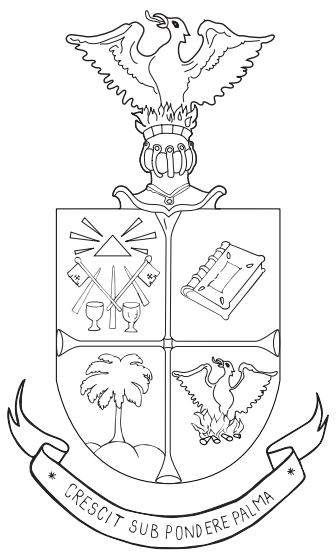
Karoli Mundus I.

Karoli Mundus I.

edited by:
Osztovits, András



Budapest, 2021
Károli Gáspár Református Egyetem Állam- és Jogtudományi Kar

Kecskés, András[1] **– Halász, Vendel**[2]

The Most Important Changes in the European Regulation of IPO Prospectuses

1. The role of prospectus documents in IPO transactions

Initial public offering *(IPO)* refers to the process by which the shares of a company are publicly offered[3] for the first time[4]. This can happen by selling newly issued shares (*primary shares*) or by the public selling of the shares that have previously been privately offered (*secondary shares*). In Hungary, a public offering is a sale offer of securities aimed at investors not specified previously, which includes sufficient information on the conditions of the offer and on the securities in order to facilitate the decision-making of potential investors.[5] Because this is the first time that the company's shares are offered publicly to the community of investors, those who intend to purchase/subscribe to those shares cannot be made aware of the capital market performance of those shares; there is no stock market presence and therefore no data. To ensure investor confidence, comprehensive information is needed on the investment opportunity and the company. This is why prospectus documentation is important during an initial public offering. In the course of an initial public offering, the prospectus is the primary informational and marketing document for investors. In fact, the issuer tells the story of the company (and that of the security) in this document.[6] It contains all the information that might be necessary for potential

1 Associate Professor, Department of Economics

2 **

3 See GRIFFITH, Sean J.: *Spinning and Underpricing – A Legal and Economic Analysis of the Preferential Allocation of Shares in Initial Public Offerings*, Brooklyn Law Review Vol. 69. Issue 2. (2004) p. 585

4 See UTSET, Manuel A.: *Producing Information: Initial Public Offerings, Production Costs, and the Producing Lawyer,* Oregon Law Review Vol. 74. Issue 1. (1995) p. 280; GRIFFITH, Sean J.: Spinning and Underpricing – A Legal and Economic Analysis of the Preferential Allocation of Shares in Initial Public Offerings, Brooklyn Law Review (2004/2) p. 585.; KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC – LexisNexis, Budapest-Wien, 2013.) p. 25.

5 See DR. TOMORI, Erika: *Értékpapírjog és a tőkepiac szabályozása* (Közép-európai Brókerképző Alapítvány, Budapest, 2008) p. 168; Article 5 paragraph (1) point 94. of Act CXX of 2001 on capital markets

6 See GEDDES, Ross: *IPOs and Equity Offerings* (Butterworth-Heinemann 2008) 95

investors to make a decision regarding the investment.[7] During its preparation, it also has to be taken into consideration that the prospectus must comply with the rules of the stock exchange where the securities are to be listed. For issuing shares on foreign markets, it is advisable to prepare the prospectus in the language used in the international financial sector.[8]

In principle, each state, securities commission and stock exchange has its own regulation concerning the content of the prospectus. At the same time, each has similar characteristics. In 1998 the *International Organization of Securities Commissions (IOSCO)* released its own international disclosure standards *(International Disclosure Standards)* in order to promote cross-border offerings. The standards are intended to guarantee the comparability of information and high levels of investor protection. As for the content requirements of the prospectus, ten different categories are indicated. The order and organisation of information can be changed, but each item must be incorporated. This is important, because the effective European Union regulation on prospectuses is also founded on the above standards with regard to the content requirements.[9] The prospectus is indispensable during the IPO transaction for three reasons. First, it is a statutory obligation to prepare one; second, it is an essential marketing tool; and third, an accurate prospectus reduces possible liability arising from misleading investors. As such, it has to fulfil several functions. As it reduces the liability of the company's management, it should be sufficiently long, yet to-the-point.[10] Nevertheless, its marketing function should not be neglected during its preparation, either.[11]

The disclosure of the prospectus provides potential investors with the necessary data in order to evaluate the securities.[12] It gives an accurate picture of the shares

7 See GEDDES, Ross: *IPOs and Equity Offerings* (Butterworth-Heinemann 2008) 54; KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC – LexisNexis, Budapest-Wien, 2013.) pp. 25-27., 69-71.

8 See KECSKÉS, András: *The European Regulation on Drafting Prospectuses in Initial Public Offering Transactions*, JURA 21: 1 pp. 56-66., 11 p. (2016)

9 See GEDDES, Ross: *IPOs and Equity Offerings* (Butterworth-Heinemann 2008) 95–97

10 See SZUCHY, Róbert: *A gazdasági társaságok társadalmi felelősségvállalása* In: Szalma, József (szerk.) A Magyar Tudomány Napja a Délvidéken, 2013 Újvidék, Szerbia: Vajdasági Magyar Tudományos Társaság, (2014) 287-307 old.

