THE VOICE OF
PRIVATE CAPITAL
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INFRASTRUCTURE
LONG TERM INVESTORS

Position Paper

Prospectus Regulation

April 2016

Invest Europe key proposed amendments

1. Raising the exemption threshold to offers above € 50 million (Article 3)

The European Union should follow the example of the United States in the JOBS Act. Only a significant change in the existing threshold will make capital markets more attractive.

2. Apply the minimum disclosure regime to emerging companies (Article 15)

The minimum disclosure regime should not only cover SMEs but also all new companies that have the potential to grow over time.

3. Adding a reference to sophisticated investors (Article 1-2)

The Prospectus Regulation should not apply to offers made to investors who have demonstrated an appropriate knowledge of the industry when they invest above a certain threshold. The definition of "sophisticated investors" set in EuVECA achieves this objective best.

4. A more flexible Prospectus document and summary (Article 7, 16 and 18)

We welcome the additional flexibility brought by the new proposal, in particular when it comes to incorporation by reference, but fear the new risk factors system might give a false impression to the investor. We also call for flexibility regarding the length of the prospectus summary.

I. Who we are

Invest Europe (formerly known as the European Private Equity & Venture Capital Association (EVCA)) is the voice of private capital in Europe. Our members cover the full range of private equity activity, from early-stage venture capital to the largest private equity firms, and funds investing in infrastructure. We also represent institutional investors such as pension funds and insurance companies, who are a key source of long-term financing in Europe and invest in private equity and venture capital funds.

Private equity fund managers act as "connectors" between large institutional investors and European businesses that require funding at different stages of their life-cycle. In that context, private equity activity has three components: **fundraising**, during which fund managers raise capital from investors; **investment**, during which the manager puts that capital to work, investing it into companies and working with them to develop the business; **exit**, the point at which the company is transferred to its next owner(s), providing a return for the investor which is then used, in part, to help fund investment in future private equity and venture capital funds.

II. Relevance of the proposal for private equity

Prospectus requirements can create barriers or hurdles at the fundraising and exit stages and can therefore act as a disincentive for European private equity long-term investors into European companies.

While investors into private equity are usually institutional investors such as pension or insurance funds, private equity funds may in some cases raise funds on capital markets and issue transferable securities. Changes to the Prospectus Directive could make capital markets more attractive as a source of funding for European businesses by reducing the burdens on those fund managers that decide to access them as part of their fundraising.

More importantly, private equity fund manager will usually divest a company after an average of six years of patient and active investment in the business. One option is to divest following the listing of shares on the stock market through an Initial Public Offering (IPO). While potential investors need reliable information about a company and the potential risks associated with investing at IPO, the costs of the requirements faced by small innovative companies backed by venture capital funds are often disproportionate and discourage them from seeking capital market financing. The recent CEPS Report on the Capital Markets Union highlights the importance of a vibrant exit market for the healthy development of venture capital and private equity in Europe. According to the Report, private equity and venture capital "appear most suited to financing fast-growing innovative projects" yet their "effective functioning is guaranteed only by a proper exit option for investors"[1]. As the Commission recognised in its Action Plan, the difference in access to capital markets is an important weakness of the European economy, in particular compared to the United States, and one of the key reasons behind the lack of financing of small but rapidly growing businesses.

[1] Europe's Untapped Capital Markets, CEPS, February 2016

INVEST EUROPE

III. Implications of the proposal for fundraising

a. Exemption for all semi-professional investors (and fund managers investing into the fund) (**Article 1.3**)

Alongside catering for the investment and diversification needs of institutional investors such as banks, pension funds and insurers, some private equity funds may also issue transferable securities to high-net worth individuals, many of whom will have significant experience of investing in private equity funds, or in the sector or sectors in which the funds are active. Such investors are categorized as "retail" investors under Annex II of MiFID II and do not meet its conditions to be considered as “professional investors” upon request.

