

EUROPEAN COMMUNITY

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1. REGULATORY FRAMEWORK

The European Community's ("EC") initiatives in the securities field have been governed by principles of (a) mutual recognition, (b) harmonization of minimum standards (leaving Member States to impose more stringent standards at their discretion) and (c) coordination of regulation between national authorities. The overriding purposes have been (1) to establish a basic framework for the protection of investors so as to enhance the EC's role as a provider of finance and encourage greater confidence in the financial sector and (2) to remove barriers between the various markets, thus allowing greater access to the EC's capital markets.

It is important to remember that the EC's principal legislative tool in the financial services and securities fields is the Council Directive which binds each Member State as to the results to be achieved but leaves implementation to the national authorities. Directives therefore require specific legislative measures in each Member State in order to be implemented. Some Member States have been slow to implement Directives and sometimes, when they have done so, have not always implemented them correctly.

The EC's initiatives have focused on the following areas:

(a) disclosure of information to prospective investors (the Public Offer Prospectus Directive¹ covering offers to the public and the various directives collectively known as the "Stock Exchange Directives" covering admission and disclosure requirements for listed securities,² the Council Directive on

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¹ Council Directive 89/298, 1989 O.J. (L 124) 8 [hereinafter Prospectus Directive].

² These are:

(a) Council Directive 79/279 Coordinating the Conditions for the Admission of Securities to Official Stock Exchange Listing, 1979

Undertakings for Collective Investment in Transferable Securities ("UCITS") Directive covering the constitution, operation and offering of mutual funds,³ and the draft Takeover Directive covering takeover bids or mergers⁴); and

(b) authorization and conduct of business in the securities field (the Second Banking Directive) covering credit institutions⁵ together with related directives on the consolidated supervision of funds and solvency and a draft directive on large risks, the draft Investment Services Directive covering other organizations⁶ together with the related draft directive concerning capital adequacy (which will also apply to banks), the Insider Dealing Directive coordinating regulations on insider trading⁷, the Major Shareholdings Directive requiring disclosure of voting share interests in listed companies⁸, and the draft Takeover Directive covering the conduct of takeover bids).

The subject of this Article requires concentration on disclosure issues and relevant exemptions therefrom, and to a

O.J. (L 66) 21, as amended by Council Directive 82/148, 1982 O.J. (L 62) 22;

(b) Council Directive 80/390, 1980 O.J. (L 100) 1, as amended by Council Directive 82/148, 1982 O.J. (L 62) 22, Council Directive 87/345, 1987 O.J. (L 185) 81, and Council Directive 90/211, 1990 O.J. (L 112) 24 [hereinafter Listing Particulars Directive]; and

(c) Council Directive 82/121 on Information to be Published on a Regular Basis by Companies, 1982 O.J. (L 48) 26.

³ Council Directive 85/611, 1985 O.J. (L 375) 3, as amended by Council Directive 88/220, 1988 O.J. (L 100) 31 [hereinafter UCITS Directive].

⁴ Amended Commission Proposal for a Thirteenth Council Directive on Company Law, Concerning Takeover and Other General Bids, art. 1, 1990 O.J. (C 240) 7 [hereinafter Proposed Thirteenth Council Directive].

⁵ Council Directive 89/646, 1989 O.J. (L 386) 1, amended by Council Corrigendum of March 30, 1990, 1990 O.J. (L 83) 128 [hereinafter Second Banking Directive].

⁶ Amended Commission Proposal for a Council Directive on Investment Services in the Securities Field, 1990 O.J. (C 42) 7 [hereinafter Draft Investment Services Directive]. Since that date, a number of revised texts have been produced as internal working drafts for discussion purposes. The Council of Ministers reached agreement in principle on all outstanding issues at a meeting on November 23, 1992. The remaining task is to finalize the text of the draft in the nine Community languages.

⁷ Council Directive 89/592 Coordinating the Regulations on Insider Dealing, 1989 O.J. (L 334) 30.

⁸ Council Directive 88/627 on the Information to be Published when a Major Holding in a Listed Company is Acquired or Disposed of, 1988 O.J. (L 348) 62.

lesser extent on authorization and conduct of business issues.

