already too short 6 page limitation (compare our critique above) disproportional.

**The summary needs to be extended for at least two pages**, as financial information for two companies needs to be presented.

### 5.1.3 Art. 7 para. 3 – Translations should be allowed to be longer

Member States are according to Art. 25 draft PR allowed, to demand in the case of cross border offers for a translation of the summary in their official language. If the limitation of 6 pages also applies to these translations is unclear. However, giving the same level of information in a French or German summary might require much more words or characters than in English. Therefore, extending the maximum length of the summary for translation for at least one page should be included.

## 5.2 A limitation to the five most relevant risk factors bears substantial factual and legal problems

This issue will be explained in detail later regarding the general requirements for risk information according to Art. 16 draft PR in chapter 9. Summarizing our opinion, it can be said, that we are against a limitation on the five most relevant risk factors. This would give investors the impression that they only need to consider these five risks. This restriction means to omit material information, which especially retail investors probably don't take into account. In addition, it contradicts the actual idea of a summary to give a brief overview of all key information. Thereby, the actual liability of the summary would be fulfilled in Art. 11 para. 2 draft PR.

## 6 Art. 8 – Preserve the base prospectus regime

*The EU Commission only plans small changes to the base prospectus regime, which, however, could have bigger consequences. The base prospectus regime is a well-recognized and functioning system to issue bonds promptly.*

**The base prospectus regime should thus remain untouched as far as possible.**

- Art. 8 para. 2 (a) draft PR should like today only give an indication of the information to be included in the final terms.
- The formulation “where possible” should be used in Art. 8 para. 4 draft PR and thus facilitate issuing securities on short notice.
- Art. 8 para. 7 draft PR should be adjusted to make clear that final terms, which are not part of the prospectus or the supplement, have only to be filed.
- Art. 8 para. 9 draft PR should be deleted because of its confusing wording.

### 6.1 Excursus: The base prospectus regime and other alleviations

In general, a prospectus consist of three parts: information about the issuer, information about the securities and the summary. It is possible to approve each part of the prospectus separately, so-called tripartite regime. The corresponding rules can be found in Art. 10 draft PR. The information about the issuer then has to be published in a registration document and the information about the securities in a securities note.

The EU Commission now proposed in Art. 9 draft PR to expand this tripartite regime and to allow a universal registration document besides the present registration document. The universal registration document can be used for any type of securities and shall enable a faster approval of the remaining documents within 5 working days instead of 10. This universal registration document primarily targets frequent issuers, allowing them to file its universal registration document, without prior approval, providing that universal registration documents have been approved for three consecutive years (opinion “URD”, see chapter 9).

As in the past, the base prospectus regime shall continue to be part of Art. 8 draft PR. The base prospectus can only be used for non-equity securities (e.g. bonds). It is published and approved independently of a specific issuance and contains information about the issuer and the securities. Logically, it only includes information which is available at the time of the first preparation of a prospectus or the annual update, i.e. issuer specific information or principal information about the securities (e.g. terms and conditions). In the course of the actual issuance the

missing information about the coupon, denomination, maturity etc. will become part of the final terms, which will be published together with the summary. These final terms will not be approved to permit issuers a fast issuance of securities.<sup>11</sup>

While base prospectus regime, tripartite regime, even modified by an universal document, generally use the same amount of required information, secondary issuances and SMEs shall benefit of alleviated information regimes.

The alleviated regime for secondary issuances, Art. 14 draft PR, will apply to offers or admissions concerning securities issued by companies already admitted to trading on a regulated market and are therefore subject to ongoing disclosure requirements under the Transparency Directive and Market Abuse Regulation.

The specific regime for SMEs, Art. 15 draft PR, allow these substantial alleviations in case of an “offer of securities to the public provided that they have no securities admitted to trading on a regulated market”. Furthermore, SMEs which issue shares and simple bonds will be allowed to publish their prospectus in the form of a questionnaire.

