German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

Commission proposal for a Prospectus Regulation

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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I. General Remarks

The German Banking Industry Committee, which represents approximately 1,700 banks in Germany, welcomes the Commission's proposal for a Regulation on the prospectus to be published when securities are offered to the public or admitted to trading in order to review the existing EU prospectus regime. We support the proposal's objective of reducing the burden on issuers while safeguarding a high level of investor protection. We consider the proposal to be an important step towards the Capital Markets Union (CMU).

We especially welcome the aim of facilitating the **approval process for frequent issuers**. However, further work might be needed in respect of other issues, like the **alignment with Regulation (EU) No. 1286/2014 (PRIIPs Regulation)**. Also, there are other parts where the proposal is on the right track, but could be more ambitious. This concerns especially the **universal registration document** regime, introduced by Article 9 of the proposal. We strongly support the concept, but do not believe that the approach goes far enough to be of much use.

Please find our detailed remarks below.

II. Detailed comments

1. Securities with a denomination per unit of at least EUR 100 000

The current prospectus regime provides in Article 3(2) 1 d) of Directive 2003/71/EC for an exemption from the obligation to publish a prospectus in the case of a public offer of securities with a denomination per unit of at least EUR 100 000. This threshold aims at distinguishing between retail and wholesale offers when non-equity securities are admitted to trading on a regulated market. According to the new proposal, this exemption would be dropped. The reason given for this change is increasing the number of bonds available to retail investors by encouraging the issuance of debt securities with lower denominations. However, we do not believe that removing the EUR 100 000 denomination exemption would achieve this objective. The existing regulation is based on the principle that investors investing in these volumes don't need a prospectus to make their decision. We believe that nothing has changed in this regard and that this rule is still legitimate.
High denominations will continue to be applied for different reasons. *Firstly*, where securities are not suitable for non-professional investors. In this respect, denominations per unit of at least EUR 100 000 might simply make an investment for inexperienced investors very unlikely. *Secondly*, to mitigate and cope with remaining legal uncertainties for debt issuers in the primary market phase. It is not easy to determine from the beginning when the final placement of an offer of securities occurs through financial intermediaries and whether the final placement will meet one of the possible exemptions when it takes place. It is also unclear from what moment on a prospectus is then required should the last possible exemption be lifted.
With a clear definition in Article 5 of what final placement in the context of offers through financial intermediaries means and clarification of at what time a prospectus then needs to be available, uncertainties for issuers and underwriters would be removed and lower denominations could follow suit, where retail investors request this.
The removal of the existing exemption for non-equity securities with a denomination per unit of at least EUR 100 000 will not only miss the target of achieving lower denominations, it will at the same time negatively affect the efficient operation of the EU wholesale markets for debt

securities by eliminating the distinct and lasting separation from the retail markets provided solely by this exemption.

A second exemption, also removed by the proposal, for non-equity securities with a denomination of at least EUR 100 000 allows in Article 5(2) of Directive 2003/71/EC omission of the summary from a prospectus. This exemption is relevant for debt securities within the EU prospectus regime that are admitted to a regulated market and are targeted at professional investors who do not require the same amount of information in a prospectus as retail investors, in particular no summary.

The decrease in the efficiency of issuance processes in the wholesale markets resulting from the removal of these two EUR 100 000 denomination exemptions is disproportionate, nor is the removal of the exemption likely to achieve the objectives set out in Recital 47 for the above-mentioned reasons; the EUR 100 000 denomination exemptions should therefore be retained.

2. The universal registration document (URD)

The universal registration document (URD), as set out in the **Article 9** of the proposal, is a very welcome and promising starting point for improving the EU issuer disclosure regime both for issuers themselves and for investors looking for easy access to exhaustive information on an issuer of securities. In its current form, however, it falls short of what it could achieve. Left unchanged, we believe the URD will not be taken up by many issuers because it does not improve the issuance processes for frequent issuers with several base prospectuses in place. For frequent issuers, the true benefit of the URD would be a simplification of the management of issuer disclosure for existing and new (base) prospectuses. The URD could in this respect be an important ingredient of more efficient EU capital markets. This will largely depend on how easily the information in the registration document can be integrated into existing and new issuance platforms, i.e. base prospectuses.