11 See GEDDES, Ross: *IPOs and Equity Offerings* (Butterworth-Heinemann 2008) 95–97; KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC-LexisNexis, Budapest-Wien, 2013) 69-71.; KECSKÉS, András: *The European Regulation on Drafting Prospectuses in Initial Public Offering Transactions*, JURA 21 : 1 pp. 56-66., 11 p. (2016)

12 See SPINDLER, James C: *'IPO Liability and Entrepreneurial Response'* (2007) U Pa L Rev Vol 155 1187, 1195–1201

offered for purchase, the financial situation of the company and its capital structure. It contains the description of the company's business activity and the presentation of the business results from the last period.[13] The compilation of these data is primarily the task of the issuer and the investment service provider acting as lead bank. The basis of the prospectus is the information reviewed and compiled in the course of the *due diligence* investigation. The consultants of investment service providers participating in the transaction also review and complete the prospectus[14], and auditors check all of its statements of financial relevance, and confirm their accuracy (this is known as a *comfort letter*). The legal advisor assists in the preparation of the document and identifies and addresses potential liability issues.[15]

The legal advisor also reports on whether the prospectus can be regarded as complete, and whether the data included in it are accurate.

On the other hand, the prospectus has a significant marketing role as well. It is advisable that it makes a favourable impact and promotes purchase intentions. It therefore contains the strategy of the company and its investment activity; it also indicates the position of the company within the industry. Preparing the prospectus is an important and time-consuming element of the IPO process. The full length of a prospectus might even be 300–400 pages. Accordingly, one must devote sufficient time to its preparation in the timetable of the transaction. This might last for one or two months depending on the company and the amount of data to be processed. As was pointed out previously, the issuer, his legal advisor, the auditors and investment service providers also take part in preparing the prospectus. Conflicts of interest may arise between issuer and the underwriter during an IPO, which is why Nasdaq requires an independent investment bank to be used as an advisor.[16] The drafting of a prospectus document requires considerable experience in order to find the delicate balance between the different functions. On one hand, it has to meet legal requirements and the regulations connected to listing; on the other hand, it has to function as an effective marketing tool as well.[17]

---

13 See GEDDES, Ross: *IPOs and Equity Offerings* (Butterworth-Heinemann 2008) 95

14 See COKE, Michael: *'Success in the Form of an IPO: A Brief Case Study of A123 Systems, Inc.'* (2009) Nanotech L & Bus Vol 6 513, 519

15 See KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC-LexisNexis, Budapest-Wien, 2013) 69-71.

16 See BUJTÁR, Zsolt: *Eladó az egész világ? Avagy - ETF-k szabályozási kérdései* JURA 2016, 22. évf: 1. szám 171-181. old.

17 See KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC-LexisNexis, Budapest-Wien, 2013) 69-71.; KECSKÉS, András: *The European Regulation on Drafting Prospectuses in Initial Public Offering Transactions*, JURA 21 : 1 pp. 56-66., 11 p. (2016)

2. The development of rules on prospectuses in the European Union

The success of an offer of securities, and thus of the capital-raising process, is usually dependent on the existence of a market on which the securities in question can subsequently be traded and which will provide liquidity for the securities. There must also be an efficient price-formation process, such where any capital gains can be effectively realised. And in particular, admissions to trading rules are a key element in the capital-raising process as they provide issuers with a means of signalling their credibility to investors.[18] The Admission Directive[19] of 1979 imposed detailed, harmonised admission requirements in respect of the admission of securities to an official listing on stock exchanges operating within the EU Member States.[20] This directive was the first to impose mandatory disclosure requirements on issuers accessing the capital markets. The main purpose of its adoption was to harmonise the conditions applicable to admission to official listing on stock exchanges operating within the Member States. Its regulation also addressed the ongoing disclosure obligations of officially listed issuers.[21]

The so-called Listing Particulars Directive[22] was adopted in 1980; it linked harmonisation to the integration of European securities markets, and its aim was also to remove the regulatory obstacles of varying disclosure requirements faced by issuers in raising finance. In 1989, the Public Offers Directive[23] in turn introduced a code of disclosure covering issues of securities to the public.[24]

Mutual recognition was initially addressed for listing particulars in 1987, and then for public-offer prospectuses in 1990.[25] These early directives, did not however favour the system of mutual recognition of disclosure documents between Member States, and therefore they could not properly foster capital increases on a pan-European basis.

---

18 See MOLONEY, Niamh: *EC Securities Regulation* (Oxford University Press, Oxford, 2008) p. 67.

19 Directive 79/279/EEC (coordinating the conditions for the admission of securities to official stock exchange listing)

20 See MOLONEY, Niamh: *EC Securities Regulation* (Oxford University Press, Oxford, 2008) p 68.

21 See MOLONEY, Niamh: *EC Securities Regulation* (Oxford University Press, Oxford, 2008) p 103; KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC – LexisNexis, Budapest-Wien, 2013.) 72.

