BREXIT: SOME INITIAL THOUGHTS ON PROSPECTUS REQUIREMENTS FOR ISSUERS OFFERING FINANCIAL SECURITIES IN THE UK/EU

In this article based on a client briefing, Peter Green (Partner) and Jeremy Jennings-Mares (Partner) at Morrison & Foerster LLP provide some initial thoughts on the potential impact of Brexit on issuers and distributors of securities in the context of prospectus requirements applying to offers of financial securities in the UK and the rest of the EU.

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The United Kingdom has voted in a referendum by a narrow majority to leave the European Union (Brexit).

The outcome of the referendum will have far-reaching consequences on financial markets and international capital raising. This article sets out some initial thoughts on the potential impact of Brexit on issuers and distributors of financial securities in the context of the prospectus requirements applying to offers of financial securities in the UK and rest of the EU.

EFFECT OF BREXIT VOTE

The referendum result is advisory only and therefore has no automatic effect under UK or EU laws. For the time being, the UK remains a member of the EU and subject to the EU treaties. All existing EU-derived laws and regulation continue to apply in the UK. However, the UK government has stated that it intends to give effect to the result of the referendum.

The UK will need to commence the process of its exit from the EU by serving a notice of its intention to leave the EU under Article 50 of the Lisbon Treaty (Article 50 Notice). Once the Article 50 Notice is served, the UK will have two years to negotiate and agree the terms of its exit. The terms would need to be approved by a qualified majority of the European Council (excluding the UK), and the consent of the European Parliament. If no agreement is reached within such two-year period, or any extended period agreed by all member states, the UK would automatically cease to be a member of the EU.

There is no prescribed timescale for the UK to submit its Article 50 Notice and it is not currently expected to be presented to the EU Council of Ministers until sometime after David Cameron's successor as Prime Minister has been appointed.

A key issue in determining the effect of Brexit on the issuance and distribution of financial securities is the legal and trading relationship put in place between the UK and the EU following Brexit and, in particular, if and the extent to which the UK will continue to have access to the EU single market after leaving the EU.

This article does not consider in detail the various options that the UK may seek to pursue in this regard. It is, however, worth noting that the option that would cause the least disruption in the context of financial regulation is what has been termed the "Norwegian model". Under this model, the UK would leave the EU but remain a member of the European Economic Area (EEA) and the European Free Trade Area (EFTA). This would continue to give the UK access to the EU single market, but it would also require the UK to make financial contributions towards the EU without having any right to participate in EU rule-making and would require the UK to be bound by many of the rules of the EU which have been unpopular with Brexit supporters, including the free movement of people. The general view of market and political commentators at the moment is therefore that this route is unlikely to be the favoured route of the UK government in Brexit negotiations. Such option would, however, have a relatively small impact on EU financial regulation, as the vast majority of such regulation applies to EEA members.

It is currently regarded as more likely that the UK will seek to pursue a free trade agreement model with the EU along the lines of the free trade agreements between the EU and South Korea, and the EU and Canada, which would preserve some access to the EU single market. However, these agreements took many years to agree and it would seem ambitious to expect arrangements between the UK and the EU to be agreed within a two-year period. These agreements also do not provide access to the EU single market for financial services in any material way. Having regard to the scale and importance of the financial services market to the UK, preserving the UK's access to such market is likely to be an important objective in its negotiations with the EU. The extent to which this can be achieved is, however, very uncertain at present.

THE EXISTING PROSPECTUS DIRECTIVE

The Prospectus Directive (PD) imposes form and content requirements for prospectuses in respect of offers of financial securities to the public in the EU or where the issuance is listed on an EU-regulated exchange. Where the securities are not listed on a regulated exchange in the EU, there is an exemption from the need to prepare a PD-compliant prospectus in certain cases. The most commonly used exemption at present is for securities with a denomination of at least EUR100,000. Other exemptions include offers to qualified investors (primarily institutional and professional investors) and offers made to fewer than 150 persons, other than qualified investors, per member state.

Before securities within the scope of the PD can be offered to the public in the EU, a PD-compliant prospectus must be approved by the competent authority in the issuer's "home member state". Following such approval, the issuer can take advantage of "passporting" provisions and offer the securities across all EU member states without the requirement for any further authorisations.

Assuming that the UK does not remain a member of the EEA following Brexit, subject to the Brexit terms agreed between the UK and the EU, the PD will cease to apply to the UK (and the rest of this article assumes this to be the outcome following Brexit).

The UK will therefore need to decide whether to replicate the PD (or if it has then come into force the new Prospectus Regulation referred to below) into UK law. UK law currently implements the existing provisions of the PD, so this should not be a major exercise. In view of the amount of other issues the UK will need to deal with in relation to Brexit, it would seem unlikely that making changes to the current approach to prospectus regulation will be high on its list of priorities. In addition, many issuers of financial securities seek to distribute them to investors in both the UK and the rest of the EU. It would be highly undesirable for such issuers to have to comply with two different sets of prospectus requirements. It therefore seems likely that immediately after Brexit, the UK rules in relation to prospectuses for offers of financial securities will be consistent with those then applying in the EU.