But these are not typical retail investors. They often have very specific industry or sector experience (for example in an operational role, or as an entrepreneur) that gives them what may be described as a professional level of understanding of the specific investment that they are intending to make. This is particularly relevant as these investors represent a significant source of capital for private equity and venture capital funds:

- capital raised from family offices and private individuals – who are *typically* deemed non-qualified investors (i.e. retail in this context) - constituted around 15% of the investment made into venture capital funds and thus into SMEs in 2014.
- capital raised among academic institutions or endowments – also often deemed non qualified investors - was more than 5% of overall capital raised of by private equity and venture capital fund managers in 2014.

Furthermore, investment in a fund made by the executives, directors or employees of the manager of the fund would also generally fall out of the qualified investors’ category. Such co-investment by the fund manager along side the institutional investors in the fund’s investments is an important characteristic of the private equity asset class, providing crucial alignment of interest between the fund manager and its investors by enabling the manager to have “skin-in-the game”.

Due to these characteristics, these “sophisticated” investors were recognised as a specific category under EuVECA (Article 6.1). The importance of these investors was also *partially* acknowledged in the current Prospectus Directive and in the Commission’s proposal for the Prospectus Regulation by two exemptions from the obligation to draw up a Prospectus:

(b) an offer of securities addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors;

(c) an offer of securities addressed to investors who acquire securities for a total consideration of at least EUR 100 000 per investor, for each separate offer;

Both of these exemptions are helpful in the current text of the Regulation for the following reasons:

- Point b will typically allow the fund to be marketed to a limited number of non-qualified investors, such as the executives and employees of the fund.
- Point c gives fund managers the freedom to market to high net worth individuals without having to draw up a Prospectus.

Nonetheless, we would suggest clearly exempting all investors which meet the “sophisticated investors” definition. This new approach will have the advantage of using the existing EuVECA concept to allow for more consistency in the EU rulebook. We believe it is a good alternative to the

option of raising the 150 retail investors threshold, and which will not lessen investor protection, and possibly even strengthen it, as all non-qualified investors will then need to be aware of the risks they will be taking.

Graph: *Number of retail and sophisticated investors an offer can be addressed to without triggering the Prospectus obligation in the different proposals*

Note: Pure retail investors are in light yellow, sophisticated ones in dark green.

Commission and Council proposal

150 retail investors	Investors who commit more than €100.000

Rapporteur's proposal

500 retail investors	Shareholders and employees (of the company)

Possible final compromise (based on existing positions)

X retail investors (compromise between 150 and 500)	*Shareholders and employees (of the company)*

Invest Europe compromise

150 retail investors	Shareholders and employees (of the company **and of the fund**)	Investors who commit more than €100.000 **and state in writing they are aware of the risk**

Suggested amendment

Article 1.3:
"This Regulation shall not apply to any of the following types of offers of securities to the public:
(a) an offer of securities addressed solely to qualified investors;
(b) an offer of securities addressed to fewer than 150 natural or legal persons per Member State, other than qualified **or sophisticated** investors;
~~(c) an offer of securities addressed to investors who acquire securities for a total consideration of at least EUR 100 000 per investor, for each separate offer;~~
(d) an offer of securities addressed solely to **sophisticated** investors;

Article 2.1: additional definition
"(wa) 'Sophisticated investors' means investors who are not qualified investors and:

(i) who commit to investing a minimum of EUR 100 000; **and state in writing, in a separate document from the contract to be concluded for the commitment to invest, that they are aware of the risks associated with the envisaged commitment or investment;** or

(ii) **who are executives, directors or employees of the issuer or of a manager of collective investment undertakings which have acquired assets of the issuer prior to the publication of the prospectus"**

b. <u>Exemption to publish a Prospectus</u> (Article 3.2)

It is in everyone's interest that more companies are able to access growth opportunities by issuing shares on listed markets. In light of this, the opportunity for Member States to allow issuers not to draw up Prospectus for offers below €10 million is a welcome proposal. However, it is far from being ambitious enough. If the EU is to increase capital markets financing, as suggested in the respective Capital Markets Union reports from all three European institutions, the Prospectus exemption should be broad enough to ensure no company is prevented to access capital markets due to the costs of the Prospectus.

