The new EU Prospectus Regulation: a guide for equity issuers

July 2019

On 21 July 2019 significant changes will be made to the prospectus regime in the UK and other EEA states when the remaining bulk of the new EU Prospectus Regulation takes effect. This guide considers the impact of the changes on IPOs, secondary issues and other transactions where an equity prospectus is required.

Overview

Overall, the changes have two main purposes: to reduce the burden on issuers; and to make prospectuses more user-friendly. As such, the changes are evolutionary rather than revolutionary.

The key changes are summarised in the box on the right: further details are given in the remainder of this guide.

Background and further information

For details of what is not changing, and for provisions that have already come into force, see the boxes on page 8. For background to the changes see our client briefing published in December 2015, "*The new EU Prospectus Regulation: an equity capital markets perspective*". For details of how the changes will affect debt issuers see our guide for debt issuers.

Key changes

- The Summary will be in a Q&A format, rather than a tabular format. In the early days of the new regime before market practice settles down, the Summary is likely to be the subject of particular scrutiny by the FCA.
- Issuers will need to group risk factors into (typically) no more than 10 categories and, in each category, decide which risk factors are the most material, based on severity of impact and probability. Where possible, a quantitative assessment of the impact of a risk should be included.
- Putting together a prospectus for a rights issue or other secondary offer may be less onerous in some circumstances.
- SMEs and certain other small and mid-sized companies that have shares traded on AIM or another SME growth market or that are unquoted will be able to publish an "EU Growth Prospectus" that need contain less information than a full prospectus.
- Frequent equity issuers will be able to file a Universal Registration Document (shelf registration document) to speed up the process of getting a prospectus approved by the FCA or other competent authority.
- A wider range of information can be incorporated by reference.
- Fewer offers of shares to EU employees will need a prospectus.

Brexit

If the UK ceases to be a Member State on 31 October 2019 or some later date with no Withdrawal Agreement in place between the UK and EU (i.e. there is a "no deal Brexit"), the UK prospectus regime existing on 31 October 2019 (which will include the new Prospectus Regulation) is expected to continue broadly unchanged, at least for the time being. However, it will no longer be possible to passport a prospectus from the UK to a Member State or vice versa.

If the UK leaves the EU with a Withdrawal Agreement that looks similar to Mrs May's deal, the new Prospectus Regulation will continue to apply, and it will continue to be possible to passport a prospectus from the UK to a Member State or vice versa, until the end of the transition period (which would probably last for around 18 to 24 months).

New regulatory framework

Unlike the existing Prospectus Directive, the new Prospectus Regulation is directly applicable in Member States and need not be implemented through national legislation. This is designed to reduce the scope for legislative inconsistencies between Member States.

Many of the detailed rules, particularly relating to the information that must be included in a prospectus, are set out in Delegated Regulations, which also are directly applicable. Relevant sections of the new Prospectus Regulation and Delegated Regulations will be copied out into the FCA's new Prospectus Regulation Rules Sourcebook (PRR), which will replace the current Prospectus Rules Sourcebook. For more details of the new regulatory framework see the table at the end of this guide.

The FCA is already accepting for review draft prospectuses that will be approved after the new Prospectus Regulation has come into force, and has published checklists for issuers and their advisers to use.

The Summary

- **Length**: the summary must usually be no longer than seven sides of A4 and include no more than 15 risk factors.

- **Sections**: there will be four sections: the introduction, including prescribed warnings; information on the issuer, including certain key historical financial information presented in a prescribed format; information on the shares; and information on the offer and/or admission of shares to trading.

- **Format**: the format of the summary is closely modelled on the Key Information Document required under the Packaged Retail and Insurance-based Investment Products Regulation (1286/2014) (PRIIPs Regulation). Instead of having to present specified categories of information in a table, the summary must be written in a Q&A format – e.g. "What are the key features of the shares?" Within this format, issuers have more scope than previously to decide which information should be included and how it should be presented.

