December 18, 2014

JAC Response to ESMA Consultation Paper: "Draft Regulatory Technical Standards on prospectus related issues under the Omnibus II Directive"

This letter is a response to ESMA's consultation paper published on 25 September 2014 relating to the preparation of draft regulatory technical standards in respect of certain aspects of the Prospectus Directive and the Prospectus Regulation (the "**Consultation Paper**"). The Consultation Paper addresses the four mandates given to ESMA in the Omnibus II Directive on procedures for approval of prospectuses, incorporation of information by reference, publication of prospectuses and dissemination of advertisements relating to offers to the public and admissions to trading.

The Joint Associations Committee on Retail Structured Products (the "**JAC**") welcomes the opportunity for a public discussion of the matters raised in the Consultation Paper. The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved in the creation, manufacturing and distribution within the EU of structured products that are distributed to retail investors. The JAC is therefore well positioned to comment on the subject matter of the Consultation Paper and the issues it raises.

The members of the JAC have not prepared a response to each of the questions raised in the Consultation Paper. The JAC works closely with other trade associations, including the International Capital Market Association (the "**ICMA**"), which is itself a member body of the JAC. A number of JAC members have assisted the ICMA with the preparation of a separate comprehensive response to the Consultation Paper. In order to avoid duplication, we have not sought to re-write or replicate the responses prepared by the ICMA. We have instead addressed our responses to those questions in the Consultation Paper which we feel are particularly relevant to the JAC and the concerns of its members: being, **questions 4-8** and **question 16**. For the other questions, we support the responses provided by the ICMA.

Yours faithfully,

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ANNEX

Section 2: Draft RTS on incorporation by reference

Question 4: Do you agree that the three abovementioned documents constitute the documents which comply with the requirement of being approved or filed in accordance with the Prospectus Directive and from which information can be incorporated by reference? If not, please provide your reasoning.

We do not agree with ESMA's interpretation of the condition in PD Article 11 of the relevant documents having been "approved or filed" in accordance with the Prospectus Directive and the proposed list of documents from which information may be incorporated by reference in accordance with such condition.

PD Article 11 is an edict of the PD co-legislators to the Member States to direct that Member State NCAs "shall allow" information to be incorporated by reference. The rationale for such edict is set out in PD recital 29:

> "*[t]he opportunity of allowing issuers to incorporate by reference documents containing the information to be disclosed in a prospectus – provided that the documents incorporated by reference have been previously filed with or accepted by the competent authority – should facilitate the procedure of drawing up a prospectus and lower the costs for the issuers without endangering investor protection.*"

The mandatory direction in PD Article 11 to the Member States and the positive view of incorporation by reference reflected in PD recital 29 demonstrate the clear intention of the PD co-legislators that incorporation by reference should be facilitated, with the only caveat being that investor protection not be endangered. As CESR noted in its original mandate in relation to PD Article 11:

> "*Therefore, adequately balancing the interests of issuers and those of investors, it should be possible to incorporate as many documents as possible provided that the interest of investors of receiving at no cost an easily analysable prospectus is duly protected*." [paragraph 92, CESR's Advice on Level 2 Implementing Measures for the Prospectus Directive (CESR/03-208)]

We note as well that PD recital 29 speaks of "filed with or accepted by the competent authority" without reference to the Prospectus Directive or the CARD (or the Transparency Directive) or to the "publishing" requirement, implying that these 'conditions' of PD Article 11 were not at the forefront of the minds of the PD co-legislators and therefore should not be considered strictly when interpreting that article.

For these reasons, PD Article 11 should be interpreted broadly, in order to satisfy the legislative intention of seeking to facilitate incorporation by reference, subject only to ensuring that there is no endangerment of investor protection.

The Amending Directive deleted PD Article 10 as it was determined that the obligation to provide the annual information statement is not necessary. The Amending Directive replaced the reference in PD Article 11 to the since repealed CARD with its replacement, the Transparency Directive. These amendments were made for purposes other than in relation to PD Article 11 and were not, as far as we can see, motivated by a desire to restrict the information which may be incorporated by reference. No other changes were made by the PD co-legislators to PD Article 11 or to add a meaning for the term "filed", and no changes were made to the recitals to reflect any change in approach to the permissible scope of incorporation by reference. That being the case, there is no reason to think that the intention of the PD co-legislators as regards the facilitation of incorporation by reference has changed.

If the co-legislators had intended that the deletion of PD Article 10 and the replacement of the reference to CARD with the Transparency Directive should severely restrict the scope of the type of documents from which information may be incorporated by reference, they would have explicitly signalled such change in the legislation. For example, they could have added a definition of "filed". Or, more readily, they could have added

a recital to the Amending Directive acknowledging that the consequence of these changes to the Prospectus Directive would be to severely restrict the scope of PD Article 11. They have done neither.

