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More Union for the EU's IPO market

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An EU-wide market for initial public offerings, or IPOs, is vital to allow a Capital Markets Union to emerge. A single procedure for approving a prospectus should permit companies to raise capital throughout the EU. The latest draft prospectus Regulation, published on 30 November 2015, goes somewhat further than the European Commission has previously entertained, but it does not create a European market. The Commission is hostage to its own (or member states') unwillingness to expand the powers of the European Securities and Markets Authority (ESMA) to become an EU-wide listing authority. The Union that the EU wants to create for capital markets still seems a distant ambition. The ongoing merger talks between the two largest European exchanges suggest how far markets are ahead of the regulatory framework.

A prospectus should disclose essential information to investors to allow them to make an informed decision about an issue. It should bring the interests of issuers and investors together, by obliging issuers to provide accurate and relevant information about the company in order to allow the investor to make a correct assessment of the value of the issue.

The main novelty of the new draft is that, unlike the previous regimes, it is a regulation, and hence directly applicable across all member states, and it also introduces two new regimes: no prospectus for IPOs below €500,000 and a light regime up to €10 million for SMEs. This comes close to addressing the problem that the cost of producing a prospectus for many firms is disproportionate to the proceeds of an offer. But this exemption only applies for domestic offers for which no EU-wide passport notification is sought.

Notwithstanding 25 years of harmonisation of financial market regulation, the primary issuance of securities is still very much a national matter throughout the EU. A myriad of factors have kept the primary issuance of government bonds, corporate debt or IPOs for retail investors a local activity, with the exception of blue chip corporations. The main purpose of the current review should be to facilitate the raising of capital in a European-wide context.

The 2003 prospectus Directive, which was part of the Financial Services Action Plan, unified the various previous directives in a single EU legal document under maximum harmonisation disclosure requirements. It specified that a prospectus should be composed of the following three elements, under the tri-partite regime whose structure is maintained in the draft Regulation:

1) *Registration document* containing general information about the issuer and its financial statements, which is to be updated each year (Art. 9 draft regulation);
2) *Base prospectus*, with details about the securities offered and the modalities of the operation (Art. 8) and
3) *Summary note* containing the main items of the first two elements (Art. 7).

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The 2003 Directive was especially successful in creating a single regime for large issuers, although uneven implementation was seen in some member states, according to the Commission in the draft Regulation. A hallmark of the 2003 Directive was the introduction of a unified language regime for the prospectus, consisting of the local language of the country of issuance and a language customary in international finance, i.e. English, for the Union-wide validation of prospectuses. The Directive was amended in 2010 to reduce administrative requirements for small issuers, frequent issues by banks and secondary issuances. The proportionate disclosure regime, however, was hardly used.

A further review of the prospectus Directive was singled out in the Capital Markets Union Action Plan as one of its early and high-priority actions, but the ambition of the review is too limited. The Directive is turned into a Regulation, and a special regime or exemption from the obligation to publish a prospectus is introduced for SMEs and for frequent issuers. However, as also noted above, the SME regime only applies to issues below €10 million and is not an EU regime, but rather a national regime that is not subject to mutual recognition. Hence, rather than unifying markets, it further fragments them. The draft also does not apply to issues below €500,000 and for offers of securities addressed to qualified investors, defined as investors who each acquire (debt) securities for a total consideration of at least €100,000.

Another element hindering the formation of the Capital Markets Union is the notification procedure (Art. 24). As presently drafted, an issuer for a pan-European IPO has to notify possibly 30 member states (EU-28 + EEA-3, minus 1, being the home country that authorises the notification), and eventually translate the summary of the prospectuses into as many languages, as well as ESMA.

The prospectus approved by the home member state should be valid for the offer to the public or the admission to trading in any number of host member states, provided that ESMA and the competent authority of each host member state are notified in accordance with Art. 24. Host member states should not undertake approval, although they may superimpose marketing rules. The same procedure applies for the supplements. In the context of the CMU, a single notification to ESMA should have been proposed, and should be considered sufficient for an offer to have EU-wide validity. Imagine how outdated the practice of notification must seem for pan-European exchanges that want to create a European market for securities. It should be remembered that already in the context of the discussions on the 2003 Directive, the then German Finance Minister Hans Eichel proposed a *single prospectus agency* for issues. More than 10 years later, it seems that this is still not on the cards.

The only additional task for ESMA, apart from the drafting of regulatory standards, is to develop an online storage mechanism for approved prospectuses and a peer review of procedures for the scrutiny and approval of prospectuses by national authorities. Such an online storage mechanism would certainly be useful, but it remains to be seen whether the means proposed in the annex to the draft Regulation, about €1.5 million in 2017 and in 2018, will be sufficient to allow ESMA to put this in place.