22 Council Directive 80/390/EEC of 17 March 1980 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing

23 Council Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public

24 See MOLONEY, Niamh: *EC Securities Regulation* (Oxford University Press, Oxford, 2008) p.104

25 See MOLONEY, Niamh: *EC Securities Regulation* (Oxford University Press, Oxford, 2008) p.104

Hardly two or three issuers per year chose the complex regime available.[26]

In 1999, the Financial Services Action Plan was adopted by the European Commission. This ambitious programme had four key strategic objectives: developing a single European market in wholesale financial services; creating open and secure retail markets; ensuring financial stability through establishing state-of-the-art prudential rules and supervision; and setting wider conditions for an optimal single financial market.[27] The Action Plan – to encourage raising capital on an EU-wide basis – proposed (as a priority 1 action) the upgrade of the Directives on Prospectuses through a possible legislative amendment. The objective was to overcome obstacles to the effective mutual recognition of prospectuses, so that a prospectus or offer document approved in one Member State would be accepted in all. In addition, incorporating "shelf registration" would provide for easier access to capital markets on the basis of streamlined prospectuses, derived from annual accounts.[28]

At its Lisbon session held in 2000, the European Council treated the reform of disclosure obligations connected to the trade of securities as a priority, and it tried to open up the widest possible access to investment capital on an EU-wide basis. In this way, the creation of a single European passport for the issuers, which was deemed to be of fundamental importance for the completion of the internal market in financial services, came into focus.[29] This political intention also materialised in the Second Progress Report relating to the implementation of the Financial Services Action Plan[30], in which the reform of

26 See MOLONEY, Niamh: *EC Securities Regulation* (Oxford University Press, Oxford, 2008) p.107; KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC – LexisNexis, Budapest-Wien, 2013.) 72-73.

27 See MALCOLM, Kyla, TILDEN, Mark, WILSDON, Tim, *Evaluation of the Economic Impacts of the Financial Services Action Plan* (March 2009) p. 3. Available at http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_economic_impact_en.pdf

28 See Financial Services: Implementing the Framework for Financial Markets: Action Plan, Communication of the Commission, COM (1999) 232, 11.05.99. p. 22. Available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf; KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC – LexisNexis, Budapest-Wien, 2013.) 72-73.

29 See SZUCHY, Róbert: *Az Európai Unió összefonódás-ellenőrzési rendszere a jogbiztonság tükrében* 2010 Gazdaság és Jog 18. évf. 7-8 32-40. old. and SZUCHY, Róbert: *Verseny, szabályozás és a hatékonyság – A hatékonyság szerepe az Európai Uniós összefonódás-ellenőrzési rendszere tükrében.* 2010 Ünnepi tanulmányok Sárközy Tamás 70. születésnapjára pp. 425-449. old.

30 The *Financial Services Action Plan [(FSAP), Financial Services – Implementing the Framework for Financial Markets: Action Plan. Commission Communication of 11.05.1999* COM (1999)232] was adopted by the main decision-making bodies of the European Union in 1999. The necessary legislation procedures were concentrated on three areas in order to ensure the competitiveness of European capital markets: single EU market for institutional investors, public and safe market for private investors, modernised rules to ensure fair commercial

the regime of mutual recognition received significant attention.[31] The *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (Lámfalussy Report)[32] also strongly advocated the model of market financing, and urged quick measures for the completion of the internal capital and securities market. It pointed out that, in the European Union, the single passport ensured for issuing securities was still not a reality. The then-prevailing system discouraged companies from raising capital on a European level, and thus accessing a really large, liquid and integrated financial market.[33]

Based on the above reasons, Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (Prospectus Directive) was adopted. The purpose of this Directive was to harmonise requirements for drawing up, approving and distributing the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State.[34] The aim of the Directive (and its implementing measures) was also to ensure investor protection and market efficiency, in accordance with high regulatory standards adopted in the relevant international fora.[35] The Directive has been amended several times, and its regulatory framework was completed by implementation regulations. It is therefore important to mention Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses, as well as the format, incorporation by reference and disclosure of such prospectuses and dissemination of advertisements. Since it was adopted, this source of law has been amended several times.[36] This regulation was directly effective and applicable in Hungary as well.[37]

---

conduct and modern supervision of markets.

31 Commission of the European Communities: REPORT FROM THE COMMISSION Progress on Financial Services SECOND REPORT Brussels, 30.05.2000 COM (2000) 336 final Accessible at (16.06.2020.): http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2000:0336:FIN:EN:PDF

32 See Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (Lamfalussy Report) (Brussels, 15 February 2001) Accessible at (19.06.2020.): https://www.esma.europa.eu/sites/default/files/library/2015/11/lamfalussy_report.pdf

33 See MOLONEY, Niamh: *EC Securities Regulation* (Oxford University Press, Oxford, 2008) p. 110; KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance, and Hostile Takeovers* (Translated by Anna Tolnai and the Authors) (HVG-ORAC – LexisNexis, Budapest-Wien, 2013.) 73.

