THE PROPOSED UK PROSPECTUS REFORMS: A CHANGE IN APPROACH?

As discussed in the article entitled “UK Edinburgh Reforms: what next for UK financial services?” earlier in this volume, the Government has stated that it will use its post Brexit legislative flexibility to redesign the UK financial services framework. In this article, we discuss what the UK Edinburgh Reforms look like and how they will affect the UK prospectus regime, including examining a new structure for the regime that separates “public offer” and “listing” prospectus exemptions and eliminates EU rules allowing for differentiated disclosure between “wholesale” and “retail” issues of debt securities.

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Key Issues

- New designated activities regime and public offer prohibition.
- Separation of rules on public offers and listing.
- Elimination of “wholesale”/ “retail” differentiated disclosure regime.
- Most of the detail still to come in the FCA rules.
- Practical outcomes likely to be similar to EU regime.

Introduction

Reform of the UK prospectus regime is part of the first tranche of legislation to be revised and the Government published an “illustrative” draft statutory instrument and related Policy Note on 9 December 2022 as part of the UK Edinburgh reform package. These give an indication of how the new regime will work. However, we currently only have half the story. This is because, in line with the general approach to the revision of financial services, much of the power to make rules will be delegated to the FCA under the new regime. The FCA is undertaking a thorough market feedback exercise in relation to the establishment of its rules under the new regime. It published four engagement papers on 18 May 2023 namely, Engagement Paper 1 “Admission to trading on a regulated market”, Engagement Paper 2 “Further issuances of equity on regulated markets”, Engagement Paper 3 “Protected forward- looking statements” and Engagement Paper 4 “Non equity securities”. While these papers set out the positions the FCA is minded to take, including the areas in which it is considering adopting a different approach to that under the existing UK prospectus regime, these positions are just the starting points in the conversations with stakeholders. The engagement process is intended to result in draft rules for consultation being published in Q1 2024.

What we do know is that the structure of the legislation will be quite different from that under the current UK prospectus regime which was onshored as part of the Brexit process, so (currently) reflects the existing EU prospectus regime. It is entirely feasible that while the eventual statutory instrument and forthcoming FCA rules will ‘rearrange the deckchairs’, the outcomes will remain broadly similar to the existing regime. This is to some extent supported by statements in the Government’s Edinburgh Reforms Policy Statement such

as “the government will not be pursuing change for its own sake” and that “much [retained EU law] will remain appropriate in substance”. The FCA has similarly stated that “We recognise that there are strong arguments… that we should stick broadly with existing requirements as set out in the UK Prospectus Regulation”. Regardless, these changes will require practitioners to think afresh and in a slightly different way when dealing with concepts they have got very familiar with over the last (almost) 20 years.

Designated Activities Regime

The illustrative draft statutory instrument (the Financial Services and Markets Act 2000 (Public Offers and Admissions to Trading) Regulations 2023 (“**SI**”) fits within the new structure for financial services regulation set out in the Financial Services and Markets Bill (“**FSM Bill**”) and the proposed “designated activities regime” (“**DAR**”). These are more fully described in the article entitled “UK Edinburgh Reforms: what next for UK financial services?” earlier in this volume. The SI specifies that offering securities to the public or admitting or requesting admission of securities to trading on a UK regulated market (i.e. the London Stock Exchange Main Market) or UK primary MTF (e.g. the PSM or ISM) will be designated activities. Related communications and advertisements will also be designated activities. The SI gives the FCA powers to make designated activity rules in relation to these activities. In developing its rules FCA is to “have regard” to the desirability of offers of transferable securities in the United Kingdom being made to a wide range of investors.

Separating the Public Offer and Listing Regime

The existing UK prospectus regime sets out the rules for when a prospectus is required, and the exemptions that apply, in relation to both public offers and admission of securities to trading on a regulated market (referred to as “listing”). In contrast, under the proposed new regime there will be a separation of offers and listing. In broad terms, the SI will create the new UK public offers regime but virtually all powers in relation to admission to trading on a regulated market, or a primary MTF, in the UK will be delegated to the FCA.

The Proposed New Public Offer Regime: relevant securities, transferable securities and excluded securities

The SI creates a prohibition on offers of “relevant securities” to the public and sets out a number of exceptions to the prohibition. Helpfully, the definition of a public offer remains the same as under the current UK prospectus regime.

Less helpfully, the definition of “relevant securities” is very broad. It includes “transferable securities” (“transferable securities” are subject to the current regime and the definition of “transferable securities” used in the SI remains the same as under existing English law) but also catches a range of financial contracts not currently within scope, such as loans and certain derivatives. The 9 December 2022 Policy Note published as part of the Edinburgh reforms indicated the main driver behind this broad definition was to bring minibonds in scope in order to deliver on a recommendation of the Gloster Review. However, there are serious market concerns on the breadth of the definition of “relevant securities” given the marked expansion in scope.

The SI excludes certain securities from the definition of relevant securities. (For the avoidance of doubt, these securities are carved out from (or “excluded” from) the scope of the definition itself, as opposed to being covered

by one of the various exceptions to the public offer prohibition.) “Excluded securities” is a category that covers debt securities issued by certain types of issuer (e.g. sovereigns, local authorities, central banks), money market instruments with a maturity of less than 12 months, and debt securities issued by charities and housing associations.

Offers to the Public: exceptions old and new

There are a number of exceptions to the public offer prohibition and the SI states these may be combined. Some are familiar, some are not. The “general exceptions” mirror the current UK prospectus regime, these are:

- offers below a threshold amount - this threshold amount is yet to be determined;
- an offer of relevant securities addressed solely to qualified investors;
- an offer addressed to fewer than 150 persons in the UK (other than qualified investors);
- an offer of relevant securities whose denomination per unit amounts to at least £50,000 (or an equivalent amount); or
- an offer of relevant securities addressed to investors who acquire securities for a total consideration of at least £100,000 (or an equivalent amount) per investor, for each separate offer.