The US JOBS Act (Reg A+), which raised the threshold of exemption from Prospectus issuance as part of IPO from $ 5 million to $ 50 million in 2012 is an interesting example. A similar change in EU law could also have a positive impact on jobs. As shown in the IPO Task Force report, studies have shown that 92% of the new jobs created by companies come after they become public[2]. Allowing Member States to have the flexibility to determine the threshold at national level would also take into account the difference in market sizes between EU countries.

Furthermore, we regret that the existing exemption only applies to offers which are made in only one Member State. The Commission proposal would impose an additional burden to offers which are made in several Member States, in spite of the fact that increasing cross-border capital flows within the EU is one of the objectives of the Capital Markets Union. The proposed rules could therefore affect EU harmonisation and have negative consequences for the Single Market.

If the European policymakers are committed to Europe closing the gap with the US, where SMEs receive five times more funding from capital markets[3], we suggest the following amendment:

Article 3.2 (new)

"A Member State may exempt offers of securities to the public from the prospectus requirement of paragraph 1 provided that:

~~(a) the offer is made only in that Member State, and~~

~~(b)~~ the total consideration of the offer is less than a monetary amount calculated over a period of 12 months, which shall not exceed EUR ~~10 000 000~~ **50 000 000.** […]"

c. <u>Risk factors</u> (Article 16)

The proposal recommends that "risk factors shall be allocated across a maximum of three distinct categories which shall differentiate them by their relative materiality". While we understand the desire of the Commission to avoid purely generic messages about the risk associated with any particular investment, we also need to ensure that risks are communicated to investors in a manner that suits market practices or industry specificities.

The materiality of any risk to which an issuer is or may be exposed, and hence also the investor, is difficult for the issuer to fully assess, likely to be subjective and, in part, could also be dependent on the characteristics of the specific types of investors looking at a specific type of issuer. The more

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[2] IPO Task Force Report; FESE, European issuers, Invest Europe; p. 71

3 European Commission, Capital Markets Union Action Plan

prescriptive the risk categorisation, the higher the possibility that the harmonised rules will give a false sense of precision to the investor and will give rise to liability issues for the issuer.

In any case, the approach chosen would have to be in line with practices which are well-established, whether by the companies themselves, by international bodies, such as the IASB, or within existing EU legislation, such as the Transparency Directive. There is a real concern amongst practitioners that the current proposals in relation to risk factors will be practically difficult to meet and would again put the European rules at significant variance with the US market.

Suggested amendment

Article 16.1

The risk factors featured in a prospectus shall be limited to risks which are specific to the issuer and/or the securities and are material for taking an informed investment decision.~~, as corroborated by the content of the registration document and the securities note~~. ~~They shall be allocated across a maximum of three distinct categories which shall differentiate them by their relative materiality based on the issuer's assessment of the probability of their occurrence and the expected magnitude of their negative impact.~~ […]"

d. Incorporation by reference (Article 18)

We welcome the opportunity to incorporate by reference information which has already been prepared by the issuer. Re-using existing documentation will allow fund managers to avoid the additional costs of preparing and publishing the same information for the same investor twice (or more) and will help investor protection by avoiding unnecessary duplication of the documentation they are due to read to understand the investment.

In this context, we believe the wording of the Article should be flexible enough to allow companies to incorporate by reference ***any*** official document which provides similar information to the Prospectus if it is available. We recognise, however, that any extension would need to be restricted to documents that were themselves subject to sufficient disclosure standards. For this reason, we believe only information required under EU legislation should be incorporated by reference.

Suggested amendment

Article 18.1

Information may be incorporated by reference in a prospectus where it has been previously or simultaneously published electronically, drawn up in a language fulfilling the requirements of Article 25 and where it is contained in one of the following documents:
(a) documents which have been approved by the competent authority of the home Member State, or filed with it, in accordance with this Regulation;
(b) documents referred to in points (f) and (g) of Article 1(3) and points (d) and (e) of Article 1(4);
(c) regulated information as defined in point (l) of Article 2(1);
(d) annual and interim financial information;
(e) audit reports and financial statements;
(f) management reports as defined in Article 19 of Directive 2013/34/EU of the European Parliament and of the Council;
(g) corporate governance statements as defined in Article 20 of Directive 2013/34/EU;
(h) [remuneration reports as defined in Article [X] of [revised Shareholders Rights Directive]
(ha) annual reports or any disclosure information required under Article 22 and 23 of Directive 2011/61/EU
(i) memorandum and articles of association;

