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## **THE PROPOSED PROSPECTUS DIRECTIVE FREQUENTLY ASKED QUESTIONS**

- 1. WHY DID THE COMMISSION NOT LAUNCH AN OPEN AND PUBLIC CONSULTATION BEFORE ADOPTING THIS PROPOSAL, AS RECOMMENDED BY THE REPORT OF THE COMMITTEE OF WISE MEN (“LAMFALUSSY COMMITTEE”)?**
- Before making its proposal the Commission’s services benefited from the wide consultation led by the European securities regulators, FESCO<sup>1</sup> (Forum of European Securities Commissions, which is composed of Europe’s top securities regulators, e.g. FSA, CONSOB, COB, BAWE, CNMV, etc. ) a year earlier. All the major European federations involved in the securities markets responded to this consultation (FESE, International Primary Market Association, London Investment Banking Association, Association for Investment Management and Research, ...) as well as individual market participants. FESCO substantially amended their position, following these responses and published a new report in January 2001. Comments on this version were also communicated to and taken into account by the services of the Commission when drafting their proposal. Certain Securities Commissions or stock exchanges also responded individually. In some Member States, the securities regulator organised meetings to gather reactions from interested parties. The consultation paper was published on the FESCO web site and on the web sites of certain securities regulators. The Commission also consulted the Member States in January 2001 in a one day meeting to look at aspects of the forthcoming proposal.
  - Secondly, the text adopted by the Commission takes the fullest account of FESCO’s final text. In fact, the only major difference with FESCO’s document is the obligation, imposed by the Commission’s proposal, to annually update the registration document. This obligation is aimed at giving investors updated information on the issuer (and is incidentally well below US standards).

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<sup>1</sup> FESCO has now been transformed into CESR – Committee of European Securities Regulators.

- **Therefore, the Commission's proposal is the result of two years of substantial discussion with Member States' Governments, Securities Regulators and market participants.**
- The decision to move ahead was prompted by two other important political parameters: firstly, the decision of the heads of State and Government at Stockholm to accelerate the time-scale for a unified securities market; secondly, the need to demonstrate to the European Parliament how the Lamfalussy process would work in practice.
- In accordance with the recommendations of the Lamfalussy Report, the Commission has demonstrated its evident determination to follow a new, open and transparent policy process by launching two internet consultations on the reform of the Investment Services Directive and on the transparency obligations of listed issuers.
- This debate is now passé and fruitless. The proposal has already been adopted by the Commission. What is important now is to concentrate on the material aspects of the proposal that might cause problems to interested parties and try to find balanced solutions.

## **2. WHY DO WE NEED A PROSPECTUS DIRECTIVE?**

Today, despite the fact that the current directives are based on the principle of mutual recognition, the overlapping of "home" and "host" country requirements - notably, the full translation of the prospectus and the possibility for the host country authority to introduce additional requirements - is a major obstacle to cross-border capital raising in the EU. In practice, EU firms conducting cross border business have to comply with 15 different sets of regulations. The current system is rightly criticised as being burdensome, bureaucratic, costly and inefficient.

Therefore the Financial Services Action Plan decided that a reform of existing legislation was necessary. This has been strongly endorsed by the European Council on several occasions.

The prospectus Directive introduces a new concept: the "single passport" for issuers, i.e. the prospectus approved in one Member State will have to be accepted without any further conditions or procedures throughout the EU.

The new system proposed by the Commission is based on two principles: simplification of procedures and high investor protection.

*Simplification of procedures for issuers, notably through:*

- One competent authority
- A single European passport
- A simplified language regime
- A simplification of registration and filing

### *High investor protection*

- The provision of full, appropriate information concerning securities and issuers of such securities to protect investors. It is also an effective means of increasing confidence in securities and thus contributing to the proper functioning and development of securities markets.
- The introduction of enhanced disclosure standards in line with IOSCO (International Organisation of Securities Commissions) standards.
- IOSCO disclosure standards will upgrade the information available for markets and investors and make it easier for EU issuers to offer their securities in third countries, notably the US. US disclosure rules are still more stringent than the ones included in the proposal. It would have been far unrealistic for the Commission to propose lower initial disclosure standards than the ones that exist and have been agreed globally.