## **6.2 Art. 8 para. 2 (a) – Only indicative list**

In contrast to the present Art. 22 para. 5 subpara. 1 PR the EU Commission is against an indicative list, which information will be given in the final terms, in the base prospectus. Instead there should be a “fixed” list of the information, which should be included in the final terms. This would be kind of a cross reference list. However, due to the empty spaces in the base prospectus it is already visible without this list, which information is missing. Moreover, the template makes visible, which information has to be named in the final terms. An extra list would therefore be redundant.

## **6.3 Art. 8 para. 4 – Publishing of final terms also after the start of the public offer**

Especially bonds are sometimes issued within 1-2 hours, to benefit of favorable market opportunities. In these cases the complete documentation is often sent subsequently, as this needs longer time than the issuance itself.

The present Art. 5 Para. 4 SPara. 3 PD II allows this but the EU Commissions plans to oblige issuers to finish the final terms before the public offer starts. We recommend to keep the opportunity for issuers to obtain financing on short notice by taking advantage of favorable capital market windows in the sense as laid down in the Capital Markets Union and thus to apply Art. 5 para. 4 subpara. 3 PD II.

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<sup>11</sup> Compare recital 24 of the directive 2003/71/EG.

#### **6.4 Art. 8 para. 7 – No approval before the final terms**

According to the PD II, final terms do not need to be approved but have to be filed in compliance with Art. 5 para. subpara. 3 PD II. Art. 8 para. 4 draft PR only specifically demands filing, if the final terms are neither part of the base prospectus nor of the supplement (as prospectus and supplement have to be approved anyway).

A difference to the current prospectus regime lays in Art. 8 para. 7 draft PR. Accordingly, summaries have not to be included in the base prospectus but have to be prepared together with the corresponding issuance. This avoids efforts preparing the prospectus. Especially taking into account that the summary in contrast to the prospectus not only has to be published in English but also in the respective language of the countries where the securities are admitted to trading or where they are offered to investors (compare Art. 19 para. 2 and 3 PD II).

However, confusing is the reference to approved final terms in para. 7. This phrase shall probably take into account that the final terms are already part of the base prospectus or the supplement and thus have to be approved. This makes sense as according to recital 29 of the draft PR, it is not the objective to approve the final terms and the succeeding summary (compare also recital 30).

Moreover, the following phrase is confusing: “A summary shall only be drawn up when the final terms are approved or filed [...].” This would mean the summary has to be prepared only after the filing. Reasonably and according to para. 8 the summary has to be attached to the final terms, thus they have to be filed together.

**In order to avoid this confusion for the user, we recommend to adjust the wording of Art. 8 para. 7 draft PR: „A summary shall only be drawn up to the same time as the final terms and shall be specific to the individual issue.”**

#### **6.5 Art. 8 para. 9 causes confusion**

Base prospectuses are already part of a prospectus according to Art. 8 para. 1 draft PR and thus can be subject to the supplement requirements in Art. 22 draft PR. Consequently, we do not understand the intended material content of para. 9. We recommend to remove this paragraph in order to avoid that the text will be interpreted in the way that the base prospectus has to be kept up to date at all time regardless if it is currently used.

**7** Art. 9 – Universal registration document does not present any particular advantage to so-called non-financial issuers

The universal registration document (URD) did not generate much interest in the corporate bonds market so far. As we understand Art. 10 para. 2 subpara. 2 and 3 draft PR, the URD has to be approved again for each issuance in the fourth year, although it should only be filed. The base prospectus regime does not demand any approval and thus is more flexible in order to take advantage of market opportunities on short notice.