More broadly, one could ask why would the PD co-legislators change their views on incorporation by reference? We are not aware of investor complaints in relation to incorporation by reference. Nor are we aware of NCAs seeking to clamp down on the practice for investor protection reasons. In fact, as ESMA notes, many (if not most) NCAs specifically permit "voluntary" filing, in order to facilitate incorporation by reference under PD Article 11. We can see no evidence of the PD co-legislators changing their view on the permissible scope of incorporation by reference, nor any rationale why they might have done so.

In our view, the purpose of the mandate to ESMA to provide regulatory technical advice in relation to PD Article 11 is not to reflect any change in approach as to the permissible scope of incorporation by reference, but solely to ensure harmonisation of approach:

> "*In order to ensure consistent harmonisation in relation to this Article, ESMA shall develop draft regulatory technical standards to specify the information to be incorporated by reference.*" [Article 1(2) of the Omnibus II Directive]

Harmonisation is obviously an important goal of the PD regime. In this context, to achieve harmonisation, we suggest to bring in line those NCAs who are interpreting PD Article 11 in as narrow a fashion as ESMA proposes to be consistent with those NCAs who are interpreting the article more broadly, in the manner that the PD co-legislators intended. In particular, with regard to ESMA's focus on the specific meaning of the term "filed" for this purpose, we suggest that such term should be interpreted to mean provided to the competent authority as part of the process of having the prospectus approved as constituting necessary information for the purpose of PD Article 5. The scope of permissible documents should remain as set out in Article 28 of the Prospectus Regulation.

Question 5: Do you believe that specifying the documents which are considered approved or filed in accordance with the Prospectus Directive as proposed in paragraph 87 will impose costs on issuers, offerors or persons asking for admission to trading? If yes, please specify the nature of such costs, including whether they are one-off or on-going, and quantify them.

Specifying the documents which are considered approved or filed in accordance with the Prospectus Directive will restrict the information which is able to be incorporated by reference. As a result, any information which falls outside ESMA's narrow interpretation of what may be incorporated by reference, but which an issuer views as necessary information for the purpose of meeting its disclosure obligations under the Prospectus Directive and Prospectus Regulation, must be set out in full in the prospectus. This will lead to an increase in the overall cost of producing a prospectus: longer documents are more expensive for printers to format, amend and print and including financial information in prospectuses will require greater input from lawyers and auditors in order to provide comfort to the issuer and the underwriters that such financial information has been correctly extracted and reproduced in the prospectus. The level of such fees will vary depending on the extent of the information to be processed and verified as well as factors such as the market in which the prospectus may be used (and therefore the degree of comfort required) and the nature of the transaction.

Such costs would be increased not only at the time of preparation of the prospectus (or base prospectus) but also when preparing any supplement under PD Article 16. By way of an example, current market practice in the context of MTN programmes is for issuers to incorporate by reference interim financial information following publication if such information is considered to meet the "significant new factor" test under PD Article 16. Such a supplement would typically amount to no more than a single page and would often be prepared within a short timeframe (even within a single day). If the RTS are issued in their current form, for a number of issuers (including issuers of wholesale only securities) interim financial information will not fall within the categories of information which can be incorporated by reference with the result that such information would need to be set out in full within the supplement. Aside from any legal and printing costs arising from formatting, amending and

printing a much longer supplement, issuers may be required to deliver a comfort letter confirming the accuracy of the information as well as suffer the opportunity cost of missing a window in the market while an NCA takes additional time in its review of the supplement. This is not consistent with the Commission's own agenda, as set out in the recitals to the PD Amending Directive, of reducing the administrative burdens weighing on participants in the EU securities markets.

Question 6: Do you agree that the abovementioned information constitutes the information which complies with the requirement of being filed in accordance with the TD? If not, please provide your reasoning.

Applying ESMA's strict interpretation of the information which complies with the requirement of being filed in accordance with the Transparency Directive, the list set out in paragraph 92 of the Consultation Paper and in Articles 4(5), (6) and (7) would appear complete. However, applying an unduly restrictive interpretation to PD Article 11 significantly diminishes an issuer's ability to incorporate information by reference.

An issuer that is exempt from the periodic financial reporting requirements under the Transparency Directive may still choose to file periodic financial information with the NCA of the home Member State, for good practice and in the interests of transparency, even if it is not obliged to do so. This practice is commonplace among issuers of wholesale debt securities. Such information should not be treated differently to information filed in satisfaction of an obligation under the Transparency Directive. From a practical perspective, provided such information is equally accessible by investors, there should be no reason why 'voluntary' filings should be treated any differently to filings made under obligation.