2. PUBLIC OFFERS OF SECURITIES

2.1. Requirement for a Prospectus

Offers to the public of transferable securities in a Member State fall under the Prospectus Directive if it is the first time they are so offered in that Member State and the securities are not already listed on a stock exchange located or operating in that Member State.⁹

The Prospectus Directive requires persons (both issuers and third parties) making an offer of transferable securities to the public within any Member State (whether on a primary or secondary basis) to publish or make available a detailed prospectus not later than the time when the offer is made.¹⁰ "Transferable securities" include shares in companies, debt securities having a maturity of at least one year and other transferable securities conferring rights to acquire such shares or debt securities by way of subscription or exchange.¹¹ The Prospectus Directive does not, however, apply to transferable securities which are already listed on a stock exchange situated in the Member State in which the offer is being made.¹²

There is no definition in the Prospectus Directive of the term "offer to the public," and indeed one of the Prospectus Directive's recitals records that "so far, it has proved impossible to furnish a common definition of the term 'public offer' and all its constituent parts."¹³ This absence of a common definition at the EC level combined with the exemptions and exclusions discussed below means that there will be uncertainty as to what constitutes a public offer in the EC. The answer will depend on how each Member State defines or applies the

⁹ This directive should have been implemented into national legislation by Member States by April 17, 1989. As of July 30, 1992, Ireland had not notified the Commission of implementation.

¹⁰ Prospectus Directive, *supra* note 1, art. 9.

¹¹ *Id.* art. 3.

¹² This is because in order to obtain such a listing, the issuer must have complied with the disclosure requirements of the Listing Particulars Directive.

¹³ Prospectus Directive, *supra* note 1.

term.

2.2. *Exclusions and Exemptions*

The Prospectus Directive expressly does not apply to the following types of offers or transferable securities:¹⁴

- a) offers to persons in the context of their trades, professions or occupations;
- b) offers to a restricted circle of persons (which is not further defined in the Prospectus Directive);
- c) offers where the aggregate selling price of the transferable securities does not exceed ECU 40,000;
- d) offers with a minimum subscription or purchase of ECU 40,000 per investor;
- e) transferable securities with a minimum individual denomination of ECU 40,000;
- f) transferable securities offered in connection with a takeover bid or merger;
- g) share exchange offers (provided that there is no increase in the issued share capital of the relevant issuer);
- h) transferable securities offered to employees;
- i) offers of certain types of transferable securities to be issued on conversion of debt securities or the exercise of warrants or in exchange for debt securities (provided that a prospectus or listing particulars in relation to the convertible or exchangeable debt securities or the warrants was published in the same Member State);
- j) offers of Euro-securities not subject to a generalized campaign of advertising or canvassing ("Euro-securities" being those transferable securities which are underwritten and distributed by a syndicate at least two of the members of which are from different States, are offered on a significant scale in one or more States outside the issuer's State and are subscribed for or acquired only through a credit or other financial institution);
- k) offers of units issued by collective investment

¹⁴ *Id.* art. 2.

undertakings (other than closed-ended) (these may be covered by the UCITS Directive);

l) offers of transferable securities issued by a State or its regional or local authorities or by public international bodies of which one or more Member States are members;

m) shares offered free of charge to shareholders;

n) transferable securities issued by non-profit institutions; and

o) shares or their equivalent issued by certain specialized types of credit institutions such as building or Industrial and Provident Societies in the United Kingdom, "credit populaires" in France and "Genossenschaftsbanken" in Germany.

2.3. *Optional Exemptions*

Member States also have the option to exempt (partially or wholly) from the requirement of publishing a prospectus for offers of the following securities: debt securities issued by credit institutions in a continuous or repeated manner; debt securities issued by persons benefiting from a State monopoly and governed by a special law or whose borrowings are guaranteed by a Member State or its regional or local authorities; and debt securities issued by persons, not being companies, governed by a special law whose activities consist solely in raising funds under State control and whose debt securities are State obligations.¹⁵ Member States also have the option to exempt offers of shares if the number or value amounts to less than ten percent of the shares of the same class which are already listed on a stock exchange, provided that investors already possess equivalent information as a result of stock exchange disclosure requirements.¹⁶ Further, Member States may allow exemptions where equivalent information is available to investors not later than the time a prospectus should have been published or made available to the public.¹⁷

The extent of the above exemptions and exclusions will

¹⁵ *Id.* art. 5.

¹⁶ Listing Particulars Directive, *supra* note 2, art. 6.

¹⁷ Prospectus Directive, *supra* note 1, art. 13(3).

differ among Member States as the Prospectus Directive leaves it to the Member States in such cases to define the parameters of the particular exemption or exclusion.