- **Regulatory scrutiny**: the greater freedom over the way that the Summary is presented, and its perceived importance to investors (particularly retail investors), mean that this

section of the prospectus is likely to be the subject of particular scrutiny by the FCA or other competent authority, particularly until market practice settles down.

Risk factors

- **Specific**: risk factors must be specific to the issuer or the shares. ESMA expects competent authorities to challenge risk factors that are too generic or that are principally designed to protect the issuer and its directors from liability ("disclaimers").

- **Categories and order of materiality**: risk factors must be grouped into (typically) no more than 10 categories and, in each category, those that the issuer considers most material must be presented first. However, it is not necessary to list all the remaining risk factors in order of materiality.

- **Material**: materiality should be assessed by reference to magnitude of impact and probability. Where possible, the prospectus should include a quantitative assessment of each risk – e.g. where the issuer has previously disclosed to the market the likely impact of a risk on its financial position and the issuer is willing to repeat this in the prospectus. Where this is not possible, a qualitative assessment should be included. An issuer can choose to grade risk factors according to a scale – e.g. low, medium or high risk – but this is not mandatory.

The FCA already requires risk factors in UK prospectuses to be specific, although it does permit risk factors that are common to other issuers in the same industry or that relate to the same type of shares. It also requires risk factors to be grouped together "in a coherent manner", with those considered to have the greatest or most immediate significance presented at the beginning of each section or group of risk factors. Overall, therefore, we expect UK practice on risk factors to continue broadly as before, although issuers will need to consider whether they can include a quantitative assessment of any risks.

Reduced disclosure regime for secondary issues

In order to make it easier and cheaper for companies to do secondary issues, the new Prospectus Regulation requires less information to be included where a secondary issue prospectus is published by a company whose shares have been traded on a regulated market or a SME growth market for at least 18 months. AIM is an SME growth market. Unlike the "proportionate disclosure regime" for secondary offers under the current prospectus regime, which has been very rarely used, in order to qualify for reduced disclosure the secondary issue need not be pre-emptive. In practice, though, the reduced disclosure regime will be most useful for rights issues and open offers.

Overall, it is assumed that investors are already familiar with the company, so the main focus for disclosure is any changes that have occurred since the last financial year end, as well as the purpose of the fundraising and its impact on the issuer's capital structure. In particular:

- The legal standard of disclosure is lower than for a normal equity prospectus. Instead of the prospectus having to include, broadly, all the information needed for investors to make an informed assessment of the issuer's financial position and prospects, it must include all

information needed for investors to understand the prospects of the issuer and any significant changes in its business or financial position since the end of the last financial year.

- The prospectus must include a summary of the information that the issuer has disclosed to the market over the last 12 months under MAR – i.e. announcements of inside information and details of dealings by PDMRs.
- The prospectus need include only financial information that the issuer has published during the last 12 months.
- There is no requirement to include an operating and financial review (OFR) or a management discussion and analysis (MD&A).
- Less information is required about the issuer's business activities; markets; strategy and material contracts.
- No information is required about the issuer's group structure; funding structure; regulatory environment; directors' remuneration; corporate governance arrangements; share capital history; or articles of association.

In addition, it will be possible to incorporate by reference a broader range of information than at present: see "*Incorporating information by reference*" below.

However, where the offering has a U.S. component the issuer is unlikely to be able to take advantage of reduced disclosure: see the box on the right.

Even where the offering does not have a U.S. component, the issuer and its banks will need to be comfortable that the "remaining" information is sufficient to satisfy investor expectations and meet the legal standard of disclosure.

U.S. securities law considerations

Issuers hoping to take advantage of the reduced disclosure regime for secondary issues or for an EU Growth Prospectus may well be unable to do so if their offering has a U.S. component. The "rump" component of rights issues, particularly for larger companies, tends to include a U.S. tranche and, as long as underwriters are expecting 10b-5 disclosure letters, the level of financial information and related disclosures (an OFR or MD&A) is unlikely to change.