We would also suggest that certain of the information included in the Article 4 list only highlights the illogical outcome of applying ESMA's strict interpretation of PD Article 11. We would query the value of applying such an interpretation when its result is to allow issuers to incorporate by reference, for example, the "final offer price and amount of securities filed in accordance with Article 8(1)" of the Prospectus Directive (information relating to a historic transaction which would amount to a handful of words and should not be of any interest to future investors) but to prevent an issuer of wholesale debt securities from incorporating by reference its latest annual or interim financial information.

Question 7: Do you believe that specifying the information which is considered filed in accordance with the TD as proposed in paragraph 92 will impose costs on issuers, offerors or persons asking for admission to trading? If yes, please specify the nature of such costs, including whether they are one-off or on-going, and quantify them.

Specifying the documents which are considered filed in accordance with the Transparency Directive will restrict the information which is able to be incorporated by reference. As described in the response to question 5, this will lead to an increased need to set out information in full in a prospectus which would previously have been able to be incorporated by reference. This will result in an increase in the upfront costs of producing the prospectus as well as any further supplements. Please see our response to question 5 for an analysis of the types of additional costs which will be incurred.

Question 8: Do you consider that there are any other documents that could meet the criteria of being "simultaneously published" from which information could be incorporated by reference?

The term "simultaneously published" should be given its natural meaning, that is, published at the same time as the prospectus. Put another way, it would exclude any documents which are published after the prospectus has been published. As an example, if an issuer announces the publication of a shareholder circular relating to an acquisition in the same notice as publishing a prospectus, the prospectus should be able to incorporate by reference the relevant shareholder circular. Assuming the notice either includes a link to the relevant shareholder circular or specifies where copies are available, investors would be able to access it. Again, we

would suggest that, in limiting the situation where a document may be simultaneously published to the registration document scenario described in paragraph 98, ESMA has applied an unduly strict interpretation of the legislation. The key requirement is that documents may not be incorporated by reference if they are published after the prospectus has been approved.

General observations on draft RTS on incorporation by reference

- Paragraph 70 of the Consultation Paper acknowledges that it is imperative to strike a balance between reducing costs for companies raising capital and ensuring that adequate investor protection is preserved. Recitals (1)-(3) of the PD Amending Directive made further claims towards reducing administrative burdens on issuers whilst maintaining the protection of investors. It is further acknowledged in the Consultation Paper that the principle of permitting issuers to incorporate information by reference in prospectuses generally does not endanger investor protection or compromise an issuer's overriding obligation to present information in an "easily analysable and comprehensible form". Set against this context, it is not clear why ESMA is seeking to reduce the categories of information which can be incorporated by reference to an exhaustive list. This approach by ESMA will mean that prospectuses going forward will be considerably longer than those in the current market, potentially by several hundred pages. The negative effects of this include increasing costs to issuers (as noted above, through added lawyer and auditor time spent verifying the accuracy of the information), impeding deal execution by drawing out the time it will take to prepare prospectuses and supplements, and enhancing the attractiveness of other non-EEA or non-regulated markets which permit more streamlined documentation. Furthermore, while ESMA may be seeking to assist investors by pooling all disclosure in a single document, this may have the effect of rendering the prospectus more difficult to navigate. We do not believe that setting out information in a prospectus which is equally available by clicking through a hyperlink will necessarily enhance investor protection.

- Many issuers will typically incorporate by reference historic annual financial information and latest interim financial information in its prospectus. The exhaustive list of eligible information in Article 4 of the RTS reflects an unduly strict and literal interpretation of the Level 1 principles set out in PD Article 11. A key consequence of the Article 4 list and the basis on which it has been drawn up will be to restrict issuers of wholesale debt securities who are exempt from the periodic financial reporting requirements under the Transparency Directive from being able to incorporate by reference annual and interim financial information in their prospectuses. If ESMA's approach in the RTS is predicated on the belief that setting out information in a prospectus offers greater protection to investors than incorporating it by reference, then in this context the Article 4 list fails in its objective. Prospectuses prepared for institutional and other professional investors to whom wholesale securities are generally marketed will be required to contain historic financial information (for example) in its entirety. On the other hand, as issuers of retail securities are required to file historic financial information with the relevant NCA in the home Member State under the Transparency Directive, such information will fall within the Article 4 list and may thereby be incorporated by reference. Retail investors therefore seem to benefit from less 'protection' compared to professional investors.