The *first* important point in this respect is that the URD and its amendments need to be usable in prospectuses without further approval steps. As long as amendments to the URD filed by issuers with frequent issuer status trigger the obligation of approval in case the URD is to be included in prospectuses, the main potential benefit of the URD is negated. The privilege for frequent issuers to modify the URD by simply filing amendments instead of being required to have supplements approved becomes meaningless if the resulting amended URD cannot be directly used for prospectuses without further approvals. The same goes for the privilege to only file the URD after having had it approved for three consecutive years. Due to the fact that the benefit of only filing a URD (instead of having it approved before it is published) is safeguarded with a post-filing review, allowing the inclusion of the URD and its amendments in prospectuses without further approvals should not be too ambitious. If this appears too bold a step for the initial phase, consideration could be given to delaying the filing-only privilege for amendments to the URD to the time after three satisfactory years have passed, as is already the case for the URD itself in the current draft.

The *second* crucial point is that changes to the URD must automatically become part of all related prospectuses. As the URD is developed to become the exhaustive, central document for the most recent information on the issuer, by using it to replace periodic disclosure (in annual and half-yearly financial reports) under the Transparency Directive and possibly ongoing ad hoc disclosure under MAR, the URD should also be the only source of issuer disclosure that

securities investors are referred to when provided with a prospectus. In order to subject this issuer information to prospectus liability, it will remain necessary to have the URD included in all prospectuses. But to simplify prospectus processes for frequent issuers, it is important to allow a dynamic reference in the prospectus to the latest URD. This would also avoid the distortion in the availability of information in the primary and secondary markets caused by the time lag between the update of an URD and a supplement to each individual prospectus. To achieve this, dynamic incorporation by reference of the most recent version of the URD must be allowed or it must be ensured that any changes to the URD flow directly through to an assembled tripartite prospectus, where applicable.
With these changes, regular updating of issuer disclosure could become a centralised workflow that is separate from prospectus management. That would be a substantial contribution to the CMU by way of increased efficiency of issuance processes on a pan-European level.

The *third* point is that a URD approved in one Member State needs to be available with its full functionality for prospectuses to be approved in any other Member State, subject to the limits of the language regime. This is not only a matter of efficiency, but also very important to ensure the consistency of issuer disclosure across the EU. One way to achieve this would be to extend the passporting mechanism to registration documents; another could be to simply let the URD be filed with the relevant competent authority of the other Member States, while at the same time discouraging a duplicative review by these competent authorities.

If considered necessary, any change to the information in the URD could trigger a withdrawal right under all relevant prospectuses in accordance with **Article 22** of the draft, as if a supplement to the relevant prospectuses had been published at the same time.

A successful URD could become the convergence point for several regulations in the EU that govern disclosure requirements for issuers of securities. Elements of the periodic disclosure requirements of the Transparency Directive and of the key information document under the PRIIPs Regulation have already been incorporated into the current draft; ad hoc announcements based on the MAR regime could follow suit, for example by allowing amendments to the URD to substitute and fulfil the obligation to publish ad hoc announcements or vice versa, i.e. an ad hoc announcement could also work as an amendment to the URD, at least if expressly so declared (e.g. by a header "*Public disclosure of inside information according to Article 17 MAR and amendment to the URD of…*"). This could lead to a European issuer disclosure regime that is equally as efficient as its U.S. capital markets counterpart.

Furthermore, it should be made clear that the provisions of Article 9 are equally applicable to non-listed and/or non-equity frequent issuers. There should be no discrimination with regard to the legal form of the issuer. Article 9 should be applicable to all capital market-oriented companies. We consider the focus of the current provisions on Aktiengesellschaften (stock corporation)-listed equity issuers to be disproportionate.

3. Risk factors

We agree with the objective of preventing lengthy, incomprehensible risk factor sections in prospectuses. However, prescribing under **Article 16** of the proposal that risk factors need to be allocated across a maximum of three distinct categories according to their materiality does

not address the issue, as risk factors do not become any shorter or more readable simply because they are sorted into two or three categories.