34 See Directive 2003/71/EC Article 1 (1)

35 See Directive 2003/71/EC Preamble 10.

36 It is also important to mention Commission Regulation (EC) No 1569/2007 of 21 December 2007, which regulates the establishment of a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament and of the Council. This regulation is still in force.

37 See KECSKÉS, András, HALÁSZ, Vendel: *Stock Corporations – A Guide to Initial Public Offer-*

3. The new Prospectus Regulation and related Commission Delegated Regulation

Since July 21, 2019[38] a new regulation is applicable to initial public offering prospectuses[39] in the European Union, Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (Prospectus Regulation). This new Prospectus Regulation was amended once by Regulation (EU) 2019/2115 of the European Parliament and of the Council of 27 November 2019 amending Directive 2014/65/EU and Regulations (EU) No 596/2014 and (EU) 2017/1129 as regards the promotion of the use of SME growth markets. Based on Article 44 of the Prospectus Regulation, the European Commission adopted a delegated act to supplement the regulatory framework of the Prospectus Regulation. This became Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004.

The background of the adoption of this new regulatory framework was analysed by the Commission Staff Working Document – Impact assessment – Accompanying the document Proposal for a Regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading (Impact assessment).[40]

---

ings, Corporate Governance, and Hostile Takeovers (Translated by Anna Tolnai and the Authors) (HVG-ORAC – LexisNexis, Budapest-Wien, 2013.) pp. 73-74.

38 According to Article 49 of the Prospectus Regulation, as a main rule, it shall apply from 21 July 2019. However, certain exceptions (regarding certain Articles of the Prospectus Regulation) are listed in Article 49 paragraph 2 of the Prospectus Regulation.

39 According to Article 1 paragraph 1 of the Prospectus Regulation, the Prospectus Regulation lays down requirements for the drawing up, approval and distribution of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State. So the Prospectus Regulation is not only applicable just to IPO prospectuses. However, this Article focuses mainly on its effects regarding IPO transactions.

40 EUROPEAN COMMISSION: COMMISSION STAFF WORKING DOCUMENT - IMPACT ASSESSMENT Accompanying the document Proposal for a Regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading {COM(2015) 583 final} {SWD(2015) 256 final} Brussels, 30.11.2015 SWD(2015) 255 final (cited as European Commission: Impact Assessment) Accessible at (2020.06.15.): http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015SC0255&from=EN

4. The IPO-related reasons for adopting the new Prospectus Regulation

According to the Impact Assessment, the previous Prospectus Directive (2003/71/EC) had some deficiencies.

The Prospectus Directive resulted in insufficient harmonisation. It left Member States with considerable discretion in its implementation and application. According to the Impact Assessment, the resulting differences hindered the emergence of a truly integrated EU capital market. As an example, it can be mentioned that Member States have applied differently the flexibility in the Prospectus Directive to exempt offers of securities with a total value below EUR 5 000 000. The result was that the requirement to produce a prospectus arose at different levels across the EU. The European Securities and Markets Authority (ESMA) also found indications that, in practice, prospectus approval procedures were handled differently between Member States.[41] To solve these problems, it was fundamental to achieve more convergence in the disclosure regimes for capital markets across Member States and also to achieve more convergence in the application of rules relating to the preparation and publication of prospectuses.[42]

It was also an important problem that the compliance costs related to the Prospectus Directive were considerably high. The Impact Assessment estimated that the costs for an equity prospectus were EUR 1 million on average, which is a significant cost in connection with an IPO transaction. Legal fees were considered as the most significant part of the costs associated with prospectus documentation; these accounted for 40% or more of the costs. What probably stands in the background of the high legal costs is that IPO prospectuses and their summaries are long documents, which were often drafted with a focus on avoiding liability risks and that required substantial legal support.[43] Internal costs (about 23%) are the second most important cost factor. Third, we should mention audit costs and fees charged by the competent authorities, which represent together about a quarter of the costs. An important aspect of the costs associated with drafting prospectus documents is that some of these costs are fixed, so they do not vary perfectly in proportion to the sums raised. This is especially problematic and demanding for smaller issuers, such as SMEs.[44] Consequently, the Impact Assessment concluded that the costs of a new prospectus have a proportionally bigger impact on smaller issuances (and probably so on smaller issuers).[45] Based on the above, the compliance costs and disclosure requirements related to an IPO are particularly high for smaller firms. For example, in 2013 a study[46] provided an estimation

41 See European Commission: Impact Assessment p. 10.
42 See European Commission: Impact Assessment pp. 15-16.
43 See European Commission: Impact Assessment p. 8.
44 See European Commission: Impact Assessment pp. 8-9.
45 See European Commission: Impact Assessment p. 8.
46 See FESE, Guide to Going Public in Europe, 2013. Annex 7 provides additional data on European IPOs by value and volume. European Commission: Impact Assessment p. 11.