- As a result of the more restrictive approach to incorporation by reference and the added costs and administration this will entail, issuers may be discouraged from including certain items of information in its prospectus going forward. This change in approach would have the effect of reducing the amount of information which investors have available to them and upon which they can make their investment decision. This seems to be at odds with the overriding principle of transparency which underpins the prospectus regime in the EEA.

- Those issuers who habitually incorporate by reference filings made under local laws and regulations will also be significantly impacted by ESMA's approach in Article 4 of the RTS to the extent such filings fall outside the Article 4 list. This is particularly the case for non-EEA issuers who wish to incorporate by reference regulatory filings made in their own jurisdiction (for example, US SEC filings). If the additional time and cost required to set out such filings in their entirety in the prospectus

are considered unduly burdensome and provided an issuer believes it can still comply with its obligations under PD Article 5, investors in EEA markets may be required to base their investment decision on an abridged disclosure package compared to investors in the issuer's domestic market. Again, we would query whether this is in investors' interests.

- We would suggest that if ESMA believes its mandate in this area of prospectus regulation is to provide an exhaustive list, such list should not be based on the strict and literal interpretation of PD Article 11 reflected by the current version of Article 4 of the RTS. Issuers of wholesale and retail securities should be entitled to incorporate the same categories of information and this should include annual and interim financial information, regulatory filings or other filings made pursuant to EU, domestic or third country securities laws and regulations.

- PD Article 11 is a directive from the PD co-legislators to the Member States and their NCAs to specifically allow for incorporation by reference. PD recital 29 makes clear that the PD co-legislators regarded incorporation by reference as beneficial in terms of facilitating the drawing up of the prospectus and reducing costs without endangering investor protection. We see no evidence that the legislative intention has changed through the Amending Directive. Therefore, we see no rationale for restricting the scope of documents from which information may be incorporated by reference.

Section 3: Draft RTS on publication

Question 16: Do you believe the proposed measures will enhance the accessibility of electronically published prospectuses? If not, please provide reasoning and/or alternative measures.

In general terms, the proposed measures should enhance the accessibility of electronically published prospectuses. However, we have a number of concerns with the proposed wording of Article 5 of the RTS.

Disclaimers

A key issue is the reference to disclaimers in Article 5(3)(2) of the RTS ("*Access to a prospectus published in electronic form shall not be contingent on … acceptance of a disclaimer"*). As currently drafted, there appears to be an inconsistency between Article 5(2), which expressly encourages the use of a disclaimer in order to make clear who are the addressees of the offer, and Article 5(3)(2) which suggests that including a disclaimer will invalidate publication. It is important to be clear what ESMA means by a disclaimer in each case. Paragraph 126 refers to the practice, apparently followed by some issuers, of including disclaimers in order to limit the rights of any prospective investor or limit the remedies available to him should the publication not comply with the requirements of the Prospectus Directive or be deficient in any way. We agree that this practice should be resisted by ESMA and issuers should not be entitled to disclaim responsibility for due publication of the prospectus under the Prospectus Directive. Article 5(2), on the other hand, refers to the use of disclaimers as a form of investor protection in order to make it clear to whom an offer of securities is made and avoid targeting residents in Member States or third countries where the offer of securities is not intended to take place. In such circumstances, it seems to us that asking an investor to click through a disclaimer screen in recognition of the terms of the disclaimer and the territorial reach of the offer would be a useful means of implementing this protection. Issuers commonly use click-through screens of this type in order to address concerns over directed selling efforts under Regulation S of the U.S. Securities Act of 1933 and follow SEC guidance on the use of websites. In particular, the SEC has indicated that when offerors implement adequate measures to prevent U.S. persons from participating in an offshore internet offer, it would not view the offer as targeted at the United States and thus would not treat it as occurring in the United States for registration purposes. The SEC acknowledges that what constitutes adequate measures will depend on all the facts and circumstances of any particular situation; however, the SEC will generally not consider an offshore internet offer made by a non-U.S. offeror as targeted at the United States if the website includes a "prominent disclaimer" making it clear that the offer is directed only to countries other than the United States.[1] We trust ESMA is not seeking to outlaw these practices which are an important tool in an issuer's efforts to comply with applicable securities laws. As an act of positive agreement, however, clicking through a screen would likely amount to 'acceptance' of a disclaimer for the purposes of Article 5(3)(2).

We assume it is a disclaimer of liability for publication of the type described in paragraph 126 of the Consultation Paper which is in contemplation in Article 5(3)(2) of the RTS. If so, this should be made clear perhaps by adding the underlined words: "acceptance of a disclaimer *of liability for publication*" (or similar) and/or referring to a 'notice requiring acceptance as to who the addressees of the offer are' instead of disclaimer in Article 5(2).

