International
Capital
Market
Association

ICMA

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris
France

(submitted online at www.esma.europa.eu under the heading 'Consultations')

15 July 2011

Dear Sirs,

Consultation Paper – ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU

The International Capital Market Association (ICMA) is responding to the above.

ICMA is a self regulatory organisation and an influential voice for the global capital market. It represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years. See: www.icmagroup.org.

ICMA is responding in relation to its primary market constituency that lead-manages syndicated bond issues throughout Europe. This constituency deliberates principally through ICMA's Primary Market Practices Sub-committee[1], which gathers the heads and senior members of the syndicate desks of 27 ICMA member banks, and ICMA's Legal and Documentation Sub-committee[2], which gathers the heads and senior members of the legal transaction management teams of 19 ICMA member banks, in each case active in lead-managing syndicated bond issues in Europe. ICMA has also sought feedback from its structured product and asset backed constituencies.

We set out our response in the annexes to this letter and would be pleased to discuss them with you at your convenience.

Yours faithfully,

Ruari Ewing
Director - Primary Markets
ruari.ewing@icmagroup.org
+44 20 7213 0316

[1] http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Primary-Market-Practices-Sub-committee.aspx.
[2] http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Legal-and-Documentation-Sub-committee.aspx.

Annex 1 – Initial remarks

ICMA fully supports the consumer protection aims of the review process and considers that its earlier submissions setting out its suggestions regarding final terms and prospectus summaries (further referred to in Annex 2) addressed the Commission's concerns in this regard. ICMA's suggestions represented a distinct departure from current practice, but sought to do so in a way which made implementation as efficient as possible without detracting from consumer protection goals.

However, the suggestions put forward in the Consultation Paper seem to both be beyond the scope of the Prospectus Directive and fall some way short of striking an appropriate balance between limiting administrative burdens and promoting investor protection. Furthermore, the current proposals, rather than delivering additional clarity for investors, are likely to confuse the disclosure regime, particularly once the PRIPs regime comes into force. This is neither in the interests of investors nor borrowers and runs contrary to the Financial Services Action Plan goals of facilitating liquid and efficient markets.

General concerns in relation to ESMA's current proposals are set out in Annex 2. Fundamentally, the impact of these proposals will be felt far more acutely in some markets than others. The programme issuance model is used for a significant proportion of issuances across a broad range of market sectors, ranging from the vanilla wholesale markets right through to the structured retail markets. It is essential that ESMA considers fully the likely impact of these proposals on each market sector to ensure that the reforms proposed are both necessary and proportionate given the complexity of products issued and sophistication of investors involved. In particular, if the reforms are introduced as proposed, they will adversely impact the wholesale structured products markets without any obvious benefit for investors. Whilst investor protection is clearly a pressing concern in the retail markets, the approaches ICMA has proposed would be more effective and less disruptive to the markets and can be formulated to deliver such protection.

Given the extremely short duration of the consultation, ICMA has had to limit its response to observations only on the general approach taken by the Consultation Paper. ICMA has not included feedback in respect of more detailed elements of the proposals, most notably the categorisation of the PD Regulation annex requirements and the proposed expression of these requirements in the context of the summary. If ESMA elects to pursue the proposals in the form suggested in the Consultation Paper, ICMA would welcome the opportunity to provide more detailed feedback in this regard. For example, certain of these classifications would appear inappropriate in certain contexts and some of the abbreviated/truncated descriptions of the PD Regulation annex requirements for use in the summary appear to be either inaccurate or incomplete.

Annex 2 – General comments

Set out below are a number of general comments on the Consultation Paper.

1. Final terms

1.1 Restrictive approach to final terms inconsistent with the Prospectus Directive

ESMA proposes a highly restrictive approach to final terms. In particular, it suggests that:

- all information that is "knowable" at the time of approval of the base prospectus should be included in the base prospectus (paragraph 28); and
- final terms "are not allowed to amend or replace any information contained in the base prospectus" but such amendment or replacement should instead be included in a supplement (if the change is significant) or a new prospectus (paragraph 35).

This approach is inconsistent with the provisions of the Prospectus Directive and the PD Regulation, which do not require that all the terms of the securities should be included in a prospectus. Rather, they require that the prospectus must contain the information necessary to "enable investors to make an informed assessment of the […] rights attaching to the securities". Equally, the PD Regulation does not require that the prospectus should set out all information on the securities in exhaustive detail. Rather, it describes, in a general way, information on the legal terms of the securities that must be described in the prospectus. There may be (and often are) elements of this information that will not affect an investment decision and therefore do not need to be described in the prospectus. Indeed, omitting these elements may be entirely consistent with the desire to keep the prospectus short, clear and easily analysable. Equally, it is wrong to suggest, as the Consultation Paper does, that whatever is not in the base prospectus must either be included in a supplement (if it is significant) or in a new prospectus (if it is not). The Prospectus Directive clearly states that whatever is not significant (in terms of the investment decision) does not have to be included in a prospectus and indeed should not be included, if its inclusion would make the prospectus difficult to analyse and understand.

