The new prospectus regime – a guide for debt issuers

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The date that the new prospectus regime takes full effect, 21 July 2019, is fast approaching. In this briefing we seek to answer questions that may arise, to ensure that the transition from the old regime to the new regime is a smooth one. We also discuss some disclosure problems that frequently arise under the prospectus regime and the circumstances under which some issuers avoid the prospectus regime altogether.

How will the transition work operationally? Should we choose the old regime or the new regime?

Base prospectuses and stand-alone prospectuses published prior to 21 July 2019 will be approved on the basis of the old regime, but remain valid for their natural life of 12 months. In the case of debt issuance programmes, this means that base prospectuses approved under the old regime will effectively be grandfathered and can be supplemented and used for drawdowns until they expire. All base prospectuses and stand-alone prospectuses published from 21 July 2019 will be approved on the basis of the new regime.

There will inevitably be a period of uncertainty in the immediate aftermath of 21 July 2019 while the positions of national competent authorities are confirmed, market practice develops among advisers and a body of precedent emerges. To avoid this uncertainty some programme issuers are bringing forward their programme update timetables to maximise their grandfathering period. We anticipate that by the end of 2019 much of the initial uncertainty will have bedded down.

Key considerations:

- The new regime is almost upon us. Issuers should be prepared for a longer prospectus approval process in the immediate aftermath.
- The disclosure of risk factors will be more heavily regulated and the scrutiny of them by competent authorities will likely increase.
- It should be easier for issuers to issue low denomination debt to qualified investors. But there will continue to be regulatory obstacles to accessing true retail investors.
- The new regime will continue to regulate pro forma financial information, profit forecasts and roadshow presentations heavily.
- It will continue to be possible to avoid the prospectus regime, for example by using the high denomination exemption in combination with the MTF exemption.

Some competent authorities, including the FCA, are already operationally ready for the new regime. Issuers beginning a prospectus approval process now should confirm with their competent authority their prospectus publication timetable, so that the approval process is undertaken on the basis of the appropriate regime. If the transaction timetable may slip beyond 21 July 2019 it may be prudent to opt for the new regime, to avoid a prospectus re-write during the approval process.

What is the underlying legislative framework for the new regime?

Almost the entire existing regulatory framework for the prospectus regime is being re-written, as follows:

	Old Regime	New Regime
Level one: need for a prospectus, exemptions, general duty of disclosure, responsibility, publication, incorporation by reference, supplements, advertisements	The Prospectus Directive (Directive 2003/71/EC)	The Prospectus Regulation (Regulation (EU) 2017/1129
Level two delegated act: rules on format, contents and annexes. The new regime also has rules on scrutiny and approval of prospectuses	The PD Regulation (Regulation (EC) 809/2004)	The PR Regulation (Commission published draft on 28 November 2018)
Level two technical standards: Both regimes have rules on advertisements and prospectus publication. The old regime had rules on approval. The new regime has rules on supplements and key financial information in summaries.	The PD RTS (Regulation (EU) 2016/301)	The PR RTS (ESMA published final report in July 2018, endorsed by the Commission in March 2019)
Level three guidance: The old ESMA prospectus Q&A and the ESMA update of the CESR recommendations continue to apply, to the extent that they are compatible with the new regime. They may be re-written at a later stage. The ESMA guidelines on APMs are not being re-written and remain relevant.	Old ESMA prospectus Q and A. ESMA update of the CESR recommendations. ESMA guidelines on alternative performance measures.	
The new ESMA prospectus Q&A relate to the transition from the old regime to the new regime.		New ESMA prospectus Q&A
The ESMA guidelines on risk factors are entirely new.		ESMA guidelines on risk factors

How will the new prospectus regime be implemented in the UK? How will Brexit impact this analysis?

Much of the new regime is in the form of EU regulations and will therefore be directly applicable across the EU from 21 July 2019 without the need for local implementation.