that listing costs can account for 10 to 15% of proceeds for IPOs of less than EUR 6 million and only 5 to 8% for IPOs above EUR 50 million.[47] This particularly shows that, for numerous firms (most notably for SMEs), these costs represent a significant burden, which may deter them from a potential IPO transaction. With regard to these firms, the listing costs may outweigh the benefits of a listing.[48] The IOSCO also recognised that the 'costs and fulfilment of regulatory requirements' (i.e. the financial and bureaucratic burden) are one of the two most important factors that may hinder the access of SMEs to capital markets. [49]

Furthermore, the regulatory framework of the Prospectus Directive not proved to be flexible enough and so it was inappropriate for SMEs (and also for some type of securities). The reason for this was that the Prospectus Directive applied insufficient differentiation and proportionality to the requirements between specific situations and issuers. This resulted, in some cases, in an inappropriate administrative burden and one that might even have deterred companies from accessing capital markets.[50] It was important to address this problem because bank financing is usually predominant among European companies, and in particular SMEs.[51] According to the European Commission, the vast majority of SME financing was provided by banks and only 20 per cent or less of the capital was obtained from capital markets. Also, there were (and probably are) considerable differences between Member States regarding the means of financing used by SMEs. For example, in Slovakia, Denmark and Sweden, equity financing was used by 9 to 32% of SMEs as a source of funding. On the other hand, in Hungary, Portugal and the Czech Republic, almost no equity funding was used. Also, the overall average percentage of SMEs that used equity financing in the EU was only 3%.[52] The banking and financial crisis[53] that started in 2007-2008 showed that such strong reliance on bank financing may have significant drawbacks.[54] For example, with regard to such crises, the availability of bank financing significantly decreases, as liquidity drains from the banking system. It is also important to mention that (although most SMEs and companies in general have well-established relationships with their banks) such (almost) exclusive reliance on one financing option (i.e. bank financing) limits the

47 See European Commission: Impact Assessment pp. 10-11.

48 See European Commission: Impact Assessment pp. 10-11.

49 See European Commission: Impact Assessment pp. 10-11.

50 See European Commission: Impact Assessment p. 9.

51 See LENTNER Csaba-ZÉMAN, Zoltán: *A pénzügyi válság bankszabályozási controll elveinek meghatározóbb történeti elvei* Európai Jog 17. évf. 1. szám 2017. január 8-13. old

52 See European Commission: Impact Assessment p. 12.

53 See BUJTÁR, Zsolt: *Az eszközalapú kereskedelmi kötvény Egyesült Államokbeli tündöklésének és bukásának okai* Jura 2016 22. évf. 2.szám 214-224. old.

54 See LENTNER, Csaba: *A pénzügyi válságkezelés lehetséges alternatívái Magyarországon és az Európai Unióban* 2009 Gazdaság és Jog 17. évf. 12. szám 15-21. old. and LENTNER, Csaba – ZÉMAN, Zoltán: *Handling Crisis – Role in the Economy*, Moderni Veda 2016, 2016. év 3. szám, 45-58. old.

company's bargaining position. Equity financing and so capital markets should be used at least as a viable alternative (and so as a potential competitor) to bank financing.[55]

In the European Union as a result of such problems, capital markets remained unattractive for many companies, in particular SMEs, as an alternative source of funding. However, if companies have problems with raising capital effectively, that may result in less investment and so fewer jobs and less growth in the European Union.[56] Consequently, regarding this problem, it became an important objective to reduce the administrative burden of compliance with the EU rules on prospectuses, and to make the regulatory framework of prospectuses more flexible and appropriate for the various types of securities and issuers covered, in particular SMEs. New regulations therefore had to improve access to capital markets for SMEs and companies with reduced market capitalisation.[57]

The regulatory framework of the Prospectus Directive was also criticised on the ground that it was not effective enough at protecting investors. As mentioned above, prospectus documents were usually drafted in order to mitigate potential legal liability risks, and that led to overly lengthy and complicated prospectus documents. However, such an approach is not entirely suitable for informing potential investors properly and providing them with suitable and appropriate information to avoid bad decisions.[58] Among the rules on drafting prospectuses. the Achilles-heel of investor protection was particularly the way that prospectus summaries were regulated and prepared. The role of the prospectus summary is basically to provide potential investors with concise and easy to understand information about the investment opportunity and the (equity) security subject to the transaction. Although these documents should be very easy to read and to the point, they were blamed – as they were prepared under the Prospectus Directive – for being too long, unwieldy and too comprehensive.[59] Consequently, an important objective was to reform the requirements regarding the prospectus summary (and, hence, investor protection). To achieve this goal, making disclosures to investors under the prospectus regime more effective was a key element.[60]

5. The most important IPO-related changes in the Prospectus Regulation

With the adoption of the Prospectus Regulation, the regulation and harmonisation of rules on preparing and publishing prospectuses in the European Union is achieved in the legislative form of a „regulation". The proposal of the Prospectus Regulation[61] also