ESMA's proposal is also inconsistent with the Prospectus Directive in that it makes no distinction between the different types of investor in the market. For example, the categorisation of information that must be in the base prospectus is applied equally to the PD Regulation wholesale and retail annexes. But Recital 16 to the Prospectus Directive expressly states that, in pursuit of the objective of protecting investors, it is appropriate to "take account of the different requirements for protection of the various categories of investors and their level of expertise". It then goes on to say that "disclosure provided by the prospectus is not required for offers limited to qualified investors". In other words, inclusion of everything in a base prospectus so that it can be approved is less relevant where the buyer is a qualified investor.

ESMA's advice on final terms should, therefore, focus on what is material to the investment decision, rather than on the inclusion in the base prospectus of *all* of the information on the securities that is "knowable" at the date the prospectus is approved. Some elements that are not necessary to an informed investment decision can, according to the Prospectus Directive, be omitted from the prospectus and still constitute information on the securities. Given this, there is no logical reason why such information should not be included in final terms in addition to terms which are not known when the base prospectus is approved (e.g. rates of interest, size of issue). Indeed, there is a practical reason why they should be so included, because the security itself is constituted by attaching the final terms to the global note for the issue and the final terms (taken together with the terms and conditions of the securities) therefore need to contain all of the terms of the issue (including those that are not significant to the investment decision).

1.2 Significant increase in review burden for competent authorities

If the restrictive approach to final terms is adopted, there will be a very significant increase in the numbers of documents requiring approval by competent authorities. Some banks issue 3,000-5,000 structured products in some jurisdictions every year (and one has informed ICMA it issues

as many as 50,000-60,000). If these issues have to be done using an approved supplement instead of final terms (or standalone prospectuses or securities notes), the home state competent authority would have to increase staffing levels very significantly, in order to deal with approvals within the timescales laid down in the Prospectus Directive. These volume constraints are highly likely to result in market disruption and a loss of investment choice for investors (timing delays may result in borrowers missing issuance opportunities altogether in fast-changing markets, particularly in the in the vanilla context). They may even have the effect of driving wholesale securities out of the hands of EU competent authorities if the additional burden of the proposed changes causes borrowers to list outside the EU and offer in the EEA pursuant to an exemption under the Prospectus Directive.

1.3 Restrictive approach precludes the use of final terms to issue into non-EEA jurisdictions

Borrowers may use final terms to issue securities simultaneously into both EEA and non-EEA jurisdictions. Where this is the case, legending or similar wording may be required to comply with regulatory requirements in those other jurisdictions. There should be flexibility in the final terms regime to allow such mandated further disclosure to be incorporated.

1.4 Consolidated conditions

Paragraph 30 of the Consultation Paper says that whatever is included in the base prospectus "cannot be reproduced in the final terms […] The final terms should not be used as a kind of short form prospectus or securities note, where investors would need to only revert to the base prospectus for the information of the issuer". This approach to consumer protection conflicts with that which has been adopted in a number of EU Member States for many years, based on the idea that as far as practicable the investor should *not* receive a document that requires him to refer to another document (the base prospectus) to ascertain what the terms of the securities are. Rather, these laws are predicated on the premise it is easier for an investor to understand the terms of the securities if they are extracted from the base prospectus and set out in full – what you see is what you get. This approach is well established in certain markets and is something that investors in those markets are now familiar with. For this reason, it would seem ill-advised to remove the flexibility to adopt this approach both from an investor perspective (removing a tried and tested disclosure format with which investors are familiar – hence running contrary to the improving consumer comprehension agenda) and from a borrower perspective (placing borrowers in a position where they are unable to comply with consumer protection requirements in a number of EU Member States).

1.5 ICMA alternative approach

As above, ICMA has already suggested an alternative approach to resolve the question of what can, and what cannot be, included in final terms (c.f. item C in the annex to ICMA's 25 February response[3] to ESMA's January call for evidence). This approach has the advantage of meeting consumer protection goals whilst at the same time being consistent with the Prospectus Directive and maintaining market efficiency. This being the case, pursuing this approach would not require a further amendment to the Prospectus Directive.

2. Prospectus summary

2.1 Duplication of requirements with the PRIPs initiative

It is premature to undertake this work in the context of the Prospectus Directive, given that the debate about what form of short form disclosure works best is still on-going in the context of the Packaged Retail Investment Products (PRIPs) initiative. If ESMA is determined to proceed with this work, it would seem essential that at the very least an attempt should be made to ensure that a smooth transition would be possible to any subsequent PRIPs regime. From an investor perspective this is important to avoid a situation in which investors are forced to familiarise themselves with a new regime, only for that to then be subsequently replaced, shortly thereafter by another quite different regime. From a borrower perspective, it seems imperative that there

[3] http://www.icmagroup.org/ICMAGroup/files/ec/ecaca26d-3127-4aa7-9901-2bfe9388fb78.pdf.

be an ability to leverage the work carried out in complying with the new PD regime when borrowers subsequently need to align themselves with the PRIPs requirements (which one assumes would usurp the PD regime). If not, this is likely to result in short term disruption in the markets and a significant increase in issuance costs which will inevitably need to be recouped, at least in part, from investors. From an investor perspective confusion will also arise from an unnecessary amount of changes in disclosure format. Such upheaval, administrative burdens and confusion would be avoided in their entirety if ESMA awaited the outcome of the PRIPs process before finalising its proposals for the summary.

