European Financial Markets Lawyers Group

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EUROPEAN COMMISSION PROPOSAL FOR REVIEW OF REGULATION (EU) 2017/1129 (PROSPECTUS REGULATION) AND FOR REVIEW OF DIRECTIVE 2014/65/EU (MIFID II)

Dear Sirs, Madam,

As you know, the European Financial Market Lawyers Group (EFMLG) is a group of senior legal experts from the EU banking sector dedicated to making analysis and undertaking initiatives intended to foster the harmonization of laws and market practices and facilitate the integration of financial markets in Europe. The members of the Group are selected amongst lawyers of major credit institutions based in the EU active in the European financial markets. The Group is hosted by the European Central Bank.

By means of this letter, the EFMLG hereby wishes to provide its comments about

i) the proposal for review of Regulation (EU) 2017/1129[1] (Prospectus Regulation, PR) (Part 1 of this letter) and

ii) the proposal for review of Directive 2014/65/EU[2] (MiFID II Directive) (Part 2).

[1] Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises (COM (2022) 762 final).
[2] Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/65/EU to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises and repealing Directive 2001/34/EC (COM (2022) 760 final).

Both proposals were published by the European Commission (EC) on 7 December 2022 as integral part of the Listing Act package.

We focus on specific amendments proposed by the EC. We submit to the consideration of the EC our main suggestions in relation to such amendments.

Part 1 – EC proposal for review of the Prospectus Regulation

1. Exemptions

Pursuant to the EC proposal, an exemption will apply:

i) to admission to trading on a regulated market (RM) of securities fungible with securities already admitted to trading on the same RM provided that they represent, over a 12-months period, less than 40% (and not 20% as per the rule currently in force) of the number of securities already admitted to trading on the same RM[3] (same threshold is due to apply to the exemption on shares resulting from conversion or exchange of securities)[4]

ii) and also – innovating vis-à-vis current rules – to an offer of securities to be admitted to trading on RM or SME Growth Market (GM) that are fungible with securities already admitted to trading on the same market, provided that they represent, over a 12- months period, less than 40 % of the number of securities already admitted to trading on the same market[5].

Seemingly, the above-mentioned amendment waters down disclosure rules currently in force in those instances where issuers decide to raise large amount of capital insofar as these latter would not be under the obligation to update sensitive information such as, for example, i) risk factors as well as ii) rationale of their decision and effect thereof on their business activities. It is also worth considering that the amendment at issue is not accompanied by a quantitative threshold expressed in absolute value.

As a consequence, we fear that this amendment may i) reduce the informational safeguards available for investors – which would be deprived of the opportunity to have access to a single document containing all the information necessary for them to take informed investment decisions – and, ii) ultimately, might not be conducive to reinforcing confidence towards EU public markets.

The EC proposal introduces an additional exemption due to apply

i) to an offer of securities fungible with securities admitted to trading on a RM or an SME GM continuously for at least the 18 months preceding the offer of the new securities[6]

ii) or to admission to trading on a RM of securities fungible either with securities admitted to trading on a RM continuously for at least the last 18 months before the admission to trading of the new

3 Amended Article 1 (5) (a) PR under the EC proposal.
4 Amended Article 1 (5) (b) PR under the EC proposal.
5 New Article 1 (4) (da) PR under the EC proposal.
6 New Article 1 (4) (db) PR under the EC proposal.

securities, or with securities offered to the public with a prospectus and admitted to trading on an SME GM continuously for at least the last 18 months[7].

This exemption will apply on the condition that

i) the securities offered to the public or to be admitted to trading are not issued in connection with takeover through exchange offer, merger or division
ii) the issuer of securities is not under insolvency or restructuring procedure and
iii) a summary document (Annex IX) with key information on the issuer and the securities, together with a statement of compliance with reporting obligations is published and filed with the National Competent Authority of the home Member State.

In our view, this second exemption is even broader and more impactful than the first one discussed above insofar as it

i) does not require the new securities must be admitted to trading on the same market
ii) does not prescribe a percentage cap and
iii) provides for a ten-pages summary document as an alternative to prospectus.

With specific reference to this latter point, our concern is that the above-mentioned summary document, due to its length and content, may not be fit for sound due diligence purposes; rather, it risks generating additional liability concerns and making ineffective and, ultimately, more costly the capital raising activities in the EU public markets.

2. Page limit for share prospectuses

Under the EC proposal, a 300-page limit is introduced for prospectuses relating to shares and other transferrable securities equivalent to shares in companies[8].