## 8 Art. 14 and Art. 1 para. 3 and 4 – Substantial alleviations for secondary issuances

*We explicitly welcome the intention of the EU Commission to create alleviations for secondary issues in Art. 14 draft PR.<sup>12</sup> Issuers, whose securities are already admitted to trading on a regulated market and are therefore subject to the Transparency Directive<sup>13</sup> and the Market Abuse Regulation<sup>14</sup>, should not be obliged to continuously repeat already published information in prospectuses.*

**If Art. 14 is supposed to reach its actual objective, several adjustments are necessary.**

- It has to be made clear that the term class only differentiates between equity and non-equity securities. Otherwise the intended alleviations cannot be reached.
- A guarantor, also issuing shares, is often involved in bonds issues. Thus this common constellation should be included.
- The information level should be clearly reduced on level 1 to avoid a delegation to level 2. Concerning issuers, there should only be disclosed the securities note and, in the case of a public offer, recent developments since the last regular report.
- Art. 14 should only demand a “document” and not a prospectus in order to avoid that investors expect a complete information document.

### 8.1 Art. 14 para. 1 a) – Concretize term “class of security”

Art. 14 para. 1 draft PR should determine, in which case secondary issuances are given. According to a), if an issuer issues the same class of securities, already admitted to trading on a regulated market or SME growth market for at least 18 months.

However, the term “class of securities” is an undefined term, which has not been used before, as far as we know. Solely the differentiation between share classes is known, compare Art. 14 para. 1 PD II (Art. 20 para. 1 subpara. 2 draft PR). Regarding shares, it is at least necessary to differentiate between bearer and

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<sup>12</sup> Deutsches Aktieninstitut calls for the implementation of alleviations for secondary issues since the consultation of the prospectus directive, compare Position of Deutsches Aktieninstitut on 13/05/2016, p. 17.

<sup>13</sup> Directive 2004/109/EG as amended by Directive 2013/50/EU.

<sup>14</sup> Regulation (EU) No. 596/2014, applicable from 3/7/2016 and Directive 2014/57/EU.

registrared shares, as they grant different rights. However, a general differentiation concerning rights for non-equity securities would mean that each bond would present an own class. Each bond is different from the others, based on its terms, interest rate, maturity and therefore the rights granted. Such interpretation of Art. 14 Para. 1 a) draft PR would miss its original purpose, as it is meant to facilitate a recurrent issue of bonds. Our argumentation is supported by the formulation of Art. 1 para. 4 a) draft PR, requiring fungibility. Securities are fungible, if they are interchangeable due their structure and rights granted. Obviously, the term “class” in Art. 1 para. 4 a) draft PR has been deleted intentionally in the current Art. 4 para. 1 a) PD II in order exempt only tap issues, while the term class would have permit the issuance of several bonds with attached rights.

Certainly, class aims at the distinction between equity and non-equity securities. This corresponds to the differentiation between shares and debt securities in the Transparency Directive(e.g. Art. 5 Para. 1 TD). These two securities classes are subject to different transparency requirements. After all, issuers of shares have to meet the highest information requirements which is why they are privileged in lit b).

This also results from the fact that it is still necessary to present a securities note, which clearly distinguishes between different equity and non-equity securities.

**To avoid doubts about the legislator’s interpretation of the term class of securities, we recommend a definition in a new Art. 2 b) draft PR, which could be for example: “Classes of securities in this directive are equity and non-equity securities.**

## **8.2 Art. 14 Para. 1 a) and b) – Inclusion of guaranteed bonds**

Art. 14 para. 1 b) draft PR. Lit. b) states that the issuance of non-equity securities (e.g. bonds) is as well regarded as a secondary issuances, if only equity securities (e.g. shares) have so far been admitted. Although no related explanation can be found in the recitals, this is due to the fact that issuers of shares have to meet the highest information requirements.

### **8.2.1 Consider the guarantor**

However, Art. 14 para. 1 b) draft PR only seems to be helpful for typical bond issuance. Often the issuer of equity securities and non-equity securities differ, as large corporations, whose shares are admitted on the regulated market, mostly issue bonds through a financing subsidiary (compare above). The parent company, which is listed with its shares, functions as guarantor, meaning that its creditworthiness and financial performance and thus its reporting is relevant, although another corporation issues the securities. Hence, it should be sufficient, that the guarantor’s shares are listed for more than 18 months. This should be also the legislator’s intention.

