



A European Prospectus Revolution?

The EU prospectus regime, based on Directive 2003/71/EC (the “**Prospective Directive**”) as amended, has been in place now for nearly 10 years and was due to be reviewed by the European Commission by 1 January 2016. However, the European Commission has moved forward its review, and on 18 February 2015 released a consultation¹ on possible reform of the current regime, in conjunction with its Green Paper on a possible EU Capital Markets Union, released on the same date.

The main focus of the proposed EU Capital Markets Union is on improving the access to capital markets for smaller business entities (“SMEs”), in order to broaden the range of funding without the need for bank intermediation. The European Commission considers that the review of the EU prospectus regime is a vital part of developing a Capital Markets Union and, as such, has accelerated the timing of the review by launching its consultation now.

Background

The prospectus regime review is driven by the European Commission’s belief that there are many shortcomings in the current prospectus framework, such as the expense and complexity of preparing a prospectus, getting it approved, and the time-consuming nature of that process. It considers that these factors act as a barrier for many smaller-sized business entities that wish to access the capital markets. The stated aim of the review is therefore to reform the current regime to make it easier for companies to raise capital throughout the EU, at a lower cost, whilst still maintaining an effective level of investor protection. It also aims to update the regime to adapt to market and regulatory developments, including the prevalence of securities trading via multilateral trading facilities and organised trading facilities, the creation of SME growth markets, and also to reflect the upcoming introduction of Key Information Documents for packaged retail investment products under the new PRIIPs Regulation.²

The consultation takes the form of a number of questions, on which the European Commission invites the submission of on-line responses by 13 May 2015 at the latest. From the very first question, “should a prospectus be necessary for admission to trading on a regulated market, or an offer of securities to the public?”, it is clear that no part of the current prospectus regime is off-limits for discussion purposes – this is a “root and branch” review.

¹ European Commission Consultation – REVIEW OF THE PROSPECTUS DIRECTIVE, Brussels, 18 February 2015, available at http://ec.europa.eu/finance/consultations/2015/prospectus-directive/docs/consultation-document_en.pdf.

² See Morrison & Foerster, Structured Thoughts, Volume 5, Issue 4, available at <http://www.mofo.com/~media/Files/Newsletter/140602StructuredThoughts.pdf>.

Other starter questions in the consultation include whether there should be a different treatment for a prospectus used for admission to trading compared to one used for an offer to the public. The consultation also asks for details of the costs of producing different types of prospectuses, in different circumstances, and a breakdown of how those costs are constituted. It also seeks views as to whether the costs of producing a compliant prospectus are justified by the major benefit provided to issuers by the Prospectus Directive – that of the “passport”, which permits the issuer access to all EU member states and regulated exchanges, without the need for any additional prospectus approvals.

The consultation is then broken up into separate sections.

When Should a Prospectus Be Required?

Exemptions

This section focuses particularly on the existing exemptions from the need to publish an approved prospectus and whether those existing exemptions are appropriate or should be amended.

It also focuses on the fact that, for small offerings (i.e., below EUR 5 million), the Prospectus Directive does not mandate the production of a prospectus, but leaves it open to individual member states as to whether a prospectus should be required in such circumstances, and whether there should be a harmonised approach across the EU to the question of prospectuses for small offerings.

Secondary Issuances

It also asks the question whether there should be a general prospectus exemption for secondary issuances of a class of securities that is already admitted to trading on a regulated market. Currently there is a limit of 10 percent per annum for an admission to trading without a prospectus of a secondary issuance of securities that are already listed, and the European Commission invites views as to whether that exemption should be extended or whether there should be instead be a more general, lighter (or proportionate) disclosure regime for secondary issuances of securities that are already listed.

Trading Venues

It considers whether the current requirement for publication of a prospectus for admission to trading on a regulated market should be extended also to admission to trading on a multi-lateral trading facility, and if so, whether there should be a differentiation between different types of multi-lateral trading facilities (including SME growth markets).