It is imperative that the wording of the RTS does not prevent issuers from continuing to use disclaimers and click-through screens to clearly prescribe the territorial reach of an offer and/or to address applicable securities laws.

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[1] *"Interpretation: Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore"*, International Series Release No. 1125, Securities and Exchange Commission (23 March 1998)

Group websites

Article 5(5) of the RTS provides that, in the case of an issuer that is part of a group, the issuer shall be entitled to use the website of the group for the purpose of electronic publication of the prospectus provided such does not hinder access to the prospectus by investors. Where publication is on the website of the group, the issuer shall inform investors of using the website of the group for the purpose of prospectus publication. It is not clear how this requirement to "inform investors" is intended to work in practice. Corporate and financial institution issuers are almost invariably part of a group but will not normally have their own individual websites. The issuing company may be a holding company, an operating company or a special purpose vehicle. Which of these members of the group is this requirement intended to capture? Furthermore, please could ESMA clarify how issuers should be expected to "inform investors". Informing investors by placing a notice on the group website would be circular. Equally, if an issuer seeks to satisfy this requirement by publishing a notice on a regulated market website, for example, it may as well simply publish the prospectus on that website. We would recommend the deletion of the final sentence of Article 5(5) of the RTS.

It is also unclear how Article 5(5) would operate in the case of an originator or seller in an ABS context where the issuer is an orphan SPV. Would such an issuer be treated as part of the group of the originator/seller?

Use of hyperlinks

The prohibition on the insertion of hyperlinks in a prospectus, save in the case of of documents incorporated by reference, as provided in Article 5(1)(3) of the RTS, is problematic in a number of respects. Circumstances may arise where it is necessary to refer to a website in the prospectus. Certain NCAs currently require the inclusion of a hyperlink to the list of registered and certified credit rating agencies available on the ESMA website in the context of an issuer's disclosure obligations under the Credit Rating Agencies Regulation (No. 1060/2009). In the context of non-exempt public offers, issuers are required to identify in the prospectus how any new information with respect to financial intermediaries unknown at the time of approval of the prospectus is to be published. Consistent with ESMA's own orientation towards electronic publication, issuer's will typically identify a website for this purpose (see Annex XXX of the Prospectus Regulation). An issuer may also wish to include a website reference when identifying how any post-issuance information will be disclosed (see paragraph 7.5 of Annex XII of the Prospectus Regulation). The proposed restriction on including hyperlinks in prospectuses may limit the effectiveness of each of the above provisions, and additional instances may arise in the future.

Again, we would recommend that this restriction is deleted.

General observations on draft RTS on publication

The effects of the ECJ case C-359/12 (the so-called "Timmel case") and its analysis of the issue of document accessibility in the context of PD Article 14 are widely known. That its conclusions have informed certain aspects of the draft RTS relating to the publication mandate is evident both from ESMA's commentary and also the wording of RTS themselves. We would caution, however, against any such attempt to codify the findings of the Timmel case.

In certain respects, an acute awareness of the findings of the Timmel case has produced an unhelpful result in the RTS. For example, the opinion of the Advocate General states that it is incompatible with Article 29 of the Prospectus Regulation to make access via a website to a prospectus subject to conditions such as "requiring registration which involves acceptance of a disclaimer and provision of an email address". It is important to understand, however, that the term "disclaimer" has a number of different meanings to market participants. In the context of the Timmel case, the type of disclaimer was a "comprehensive legal disclaimer which had to be accepted before the viewer could proceed further". Whilst we would agree with ESMA that attempts by issuers to make the acceptance of such a disclaimer a pre-condition to viewing the prospectus should be resisted, the expression of this in Article 5(3) of the draft RTS, and particularly the carry-across of the term "disclaimer", may have a number of unintended consequences. As noted above, it is imperative that the wording of the RTS

does not prevent issuers from continuing to use disclaimers and click-through screens for investor protection purposes (such as by defining precisely the investors at whom an offer is targeted) and also to meet their obligations under international securities laws (such as complying with SEC guidelines on the use of websites). Similarly, in Timmel it was held that a combination of a website registration process, acceptance of a disclaimer **and** the obligation to provide an email address was inconsistent with Article 29 of the Prospectus Regulation and therefore . In Article 5(3) of the RTS, either the completion of a registration process **or** the acceptance of a disclaimer would be sufficient to invalidate publication.

PARTICIPATING ASSOCIATIONS

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ICMA represents financial institutions active in the international capital market worldwide. ICMA's members are located in 54 countries, including all the world's main financial centres. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants including regulatory authorities and governments. See: www.icmagroup.org.

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