### 8.2.2 Financial subsidiary is not relevant

However, as the primary focus anyway is on the guarantor, Art. 14 Para. 1 a) draft PR should not demand that the subsidiary has already issued a security of the same class. It should be sufficient, if a security of the same class has been issued by the holding company within the last 18 months. Based on this formulation, issuing shares would be unnecessary.

### 8.2.3 Reduced information also for guarantor

The inclusion of the guarantor only benefits issuers if the reduced information is also applicable to the guarantor. The legislators should take this into account.

## 8.3 Art. 14 – Actual reduction in level of information

Art. 14 Para. 2 draft PR contains requirements for smaller prospectuses in secondary issuances. Accordingly, information about the prospects of the issuer and of any guarantor, rights attaching to the securities, the reasons for the issuance and its impact on the issuer are necessary. Today, information of how these prospects of the issuer have changed compared to the latest regular publication is published through so-called trend information (compare PR Annex I No. 12). All other conditions are part of the securities note (compare PR Annex IV No. 3.2). We consider the idea to include the most recent developments and a securities note as necessary but sufficient.<sup>15</sup>

### 8.3.1 Remove uncertainties based on recital 40

However, we have identified three problems: Firstly, recital 40 seems to pursue another intention than Art. 14 para. 2 draft PR. This recital specifies for example that it should be also described risk factors specific to the issuer and the securities, board practices (corporate governance), directors' remuneration, the shareholding structure or relating-party transactions. EU Commission alleges such information is not required to be disclosed on an ongoing basis under the Transparency Directive or the Market Abuse Regulation. However, this list is diametric to the list in Art. 14 Para. 2 draft PR, which is supposed to make clear that such information is not needed. The remuneration of directors doesn't change continuously, why should this be a relevant information in the case of a secondary issuance? The same could be said about the corporate governance. Such information in addition to the management report is not necessary. This comprehensive list would unsettle practitioners and would probably lead to the preparation of complete prospectuses again, similar to the fail of the "proportionate disclosure regime".

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<sup>15</sup> Compare also the claims of Deutsches Aktieninstitut in position on 13/05/2015, p. 17.

The list in recital 40 is very irritating which is why it should be adapted to the list in Art. 14 Para. 2 draft PR. Moreover, the recital does not mention that the Market Abuse Regulation requires permanent disclosure; meaning that relevant information for investor has to be disclosed immediately (Art. 17 MAR).

### **8.3.2 No prospectus – documentation requirements**

Yet also Art. 14 para. 2 draft PR needs several adjustments. Particularly the last sentence would make the practitioner unsure, so he would prepare a complete prospectus due to legal liability reasons. According to this sentence, information contained in the (smaller) prospectus “shall enable investors to make an informed investment decision”. This formulation reminds us of the standard level in Art. 6 Para. 1 draft PR. Accordingly, the information shall enable an “informed assessment”. This formulation in Art. 14 para. 2 draft PR goes too far and contradicts the idea of eased secondary issuances. The decision of the investor should not be based solely on the (smaller) prospectus but even on information disclosed in the financial reports. As other information is already available, the investor is supposed to consider this as well. Information in context of secondary issuances shall only give a comprehensive picture and thus be only complementary. Consequentially, this complementing information cannot be called a prospectus. Therefore, - also to create an actual alleviation with Art. 14 draft PR – the term prospectus should be replaced by “document”, just like the exemptions in Art. 1 Para. 3 f), g) etc. and Para. 4 d), e) etc. ProspV-E.

### **8.3.3 Issuer specific information should only include recent developments**

Furthermore, the term issuer specific information should be adjusted to the current requirements for trend information. The term expectations contradicts the prospectus regime. In general, the prospectus is based on the past and only gives forward-looking statements under very special circumstances. Hence, the issuer should, especially due to possible prospectus liability claims, not be forced to do so.

