

Towards a New Prospectus Regulation.

Key features for Debt Capital Markets.

Political agreement has been reached on a new prospectus regime, which will take the form of a regulation and have direct effect across the European Union.

We are expecting the final text of the primary legislation to be adopted in Q2 2017. Much of the detail will be included in delegated legislation, and a staged approach is being taken to implementation. Although we expect that certain provisions will be applicable from as early as Q2 2017, the majority of provisions relevant to the wholesale debt capital markets will apply from Q2 2019.

This briefing considers the key features for debt capital markets.

Background

In November 2015, following its review of the Prospectus Directive¹, the European Commission published a proposal for a new prospectus regulation² as part of a package of proposals aimed at establishing a capital markets union in the European Union. Following discussions between the European Parliament, the Council and the Commission, the **agreed text** of the prospectus regulation was published on 16 December 2016.

By choosing a regulation rather than an amended directive, the Commission is seeking to maximise harmonisation of prospectus rules throughout the EU.

Following legal and linguistic checks, it is anticipated that the text will be formally adopted by the co-legislators by the second quarter of 2017. The final text must then be endorsed by the European Parliament and the Council of the European Union. This will be followed by the publication of the regulation in the Official Journal of the European Union, which is likely to take place in the second quarter of 2017.

¹ Directive 2003/71/EC

² Proposal for a Regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading

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When will the new regulation apply?

The 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 certain exceptions described below). Therefore, we expect that, *at the earliest*, the majority of the provisions will apply from the second quarter of 2019.

What can we expect?

The good news, for wholesale debt markets at least, is that the substantive changes being proposed are significantly less dramatic than the original version of the Commission's proposals. In addition, the timetable for application means that, for the majority of market participants, there is time to prepare for the changes required by the new regime.

Key Takeaways:

- > Application of the new regime will be staged; however, the majority of provisions will apply from Q2 2019 at the earliest.
- > Current public offer restrictions remain unchanged.
- > Issuers of debt convertible into underlying shares where such shares are to be admitted to trading on a regulated market will need to consider changes as early as Q2 2017.
- > Current exemption for EU sovereigns retained.
- > New exemption for small scale offers.
- > New alternative trigger to applicability of wholesale "alleviated" disclosure regime.
- > Summaries only required for retail issues, but with more prescriptive requirements.
- > Risk factors to be presented 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 with some overlap of use with the transparency regime.

Key features for debt capital markets

Exemptions from the obligation to publish a prospectus

Offers to the public

The exemptions from the obligation to publish a prospectus in connection with offers to the public which are most relevant to debt capital markets under the current regime, will be retained, with prospectuses not being required for offers: (i) solely to qualified investors; (ii) to fewer than 150 persons (excluding qualified investors) per Member State; (iii) of securities where the

denomination per unit is at least €100,000; and (iv) of securities addressed to investors who acquire securities for a total consideration of at least €100,000.

The scope of the definition of qualified investors will be narrower from 1 January 2018 due to changes contemplated by Directive 2014/65/EU (MiFIDII) which means that it will no longer automatically include public authorities and municipalities.

Admission to trading

Changes to the obligation to publish a prospectus in connection with admission to trading will be significant, and certain of those changes will apply from the date when the prospectus regulation enters into force (which is likely to be in the second quarter of 2017) and should be considered by issuers (particularly those contemplating convertible debt issues) now.

Shares resulting from the conversion or exchange of other securities (e.g. convertible bonds) or from the exercise of the rights conferred by other securities, where the resulting shares are of the same class as the shares already admitted to trading on the same regulated market, will become subject to an obligation to publish a prospectus in connection with their admission to trading on a regulated market UNLESS the shares represent less than 20 per cent. of the number of shares of the same class already admitted to trading on the same regulated market (calculated over a period of 12 months). Note that this particular provision of the regulation will apply from the date of entry into force of the regulation which could be as early as the second quarter of 2017.

With respect to shares resulting from conversion or exchange of other securities or from the exercise of the rights conferred by other securities, the 20 per cent. exemption will not apply, but a prospectus for listing of such shares will not be required where:

- > a prospectus was drawn up under the prospectus regulation (or the current Prospectus Directive) for the offer or admission to trading of the securities giving access to the shares;
- > the securities giving access to the shares were issued before the entry into force of the prospectus regulation;
- > the shares qualify as CET1 items under Article 26 of Regulation (EU) No 575/2013 (the “CRR”) of an institution (as defined in Article 4(1)(3) of the CRR)³ and result from the conversion of AT1 instruments issued by that institution as a result of a trigger event (as set out in Article 54(1)(a) of the CRR); or
- > the shares qualify as eligible own funds or eligible basic own funds as defined in Section 3 of Chapter VI of Title I of Directive 2009/138/EC

³ An “institution” is defined to include credit firms and investment firms; it does not include holding companies. It seems unlikely that the legislation is indeed intended to treat differently AT1 instruments issued by a listed parent of a credit or investment firm to those issued directly by the credit or investment firm. This will require further clarification and/or consideration.