55 See European Commission: Impact Assessment p. 12.
56 See European Commission: Impact Assessment p. 13.
57 See European Commission: Impact Assessment pp. 15-16.
58 See European Commission: Impact Assessment p. 9.
59 See European Commission: Impact Assessment p. 9.
60 See European Commission: Impact Assessment pp. 15-16.
61 See European Commission: Proposal for a Regulation of the European Parliament and of

emphasised that applying this legislative form "would address such problems which typically arise in the transposition of a directive and would enhance coherence and integration throughout the internal market".[62] The Preamble of the Prospectus Regulation also emphasises the necessity to adopt a regulation in this field and provides a detailed analysis regarding the background to choosing this legislative form. According to the Preamble, "*it is appropriate and necessary for the rules on disclosure when securities are offered to the public or admitted to trading on a regulated market to take the legislative form of a regulation in order to ensure that provisions directly imposing obligations on persons involved in such offers are applied in a uniform manner throughout the Union. Since a legal framework for the provisions on prospectuses necessarily involves measures specifying precise requirements for all different aspects inherent to prospectuses, even small divergences on the approach taken regarding one of those aspects could result in significant impediments to cross-border offers of securities, to multiple listings on regulated markets and to Union consumer protection rules. Therefore, the use of a regulation, which is directly applicable without requiring national law, should reduce the possibility of divergent measures being taken at national level(…).*"[63] As the preparation and publishing of prospectuses is regulated by means of a Regulation, those rules (as emphasised above) are directly effective and directly applicable in all Member States of the European Union[64] without any specific transposition to national law.

The Prospectus Regulation recognised that, for offers of securities to the public with a total consideration in the Union of less than EUR 1 000 000, the cost of producing a prospectus is likely to be disproportionate to the envisaged proceeds of the offer. For this reason, the Prospectus Regulation considered it appropriate that the obligation to draw up such a prospectus should not apply to offers of such a small scale.[65] Based on the above, Article 1 paragraph 3 of the Prospectus Regulation stipulates that its rules "shall not apply to an offer of securities to the public with a total consideration

---

the Council on the prospectus to be published when securities are offered to the public or admitted to trading, Brussels, 30.11.2015 COM (2015) 583 final 2015/0268 (COD) {SWD (2015) 255 final} {SWD (2015) 256 final} Accessible at (14.06.2020): https://eur-lex.europa.eu/resource.html?uri=cellar:036c16c7-9763-11e5-983e 01aa75ed71a1.0006.02/DOC_1&format=PDF

62 See European Commission: Proposal for a Regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading, Brussels, 30.11.2015 COM (2015) 583 final 2015/0268 (COD) {SWD (2015) 255 final} {SWD (2015) 256 final} pp. 7-8. Accessible at (14.06.2020): https://eur-lex.europa.eu/resource.html?uri=cellar:036c16c7-9763-11e5-983e 01aa75ed71a1.0006.02/DOC_1&format=PDF

63 See Regulation (EU) 2017/1129 Preamble 5.

64 According to Article 288 of the Treaty on the Functioning of the European Union, a regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.

65 See Regulation (EU) 2017/1129 Preamble 12.

in the Union of less than EUR 1 000 000, which shall be calculated over a period of 12 months".

The Prospectus Regulation also considered the varying sizes of financial markets across the Union. Based on that, it provided the option for Member States to exempt offers of securities to the public not exceeding EUR 8 000 000 from the obligation to publish a prospectus. According to Preamble 13 of the Prospectus Regulation, Member States should be free to set out in their national law a threshold between EUR 1 000 000 and EUR 8 000 000, expressed as the total consideration of the offer in the Union over a period of 12 months, below which the exemption should apply, taking into account the level of domestic investor protection they deem to be appropriate. According to Article 3 of the Prospectus Regulation (*Obligation to publish a prospectus and exemption*), securities shall only be offered to the public in the Union after prior publication of a prospectus in accordance with the Prospectus Regulation. However, based on the second paragraph of this Article, a Member State may decide to exempt offers of securities to the public from the obligation to publish a prospectus provided that the total consideration of each such offer in the Union is less than a monetary amount calculated over a period of 12 months that shall not exceed EUR 8 000 000.

Article 1 paragraph 3 thus exempts small-scale offerings from the scope of the whole Prospectus Regulation, and Article 3 paragraph 2 also provides an opportunity for Member States to exempt some small-scale offerings (under EUR 8 000 000) from the obligation to publish a prospectus. These rules of the Prospectus Regulation provide significant flexibility for issuers when planning smaller equity offerings.