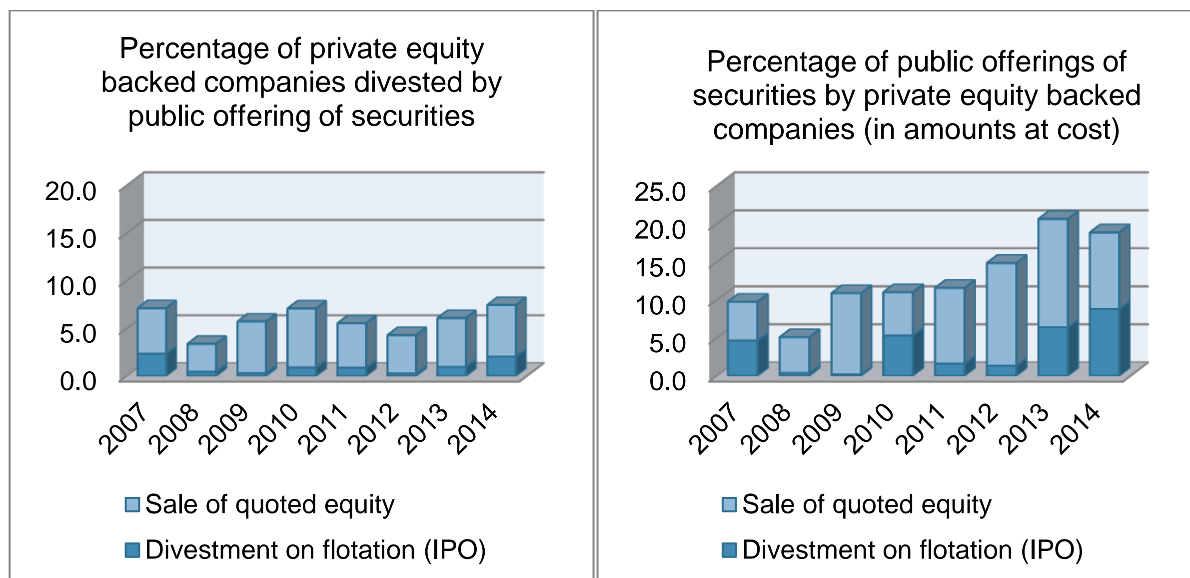
The above mentioned list should be non-exhaustive, provided the information is required under EU legislation.

Such information shall be the most recent available to the issuer. Where only certain parts of a document are incorporated by reference, a statement shall be included in the prospectus that the non-incorporated parts are either not relevant for the investor or covered elsewhere in the prospectus. […]"

IV. Implications of the proposal for exits: Minimum disclosure for Small and Medium-sized Enterprises (SMEs) (Article 15)

Issuing shares of their most successful portfolio companies on regulated markets is a crucial channel for private equity fund managers to generate value for their investors. The minimum disclosure regime for SMEs is welcome as it will reduce the cost of issuing shares in an SME on the public markets. Simplified requirements could potentially help venture capital and growth fund managers to sell their companies on stock markets. According to data from the Federation of European Securities Exchanges (FESE), depending on the amount raised from the IPO, the cost of raising capital can range from 3% (for very large offers) to 15%.

By way of background, listing shares on a stock market via an IPO or a sale of quoted equities is one of three main routes private equity fund managers use when selling a company in which they have invested (the other two being trade sales and sales to other financial investors). In 2014, 18.9% of the exits (by value) were through public offerings, of which roughly 9% were IPOs. Public offerings represent a larger share of divestments in the context of large private equity funds (18.8%) than growth (15%) and venture capital funds (10.6%). Below are two graphs which give more detailed information on the importance of public offerings in the context of private equity.