2.4. *Contents and Recognition of Prospectus*

The Prospectus Directive contains requirements concerning the contents of the prospectus. These depend on whether or not the transferable securities are subject to an application for listing on a stock exchange in the same Member State as the public offer. If listing has been applied for in the same Member State, then the contents of the prospectus and the procedures for its pre-vetting are subject to the Listing Particulars Directive.¹⁸ If a public offer is made in one Member State and listing is sought in another, the person making the offer has the right to draw up the prospectus in accordance with the Listing Particulars Directive and thus use it for listing purposes in the other Member State, subject to certain limitations¹⁹.

If the public offer relates to securities which are not subject to a listing application in a Member State, the prospectus must comply with the content requirements of the Prospectus Directive, although Member States can allow offerors to draw up the prospectus in accordance with the Listing Particulars Directive even though no listing is being sought, provided the prospectus is subject to pre-vetting.²⁰

It is important to determine the standards to which the prospectus is drawn, as only those prospectuses drawn up to listing particulars' standards *and* pre-vetted by the relevant authority in one Member State will be treated as satisfying the requirements of another Member State where offers to the public are made simultaneously or within a short interval of

¹⁸ *Id.* art. 7.

¹⁹ Council Directive 90/211, art. 2, 1990 O.J. (L 112) 24 (amends the Listing Particulars Directive and provides that where an application for listing in one or more Member States is made and the securities have been the subject of a public-offer prospectus drawn up to listing particulars' standards and pre-vetted in another Member State within the three preceding months, the prospectus is recognized as listing particulars in each Member State where application for listing is made, subject only to translation and the inclusion of certain limited additional information.).

²⁰ Prospectus Directive, *supra* note 1, arts. 11-12.

one another.²¹ In order to be eligible for mutual recognition, the prospectus may have to be translated and include limited additional information specific to the market concerned.²²

Mutual recognition under the Prospectus Directive could be helpful in multijurisdictional offerings where there is an offer to the public in one Member State, and there is also to be an offer in another, but some uncertainty or difficulty exists in complying with national legislation in that other Member State. Ensuring that the prospectus will satisfy the requirements for recognition as a public offer prospectus under the Prospectus Directive should remove that doubt.

2.5. *Offer of Securities by Non-EC Issuers*

A Member State may, at its option, permit recognition of public offer prospectuses or listing particulars if the issuer's registered office is outside the EC.²³ By agreement with third countries, the EC may extend mutual recognition to include prospectuses and listing particulars drawn up and approved in accordance with the rules of such third countries, provided there is reciprocity and the third country's rules give investors equivalent protection.²⁴ As of July 30, 1992, no such agreement has been entered into by the EC nor have any negotiations on such an agreement been commenced.²⁵

3. "BROKER/DEALER" REGISTRATION

In Europe, securities business has been carried on by specialized securities houses, and in some countries, by banks. The Commission's intention is that investment services in

²¹ *Id.* art. 21.

²² *Id.*

²³ *Id.* The U.K. government has indicated that it will allow mutual recognition of prospectuses covering securities issued by non-EC issuers.

²⁴ *Id.* art. 24; Listing Particulars Directive, *supra* note 2, art. 25(a), as substituted by Council Directive 87/345, sec. VII, 1987 O.J. (L 185) 81.

²⁵ On September 23, 1991, the Commission and the Securities and Exchange Commission of the United States issued a joint statement aimed at promoting cooperation between them and Member States' regulatory authorities in the administration and enforcement of securities laws. It envisaged exchanges of information, mutual provision of assistance and regular consultation in relation to the supervision and operation of securities markets. It may also cover mutual recognition of prospectuses.

securities can be provided both by banks and non-banking institutions, subject to due authorization in the Home State. The principal proposals in this area are the Second Banking Directive and the draft Investment Services Directive, the latter of which applies to non-banking institutions. Adoption of the draft Investment Services Directive by the Council of Ministers has been severely delayed, but on June 29, 1992, the Council reached a political agreement which was followed by agreement in principle on outstanding issues at a meeting on November 23, 1992.

There are certain principles common to both the Second Banking Directive and the draft Investment Services Directive:

(a) Institutions (both banking and non-banking) will generally require authorization for their operations only in the Member State in which their registered or head office is situated. An institution which holds such an authorization will be able to provide services and open branches in other Member States without having to obtain separate authorization in each country.²⁶ The single license will amount to an EC passport, recognized in all Member States.

