SLAUGHTER AND MAY

The New EU Prospectus Regulation

An equity capital markets perspective

On 30 November 2015, the European Commission published its proposals for a new prospectus regulation to reform the European prospectus regime (the **"New Prospectus Regulation"**). The publication of the New Prospectus Regulation follows a consultation launched in February 2015 and forms a key part of the European Commission's Capital Markets Union project, which aims to facilitate access to the European capital markets and increase their depth and liquidity.

The New Prospectus Regulation remains subject to the EU's ordinary legislative procedure which requires consent of the European Council and the European Parliament. Because of the political capital invested in the success of the Capital Markets Union, it may be that agreement is sought at an early stage in 2016, with the New Prospectus Regulation entering into force later in 2016. Issuers will have a further 12 months after it has entered into force before it applies. Unlike the predecessor legislation, as a regulation rather than a directive, the New Prospectus Regulation will be directly applicable in Member States and will not need to be implemented through national legislation, which reduces the scope for legislative inconsistencies between Member States. Much of the content of the new regime will be set out in secondary legislation once the New Prospectus Regulation is finalised, so the full scope of the new regime is not yet clear.

This briefing considers the key changes proposed and issues raised by the New Prospectus Regulation for equity capital markets practitioners.

Key changes to the prospectus regime:

- Where there is no offer to the public, issuers will have the ability to issue up to 20% of existing capital in a 12-month period without the need for a prospectus.
- Existing listed issuers and SMEs will be able to benefit from new minimum disclosure regimes for their prospectuses.
- The contents and format of summaries will be changed, limiting the length of summaries to six pages and limiting to 10 the number of risk factors included in a summary.
- Risk factors will be required to be categorised according to their materiality.
- Issuers will be able to publish a uniform registration document which can be used both for the prospectus regime and the transparency regime.
- Issuers will be able to incorporate by reference a wider range of information.

Changes to the exemptions to the requirement to publish a prospectus

The European Commission has proposed certain changes which would affect the requirement for issuers to publish a prospectus.

First, the existing exemption allowing issuers with shares listed on a regulated market to admit to trading on the same regulated market further shares of the same class without a prospectus will be extended. Currently this exemption applies only to share issuers and allows them over a period of 12 months to issue up to 10% of the number of shares of the same class already admitted. Under the proposed new regime this exemption will apply to all issuers of fungible securities (including GDR issuers) and allow them to issue over a period of 12 months up to 20% of the same class of securities that are already admitted to the same regulated market. In the UK, this change will be of limited use given pre-emption guidelines.

Secondly, the existing exemption allowing shares resulting from a conversion or exchange of equity-linked securities to be admitted to trading provided that the resulting shares are of the same class as shares already admitted on the same regulated market will be capped at 20% (currently there is no limit) over a period of 12 months. This limit will not apply to the conversion or exchange of equity-linked securities that are issued before the New Prospectus Regulation enters into force (which will be grandfathered) or the conversion or exchange of those securities for which a prospectus was published at the time of issue of the equity-linked securities. The European Commission has not explained its rationale for this change, though ESMA and the UKLA have in the past noted that the lack of limit could be used by issuers to circumvent the prospectus regime. This proposal will impact financial institution issuers (typically banks and insurers) of regulatory capital instruments with an automatic conversion feature on certain (regulatory capital-based) triggers. Given the requirement for automatic conversion, producing a prospectus at conversion will not be feasible and thus it will be necessary to produce a prospectus on issue of the securities. To date most issuers have avoided this because although the relevant instruments are debt, the prospectus is treated as an equity prospectus given the conversion feature, requiring, among other things an operating and financial review, a working capital statement and a statement of capitalisation and indebtedness.

Thirdly, the employee offer exemption which currently allows issuers with their head office or registered office in the EU to offer securities to their employees located in the EU without producing a prospectus will be extended to all issuers wherever the location of their head office or registered office. Under the current regime, issuers located in third countries are theoretically able to make employee offerings to their employees in the EU once the European Commission has adopted an equivalence decision regarding the third country concerned. To date the European Commission has not adopted any equivalence decisions. Third country issuers therefore typically rely on the 150 person per member state exemption or offer the shares for nil consideration or rely on ESMA's short-form disclosure regime for employee share schemes. It is welcome that the European Commission is aligning the position of non-EU-based issuers with that of EU-based issuers. As before, issuers taking advantage of this exemption will be required to make available a document containing information on the number and nature of the securities and the reasons for and details of the offer.

Fourthly, no prospectus will be required for offers of securities with a total value in the EU below EUR 500,000 over a period of 12 months and Member States will have the option whether to require a prospectus for offers of securities with a total consideration between EUR 500,000 and EUR 10,000,000 over a period of 12 months, provided that the offer is only made in that Member State. These thresholds have been raised from EUR 100,000 and EUR 5,000,000 respectively.