### **3. HOW DOES THE PROPOSAL AFFECT SME AND SECOND TIER MARKETS?**

The proposal has been criticised because of fears that the obligation to publish a prospectus and to have it vetted by the competent authority, will have negative consequences on SMEs and on second and third tier markets.

Firstly, it is true that the proposal provides for a single set of disclosure documents, irrespective of the size of the issuer. In line with the policy of international organisations (IOSCO, FESCO), the Commission considers that in order to ensure investor protection and to create market confidence, upgraded information and high level disclosure standards are just as important and necessary for small companies traded on smaller or unregulated markets as for global issuers traded on the official listing. Recent “.com” evidence bears this out.

We believe that a high level of disclosure requirements is a precondition for generating efficient market liquidity. Nowadays, certain European stock exchanges impose more stringent rules on SMEs because of the higher risk profile.

Secondly, existing legislation, such as the prospectus and listing particulars Directives, make no distinction as regards the size of a company.

Finally, it is surely in the interest of “unknown” SMEs to fulfil exacting disclosure requirements in order to attract new investors. Indeed, such requirements have not prevented the development of deep liquid markets for SME stocks in the United States. SMEs are subject to much tougher disclosure rules under US regulations and they have to disclose information on a continuing basis.

This being said, it should be noted that the exact scope of the disclosure obligations, i.e. the precise contents of the schedules will be determined (in *comitology*) through the implementing measures to be adopted once the Directive has been agreed by Council and Parliament. Schedules will have to be adapted to the particularities of the issuer and of the securities offered. Therefore, implementing legislation will allow the adaptation of schedules to the particular needs of SMEs.

#### **4. WHAT ARE THE CONSEQUENCES OF THE OBLIGATION OF SCRUTINY AND APPROVAL OF THE PROSPECTUS FOR THE LIABILITY OF THE COMPETENT AUTHORITY?**

Some have expressed fears that the obligation to scrutinise and approve the prospectus might have negative consequences on the legal liability of the competent authority for the reliability and accuracy of the information provided in the prospectus.

In order to have a common understanding of how the prospectuses should undergo scrutiny by the competent authorities throughout the EU, the proposal foresees that implementing measures on this subject will have to be adopted via the *comitology* procedure. The appropriate level of scrutiny will be defined at that stage and not in the proposal.

On the question of liability of competent authorities, the proposal fully follows the principle of subsidiarity laid out in the Treaties: in other words, this question is left to national law. Therefore the structure of legal costs associated to the drafting of the prospectus and the potential liabilities of the competent authority will depend on national legislation and on advisors' practices on due diligence.

#### **5. WILL THE PROPOSAL RESULT IN INCREASED DELAYS AND MORE COSTS AND BUREAUCRACY?**

No, on the contrary, the new proposal introduces very clear provisions aimed at accelerating offerings and reducing costs and red tape:

- There is for the first time a strict *maximum* delay imposed on the supervisory authority for the scrutiny of the prospectus (15 days for full prospectus, 7 days if only securities note and 40 days for IPO, initial public offerings). The approval could be even faster – that will depend on the efficiency of national competent authorities
- There are also some important new features in the proposed directive, which will contribute to simplify and streamline procedures, notably:
  - In case of multinational offers, the prospectus will only have to be approved by one competent authority and not by all authorities of all Member States concerned, as is the case today.
  - The prospectus will not have to be translated in all languages of the countries concerned by a multinational offer; only a summary note will be translated.
  - The issuer can publish the prospectus in electronic form; this will result in significant cost and time savings.
  - The separation of the prospectus in three different documents, registration document (on the issuer), securities note (on the securities offered) and summary, will have as a consequence, that frequent issuers will only have to draft and publish a new securities note for each new issuance and refer to the previously filed registration document.

