

Towards a new Prospectus Regulation. Key features for equity capital markets.

Introduction

Political agreement has been reached on a new, directly applicable, prospectus regime, which will take the form of a regulation. By choosing a regulation rather than an amended directive, the Commission is seeking harmonisation of prospectus rules throughout the European Union. Once implemented, the new regime will impact on the marketing of offers of securities across the European Union.

This briefing considers the key features of the new regime for equity capital markets. A briefing on the impact of the new Regulation on debt capital markets (including with respect to equity-linked securities) can be found on our Client Knowledge Portal.

When will the new Regulation apply?

We are expecting the final text of the primary legislation to be adopted by mid-2017. Much of the detail will be included in delegated legislation and a staged approach is being taken to implementation, with the majority of the provisions relevant to equity capital markets unlikely to take effect until 2019 at the earliest. One provision that will apply earlier is the ability, where there is no offer to the public, for issuers to issue up to 20% of existing share capital over a 12 month period without the need for a prospectus. This will take effect immediately in mid-2017, on the date when the final text is officially published.

What can we expect?

Many of the changes affecting equity capital markets are helpful in principle, although much of the detail will be included in delegated legislation and the practical impact may be limited by factors such as issuer and investor preferences. The timetable for application means that, for the majority of market participants, there is time to prepare for the new regime.

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Key takeaways

- Application of the new regime will be staged, with the majority of provisions likely to apply from Q2 2019 at the earliest
- Current public offer restrictions remain unchanged
- Ability to issue up to 10% of capital over 12 months increased to up to 20%
- A new, simplified disclosure regime for secondary issuances
- Changes to the content, length and format of the prospectus summary
- A revamp of the “necessary information” test
- Risk factors to be allocated across a “limited number of categories” and must be set out in order of materiality (based on probability of occurrence and magnitude of negative impact)
- Issuers able to publish a universal registration document

Prospectus disclosure

Simplified disclosure regime for secondary issues

The new Regulation replaces the existing proportionate disclosure regime for rights issues with a simplified disclosure regime for secondary issuances, noting that, from an investor protection perspective, the need for a full prospectus is less pronounced in subsequent offers to the public or admissions to trading by an existing listed issuer, given that such issuers are subject to continuing disclosure requirements. The detail will be set out in delegated legislation although it is worth noting that, for equity issues, a working capital statement will still be required.

Issuers will remain subject to liability risks across the range of jurisdictions in which securities are offered, including the U.S.. As has been the case with the existing proportionate disclosure regime for rights issues, there may therefore be only a limited impact on the extent of prospectus disclosure on secondary offers.

“Necessary information” test

The general disclosure (“necessary information”) test in Article 5 of the existing Prospectus Directive will be updated to include recognition that the necessary information which is material to an investor can vary depending, not only on the nature of the issuer and the type of securities, but also on the type of investor to whom the securities are being offered. Note, however, that disclosure will need to be made in an “easily analysable, **concise** and comprehensible form” (emphasis added). The scope of “necessary information” is broadened to include the reasons for the issuance and its impact on the issuer.

Risk factors

The presentation of risk factors may change under the new regime. Given that many of the detailed requirements will be included in secondary legislation, it is not yet clear what the changes will look like in practice. However, it is worth noting the following:

- Risk factors are required to be presented in a “limited number of categories depending on their nature”, with the most material risk factors appearing first within each such category.
- Issuers will be required to assess the “materiality” of risk factors, based on the probability of their occurrence and the expected magnitude of their negative impact. In addition issuers may, but will not be compelled to, disclose their assessment of the materiality of a given risk factor, using a scale of low, medium or high.
- The criteria for assessment by the issuer of the specificity and materiality of risk factors and their presentation across categories will be set out in delegated legislation to be adopted by the Commission.
- ESMA is tasked with developing guidelines to assist competent authorities in their review of the “specificity and materiality” of risk factors and of the presentation of risk factors across categories.
- Issuers will need to consider the liability implications of these new requirements, particularly those resulting from a failure to set out risk factors in the required order, when judged with hindsight.

