



Evolution Not Revolution: The New EU Prospectus Regulation

The EU's new Prospectus Regulation was published in the Official Journal of the EU on 30 June 2017¹ and enters into force 20 days after such date, so 20 July 2017. The vast majority of its provisions will have effect from 21 July 2019. Although many market participants have pushed for a major revamp of the prospectus regime for securities in the EU, the new Regulation maintains the broad framework of the existing regime. There are, however, some important changes which we highlight below.

Background

The current Prospectus Directive ("PD")² came into force on 31 December 2003 and introduced, for the first time, a unified framework for the approval and content requirements for securities prospectuses across the EU. Importantly, it also provided for a pan-European passporting regime so that prospectuses approved in one member state could be used for offers of relevant securities in other EU member states. Although there have been some amendments to the PD in the intervening years, the current regime remains in essentially the same form as it was when introduced in 2003.

Despite this longevity, the PD has been much criticised over the years. Criticisms include arguments that the current exemption regime is too restrictive, that the content requirements for prospectuses are too onerous, particularly for smaller firms, and there is not sufficient proportionality built into the regime. Other concerns voiced are that the content requirements are burdensome and have led to overly long prospectuses, which are of little value to investors (and hence are rarely read), with required prospectus summaries often running to many pages.

As part of the EU Commission's Capital Markets Union ("CMU") Action Plan³ intended to reinvigorate the European Capital Markets, the EU Commission published a legislative proposal⁴ in November 2015 for a new Prospectus Regulation (the "Regulation") to repeal and replace the PD and its implementing measures. It is hoped, in particular, that the new Regulation will make it easier and cheaper for SMEs to access capital markets and will generally simplify the process for all companies wishing to offer debt securities or shares to the public within the EU.

The provisions of the draft Regulation were extensively debated during the legislative process and the dialogue between the EU Commission, the EU Council of Ministers and the European Parliament and various amendments were proposed. Eventually it was announced in May 2017 that the EU Council had adopted the Prospectus in the same form as that previously approved by the EU Parliament on 5 April 2017.

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2017:168:FULL&from=EN>.

² <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:345:0064:0089:EN:PDF>.

³ http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf.

⁴ http://eur-lex.europa.eu/resource.html?uri=cellar:036c16c7-9763-11e5-983e-01aa75ed71a1.0006.02/DOC_1&format=PDF.

Although the new Regulation will significantly overhaul elements of the existing PD regime, many of the existing provisions relating to the approval of prospectuses by national competent authorities and the passporting regime will remain largely unchanged. We have set out below the principal areas of change under the new Prospectus Regulation.

Exemptions

The Regulation will not apply at all to an offer of securities to the public with a total consideration in the EU of less than €1 million calculated over a 12-month period. This is reduced from the current limit of €5 million in the PD. However, each Member State may decide to increase the amount of such exemption, up to a maximum of €8 million over a 12-month period. Where such an exemption applies, member states may require other disclosure requirements at a national level, to the extent that such requirements do not constitute a disproportionate or unnecessary burden. These new provisions will apply with effect from 21 July 2018.

The exemptions from the obligation to publish a prospectus under the Regulation in respect of an offer of securities to the public are not radically changed from the provisions in the PD. It is, however, worth noting that although the current exemption relating to an offer of securities solely to qualified investors is, on its face, unchanged, the definition of qualified investors is now defined by reference to the equivalent definition in MiFID II, which is a somewhat narrower definition than under the PD. Also, although the initial legislative proposal provided for the deletion of the current exemption applying to securities with a denomination of €100,000 or more (often referred to as the “wholesale exemption”), this exemption has been retained. Similarly, although there had been proposals to amend the current exemption where there is an offer of securities addressed to fewer than 150 persons per member state (by increasing this to 350 persons per member state subject to an overall limit of 4,000), this exemption remains unchanged.

