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Prospectus Directive: The Commission's Proposal for a New Prospectus Regulation

The European Commission, as part of its Capital Markets Union action plan and its commitment to simplify and harmonize EU laws, on November 30, 2015 adopted a proposal for a new prospectus regulation, intended to replace the EU Prospectus Directive 2003/71/EC as amended (the "Prospectus Directive") along with its corresponding implementing measures. The new proposal aims mainly at simplifying the rules for companies wishing to issue shares or debt on the market and reducing the costs of preparing a prospectus, thus fostering cross-border investments in the single market, while at the same time still enabling investors to make informed investment decisions. In addition, transforming the Prospectus Directive into a regulation would serve the purpose of addressing the problems that typically arise in the transposition of a directive and enhancing coherence and integration throughout the internal market, while reducing divergent and fragmented rules across the Union.

The Proposed Changes to the Current Disclosure Regime

The high costs of compliance with the Prospectus Directive, the rigid and "one-fits-all" type of disclosure as well as the insufficient harmonization of disclosure regimes across the EU are the main issues that seem to still hinder the raising of capital on an EU-wide basis and that led the Commission to propose the amendments discussed in this note.

Effective and Focused Disclosure

The proposal includes a number of amendments to the documents, or parts thereof, that issuers are currently required to file with the competent authorities when they wish to raise capital on the markets.

- *The prospectus summary.* The current summary would be replaced with a new prospectus summary, closely modeled after the key information document (KID) required under Regulation (EU) No. 1286/2014 (PRIIPS Regulation on key information documents for packaged retail and insurance-based investment products) and subject to a maximum length of six sides of A4 – sized paper when printed. Together with an introductory section containing warnings, the summary would be comprised of three main sections, covering key information on the issuer, the securities and the offer, respectively. The prohibition to incorporate information by reference into the summary will remain, so as to avoid the summary to become a mere collection of hyperlinks and cross-references thus losing its purpose. The liability regime applicable to the prospectus summary would remain unchanged. These changes would allow investors to benefit from a shorter document, from which it would be much easier to grasp the relevant information and which would lead to a considerable reduction in administrative burden for issuers.
- *Risk factors.* The risk factors to be included in a prospectus would be limited to risks that are material and specific to the issuers and its securities. They would have to be allocated across a maximum of three distinct categories, based on materiality and the expected magnitude of their negative impact, for the assessment of

which by the competent authorities the European Securities and Markets Authority (ESMA) will develop specific guidelines. The aim of this change is to curb the tendency of overloading the prospectus with generic risk factors, which obscure the more specific risk factors that investors should be aware of, and only serve to protect the issuer or its advisors from liability.

- *Incorporation by reference.* The proposal broadens the scope of the documents that would be incorporated by reference (e.g., annual and interim financial information, audit reports and financial statements, corporate governance statements, management reports, memorandum and articles of association) provided that the information is published electronically and complies with the language regime set forth by Article 25 of the proposal (e.g., depending on whether the offer to the public is made or admission to trading on a regulated market is sought in the home member state or in one or more than one member state, the prospectus will have to be drawn up in a language accepted by the competent authority of the home member state or either in a language accepted by the competent authorities of those member states or in a language customary in the sphere of international finance). The proposal also goes in the direction of allowing companies that do not fall under the scope of the Transparency Directive (for example, companies whose securities are traded on an MTF) to incorporate by reference all or parts of their annual and interim financial information and management reports.

Small Issuances

- *Exemptions for the smallest capital raisings.* The proposal sets out higher thresholds to determine when companies must issue a prospectus. A EU prospectus will not be required for capital raisings below EUR 500,000 (vs. current threshold of EUR 100,000). This change acknowledges that the cost of preparing a prospectus is disproportionate as compared to the proceeds of an offer of securities that is lower than EUR 500,000. Member States will be given the choice to set higher thresholds, provided that the offer is only made in that member state and the total consideration of the offer does not exceed EUR 10,000,000.
- *Lighter disclosure for smaller companies.* The proposal, recognizing the need to adapt the disclosure regime applicable to smaller companies to their economic needs, goes in the direction of a lighter disclosure regime applicable to small-to-medium enterprises (SMEs), introducing the possibility for SMEs to prepare prospectuses that are tailor-made when they offer securities to the public, with a focus on information that is material and relevant for companies of such small size. Compared to the existing Annexes XV to XXVIII of Regulation (EC) No 809/2004 further alleviations will be introduced, so as to ensure proportionality between the company size and the cost of preparing a prospectus. The proposal also introduces an optional format of the prospectus for SMEs, which can take the form of a “question and answer” disclosure document (the details of which will be included in the delegated acts). ESMA will be empowered to develop guidelines helping SMEs to draw up a prospectus under the new format. The proposal also raises to EUR 200 million (from the current EUR 100 million) the threshold of market capitalization below which SMEs can benefit from this lighter disclosure regime. This new regime will apply to SMEs provided that they have no securities already admitted to trading on a regulated market so to avoid creating a two-tier disclosure standard on markets, which might undermine investor confidence.