Instead the proposal creates other problems. Establishing two or even three different categories forces issuers to draw an artificial line between different risk factors that may not be far apart in terms of materiality. Issuers and competent authorities will spend time discussing where to draw this line, making the approval process less efficient. Issuers are also exposed to additional and unnecessary liability for having made wrong allocations to the different categories, which is aggravated by the fact that it is unclear how the different liability regimes in different jurisdictions would deal with such a wrong allocation of risk factors. The prospectus could even be considered misleading if a risk factor that was categorised as a lower risk materialises and causes substantial damage. Furthermore, the whole allocation procedure and the idea of using mitigating language for lower categories may be dangerous for investors. They may be induced not to read all relevant risk factors and to focus on the ones in the first category instead. Finally, for issuers that access both the EU and the U.S. capital markets and need to align their disclosure, particularly the risk factors, in these two markets, this categorisation requirement, which is unknown in the U.S. markets, will cause a divergence between their EU and the U.S. disclosure. This might give the impression of selective or even misleading disclosure and, as a result, trigger additional liability risks.

A new requirement for the presentation of the risk factors is also not necessary for several reasons:

- As long as there is prospectus liability, the prospectus is by definition a liability shield and naturally leads to an exhaustive description of all relevant risk factors. Issuers are already strongly incentivised to create a complete and comprehensible prospectus.
- The prospectus summary already offers an executive summary of the risks, presenting key risks in a concise manner; anyone interested in more details should then be allowed to turn to the main prospectus for an exhaustive description of all risk factors. With regard to the risk factors in the summary, we also refer, however, to our comments on Article 7(6)(c) and (7)(d) in section 6 below.
- Competent authorities already today have the option of refusing to approve a prospectus whose risk factors are not presented in a comprehensible manner. The categorisation of risk factors is not necessary to address identified deficiencies in specific prospectuses.
- Today, issuers have and use the opportunity to specify the degree of materiality within the risk factors themselves. This is a more suitable and differentiated tool than allocating risk factors to two or three categories.
- Some risks are appropriately described by generic wording, as they are of a general nature but nevertheless material to the assessment of the investment.

As the new requirement to allocate all risk factors to two or three categories of differing materiality is not suitable for remedying the identified issue, creates new problems instead, and is not needed to address the issue, it should be removed.

4. Base prospectus

The draft Prospectus Regulation contains in **Article 8** several beneficial and welcome changes in respect of base prospectuses, including the reintroduction of the tripartite base prospectus and the availability of base prospectuses for all types of non-equity securities. All improvements to the base prospectus regime directly lead to a more efficient issuance process

for frequent issuers. They also help those corporate issuers that issue less frequently, but maintain such a platform for the moment when they need to quickly enter the market.

Certain modifications in the new Prospectus Regulation are, however, detrimental in our view to the efficiency of the base prospectus regime and should be reconsidered:

- **Article 8(2)(a)** of the proposal requires the base prospectus to contain a list of the information that will be included in the final terms. This requirement could, in practice, prove quite burdensome to issuers without really adding value for investors. Today, the base prospectus only needs to contain an indication of the information that will be included in the final terms. This current requirement is fulfilled by decentralised references in the description of the securities to information items that are completed in the final terms. The form of final terms included in the base prospectus is another clear indication which items will be completed later on. A list of the information would, however, require creating another reference list showing all the items that are included in the final terms again. This would not only use up additional resources on the part of issuers but would also make the base prospectus longer and less comprehensible, without any apparent benefit to the investor. We would therefore recommend returning to the current wording that simply asks for an indication of the information.
- **Article 8(4)** of the proposal introduces stricter timing for the publication of final terms. Instead of "*as soon as practicable upon the making of a public offer and, where possible, before the beginning of the public offer*" under the current rules, the issuer would have to make the final terms available to the public "*as soon as practicable before the beginning of the public offer*" under the proposed rules. Time is of the essence between the decision to approach the market and the beginning of the offer. A key advantage of the base prospectus is allowing the issuer to begin a public offer on the basis of the approved base prospectus, while the completed final terms are provided as soon as possible thereafter. This is permitted because the final terms only contain information on the securities and the offer that is already provided to investors via other information systems in connection with the offer itself. Having to prepare and distribute the final terms before the beginning of the offer would reduce the flexibility of the instrument, without providing investors with information they do not already receive otherwise. We would recommend returning to the current wording.
- **Article 22** of the proposal establishes the requirement to publish supplements without undue delay. This is a sensible approach for standard prospectuses, but not for those base prospectuses that are less frequently used. Many months may pass between the approval of a base prospectus and first issuance thereunder. Issuers should not be forced to continuously supplement their base prospectuses even when they are not used. It would therefore be more appropriate to require the publication of a supplement for a base prospectus only before the beginning of the next offering or admission to trading on a regulated market of securities under it.