The way that the new regime will be implemented and apply in the UK will depend on Brexit (see further our client briefing discussing Brexit and debt capital markets). Although as a matter of politics the timing and outcome of Brexit remain very unpredictable, the legal position is much clearer. If the UK leaves the EU by way of the withdrawal agreement (a "deal Brexit"), the prospectus regime will be directly applicable in the UK from 21 July 2019 until at least the end of 2020, via the UK legislation implementing the withdrawal agreement. If the UK leaves the EU after 21 July 2019 without the withdrawal agreement being in place (a "no deal Brexit") the prospectus regime will be on-shored into UK domestic legislation via the EU Withdrawal Act 2018.

In order to ensure that the FCA handbook remains up-to-date, the FCA will replace the existing Prospectus Rules Sourcebook with a new Prospectus Regulation Rules sourcebook which will replicate the underlying EU rules. FSMA 2000 will also be amended.

Will there be operational differences impacting the prospectus approval and publication process?

The FCA has prepared new checklists which will replace the existing checklists for the purposes of prospectus drafting and approval. The methods of prospectus publication will remain the same, though issuers with prospectuses approved by the FCA will no longer be required to file their prospectuses with the UK national storage mechanism. There will be an entirely new requirement for issuers to send a "data checklist" to competent authorities, covering certain prospectus-related data items, including the type of prospectus and the disclosure regime, the issuer LEI, the denomination and currency of the securities, so that the competent authority can submit this information to ESMA. This exercise may be somewhat onerous and time-consuming so issuers should familiarise themselves with it early.

What about the technical contents requirements? For example, the annexes have been completely re-written and reorganised, the general duty of disclosure has been reformulated and there is a new obligation for prospectuses to be "concise". What will all this mean in practice?

While the annexes have been completely re-written and reorganised, in most cases the changes are intended to clarify the law rather than change it. Unfortunately some of the wording in the new annexes is unclear and confusing in places. There is therefore a risk that there may be some unforeseen consequences and divergences in the approach taken by difference competent authorities. This may only become apparent during the prospectus drafting process. For this reason we recommend that an issuer planning on publishing a prospectus in the immediate aftermath of the new regime allows for a longer time to market than usual, while problems are flushed out.

It is true that the new general duty of disclosure test is more focused on the nature of investors

than the current test, but we do not envisage that this will make a big difference. This is because in practice the contents of prospectuses are lead as much by market expectations as they are by regulatory requirements. We also expect that competent authorities will apply a proportionate approach to the requirement that prospectuses are "concise", particularly in the case of prospectuses aimed at qualified investors. In some circumstances issuers may be required to justify why certain disclosure is material.

Issuers should also be aware that boilerplate prospectus rubrics, including those recommended by ICMA on selling restrictions, retail cascades and final terms which are included in the ICMA primary market handbook, will also need to be amended.

What changes will we need to make to our risk factor disclosure?

Under the new regime, risk factor disclosure will be significantly more regulated than it is at present. The prospectus regulation contains requirements that risk factors are categorised, with the most material risk factors in each category being presented first. There are also requirements that the risk factors are specific to the issuer or the securities and that they are adequately described and corroborated by the content of the prospectus as a whole. The prospectus regulation requirements are complemented by ESMA's new risk factor guidelines which explain further how competent authorities should apply concepts such as "specificity", "materiality" and "categorisation". Because these guidelines are confusing in places they may end up giving competent authorities a wide discretion as to how to apply them.

It is clear from the ESMA guidelines that ESMA expects risk factor disclosure practice to change. We expect that those issuers with prospectuses approved by the FCA which already meet their high standards of risk factor disclosure (as described in their technical note) should not need to change practice significantly, especially if the securities are aimed at qualified investors. There is therefore some uncertainty as to how ESMA's guidelines will be applied and what they will mean for issuers in practice. We hope that competent authorities are pragmatic, given that it is issuers who are responsible for their prospectus contents and who remain liable to investors on the same basis as they currently are. This uncertainty is another reason to plan for a longer prospectus approval timetable under the new regime.

Will there be a move towards the new universal registration document concept? Or does it make sense for most debt issuers to continue with programme base prospectuses or stand-along prospectuses?

Other than in the case of some bespoke markets, we do not envisage that there will be a move towards the new universal registration document concept, under which an issuer maintains a generic registration document on an on-going basis that can be used for a range of different prospectuses. Instead, we expect that most debt issuers will continue to issue either under their programmes or on a stand-alone basis as they currently do. Not only are there no obvious advantages to using a universal registration document, but it is underpinned by a level of unwieldy regulatory complexity, particularly when it is amended, or used on a cross-border basis, which may act as a deterrent. However, it is

worth seeing how the market develops in this area.