The PRIPs workstream is insufficiently advanced to provide useful direction as to the likely outcome with respect to the more detailed requirements of the PRIPs short form disclosure regime. Nonetheless, certain general themes have emerged (for example, in relation to likely format and length) from both the recent PRIPs consultation and indeed its forerunner in the UCITS market. The proposals in the consultation appear to take a different general course than that seemingly anticipated for PRIPs, with the risk of creating two similar but incompatible regimes. Of most obvious concern is the divergent style contemplated in terms of presentation and length. The requirement that the summary "be written as though [it] formed the body of a letter from the chair, or managing board of the issuer" (paragraphs 99 and 101), combined with the proposed requirement to set out the PD Regulation annex requirements next to the relevant disclosure, would suggest a document at odds with the bullet point 'line item' approach likely to be taken for the PRIPs Key Investor Information document. It is also at odds with the desire to create a short, attractive and accessible document.

In relation to the short form disclosure element of the PRIPs initiative, please refer to the responses of the Joint Associations Committee on Retail Structured Products (of which ICMA is a member) to both the Commission's April 2009 Communication[4] and the Commission's November 2010 Consultation[5].

2.2 Risk relating to conflicting disclosure approach

In relation to the proposal that the summary should not be a "copy-out of text that appears in the main body of the prospectus" but should "be written as though [it] formed the body of a letter from the chair, or managing board of the issuer" (paragraphs 99 and 101), this may cause confusion on the part of investors. The summary must be consistent with the body of the prospectus and it is extremely difficult to say the same thing using different words and a different tone. For example, it would be very damaging to a borrower if an investor interpreted the risk factor in the prospectus itself in the light of a differently worded and necessarily simplified restatement of that risk in the summary. In other words, it is dangerous to require a summary that will "colour" whatever is in the prospectus and perhaps change its meaning in the mind of the investor. It would be wrong to expose borrowers and investors to such a risk of misinterpretation. To do so would be burdensome and only lead to confusion in the markets.

2.3 Proposed purpose, format and content appears to contradict that set out in the Prospectus Directive

The nature of the summary document contemplated in the Consultation Paper appears to be very different to that contemplated in the Prospectus Directive. The Directive envisages a summary document whose purpose is to "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" – effectively an introduction to the prospectus improving its accessibility for investors. On the other hand the Consultation Paper requires a "fresh assessment by the issuer of the key information in the prospectus" tailored to the terms of each individual issuance. In addition there seems to be no basis in the Prospectus Directive for requiring that a new summary – being a version of the one in the base prospectus amended to exclude information that is not directly relevant to the individual issue – be produced for each issue under a programme and attached to the final terms. The precise formulation of wording contained in the Prospectus Directive relating to the purpose of the summary was arrived at after considerable debate as to the proper role of

[4] See http://www.icmagroup.org/ICMAGroup/files/fb/fb5074a6-7c4e-4332-9580-b470071e4ac5.pdf and http://www.icmagroup.org/ICMAGroup/files/80/80edb65a-cf7b-459b-94db-af2de8188461.pdf.
[5] See http://www.icmagroup.org/ICMAGroup/files/d1/d110c3e4-d8a4-4d79-aef9-a8cc71aeb396.pdf.

the summary and more comprehensive formulations were discussed and rejected. Given the careful consideration of this point at Level 1, it seems wholly inappropriate to seek to recast these provisions at Level 2. Even if there were a basis in the Prospectus Directive for requiring such a summary, the production of a summary of this nature will involve significant additional administrative burdens (including extra cost and time delays). This conflicts with the purpose of the programme format under the Prospectus Directive, which is designed to provide “fast-track procedures for issuers admitted to trading on a regulated market and frequently raising capital on these markets” (Recital 23).

The approach taken by ESMA to specify the information which must go into the summary is also inconsistent with an issuer having responsibility for the prospectus (as mandated in the Prospectus Directive), including the summary, and, therefore, having the responsibility to determine what is, and what is not, "key information" for the purposes of the summary.

2.4 Utility of cross references

The proposal to ban the use of cross references in the prospectus summary is puzzling. Provided that cross references are not used in lieu of adequate disclosure, it would seem that carefully selected cross references, to help investors identify sections of the prospectus where they might find more detailed disclosure on points summarised in the summary, only improve accessibility for investors and hence enhance comprehension.