### **8.3.4 Decision to be made on level 1**

In the past, delegating decision to level 2 often did not lead to alleviations but higher effort and interpretive problems. If a new system for secondary issuances can actually create alleviations and whether repeated issuances become easier, plays an important role for the objectives of the Capital Markets Union. However, the crucial decision should not be left to drafting on level 2 but have to be decided by the EU legislators.

The list in Art. 14 Para. 2 draft PR should clearly state that in the case of public offers, only information about the issuer and the guarantor and a securities note should be given. The delegation in para. 3 should therefore be deleted.

## 8.4 Listing prospectuses need even less information

The term “listing prospectuses” labels prospectuses, which are necessary for the admission of securities to the regulated market, without a public offer (compare Art. 3 Para. 2 draft PR). The admission of the securities typically takes place after the private or prospectus free placement with investors. Those have apparently decided without a prospectus. As soon as the securities are traded on the secondary market, the prospectus may not help anybody. As the obligation to offer supplements in Art. 22 draft PR is connected to a public offer, the prospectus may not contain the most recent information when the investors takes his investment decision. This means that a listing prospectus has to be prepared, although under normal circumstances nobody can rely on it (!). From our point of view, at least the idea of an obligatory prospectus (with the intention to present all relevant information to take a proper investment decision) should be given up at this point. A securities note should be sufficient for the admission of secondary issuances, as issuer specific information is not relevant for anybody or can be found in financial statements, management reports and ad hoc disclosed inside information.<sup>16</sup>

## 8.5 No summary possible for secondary issues

In the case of secondary issuances the preparation of a summary is not possible. As the objective is to omit information already published in other reports (especially in the regular reporting due to the Transparency Directive), the prospectus/document is missing on purpose “all” relevant information. If requirements of the summary have to be fulfilled, information from other documents have to be included. This in turn would contradict Art. 11 para. 2 draft PR. This rule precisely demands that the summary has to be readable together with the prospectus in order to obtain all relevant information. Yet, the reader could not find this information, as references are not allowed in the summary.

**Therefore, it makes sense to either waive the summary for public offers in secondary issuances or to restrict the requirements for the summary to the information given in the prospectus/document.**

In the case of listing prospectuses no summary should be needed. As explained above, investment decisions cannot be made on basis of a listing prospectus. Preparing a summary with all the necessary information would be useless. **We recommend therefore to at least abstain from a summary in the case of a listing prospectus/document in secondary issuances.**

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<sup>16</sup> Compare the position of Deutsches Aktieninstitut on 13/05/2015, p. 17.

## **8.6 Art. 19 para. 5 – Shorten approval period to 5 days**

In order to integrate a shorter prospectus/document for secondary issuances in the law, we recommend to also offer the possibility of a faster approval, as included in Art. 19 para. 5 draft PR for frequent issuers.

In the event of a secondary issuance the prospectus/document demands significantly less information. The prospectus scrutiny is then shortened. **Based on this reduction in effort the approval period should be reduced to 5 days.**

## **8.7 Clarify relation to Art. 1 para. 4 h)**

Art. 14 para. 1 draft PR does not demand an issue of other securities on the same regulated market. Consequently, issues on other regulated markets, in other Member States, would be secondary issuances as well. From our point of view, this renders the exemption in Art. 1 para. 4 h) draft PR useless.

## **8.8 Include these exemptions in Art. 1 para. 3 and 4**

As we recommend to only demand a document instead of a prospectus, it should be clarified in Art. 1 para. 3 and 4 draft PR that secondary issuances do not require a prospectus but only a document determined in Art. 14 draft PR. Otherwise a document would be required alongside a prospectus instead of substituting it.