Investment Funds

In relation to investment funds, the Prospectus Directive currently provides that open-ended collective investment schemes are outside of its scope, but closed-ended collective investment schemes marketed to non-professional investors are potentially within scope. The European Commission invites views on whether certain types of funds, such as European long-term investment funds, European social entrepreneurship funds, and European venture capital funds, should be exempted from the prospectus requirement (even though they may remain subject to any bespoke disclosure requirements imposed by their sectoral regulation and/or by the PRIIPs regulation).

Share Schemes

In relation to employee share schemes, currently an exemption is granted for offers of securities by a firm to its employees, though this applies only where the issuer has its head office or registered office in the EU, or if it is a non-EU company whose securities are admitted to trading on a regulated market or on a third-country market. Views are invited as to whether this exemption should be extended also to employee share schemes of private non-EU companies.

Wholesale Denomination

Currently, a prospectus is not required in relation to debt securities with a denomination of at least EUR 100,000. The original reason behind this exemption was that it was considered that private or retail investors (who were the primary focus of the investor protection provisions of the prospectus regime) were less likely to invest in high-denomination debt (and in fact, this exemption is commonly known as the “wholesale exemption”). In terms of what was considered high-denomination, the amendments made to Prospectus Directive in 2010 increased that amount from EUR 50,000 to EUR 100,000. However the European Commission is now asking the question as to whether this exemption is still appropriate or whether having a high threshold may create an incentive to issue in larger denominations and so limit the issuance of debt securities in smaller denominations.

The other benefits to issuing in higher denominations are lighter disclosure requirements for such high-denomination securities where they are to be admitted to trading on a regulated market (and therefore still require an approved prospectus). Issuers of high-denomination securities are also not required to provide a prospectus summary, and in addition, under the Transparency Directive (Directive 2004/109/EC), an issuer of exclusively high-denomination debt securities, that are admitted to trading on a regulated market, is exempted from the obligation to publish annual and semi-annual financial statements. Views are now invited as to whether the high-denomination exemption may be detrimental to liquidity in corporate bond markets, and if so, whether the EUR 100,000 threshold should be lowered and whether some or all of the benefits of issuing in high denominations should be removed. It even asks whether the threshold should be removed altogether, with the effect that the current exemptions and benefits should be granted to all debt issuers, regardless of the denomination of those securities.

Prospectus Contents

The next section considers the information that a prospectus should contain.

Proportionate Disclosure

Firstly, it focuses on the proportionate disclosure regime that was introduced in 2010 for SMEs and companies with “reduced market capitalisation”. The Commission’s concern is that the proportionate disclosure regime has not delivered on its intended effect and is still not widely used, as it is still perceived as too burdensome by smaller entities. It asks whether the regime should be modified to improve its efficiency and whether it should be extended to other types of issuers not yet covered. It also asks whether respondents would support the creation of a simplified prospectus regime for SMEs admitted to trading on an SME growth market.

Incorporation by Reference

The Prospectus Directive allows for prospectuses to incorporate certain information by reference only, where that information has been published and approved or filed with the relevant authority. The Commission invites responses on whether the provisions on incorporation by reference should be recalibrated to achieve more flexibility and allow other documents to be incorporated by reference, including (but not limited to) documents already required pursuant to other financial regulation, such as the Transparency Directive and the Market Abuse

Directive. This reference to flexibility is interesting, given that one of the criticisms by market participants of the approach of the European Securities and Markets Authority (“ESMA”) to implementing the amendments made to the prospectus regime by the Omnibus II Directive is its overly restrictive interpretation of the Prospectus Directive provisions on incorporation by reference.

Short-Form Disclosure

One of the key criticisms of the approach to the recent PRIIPs regulation is the fact that, for a packaged retail product in the form of a security, when the PRIIPs regulation comes in to force there will be a need to provide a key investor document (“KID”) summarising the essential features of the product, in addition to the separate prospectus summary required in relation to debt securities with denominations below EUR 100,000. There will be a large degree of overlap in the information required for these two documents, yet there is no proposal in either the PRIIPs regulation or the Prospectus Directive to address this overlap in an efficient manner. The European Commission now asks whether there is a need to reassess the rules regarding the prospectus summary (for instance, regarding the concept of key information and its usefulness for retail investors, regarding the comparability of summaries of similar securities and regarding the interaction of the prospectus summary with final terms for securities issued under a base prospectus). It also asks for views as to how the overlap of information between the PRIIPs KID and the prospectus summary should best be addressed - whether that may be by providing for information already contained in the KID not to be duplicated in the prospectus summary, or by eliminating the need for a prospectus summary for such securities altogether. Another suggested alternative is the alignment of the format and content of the prospectus summary with that of the PRIIPS KID, with the view to minimising costs and promoting comparability of products.