Minimum disclosure regime for secondary issuances

The 2012 review of the prospectus regime introduced a proportionate disclosure regime for prospectuses for certain pre-emptive secondary offerings of shares, though few issuers have taken advantage of this regime. The European Commission believes that the proportionate disclosure regime does not go far enough and still requires unnecessary disclosure and is therefore further proposing to recalibrate this regime. Under the new regime, issuers of any securities (i.e. debt securities and GDRs as well as shares) that have been admitted to trading on a regulated market or an SME growth market for at least 18 months and who issue more securities of the same class will be able to publish "minimum disclosure" prospectuses containing financial information covering the last financial year only. The precise contents requirements of "minimum disclosure" prospectuses will be outlined in secondary legislation in due course and prospectuses drawn up under this regime will also benefit from a reformulated "general duty of disclosure" test, relating specifically to the secondary issuance.

A recalibration of the proportionate disclosure regime for secondary issuances would be a welcome development. It is certainly more logical that the new framework will cover GDR issuers in addition to share issuers and non-pre-emptive secondary offerings in addition to pre-emptive secondary offerings. The European Commission's rationale for excluding from this framework issuers which have been admitted to trading on a market for less than 18 months is somewhat illogical. It would be better to include those issuers provided that there are no gaps in their financial disclosure. There is also an open question as to whether or not this new regime will benefit many secondary offering issuers in practice, given that these offerings are typically structured to include a Rule 144A component. Even though the prospectus regime disclosure standards may be lowered, secondary offering issuers may in practice continue to be required to meet the relatively higher disclosure standards of the Rule 144A market.

Minimum disclosure regime for small and medium-sized enterprises (SMEs)

Enabling SMEs to access capital markets more easily is a key political objective of the Capital Markets Union. The 2012 review of the prospectus regime introduced a proportionate disclosure regime for SMEs, though few SMEs have taken advantage of this regime. The European Commission believes that it did not go far enough and is therefore proposing to recalibrate that regime. The precise requirements of the new "minimum disclosure regime" for SMEs will be outlined in secondary legislation in due course. The scope of the regime will be expanded to include companies with an average market capitalisation of less than €200 million on the basis of end-year quotes for the previous three calendar years (the existing regime imposes a €100 million threshold), provided they do not have securities admitted to trading on a regulated market. SMEs making use of this regime which issue shares will also have the option to draft their prospectuses using the form of a questionnaire. It remains to be seen whether or not minimum disclosure prospectuses for SMEs will in fact be easier for them to produce compared to standard prospectuses given that the general duty of disclosure and the liability regime for SME prospectuses will be the same as those for standard prospectuses.

New requirements for summaries

The requirements for prospectus summaries are to change significantly under the New Prospectus Regulation. In particular, the length of the summary is to be limited to six sides of A4, the summary must contain no more than 10 of the most material risk factors (five each in respect of the issuer and the securities), and it must be "easy to read", "in language which is clear, non-technical, succinct and comprehensible" and be "accurate, fair, clear and not misleading". The precise content and format requirements are to be set out in secondary legislation, but the regime outlined in the New Prospectus Regulation remains very prescriptive.

The European Commission believes that the reform to the contents requirements for summaries included in the 2012 review of the prospectus regime did not

achieve its objectives and instead made summaries too long and confusing, particularly for retail investors. While inserting some more flexibility into the way that summaries can be drafted would be welcome, the proposals remain too prescriptive. The length and simplicity requirements seem to be too restrictive and may prevent issuers from being able to provide an accurate summary of complex businesses and transaction structures. It may also be difficult for issuers to identify the five most material risk factors in respect of each of the issuer and the securities. The specific thresholds of six pages and ten risk factors are arbitrary numbers which may not be appropriate for all transactions. Issuers may be concerned regarding additional liability risks as a result of them giving restricted disclosure in the summary (e.g. by selecting the most material risk factors or by complying with the simplicity requirements).

Categorisation of risk factors

In addition to the requirement for issuers to include no more than five risk factors in respect of each of the issuer and the securities in the summary, under the New Prospectus Regulation issuers will also have to categorise all risk factors disclosed in the prospectus into a maximum of three distinct categories according to their relative materiality. The precise requirements for these categories are to be set out in secondary legislation. The process of categorising risk factors will place additional burdens on issuers and may expose issuers to liability if investors subsequently consider (with the benefit of hindsight) that this categorisation was incorrect. In practice, issuers already have to consider the materiality of risk factors disclosed in the prospectus, but such materiality is best communicated through the wording of the risk factor itself rather than by artificial categorisation. The current approach allows for accuracy and specificity, whereas imposing a small number of discrete categories is inflexible and could make risk factors unintentionally misleading to investors.

