

Consultation on the review of the Prospectus Directive

Submission from the Association of Investment Companies

The Association of Investment Companies (AIC) welcomes the opportunity to respond to the European Commission's consultation on the Prospectus Directive.

The AIC is the trade body representing some 350 closed-ended investment companies, the vast majority of which are listed on the London Stock Exchange. Our Members are closed-ended funds that invest in a portfolio of assets, including shares listed on EU regulated markets, to provide shareholders with an investment return. Investment companies have an interest in the impact of the Prospectus Directive as both issuers and investors.

General comments

The AIC continues to support the main objectives of the Prospectus Directive, that is ensuring investor protection and market efficiency. Investors should be provided with sufficient, accurate information about the issuer and the relevant financial instruments to allow them to make informed investment decisions. The AIC's response to the specific consultation questions are set out below.

Our key **recommendations** are that the Commission should:

- remove the requirement to produce a prospectus when companies issue shares identical to those already trading in the secondary market
- allow issuers to publish a form of "Key Investor Information" document for retail investors as an alternative to producing a summary to the full prospectus
- delete the requirement for issuers to publish an annual information update as sufficient information is already required under the Transparency Directive
- increase the threshold below which a prospectus is not required from €2.5m to €10m of the total consideration of the offer, and introduce a form of 'mini-prospectus' for offers between €10m and €25m
- raise the ceiling for the exemption from producing a prospectus for admission to trading from 10% to 20%.

Response to consultation questions

General assessment of the Prospectus Directive

Do you agree with the Commission services' preliminary assessment of the functioning of the Prospectus Directive?

The AIC **agrees** with the general view that, on the whole, the Prospectus Directive has created a regime which has a "*harmonised and coherent structure of disclosure requirements*". However, there are specific areas of

the Prospectus Directive which need to be adjusted to increase investor protection and to reduce unnecessary administrative burdens on companies. For example, there are certain circumstances in which the production of a full prospectus is unnecessary. An exemption should be introduced when new shares are offered which are identical to those already in issue, for example in the case of a rights issue (see response on “rights issues” for further discussion).

The AIC is also concerned about the complexity and length of disclosures required under the Prospectus Directive. In many cases, the regulations fail to result in a document which contains relevant information, in a user-friendly format, which allows retail investors to make informed investment decisions. Instead, prospectuses are often complicated, overly-long and fail to highlight the key information likely to be of most use to investors. A good illustration of this are risk warnings, where ‘boilerplate’ disclosures make it more difficult to identify the critical issues investors should focus on (see discussion on “liability” for further details). There are also areas of the Prospectus Directive, notably the annual information update requirement, where costs and resources are wasted on producing unnecessary information.

The AIC’s position is discussed in more detail below. It is encouraging that these issues have been highlighted by the Commission in the consultation paper and that views are being sought on appropriate action.

We **agree** with the Commission’s statement that legislative amendments should only be made where they are “*necessary and sufficiently evidence-based as well as subject to a thorough impact assessment*”. This will ensure that appropriate solutions are implemented to address real issues in a way which ensures that the benefits outweigh the costs.

Article 2(1)(2) – Definition of qualified investors

Do you agree with this analysis? Do you agree with the change proposed in Article 2.1(e) of the Prospectus Directive?

The AIC **agrees** that the proposal to align the requirements of the Prospectus Directive with the categories of clients applied by MiFID is sensible. Simplification of the rules will help to reduce administrative and compliance costs for companies. The AIC has no comments on the details of the proposed change to Article 2.1(e).

Article 3 – Exempt offers

Do you agree with this analysis? Do you agree with the change proposed in Article 3.2 of the Prospectus Directive?

The AIC **agrees** with the change proposed in Article 3.2 of the Prospectus Directive.

Article 4 – Exemptions for Employee Shares Schemes

Do you agree with this analysis? Do you agree with the change proposed in Article 4(1)(e) of the Prospectus Directive?

The AIC has no comment on this issue.

Article 10 – Information

Do you agree with this analysis? Do you agree with the removal of Article 10 of the Prospectus Directive?

The AIC **agrees** with the analysis provided in the consultation paper and **agrees** that Article 10 should be deleted. The Transparency Directive requires companies to produce a large amount of periodic financial and other regulatory information to the market. This information is readily available to investors. It is unnecessary for issuers to be required to provide an additional annual document containing or referring to all information published in the preceding twelve months. Deletion of Article 10 will remove an unnecessary administrative burden for companies and is a very welcome measure.

Article 16 – Supplement to the prospectus

Do you agree with this analysis?

The AIC **agrees** that technical queries in relation to Article 16 should be addressed at level 3.