**9** Art. 16 and 7 para 6 c) und para 7 d) - The categorisation of risk factors and the restriction to the five highest risk factors in the summary are likely to impede capital market finance

*Our following argumentation combines the presentation of risk factors in the prospectus and in the summary in order to avoid duplications.*

*The EU Commission proposes three significant new changes. According to Art. 16 draft PR risk factors featured in a prospectus shall be limited to risks which are specific to the issuer and/or the securities and are material for taking an informed investment decision. In addition, they shall be allocated across a maximum of three distinct categories which shall differentiate them by their relative materiality based on the issuer's assessment of the probability of their occurrence and the expected magnitude of their negative impact. That risk factors should be specific or material are current requirements, but that Art. 16 para. 2 draft PR empowers ESMA to develop guidelines to determine the condition of specificity and materiality is new. An allocation across two or three risk categories is nowhere else required and hence, an unexperienced new approach.*

*Moreover, the summary shall be restricted to the five most material risk factors of the highest category concerning the issuer and the five most material risk factors of the highest category concerning the securities.*

**We doubt that more specific and material risk factors could really be obtained.**

- Risk factors are dynamic. It is uncertain how fast they could materialise. To mention the risk factors of nature catastrophes might seem to be too generic but how should one specify the consequences of Fukushima in advance?

**We refuse the categorisation of risk factors in the prospectus and the restriction to the five most material risk factors in the summary.**

- To classify risk factors does not mean to reduce them. Risk factors classified as low risks are likely to not be considered as material. Therefore, a retail investor would not take it into account.
- The presentation of only five risk factors in the summary is likely to lull especially retail investors in a false sense. They would assume only this five risk factors as relevant for their investment decision.
- Classifying risk factors is discretionary. The wide range of possible assessments and graduations would cause the high risk of liability actions. To avoid such actions the issuer might be motivated to classify risk factors as "high" and to present them generic as much as possible. As example, the world political situation can significantly influence the performance of

industries and is therefore a material risk factor. Nevertheless, nobody is capable to assess the probability how the relation between Russia and the EU will develop.

- How the allocation shall happen is moreover uncertain. Either ESMA nor the EU Commission should be allowed to develop any further rules. If any, the EU legislators have to decide on this crucial point. But note, diverging provisions how to assess risk factors could cause differences to US prospectuses or the management report. In both cases, the accusation of misleading information could raise.
- Furthermore, the assessment of risk factors is sufficiently facilitated. Ratings have to be mentioned, Management Discussions & Analysis have to be given and in any case, Trend information and as the case may be profit estimates have to be presented.
- As an issue can currently be conducted within 1 to 2 hours, the difficulties to classify and graduate risk factors are likely to prolong the issuances of debt securities under current base prospectuses.

### **9.1 Risk factors are dynamic and therefore determination of specificity and materiality are almost impossible**

Today, the minimum condition to mention a risk factor is specificity and materiality (e.g. Art. 25(1) no. 3 and Art. 26(1) no. 3 PR and Art. 5 PD II). By acknowledging these minimum provisions, they even become approved as such by national authorities (NCAs). This means, what the EU Commission criticises as too generic are specific and material in the opinion of the market participants and the NCAs. The reason is that several risk factors could not be made more concrete.

*As an example, anyone has expected nature catastrophes like "Fukushima" or terrorist attacks like "9/11". Nevertheless, they have impeded financial importance of different companies to great extent which is why investors should know that such situations could occur. This is only possible with a wide description of such catastrophes.*

Already this example shows how difficult any concretisation would probably be. Please note, that especially the requirements on risk factors are of significant importance for the issuer's liability risks. This is why the legislators should, if any, make own decisions how to concretise the requirements of risk factors. Therefore, the empowered of ESMA to develop guidelines should be abolished.

By scrutinizing the possibilities of concretisation, the EU legislators probably realise any concretisation of specificity and materiality would lead to the avoidance of risk factors potentially necessary for the investment decision. That is why we assume that the result of scrutiny is that nothing might be changed.