This will increase the tension between what is required under EU rules and what needs to be added or modified in order for new U.S. investors to be included in the offering. The tension may be exacerbated where an issuer seeks to shorten its prospectus by incorporating certain information by reference: because the information will not usually have been prepared with the same level of scrutiny as offering-related disclosures, the documents are unlikely to satisfy U.S. securities law requirements.

Reduced disclosure regime for SMEs: the EU Growth Prospectus

In order to make it easier and cheaper for SMEs and other smaller companies to raise funding from investors, the new Prospectus Regulation permits them to draw up an EU Growth Prospectus instead of full prospectus. This is designed to be an improvement on the "proportionate disclosure regime" for SMEs under the current prospectus regime, which has been very rarely used. For details of which companies can use an EU Growth Prospectus see the box below.

Which companies can use an EU Growth Prospectus?

- SMEs – i.e. a company which either: (i) satisfies two or three of the following criteria: less than 250 employees; net assets of €43m or less; and annual turnover of €50m or less; or (ii) has a market cap of less than €200m.
- Other companies with shares traded on an SME Growth Market whose average market cap over the previous three years was less than €500m. Most AIM companies would fall into this category.
- Unquoted companies with fewer than 500 employees that seek to raise €20m or less through an offer to the public.

Although the disclosure requirements for an EU Growth Prospectus were intended to be significantly lighter than for a full prospectus and modelled on the requirements for MTF admission documents, the Commission has erred towards protecting investors rather than simplifying disclosure for issuers. In particular:

- The legal standard of disclosure and the liability regime are the same as for a normal equity prospectus.
- The categories of required information are very similar.

On the plus side for issuers:

- Less information will be needed on the development of the issuer's business; investments; capital resources; organisational structure; research and development, patents and licenses; corporate governance arrangements; employees; and material contracts.
- Historical financial information will need to cover the most recent two years, rather than three.
- An OFR, working capital statement and a statement of capitalisation and indebtedness are mandatory only where the issuer's market cap is over €200m.
- Certain information can be incorporated by reference, including annual financial statements and articles of association – which previously would not have been possible.

Overall, an issuer that is eligible to use an EU Growth Prospectus should usually be able to take advantage of the reduced disclosure requirements as long as the remaining information is sufficient to satisfy investor expectations, meet the legal standard of disclosure and comply with the rules of the relevant market. However, even with the reduced requirements a prospectus will still be fairly onerous and expensive to produce.

An AIM company that does, say, an open offer will be able to use either the reduced disclosure regime for a secondary issue or, if its average market cap over the previous three years was less than €500m, an EU Growth Prospectus.

But where an offering has a U.S. component the issuer is unlikely to be able to take advantage of reduced disclosure: see the box on page 4, "*U.S. securities law considerations*".

Universal registration documents

An issuer with securities admitted to an EU regulated market or an MTF will be able to draw up and file with the competent authority of its home Member State a "universal registration document" (URD). The URD is intended to function as the registration document component of all the issuer's prospectuses, in a similar manner to shelf registrations in the US.

A URD must be filed annually and made available to the public. Once an issuer has had a URD approved by the relevant competent authority for two consecutive years, it becomes a "frequent issuer". This means that:

- Subsequent URDs can be filed without having first to be approved by the competent authority.
- The competent authority has five, rather than ten, working days to approve the composite prospectus. However, like the usual ten working day deadline, the five working day deadline runs from when the competent authority is satisfied that the prospectus includes all the required information. In practice, most of the time required to prepare and publish a prospectus is usually taken up with satisfying the competent authority that the prospectus includes all the required information, so the shorter deadline for the competent authority actually to approve the complete prospectus will not significantly shorten the prospectus timetable overall.