Do you agree with this analysis? Do you agree with the change proposed in Article 16.2 of the Prospectus Directive?

The AIC **agrees** with the objective of harmonising the time frame for the exercise of the right of withdrawal following the issue of a supplement. This will remove uncertainty with regard to the relevant withdrawal period for cross-border offers.

However, to achieve harmonisation across Member States, the Prospectus Directive needs to contain a maximum time period. The proposed text for Article 16.2 of “*within at least two working days after the publication of the supplement*” will not achieve a common period as Member States would still be able to implement a period of two days or more. The AIC **recommends** that Article 16 is amended to include a maximum time frame.

Modification of thresholds

Do you agree with this analysis? Do you agree with the change proposed in Article 2(1)(m)(ii) of the Prospectus Directive?

The AIC has no comment to make regarding the proposed change to Article 2(1)(m)(ii).

The consultation paper states that *“the evidence collected during the review seems to suggest that at this stage most of the thresholds in the Directive are actually workable and efficient”*. Specific reference is given to the 10% ceiling in Article 4(2)(a). There is an argument for removing the requirement for a prospectus when shares are admitted to trading and acquired by a professional investor. A prospectus will be required in any event if a public offer is made (which is when the need for regulatory protection arises). However, we recognise that such a step may be too ambitious at this stage. Therefore, in line with the objective of this consultation to reduce administrative burdens whilst at the same time maintaining high standards of investor protection, we would ask the Commission to consider raising this threshold. We **recommend** raising it to 20%. This represents a suitable compromise and will increase flexibility for capital raising without diluting standards.

Disclosure obligations: the prospectus and its summary

Do you agree with this analysis? Do you have any suggestion in this regard?

The AIC **agrees** with the Commission’s concern that the correct balance is not being achieved between providing all the necessary information to allow investors to make an informed decision and, at the same time, ensuring that the prospectus is comprehensible and user-friendly. Prospectuses produced under the Prospectus Directive are lengthy documents and often include ‘boilerplate’ statements which make them less useful to investors.

This is particularly an issue with regard to the use of prospectuses by retail investors, who may not have the experience and knowledge to analyse the detailed disclosure requirements. There is a danger that they are not able to select the important factors from the full range of disclosures and identify those that would have a real impact on whether they choose to invest or not.

One example can be seen in relation to risk warnings. These disclosures have become significantly longer not because the issuer is facing more risks, but because the process of preparing information under the Prospectus Directive had led to more risks being included (see comments on liability). Often standard risks are presented, such as “the company may not achieve its business objectives”, which, although true, could relate to any type of issuer and fail to communicate specific information about the company. Consequently, retail investors may disregard the risk factors in their entirety, concluding that they are disclosed for purely legal reasons, rather than to set out the genuine risks facing the company. In turn, useful and relevant information may be overlooked.

Retail investors should be presented with sufficient information in an appropriate format in order to make informed investment decisions. This is a particular issue for the AIC as, across the industry as a whole, about half the shares issued by investment companies are held by retail investors. Venture Capital Trusts, which form part of our membership base, are almost entirely owned by retail investors.

The summary section of the prospectus is designed to ensure that the detailed disclosures are more easily understood by retail investors. However, in practice, we are unconvinced it meets their needs.

The AIC welcomes the Commission's decision to consider suitable alternatives. The "Key Investor Information" (KII) approach could provide a suitable starting point for designing an alternative document tailored to the particular needs of retail investors. This format could be particularly suitable for retail investors of investment companies as UCITS funds are not dissimilar in purpose to investment companies. However some modifications to the UCITS model are likely to be necessary to ensure the output is appropriate to the needs of retail investors buying shares in other sectors.

More specifically in relation to the UCITS framework, retail investors of investment companies would welcome a short non-technical document along the lines of a "Key Investor Information" document which clearly sets out, amongst other things, the investment objective, details of the investment policy, past performance (if relevant), costs, dividend policy, relevant risks as well as information about the financial instruments. The new regulations would need to strike the right balance between prescribing a standard format, which helps investors in making comparisons, and providing issuers with sufficient flexibility to tailor the contents to the specific circumstances of their company. The document could be in the style of a factsheet and should only contain information which is considered essential for retail investors to make an informed investment decision.

However, the KII approach should only be adopted if it is an alternative to producing a summary. An issuer should not be required to produce both a summary and KII or it will simply increase costs and administrative burden for no purpose. After all, institutional investors should be able to use the prospectus in its long format. The AIC **recommends** that any KII document is allowed as an alternative to the requirement to produce the summary section within a prospectus. As well as reducing costs and providing necessary information, this will also ensure that there is no duplication, which could lead to increased confusion.