(the “Solvency II Directive”), and result from the conversion of other securities which was triggered for the purposes of fulfilling the obligations to comply with the Solvency Capital Requirement or group solvency requirement of the Solvency II Directive.

Securities resulting from the conversion or exchange of other securities, own funds or eligible liabilities by a resolution authority due to the exercise of a power referred to in Article 53(2), Article 59(2) and Article 63(1) or (2) of Directive 2014/59/EU (the “BRRD”) will also be exempt from the obligation to publish a prospectus in connection with their admission to trading (no caps apply).

Exemptions from the regulation

EU sovereigns and others

The exemptions from the regulation for certain types of securities will broadly reflect the exemptions from the application of the present Prospectus Directive, so that important exemptions which are routinely relied on under the current regime, such as the exemptions for debt securities issued or guaranteed by EU sovereigns (or their regional or local authorities) and debt securities issued by certain supranationals and central banks, will continue to be available under the new prospectus regulation.

Small scale offers

No prospectus will be required for an offer of securities with a total consideration in the Union of less than €1,000,000 (calculated over 12 months), although Member States may impose other disclosure requirements outside the regulation. This threshold is subject to increase at the discretion of the Member States for offers with a total consideration (calculated over 12 months) that does not exceed an amount of up to €8,000,000. These changes are scheduled to apply 12 months after the prospectus regulation enters into force. Offers using this exemption do not benefit from passporting rights.

Wholesale disclosure regime

The prospectus regulation expands the categories of “wholesale” issuances which will benefit from so-called “alleviated disclosure” requirements for prospectuses relating to admission to trading. These will include, as alternatives, not only securities with a denomination per unit of at least €100,000 (as per the current regime) but also securities which are offered to qualified investors only (provided that they are traded only on a regulated market, or a segment thereof, to which only qualified investors have access).

See above “Offers to the public” for a description of changes to the definition of “qualified investors” which will apply from 1 January 2018.

What is a regulated market to which only qualified investors have access?

There are currently very few regulated markets in Europe which are restricted to qualified investors only. However, it should be possible to establish such a market (for example, the UK's Professional Securities Market, although not a regulated market, is so restricted). Assuming such markets (or segments thereof) are established, changes to the current EEA selling restrictions will be possible to enable offers of low denomination bonds to be made to qualified investors in reliance on the alleviated disclosure regime. However, unless, and until, such regulated markets (or segments) are established, we would not anticipate changes to the current regime for (€100,000) wholesale issues admitted to trading on a regulated market.

Allowing for low denomination issues to be offered to qualified investors would give discretionary fund managers greater flexibility in allocation amongst portfolios and allow for increased liquidity in the secondary markets.

Where a prospectus for admission to trading is approved for offers to qualified investors only, restrictions on re-sale will be needed, so that the relevant securities are not resold to "non-qualified" investors unless a prospectus is drawn up in accordance with the prospectus regulation which is "appropriate" for such investors.

What does alleviated disclosure mean?

Further detail on the format and the schedules defining the specific information which must be included in a prospectus, including where alleviated disclosure is permitted, will be developed in delegated acts to be adopted by the Commission. However, it is clear from the regulation itself that the disclosure requirements relating to risk factors will be more restrictive than at present (see "Risk Factors" below).

General disclosure obligation

The general disclosure (necessary information) test in Article 5 of the current Prospectus Directive will be helpfully updated to include express 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 investors 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).

Prospectus summary

Wholesale issues

Prospectuses for the admission to trading of securities with a denomination per unit of at least €100,000 will not be required to include a summary, in line with the current prospectus regime. In addition, prospectuses for the admission to trading of securities offered to qualified investors only (provided that they are traded only on a regulated market, or a segment thereof, to which only qualified investors have access) will also be exempt from the requirement to include a summary.

Retail issues

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

Summary – 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 it is misleading, inaccurate or inconsistent when read together with the prospectus or where key information which investors would use in deciding whether or not to invest in the securities is not provided. Further analysis of the definition of “key information”, in this context, will be required. Concerns with respect to liability attached to the summary should be alleviated by the fact that the new prospectus regulation will provide that the summary is to “be read together with” and “as an introduction to” the prospectus.

