ALERT MEMORANDUM

The New Prospectus Regulation – The Story So Far

7 March 2019

The new Prospectus Regulation (the "New Regulation") will come into full effect across the European Union from 21 July 2019.[1] In this memorandum, we consider both the positive impacts issuers can expect from the New Regulation (see the section entitled *Good news for issuers*) and certain developments to the prospectus regime which issuers may welcome less readily (see the section entitled *Issuers' causes for concern*).

Issuers will also be anxious to follow the development of the Level II and Level III delegated legislation to supplement the New Regulation, where much of the detail of the various disclosure standards under the new regime will be set out.

A key question is the application of the new prospectus regime after the United Kingdom's expected withdrawal from the European Union on 29 March 2019. Under the European Union (Withdrawal) Act 2018, the New Regulation will not automatically become part of UK law at the date of exit, as it will not yet be fully operative in the United Kingdom. However, if the United Kingdom ratifies the draft Withdrawal Agreement between the United Kingdom and the European Union, there will be a 21-month implementation period during which the United Kingdom will continue to implement new EU laws, including the New Regulation. In the alternative scenario of a no-deal Brexit, the Financial Services (Implementation of Legislation) Bill proposes that the New Regulation apply in full in the United Kingdom from 21 July 2019. This would ensure consistency, at least initially, with the EU regime and support the continued appeal to issuers of a London listing.

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The New Regulation requires the European Commission (the "Commission") to adopt delegated acts on a number of topics, including the content of the prospectus, key financial information for the prospectus summary, provisions concerning advertisements, and situations where a prospectus might be required to be supplemented in light of a material new factor, mistake or omission. The

[1] Some provisions of the New Regulation are already applicable. These have been noted, where relevant.

delegated acts are prepared by the European Securities and Markets Authority ("ESMA"), which is also engaged in the consultation process regarding guidelines for risk factors under the New Regulation and the documentation required in the case of an exchange public offer, merger or spinoff (both expected to be published in the spring of 2019).[2] On 28 November 2018, the Commission released a draft version of the delegated act on the format, content, scrutiny and approval of the prospectus for consultation (the "Draft Delegated Act"), which the New Regulation required to be adopted by 21 January 2019. However, due to an extended consultation period with market participants and the resulting requirement for amendments, it seems likely that the Draft Delegated Act will not be finalised until around the time that the New Regulation comes into full effect. Certain requirements proposed by ESMA and the Commission are more onerous than those under the current regime. This memorandum considers the position for issuers in light of the Draft Delegated Act and ESMA's proposed guidelines.

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OVERVIEW OF CHANGES

Implementation. As the provisions of the new prospectus regime are now set out in a regulation instead of a directive, they are directly applicable, without the need for implementing laws in each EU member state.

Universal Registration Document. Regular issuers will have the option of drawing up a shelf registration-type document, which may allow faster access to capital markets and more efficient financial reporting for those that use it.

Reduced Disclosure for Secondary Issuances. Secondary issuances will be subject to more relaxed prospectus requirements, and offers to directors and employees continue to be exempt from the obligation to publish a prospectus.

Alleviated Treatment for Non-Equity Securities. As an expansion of the existing wholesale regime, the New Regulation permits an alleviated standard of disclosure in issuers' prospectuses for admissions to trading of non-equity securities on regulated markets to which only qualified investors have access or, irrespective of the market, for an issuer's non-equity securities that have a minimum denomination of at least EUR 100,000.

Risk Factors. Issuers will have to limit risk factors to those determined to be material and specific to the issuer. Additionally, risk factors will have to be set out in a limited number of expressly stated categories depending on their nature, with the most material listed first. Risks included in the risk factor section must be corroborated elsewhere in the prospectus. The ultimate impact of these new rules will depend on the final form of the delegated acts.

Requirements for Summaries. There are new summary requirements, including a limit on listing only the fifteen most material risk factors and restricting the length of summaries in most cases to a maximum of seven sides of A4. Materiality may be assessed using a qualitative scale of low, medium or high.

[2] See "Consultation Paper: Guidelines on risk factors under the Prospectus Regulation", https://www.esma.europa.eu/sites/default/files/library/esma31-62-996_consultation_paper_on_guidelines_on_risk_factors.pdf, and "Consultation Paper: Draft technical advice on minimum content for prospectus exemption", https://www.esma.europa.eu/sites/default/files/library/esma31-62-962_consultation_paper_on_minimum_information_content_for_prospectus_exemption.pdf.

EU Growth Prospectus. The New Regulation introduces the concept of an EU Growth Prospectus for certain issues by SMEs, which permits an alleviated standard of disclosure in a standardised format, and widens the definition of SMEs. These provisions aim to facilitate access to capital markets for smaller companies.

Level II and Level III legislation. The European Commission has been granted the power to adopt additional measures in various key areas of the New Regulation. In that context, the Commission will specify, among other things, the criteria for the scrutiny and review of the universal registration document and the information to be provided under the simplified disclosure regime (see the Draft Delegated Act), and will adopt regulatory technical standards on key financial information in the summary and advertisements. The intervention of the Commission in the coming months is therefore likely to have a pivotal effect on the legal framework set out in the New Regulation.