This specific amendment suggested by the EC raises five main concerns.

First, it amounts to a "one-size-fits-all" solution that may prevent prospectus readers from grasping the peculiarities

i) of each issuer (for example, in terms of size, business sector and model, economic and financial situation, legal and regulatory framework) as well as
ii) of each security.

In our view, these peculiarities should be appropriately and comprehensively disclosed.

We are cognizant that, as per the EC proposal, additional information to be provided where the issuer

i) has a complex financial history or
ii) has made a significant financial commitment

[7] New Article 1 (5) (ba) PR under the EC proposal.
[8] A4-sized paper when printed, presented and laid out in a way that is easy to read and using characters of readable size. New Article 6 (4) PR under the EC proposal.

is excluded from the page limit and is not to be taken into account for this maximum length[9].

That said, we would like to underline that additional cases could materialize where prescribing the above-mentioned page limit risks hindering a complete and accurate representation of the complexities of an issuer business. However, based on the wording of the EC proposal, these cases will not benefit from the above-mentioned carve-out. That would be the case, for example, of large issuers which operate in multiple and/or innovative economic sectors and/or in a plurality of jurisdictions.

Second, it could expose issuers to an increased risk of litigation for omitted and/or inaccurate information. This increased risk may deter access to EU capital markets. In this respect, it should be borne in mind that the differences among EU Member States as to the length of prospectus can be attributed, at least partially, to the differences of their respective legal frameworks as far as civil liability is concerned[10].

Third, that page limit risks reducing the degree of thoroughness and accuracy of due diligence activities and, as an outcome, it may prompt the adoption of not sufficiently informed decisions by investors. This risk and this eventual consequence may be particularly acute for those issuers which, for example,

i) feature complex organizational structures or business strategies,
ii) are exposed to broad and diversified set of risks or
iii) undergo transformational processes of material entity.

Fourth, clearly, the page limit is likely to constrain issuers who attempt to craft disclosure

i) so as to appropriately deal with all specific facts, situations and risks at the time of their capital raising activities on EU public markets and
ii) with a view to maximizing their chances to succeed in their issuance.

Fifth, the page limit cannot be justified easily with the argument of potential cost savings to the benefit of issuers since

i) as per longstanding practice widely spread in the market nowadays, prospectuses are no longer printed and
ii) as per the EC Proposal itself, publication and distribution of prospectus shall be allowed only in electronic format and investors shall no longer be entitled to request paper copy of a prospectus[11].

The concerns set out above also apply, mutatis mutandis, to other parts of the Proposal where page limits are suggested by the EC i.e. i) EU Follow-on prospectus (50-page limit)[12] and ii) EU Growth issuance document (75-page limit)[13].

3. Incorporation by reference

[9] New Article 6 (5) PR under the EC proposal.
[10] Commission Staff Working Document Impact Assessment Report (page 195). Please note that this report mentions, in this respect, the "Peer review report - Peer review of the scrutiny and approval procedures of prospectuses by competent authorities" published by ESMA and dated 21 July 2022 (page 36).
[11] New Article 6 (4) PR under the EC proposal.
[12] New Article 14b (5) PR under the EC proposal.
[13] New Article 15a (5) PR under the EC proposal.

As per the EC proposal, incorporation by reference, as a general rule, will no longer be an option that issuers may avail themselves of. Rather, it will turn into a mandatory requirement, when information is to be disclosed in a prospectus and fulfils specific conditions[14].

In our view, the concrete outcome of this amendment does not seem in line with one of the key objectives the EC intends to pursue by means of its proposal i.e. to simplify i) drafting and ii) understanding of prospectuses by and to the benefit of, respectively, i) issuers and ii) investors.

With reference to the second point – understanding of the prospectus by investors – it is not self-evident that requiring issuers to remove relevant information from the text of the prospectus and to refer to other documents may assist readers in gathering and assessing the whole set of information that contributes to defining the substantive content of prospectuses. Also, incorporation by reference makes in principle the prospectus simpler but the need to look for other documents in order to complete the information contained in it seems to go against the intention of making the prospectus easier to be read and understood.