(b) The initial authorization and continuing prudential supervision will be carried out by Home State authorities. The Host State is intended to have only a limited, complementary role, principally in supplying the Home State authorities with information relating to the activities in its territory of institutions authorized by the Home State.²⁷ However, until a further directive is adopted establishing common standards for conduct of business rules, thereby allowing for mutual recognition of such rules, the Host State will continue to have a major role to play in administering rules concerning the conduct of business carried on within its territory by investment firms.

(c) EC directives will establish common minimum standards for authorization and continuing supervision, and in this way aim to prevent an institution from putting consumers at risk by obtaining EC-wide authorization in a State with low

²⁶ See Second Banking Directive, *supra* note 5, art. 18; see also Draft Investment Services Directive, *supra* note 6, art. 12.

²⁷ See Second Banking Directive, *supra* note 5, art. 12; see also Amended Commission Proposal for a Council Directive on Investment Services in the Securities Field, 1990 O.J. (C 42) 7.

regulatory standards.

(d) Member States will be required to recognize each other's authorization and supervisory standards. Therefore, essential prudential and investor protection requirements will be harmonized so that agreed minimum standards are observed throughout the EC.

(e) A Member State will generally be able to impose stricter national rules than the common EC rules, although these will have to be on a non-discriminatory basis. However, if stricter rules or standards are imposed, a Member State applying such rules or standards will not be able to prevent firms authorized in other Member States from establishing branches in its territory or providing cross-border services.

(f) In all areas which are not expressly dealt with by EC legislation, Member States will be free to adopt their own rules, so long as these do not conflict with EC law.

It is important to note that any business providing investment services relating to transferable securities, money market instruments, financial futures and options, and currency and interest swaps, including brokerage, or dealing as principal, market-making, underwriting, portfolio management and investment advice, will require authorization in its Home State in accordance with the proposed Investment Services Directive, unless it is a credit institution to which the Second Banking Directive applies.²⁸

Therefore, it will be necessary for a person offering securities to institutional investors to consider if, by doing so, he or she is conducting a business in a particular Member State. If the person is conducting a business, the business will need to be authorized, unless it has already obtained authorization in another Member State.

The details of the Second Banking Directive, the draft Investment Services Directive and the other Directives relating to credit institutions and other organizations are outside the scope of this paper. It is, however, important to note that the Second Banking Directive has been adopted and is scheduled for implementation by Member States by January 1, 1993. This will allow credit institutions authorized in their Home State to conduct certain types of securities business to

²⁸ Draft Investment Services Directive, *supra* note 6, arts. 2-3.

carry on those activities throughout the Community. If implementation of the proposed Investment Services Directive is significantly delayed, investment firms other than banks needing a European passport to carry on securities business throughout the Community will be at a disadvantage.

Both the Second Banking Directive and the draft Investment Services Directive contain reciprocity provisions.²⁹ These provide, among other things, that requests by a non-EC entity to establish or acquire an EC banking business or investment firm should be reported to the Commission if the Commission has determined that the applicant's home country is not granting national treatment or effective market access to EC credit institutions or investment firms. The Commission must report how EC banks and investment firms are treated in non-EC countries before the Second Banking and Investment Services Directives come into effect and periodically thereafter.³⁰ If equivalent treatment is not granted, the Commission may propose opening negotiations with the non-EC countries concerned. If national treatment and effective market access are not accorded to EC banks or investment firms in a particular country, the Commission may limit or suspend new authorizations and acquisitions by parent companies or their subsidiaries from that country.³¹ The Commission has a considerable amount of discretion and is responsible for determining the ambit of imprecise language, such as "national treatment" and "effective market access."

4. OTHER CONSIDERATIONS

4.1. Takeovers

The Prospectus Directive does not apply to the issue of transferable securities offered in connection with a takeover bid.³² The proposed Takeover Directive applies to the conduct of takeover and other general bids for securities of certain

²⁹ Second Banking Directive, *supra* note 5, art. 9; Draft Investment Services Directive, *supra* note 6.

³⁰ The Commission issued its first report to the Council dated July 15, 1992 and titled "Treatment Accorded in Third Countries to Community Credit Institutions and Insurance Companies."

³¹ See *supra* note 29.