GOOD NEWS FOR ISSUERS…

Scope

As under the existing regime, in the case of a public offer of securities, there is no obligation to publish a prospectus where, inter alia, the offer (i) is made solely to qualified investors;[3] (ii) is made to fewer than 150 persons other than qualified investors per member state; (iii) consists of securities denominated in units of at least EUR 100,000; or (iv) consists of securities addressed to investors who acquire securities for a total consideration of at least EUR 100,000. There is also no requirement to publish a prospectus for the admission to trading of additional securities of the same class as, and amounting to 20% of the number of, those already admitted to the same regulated market (calculated over a 12-month period).[4] (See also the paragraph ‘Secondary Issuances’ in *Good news for issuers*.)

In addition, the New Regulation does not apply to offers of securities with a total consideration across the European Union of less than EUR 1 million raised over twelve months (up from EUR 100,000).[5] This threshold can be raised to EUR 8 million for the same period at the individual member states’ discretion and numerous member states have already done so.[6] Until the employee offer exemption is widened (see the paragraph entitled ‘Further Issues of Securities’ in *Good news for issuers*), these increased thresholds may be helpful for certain employee offers which do not currently fall within the exemption.

Wholesale Disclosure Regime

The New Regulation expands the types of offers that are eligible to receive so-called ‘alleviated treatment’. It retains the existing wholesale disclosure regime, whereby debt securities denominated in amounts of at least EUR 100,000 are subject to lower disclosure requirements, but has expanded the universe of eligible deals to include offers of any non-equity securities that are to be traded only on a regulated market to which only qualified investors have access. As a result, such securities may not be sold in the secondary market to non-qualified investors unless a New Regulation-compliant prospectus appropriate for non-qualified investors has first been published.

The move to dispose of the typical wholesale denomination threshold in a qualified investor-only arena is a solution that straddles two competing market instincts. The initial notion of eradicating the wholesale regime demonstrated the desire of European lawmakers to support more liquidity in capital markets by creating a broad investor base for all debt securities, but a cautious market response focused attentions on the importance of appropriate disclosure requirements.

Issuers should be relieved by the New Regulation’s final landing place on this question, which is likely to preserve the alleviated treatment of many corporate bond offerings, thereby avoiding a feared exodus of issuers from European markets. However, the true success of this balancing-act solution would

[3] Following changes under MiFID II, since 1 January 2018, the definition of qualified investors no longer automatically includes public authorities and municipalities.
[4] This provision has applied since 21 July 2017.
[5] This provision has applied since 21 July 2018.
[6] In the United Kingdom, Germany, Italy and France, the threshold has been increased to EUR 8 million. In Belgium, the threshold has been increased to EUR 5 million, subject to exceptions.

be visible in the growth of the qualified investor-only regulated markets, of which there are currently very few.[7] Although excluding retail investors from such markets is obviously a compromise on policymakers' initial aspirations of vastly expanding the corporate bond investor base, there is still hope that removing the minimum denomination requirement will have a positive impact in this regard, as well as encouraging secondary market liquidity.

Universal Registration Document ("URD")

The New Regulation introduces the URD – a shelf registration-type structure which provides the option of fast-track access to capital markets for issuers who have published preapproved URDs two years in a row. A similar system has been used successfully in France for many years with the further benefit of helping to avoid duplicative public disclosures to the market.[8] The content of the URD is mainly aligned with the existing registration document under the Prospectus Directive. (However, see also the relevant section in *Issuers' causes for concern* below.)

The URD does not replace the existing registration document system, and both URDs and registration documents can be incorporated by reference into a prospectus. The key differences between the two regimes are as follows:

- The URD can also be used in lieu of the annual report (or half-yearly report) required under the Transparency Directive, allowing for a single annual disclosure document;[9]
- Once a URD has been published, a prospectus using that URD benefits from a fast-tracked approval process (of five rather than ten working days), although it should be noted that the regulatory approval periods are somewhat illusory in practice; and
- Issuers who have published preapproved URDs two years in a row can publish subsequent URDs without prior regulatory approval.[10]

Provided the URD has not become a constituent part of an approved prospectus, issuers are able to amend the URD to ensure it contains updated disclosure. (See the relevant section in *Issuers' causes for concern* below for the potential drawbacks of the URD.)

Issuers can passport URDs. In addition, a significant development on earlier drafts of the New Regulation is that issuers no longer have to be incorporated in the European Economic Area to draw up a URD. This means that all companies trading on European regulated markets have the option of benefitting from the URD innovation.