Summary – 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 length of 7 per cent. of the prospectus or 15 pages (whichever is longer).

Summary – key information document

Under the new regime, if the issuer is required to provide a key information document under Regulation (EU) No 1286/2014 (the “PRIIPs Regulation”) and then includes the content of that key information document in the prospectus summary (in which case the maximum length of the summary will be increased), then the persons advising on, or selling, the securities on behalf of the issuer will be deemed to have fulfilled (during the offer period) the obligation to provide a key information document under the PRIIPs Regulation, provided they give a copy of the summary to investors who would otherwise have been entitled to receive the PRIIPs key information document.

Summary – risk factors

The summary must include a brief description of the most material risk factors. 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.

Base prospectus summary

Under the new regime, a summary should only be drawn up in relation to each individual issue offered, so no summary of the base prospectus as a whole will be required. However, it is unlikely that issuers will want to wait until a retail issue is made before producing a summary, at least so far as it relates to information specific to the issuer, so it is likely that a *pro forma* summary will be prepared at the same time as the base prospectus (whether it forms part of it or not).

It is unclear whether the issue specific summary for a drawdown under a base prospectus requires approval (as, for example, would be the case for a summary that, together with a securities note, completes a registration document to form a prospectus). It would seem logical that it should and, if so, retail issues under programmes will be delayed by the time required for such approval.

Risk factors

Practice with respect to the presentation of risk factors is likely to change under the new regime.

- > Risk factors will have to be presented in a “limited number of categories depending on their nature”, with the most material risk factors being presented first within each such category.
- > Issuers will be required to assess the relative “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.
- > Additional detail on risk factors will need to wait for secondary legislation supplementing the prospectus regulation.
- > The Commission will be empowered to adopt delegated acts specifying criteria for the assessment by the issuer of the “specificity and materiality” of risk factors and for the presentation of risk factors across categories.
- > 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. It is not clear, however, whether those guidelines will be available at the time the new prospectus regulation will take effect.
- > 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.

Publication

Prospectuses will need to be published in electronic form on one or more prescribed websites, in a dedicated section which is easily accessible. Any documents incorporated by reference and a separate copy of any summary will also need to be accessible in the same section. All prospectuses, including documentation incorporated by reference, will have to remain publicly available in electronic form for a minimum of 10 years.

Other key features

In line with the objectives of increasing access to, and decreasing compliance costs for SMEs to access, the capital markets, a number of additional initiatives have been incorporated in the regulation.

Universal Registration Document

Frequent issuers will be permitted to use a Universal Registration Document or “URD” as a constituent part of the base prospectus.

Under this new URD regime, an issuer would complete a registration document annually, which would allow that issuer to obtain fast-track approval (five days instead of 10 days) with the competent authority when a prospectus is later required. Issuers would be allowed to publish their annual and half-yearly financial reports as parts of the URD, fulfilling their obligations under the Transparency Directive⁴. After an issuer has had a URD approved by the competent authority each financial year for two consecutive years, subsequent URDs may be filed with the competent authority without prior approval (although the URD would need to subsequently be approved, before becoming a constituent part of a prospectus).

Disclosure standards for the URD are likely to be based on equity standards for disclosure, however, meaning that a URD is unlikely to be useful to debt issuers without equity listings in the EEA. Incorporation of future information by reference is not permitted either, which may also limit the utility of the URD.

Simplified Disclosure Regime for Secondary Issuances

This will apply broadly to issuers with certain categories of securities admitted to trading on a regulated market or SME growth market continuously for at least the last 18 months. However, as issuers using this option will be required to produce a summary in accordance with the regime described above, the simplified regime is unlikely to be attractive to wholesale issuers, particularly those who are content to continue to use base prospectuses.

EU Growth Prospectus

This will allow for certain SMEs and other smaller issuers to benefit from a proportionate disclosure regime.

Summary conclusion

The new prospectus regulation affects both wholesale and retail debt markets by imposing additional requirements.

In the case of wholesale debt markets, the most notable additional requirement relates to the new regime for risk factors described above. While this appears somewhat burdensome and, for issuers that issue in non-EU jurisdictions and wish to make the same disclosure to all markets,

⁴ Directive 2004/109/EC

inconvenient, it is likely that the markets will not be too disrupted by the changes.

The alternative trigger to applicability of wholesale “alleviated” disclosure regime for prospectuses approved for admission to trading for qualified investors only on a new regulated market or segment could allow for increased liquidity in the secondary market.

The changes for retail markets are more fundamental, however, and represent a significant increase in the disclosure obligations of issuers. It remains to be seen whether this will affect the willingness of issuers to access such markets.

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