

CMU: The New Prospectus Regulation (PD3) – Impact on Issuers of Debt Securities

June 2017
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On 30 June 2017 the long-awaited text of the new Prospectus Regulation was published in the Official Journal. The Prospectus Regulation is an important step forward in the completion of [Capital Markets Union](#), a key policy objective of the European Union (EU).

This article looks in detail at the future regulatory framework for offers and admissions to trading of securities in the EU under the new Prospectus Regulation, with a particular focus on the Eurobond market.

Background

- In 2014, European Commission President Juncker kicked off the process of building a genuine EU [Capital Markets Union](#) (CMU) with a view to creating deeper, stronger and better capital markets in Europe to support jobs and growth.
- In November 2015 the Commission published a far reaching [legislative proposal](#) to overhaul and modernise the Prospectus Directive regime¹ (PD2).
- During the course of 2016, the institutions of the EU developed and debated the new Prospectus Regulation, culminating in the publication of the [Final Compromise Text](#) on 16 December 2016.
- The final text of the new Prospectus Regulation was published in the Official Journal on 30 June 2017 and will apply to all prospectuses approved on or after 21 July 2019. Certain provisions of the new Prospectus Regulation are however implemented early (as detailed below).

Summary of Key Changes vs PD2

- *“Wholesale securities”* – the concept of what constitutes a “wholesale” debt security is expanded beyond the current market practice of debt securities with a minimum denomination of at least EUR 100,000 to include securities, irrespective of denomination, which are traded only on a regulated market, or specific segment thereof, which is only accessed by qualified investors for the purposes of trading such securities.
- *Changes to form and content of summaries* – the new Prospectus Regulation abolishes the “elements” style summary introduced by PD2 in favour of shorter, clearer summaries in a user-friendly question and answer format. Helpfully, where a “key information document” (KID) is required to be prepared for purposes of an offering of securities to retail investors (under the [PRIIPs Regulation](#) regime), certain parts of the KID can be replicated in the prospectus summary. Having a KID does not exempt the issuer from the requirement to produce a summary however and vice versa.

¹ Directive 2003/71/EC, as amended by Directive 2010/73/EU.

Encouragingly, there will no longer be a requirement for a base prospectus summary (for debt issuance programmes). For issuers of structured products in particular, the creation of a base prospectus summary allowing for all possible products structures in a pro forma style has been difficult and with little investor benefit. This change is therefore welcomed.

- *Risk Factors* – under the new Prospectus Regulation, risk factors are required to be more specific and tailored to the issuer and specific securities. Risk factors must be limited to risks which are “*material for taking an informed investment decision*” and generic disclaimer risk factors are prohibited. Issuers are required to assess the materiality of the risk factors based on the probability of their occurrence and expected magnitude of their negative impact.
- *Universal Registration Document* – a new form of issuer disclosure document called a “Universal Registration Document” (URD) will be available. This is designed to reduce the administrative burden for issuers who regularly access the capital markets.
- *Fungible Issuances* – no prospectus will be required for the admission to trading of fungible increases provided that the size of the fungible increase is less than 20% of same securities already admitted to trading on the same market. In addition, a simplified prospectus regime is introduced for other types of fungible increases.

As is so often the case, the devil is in the detail and while these are the headline features of the new Prospectus Regulation, there are a number of points of detail which may have a significant impact on other areas of the market.

Detailed Review of the new Prospectus Regulation

Scope of new Prospectus Regulation

The basic triggers for the requirement to publish a prospectus are unchanged, namely: (i) an offer of securities to the public in the EEA; and (ii) admission to trading on an EEA regulated market.

In its initial consultation, the Commission did consider expanding the scope of the new regime to admissions of securities to multilateral trading facilities (MTFs), such as the Irish Stock Exchange Global Exchange Market or the Luxembourg Stock Exchange Euro MTF market. Such activities continue to be outside of the scope of the new Prospectus Regulation, allowing useful flexibility for issuers, particularly in the context of the issuance of debt securities that are not targeted at retail investors.

There have also been discussions as to whether crowdfunding activities should fall within the scope of the EU prospectus regime. In 2016 the Commission concluded that there was [no strong case for EU wide regulation of crowdfunding](#) at that time. Whilst crowdfunding is outside scope of the new Prospectus Regulation, the Commission are actively looking at this area as differing [national regimes have been identified as a barrier to capital flows](#).

Format of Legislation

The changes are being enacted by way of a Regulation (which has direct effect) rather than a Directive (which requires individual Member States to enact implementing legislation). This is helpful in achieving the goal of maximum harmonisation in the EEA as experience has shown that direct effect avoids anomalies in implementation across Member States.