Secondary Issuances

Under the New Regulation, companies that have had debt or equity securities admitted to trading on a regulated market or a small and medium-sized enterprises ("SME") growth market for at least the last 18 months are able to enjoy a simplified disclosure regime for secondary issuances.[11] Issuances of this nature will benefit from reduced disclosure regarding the issuer and its business, as well as not having to include an operating and financial review (on the basis that the regulatory disclosures required under, for example, the Transparency Directive and the Market Abuse Regulation provide sufficient information to

[7] One example of such market is the recently introduced Professional Segment of the Electronic Bond Market, MOT, in Italy. In this respect, the Italian Stock Exchange ("Borsa Italiana") clarified that the new professional segment has been made available before the New Regulation enters into force to allow issuers to use this segment on a voluntary basis. Borsa Italiana further clarified that, before the New Regulation enters into force, issuers who use this segment will still have to draw up a prospectus without the simplifications that will be introduced by the New Regulation.

[8] The French *Autorité des marchés financiers* has recommended to issuers that they prepare and publish a URD as from 1 January 2019, before the implementation of the New Regulation.

[9] To benefit from this, the URD must be published within four months of the issuer's financial year end or within three months of its half-year end.

[10] This benefit is lost if the issuer fails to file a URD for one year. Issuers who have published and filed on a yearly basis a registration document which complies with Annex I of the Prospectus Directive and which has been approved by a competent authority for at least two consecutive financial years prior to 21 July 2019 will be able to file a URD without prior approval from 21 July 2019.

[11] The disclosure standards for registration documents and securities notes for secondary issuances are set out in Annexes 3, 8, 12 and 15 to the Draft Delegated Act.

investors).[12] This is a potentially significant development for those companies and could also attract companies who envisage making multiple issuances, but who do not currently have such listings, to the European capital markets. (However, see also the relevant section in *Issuers' causes for concern* below.)

In addition to the introduction of the short form disclosure regime, the New Regulation extends the exemption from publishing a prospectus for the admission to trading of additional securities of the same class as those already admitted to trading by broadening the scope of the exemption to include any securities (instead of shares only, as under the current regime). Furthermore, the upper limit for the availability of the exemption has been raised from 10% to 20% of the number of securities already admitted to trading on the same regulated market (calculated over a 12-month period), a shift which is intended to provide greater flexibility for issuers. However, in practice, this flexibility may be limited (i) where other regulatory regimes require the preparation of an offering document (e.g., where a Securities and Exchange Commission ("SEC") registrant is offering securities to the public), (ii) where marketing, liability or reputational considerations cause transaction participants to choose to prepare an offering document, or (iii) due to the need for shareholder approval.

Offerings to the public of securities issued by SEC registrants will, in any event, be subject to a requirement under U.S. law to produce a prospectus, therefore reducing to some extent the benefit of the New Regulation's increased limit for such issuers. In some cases, however, SEC registrant issuers may be able to make use of the automatic shelf registration regime, which can significantly reduce the timeframe and burden potentially associated with the requirement to produce a prospectus. For these issuers, the increased limit on the exemption to produce a prospectus under the New Regulation may, therefore, be of greater value. The burden associated with producing a prospectus will be mitigated even in the case of many other SEC registrants who, like registrants eligible to use the automatic shelf registration regime, are also eligible to use short form registration statements (even if ineligible to use the automatic registration statement regime available only to 'well-known seasoned issuers', as defined under Rule 405 under the U.S. Securities Act of 1933). This is because of the ability to incorporate by reference regular periodic SEC filings into a registration statement to satisfy most disclosure obligations.

Even where an offering document is not required to be prepared, commercial, liability or reputational considerations might cause transaction participants to decide to prepare one. For example, it might be decided that extensive marketing is needed in particular cases, including with the use of an offering document. Alternatively, it might be decided that recent changes in the issuer, such as a significant acquisition, or other significant developments, such as important strategic or restructuring initiatives, warrant the preparation of an offering document and the conduct of extensive due diligence to address liability or reputational concerns associated with the marketing of securities in the context of such significant changes. In any such cases, the exemption would accordingly have limited utility. Absent any such special considerations, the ability to avoid the preparation of an offering document in connection with larger offerings, for example, in the context of an "accelerated bookbuilt offering" – the document-light marketing approach that is commonly used in the case of sales of securities by larger shareholders and, occasionally, primary issuances – could prove beneficial.

The flexibility afforded by the expanded exemption may be limited by the need to seek shareholder approval for (i) the issuance of the securities and (ii) where appropriate, the disapplication of pre-emption rights. While many companies seek shareholder approval for non-pre-emptive placings in advance at their AGM, the current guidance from institutional shareholder bodies in the United Kingdom is for shareholders to vote in favour of resolutions seeking authority to issue shares representing up to a maximum of only 10% of the shares already admitted to trading. Current UK

[12] See ESMA's Final Report on Technical Advice under the Prospectus Regulation and the Draft Delegated Act.

market practice sees almost universal compliance with the guidance issued by such bodies, and the Pre-Emption Group has confirmed that, despite the expanded exemption in the New Regulation, it does not intend to increase the 10% cap in its Statement of Principles. Therefore, issuers wishing to make use of the increased 20% threshold will need to factor into the timeframe for such issuances the shareholder approval process.