The regulatory system of the Prospectus Regulation reformed the rules on the summary of the prospectus to enhance the protection of retail investors. On the one hand, that resulted in a detailed description of the content of the summary in Article 7 of the Prospectus Regulation. On the other hand, the Prospectus Regulation intends to establish requirements that enhance the usefulness of the summary and ensure that it is easy to understand. This is why the Preamble of the Prospectus Regulation stipulates that the summary of the prospectus should be short, simple and easy for investors to understand.[66] Moreover, the Prospectus Regulation found it appropriate to limit the length of the summary. According to Article 7 paragraph 3 of the Prospectus Regulation, the summary shall be presented and laid out in a way that is easy to read, using characters of readable size; furthermore, it shall be written in a language and a style that make it easy to understand the information, in particular, in a language that is clear, non-technical, concise and comprehensible for investors. The summary shall be drawn up as a short document written in a concise manner and of a maximum length of seven sides of A4-sized paper when printed. The summary shall be made up of the following four sections: an introduction, containing warnings; key information on the issuer; key information on the securities; key information on the offer of securities to the public and/or the admission to trading on a regulated market. The summary is one key component of the

66 See Regulation (EU) 2017/1129 Preamble 30.

prospectus document. The other two main components of the prospectus document are the registration document and the securities note (when the prospectus consists of separate documents). However (as previously according to the Prospectus Directive), it is possible to prepare the prospectus as a single document.[67] The main parts of prospectus documents therefore remained the same as those in the former Prospectus Directive.

The Prospectus Regulation also represents a new approach regarding how the risk factors should be presented in (IPO) prospectuses. It provides detailed instructions on how to incorporate the risk factors into the prospectus documents. The primary purpose of including risk factors in a prospectus is to ensure that investors make an informed assessment of such risks. This provides them with the opportunity to take investment decisions in full knowledge of the facts.[68] According to Article 16 of the Prospectus Regulation, "the risk factors featured in a prospectus shall be limited to risks which are specific to the issuer and/or to the securities and which are material for taking an informed investment decision, as corroborated by the content of the registration document and the securities note. The Preamble of the Prospectus Regulation more specifically clarifies that a prospectus should not contain risk factors which are generic and only serve as disclaimers, as those could obscure more specific risk factors that investors should be aware of, thereby preventing the prospectus from presenting information in an easily analysable, concise and comprehensible form.[69] When drawing up the prospectus, the issuer, the offeror or the person asking for admission to trading on a regulated market shall assess the materiality of the risk factors based on the probability of their occurrence and the expected magnitude of their negative impact."[70] The Prospectus Regulation requires that each risk factor shall be adequately described. It should be explained also how the risk factor affects the issuer or the securities being offered or to be admitted to trading. The assessment of the materiality of the risk factors may also be disclosed by using a qualitative scale of low, medium or high.[71] The risk factors shall be presented in a limited number of categories depending on their nature. In each category, the most material risk factors shall be mentioned first according to the assessment described above.[72] The rules of the Prospectus Regulation regarding the presentation of risk factors in prospectus documents are complemented with further rules. For example, according to Article 16 paragraph 4 of the Prospectus Regulation, the ESMA shall develop guidelines to assist competent authorities in their review of the specificity and materiality of risk factors. The European Commission is also empowered to adopt delegated acts to provide further specific rules regarding risk factors.[73]

67 See Regulation (EU) 2017/1129 Article 6(3) and Articles 10 and 12.
68 See Regulation (EU) 2017/1129 Preamble (54)
69 See Regulation (EU) 2017/1129 Preamble (54)
70 See Regulation (EU) 2017/1129 Article 16 (1)
71 See Regulation (EU) 2017/1129 Article 16 (1)
72 See Regulation (EU) 2017/1129 Article 16 (2)
73 See Regulation (EU) 2017/1129 Article 16 (5)

One of the most important innovations of the Prospectus Regulation was that it established the possibility for smaller issuers to apply so-called EU Growth prospectuses. These are capable of facilitating IPO transactions among smaller issuers (for example small and medium-sized enterprises) and it significantly reduces the associated bureaucratic burden. As the Preamble of the Prospectus Regulation states, a proper balance should be struck between cost-efficient access to financial markets and investor protection when calibrating the content of an EU Growth prospectus.[74] According to Article 15 of the Prospectus Regulation, the following persons may choose to draw up an EU Growth prospectus under the proportionate disclosure regime. First of all (and most importantly), it is possible for small and medium-sized enterprises (SME) to choose it. According to the Prospectus Regulation, SMEs are companies, that, according to their last annual or consolidated accounts, meet at least two of the following three criteria: an average number of employees during the financial year of less than 250, a total balance sheet not exceeding EUR 43 000 000 and an annual net turnover not exceeding EUR 50 000 000. The Prospectus Regulation also regards those companies that are defined in point (13) of Article 4(1) of Directive 2014/65/EU[7576] (for example issuers, other than SMEs, whose securities are traded or are to be traded on an SME growth market) as SMEs, provided that those issuers had an average market capitalisation of less than EUR 500 000 000 on the basis of end-year quotes for the previous three calendar years.[77] Article 15 paragraph 1 point (c) and (d) describes further issuers who are allowed to choose the EU Growth prospectus. The Preamble of the Prospectus Regulation emphasises that the reduced information required to be disclosed in EU Growth prospectuses should be calibrated in a way that focuses on information that is material and relevant when investing in the securities offered. It is also important to ensure proportionality between the size of the company and its fundraising needs, on the one hand, and the cost of producing a prospectus, on the other hand.[78] Article 15 of the Prospectus Regulation requires that an EU Growth prospectus under the proportionate disclosure regime shall be a document of a standardised format, written in a simple language and which is easy for issuers to complete. It shall consist of a specific summary, a specific registration document and a specific securities note. The information in the EU Growth prospectus shall be presented in a standardised sequence in accordance with the delegated act adopted by the European Commission, namely Commission Delegated Regulation (EU) 2019/980. According to its Article 28, the EU Growth registration document for equity