Prospectus summary

The new Regulation is more prescriptive than the current Prospectus Directive with respect to summaries.

➤ Liability

Under the new regime, the summary must be “accurate, fair, clear and not misleading”, although civil liability will attach to the summary only where: (a) it is misleading, inaccurate or inconsistent; or (b) it does not provide “key information” investors would use in deciding whether or not to invest in the securities, in each case when read together with the prospectus.

➤ Risk factors

The summary must include a brief description of the most material risk factors specific to the issuer. The objective of the risk factor summary is to provide information with respect to the nature and risks of the issuer and securities. The number of risks which may be included in the summary will be limited to 15 in total.

➤ Length

The maximum length of the summary will, typically, be seven sides of A4 as compared with the current regime which prescribes a maximum summary of 7% of the prospectus or 15 pages (whichever is longer).

➤ Format

The required format of the summary is relatively rigid, with specific content requirements set out in the new Regulation. There is some overlap between the summary and the key information document under the PRIIPS Regulation¹ for issuers also subject to that Regulation.

Exemptions

The scope of the new Regulation is more limited in certain respects than the existing prospectus regime, which should have a helpful deregulatory effect at least on smaller offers of securities. The new Regulation also makes clear that the various exemptions may be combined (subject to certain restrictions).

Exemptions from application of the new Regulation

The exemptions are broadly similar to the exemptions from the application of the existing Prospectus Directive, although the threshold consideration amounts below which a prospectus will not be required are subject to change at the discretion of each Member State, which may decide not to require a prospectus for offers where the total consideration (calculated over a period of 12 months) does not exceed EUR 8 million in the European Union. No prospectus will be required for an offer of securities to the public with a total consideration of less than EUR 1 million in the European Union (calculated over a period of 12 months) (although Member States may impose other disclosure requirements outside the new Regulation).

Offers to the public

Exemptions from the requirement for a prospectus, where there is an offer to the public – which are most relevant to equity capital markets – will be retained, with prospectuses not being required for offers: (i) solely to qualified investors; and (ii) to fewer than 150 persons (other than qualified investors) per Member State.

Admission to trading

The changes to the exemptions where securities are admitted to trading (without a public offer) are more significant, with certain changes applying from the date the new Regulation enters into force. Given that this is likely to be mid next year, issuers may wish to consider the impact of these changes now.

The existing exemption allowing issuers to admit further shares of the same class to trading on the same regulated market has been extended. The current regime allows issuers to issue up to 10% of the number of shares of the same class already admitted without producing a prospectus. Under the

¹ Regulation (EU) No. 1286/2014.

new regime this exemption is increased to 20%. Although this may be helpful for certain offers in the U.K., premium listed issuers will remain subject to the U.K. pre-emption guidelines.

Other key features

Other features worthy of note include the following:

- The new Regulation introduces a new simplified prospectus regime for certain SMEs.
- Frequent issuers may complete a universal registration document (or “URD”) each year, thereby allowing fast-track approval by the competent authority if a prospectus is required in due course.
- ESMA will oversee a new centralised storage mechanism for prospectuses.
- The provisions regarding the disclosure to be included in a prospectus if the final price is not known have been expanded.
- Key information to be included in the prospectus, including the ISIN and LEI (unique codes identifying the class of securities and the issuer), must be machine-readable, including where meta data is used.
- Competent authorities in Member States where advertisements are disseminated (i.e. not just the home Member States’ competent authorities) have some powers under the new Regulation with respect to advertising activity.
- The proposed third country representative regime (which would have required third country issuers to appoint an agent in the European Union) has been dropped.

Next steps

The European Union's Committee of Permanent Representatives (COREPER) **endorsed the political agreement** on 20 December 2016. Following legal and linguistic checks, it is anticipated that the text will be formally adopted by the co-legislators by mid-2017. The final text must then be endorsed by the European Parliament and the Council of the European Union. Publication of the new Regulation in the Official Journal of the European Union is likely to take place in the second quarter of 2017.

The new Regulation will enter into force on the twentieth day following its publication in the Official Journal of the European Union and will apply 24 months from the date of its entry into force (subject to the exceptions noted above).

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