Finally, provided a short form disclosure document is published, the New Regulation incentivises director and employee investment in their own companies (or affiliated companies) with a clean prospectus exemption for offers of securities to group employees and directors. This exemption is no longer reliant on the relevant issuer having securities admitted to trading on a regulated market or an equivalent market of a member state, and is therefore available to non-EU issuers.

Requirements for Summaries

The current summary regime has been accused of encouraging highly technical and immaterial disclosure. The objective of the New Regulation is to move towards a more investor-friendly summary regime through a detailed set of requirements. (See the relevant section in *Issuers' causes for concern* below for the associated implications on an issuer's liability risk.)

Although summaries will generally be limited to seven sides of A4 paper, the length of the summary may be extended in certain circumstances, such as where a summary relates to several similar securities or where a competent authority requires that a summary relating to packaged retail and insurance-based investment products ("PRIIPs") includes specific information relating to the nature of the PRIIPs.

In addition, no summary will be required for prospectuses relating to non-equity securities traded on a regulated market to which only qualified investors have access or where the minimum denomination of such securities is at least EUR 100,000.

Finally, summaries will no longer be required for base prospectuses for debt issuance programmes, although issue-specific summaries are required once an issue's final terms have been determined. The summary must include key information from the base prospectus (including key information on the issuer) and key information on the relevant final terms which do not appear in the base prospectus.

EU Growth Prospectus

The New Regulation introduces the concept of an EU Growth Prospectus, which permits an alleviated standard of disclosure in a standardised format. An EU Growth Prospectus may be used for offers of securities by the following (provided they do not have securities already admitted to trading on a regulated market):

— SMEs;

— Non-SME issuers whose securities are traded on an SME growth market and have had an average market capitalisation of less than EUR 500 million for the previous three years; and

— Issuers making an offer of securities to the public for a total consideration across the European Union not exceeding EUR 20 million over a 12-month period, provided that they had no securities traded on a MTF and no more than 499 employees on average during the previous financial year.

The reduced disclosure standard permitted by an EU Growth Prospectus is set out in the specific summary, registration document and securities note format provided in the Draft Delegated Act, and is orientated to focus on the relevance and materiality of information for investors and the need to ensure proportionality between the size of the company and the costs of producing a prospectus.

Profit Forecasts and Profit Estimates

The Draft Delegated Act abolishes the requirement to include an audit report on profit forecasts and profit estimates in the prospectus for retail debt and equity issuances, as ESMA considers such a report to be of limited additional value to investors. Those issuers who feel that the inclusion of an audit report is burdensome may appreciate the prospect of increased flexibility in this respect. (However, see the relevant paragraph in *Issuers' causes for concern* below for the potentially negative impact.)

ISSUERS' CAUSES FOR CONCERN…

The Form of Implementation

The national laws currently implementing the Prospectus Directive will, to a large extent, no longer have effect as a result of the entry into force of the New Regulation and have been or will be repealed by the national legislators. However, other provisions of such national laws are likely to remain in place, in particular those setting out the liability principles attached to prospectuses (as no further harmonisation on that matter is provided for in the New Regulation), the administrative and criminal sanctions introduced by the member states and any additional requirements which members states (continue to) impose for offerings which are outside of the scope of the New Regulation.

In the absence of domestic implementing legislation, the courts of one member state may find the interpretation of provisions of the New Regulation by courts in other member states more persuasive than they used to while the prospectus regime was set out in a directive. There may therefore be less interpretative discretion at the national level under the new regime, and the language of the New Regulation, much of which is taken directly from the Prospectus Directive, will be subject to greater interpretative scrutiny. The departure of the United Kingdom from the European Union may have a potentially liberating impact in this regard, as the UK courts may not be persuaded to the same degree. However, a desire to maintain consistency across the EU and UK regimes could well limit this impact in practice.

In addition, although the courts of one member state are not bound by the decisions of courts in other member states, a court in any member state could refer its decision on a point of interpretation of the New Regulation to the Court of Justice of the European Union (the CJEU). It is possible that the CJEU would reach the same conclusion as that court, and if so, because decisions of the CJEU are binding on all courts within the European Union, that interpretation would become binding on the courts of all member states. It is anticipated that the United Kingdom will not be subject to decisions made by the CJEU following the its departure from the European Union.

Equally, competent authorities may be eager for the directly effective provisions of the New Regulation to be applied consistently throughout the European Union, which could mean that regulatory authorities are more willing to be influenced by the approaches and standard practices of their counterparts in other member states. As a result, issuers may find national regulators less receptive to issuers' attempts to explain their specific circumstances and to petition for a tailored and practical approach toward their own regulation.

In an alternative scenario, the potential for fragmentation among competent authorities may materialise due to the existence of various Level I, II and III acts, the guidance issued by, and administrative practices of, the national legislators and the continuing existence of national legislation (such as that relating to liability).[13] In this situation, issuers may face regulatory uncertainty and confusion.