- The possibility to incorporate information in the prospectus by reference to other existing, already published information (such as interim accounts).
- The Directive will also offer the possibility to publish one single prospectus where the final offering price will be determined at a later stage. Currently in such a (frequent) case, many MS require two prospectuses (one before the pricing at the beginning of the offer and another one after the pricing and the allotment, once the offer has been closed).

## **6. HOW WILL THE PROPOSAL AFFECT THE EUROBOND MARKET?**

Today Eurobonds are not eligible for mutual recognition; the new proposal will enable Eurobonds to obtain a European Passport. This means that each issuer will only have to publish one prospectus, have it approved once (quickly) and then be able to use the same prospectus in all Member States, which is far from being the case today. The prospectus will allow issuers to address directly retail investors, which is not the case in most Member States, where Eurobond issues are addressed solely to qualified investors.

However, this does not mean that EU legislation will not take account of the specificity of the Eurobond market and its largely wholesale nature. The implementing measures to the Directive, i.e. the precise schedules could impose very much lighter smaller information requirements for Eurobonds. In the course of the Lamfalussy process, the Commission will be seeking the technical advice of European regulators (CESR), market participants and consumers on this important issue.

## **7. WHY IMPOSE THE MANDATORY UPDATING OF THE REGISTRATION DOCUMENT?**

Fears have been expressed that the obligation to annually update the registration document may be too burdensome, especially for non frequent issuers and SMEs.

The proposal clearly differentiates between two cases:

- (1) Non frequent issuers: For “one-off” public offers without listing, the issuer can publish a prospectus in the form of a single document. In such a case there is no obligation of an annual update of this document.
- (2) Other cases: The rationale of this proposal is to impose the updating of the registration document in cases where there is a permanent market for the securities. For such issuers, the proposal will generate numerous benefits and cost reductions:
  - less costs for translations,
  - one approval of the prospectus in a Member State valid throughout the EU,
  - no obligation to publish on paper.

- These benefits have a counterpart, which is the obligation to supply necessary information. This reflects the overriding aim of the Commission's proposal: the need to facilitate cross-border capital raising in a unified financial market while at the same time ensuring adequate investor protection.
- The obligation to update the registration document responds to the need to provide investors with updated, sufficient, timely and clear information about the issuer whose securities they are being offered. It is the same (or less) than US requirements. The Commission considers that this information requirement is by no means too burdensome for companies, because this obligation can be fulfilled by reference to existing, already published documents. Indeed, issuers could use one single document for three different purposes: their annual report, their registration document and their annual accounts and management report according to the 4th and 7th Company Law Directives. We think our provision strikes a fair balance between issuers' and investors' interests.

**8. CAN THE COMMISSION EXPLAIN ITS APPROACH AS REGARDS THE DEFINITION OF THE COMPETENT AUTHORITY?**

According to our proposal the home Member State is the State where the issuer has its registered office (for EU issuers) or the Member State where the securities of the issuer have been admitted to trading for the first time (for third country issuers).

This has been contested, notably for its lack of flexibility.

We believe that our approach has several advantages:

- it is simple,
- it is clear: there is no overlapping in case of multiple listings and of offers addressed to the public of more than one Member State and
- it solves the question of the competent authority for issuers whose securities are offered to the public and admitted to trading without the issuer's consent (which is a frequent phenomenon).

This issue will be the subject of further intense political scrutiny in the Council and the European Parliament.