Will there be an increase in the volume of true retail bond issuance?

Although one of the purposes of the reform of the prospectus regime was to increase the investment opportunities available to true retail investors, we expect that the volume of debt issuance aimed at true retail investors will continue to be very low. Even though the way of drafting summaries under the new regime will be somewhat less onerous compared to the current regime several barriers remain. Many issuers will still want to avoid drafting a PRIIPs regime compliant key investor document and subject themselves to associated additional obligations and liability. The more extensive MiFID II product governance processes that EU dealers will need to undertake for bonds aimed at retail investors will still increase the effective cost of capital. Competent authorities are also likely to be strict in their application of the prospectus regime for prospectuses aimed at true retail investors.

What about low denomination issuance to qualified investors? Is this now more feasible?

Unlike the old regime under which all prospectuses allowing for the issuance of low denomination debt are required to comply with the retail disclosure annexes and include a prospectus summary, under the new regime issuers will be able to issue low denomination bonds to qualified investors on the basis of the wholesale disclosure annexes, provided that the bonds are admitted to a qualified investor segment of a regulated market. We understand that some stock exchanges are currently in the process of creating "qualified investor only segments". Given that this is an entirely new concept, there is some uncertainty over how to document transactions which aim to take advantage of this method of issuance and whether issuers and dealers will be comfortable with it. No doubt market practice will develop in this area, but in our view (and assuming there continues to be a qualified investor appetite for low denomination debt) the documentation and issuance process changes should not be too significant.

Is the new simplified disclosure regime for secondary issuances simple enough to make it worthwhile?

Under the new regime issuers which either tap existing debt issues or which have issued equity securities (in each case that have been admitted to trading on a regulated market for at least 18 months) may benefit from a new simplified disclosure regime. For example, there will no longer be a regulatory requirement for these issuers to disclose as much detail on their businesses. However, these issuers will be required to summarise their previous year's MAR disclosure, but it will have to be disclosed in the style of a prospectus and cannot simply be replicated from MAR regulatory announcements. It is difficult to see how re-writing existing public MAR disclosure in a different way for the purposes of a prospectus benefits investors and it may be that this requirement outweighs the other more relaxed disclosure requirements. It is also worth noting that issuers with debt issuance programmes are already able to tap existing issuances with relatively light documentation whereas issuers with listed equity which do not have a debt issuance programme may be required by market expectations to exceed the regulatory

disclosure requirements for their debt issuance prospectuses.

Are audited pro forma financial statements still required for debt prospectuses in some circumstances?

Under the old regime, while there is no strict regulatory requirement for debt issuers to include pro forma financial information in the event of a significant recent acquisition or disposal, some debt issuers opt voluntarily to include pro forma financial information in their prospectuses. They might take the view, for example, that because their most recently published audited financial statements do not cover a recent acquisition or disposal, without the inclusion of pro forma financial information they cannot meet general duty of disclosure requirement for a prospectus to contain information necessary for an investor to make an informed assessment of the issuer.

ESMA's position is that to the extent a debt issuer voluntarily includes pro forma financial information in its prospectus, it must comply with the strict regulatory requirements contained within the PD Regulation and in particular obtain an auditors' report on the pro forma financial information. ESMA has indicated that this position will not change under the new regime.

Because the auditors' report can be costly and time-consuming to produce and because it might not in every case improve disclosure or be required by investors, some issuers avoid this requirement by having their securities admitted to trading on an MTF, such as London's ISM, Ireland's GEM or Luxembourg's Euro MTF. We expect this debate to continue.

Is there now more certainty over what constitutes a profit forecast or profit estimate?

The current requirements for an issuer which chooses to include a profit forecast or profit estimate in its prospectus to disclose the assumptions related to such profit forecast and to state that it has been prepared on a basis consistent with its accounting policies and comparable with its historical financial information have been retained. However, there are some technical differences. In the case of a true retail debt prospectus, there will no longer be a requirement for the profit forecast to be accompanied by an auditors report. In the case of both true retail and wholesale debt prospectuses, there will be a new requirement for the assumptions underpinning the profit forecast to draw the investors' attention to uncertain factors which could materially change the outcome of the forecast. In the case of retail debt prospectuses there is also a new requirement that an issuer explains why any previously published but no longer valid profit forecast is no longer valid.