Risk Factors

As the Commission strives to encourage more investor-friendly prospectuses, risk factors are no exception to the expanding burden on issuers to make subjective judgments in their disclosure. As under the current regime, the New Regulation requires issuers to include only those risk factors which are both specific to the issuer and/or the securities involved and material for making an informed investment decision. However, the introduction of certain prescriptive requirements in this respect opens up the possibility of a marked shift in the attitudes of regulators towards the risk factors included in a prospectus. It is plausible that this shift will result in increased potential for delay and greater difficulty for issuers seeking approval of a prospectus for the following main reasons:

— The materiality and specificity requirement

[13] Precedent for such a scenario is demonstrated by the interpretative guidance and administrative practices developed by BaFin in relation to the Market Abuse Regulation, which are not fully harmonised with those of other national regulators.

Instead of disclosing any *potentially* material risks to an issuer's business, as has previously been the standard approach, issuers will now have to judge the materiality of risk factors based on the probability of their occurrence and the expected magnitude of their negative impact. In its draft guidelines on risk factors (the "Draft Guidelines"), ESMA explains that, where available, quantitative information should be included in order to demonstrate the potential negative impact of a risk factor or, when not available, qualitative information should be provided, for example, by using the qualitative risk scale of low, medium or high.

The materiality standard for information to be included in prospectuses under the current regime has been replicated in the New Regulation.[14] This requires prospectuses to contain the necessary information to enable investors to make an informed assessment of: the assets and liabilities, profits and losses, financial position and prospects of the issuer; the rights attaching to the securities; and the reasons for the issuance and its impact on the issuer. However, for the purposes of risk factor disclosure, ESMA has deviated from this standard and points instead to the definition of materiality in the International Financial Reporting Standards Conceptual Framework.[15] According to this definition, information is material if omission or misstatement could influence investment decisions based on the use of the prospectus. Issuers may consider this an unnecessary departure from the familiar materiality standard under the current regime, creating potential for further confusion when read in conjunction with the requirement for materiality judgments to be based on probability and magnitude mentioned above.

The concept of specificity in relation to risk factors is explained in the Draft Guidelines as requiring a clear and direct link between the risk factor and the relevant issuer or securities. In tandem with the new materiality standard, this puts a greater onus upon issuers to tailor risk factor disclosure to the particular issuance in question.

It is likely that regulators will no longer readily permit issuers to include very general risks to their business in the prospectus, in stark contrast to the inclusive approach to risk factor disclosure that many issuers currently regard as integral to reducing liability risk. Indeed, the Draft Guidelines emphasise the importance of the role of competent authorities in challenging the inclusion of risk factors where there is no clear and direct link between the issuer or the securities and the risk factor in question, or where the materiality is not apparent from the disclosure in the risk factor. Furthermore, the guidelines state that a competent authority should not approve a prospectus where specificity or materiality is not apparent from the disclosure of the risk factor. Giving the competent authority ultimate discretion on materiality and specificity determinations could cause delays in the approval of prospectuses, particularly due to the potential for difficult negotiations regarding the inclusion of each risk factor. This will naturally concern issuers, as they may feel that it is they, not the regulators, who are best placed to assess materiality. Furthermore, where there is a difference of opinion with a regulator resulting in the omission of a risk factor from a prospectus, it will be the issuer, not a regulator, who is exposed to the litigious claims of investors.

On possibly a more positive note for certain issuers, the New Regulation could ultimately prove to be more closely aligned with the U.S. rules relating to risk factor disclosure and the longstanding position of the staff of the SEC that issuers should avoid generic and "boiler-plate" risk factors, and instead focus on how a risk may affect an investment in the securities of that particular issuer.[16] However, the U.S. approach permits the inclusion of risk factors that are general to, for example, the industry in which the issuer operates, provided that such risk factors are drafted in such a way as to highlight their

[14] See Article 5 of the Prospectus Directive and Article 6(1) of the New Regulation.

[15] See paragraph 27 on pages 15 to 16 of the Consultation Paper on Guidelines on Risk Factors under the Prospectus Regulation and paragraph 2.11 of the International Financial Reporting Standards Conceptual Framework.

[16] See Item 503(c) of Regulation S-K. See also Plain English Disclosure, SEC Release No. 33-7497 (Jan. 28, 1998); SEC Division of Corporation Finance, Updated Staff Legal Bulletin No. 7: Plain English Disclosure (June 7, 1999); and Business and Financial Disclosure Required by Regulation S-K, SEC Release No. 33-10064 (April 13, 2016).

connection to the issuer. There continues to be a concern that, under the New Regulation, competent authorities will take a more arbitrary approach to risk factors they consider to be general, which would, in practice, constitute a more significant restriction on issuers' desires to protect themselves.