Source: Invest Europe, 2014

In light of this, we believe Article 15 could be amended in the following way:

- **The minimum disclosure regime should apply to more companies, even some who do not meet the technical EU legal definition of an SME**

As shown in the graphs above, over the last few years public offerings consistently formed only a small share of the number of companies divested (at a maximum of 7%) but a much larger share of the amount divested (maximum 20%). In other words, fund managers usually sell their companies on the public markets when the offer is sufficiently large.

The situation outside Europe – and in particular in the United States - shows that lower costs for emerging companies can make public markets more attractive to them. The US Jobs Act, enacted in 2012, allows all emerging growth companies[4] to use a proportionate regime for the first five years of their life on regulated markets.

Without detrimentally reducing investor protection, this change has led to a significant increase in IPOs of emerging growth companies. According to a study, the number of IPOs in the United States climbed from 133 in 2012 to 226 in 2013 and 291 in 2014. This increase was almost exclusively attributable to firms considered under US law as "emerging growth companies" which were able to take advantage of the reduced disclosure[5].

If a similar change had been implemented in Europe, for companies of a much smaller size (for example € 250 millions of market capitalisation), half of companies that IPO'd in 2015 could have benefitted from the minimum disclosure regime in their first year[6]. We would therefore suggest raising the existing threshold to at least €250 million, although an even more ambitious level (e.g. € 500 million in line with the ELTIF regulation, or € 1 billion to be closer to the US regime) would make capital markets even more attractive for companies.

- **The requirement to have no securities admitted to trading on a regulated market could prevent successful SMEs to continue growing on capital markets**

When a private equity fund decides to exit one of its portfolio companies through an IPO and simultaneous listing of the portfolio company's shares, the IPO can either take the form of a new issue directed towards the market (with the portfolio company issuing more shares of the same kind or shares of a different category) or through the private equity fund selling part of its holding. In either case, as it is the portfolio company which seeks the listing approval, it will be up to the company, often an SME, to issue a prospectus.

The experience of Invest Europe members is that companies, especially the most successful ones, will often raise capital from the public market more than once in the initial years following IPO. It would therefore be important to allow SMEs that raise further rounds of capital through public markets (following their IPO), to continue making use of the lighter regime throughout the first few years of issuance.

The current regime only allows SMEs to produce lighter Prospectuses at the time of the IPO and after 18 months (for secondary issuances) but forces them to produce a normal Prospectus if they want to offer more securities at the beginning of their listed life. This creates major uncertainty for high-growth potential SMEs that soon require new financing to continue developing. Here again we believe the US regime –which allows companies to benefit from the regime in the first five years of their listed life- is much more suited to the needs of companies, allowing them to grow at their preferred pace without creating uncertainties about the potential regulatory cost of issuance.

Given a minimum disclosure regime would already apply for secondary issuances after 18 months, we suggest that SMEs are allowed to make use of the minimum disclosure regime for securities that have been admitted on public markets when their securities were only admitted to trading on a regulated market in the last 18 months.

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[4] Emerging growth company is defined as any issuer that had total annual gross revenues of less than $1 billion during the five years following the IPO.

[5] The Jobs Act: mid-year update, 2015, EY.

[6] Based on FESE and LSE data, 2015 IPO markets

Further to this, it should be made clear in the Level 1 text that incorporation by reference should also be made possible in the documents produced in minimum disclosure. We see no reason why information already available may be referenced in a normal Prospectus and not in the simplified Prospectus.

Suggested amendment

Article 15.1

"**Companies with market capitalisation of less than a € 250 million** ~~SMEs~~ may choose to draw up a prospectus under the minimum disclosure regime **detailed in this Article** in the case of an offer of securities to the public provided that they have no securities admitted to trading on a regulated market **or provided their securities were only admitted to trading on a regulated market in the last 18 months**.
The minimum disclosure regime shall consist of a specific registration document and a specific securities note.
The information defined in Article 18 may be incorporated by reference in these documents.
When establishing the corresponding prospectuses schedules, the information shall be adapted to the size and to the length of the track record of such companies."

Contact

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About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

For more information please visit www.investeurope.eu