## 9.2 No risk categories in the prospectus

We refuse the EU Commission's proposal to graduate risk factors into categories. Already one of the first drafts of the EU Commission, disclosed in September 2015, has foreseen three categories "high", "medium" and "low" risks. We assume that at least ESMA is likely to introduce these categories via level 2 guidelines. This is why our further comments are still focused on these expressions.

### 9.2.1 Misleading and not capable to avoid too generic risk factors

First of all, we do not understand how a categorisation of risk factors can prevent from a too generic description? Only the EU Commission seems to be convinced to restrict too generic risk factors by this measure, p. 17 of the proposed text.

Furthermore, because of their label "low" risk any potential investor probably assess such as not relevant, although, any risk has to fulfil the minimum requirement of specificity and materiality. Materiality provides the capability to be relevant for an investor (Art. 6 draft PR). If investors not take low risks into their considerations, they would not make an informed decision. That is why we assess the provision of allocation into different categories as misleading.

### 9.2.2 Allocation is useless by facing liability risks

It has also be taken into consideration that any allocation raises significant liability risks. If as "low" classified risks materialise it would result in a flood of lawsuits. Issuers are almost unable to make a valid graduation of risks. There is a wide range how to assess risk factors, especially how to estimate the probability of occurrence since estimation of future developments are made on basis of past experiences.

*E.g. how should anyone estimate how the world political situation probably develop? Although it could have a significant impact on the sales of European industries anyone is able to expect whether Russia and Ukraine will conclude peace. Should issuers really forced to estimate how the Arabic countries will develop in the next years?*

These problems are also caused by the proposed probability-magnitude-test in Art. 16 draft PR. There are risk factors with low probability but high expected magnitude and vice versa risk factors with a high probability but low expected magnitude. Nevertheless, both could be material but how should they allocated?

*So-called compliance risks are therefore difficult to allocate. A breach of the Market Abuse Regulation could result in financial sanctions up to 15 percent of the total annual turnover. In the case of, for example, 50 billion Euro annual turnover this sanction could encompass 7.5 billion Euro. Because of the high magnitude the risk could either be assessed as "high" or because of the low probability as "low". Both allocations seems to be possible. Nevertheless, if it is categorized as "low" and any scandal gets abroad, there could be courts judging this estimation as wrong.*

For issuers it is almost impossible to make a valid graduation. Hence, issuers might be motivated to allocate risk factors in the highest category as many as possible.

In addition, facing such high liability risks the issuer is likely to use more generic risk factors with a wide range of possible estimations.

### **9.2.3 Several risks could not be estimated**

Furthermore, there are some risks relevant for any investor decision but not possible to estimate. How world economic develops could have a significant impact on the financial performance of a company. However, anyone can really estimate this.

### **9.2.4 Comparability with US prospectuses and management reports**

Please take also into considerations that management reports are describing issuer related risk factors but without any allocation in categories. This means, that investors might receive different risk reports which is likely to confuse investors.

Moreover, there is no pursuant provision for US prospectuses. In the case of cross-border offerings investors have access to different risk reports. Especially the empowerment of ESMA to develop guidelines could lead to a different assessment of risk factors, for example if a high risk, what in a US prospectuses typically is mentioned at the end of the risk section, but ESMA requires to allocate as a low risk. This increase the threat of US liability actions.

### **9.2.5 Rating and MD&A already facilitate estimation**

If the EU Commission justifies the allocation of risks to facilitate the estimation of an investment, it should be noticed, that ratings or the so-called management discussion and analysis (MD&A) are part of a prospectus. In addition, trend information or, as the case may be, profit estimates etc. are to mention. The investor receives therefore sufficient support to make an informed decision.

## **9.3 Summary – No restriction to the five highest risk factors**

EU Commission proposes to restrict the summary. Only the five most material risks relating to the issuer and relating to the securities (i.e. 10 risk factors in total) of the highest category must be mentioned. In our opinion, this restriction is not comprehensible.