**9. WHY DOES THE PROPOSAL IMPOSE ONE ADMINISTRATIVE COMPETENT AUTHORITY IN EACH MEMBER STATE? WHAT ARE THE IMPLICATIONS OF THIS RULE FOR STOCK EXCHANGES?**

- Firstly, we need to urgently simplify supervisory structures. The Lamfalussy Committee signalled that one of the important obstacles to market integration is the fact that there are approximately 40 regulatory organisations in the EU, far too many for an efficient and rigorous decision taking. The Committee recommended that there should be one authority per Member State. The Commission was convinced by the conclusions of the Lamfalussy

Report, which has received the unanimous political endorsement of all EU institutions as well as market participants.

- Secondly, we need to avoid conflicts of interest. A fundamental principle of our proposals is that there must be a strict separation between the supervisory body and the markets they are supervising. This separation reflects the new realities of the marketplace – that exchanges themselves are increasingly taking the form of publicly-quoted companies and have their shares traded on exchanges. It is no more acceptable to have a publicly-quoted securities exchange policing rules on prospectuses than to have a publicly-quoted telecommunications company policing rules on telecoms market regulation. In short, this is an expression of the principle that a person cannot be judge and party at the same time.
- It should be stressed, however, that this approach should not be interpreted as a criticism of the quality of work performed by the exchanges, which is beyond doubt. We believe that exchanges should continue to play a key role in the proper functioning of securities markets and in the development of new financial products.
- Thirdly, there is scope for some delegation of powers to exchanges. The administrative authority in each Member State could delegate some powers to exchanges, on condition that ultimate responsibility rested with the administrative authority itself.
- Finally, our proposal does not prevent competition between exchanges. It is true that as regards initial disclosure of information, exchanges will only be able to ask for the information required under the Prospectus Directive. However, exchanges will of course continue to decide whether or not an issuer's securities should be traded on their markets. Exchanges will maintain their own rule books and ask for certain minimum requirements to list companies (such as market capitalisation, minimum turnover, size of the free float, years of existence of the company, etc.). The requirement of high quality standards will thus be an integral part of their branding as quality exchanges. This is the area where competition between exchanges will take place.

#### **10. WILL THE PROPOSAL MAKE TRADING IN US “BLUE CHIPS” MORE DIFFICULT?**

For US issuers who have asked to be admitted to trading on an EU regulated market, the proposal will have no different impact than for any EU issuer.

However, for the frequent case of US blue chips traded on EU regulated markets *without* the consent of the issuer, the directive will impose a prospectus.

The question is who will have to publish such a prospectus. If the US issuer (as will presumably be the case) does not want to fulfil this obligation, the Directive will not prevent the relevant market or the offeror to issue such a prospectus. In the case of US stocks this should not be difficult, as those companies file all the necessary information with the US Securities and Exchange Commission (SEC) and as this information is available on the SEC web-site. Therefore it can be said that the proposal will not render trading in US blue chips more difficult.

## **11. HOW WILL THE PROPOSAL AFFECT PRIVATE PLACEMENTS?**

The proposal is applicable to public offers and to securities to be admitted to trading on a regulated market. In such cases, when there is a solicitation of the public, a prospectus is required. In other cases, placements can be considered as being “private” and will be outside the scope of application of the Directive (i.e. no obligation to publish a prospectus). As regards disclosure obligations, such placements will be subject to national legislation only.

For the first time the directive defines what is to be considered a “public offer” under EU law. It also harmonizes the criteria for determining whether an offer is public or private. An offer is private (i.e. no obligation to publish a prospectus) when one of the following criteria are met: either the securities are offered to “qualified investors” (e.g. banks, investment firms, insurance companies, etc.), or the offer is addressed to a restricted circle of persons (less than 150 for offers concerning one Member State or less than 1.500 for those concerning several Member States) or the minimum required consideration per investor exceeds 150.000 €. These criteria apply whether the investor is a company or an individual person. However, if the securities are going to be listed on exchanges and can be bought by the public at large a prospectus will be required.

Therefore, there will be a clearer division than is the case today, between public offers and private placements. Such definitions will be valid throughout the EU, which will increase the degree of legal certainty for operators.