The new Prospectus Regulation does still leave some room for Member States to exercise discretion and apply their own rules, though only in certain limited situations; one such example being that individual Member States may set their own limit below which no prospectus is required for public offers made in that individual Member State only in a 12-month period, provided that it is between EUR 1m and EUR 8m. The equivalent PD2 exemption (which sets the threshold at EUR 5m) is well-used by SMEs, so allowing individual Member States to limit this would appear to be somewhat at odds with the stated aims of CMU. Offers of securities with a total consideration of less than EUR 1m in a 12-month period are exempt from the new Prospectus Regulation and instead such small offers will be subject to the local regulatory law requirements of the applicable Member State.

Distinction between “wholesale” and “retail” securities

Under the new Prospectus Regulation, the main PD2 exemptions to the requirement to publish a prospectus used for private placements of debt securities, including the “EUR 100,000 minimum denomination exemption” are retained. There is also extremely helpful clarification that exemptions can be used in combination with each other where the conditions for the exemptions are fulfilled simultaneously. The welcome retention of the EUR 100,000 minimum denomination exemption means that the existing market distinction between “wholesale” and “retail” securities is likely to remain.

The new Prospectus Regulation envisages a less onerous disclosure regime for prospectuses relating to debt securities to be admitted to trading on a regulated market where either (i) the securities are traded on a regulated market, or specific segment thereof, which is only accessed by qualified investors for the purposes of trading such securities, irrespective of denomination; or (ii) the minimum denomination of the securities is EUR 100,000.

Further information on the specific disclosure requirements is yet to be published however the new Prospectus Regulation does provide that prospectuses relating to securities of this type will not be required to include a summary and will have “more flexible language requirements.” Encouragingly, the new Prospectus Regulation also provides that the information which is included in a prospectus should be adapted according to the nature and circumstances of the issuer, the type of securities, whether the investors targeted by the offer are solely qualified investors and whether the securities have a minimum denomination of at least EUR 100,000.

Under PD2, in respect of debt securities, the applicable disclosure requirements for a debt prospectus depended largely on the denomination of the securities. It is a welcome change that the applicable disclosure regime can also be determined by whom the securities are marketed to. Interestingly, the new expanded concept of what constitutes a “wholesale” issuance is likely to be of greatest benefit in terms of whether an issue of securities falls within the scope of the [PRIIPs Regulation](#) regime. As the PRIIPs Regulation only applies to products which are available to retail investors, if securities are admitted to segments of markets which can only be accessed by qualified investors for the purposes of trading such securities, there is an expectation that such securities would be outside of the scope of the PRIIPs Regulation.

Whilst the applicable “wholesale” and “retail” disclosure requirements are yet to be published, the recognition that there should not be a “one size fits all” approach to prospectus disclosure is welcomed as it is simply unnecessary and inefficient to produce retail disclosure and summaries for wholesale markets. New segments of regulated markets will need to be established which are accessible by qualified investors only to enable issuers to take advantage this welcome change.

Summaries

One of the most contentious aspects of the implementation of PD2 in 2012 was the introduction of over-rigid and very formulaic prospectus summaries. These have been particularly problematic in the context of retail structured products, where it has been challenging to condense complex concepts into the prescribed summary format. In the context of EMTN programmes, the requirement imposed by some competent authorities for a base prospectus summary which includes in it options for an issue-specific summary has made summaries particularly unwieldy, and it is clear that the current prescribed format is not helpful for anyone, least of all retail investors (at whom summaries are aimed).

The new Prospectus Regulation addresses these issues by introducing a Q&A style approach to summaries. The summary should be written in a clear, non-technical, concise way which is and comprehensible to investors. It must be presented in characters of a readable size on a maximum of seven sides if A4 paper. Where the securities are guaranteed, a further side of A4 paper is permitted.

The Regulation prescribes in some detail the content of summaries, which will be required to be split into the following four key sections:

- introduction and warnings
- key information on the issuer
- key information on the securities, and
- key information on the offer to the public or admission to trading.

On the plus side, no summary is required where the prospectus relates to “wholesale” debt securities, being securities which (i) are traded on a regulated market, or specific segment thereof, which is only accessed by qualified investors for the purposes of trading such securities, irrespective of denomination; or (ii) have a minimum denomination of EUR 100,000. In addition, the PD2 requirement for a *pro forma* base prospectus summary is abolished and instead a summary will only be required for individual issuance.

Where a KID is required in addition to the summary, an issuer may substitute certain parts of the summary with the KID. If an issuer chooses to do this, the length limit of the summary is extended by 3 additional sides of A4 paper. The KID should be included as a distinct section of the summary which is clearly identified as being the content of the applicable KID.

The shorter regime for summaries, and removal of the requirement for a summary for base prospectuses for EMTN programmes, should facilitate the preparation of base prospectuses and should alleviate concerns around condensing a large amount of detailed information contained in base prospectuses (particularly for financial institution issuers) into a short summary document. Some aspects of the new regime may be contentious, however – for example, risk factors relating to each of the issuer and the securities in a summary are limited to fifteen in total.