The most significant change to the exemptions under the PD regime relate to the exemptions from the obligation to publish a prospectus in relation to the admission of securities to trading on a regulated market. In particular:

- the obligation to publish a prospectus will not apply to the admission to trading on a regulated market of any debt or equity securities fungible with securities already admitted to trading provided that, over a 12-month period, they represent less than 20% of the securities already admitted to trading (subject to certain exclusions including where shares qualify as Common Equity Tier 1 capital or eligible own funds for regulatory capital purposes). A similar exemption previously applied under the PD, although this only applied to shares and had a limitation of 10%. This new provision will apply with effect from 20 July 2017; and
- the previous exemption relating to issuances of shares on the conversion of a convertible bond has been deleted. However, an exemption will apply where shares resulting from the conversion or exchange of other securities, or from the exercise of the rights conferred by other securities, are of the same class as the shares already admitted to trading on the same regulated market, provided that the resulting shares represent, over a period of 12 months, less than 20% of the number of shares of the same class already admitted to trading on the same regulated market. This provision will also apply with effect from 20 July 2017.

Voluntary Prospectus

Article 4 of the Regulation enables an issuer, offeror or person asking for admission to trading on a regulated market to voluntarily draw-up, and have approved, a prospectus in accordance with this Regulation even where a prospectus is not required under the Regulation. This option was not available under the PD and potentially enables issuers to obtain the benefit of passporting even where a prospectus is not legally required.

Resale

As with the PD, the Regulation provides that the resale of securities offered under a prospectus shall be considered as a separate offer of such securities and, unless an exemption applies, a new prospectus may need to be drawn-up in accordance with the Regulation. However, similar to provisions in the PD, the Regulation provides that no

additional prospectus shall be required in any subsequent resale of securities or final placement of securities through financial intermediaries as long as a valid prospectus relating to the securities is available and the issuer or other person responsible for drawing up the prospectus consents to its use in writing. This therefore enables securities to be placed to ultimate investors through one or more intermediaries without a new prospectus having to be drawn up (such an arrangement where securities are ultimately resold to retail investors is frequently referred to as a “retail cascade”).

Where a prospectus relates to the admission to trading on a regulated market of non-equity securities that are to be traded only on a regulated market, or a specific segment thereof, to which only qualified investors can have access for the purposes of trading in such securities, the Regulation provides that securities shall not be resold to non-qualified investors, unless a prospectus is drawn up in accordance with the Regulation that is appropriate for non-qualified investors. This provision therefore prevents securities, which are admitted to a regulated market and where a prospectus has been prepared under the more benign regime available where the denomination of each security is at least €100,000 (see below) or is traded on a “qualified investors only” market from being resold to retail investors unless a prospectus is drawn-up in accordance with the requirements that would apply if an offer of securities was made to such investors.

Drawing-up the Prospectus

The provisions relating to drawing-up the prospectus are not radically changed under the Regulation from the position under the PD. The prospectus is required to contain the necessary information material to an investor for making an informed assessment of:

- the assets and liabilities, profits and losses, financial position, and prospects of the issuer and any guarantor;
- the rights attaching to the securities; and
- the reasons for the issuance and the impact on the issuer.

It is stated that this information may vary depending on the nature and circumstances of the issuer and the type of securities. With an eye to the desire to make prospectuses shorter and more user-friendly to investors where possible, it is also stated that the information in a prospectus shall be written and presented in an easily analysable, concise and comprehensible form, taking into account the factors above.

As is the case under the PD, a prospectus shall be comprised (either as a single document or separate documents) of a registration document, a securities note and (where required) a summary. Also consistent with the PD, for non-equity securities, the prospectus may consist of a base prospectus containing necessary information concerning the issuer and the securities to be issued or admitted to trading on a regulated market. In this case, the terms of individual issuances will be set out in final terms containing information relating to the securities note.

Detailed content and format requirements are to be provided by the EU Commission in delegated acts. These requirements should take account of factors such as whether the securities are equity or non-equity securities and the various types and characteristics of offers and admissions to trading on a regulated market for non-equity securities. The EU Commission is required to set out specific information for prospectuses that relate to the admission to trading on a regulated market of non-equity securities that have a denomination per unit of at least €100,000 or that are to be traded only on a regulated market, or a specific segment thereof, to which only qualified investors can have access for the purpose of trading in such securities. It is stated that those information requirements shall be appropriate, taking into account the information needs of the investors concerned, and the requirements will therefore be less extensive.

As is the case under the PD, the Regulation allows certain publicly available information to be incorporated by reference into the prospectus. The information that can be incorporated by reference will be wider than under the PD and includes regulated information, annual and interim financial information, audit reports and financial

statements, management reports, corporate governance statements, remuneration reports, annual reports and memorandum and articles of association.