Typically an issuer would update its URD when it publishes its annual financial results. Other information can be incorporated by reference or by filing an amendment.

In theory, a URD may be attractive to frequent issuers of debt or equity. However, the cost and effort required to draw up a URD initially and to update it at least once a year is likely to mean that only those issuers who expect to have to publish a prospectus frequently are likely to consider using a URD. In equity markets, a URD may therefore be worthwhile for certain investment trusts that expect to issue new shares frequently, but we do not expect to see much take-up from other issuers.

Takeover offers

Under the existing prospectus regime, no prospectus is required where securities are offered to the public or admitted to trading on an EU regulated market in connection with a takeover – for example, where a regulated market bidder offers its own shares as consideration. However, the bidder must instead publish an "equivalent document". Different Member States have taken different views on what constitutes an equivalent document. In the UK, the FCA takes the view that it must include essentially the same information as a prospectus.

Because an equivalent document cannot be passported into other Member States, where a takeover has a significant cross-border element the bidder often chooses to publish a prospectus anyway.

Under the new Prospectus Regulation there will continue to be an exemption for takeover offers but, instead of having to publish a document that is "equivalent" to a prospectus, the bidder will have to publish an "exempted document" whose contents will be prescribed. This will eliminate the current discrepancies in the information required by different Member States.

In light of concerns about investor protection and issuers using a takeover to effect a backdoor listing, the amount of information that must be included in an exempted document will, as a general rule, be very similar to a prospectus. However:

- Where the bidder's shares have been traded on a regulated market or a SME growth market for at least 18 months, the exempted document will need to include broadly the same information as a prospectus for a secondary issue by such a company (see above). Many bidders will be able to take advantage of this.

- Information in the offer document or scheme circular can be incorporated by reference (in addition to the other information that can be incorporated by reference into a prospectus).

- No summary is required.

Because an exempted document is not a prospectus, it will not have to be approved by a competent authority and the liability regime for a prospectus will not apply to it. Unlike the current regime, the relevant competent authority is not required to confirm that the document includes all the required information. However, if the consideration shares are to be admitted to the UK Main Market, the FCA may require the bidder to confirm to it that the exempted document includes all the required information and therefore that no prospectus is needed.

Whether it is better to publish an exempted document or a full prospectus will depend on various factors, including the market on which the bidder's shares are traded; the way the offer is structured (e.g. whether it is a scheme of arrangement or a conventional offer); the proportion of target shareholders who are resident in other Member States; the cost savings to be achieved through using an exempted document rather than a full prospectus; and the extent to which any concerns about liability can be mitigated.

Incorporating information by reference

New issuers will be able to incorporate by reference their financial information rather than set it out in full within their prospectuses. For existing issuers, the range of information that can be incorporated by reference will be extended to include, for example, corporate governance statements and management reports that accompanied periodic financial information.

Employee offers

At present, a company that is registered in a non-EU country can take advantage of the employee offers exemption only if it has securities traded on an EU regulated market or another market that is recognised by the EU as equivalent. To date the European Commission has not adopted any equivalence decisions, so third country issuers often have to rely on the 150 person per Member State exemption or offer the shares for nil consideration.

However, under the new rules all non-EU companies, even those that do not have shares traded on any market, will be able to offer shares to their EU employees without needing a prospectus. As at present, the company will have to make available a document containing information on the number and nature of the securities and the reasons for and details of the offer.

Changes that have already come into force

Since 20 July 2017 Main Market companies have been able to issue less than 20% of their ordinary share capital over a 12 month period without needing a prospectus. Previously the limit was 10%.

Since 21 July 2018 no prospectus has been required under UK law for a "domestic-only" offer to the public that seeks to raise less than €8 million. Previously the threshold was €5 million.