³² Prospectus Directive, *supra* note 1, art. 2.

types of companies incorporated in Member States.³³ The proposed Takeover Directive contains provisions designed to ensure adequacy of information, and provides for equality of treatment and protection of shareholders.³⁴ It requires, in certain circumstances, a mandatory bid by a person acquiring a certain percentage of securities.³⁵ It also contains provisions concerning the contents of offer documents. Where securities are offered as consideration and an application for their listing has been made, the relevant listing particulars complying with the Listing Particulars Directive must be sent with the offer document.³⁶ If no application for listing has been made, the offer document must contain all the facts necessary to enable the addressees of the bid to form an informed judgment as to the assets and liabilities, financial position, record and prospects of the issuer.³⁷

The proposed Takeover Directive contains no special exceptions for institutional holders of shares in the target or bidding company.

4.2. *Mutual Funds*

Neither the Prospectus Directive nor the Listing Particulars Directive applies to offers of interests in collective investment undertakings (mutual funds) unless they are closed ended. There is, however, a separate scheme for the recognition and marketing of mutual funds throughout the EC which was introduced by the UCITS Directive on December 20, 1985.³⁸

The UCITS Directive deals with the coordination of Member States' provisions relating to undertakings for collective investment in transferable securities. The UCITS Directive covers open-ended UCITS (both unit trusts and investment companies), but not closed-ended UCITS or UCITS which do not promote or sell their units within the EC.

Member States other than Portugal and Greece had until

³³ See Proposed Thirteenth Council Directive, *supra* note 4.

³⁴ *Id.* arts. 3, 10.

³⁵ *Id.* art. 4.

³⁶ *Id.* art. 10(3).

³⁷ *Id.* art. 10(4).

³⁸ UCITS Directive, *supra* note 3.

October 1, 1989 to implement the Directive into their own national legislation. Portugal and Greece were allowed until April 1, 1992, with the possibility of a further four year extension.³⁹ The aim of this Directive is to ensure that once authorized in one Member State, the units or shares of a UCITS may be marketed throughout the EC.

Mutual funds established in non-Community countries will be outside the scope of the UCITS Directive and thus will not be able to benefit directly from Community-wide marketing envisaged by the Directive.

The UCITS Directive contains no special exceptions for offerings to institutional investors.

If, therefore, the mutual fund does not fall within the Prospectus Directive, the Listing Particulars Directive or the UCITS Directive, offers of interests in the fund will be governed solely by national law which may allow exemptions for institutional investors.

5. CONCLUSION

The Prospectus Directive therefore contains a number of exemptions or exclusions which may be of assistance in offers to institutional investors, namely:

(a) a form of professionals exemption, where the offer to them is "in the context of their trades, professions or occupations";⁴⁰

(b) a private placement exemption, where the offer is to "a restricted circle of persons";⁴¹

(c) larger scale subscriptions or purchases (a minimum of ECU 40,000 per investor or higher) or a large denomination of securities (ECU 40,000 and above);⁴²

(d) where Euro-securities are offered (but note there must be a syndicate with at least two members from different States and the securities must be offered on a significant scale outside the issuer's state);⁴³

³⁹ *Id.* art. 57(3).

⁴⁰ Prospectus Directive, *supra* note 1, art. 2.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

(e) offers of short-term debt securities (less than one year).⁴⁴

Notwithstanding the above exemptions and exclusions, it will, nonetheless, be necessary to consider the national legislation of the Member State in which the offer is proposed to be made. The national legislation will determine whether or not the offer is an "offer to the public" and how the exemptions are applied. It will also determine how the offer can be made, what level of disclosure is required and what other requirements are prescribed.

It is possible for Member States to impose requirements stricter than those contained in the Prospectus Directive, but if they do so, they must be applied in a non-discriminatory fashion. In addition, a Member State cannot prevent recognition of a prospectus approved in another Member State in accordance with the Prospectus Directive, except in certain very limited circumstances.⁴⁵

Therefore, where offerings are to be made simultaneously or close together in more than one Member State and the prospectus requirements are satisfied in one Member State, mutual recognition of that prospectus in other Member States will facilitate offerings to institutional investors in these other States regardless of whether those States permit or exempt offerings to such investors.

There are no special exemptions or exclusions under EC law for offerings of securities to institutional investors in connection with takeover bids or offers of interests in collective investment undertakings (mutual funds). There are also no special exemptions under the Second Banking Directive or proposed Investment Services Directive concerning offers to institutional investors.

⁴⁴ *Id.*

⁴⁵ UCITS Directive, *supra* note 3, art. 21.