— The categorisation requirement

Issuers will have to present risk factors in a limited number of categories – the Draft Guidelines are pointing towards a limit of 10 categories – depending on their nature. The categories may, but are not required to, describe a qualitative risk scale (i.e., low; medium; high) or group risk factors according to other criteria. While, under the current regime, many issuers already categorise risk factors, Draft Guidelines suggest that issuers organise risk factors in categories pertaining to the issuer and to the securities.[17] It is not yet clear whether the market will follow these suggestions or whether regulators will, directly or indirectly, put pressure on market participants to do so. However, the Draft Guidelines impress upon competent authorities the need to challenge the presentation of risk factors where the approach to categorisation does not support their comprehensibility and assist investors in understanding the source and nature of each disclosed risk factor. In the interests of avoiding delay, issuers may feel that their hand is forced in respect of these suggested categories, or, alternatively, market standard categories may develop, reducing the degree of discretion issuers feel they are afforded in practice.

Within each category, the most material risk factors must be listed first. This 'most material' requirement expands issuers' determinations for each risk factor from a simple material/non-material judgment to an assessment of how the materiality of each risk corresponds with other risks. Again, this represents an increased burden on the issuer to make more precise evaluations of risk factors. With innumerate plausible and unforeseeable influencing factors, in many ways, business risks do not conform to this type of analysis. Issuers could find themselves pondering, for example, the relative materiality of a high probability risk with a relatively modest direct impact (such as competitive market conditions), versus a low probability risk with a potentially catastrophic effect on the business (such as a natural disaster destroying a key industrial facility). Furthermore, this represents something of an 'all-or-nothing' judgment as, while the most material risk factors must be listed first, subsequent risk factors are not required to be listed in order of materiality. Issuers may be concerned that this will place them under increased pressure to select the "correct" risk factor to list first: how will investors react if a risk factor that has not been listed first is the one to cause them harm? The consequences, if any, of getting such a determination wrong remain unclarified.

— The corroboration requirement

Under the New Regulation, information included in a risk factor must also be "corroborated" by the content of the rest of the prospectus. The Draft Guidelines explain that the information contained in the prospectus should confirm that the risk factor is material and specific to the issuer or the securities, as appropriate. Issuers may be concerned by the potential for competent authorities to require the inclusion of repetitive information in the prospectus in order to satisfy this corroboration requirement and by the potential delay to the approval process that such discussions could introduce. They should also be concerned at the possibility that competent authorities will baulk at the seeming inconsistency of a factor being both a strength and a risk; for example, a very large and lucrative customer.

— The mitigating language requirement

The Draft Guidelines propose that the competent authority challenge the use of any mitigating language in relation to a particular risk factor where the inclusion of such language compromises the materiality of the risk factor.[18] Mitigating language is

[17] The suggested categories for the issuer are: risks relating to the issuer's financial situation; risks relating to the issuer's business activities and industry; legal and regulatory risks; internal control risks; and environmental, social and governance risks. The suggested categories for the securities are: risks relating to the nature of the securities; risks related to the underlying; risks related to the guarantor and the guarantee; and risks relating to the offer to the public and/or admission of the securities to trading on a regulated market.

[18] This is another example of how the New Regulation and Draft Guidelines align with the longstanding position of

permissible insofar as it relates to the probability of occurrence or expected magnitude of a risk factor. Issuers may be concerned that they will no longer be able to explain the steps they take to reduce their exposure to risk and that this could distort an investor's understanding of the true risk profile of the issuer or security. In practice, issuers may feel that their ability to include mitigating language is restricted by the requirement to convince a competent authority that such language does not compromise the materiality of the risk factor and is permissible on the basis set out above. Furthermore, issuers may reach differing conclusions when weighing up the benefits of including mitigating language for a particular risk factor against the potential delays involved in advocating its inclusion.

We can expect greater clarity on the specifics of the requirements for risk factors when the consultation process on the Draft Guidelines comes to a conclusion. No efforts to mitigate potential issuer liability have yet been made in Europe, and no allowance for the new European rules could reasonably be expected from the rest of the world, so issuers can justifiably be concerned about the liability risks these new requirements represent.[19]

Requirements for Summaries

Summaries will have to comprise three sections covering key information on the issuer, the securities and the offer/admission. The current requirement for summaries to be written in non-technical language is maintained; however, under the New Regulation, even greater emphasis is to be placed on concision, comprehensibility and a clear layout. This is part of an effort to make summaries more investor-friendly. Further key changes in this respect are as follows:

— Inclusion of 15 'most material' risk factors only

The requirement represents another example of the troublesome burden on issuers to determine the materiality of risks. Issuers' liability to investors who ultimately suffer a loss under a risk not included in the summary but described in the risk factors may be greater than if the issuer had been permitted to disclose all key risks in the summary. Again, it is worth noting that there have been no amendments to the European liability regime proposed to mitigate the potential increase in issuer liability risk under these changes, notwithstanding potential liabilities elsewhere in the world.

— Shorter summary

Under the New Regulation, summaries are generally limited to seven sides of A4 paper irrespective of the length of the prospectus or the type of the security.[20] This represents a loss of length and flexibility against the current regime, which allows for the longer of 7% of the prospectus' length or fifteen A4 sides. The obvious concern is that this loss of length and flexibility will hinder issuers, particularly those of complex products, in drafting a suitable summary containing all the key information for investors.

