TIME TO MAKE AMENDS

SIMON HILLS OF THE BRITISH BANKERS' ASSOCIATION EXPOSES THE AREAS HE BELIEVES NEED TO BE READDRESSED BEFORE THE PROSPECTUSES DIRECTIVE COMES INTO BEING.

At the end of May the European Commission published a draft Directive on prospectuses. It will have a significant effect on the way in which corporate treasurers access the debt and equity capital markets in Europe.

The need for a new Prospectuses Directive was flagged in the final report of the Lamfalussy Committee, released earlier this year. This group of 'wise men' was established to look at how the implementation of the EU Financial Services Action Plan – which aims to introduce a legislative framework to facilitate the integration of European capital markets by 2005 – could be speeded up. The Lamfalussy Committee recommended that a single prospectus for issuers, with mandatory shelf registration, as well as a single passport, would be key to making it easier for companies to raise funding across European borders. The new Prospectuses Directive will replace the existing listing particulars and securities offerings Directives and help to distil "the remarkable cocktail of Kafkaesque inefficiency that serves no-one", as Baron Lamfalussy put it at the press conference releasing his committee's final report on the European securities markets.

The general objective of the draft prospectuses Directive, which runs to 28 Articles, is to simplify the process of raising capital for all types of companies. It achieves this by allowing an issuer to offer securities to the public in any EU state, once the prospectus has been approved by the competent authority in the home state (the issuer's country of incorporation) without any need for further approval by host states (where the securities are to be sold). The key features of the new system are the:

- introduction of disclosure standards in line with international best practice for the public offering of securities and admission to trading;
- requirement for a registration document system to ensure an annual update of key information about the issuer;
- focusing of responsibility for monitoring in the home competent authority;
- offering or admission to trading of securities in any host state following the simple notification of a prospectus approved by the home state competent authority; and
- allowing the new Committee of European Securities Regulators to put the implementing flesh on the bones on the prospectuses Directive under the comitology process.

The Commission recognises that this new way of working will require a great degree of trust. Individual host state authorities will devolve the responsibility for initial approval and continuing disclosure requirements to the home state, for securities that will nonetheless be sold to their citizens – an emotional tie which, in the past, has been difficult for some European countries to break.

Although the European Parliament has some concerns about the process for approval of the new Directive, the Commission hopes it will be finished by the end of the year – meaning that it will come into effect in member states at the end of 2003. This fast tracking of new legislation, under a process suggested by the Lamfalussy Committee, has a number of benefits, but also means that there is less time for consultation with industry participants. Certainly, the accelerated fashion in which draft legislation has been put forward means that practitioners have a number of concerns about its impact on established market practice, as we will explore further in this article.

IS THE END OF THE QUALIFIED INVESTOR EXEMPTION? The current listing particulars Directive allows pan-European offerings based on a simplified prospectus, as long as sales are made to people who invest in the 'context of their trade, profession or occupation'. While the proposed Prospectuses Directive contains a 'qualified investor buying for own account' derogation similar to the current 'professional investor' exemption, the new definition is narrowly drawn. It will not include for instance large corporations buying bonds as part of their day-to-day treasury management operations, close-ended funds or national central banks. Furthermore, the 'purchasing for their own account' requirement could preclude professional fund managers from buying securities on behalf of their underlying investors and may impede secondary market activity between professionals.

A concept of professional investor should be introduced – doing so will not inflict any appreciable harm to consumer protection

‘COMPETENT AUTHORITIES SHOULD HAVE THE FLEXIBILITY TO APPROVE DOCUMENTATION THAT DOES NOT ENTIRELY FOLLOW THE REQUIREMENTS AS LONG AS, IN THE ROUND, IT DOES NOT MISLEAD INVESTORS’

standards. Not to do so will damage capital market liquidity and prevent the current range of exempted investors from continuing to play their part in the European new issues market.

NO CHOICE OF LISTING AUTHORITY. At the moment, most eurobonds are listed on either the London or Luxembourg exchange. In part, this is because of the familiarity of those exchanges with the listing process and the quick turnaround they offer, and in part because of the familiarity of intermediaries and issuers with the implementing regimes in these two countries. In the future, approval of the prospectus must take place in the home jurisdiction of the issuing company, removing the current element of choice and requiring intermediaries, such as investment banks, to be familiar with at least 15 different regimes.