The definitions of profit forecast and profit estimate have not been changed and therefore there will continue to be a fine line over whether certain statements should be considered profit forecasts or simply trend information. ESMA's guidance on these definitions suggests that an issuer should be extremely cautious in its approach. ESMA recognises the fine definitional line, but also requires an issuer to clearly differentiate between a profit forecast and trend information which can cause problems in practice. Programme issuers will now have an added incentive not to include profit forecasts or estimates in their base prospectuses because

under the new regime there is a new requirement for a supplement to be published whenever a profit forecast or estimate included in a prospectus is amended or withdrawn. Under the current regime a supplement is only required if such amendment or withdrawal constitutes a significant new change affecting the assessment of the securities.

Even though the disclosure rules for MTFs in this area closely resemble the prospectus regime, the ESMA guidance does not apply to them which may make compliance more straightforward.

Have the rules on roadshow presentations changed?

Both under the old regime and under the new regime, roadshow presentations fall within the definition of advertisements and are therefore highly regulated. There continues to be a requirement that roadshow presentations are clearly recognisable as advertisements, refer to where the related prospectus will be published and are consistent with the prospectus. Consistency not only means that the roadshow presentation does not contradict the prospectus, but also that it does not present information in a materially unbalanced way, for example by giving negative aspects less prominence than positive aspects or by omitting certain pieces of information. Alternative performance measures can only be included in a roadshow presentation to the extent that they are also included in the prospectus. In circumstances where a prospectus is supplemented, consideration should also be given as to whether there is a need to supplement the road show presentation.

In order to ensure that the preparation of the roadshow presentation runs smoothly, it is advisable to focus on the need for consistency with the prospectus early and to ensure that the two different work streams are not entirely separated.

In the context of debt securities admitted to MTFs there are no equivalent regulatory requirements for roadshow presentations, which can make things easier in terms of technical rules. As a matter of best practice (and to avoid other potential heads of liability, for example statutory misrepresentation) issuers should still want to ensure broad consistency between their roadshow presentations and their prospectuses.

Are green bonds covered by the new regime?

As it stands the prospectus regime still does not have a dedicated framework for green bonds. There is therefore a wide variety of approaches that issuers take to documenting green bonds and in particular explaining how the proceeds will be used. Many issuers voluntarily choose to adhere to ICMA's "Green Bond Principles" but these still leave certain questions open: in the case of an issuer with a debt issuance programme for example, some issuers choose to include green disclosure in their base prospectus whereas others include it in their final terms. The European Commission plans to specify the disclosure requirements for green bond prospectuses during Q2 2019.

Can the prospectus regime be avoided?

The prospectus regime will continue to be relatively easy to avoid for most debt issuers: they can do this by ensuring that their debt securities are offered in high denominations or to qualified investors and that they are admitted to trading on an MTF rather than a regulated market. In practice the only real advantage to the prospectus regime, the ability to offer true retail debt securities on a cross-border basis easily, is not used by many debt issuers. In recent years we have seen an increase in certain products moving away from the prospectus regime, particularly equity-linked debt and high yield debt. In the case of MTFs (for example London's ISM, Ireland's GEM and Luxembourg's Euro MTF) the level of regulation is arguably more appropriately calibrated than the prospectus regime for qualified investors. Issuers wanting to make use of an MTF should be aware that MAR still applies to MTFs in the same way that it applies to regulated markets.

Conclusion

The aims of the EU's capital market union – breaking down barriers to investment and capital raising between and within EU member states – are certainly laudable. It will take a while to be able to judge the extent to which those aims have been achieved in the area of prospectus reform.

While some of the changes to the prospectus regime are welcome, in our view it is likely that they will not, when considered cumulatively, make a significant difference to the cost and time of accessing debt capital markets in the EU. As such the reform represents a missed opportunity.

If you have any questions on how you will be impacted by the reform of the prospectus regime, please get in touch with your usual Slaughter and May contact or one of the below.

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