— Key financial information

The New Regulation requires a prospectus summary to include a selection of historical key financial information about the issuer. The key financial information is to be extracted from the income statement, the balance sheet, and the cash flow statement. ESMA's final report on the draft regulatory standards, which was published in July 2017 (the "Draft RTS"), sets out a number of prescriptive templates for issuers to follow, depending on the classification of the issuer and the security in question, which will reduce issuers' discretion in how they present their key financial information. Some issuers, may find that these particular line items prove arbitrary or unsuitable, and some may be concerned that the page length of the summary will prohibit them from providing a

the SEC staff in its comments on risk factors included in filings with the SEC that issuers should avoid the use of mitigating language in risk factors, such as statements and clauses beginning with "while," "although" and "however". See SEC Division of Corporation Finance, Staff Observations in the Review of Smaller Reporting Company IPOs, available at: https://www.sec.gov/divisions/corpfin/guidance/cfsmallcompanyregistration.htm.

[19] The risks of disclosure liability in this respect are particularly acute in relation to international offerings that also involve the offer and sale of securities in the United States and the related exposure to liability under the anti-fraud provisions of the U.S. securities laws.

[20] As per the existing regime, the summary cannot contain cross-references to the prospectus or incorporate information by reference.

representative picture of their key financial information. Although the question of length cannot be circumvented, ESMA has provided flexibility for issuers where particular line items do not appear in an issuer's historical financial information or in the main body of the prospectus. In such cases, these line items may be substituted by a sufficiently comparable alternative.

Besides the key financial information which an issuer must provide in the summary in accordance with the relevant template, issuers are permitted to include additional line items or alternative performance measures ("APMs") in the summary.[21] This flexibility is helpful to issuers, as an issuer may consider that an APM from elsewhere in the prospectus is key financial information, providing some degree of discretion as to how their business is presented. Greater discretion is particularly useful where issuers have complex financial histories, and some issuers may seek to include financial information about other entities where relevant. There is no cap on the number of APMs permitted, but issuers should note that the APMs should not be given more prominence than the historical financial information and that the inclusion of APMs must not cause the summary to exceed the page limit.[22]

Generally speaking, some issuers may find these prescriptive requirements onerous and restrictive of their ability to present their business as they would like.

Universal Registration Document

As the URD is a multi-purpose shelf document which can subsequently be used for offers or admissions to trading of both equity and non-equity securities, it needs to be prepared in accordance with the most onerous disclosure requirements for equity issuances, irrespective of the type of issuance for which the URD is to be used.

Another aspect of the URD that will give issuers pause will be the uncertainty for an issuer who, having previously had a URD approved for two consecutive years, publishes a non-preapproved URD in compliance with the regime. If the competent authority concludes that the URD contains "a material omission, a material mistake or material inaccuracy", that competent authority can require the issuer to make changes to the URD even after it has been published. Issuers will be obliged to explain how a request from the competent authority for an amendment or supplementary information has been taken into account in the URD.

Issuers will be justifiably concerned about amendment requests resulting in a liability to investors who made investment decisions in the meantime, and, even if no liability results, such requests will do little to enhance an issuer's reputation. While the French regulator has only rarely required issuers to change the equivalent French documents that are the genesis of the URD system, it cannot currently be known whether other European regulators will use their discretion more aggressively.

Secondary Issuances

Although the disclosure required for secondary issuances by listed issuers is not as onerous as originally envisaged by the legislators, the simplified disclosure regime under the New Regulation encompasses several requirements which may present some difficulty for issuers.

Such issuers must comply with certain prescriptive disclosure requirements, including: information on the issuer's prospects, the significant changes in the

[21] APMs are defined by ESMA as "a financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework". See ESMA's Guidelines on Alternative Performance Measures.

[22] The Draft RTS clarify the position regarding how APMs should be explained in the summary, following concern in the consultation responses that issuers may encounter problems including and explaining APMs in a summary due to its capped length. The rule against cross-references in the summary also constrains issuers in this respect and may promote investors to rely excessively on the summary. Helpfully, ESMA permits the use of footnotes to explain APMs, but this may lead to substantial footnotes and may detract from the clarity of the issuer's summary. Importantly, ESMA considers that the summary is a part of the prospectus as a whole and therefore confirms that it may not always be necessary to duplicate explanations of APMs where such explanations are provided in the body of the prospectus.

business and the financial position of the issuer since the end of the last financial year; the rights attaching to the securities; and the reasons for the issuance and its impact on the issuer. In particular, issuers must include annual and half-yearly financial information for the last 12 months, profit forecasts (where applicable), risk factors and, for equity securities, the working capital statement, the statement of capitalisation and indebtedness, a disclosure of relevant conflicts of interest and related-party transactions, major shareholders and, where applicable, pro-forma financial information.

