

Guidance Notice

Scrutiny of securities prospectuses for comprehensibility

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BaFin's aim in issuing this Guidance Notice is to provide market participants with information on how the new European requirements on scrutinizing the comprehensibility of securities prospectuses are applied in practice. The goal here is to support market participants in drawing up prospectuses and to make it easier for them to apply the new rules. The background is the prospectus regime that came into force on 21 July 2019 together with the EU Prospectus Regulation, and that potentially requires modifications to be made to the language and structure of prospectuses compared to the format previously used by issuers. This Guidance Notice provides initial assistance in implementing these requirements. However, BaFin reserves the right to refine and enhance its administrative practices in this area in future.

I. Legal requirements:

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 (the "Delegated Regulation") provides details, among other things, of the requirements to be met by the competent authorities when scrutinizing prospectuses. The Delegated Regulation came into force on 21 July 2019 and therefore applies to all prospectuses that are scrutinised in accordance with the new law as set out in the EU Prospectus Regulation.

Specifically, Article 37 of the Delegated Regulation contains a catalogue of criteria to be considered when scrutinising the information contained in the prospectus for comprehensibility. This specifies that the following issues must be considered:

- a) whether the draft prospectus has a clear and detailed table of contents;
- b) whether the draft prospectus is free from unnecessary reiterations;
- c) whether related information is grouped together;
- d) whether the draft prospectus uses an easily readable font size;
- e) whether the draft prospectus has a structure that enables investors to understand its contents;

- f) whether the draft prospectus defines the components of mathematical formulas and, where applicable, clearly describes the product structure;
- g) whether the draft prospectus is written in plain language;
- h) whether the draft prospectus clearly describes the nature of the issuer's operations and its principal activities;
- i) whether the draft prospectus explains trade or industry specific terminology.

According to Article 40 of the Delegated Regulation, this list is not exhaustive. Where necessary for investor protection, BaFin may in individual cases apply additional criteria for the purpose of scrutinising the comprehensibility of the information contained in the prospectus.

The new requirements aim to achieve a greater degree of harmonisation not only of the directly applicable legal rules but also of their application in practice by the competent authorities when scrutinising prospectuses. One of the EU lawmakers' basic objectives in introducing the new prospectus regime is to make prospectuses more comprehensible for investors.

II. The requirements in more detail:

The following section explains how BaFin deals with individual requirements of Article 37 of the Delegated Regulation that are considered to be particularly important when scrutinising the comprehensibility of prospectuses. According to the standards for scrutiny to be applied pursuant to the definition of "approval" contained in Article 2(r) of the EU Prospectus Regulation, the comprehensibility of the information contained in prospectuses is a key condition for their approval, along with their completeness and consistency. Failure to comply with the comprehensibility requirements set out in detail in Article 37 of the Delegated Regulation can therefore result in the prospectus as a whole being incomprehensible, and hence to approval of it being refused.

Since base prospectuses are considered in practice to be particularly problematic from a comprehensibility perspective, there is a particular focus on them in the following. However, individual issues that are not limited to base prospectuses should be generally applied.

The general principle is that BaFin does not take a "one size fits all" approach when scrutinising prospectuses and applying the requirements of Article 37 of the Delegated Regulation. The key criteria that it uses in all cases to arrive at an assessment of comprehensibility in the course of its overall examination are the details of the specific case, the subject matter of the prospectus and the latter's structure.

1. With reference to Article 37(1)(a) of the Delegated Regulation (clear and detailed table of contents)

A clearly structured table of contents that among other things permits the information about different products in base prospectuses to be easily found

a) In the case of base prospectuses covering more than one type of product, the table of contents must be structured in such a way that readers can identify the different products in the prospectus. To achieve this, the table of contents should be structured into enough different levels to enable readers to directly identify the sections or subsections relating to specific, distinguishable topics.

b) The degree of detail to be provided by the table of contents depends on the contents and structure of the prospectus. For example, breaking the risk factors down into issuer risk and securities risk in the table of contents always seems to be appropriate. Whether or not to go further and provide a further breakdown of securities risk into the risks associated with specific products or product variants depends on the contents and structure of the prospectus. Conversely, it should be borne in mind at the same time that an overly detailed breakdown featuring a very large number of sublevels can also impair the table of contents' clarity. The general rule is that the number of levels in the table of contents should adequately reflect the structure and complexity of the prospectus.

c) The requirement for a clear, detailed table of contents that can be used by readers of the prospectus to identify the different products and product variants is in line with the prohibition of an overly modular design for base prospectuses (see below for further details) as regards different products and product groups: a prospectus design that is so modular that it does not permit different products and product groups to be identified using a clear table of contents is inconsistent with the requirement that the prospectus be comprehensible. For example, individual products should be numbered or identified by other suitable means that enable the provisions of the prospectus applicable to concrete products to be easily found using the table of contents.

d) As a general rule, the different levels in the table of contents must be structured alphanumerically (alphabetically and/or numerically).