Simplified Prospectus for Secondary Issues

The Regulation also allows certain persons to draw up a simplified prospectus for secondary issuances in the case of an offer to the public or of an admission to trading of securities on a regulated market. This applies to:

- issuers whose securities have been admitted to trading on a regulated market or SME growth market continuously for at least the last 18 months, where the securities issued are fungible with existing securities;
- an issue of non-equity securities by issuers whose equity securities have been admitted to trading on a regulated market or SME growth market continuously for at least the last 18 months; and
- offerors of securities admitted to trading on a regulated market or an SME growth market continuously for the last 18 months.

These provisions are designed to replace the proportionate disclosure regime for rights issues under the PD, which has not been widely used in practice. The simplified prospectus must consist of a summary, a specific registration document and a securities note. The prospectus is required to contain the relevant reduced information that is necessary to enable investors to understand the prospects of the issuer and any significant changes in the business and the financial position of the issuer and any guarantor that have occurred since the end of the last financial year, the rights attaching to the securities and the reasons for the issuance and its impact on the issuer, including on its overall capital structure, and the use of the proceeds. The EU Commission is required to prepare delegated acts to set out specific requirements as to information to be included under the simplified disclosure regime.

Prospectus Summaries

A number of significant changes have been made in relation to the requirement for prospectus summaries. A summary will continue to be required for all prospectuses except in the case where the prospectus relates to the admission to trading on a regulated market of non-equity securities that have a denomination of at least €100,000 per unit or where the securities are only to be traded on a regulated market or a specific segment thereof to which only qualified investors can have access for the purpose of trading in such securities.

The summary will be required to be written in a concise manner and be no longer than seven pages of A4 paper (reduced from the limit in the PD of the longer of 15 pages and 7% of the length of the prospectus). It is required to be presented and laid out in a way that is easy to read, using characters of readable size and to be written in a language and a style that facilitates the understanding of the information. It should be in clear, non-technical language and be concise and comprehensible for investors. It should comprise four sections: an introduction containing warnings, key information on the issuer, key information on the securities and key information on the offer of securities to the public and/or the admission to trading on a regulated market. The summary must contain a maximum of the 15 most significant risk factors specific to the issuer. It must not make cross-references to other parts of the prospectus or incorporate any information by reference. The Regulation contains detailed content requirements for the summary and ESMA is required to supplement the content and format requirements in relation to the summary in further technical standards.

The new Regulation also seeks to simplify the rules relating to summaries in the base prospectus. A summary will not be required in the base prospectus itself, but the final terms in respect of each issue of securities under the base prospectus must include a summary of the relevant issue as an annex to such final terms.

Risk Factors

The Regulation also includes important changes in relation to risk factors to be included in the prospectuses that were not dealt with in any detail in the PD. The Regulation provides that risk factors shall be limited to risks that are specific to the issuer and/or the securities and that are material in the context of a person making an informed

investment decision. When drawing up prospectus, the issuer, offeror or person asking for admission to trading on a regulated market is required to assess the materiality of the risk factors based on the probability of their occurrence and the expected negative impact if the relevant risk materialises.

The risk factors are required to be presented in a limited number of categories depending on their nature. In each category, the risk factors assessed to be the most material shall be mentioned first. ESMA is required to produce guidelines to assist competent authorities in their review of the specificity, materiality and presentation of risk factors.

Universal Registration Document

The Regulation also introduces the concept of a universal registration document (“URD”) which may be utilised by any issuer whose securities are admitted to trading on a regulated market or multilateral trading facility (“MTF”) in the EU. The URD must describe the issuer’s organisation, business, financial position, earnings and prospects, governance and shareholding structure. The URD must be submitted to the competent authority of the issuer’s home member state⁵ for approval. The URD is intended to work in a similar way to the U.S. “shelf registration” system so that an issuer that wishes to issue any equity or debt security can use the URD to meet its registration statement requirements and effect a take-down of securities by filing a securities note and summary at the time of issuance. Issuers with a URD will have the benefit of a faster approval process for issuances under the URD – reduced to five days from ten.

If an issuer has had a URD approved by the relevant competent authority for two consecutive years, it may file subsequent URDs without prior approval, although they are still subject to review by the competent authority. The issuer may amend the URD provided that it has not formed part of an approved prospectus.