74 See Regulation (EU) 2017/1129 Preamble 51.

75 'Small and medium-sized enterprises' for the purposes of Directive 2014/65/EU, means companies that had an average market capitalisation of less than EUR 200 000 000 on the basis of end-year quotes for the previous three calendar years.

76 See Regulation (EU) 2017/1129 Article 2 (f)

77 See Regulation (EU) 2017/1129 Article 15 (1) b)

78 See Regulation (EU) 2017/1129 Preamble 52.

securities is a specific registration document for equity securities that shall contain the information referred to in Annex 24 of the Commission Delegated Regulation. Such information comprises the persons responsible, third party information, experts' reports and competent authority approval; strategy, performance and business environment; risk factors; corporate governance; financial information and key performance indicators (KPIs); shareholder and security holder information; and documents available.[79] According to Article 30 of the Commission Delegated Regulation (EU) 2019/980, the EU Growth securities note for equity securities is a specific securities note for equity securities that shall contain the information referred to in Annex 26 of the Regulation. Such information is the purpose, persons responsible, third party information, experts' reports and competent authority approval; working capital statement and statement of capitalisation and indebtedness; risk factors; terms and conditions of the securities; details of the offer/admission to trading.[80] Article 33 contains detailed rules regarding the specific summary for the EU Growth prospectus. It requires that the specific summary for the EU Growth prospectus shall provide the key information that investors need to understand regarding the nature and the risks of the issuer, of the guarantor and of the securities that are being offered. The content of the specific summary shall be accurate, fair, clear and not misleading. It is also stipulated that the specific summary shall be consistent with the other parts of the EU Growth prospectus,[81] the main parts of the specific summary for the EU Growth prospectus are the following: introduction; key information on the issuer; key information on the securities; key information on the offer of securities to the public.[82] The above-listed requirements of Commission Delegated Regulation (EU) 2019/980 on the specific summary, registration document and securities note for EU Growth securities are less complicated and particularised as with regard to "ordinary" equity securities summary, registration document and securities note.[83]

6. Conclusion

Regulation (EU) 2017/1129 (Prospectus Regulation) can be considered as an important step forward in strengthening the European capital market. By choosing the legislative form of a Regulation, it can enhance coherence and integration throughout the internal

79 See Commission Delegated Regulation (EU) 2019/980 Annex 24 Section 1 – Section 7.

80 See Commission Delegated Regulation (EU) 2019/980 Annex 26 Section 1 – Section 5.

81 See Commission Delegated Regulation (EU) 2019/980 Article 33 (1) – (3)

82 See Commission Delegated Regulation (EU) 2019/980 Annex 23 Section 1 – Section 4.

83 Compare in this regard Commission Delegated Regulation (EU) 2019/980 Annex 24 and 26 (which regulates the specific registration document and securities note for EU Growth securities) with Annex 1 and Annex 11 (which regulate the registration document and securities note of "ordinary" equity securities). Annex 24 has 7 sections, while Annex 1 has 21 sections. Annex 26 has 5 sections, while Annex 11 has 10 sections.

market. It provides significant legal certainty for investors and also for issuers that they face the same rules regarding the preparation and publication of prospectuses in all EU Member States, thanks to the Prospectus Regulation.

Prospectus Regulation also significantly improves investor protection. For example, the new rules on the prospectus summary enhance the usefulness of this important part of the documentation. As the summary is the only part of the prospectus that is usually read by the majority of potential investors, the new requirements can significantly contribute to informed investment decisions. In addition, the new approach regarding how the risk factors should be presented in an IPO prospectuses significantly improves their ability to assess risks. These new rules significantly contribute to the protection of retail investors.

Furthermore, it can be considered an important contribution of the Prospectus Regulation to capital market development and IPO activity that it introduces the so-called EU Growth prospectuses for smaller issuers. This new possibility for smaller issuers (most importantly SMEs) takes into consideration the size of the company and its fundraising needs when it establishes the requirements regarding the content and complexity of the prospectus. As such, EU Growth prospectuses intend to ensure that the costs associated with the preparation of prospectuses do not deter smaller issuers from accessing capital markets (and so from carrying out successful IPO transactions). At the same time, they also ensure appropriate investor protection, as they focus on information that is material and relevant.