The proposed Level II legislation is set out in ESMA's Final Report on Technical Advice and the Draft Delegated Act. Issuers will likely be concerned by any continued ambiguity in their simultaneous obligations under the simplified disclosure regime and the overarching general disclosure obligation, as well as disclosure liability considerations in relation to other jurisdictions in which the securities may be offered and sold, such as Rule 10b-5 in connection with offerings of securities in the United States.

Exchangeable or Convertible Securities

The New Regulation will maintain the current exemption from the requirement to produce a prospectus for the admission to trading of shares resulting from the conversion or exchange of other securities. However, for the exemption to apply, the resulting shares must represent, over a period of 12 months, less than 20% of the number of shares of the same class already admitted to trading on the same regulated market.[23]

Although in most cases it will be clear at the outset that the number of new shares resulting from the conversion or exchange will remain well below the 20% limit, this new requirement may be problematic in other cases, in particular when the issuer has issued several series of convertible or exchangeable securities. For the purposes of making the calculation, two figures are key: the total number of outstanding shares, and the total number of underlying shares, which will usually be equal to the total issue number divided by the conversion price.

The total number of outstanding shares may vary over the life of the convertible or exchangeable securities, as a result of further issuances, share buybacks followed by cancellation, or mergers. Likewise, the total number of underlying shares may be impacted by adjustments to the initial conversion price.

Finally, the exemptions for fungible securities and shares resulting from the conversion or exchange cannot be combined if this results in the admission to trading of more than 20% of the same securities over a 12-month period without a prospectus being published. Issuers may want to build in some flexibility to avoid crossing the 20% threshold, for example, in the event that the issuer delivers existing (already admitted to trading) securities, and/or that the underlying shares are not admitted to trading immediately.

Profit Forecasts and Profit Estimates

In practice, the removal of the requirement for audit reports on profit forecasts and profit estimates may raise some concerns for market participants. Under the current regime, the required audit reports help to provide comfort and market confidence. A natural question will arise as to how directors and underwriters will, as a diligence matter where relevant, get comfortable with the matters that would otherwise be comforted through the audit reports that will no longer be required. Furthermore, without the discipline imposed by the audit report process, there is a possibility that issuers become less cautious regarding forward looking statements, which could lead to increased market cynicism around such statements and an increased litigation risk.

Use of Proceeds

Issuers can expect greater scrutiny in respect of disclosure of the use of proceeds than under the current regime. ESMA considers this as important information for investors and seeks to move away from use of the term "general corporate purposes". The annexes to the Draft Delegated Act set out the requirement for issuers to disclose, where applicable, the estimated net amount of proceeds and the

[23] This provision has applied since 21 July 2017. The 20% limit does not apply if, inter alia, a prospectus in respect of the securities giving access to the shares was drawn up in accordance with the Prospectus Directive or the New Regulation, or the securities giving access to the shares were issued before the New Regulation entered into force.

breakdown of each principal intended use of such proceeds, presented in order of priority. Credit institutions making debt issuances and other non-equity issuers raising funds for general corporate purposes will not be required to make such detailed disclosure.

Advertisements

The New Regulation replicates the requirement under the current regime for advertisements to satisfy certain criteria. Advertisements must: (i) be clearly recognisable as such; (ii) not contain information which is inaccurate or misleading; and (iii) be consistent with the information contained in the prospectus, whether that prospectus has already been published or is yet to be published. In addition, advertisements must state that a prospectus has been or will be published and give detail as to where such prospectus is or will be available to investors. However, the New Regulation widens the definition of an advertisement to cover any "communication", rather than simply "announcements" as under the current regime. Furthermore, the consistency requirement expressly applies to the oral or written disclosures of information concerning the offer, even where not for advertising purposes. Issuers are likely to be concerned by the prospect that even oral communications between two individuals will be subject to the regime. In addition, the competent authority in the member state in which the advertisement is disseminated will have the power to exercise control over compliance with the rules for advertisements. This has the potential to be problematic for issuers engaged in cross-border offerings due to the possibility that competent authorities will diverge in their attitudes to compliance.

A NEW ROLE FOR ESMA

On 9 November 2018, the European Commission published an amended proposal for a regulator to confer upon ESMA the role of competent authority for four categories of prospectus: (i) prospectuses relating to the admission to trading of non-equity securities to be traded on a regulated market to which only qualified investors have access; (ii) prospectuses related to asset-backed securities; (iii) prospectuses drawn up by property companies, mineral companies, scientific research-based companies or shipping companies; and (iv) prospectuses drawn up by third country issuers.[24]

Under the proposal, ESMA would be granted the powers to scrutinize and approve these prospectuses, as well as to process passport notifications and supervise advertisements relating to such prospectuses. A specific chapter would be added to the New Regulation setting out the powers and competencies of ESMA necessary to fulfil these roles. The European Commission plans for the new proposal to be in place before 2020.

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[24] See Article 31a of "Amended proposal for a Regulation of the European Parliament and of the Council", 2017/0230 (COD), http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-646-F2-EN-MAIN-PART-1.PDF.