What is not changing

Most of the key rules around prospectuses will not change significantly. In particular:

- The key triggers for a prospectus will remain the same, namely when either: (i) an offer of transferable securities is made to the public in an EU Member State; or (ii) transferable securities are admitted to trading on an EU regulated market, such as the UK Main Market.
- Most of the contents of a normal equity prospectus.
- The process for getting a prospectus approved by the FCA or another competent authority and publishing it.

New regulatory framework: a multi-layered regime

LEVEL AND CONTENT	OLD REGIME	NEW REGIME
EU framework		
Level one legislation: when a prospectus is required; exemptions; general duty of disclosure; contents of the summary; the URD; persons responsible; outline requirements for the reduced disclosure regime for secondary issues and the EU Growth Prospectus; basic requirements on risk factors; incorporation by reference; approval and publication; advertisements; supplements; passporting; use of languages	The Prospectus Directive (Directive 2003/71/EC)	The Prospectus Regulation (Regulation (EU) 2017/1129)
Level two delegated acts:		
- Format, contents and approval of prospectuses, including Annexes specifying the information that must be included for different types of issuer and circumstances (including a secondary issue, an EU Growth Prospectus and a URD)	The PD Regulation (Regulation (EC) 809/2004)	Delegated Regulation on the format, content, scrutiny and approval of the prospectus (Delegated Regulation (EU) 2019/980) (the **Delegated Regulation** (or PR Regulation))
- Key financial information to be included in a summary; publication and classification of prospectuses; advertisements; supplements	The PD Regulation (Regulation (EC) 809/2004) and PD RTS (Regulation (EU) 2016/301)	Delegated Regulation setting regulatory technical standards on the key financial information to be included in a summary; publication and classification of prospectuses; advertisements; and supplements (Delegated Regulation (EU) 2019/979) (the **RTS Regulation**)
- Information to be included in an exempted document relating to a takeover	N/A	Delegated Regulation on the minimum information contents of an exempt document relating to a takeover or merger (ESMA published its Technical Advice on 29 March 2019; final version expected to be published in mid-July) (the **Takeover Delegated Regulation**)
Level three guidance:		
- ESMA update of the CESR recommendations on the consistent implementation of the PD Regulation	These continue to apply to the extent they are compatible with the new regime. They may be re-written at a later stage	
- ESMA Q&A on the Prospectus Directive	These continue to apply to the extent they are compatible with the new regime	

Dated July 2019

LEVEL AND CONTENT	OLD REGIME	NEW REGIME
- ESMA guidelines and Q&A on alternative performance measures	These are not being re-written and remain relevant	
- ESMA Q&A on the new Prospectus Regulation	N/A	These are new
- ESMA guidelines on risk factors under the new Prospectus Regulation	N/A	These are new
UK framework: main sources		
- FCA's Prospectus Sourcebook	FCA Prospectus Rules	FCA Prospectus Regulation Rules Sourcebook, which will replace the current FCA Prospectus Rules. It will consist mainly of copied out sections of the Prospectus Regulation, Delegated Regulation and RTS Regulation, as well as specifying the persons responsible for a prospectus
- Part 6 of the Financial Services and Markets Act 2000 (FSMA), including when a prospectus or supplement is required and penalties for breaching prospectus requirements	Part 6 FSMA	Part 6 FSMA. FSMA will be amended with effect from 21 July 2019 to bring it into line with the Prospectus Regulation
- FCA Technical Notes and Procedural Notes	Various	These continue to be relevant to the extent they are compatible with the new regime. New and revised Notes will be published in due course
- FCA forms and checklists	Various	New checklists have already been published; more are likely to follow
- AIM Rules	- AIM Rules for Companies, including annex specifying which information required for a prospectus need not be included in an AIM Admission Document (known as "AIM-PD") - Note for Investing Companies - Note for Mining, Oil and Gas Companies	LSE has published updated versions of the AIM Rules for Companies, including the AIM-PD annex; the Note for Investing Companies; and the Note for Mining, Oil and Gas Companies

Dated July 2019