EU Growth Prospectus

SMEs and certain other issuers⁶ will be permitted to draw up an “EU Growth prospectus” under a proportionate disclosure regime set out in Article 15 of the Regulation. There is currently little information about what such document will be required to include, although the Regulation states that it will be a document of a “standardised format, written in a simple language and which is easy for issuers to complete”. It will consist of a summary, registration document and securities note. The EU Commission is required to adopt delegated acts by 21 January 2019 setting out the content and format requirements for the EU Growth prospectus. In preparing such delegated acts, the EU Commission is required to take into account the need for the EU Growth prospectus to be significantly lighter than the standard prospectus in terms of administrative burdens and costs to issuers and the need to facilitate access to capital markets and to minimise costs for SMEs whilst ensuring investor confidence in investing in such companies.

Supplements

A prospectus supplement must be prepared in the event of a significant new fact, material mistake or material inaccuracy relating to the information included in the relevant prospectus that may affect the assessment of the securities and that arises or is noted between the date of approval of the prospectus and the closing of the offer period in respect of securities issued under the prospectus. This is also the case under the PD, but the Regulation provides that the relevant competent authority must complete the determination as to whether to approve the supplement within five working days (reduced from the seven-day period provided for in the PD).

⁵ Determined in accordance with criteria set out in the Regulation.

⁶ Including non-SMEs whose securities are traded on an SME growth market that have had an average year-end market capitalisation of less than €500 million for the previous three calendar years and other issuers where the offer of securities to the public is of a total aggregate consideration of no more than €20 million over a 12-month period provided such issuer has no securities traded on an MTF and had no more than an average of 499 employees during the previous financial year.

Equivalence

The Regulation provides more extensive provisions in relation to approval of prospectuses prepared in accordance with third-country laws. The EU competent authority of the home member state of an issuer located outside the EU may approve a prospectus prepared under the rules of such issuer's home jurisdiction provided that the information requirements of such jurisdiction are determined to be equivalent to the requirements under the Regulation and that the competent authority in the EU home member state has entered into cooperation arrangements with the relevant authorities in the jurisdiction in which the non-EU issuer is located. This provision may be particularly important in the context of Brexit and the UK leaving the EU. Brexit is due to be completed prior to the Regulation coming into effect. Therefore arrangements, perhaps initially on a transitional basis, where the UK rules are determined to be equivalent to the Regulation may be sought pursuant to the Brexit negotiations. Provided that the Great Repeal Bill under which EU law will be enshrined into UK law at the date of Brexit ensures that provisions equivalent to the Regulation become effective in the UK on the same dates as under the Regulation, this should be achievable.

Online Access

The Regulation provides that ESMA is required to establish a platform whereby all prospectuses approved under the PD can be accessed online.

Grandfathering

The Regulation provides that all authorisations under the PD in respect of prospectuses prior to the date from which the Regulation applies will continue to be valid until the earlier of the expiry of such authorisation and 12 months from the date from which the Regulation applies.

Final Thoughts

Although the new Prospectus Regulation makes some important changes to the existing regime, it is far from the radical overhaul of the existing regime that many were advocating. It is expected that drafts of the delegated acts setting out matters such as the detailed content requirements for prospectuses (including the new regimes for simplified prospectuses for secondary issuances and EU Growth Prospectuses) will start to be published soon, but it may still be some time before it is known whether the length and complexity of many existing prospectuses is likely to be reduced in the future.

The new provisions relating to simplified prospectuses for secondary issuances, the EU growth prospectus for SMEs and other smaller issuers and the introduction of the URD will undoubtedly be welcomed by some issuers, but the jury is out as to how extensively these will be utilised in practice. Utilisation of the existing proportionate disclosure regime for rights issues has been disappointing and it is important that the relevant delegated acts seek to make these new regimes as issuer- and user-friendly as possible.

Although many of the amendments made by the new Regulation are likely to be regarded as welcome by issuers, some of the changes could be problematic. In particular, some issuers may be concerned at having to rank risk factors in prospectuses and in limiting the number of risk factors in the summary to 15. There is always a danger of these determinations being judged with the benefit of hindsight where a risk that was judged to be relatively minor in comparison with other risks comes to fruition.

Although the implementation date of the majority of the Regulation is two years away, there is much implementing legislation to be prepared and, given recent experience in relation to other financial legislation, there will be concerns by market participants as to how quickly the new rules will be finalised to give issuers sufficient time to prepare for the new prospectus rules.

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