There is also a potential concern for issuers as to whether a 7 page summary can satisfy (in particular in the case of complex securities issued by complex entities, such as financial institutions) the requirement to provide “*the key information that investors need in order to understand the nature and the risks of the issuer, the guarantor and the securities that are being offered or admitted to trading on a regulated market...to aid investors when considering whether to invest in such securities.*”

The recognition of the interplay between the EU prospectus regime and the PRIIPs regime is welcome and will hopefully reduce some of the documentary burden for issuers of products which fall within the scope of both the Prospectus Regulation and PRIIPs – though whether that will be the case awaits to be seen.

Risk Factors

Perhaps in response to the perception that risk factors in prospectuses have become primarily a risk management tool for issuers, with the benefit for investors being a secondary concern, the new Prospectus Regulation sets out a more prescribed regime for risk factors. Under the new Prospectus Regulation, risk factors are to be limited to *“those risks which are material and specific to the issuer and its securities and which are corroborated by the content of the prospectus.”* In addition, a prospectus should not contain generic, disclaimer-type risk factors as these may make it more difficult for an investor to ascertain what the specific risks are.

The new regime may result in challenges for issuers in terms of determining the risks that merit inclusion in the risk factors section of a prospectus, but the changes are consistent with the aims of CMU. There may also be a tension between other risk disclosures made by issuers (for example in their annual reports) and the limitations imposed by the new regime. This in itself reflects the underlying tension between the goal of reducing barriers to capital markets issuance for issuers and making prospectuses more user-friendly, while ensuring investor protection. Issuers who find themselves having to make quantitative judgements on the risks related to their company, while knowing that ultimately they will be judged with the benefit of hindsight, might take some time to adjust to the new regime.

As mentioned above (see “Summaries”), prospectus summaries may only include fifteen risk factors regarding the issuer and the securities in total.

Simplified Regime for Fungible Increases

The new Prospectus Regulation introduces some welcome changes in relation to fungible increases. Firstly, a new exemption is introduced such that the obligation to publish a prospectus shall not apply to the admission to trading on a regulated market of securities which are fungible with securities already admitted to trading on the same regulated market, provided that the new securities represent, over a 12 month period, less than 20% of the number of securities already admitted to trading on the same regulated market. This new exemption shall apply from 20 July 2017 which is an extremely positive development.

Secondly, a simplified prospectus disclosure regime is introduced for offers or admissions of fungible tranches of debt securities in respect of issuers whose securities have been admitted to trading on a regulated market or SME growth market continuously for at least the past 18 months and the secondary issuance is fungible with the existing issuance.

Whilst applicable disclosure requirements applicable to simplified prospectuses are yet to be published, these are welcome development which will hopefully reduce the timing and cost of fungible increases and secondary offerings, which is alignment with the stated aims of CMU.

Universal Registration Document and “Frequent Issuers”

A significant change included in the new Prospectus Regulation which could benefit regular issuers is the introduction of the concept of a “Universal Registration Document” (URD). This would be available for issuers who have securities admitted to trading either on a regulated market or on a MTF and would contain information on the issuer’s organisation, business, financial position, earnings and prospects, governance and shareholding structure.

The main benefit of having a URD is that after an issuer has had its URD approved annually by the relevant competent authority in its home Member State for two consecutive financial years, subsequent URDs can be filed without requiring approval by the competent authority. The competent authority however will still have the ability to review the URD and require amendments to be made (i.e. an “after the event” review).

Issuers who fall within this category are referred to as “frequent issuers”. In order to retain the status (and benefits) of being a “frequent issuer”, a new URD will have to be filed each year and the issuer will have to comply with the relevant requirements to publish “regulated information” under the Transparency Directive and the Market Abuse Regulation.

As an issuer can use a URD for an equity or debt prospectus, a URD must be drawn up in accordance with the equity issuer disclosure requirements of the new Prospectus Regulation (which are yet to be published). It is likely that the equity issuer disclosure requirements will continue to be more onerous than those applicable to debt issuers, so in practice debt issuers may have little appetite to adopt the URD disclosure format.

Other Amendments

A number of other less high-profile but equally important amendments include:

Higher exemption threshold

No prospectus will be required for offers of securities with a total consideration in the EU of less than EUR 1,000,000 (up from EUR 100,000.) As stated above (see *Format of Legislation*) individual Member States will have the option to exempt offers to the public from the prospectus requirement where the total consideration of the offer is between EUR 1,000,000 and EUR 8,000,000 provided that the offer is made only in that Member State. As discussed above, these rules will apply to offers of securities from 21 July 2018, which is helpful for SMEs looking to raise capital.