Simplifications for Secondary and Frequent Issuers

- *Secondary issuers.* The proposal provides an alleviated disclosure regime for offers or admissions concerning securities issued by companies already admitted to trading on a regulated market or an SME growth market for at least 18 months, allowing these companies to only focus on essential disclosure when

they wish to tap the capital markets. This change recognizes that secondary issuance prospectuses represent the vast majority of all approved prospectuses in a given year and tries to provide more flexibility and less paperwork for such companies, thus reducing costs and making disclosure more relevant for investors. In addition, such companies are already subject to ongoing disclosure requirements under the Market Abuse Regulation and either the Transparency Directive or the rules of the operator of the SME growth market. The alleviated prospectus is proposed to contain minimum financial information covering the last financial year only (which may be incorporated by reference), as well as information that issuers are not otherwise currently required to disclose on an ongoing basis under the Market Abuse Regulation and the Transparency Directive Regulation (such as the terms of the offer, use of proceeds, risk factors, board practices, directors' remuneration, shareholding structure or related-party transactions).

- *Frequent issuers.* The proposal sets out a quicker and simplified disclosure regime for companies that frequently tap the capital markets that are admitted to trading on regulated markets or multilateral trading facilities, to be implemented through (i) the use of a "universal registration document" ("URD"), and (ii) a reduction in the prospectus approval time. The URD consists of an optional shelf registration mechanism, whereby issuers would draw up every year a complete registration document containing all the necessary information on the frequent issuer, to be filed with the competent authority. When required to then prepare a prospectus to carry out a capital market transaction, such issuers would be awarded "fast-track" approval with the competent authority. In fact, since the main part of the prospectus would have either already been approved or would be already available for review by the competent authority, the authority should be able to scrutinize the remaining documents (securities note and summary) within five working days, instead of ten. In addition, issuers that have received approval for a URD for three consecutive years would be considered "well-known" to the competent authority, and therefore any subsequent URD should be allowed to be filed without prior approval and reviewed on an ex-post basis by the competent authority. In furtherance of the foregoing, the proposal also allows frequent issuers admitted to trading on a regulated market, under certain conditions, to fulfill their ongoing disclosure obligation under the Transparency Directive by simply integrating their annual and half-yearly financial reports into the URD, this way avoiding duplicative requirements and concentrating the information investors need in one single document which is updated at least every year. This approach acknowledges that currently only a very small percentage of prospectuses benefit from approval periods shorter than ten days and the incremental burden that this creates to issuers in a volatile market environment, where market windows are generally very short. Such change also recognizes the need to alleviate the incremental burden of disclosure on frequent issuers, which is however counterbalanced by the supply to their investors and analysts on a recurrent basis of a minimum set of information needed to make an informed judgment on the company's business, financial position, earnings and prospects, governance and shareholding, including at a time when the issuer is not carrying out an offer to the public or requesting the admission of its securities to trading.

Non-equity Securities Issuance Documents

- *Bond issuances.* The EUR 100,000 denomination is used in the current disclosure regime to distinguish wholesale and retail disclosure regimes as well as to provide a prospectus exemption for offers of non-equity securities. This regime appears to have created unintended distortions in the European bond markets in that it makes a significant portion of bonds issued by investment-grade companies inaccessible to a wider number of investors. The proposal, therefore, removes the EUR 100,000 exemption for retail offers of non-equity securities and introduces a uniform prospectus requirement for bond issuances, irrespective of its minimum

denomination, thus trying to provide an incentive to issuers of debt securities to choose minimum denominations that make their bonds more attractive to a wider range of investors, and as a consequence, remove a barrier to secondary liquidity on the European bond markets.

- *Base prospectus.* Although the functioning of the base prospectus under the new proposal would remain the same, the following changes would be implemented: (i) issuers would be allowed to prepare a base prospectus for any kind of non-equity securities (and not only for those issued under an offering programme or in a continuous and repeated way by credit institutions); and (ii) issuers would be allowed to use a “tripartite” base prospectus, and the registration document forming part of it would represent a URD. The new proposal would also remove the obligation to draw up a summary of the base prospectus when the final terms are not contained therein, and issuers would only have to prepare and file the summary containing the information relevant for the offer when the final terms are filed.