As a result, investors will be faced with issuing documents that will differ in substance and form, depending on the competent authority approving the prospectus. So an Italian company, wanting to list a eurobond in London, for example, would have to seek prospectus approval from CONSOB, the Italian securities commission, no doubt in Italian, before submitting (a now translated?) approved prospectus to the UK Listing Authority requesting that the bond be listed on the Stock Exchange. Despite the good intentions, this more convoluted process will undoubtedly add to costs and the time to listing. An element of choice must be re-introduced if the European securities market is not to become more, rather than less, fragmented. One approach would be that the rules of the competent authority of the country in which listing was initially sought should apply – in much the same way as they do now.

IS THIS THE DEATH OF THE GREY MARKET? As soon as a eurobond is launched professionals start dealing between themselves in the ‘when issued’ market, although the securities have yet to be physically created and the i’s dotted and t’s crossed in the prospectus itself. Such trading provides important information to investors about the price and demand for the new security and is a central feature of any healthy capital market. However, the new requirement – that a securities note and summary be provided to the competent authority in the country where it is to be admitted to trading before trading is permitted – will close down this important aspect of new issue trading to the detriment of issuers and investors alike. The draft Directive should be amended to permit trading in securities before approval of the offering material by the competent authority. This approval may take some time depending on the authority’s competence in reviewing documents.

WHERE DO MEDIUM TERM NOTES FIT IN? The majority of corporate bonds are now issued under medium term note (MTN) programmes which allow multiple issuers, incorporated in different jurisdictions to access funding under one set of documents and one over-arching guarantee. Often individual issues are privately placed and there is no offer to the public or likelihood of secondary market trading involving ordinary investors. The new proposals requiring each and every issuer under an MTN programme to prepare its own registration documentation and a securities note is a backward step, resulting in increased costs and decreased flexibility.

The draft legislation is silent about the role of the guarantor and what requirements it will be subject to, as well as how non-EU issuers will fare. For instance, it appears that having chosen an initial country of listing, an overseas issuer (which would have to comply with IOSCO standards) could never change their listing jurisdiction again, limiting the flexibility that must be a feature of the most vibrant capital markets of the future.

WHAT ARE THE ONGOING REQUIREMENTS ON ISSUERS? Once an issue is admitted to trading, the prospectus must be updated every year, regardless of whether any new securities have been issued. At the moment, the company’s annual report will suffice, but in the future companies will have to produce a document in line with the Directive’s Annex II, which demands information about the company, its management, ownership and financial results, as well as certain statutory information.

This will impose significant extra accountancy costs that are likely to impinge particularly heavily on small- and medium-sized users of the European capital markets which may tap them only infrequently.

Neither does the Directive allow for lesser informational requirements of second and third tier markets, such as Alternative Investment Market (AIM) or the Neuer Markt. These exchanges are of particular benefit to smaller companies which do not yet feel ready for a listing on a main exchange. Competent authorities should have the flexibility to approve documentation that does not entirely follow the prescribed disclosure requirements as long as, in the round, it does not mislead investors. Conversely, countries or exchanges that wished to compete, perhaps to attract investors wanting higher levels of disclosure, will not be able to deviate from the prescribed norm.

The Directive also overlooks the fact that a security may be admitted to trading by, say, an electronic exchange, without the issuer’s knowledge. Indeed, a bond may trade a few times immediately after issue on Coredeal ‘but never again’. How is an issuer going to know that its securities are trading on an exchange and why should it bear the costs of the regular informational requirements?

LOBBYING FOR A MORE EFFECTIVE DIRECTIVE. The aspirations of the Directive – that the operation of the cross-border capital markets should be improved, that small- and medium-sized companies, as well as more established issuers will have better access to funding and that retail investors will be better protected – are entirely laudable in their own right. However, the Prospectuses Directive as currently drafted will not achieve these objectives. Without change, substantial obstacles will be introduced into the capital raising process to the detriment, rather than the benefit, of the European capital markets. Treasurers should use all the lobbying routes open to them, both at national and European level, to ensure that substantial amendment of the draft prospectus takes place.

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