## **12. DOES THE PROPOSAL ALLOW “BLOCK TRADES”?**

The proposal will of course continue to allow “block trades”.

The question is whether a prospectus will have to be published in such cases. The answer follows the same logic as the regime described under the previous question on private placements.

If “block trades” concern securities already circulating and for which a prospectus has already been published, no new prospectus will be required.

In case of new issued securities, two different situations could arise: If “block trades” are conducted through private placements (e.g. securities are sold to qualified investors), no prospectus will be required. However, if “block trades” are sold through an offer to the public (“public offer” as defined in the proposal), a prospectus will have to be published.

## **13. WHY DOES THE PROPOSAL NOT USE THE EXISTING DEFINITION OF “PROFESSIONAL INVESTORS” OF THE INVESTMENT SERVICES DIRECTIVE?**

Some parties have defended that corporate trading units should be included in the definition of qualified investors, aligning it with the definition of “professional investors” currently discussed in the context of the reform of the Investment Services Directive (ISD).

In the case of the prospectus Directive, the concept of “qualified investor” is used to identify those investors who are capable of judging the merits of a proposed offer of securities without

the need for provision of financial and non-financial information in the form of a public offer prospectus.

It is true that the “qualified investor” definition is narrower than the “professional investor” definition given by the Commission Communication on the ISD. This is because the “professional investor” definition of the ISD will have a completely different scope of application covering a multiplicity of financial services and the relations between financial institutions and their customers (“conduct of business rules”).

The approach followed by our proposal is similar to the existing definition in Rule 144A of the American Securities and Exchange Commission. The Commission thinks that a consistent definition is necessary in the context of global financial markets.

#### **14. ARE US RULES, LIGHTER, SIMILAR OR MORE DEMANDING THAN THE COMMISSION’S PROPOSAL?**

In general, it can be said that the US system imposes more stringent rules on issuers than the proposed EU Directive. Some examples to illustrate this:

- Both US and EU legislation require a prospectus to be published when securities are offered to the public or admitted to trading. However, under the US system all securities offered to the public, whether or not traded on a US stock exchange, have to be registered with the SEC.
- While the definitions of “offer to the public” and “qualified investors” are similar under both regimes, the US regime is stricter than the Commission proposal as regards trading done by qualified investors among themselves. In such a case the Commission proposal does not require a prospectus to be published. Under US rules mandatory registration and a simplified disclosure document are required.
- Under US law issuers offering securities to the public not only have to disclose all significant information (financial information, changes in major shareholdings, price sensitive information such as changes in the management of the company, acquisitions, etc.), but they have to do it on a continuous basis; i.e. when it happens. This is done by filing with the SEC one of the numerous forms for the different kinds of disclosure situations. The EU proposal is less burdensome: it only requires the annual updating of the registration document.
- The Commission proposal allows the incorporation of information to the prospectus by reference to existing, already published documents (e.g. annual accounts). Under US law such a possibility is only accepted for certain types of companies, mainly “blue chip” companies.
- Both under the Commission proposal and under US law the obligation to publish a prospectus applies to all issuers, irrespective of their size and the nature of the securities offered. As is planned by the Commission proposal, under the US regime different disclosure forms require different information to be published taking into account the specificities of the different types of issuers and securities. However, it should be stressed that, notably as regards SMEs, the current US regulations impose much higher standards than existing EU requirements.

- US rules on advertising are also stricter than the ones proposed by the Commission. Advertising is not allowed before and is subject to detailed rules after the publication of the prospectus.
- The Commission proposal introduces the principle of one single competent administrative authority per Member State. The US system is much more centralised: there is one federal administrative authority for 50 US States.
- The Commission proposal requires that the prospectus be approved by the competent authority before publication. The US regime follows a different approach: there is an a priori control for smaller companies but not for “blue chips”. However, the SEC can control a posteriori, which is likely to create more legal uncertainty for the issuer.