An additional, very useful modification to the base prospectus regime not yet contained in the draft Prospectus Regulation would be allowing base prospectuses to be supplemented beyond **Article 22** of the draft for any reason, as long as the supplement does not introduce new securities that are governed by a different Annex of the Level 2 Prospectus Regulation. It is not evident why the approval process for supplements should not be sufficient to even include new products in a base prospectus instead of forcing issuers to have several add-on base prospectuses approved. The comprehensibility of a base prospectus when read together with

its supplements is, in any case, the overriding limit to supplements; and with the right of the competent authority under the proposed rules to request a consolidated version of the prospectus as supplemented, any concerns about the comprehensibility of a specific supplement can be addressed. This change would simplify the base prospectus regime and make issuances in the European capital markets even more efficient.

5. Notification

Our understanding of the provisions regarding the prospectus summary is that, in the case of a base prospectus, a summary only has to be drawn up when the final terms are approved or filed; it must be specific to the individual issue (Article 8(7)). With this proposal, it is important to provide further clarification on the notification process (Article 24) and the use of language (Article 25) in respect of base prospectuses.
Legal certainty is needed on how notification of base prospectuses to EU host Member States is going to take place. The current provisions of Article 24 and its unclear distinction between stand-alone and base prospectus could possibly create situations that are dealt with differently in different Member States. It must be avoided that a base prospectus itself and respective annual reports are required to be translated for the notification by host Member States. This would result in very high transaction costs and will stop issuers placing their products across borders, which would jeopardise and, moreover, contradict the CMU's political objective of stimulating cross-border capital flows within the EU.

Article 24(1) further states that the notification has to be made within one working day after the approval of the prospectus. It is already market standard in most jurisdictions that notification is affected on the same day as the approval. This standard should be introduced generally.

6. Summary

Article 7(6)(c) and **Article 7(7)(d)** of the Commission's proposal limit the number of risk factors that should be presented in the summary to five. That will force issuers not only to set verifiable criteria to decide on a maximum of three risk categories (cf. II.3) but also to select five key risks for the summary, each based on their proportionality of occurrence. The implementation of the proposed provision requires issuers to weight risk factors according to a predefined and objectifiable method. It remains vague if ESMA will define such a method on Level 3 and who would be liable for such a method if another, less probable risk determined and not contained in the five key risks materialises.

We welcome the general option provided for in **Article 7(7)** of the proposal of substituting the summarised description of the securities with the key information document for packaged products under Regulation (EU) No. 1286/2014 (PRIIPs Regulation). This option only has any real added value for issuers, however, if these can adopt parts of the key information document required under the PRIIPs Regulation without any further modifications. According to the wording, such an approach does not appear unequivocally possible, as Article 7(7) of the proposal calls for a differently formatted key information section than that under the PRIIPs Regulation. We therefore request clarification on this point or interpretation of "*may substitute the content set out in this paragraph*" in such a way that issuers may also deviate in this respect from the formatting requirements.

7. Threshold for small credit institutions

With **Article 1(2) i)** of the proposal, the EU Commission fortunately still recognizes that – when it comes to smaller credit institutions – a proportionate prospectus regime is required. The provision was originally created in order to exempt smaller credit institutions from the requirement to produce a prospectus. Since the current prospectus regime has been in force, practice has shown that small banks practically cannot benefit from this exemption either, as the EUR 75 000 000 limit is too low:
Since the total value of bonds issued by them is often only slightly higher than the said limit, implementation of this provision meant that smaller credit institutions in Germany faced having to produce prospectuses for their bonds for the first time. In view of the considerable time and significant costs involved in the production of a prospectus, some of these institutions have clearly rolled back their volume of issuances. A significant increase in the limit would be consistent with the declared objectives behind the review of the Prospectus Directive, i.e. reducing bureaucracy. We therefore recommend raising the threshold in order to enable smaller credit institutions to access capital markets in times of low interest rates and increased regulatory requirements, in particular regarding capital ratios. In this context, the role of small credit institutions for financial stability in times of crises should be mentioned. The ability to choose from a wide range of different issuers would also be in the interests of investors or, moreover, the financial market in general.