The European Commission believes that the current approach to risk factors means that prospectuses are overloaded with generic risk factors which obscure specific risks relating to the particular issuer and its securities. The recitals to the New Prospectus Regulation and the attached explanatory memorandum indicate that issuers should no longer be able to include generic risks in their prospectuses and it remains to be seen how competent authorities will apply this. Given that investors still need to be warned about generic risks and issuers may still have liability for not disclosing them, a better approach would be to require issuers to indicate which risk factors are generic and which ones are specific.

The new universal registration document

Another material change in the New Prospectus Regulation is the proposed creation of a universal registration document, a new concept which will allow certain issuers to maintain a generic registration document to function as the registration document component of all its prospectuses, in a similar manner to shelf registrations in the US. This will only be available to issuers with a registered office in the EU, with securities trading on a regulated market or an MTF. The universal registration document will need to be filed annually. For the first three years it must be approved by the competent authority and thereafter an issuer may file it without prior approval. An issuer with a universal registration document will be granted "frequent issuer status". This will theoretically entitle the issuer to a faster prospectus approval process of five rather than the current (also theoretical) ten working days, provided an additional five days' notice is given to the competent authority before submission of the prospectus for approval, and assuming the competent authority agrees that the first draft of the prospectus meets all relevant requirements (which is very unusual for equity prospectuses in the UK). Information can be incorporated by reference into the universal registration document and it can be updated by filing an amendment (although a supplementary prospectus is still required for amendments between the approval of a prospectus and admission to trading). Issuers which update their universal registration document within four months of their financial year end will be deemed to have discharged their obligation to publish annual accounts under the Transparency Directive and issuers which

update it within three months of the end of their half-year end will benefit from a similar provision in respect of half-yearly accounts. The exact content requirements for the universal registration document will be set out in secondary legislation in due course.

This proposed new feature is potentially useful and it makes sense to align the transparency and prospectus regimes, but is currently limited by certain serious shortcomings. In particular, if the universal registration document has only been filed with the competent authority (rather than approved) it must be subsequently approved before it can function as the registration document for a prospectus. This essentially removes the key benefit of a 'filing only' regime. The universal registration document is also not available to non-EU issuers. One of the key benefits, the "frequent issuer status", may in practice not offer any improvement on the service already provided as standard by certain competent authorities (such as the FCA in the UK), particularly given the advance notice requirement. The European Commission should consider whether the benefits of the universal registration document could be broadened to make it a more attractive option for issuers.

Takeover offers

The existing requirement to produce a prospectus (or an equivalent document) for securities offered in connection with a takeover by means of an exchange offer, a merger or a division will be replaced. Instead, the issuer will only need to make a document available containing information describing the transaction and its impact on the issuer. The minimum contents of such documents will be set out in secondary legislation.

The recitals to the New Prospectus Regulation also clarify that no "offer of securities to the public" will have taken place in circumstances in which the investor has had no individual decision to invest (for example, the issue of shares by a bidder to a target's shareholders as part of a share-for-share takeover implemented by way of a scheme or arrangement, where the outcome is dictated by the votes of the company's shareholders and by the decision of the court) confirming our view that a prospectus is not required in such cases.

Other changes

In addition to the key changes described above, the proposed New Prospectus Regulation will make numerous other tweaks to the current regime:

- New issuers will be able to incorporate by reference their financial information rather than set it out in full within their prospectuses and the range of information an existing issuer may incorporate by reference will be extended (to include, for example, management reports and corporate governance statements).

- Issuers will be able to require competent authorities to deal directly with them, which could make listing agents and aspects of the UK's sponsor regime redundant.

- The position of some gold-plated disclosure regimes in certain EU countries is now uncertain as there are indications within the recitals that competent authorities may not restrict the drawing up of prospectuses.

- Third country issuers will be required to designate an entity established in its home member state responsible for ensuring compliance with the prospectus regime and serving as a contact point of the issuer with the competent authority.

- It is also proposed to introduce a new requirement that prospectuses must be "succinct" in addition to being "easily analysable and comprehensible". It is uncertain how competent authorities will apply this.

Conclusion

The questions asked in the European Commission's consultation paper published in February 2015 indicated that it was keen to revolutionise the prospectus regime, making capital-raising in the EU significantly easier for issuers. The proposed changes are much less ambitious than that and

represent an evolution of the old regime rather than a revolution. Although some of the proposed changes are helpful, on balance, the New Prospectus Regulation will not achieve its objective of making capital raising easier overall. Some of the proposed changes are overly restrictive and seem likely to impede rather than facilitate access to the equity capital markets in the EU. Other changes may not achieve their intended outcome until other barriers to equity issuance such as pre-emption guidelines or the requirements of the Rule 144A markets are overcome.

The publication of the New Prospectus Regulation has also generated significant uncertainty given how much detail remains to be developed in secondary legislation. It will therefore be important to review the evolution of the proposals carefully going forward.

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