With reference to the first point – simplifying the drafting by issuers – the amendment proposed by the EC materializes a tightening of the rules currently in force which, in our opinion, appears questionable in the light of evolution of market practice throughout recent years and not synchronized with the latter. As a matter of fact, the option of incorporation by reference was introduced some years ago i.e. at a time where drafting and publication of prospectuses in paper format was still "the rule". Nowadays, almost all prospectuses are electronically published. As mentioned in Part 1 point 2 above, the EC proposal prescribes digital format as the only one allowed. In a context where the variety of users has, by its own initiative i.e. without being forced to do so by a legal requirement, factored in the practice of incorporation by reference, the amendment suggested by the EC seems hardly justifiable, at this stage, based on arguments such as, for example, cost savings to the benefit of issuers or positive impact on the environment. At the end, making introduction by reference mandatory, risks introducing a disproportionate element of rigidity to the detriment of prospectus drafters without any significant benefit or justification.

Part 2 – EC proposal for review of MiFID II Directive

1. Research unbundling

The EC proposal raises from 1 bn EUR (as per the rule currently in force) to 10 bn EUR the threshold of companies' market capitalization[15] below which the re-bundling of trading execution and research fees would be allowed[16]. The above-mentioned proposal confirms the other two conditions, introduced by Directive (EU)

[14] Amended Article 19 (1) PR under the EC proposal.
[15] For the period of 36 months preceding the provision of research.
[16] Amended Article 24 (9a) (point c) MiFID II under the EC proposal.

2021/338[17] ("MiFID II quick fix"), that have to be fulfilled so as to allow investment firms to pay jointly for provision of research and for provision of execution services i.e.:

i) before the execution or research services have been provided, an agreement shall be entered into between the investment firm and the research provider, identifying the part of any combined charges or joint payments for execution services and research that is attributable to the latter[18];

ii) the investment firm is required to inform its clients about joint payments for execution services and research made to third party providers of research[19].

As recognized by the EC[20], after a few years of application, the success of the rules on the so-called "research unbundling" laid down in MiFID II Directive and in Commission Delegated Directive (EU) 2017/593[21] is contestable. Namely, the Commission observes that they have not:

i) contributed to the growth of independent investment research providers and, in particular, of those focused on small and medium enterprises (SMEs)

ii) increased the overall availability of research, especially for small and medium capitalization companies (SMCCs)

iii) allowed to independently price research.

Rather, research coverage has significantly shrunk or even disappeared altogether in Europe, particularly for SMEs and research contracts have become even more concentrated on few intermediaries, mainly the most sizeable ones, to the detriment of local brokers. This EC assessment is broadly confirmed by EFMLG members, based on the information and anecdotal evidence available to them.

We support the objectives that the EC aims at achieving through its proposal i.e. to foster more investment research on companies in EU, in particular SMCCs and to provide these companies with greater visibility and more prospect of attracting potential investors[22].

However, we notice that the EC proposal

i) retains the requirement of unbundling for investment firms i.e. to separate the payments they receive as brokerage commissions from the compensation perceived for providing investment research

ii) confirms the legal architecture established by MiFID II quick fix that allows for bundled payments for trade execution and research exclusively provided that three cumulative conditions are met and

[17] Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis
[18] Art.24 (9a) (point a) MiFID II.
[19] Art.24 (9a) (point b) MiFID II.
[20] Explanatory Memorandum to the EC proposal (page 3).
[21] Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.
[22] Recital 2 under the EC proposal.

iii) amends only one of them i.e. the one related to the threshold of market capitalization below which unbundling rules are not due to apply.

In this respect, we fear that raising the threshold for exemption from unbundling while concurrently preserving the overall legal architecture currently in force could help mitigating but would not effectively contribute to solve the problems emerged throughout the last years as set out above.

For example, the EC proposal confirms the dual-system and the related dual-invoice mechanism introduced by MiFID II quick fix that has already proved itself burdensome under the 1 bn EUR exemption threshold. Paradoxically it may seem, as a consequence of the proposed increase up to 10 bn EUR of the above-mentioned threshold, that this mechanism risks becoming even more inefficient i.e. its costs/benefit ratio is likely to lean even more towards costs, due to the reduced scope and number of above-the-threshold issuers.

These observations provide, in our view, a strong case in favor of an outright repeal of unbundling, which would constitute the first best option for EFMLG Members. Nevertheless, we concede that this option could amount to a radical change of approach after a relatively short time span since the unbundling rules have started applying.

Therefore, the EFMLG could also support, as a sub-optimal alternative, the increase up to 10 bn EUR of the cap to allow joint payments provided that this marks a first step towards a comprehensive review, in the next EU legislature, of the rules governing such a critical topic.

Please do not hesitate to contact me should you have any questions on the EFMLG suggestions contained in this letter. In the meantime, I thank you in advance for your consideration of these suggestions.

Yours faithfully,

Fernando Conlledo

Vice Chairman of the EFMLG