This exemption should be extended by raising the total consideration for securities offered to less than EUR 150 000 000, calculated over a period of 12 months.

8. National exemption for offers not exceeding EUR 10 000 000

Article 3(2) of the proposal gives Member States the option of exempting offers of securities up to an amount of EUR 10 000 000 from the prospectus requirement provided that certain conditions are met. We have reservations about leaving it up to Member States to decide whether or not to exercise this option. The European Commission has consciously decided to legislate on prospectuses in the form of a regulation. This will enhance coherence and integration in the internal market and reduce diverging national rules (cf. page 7 of the proposal). Leaving such a key area of the regime to the discretion of national legislators flies in the face of these fundamental considerations. And though Article 3(2) applies only to offers made in a single Member State (not to cross-border offers), the home state of the issuer is judged to be immaterial. In our view, therefore, this is not a purely national matter. We see a danger that giving Member States this option will make it impossible to create a level playing field. We would therefore suggest removing the option from Article 3(2) and replacing it with a general exemption from the prospectus requirement, thus establishing a consistent regime across all member states. This is the only way to ensure that small and medium-sized companies throughout the EU will be able to benefit from the EUR 10 000 000 threshold by not having the expense of producing and publishing prospectuses.

9. Offers to existing shareholders of shares for a capital increase

When reviewing the existing prospectus regime, inclusion of an exemption from the prospectus requirement covering offers addressed solely to existing shareholders to subscribe to new shares for a capital increase would be desirable. With the current proposal, we would see these offers falling under the minimum disclosure regime. A prospectus would still have to be prepared and approved by the competent authority. Yet the shareholders who are invited to subscribe to the new issue will have no need for the information in the prospectus: they have

already invested in the type of share in question. With this in mind, an exemption from the scope for such cases would help to achieve the objective of making equity financing more flexible without reducing investor protection in any way.

10. Minimum disclosure regime for secondary issuances

We welcome the approach to set minimum disclosure requirements for secondary issuances in **Article 14** of the proposal and welcome the Level 2 legislation which will develop further details. In this respect, we would like to point out that issuers without listed equity, including issuers whose debt securities are admitted to trading on a regulated market and which fulfil the relevant transparency requirements, are unable to benefit from the minimum disclosure regime in Article 14(1)(b). All options of Article 14 should be applicable to all capital market-oriented companies. We consider the limitation to issuers with listed equity to be disproportionate.

11. Publication of the prospectus

Article 20(6) provides for a new way of publication by ESMA. We welcome such an additional manner of prospectus publication, which would undoubtedly be helpful for investors and would contribute to the CMU objectives. In order to avoid unnecessary costs, and in line with other similar storage obligations for issuers, we would like to suggest using already existing infrastructure like OAM or EEAP pursuant to the Transparency Directive.

Article 20(4), as well as Article 6(4)(b) of the delegated Regulation, stipulate that access to the prospectus will not be subject to (among other things) "*the acceptance of a disclaimer limiting legal liability*". Such provision must not, however, prevent issuers, offerors and financial intermediaries from installing so-called "SEC blockers" on their websites, which a reader has to confirm before obtaining access to a prospectus. This should ensure that only persons from countries in which a public offering is taking place obtain access to the prospectus in order to prevent triggering a public offering in countries where no prospectus has been published.

In addition, when it comes to prospectus publication, we take a critical view of the fact that all prospectuses approved are to remain publicly available for at least ten years on the websites specified in **Article 20(7)**. Alignment in this respect with civil limitation rules in the relevant Member States would be more appropriate.

12. Date of application

Experience with the establishment of Level 2 legislation (e.g. in respect of MiFID II/MiFIR, MAR, CSDR, PRIIPs, etc.) shows that timetables are difficult to adhere to. European legislators have understandable problems finalising the vast amount of Level 2 legislation in the envisaged timelines, which causes problems not only for them but especially for those subject to the new legislation. In order to ease the pressure on European legislators and to give issuers enough time to implement the new Level 2 legislation in their processes, we would strongly recommend a dynamic date of application, which should be 12 months after the entry into force of Level 2 legislation. **Article 47(2)** of the proposal should be modified accordingly. Alternatively, the proposed Level 1 Prospectus Regulation should only apply 24 months after its entry into force.