2. With reference to Article 37(1)(e) of the Delegated Regulation (prospectus structure that enables investors to understand its contents)

2.1 Avoidance of an overly modular structure for base prospectuses covering a large number of very different products, and clear distinction/identifiability of the different products in the prospectus

a) Generally speaking, the lawmakers' aim in revising the prospectus regime was to have "leaner" prospectuses that are more comprehensible and more accessible for investors; extremely large prospectuses covering a very wide range of different products are not investor-friendly and, in particular, are often difficult for retail investors to use.

This applies to an even greater extent if this is combined with an overly modular or “nested” structure for the various products and product variants in the base prospectus. Combining a large number of modular components and options enables a very large number of different products to be created. Investors or readers of the prospectus are often hardly able to understand the potential product variants or how the relevant information can be identified and attributed to these, with the result that the prospectus can be incomprehensible. Irrespective of this, however, issuers are free to decide how granular they want to be when distinguishing between products, provided that the individual product variants can be clearly and consistently identified in the prospectus.

Avoiding an excessive number of different products and product variants in base prospectuses regularly also improves the latter’s comprehensibility in terms of both structure and scope, and hence makes them more accessible to investors. The same applies where a single base prospectus is used to group together largely similar products and separate base prospectuses are used for highly different products – or, in the case of prospectuses consisting of separate documents, where separate securities notes are used.

b) In the end, prospectuses must not be “jigsaw puzzles with lots of pieces” for investors that they have to laboriously put together to obtain the information relevant to a specific product. Ultimately, in this case the structure would no longer enable investors to understand the contents. This can be a problem not only in the case of an overly modular prospectus structure, but also where a very large amount of highly detailed information is incorporated by reference from many different sources. The following rule should therefore be borne in mind:

The greater the number of different products involved and the more modular the structure, the more likely the prospectus is to be incomprehensible.

c) Avoiding an overly modular structure is also in line with the requirement to ensure a clearly structured table of contents (see above): a modular structure that can no longer be presented in a clear table of contents that allows the individual modules to be unambiguously identified and assigned to the individual products is inconsistent with the requirement that the prospectus be comprehensible.

2.2 Short explanation of the function and structure of base prospectuses and their components, including the final terms

Including a short explanation for investors of the principles by which the base prospectus is structured and how it works (i.e. “instructions for use”) can increase the comprehensibility of the structure and therefore seems prudent for relatively complex base prospectuses in particular. If such an explanation requires a lengthy discussion, this suggests that the structure of the base prospectus is too complex.

3. With reference to Article 37(1)(g) of the Delegated Regulation (plain language)

Use of clear, understandable language in the narrower sense of the words

a) Using clear, uncomplicated language is a precondition for creating easily readable prospectuses. The following key points should be borne in mind when drawing up prospectuses:

- Understandable, grammatical expressions
- Simple sentence constructions; excessively long sentences should be avoided
- Specialist terms and abbreviations should be avoided as far as possible; any specialist terms that are necessary must be explained (this corresponds to the requirement set out in Article 37(1)(i) of the Delegated Regulation)
- The use of a glossary is recommended particularly in the case of relatively large numbers of specialist terms and abbreviations
- A clear, logical structure
- The use of scenarios, examples and graphics to visualise relatively complex material and to provide support
- Misleading product names should be avoided

b) The points above should not be taken as suggesting that BaFin “proofreads” the prospectus when scrutinising its comprehensibility; rather, an overall examination of the prospectus is decisive here. Issuers should take the points into account when drawing up prospectuses in order to comply with the overall requirement to ensure plain language.

c) The requirement of clear, understandable language generally applies to all parts of prospectuses. If a base prospectus contains any “directions” explaining how placeholders or multiple choice elements must be completed or selected, these directions must also be clear and unambiguous for readers.

4. With reference to Article 37(1)(f) of the Delegated Regulation (clear description of the product structure)

Use of sample calculations/sample scenarios to describe how derivatives work, including visualisations using graphics.

In the case of more complex derivative products in particular, it may make sense from a comprehensibility perspective to use sample calculations or sample scenarios to show how they work.