

Group Briefing February 2016

Proposed Changes to the Prospectus Regime

In its 30 September 2015 Capital Markets Union Action Plan, the European Commission confirmed its intention to modernise the existing Prospectus Directive (the **Existing PD**), having already consulted on a review of the Existing PD in February 2015. It then published the draft of its proposed regulation and related draft annexes on 30 November 2015 (**PD3**).

PD3 will take the form of a regulation that will be directly effective in Member States, rather than a directive requiring transposition by the individual Member States. This is designed to ensure consistent application of PD3. It is expected that PD3 will be published in the Official Journal during the second half of 2016, and it will come into effect 12 months later (i.e. mid-to-end 2017).

THE COMMISSION'S CONCERNS:

Some of the concerns expressed by the Commission as part of its review of the Existing PD were as follows:

- » SMEs and companies with lower market capitalisation find it difficult to access the capital markets;
- » the distinction between wholesale and retail issuances, with its €100,000 threshold, encourages

- larger denominations and discourages retail investors;
- » the process for approving a prospectus needs to be streamlined; and
- » the use of long lists of overly-generic risk factors reduces the emphasis placed on the specific risk factors of which investors should be aware.

SUMMARY OF THE KEY PROPOSALS:

Abolition of distinction between wholesale and retail debt securities:

- » under the Existing PD public offers of wholesale debt securities with a minimum denomination of €100,000 are exempt from the obligation to produce a prospectus¹ – PD3 proposes to remove this exemption, with a prospectus being required unless another exemption is available;
- » the Commission indicated in its PD3 Fact Sheet that the Level 2 measures will define a “*unified prospectus template*” based on the current wholesale disclosure annexes IX and XIII to the EU Prospectus Regulation, adding “*only the information items necessary for retail investor protection*”.

Risk factors:

- » PD3 proposes that lists of risk factors be shorter, and that the number of risk factors be limited;
- » risk factors will need to be specific, and will also need to be material “*for taking an informed investment decision*”;
- » it is also proposed that risk factors be capable of allocation across a maximum of only 3 categories with:
 - » a maximum of 5 risk factors specific to the issuer being included in the summary; and
 - » a maximum of 5 risk factors specific to the securities being included in the summary.

Summaries:

- » PD3 proposes that prospectus summaries be capped at 6 A4 sides – this can be extended by a further 3 A4 sides where one summary is covering several securities which do not significantly differ;
- » Article 7 of PD3 is quite prescriptive as to the summary’s content – it must be divided into four sections:
 1. an introduction containing warnings;

1. Unless the securities are listed on a regulated market.

2. a section setting out key information on the issuer, the offeror or the person asking for admission;
3. a section setting out key information on the securities; and
4. a section setting out key information on the offer itself and/or the admission to trading.

Where a ‘*Key Information Document*’ is separately required under the PRIIPS Regulation (the 2014 regulation on key information documents for packaged retail and insurance-based investment products), this may be used in place of the requirement to include certain information on the securities themselves;

- » in the case of a base prospectus, a summary will not be needed until the final terms are approved or filed, and the summary must be specific to the individual issue.

OTHER PROPOSALS:

Universal registration document:

PD3 proposes that an issuer incorporated in an EEA Member State which:

- » has securities admitted to trading on a regulated market or multilateral trading facility (MTF); and
- » fulfils certain conditions enabling it to be regarded as a “*frequent issuer*”,

will be allowed to file a document in each financial year which lists its organisation, business, financial position, earnings, prospects, governance and shareholding structure. This is aimed at facilitating a faster approval process for prospectuses submitted by it to its competent authority.

Incorporation by reference:

An expanded list of information is now available for incorporation by reference into a prospectus, including “*regulated information*” under the amended Transparency Directive (i.e. information that the issuer is required to disclose under that directive, or under the provisions of the Market Abuse Directive dealing with the requirement to disclose inside information).

SMEs:²

SMEs will be allowed to prepare a prospectus under the lighter, ‘*minimum disclosure*’ regime if they have no securities admitted to trading on a regulated market. Those SMEs will instead need to prepare a specific registration document and a specific securities note.

Secondary issuances:

Certain issuers will also be allowed to prepare a prospectus under lighter, ‘*minimum disclosure*’ regime in the case of secondary issuances,

Takeover exemption

Securities offered in connection with a takeover by means of an exchange offer will be outside of PD3 scope if a document is available containing information describing the transaction and its impact on the issuer.

Broadened exemptions

PD3 proposes to widen the existing exemptions in respect of fungible securities, shares resulting from the conversion or exchange of other securities or from the exercise of the rights conferred by other securities, and employee share schemes.

Drafting

PD3 will require that a prospectus be presented in a format that is “*easily analysable, succinct and comprehensible*”.

POINTS TO NOTE:

Leaked drafts of the PD3 proposal had been in circulation for some weeks. Certain elements of the leaked draft which caused concern did not make it into the final PD3 proposal. For example, the definition of “*home Member State*” will not change, and prospectuses will not be required for the admission of securities to trading on MTFs.

While the €100,000 wholesale/retail distinction threshold has been removed, certain notable exemptions remain, including the exemption for offerings to qualified investors, the exemption for offerings addressed to fewer than 150 persons, and the exemption for offerings addressed to investors who acquire the securities for at least €100,000 per investor for each separate offer. With the removal of the €100,000 denomination exemption, these other exemptions are likely to become more important.

NEXT STEPS:

Measures that form part of the Commission’s plan for a Capital Markets Union are progressing quickly. The draft of PD3 will now be considered by both the European Parliament and EU Council and, once the final text is approved, PD3 will be published in the Official Journal. As mentioned above, this is expected in the second half of 2016, with PD3 becoming effective 12 months later.

Significant levels of detail will be left to ESMA and the Commission to develop using technical standards, delegated acts and guidance. Again, it is expected that progress will be made quickly in these areas and we will issue further updates as PD3 and the Level 2 measures progress.

2. An “SME” is a company that either:

(a) according to its last annual or consolidated accounts, meets at least two of the following three criteria:

(i) an average of less than 250 employees during that financial year,
 (ii) a total balance sheet ≤ €43 000 000, and
 (iii) an annual net turnover ≤ €50 000 000; or

(b) comes within the definition of “small and medium-sized enterprises” in the MiFID II Directive (i.e. a company that has had an average market capitalisation of < €200,000,000 on the basis of end-year quotes for the previous 3 calendar years).

OUR VIEW:

The speed that the Commission is working at to implement the Capital Markets Union is welcome. However it remains to be seen whether the PD3 proposal will in fact contribute towards better functioning capital markets. Depending on the Level 2 measures, the removal of the €100,000 exemption has the potential to significantly increase the cost and time involved in preparing a prospectus for wholesale investors.

Similarly it remains to be seen whether a more prescribed format for the presentation of Risk Factors will result in improved disclosure. Limiting the extent of Risk Factor disclosure will certainly increase risk for issuers. Further, it is likely to prove challenging to condense, into the 6 page summary, material information for a complex transaction, with significant input from issuers and advisors required to agree on what information should be treated as key.

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This document contains a general summary of developments and is not a complete or definitive statement of the law. Specific legal advice should be obtained where appropriate.

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