How and Where Will Disclosure Information be Made Available to Investors

The proposal also sets forth a series of changes and simplified procedures relating to the dissemination of the disclosure documents.

Publication of the Prospectus

The prospectus will be deemed available to the public when published in an electronic form on either (i) the website of the issuer; (ii) the website of the financial intermediaries conducting the offer; or (iii) the website of the regulated market where the admission to trading is sought, or of the operator of the MTF, where applicable. The proposal also removes two of the options provided under the Prospectus Directive for publishing an approved prospectus (*i.e.*, by insertion in one or more newspapers and in a printed form to be made available, free of charge, at the registered office of the issuer), while maintaining the requirement to provide a free paper copy to anyone who requests it. Based on the Commission’s proposal, ESMA will develop an online storage mechanism with a search tool that EU investors may use for free.

Single Access Point for all EU Prospectuses

ESMA will have to provide for the first time free and searchable online access to all prospectuses approved in the European Economic Area. Investors will therefore have a single portal where they can find information on companies that have listed shares or corporate bonds on markets where the general public can invest, instead of going through local searches. This will facilitate research, enforcement and increase the efficiency of prospectus pass-porting.

Next Steps and Transitional Regime

The draft regulation has been sent to the European Parliament and the Council of the EU for discussion and adoption under the co-decision procedure. The regulation will enter into force on the twentieth day following its publication in the official journal and will apply from the date that is 12 months after its entry into force. A number of delegated acts will need to be adopted by the Commission and draft regulatory and technical standards and guidance will need to be developed by ESMA in respect of various provisions of the new regulation. The Commission will monitor the impact of the new regulation in co-operation with ESMA and national competent authorities on the basis of the reports on prospectuses approved in the EU, which ESMA will be empowered to prepare every year.

The proposal contains a specific transitional clause for prospectuses approved in accordance with the Prospectus Directive before the date of entry into application of the proposed regulation: those prospectuses will continue to be governed by the Prospectus Directive.

Challenges and Major Concerns

More than ten years have passed since the Prospectus Directive has been originally issued, thousands of prospectuses have been approved by Member States authorities and many different types of transactions have been carried out in the European capital markets. This proved to be a considerable set of information for assessing the level of harmonization and efficiency among the different Member States' systems and the effectiveness of the disclosure regime towards investors.

The main concern related to the "new" disclosure regime is how the simplifications introduced by the Commission's proposal will fit in the "old style" disclosure regime: *i.e.*, does lighter disclosure mean less protection for the investors? The first-hand answer is no. In fact, the consultation conducted by the Commission before issuing its proposal highlighted the length of the prospectuses as a minus in the disclosure regime, as well as the fact that such prospectuses are often drafted with the objective to address potential legal liabilities of the issuers rather than to inform investors in a proper way, which seemed to run opposite the objective of allowing investors to make informed decisions. The attention, therefore, should not be on the fact that the new proposal lightens and reduces the old disclosure regime, but rather on the fact that it tries to focus the disclosure on areas that are relevant for each different type of investment. The whole purpose of the proposal for the new regulation is to make the key disclosure document for investors more accessible and easier to understand, so to provide clear and comparable information to investors across Europe, and help them fully understand the business and the offer they are investing in. Obviously, whether the new proposal will achieve such a goal is difficult to predict now and will necessarily be confirmed after the new regime takes effect.

Similarly, and by looking at the matter from a different angle, one might wonder whether this "simplified" disclosure regime raises the liability profile for issuers and underwriters or whether it changes the standard which issuers are required to attain. Under the new proposed regulation, the standard of liability remains unchanged for issuers and focused on its ultimate purpose of making available to investors "the information which, according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities." What will need to change is therefore the way in which issuers, with the guidance of the Commission and the ESMA, look at what such "information" really is, and how to present it to investors. Again, it is too early to determine whether this purpose will be achieved through the proposed changes.

From a procedural stand-point, it is still somewhat unclear what the role of the Member States' authorities and of their implementing rules and regulations (both the existing ones and the ones that would be necessary) will be in light of the new regulation. In particular, it is not clear whether local laws will have to be modified or altogether repealed to the extent they do not reflect the terms of the proposed regulation and what rule-making responsibilities the regulators of each Member State will retain.

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