UKLA Technical Note

Non-equity prospectuses aimed at retail investors

Ref: UKLA/TN/632.1 ~~Consultation~~

Prospectus Directive and PR 2.1.1

~~Non-equity retail prospectuses: ensuring they are "easily analysable and comprehensible"~~

Article 5.1 of the Prospectus Directive requires all prospectuses~~, including a non-equity retail prospectus,~~ to be 'easily analysable and comprehensible'.

This technical note sets out some of the key aspects that issuers should consider when preparing a ~~retail~~ prospectus ~~, in order~~ for retail investors, so that ~~such documents are~~ it is 'easily analysable and comprehensible' to a retail audience.[1]

~~Please note that this technical~~ This note does not provide issuers with an exhaustive list of issues and they should consider the nature of the securities and the prospectus as a whole when drafting non-equity ~~retail~~ prospectuses aimed at retail investors. This note applies both to base prospectuses for programmes and prospectuses for stand-alone transactions.

When is this guidance relevant?

~~We consider~~ This guidance is relevant to all non-equity prospectuses ~~relating to non-equity~~ except:

(1) Prospectuses for securities ~~that have~~ to be admitted to trading on a regulated market with a denomination of at least €100,000 (or equivalent in other currencies).
(2) Prospectuses which relate to the admission to trading on a regulated market of securities with a denomination of less than €100,000 ~~to be 'retail' prospectuses. This is consistent with the distinction between wholesale and retail securities made in the Prospectus Directive Amending Directive[2].~~ (or equivalent in other currencies) where the prospectus makes an 'exempt offer' to qualified investors only[2], unless the securities are to be admitted to trading on a regulated market or a segment of a regulated market which is marketed at retail investors.

~~This guidance is therefore relevant to retail denominated debt prospectuses and base prospectuses and retail denominated prospectuses and base prospectuses for structured products. This is the case even in circumstances where it is intended that a retail denominated prospectus will be used to issue securities to wholesale or exempt investors.~~

In relation to a prospectus that falls within (2) above, we would expect it to be clear in the relevant prospectus (i) that the issuer does not consent for the prospectus to be used in relation to offers other than offers to qualified investors and (ii) that there are selling restrictions preventing the relevant dealers or managers from offering the securities other than to qualified investors. We do not consider that it would be possible to use a supplementary prospectus to include required information regarding a public offer (e.g. the omitted Annex 5 and Annex 30

[1] See Article 5.1 of the PD and Recital 16 of the PD, which states that it is appropriate to take account of the various categories of investors and their level of expertise.

[2] As defined in section 86(7) of FSMA

information items) to make a public offer of securities with a denomination of less than €100,000 (or equivalent denomination).

For issuers that have published a prospectus which falls within (1) above (a high denomination base prospectus) or (2) above (a low denomination base prospectus aimed at qualified investors (which is not written in such a way that it would meet the ‘easily analysable and comprehensible’ requirements in the retail context)), a draw down prospectus (incorporating by reference information from the previously stated base prospectus) could be used for offers of low denomination bonds to retail investors, if the draw down prospectus is written in accordance with the principles set out in this note. In these circumstances, we would consider the combination of such documents to meet the ‘easily analysable and comprehensible’ requirements in the retail context.

How do I make my prospectus easily analysable and comprehensible to retail investors?

Outlined below are a number of key areas that we suggest issuers consider to make a ~~retail~~ prospectus easily analysable and comprehensible to retail investors. Other considerations may also be relevant, depending on the nature of the individual securities.

a) Language

A prospectus should be written using language~~ in a style~~ that is easily analysable and comprehensible to a retail investor. This means the prospectus should ~~not~~ be written in a ~~legal~~ style~~, nor should it place excessive reliance on~~ that is appropriate for retail investors and therefore the use of defined terms, technical language ~~or~~ and market jargon~~.~~ Should be restricted to circumstances where their use might aid the comprehension of a retail investor or where their use is necessary to ensure the prospectus is true, accurate and not misleading. Where such language is used it should be clearly explained~~ in~~, either each ~~section of the prospectus where this language is~~ time it is used or using cross-references where appropriate.

We recognise that the ~~T~~terms and ~~C~~conditions sections of ~~retail~~ securities aimed at retail investors may be directly reproduced from legal documents containing legal language. For this reason, we do not propose that the language in the ~~T~~terms and ~~C~~conditions section be presented in the ‘easily analysable and comprehensible’ language highlighted in this technical note.

b) Navigating the prospectus

Where a prospectus relates to more than one type of security, comprehensibility is greatly enhanced by including clear instructions about which sections of the ~~document~~ prospectus apply to a particular security. Issuers may wish to consider the use of ‘sign-posting’ to enable an investor to navigate through the prospectus to find the sections relevant to a particular security. This will be especially helpful where different types of securities may be offered or where certain investment features may or may not apply. A short section at the beginning of the ~~document~~ prospectus that clearly explains key aspects of the ~~document~~ prospectus could be included detailing, for example:

- a description of the type of securities that the prospectus relates to~~,~~
- a ‘How do I use this prospectus?’ section~~, and/or~~
- a description of the type of underlying asset to which the securities may be linked~~.~~

c) Calculating the return on maturity or interest payment where the maturity or interest payment is determined by a derivative component.

Prospectuses relating to structured products and to securities where the coupon is determined by a derivative component must give 'a clear and comprehensive explanation…of how the value of the investment is affected by the value of the underlying instrument(s).'[3] This explanation should focus on the features of the securities and does not require an indication of the possible performance of such securities.

The description of an investor's return should be presented without using complicated technical jargon or complex mathematical formulae. ~~Use~~ Issuers may use examples to explain complex securities, especially where various separate pay-out features or underlying linked terms may need to be explained to investors, either separately or together, producing a series of different outcomes. However, a simple equation or narrative describing the yield in the case of less complex securities may also be acceptable.

d) FAQs

FAQs ~~are~~ may be helpful, but are not essential. Although we do not require ~~retail~~ prospectuses aimed at retail investors to include FAQs, they are one method that can be used to make prospectuses easily analysable and comprehensible for retail investors.

e) Explaining bond holder protections and bond features

Retail investors ~~are~~ may not be ~~nor~~ knowledgeable of the ~~risks~~ mechanisms that can be built into bonds which, when combined with the credit risk of the issuer, will not only determine the credit rating of the bond but will, when combined with the prevailing interest rates, also determine the coupon.

In the case of bonds that are not plain vanilla unsecured and unsubordinated bonds, ~~F~~for a retail investor to understand the nature of the investment ~~why a bond pays a relatively high coupon in a low interest rate environment~~, the prospectus should clearly identify the features and risks associated with that bond. The prospectus should also clearly explain how the protections and rights that have been built into ~~the~~ that bond might work in a default scenario. For example, if the bonds are secured, there should be clear explanation of what this means and the process that needs to be undertaken before bond holders will receive repayment of all or part of their principal. Similarly, if bond holders ~~will be~~ are structurally subordinated, then this fact and its significance should be explained, so that holders are aware that they will rank behind other creditors.

To ensure that retail investors fully understand the features, risks, protections and rights associated with a bond that is not a plain vanilla unsecured and unsubordinated bond, this information should be presented in an easily analysable and comprehensible format, either through:

- a clear narrative~~, or~~
- the use of a diagram with accompanying text separately from the terms and conditions of the bond

[3] Prospectus Directive Regulation, Annex XII.4.1.2 and Annex V.4.7

- The presentation of this information may either be within the risk factor section or within a separate section of the prospectus.