Length

The European Commission is concerned about the trend towards overly long prospectuses – in Europe, base prospectuses for structured products, for example, may often exceed 1000 pages. The European Commission asks whether respondents would support the concept of introducing a maximum length for a prospectus, or a maximum length for certain specific sections of the prospectus. Many would say that this is not an issue that can properly be considered without at the same time considering the current liability standards for prospectuses, given that it is the latter that primarily drives the level of disclosure that the issuers feel is necessary to minimise their liability – that and, in the case of the base prospectuses, the regulatory changes that were introduced by the European Commission in the last few years, restricting the amount and type of information that can be included in final terms for programme issuances.

Liability

The Prospectus Directive does not currently provide any harmonised liability regime, and it is largely left to individual member states to prescribe criminal sanctions and a civil liability regime. The European Commission is now asking for comments as to whether the current provisions, requiring member states to ensure that appropriate administrative sanctions can be imposed against responsible persons, are adequate or should be improved.

Approval of Prospectuses

The final section of the consultation focuses on the issue of how prospectuses are approved. It invites views on how the approval process by national competent authorities can be streamlined and made more consistent between different jurisdictions. In particular it asks what the involvement of national competent authorities should be in relation to prospectuses, including whether there should any longer be a requirement (as currently) to review all prospectuses before the relevant offer or admission to trading, or whether authorities should review only a sample of prospectuses beforehand, with other prospectuses being reviewed only after the offer or the

admission to trading has commenced. It also asks whether the EU passporting mechanism is functioning in an efficient way or whether improvements could be made, such as whether the approval notification procedure between home and host member states could be simplified.

Base Prospectuses

Base prospectuses are currently only available for the issuance of debt securities for up to 12 months after the approval. However, views are now sought by the European Commission as to whether base prospectuses should be able to be used for all types of issuers and issues (including equity securities) and whether the base prospectus should remain valid for more than one year.

Miscellaneous

Other questions asked include whether the current distinction as to the home member state for non-equity securities above EUR 1000 denomination and non-equity securities with a denomination below EUR 1000 is a relevant distinction, or whether it should be amended. It also asks whether member states should move to an all-electronic system for the filing and publication of prospectuses.

Equivalence of Non-EU Prospectus Regimes

Most importantly for non-EU issuers is the question that the European Commission asks in relation to a possible equivalence regime. Currently, the prospectus regime does not provide for a single equivalence regime for prospectuses drawn up under the legislation of non-EU countries, and assessments of equivalence are currently made by each individual national authority. The European Commission is seeking feedback on whether an equivalence regime could be developed and applied for all non-EU countries, such that a general equivalence decision could be taken by the European Commission for each non-EU country, based on an assessment as to whether the requirements of the non-EU country's prospectus regime are equivalent to those of the Prospectus Directive in terms of investor protection.

Definitions

Finally, the consultation invites views as to whether there is a need for certain terms to be better defined, including the term "offer of securities to the public" (which is fundamental to the current prospectus regime) as well as the terms "primary market" and "secondary market".

This review of the prospectus regime, and the ensuing regulation, will test the European Commission's appetite for reform. The current prospectus regime took many years to develop, and it took many more years for participants and regulators to work through the finer details of compliance. Depending upon which approach the European Commission chooses to take, following the outcome of the consultation, the enormous scope of the potential changes could lead to many more years of work yet.

Authors

Jeremy C. Jennings-Mares
London
+44 20 7920 4072
jjenningsmares@mofocom

Peter J. Green
London
+44 (20) 79204013
pjgreen@mofocom

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