Incorporation by Reference

The scope of information that may be incorporated by reference is expanded to include information published under the Transparency Directive and specifically includes annual and interim financial information, audit reports and financial statements for issuers which fall outside of the scope of the Transparency Directive. This is subject to the requirement that all documents to be incorporated by reference must be published electronically.

20% limit on conversion or exchange

PD2 contained an exemption for the requirement for a prospectus where shares are issued on conversion or exchange of other securities, meaning that issuers of convertible or exchangeable bonds or warrants do not need to worry about preparing a prospectus when investors exercise their conversion, exchange or exercise right). The new Prospectus Regulation amends this by capping the number of securities that may be issued in this way without a prospectus to an annual amount of 20% of the number of shares of the same class already admitted to trading on the same regulated market. This will apply from 20 July 2017.

In response to market feedback to the Commission’s initial legislative proposal, the new Prospectus Regulation contains a carve out (i) where the securities giving the access to shares were issued before 20 July 2017; and (ii) for certain types of “contingent convertibles” where the conversion takes place as a result of a distress scenario. In practice, this should have little impact on the market.

Supplements

Where securities are purchased through a financial intermediary, the new Prospectus Regulation imposes new obligations on financial intermediaries to assist investors in exercising their right of withdrawal. In particular, the financial intermediary shall:

- inform investors of the possibility of a supplement being published (particularly where and when it shall be published) and that the financial intermediary will assist investors in exercising their right of withdrawal; and
- contact investors on the day which the supplement is published.

In addition, ESMA will be required to prepare draft regulatory technical standards to specify situations where a significant new factor, material mistake or material inaccuracy relating to the information included in the prospectus requires a supplement to the prospectus to be published. These are due to be tabled within 12 months of the new Prospectus Regulation coming into force.

Proportionate disclosure regime for SMEs

In line with the aims of CMU, the new Prospectus Regulation introduces the concept of the “EU Growth prospectus” aimed at SMEs and certain other types of smaller, unlisted issuers. Delegated acts and guidelines will be required to add detail to this regime, but in principle it does seem to be a positive development from the point of view of achieving the CMU ambition of making capital markets funding more easily attainable for SMEs.

Publication of prospectuses

A prospectus will be deemed to be published when it is made available on either:

- the website of the issuer, the offeror or the person asking for admission to trading
- the website of the financial intermediaries placing or selling the securities, including paying agents, or
- the website of the regulated market where the admission to trading is sought, or where no admission to trading on a regulated market is sought, the website of the operator of the multilateral trading facility.

The prospectus should be published on a dedicated section of the relevant website and must remain on the relevant website for at least 10 years after its initial publication. The prospectus must be downloadable, printable and in a searchable electronic format that cannot be modified. All hyperlinks in the prospectus must also remain functional for the same duration.

Somewhat surprisingly, however, in a world that is increasingly web-based, where a potential investor makes a specific demand for a paper copy of a prospectus, that investor should be able to receive a printed version of the prospectus. The issuer is however not obliged to keep in reserve printed copies of the prospectus to satisfy such potential requests.

More powers/responsibilities for ESMA

The new Prospectus Regulation also gives further investigatory and enforcement powers to ESMA. While the detail of these is beyond the scope of this note, they include the power for competent authorities to refuse to approve prospectuses drawn up by an issuer for a period of 5 years for cases of repeated severe infringements. It also requires ESMA to publish all prospectuses received by it on a freely accessible electronic platform (with a corresponding requirement on the part of competent authorities to do the same, and provide a copy to ESMA).

In addition, where a prospectus is to be passported to a host Member State, going forward the passport notification process will take place via a “notification portal” to be established by ESMA.

What next?

The new Prospectus Regulation allows for a two year grandfathering period so the majority of the new provisions will apply to prospectuses approved on or after 21 July 2019, which is welcomed.

As detailed above, the exemption to publish a prospectus for certain fungible increases will apply from 20 July 2017 and the exemption of domestic offers of less than EUR 1m from the EU prospectus regime entirely will apply from 21 July 2018.

While the new Prospectus Regulation provides a lot of information on the new regime there is a lot of detail that will need to follow, in particular regarding the detailed disclosure requirements that will apply to prospectuses under the new regime. Consequently a number of areas of detail will only become clear once delegated acts and/or draft regulatory technical standards are developed.

Helpfully, the new Prospectus Regulation contains a Correlation Table whereby readers can track where provisions of PD2 are transposed in the new Prospectus Regulation.

Conclusion

The new Prospectus Regulation has arguably managed to balance the Commission’s aims to modernise the EU prospectus regime with the market feedback. The changes will impact on the drafting of prospectuses however the two year grandfathering period is helpful as it gives the market time to fully assess the impact of the changes. Many of the changes are to be welcomed, but the key is that market participants (including competent authorities) work together to adapt to the new regime, in the process laying the foundations for a genuine Capital Markets Union.

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