### 9.3.1 Random selection is misleading

As explained above, a valid allocation in categories is almost impossible not to say how difficult it is to rank risk factors in one category into a hierarchy. But, this is what EU Commissions would like to require. The requirement to do so means to make an arbitrary selection.

This selection misleads the investor to a much higher extent than the allocation into categories. If an issuer has already allocated risk factors in the highest category, why is he not allowed to present at least all of them in the summary? Reminding what the original function of a summary is, namely to give especially retail investors a brief but complete overview about the prospectus information, an arbitrary selection could only be misleading. Since cross-referencing in summaries is prohibited retail investors would only take these five risk factors into account.

Moreover, why should it only allowed to present five of the highest category? If there are only three risk factors in the highest category, the issuer would not be allowed to mention the most relevant risk factors in the medium or low category. We do not recognize any benefit for the investor in this approach.

### 9.3.2 Misleading causes liability

According to Art. 11 para. 2 subpara. 2 draft PR civil liability is possible if the summary is misleading, inaccurate or inconsistent, when read together with the other parts of the prospectus, or it does not provide, when read together with the other parts of the prospectus, key information in order to aid investors when considering whether to invest in such securities.

Please note, actually the restriction to the five most material risk factors is fulfilling these provisions and might be basis for liability actions.

*A selection of five of, for example, seven risk factors is misleading because the retail investor would assume that not more than these five risk factors are relevant. Liability actions would also be justified if there are more than one risk factor which could be the fifth highest risk factor. To select five of the highest category also seems to be inaccurate.*

Moreover, omitting every risk factor behind the fifth most material means not providing key information in order to aid investors when considering on investments.

### 9.3.3 Conclusion: No arbitrary selection of risk factors

As a result, the requirement to select five risk factors should be abolished. Anyhow, we do not understand why the market practise to mention all risk factors (typically between 20 and 25 risk factors) in bullet points by providing a brief description should not suit investor needs. **If any, the EU legislators should raise this market practise to a mandatory provision.**

## **9.4 Restriction of base prospectus regime**

The benefit of the base prospectus regime is the possibility to use short market opportunities and therefore facilitates capital markets finance. However, the new requirements to allocate risk factors and the restriction in the summary would cause a review whether the graduation is still valid in advance of any issue. What the five most material risks and what the high or low risks are could change rapidly.

*For example, the situation how probable the “Brexit” or the credit default of Greece is could change from day to day.*

This probably would prolong the issuance process since it requires an agreement between the investor relation, legal and treasury department, the agency banks, the legal advisors and, perhaps, the management because the latter is typically in charge of the risk estimation.

While currently an issue under a base prospectus is often conducted within 1-2 hours, the necessary review of risk factors would prolong this process. In the result, it may be not possible to use a beneficiary market opportunity and could result in higher emission costs and would reduce the appeal of capital market finance. This is against the intention of the Capital Markets Union.

## **9.5 Stronger liability discourages issuer and esp. SMEs**

Further on, the EU legislators have to take into account that any increase of liability risks is likely to discourage issuers and SMEs from using capital markets. Moreover, issuers may seek to fund capital in other jurisdictions with less requirements. Since this is not in the intention of this draft PR, the legislators should focus on facilitations not restrictions.

## 10 Art. 18 – Incorporation by reference-mechanism

We appreciate the improvement of flexibility in the incorporation by reference-system. Especially the adjustment that Art. 18 draft PR not only encompasses documents required by the TD would allow to refer to quarterly results (Art. 18(1)d draft PR) and facilitates cross-referencing prospectus information.

## 11 Art. 19 X – Make only electronic communications with NCAs possible

To facilitate the approval process the entire documentation, including the approval of the final version, should be possible by electronic means. This should not require the implementation of any electronic system but the opportunity to submit all documents by email to the responsible persons at the NCAs.

## Contact

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