Disclosure obligations for small quoted companies

Do you agree with this analysis? Do you support any of the two alternative solutions mentioned? Do you have any other suggestion?

The AIC **agrees** that the threshold of €2.5m should be raised, and would **recommend** that a level of €10m is introduced. This will provide more opportunity for smaller companies to raise capital without the need to produce a costly prospectus.

Smaller companies, for example Venture Capital Trusts, currently take advantage of the €2.5m exemption for their fund raising, and would benefit from considerable savings if the exemption is raised to €10m. The costs

involved in producing a full prospectus (engaging a sponsor, listing authority fees, legal costs, costs of other advisers, printing and postage costs etc) mean that it is uneconomical for them to raise funds below this level.

In addition, Venture Capital Trusts are cautious about initiating an expensive fund raising exercise which, particularly in the current environment, might prove difficult to fill. Carrying out larger and less frequent fund raising is also risky given the size of companies in this sector, as they would have to wait until cash resources are relatively low before seeking to raise funds, leaving the company exposed if the fund raising was unsuccessful. By increasing the threshold to €10m, smaller companies would be able to raise funds below this level on a more cost efficient basis.

We estimate that the average cost of producing a prospectus for an investment company is between €220,000 and €250,000. If €10m is raised, this represents some 2-3% of gross proceeds. If the costs are much higher then it makes it much harder for an investment company to raise funds. This means that the minimum level of fund raising for a transaction to be economically and commercially viable is between about €7m and €11m. By raising the exemption threshold to €10m, which falls between this range, investment companies could benefit from considerable cost savings.

The AIC also supports the concept of introducing a form of 'mini-prospectus' for smaller companies. This approach could be adopted in addition to raising the exemption threshold by creating a two-tier approach. For example, if the threshold is increased to €10m, then a 'mini-prospectus' could be applied to offers between €10m and €25m. Although this may make the regulations slightly more complex for smaller companies, they would benefit from cost savings and reduced administrative burden due to a lighter-touch regime.

Disclosure requirements and Government Guarantee Schemes

Do you agree with this analysis?

The AIC has no comment to make on this issue.

Rights issues

Do you agree with this analysis? Do you have any other suggestion?

The AIC strongly **agrees** that an exemption from producing a full prospectus should be available when companies are issuing shares identical to those already trading in the secondary market. In this scenario an investor already has access to a vast amount of publicly available information, including the annual report and accounts and other regulatory announcements required under the Transparency Directive, to make a decision about whether or not to buy equivalent existing shares. There is no reason why purchasers of new shares need different information from those buying identical shares on the secondary market and issuers should not be obliged to produce a full prospectus when identical new shares are issued. Investment companies

would benefit from a significant reduction in their administrative burden and compliance costs if an exemption is introduced.

The AIC **recommends** that the exemption should apply in all circumstances that identical shares are issued – not just rights issues and open offers. One example in the UK of such a situation is the resale of treasury shares. Investment companies are able to buy back their shares and hold them ‘in treasury’ for possible future sale, instead of having to cancel them. Under the Prospectus Directive, an investment company must produce a prospectus when these shares are re-sold, even when identical shares remain available on the secondary market and those are subject to the information disclosure requirements under the Transparency Directive. The Commission should ensure that any exemption is extended to other relevant situations such as this.

The AIC **agrees** that an exemption should only be provided on the condition that “a document is available containing information on the reasons for and details of the offer”. This is important information which investors need when making investment decisions. It could be collated in a relatively short document and distributed in place of the full prospectus.

Article 2(1)(d) – Definition of offer of securities to the public

Do you agree with this analysis?

The AIC **agrees** that the definition of securities to the public should not be changed, and that inconsistent transposition in individual Member States should be dealt with through enforcement.

Liability

Do you agree with this analysis?

The harmonisation of liability is an important issue and inconsistencies between Member States can create legal uncertainties and risks for investors. This is an area which is fundamental to the attractiveness of the EU as a listing platform for both issuers and investors. The AIC would strongly **recommend** that the Commission reviews the liability regime to identify areas where improvements can be made and with a view to creating a harmonised approach amongst Member States. The review should focus on the Prospectus Directive as a priority. The AIC is keen to be involved in any future debate on this issue.

Equal treatment of shareholders

Do you agree with this analysis?

The AIC **agrees** with the analysis that issues relating to the equal treatment of shareholders, although extremely important, should fall outside the scope of this consultation.

Conclusion

We would welcome the opportunity to contribute to any further debate on these issues and to comment on proposed rule changes.

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To discuss the issues raised in this paper please contact:

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