However, even if the UK does replicate the PD following Brexit, the UK Financial Conduct Authority as the UK Listing Authority (the UKLA) will cease to be a relevant competent authority for the purpose of the PD. Issuers of securities into the EU would therefore not be able to utilise the UK as their home member state and would have to seek approval of the prospectus of its "home member state" within the EU.

For issuers of non-equity securities with a denomination of at least EUR1,000, the issuer has a choice of its home member state. The home member state can be either the jurisdiction in which it has its registered office (if in the EU) or a member state where the securities are admitted to trading or offered to the public. Therefore, absent any special agreement between the UK and the EU following Brexit, it is likely that the issuers of securities offering those securities in the UK and elsewhere in the EU would be faced with obtaining approval by both the UKLA and a competent authority within the EU. Where the UK is the home member state in respect of securities to be issued under a base prospectus approved before Brexit, it is not yet clear whether a further approval from another EU competent authority appointed as the new home member state would be required before any further post-Brexit issuances could be made off the base prospectus. Provided that the UK continues to have in place regulation identical or very similar to the PD, then under the PD, other EU competent authorities will have the power (but not the obligation) to approve a prospectus drawn up by a UK issuer on the basis that it has been drawn up in accordance with international standards equivalent to the PD.

Because the Main Market of the London Stock Exchange would cease to be an EU-regulated market for the purposes of the PD following Brexit, any securities listed on that market would not automatically require a PD-compliant prospectus to be approved by an EU competent authority even if offered in the EU. Therefore, if in these circumstances an appropriate exemption to the PD applies, it would be possible for the issuer to avoid the need for approval of the prospectus by an EU competent authority (although it may still need to be approved by the UKLA if the UK replicates the PD into UK law).

THE NEW PROSPECTUS REGULATION

The issues relating to prospectus approval in the aftermath of Brexit are somewhat complicated by the potential implementation of the draft Prospectus Regulation prior to Brexit. The draft Regulation forms part of the EU's Capital Markets Union (CMU) Action Plan aimed at encouraging further access to the EU capital markets. The proposed Prospectus Regulation will significantly overhaul the PD. The more significant changes include:

- The current "wholesale" exemption for debt securities with a denomination of at least EUR100,000 referred to above will be abolished. However, the other exemptions will be largely unchanged including the current exemption related to offers of securities addressed to investors who acquire securities for a total consideration of at least EUR100,000 per investor for each separate offer.

- The requirements in relation to prospectus summaries are significantly overhauled and will be required for all prospectuses (they are not currently required for securities with a denomination of at least EUR100,000).

- The introduction of a "Universal Registration Document" intended to be a shelf regulation mechanism similar to that used in the US which will apply to frequent issuers admitted to trading on a regulated market or MTF in the EU.

- A new minimum disclosure regime for SMEs and other companies with a market capitalisation not exceeding EUR200 million.

- Non-EU issuers seeking approval of a prospectus under the new Regulation (which will include the UK after Brexit) must appoint a representative established in the issuer's home member state which will, together with the non-EU issuer, be responsible for compliance with the Prospectus Regulation.

- Various changes related to content, including detailed rules relating to risk factors.

The draft Regulation was published by the EU Commission back in November 2015 and is currently going through the EU legislative process. Prior to the Brexit referendum, it appeared that the EU Commission hoped that the Regulation could be adopted by the relevant EU institutions and come into force by the end of 2016 or early 2017. The current draft of the Regulation provides that its provisions will become effective one year after the Regulation comes into force. On this basis, the new Prospectus Regulation may well be in force prior to the finalisation of the Brexit arrangements.

In this regard it should be noted that in the aftermath of the Brexit vote, some doubt has been cast on the future of the CMU, including the new Prospectus Regulation, particularly as this was an initiative led by Lord Hill as EU Commissioner for Financial Stability, Financial Services and Capital Markets Union, who immediately tendered his resignation following the referendum result. However, although the CMU had strong support from the UK, it is an initiative supported by many other EU member states. It is therefore far from certain that there will be any significant delay in the various elements comprising the CMU. In particular, the new Prospectus Regulation was not regarded as one of the more controversial elements of the CMU with many jurisdictions advocating an overhaul of the PD.

Assuming that the Prospectus Regulation does come into effect before Brexit, this would simplify the UK's approach, assuming it decides to seek to replicate the EU's rules in relation to prospectus regulation. Otherwise it would potentially be in the position of taking necessary steps to ensure that provisions equivalent to the PD continue to apply under UK law, and then having to amend the legislation to reflect the provisions of the Prospectus Regulation once it comes into force.

CONCLUDING REMARKS

The whole issue of prospectus regulation is therefore subject to a number of uncertainties in the context of Brexit. It will not be possible for those involved in securities issuances to undertake any detailed planning until there is much greater clarity as to the basis on which the UK will leave the EU and its future relationship with the EU, particularly in relation to financial services. Firms should, however, at some time over the next few weeks and months start to give some thought as to how their future debt securities issuances will be managed in the UK and the EU following Brexit.

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