It is worth pointing out that the minimum denomination exception of £50,000 would enable offers of €100,000 denominated securities (i.e. the denomination threshold for an exempt public offer under the EU Prospectus Regulation regime) to be offered in the UK. This though would not work ‘vice versa’ since an offering of securities with denominations of £50,000 into the EU would fall below the EU minimum “wholesale” denomination threshold of €100,000.

There are two exceptions to the public offer prohibition in the SI that would be new as compared to the existing regime. These are: an “offer of transferable securities admitted or to be admitted to trading” and an “offer by means of regulated platform”.

An “offer of transferable securities admitted or to be admitted to trading” is described as being where the offer is conditional on the admission of the transferable securities to trading on a regulated market or primary MTF, or where the transferable securities are, at the time of the offer, admitted to trading on a regulated market or primary MTF. There is some uncertainty around the meaning of “conditional on the admission” and how this might work in relation to offers that rely on this exception (although in the securitisation market other exceptions are likely to be available and will be typically used, such as the minimum denomination exception). This is because admission to trading in practice will follow after an offer has been made and accepted and the notes have been issued. Market participants will be familiar, for example, with risk factors warning that the notes may not be successfully listed (admitted to trading) – because the notes are only listed in practice after an offer has been made. Practitioners are therefore seeking clarity from HM Treasury on how this exception is intended to operate and what “conditional on” means – for example, would the offer have to lapse if the admission did not happen?

Little detail is available in respect of the “offer by means of regulated platform” exception. However, the 9 December 2022 Policy Note sets out that the Government intends to legislate to create a new regulated activity covering the operation of a public offer platform. The FCA will then determine the detailed requirements to which such platforms will be subject, including what disclosure is needed. The FCA engagement paper on public offer platforms is due to be published in June 2023.

Paragraphs 8-14 in Part 1 of Schedule 1 of the SI contain further exceptions, many of which replicate existing UK prospectus regime exemptions but are not especially relevant to structured debt instruments – such as, “offers to existing holders of equity securities”, “offers by other company in connection with takeovers etc”, an “offer of securities to directors or employees”, “securities offered under banking or central counterparty special resolution regime”, and an “offer of loan notes in connection with a takeover”.

Admission to Trading and Prospectus Requirements

As mentioned above, the admission, or a request to admit, transferable securities to trading on a UK regulated market or primary MTF will be a designated activity and subject to the relevant FCA DAR rules. Key among these will be the requirement to prepare a prospectus and the rules relating to the preparation and publication of a prospectus.

Rules made by the FCA in respect of securities admitted to trading on a regulated market are referred to as “admission rules”. These cover, among other things, when a prospectus must be published, how a prospectus is approved and the application process for prospectus approval, responsibility for a prospectus, its form and content, any permitted exemptions from disclosure, its validity period and details of publication.

The FCA Engagement Papers 1 and 4 make it clear that the FCA recognises the benefits of keeping its new rules aligned with the current UK regime and notably that "convergence rather than divergence" across jurisdictions is a desirable outcome for stakeholders (in this regard the FCA is particularly conscious of the ongoing EU Prospectus Regulation review). Key FCA starting points from the Engagement Papers are that:

- the prospectus content for admission to trading on a regulated market will remain broadly the same;
- there will be one prospectus disclosure standard based on the current "wholesale" standard;
- disclosure changes could be adopted in a few areas (to the extent stakeholders consider these to be improvements), such as:
  - prospectus summaries;
  - incorporation by reference of future information;
  - the use of forward looking statements; and
  - environmental, social and governance ("**ESG**");
- a simple standardised regime for seasoned UK corporate issuers with limited disclosure requirements could be introduced;

- the valid period of a prospectus may be extended;
- the prospectus exemptions for admission to trading will align with the public offer exemptions for excluded securities in the SI; and
- the prospectus threshold and/or content requirements will likely change in relation to secondary offers (more detail on these proposals can be found in Engagement Paper 2).

The FCA's rule-making powers in relation to securities admitted to trading on a primary MTF are more limited but include a requirement that the primary MTF operator includes in its rules that publication of a prospectus be a condition to admission to trading. The primary MTF operator will determine the form and content requirements of any prospectus prepared for admission on its MTF.

The Necessary Information Test, Forward-looking Statements and Withdrawal Rights

In the meantime, there are some provisions relating to the content of the prospectus specified in the SI that are worth highlighting.

The "necessary information" test

This is the overarching content test to determine what should be included in a prospectus and largely corresponds with the current Article 6 test under the UK Prospectus Regulation (see box), but with some differences, such as:

- the SI states that the "prospects" of the issuer are to be read as including, where appropriate, a reference to the "creditworthiness" of the issuer. Market participants have flagged that it is unclear how this should be interpreted and what other considerations should be taken into account in addition to credit;
- crucially for debt securities, what is considered "necessary information" will not vary depending on whether non- equity securities have a "wholesale" denomination – so while a minimum £50,000 denomination will be a public offer exception it will make no difference to the prospectus content requirements;
- the "necessary information" required in a prospectus may vary if the issuer already has relevant securities admitted to trading on a market and therefore is already subject to ongoing information disclosure requirements similar to the simplified disclosure regime for second issuances under Article 14 of the current UK Prospectus Regulation; and
- finally, while MTF operators will set out detailed prospectus rules, including content requirements, as mandated by the FCA – the primary MTF rules relating to prospectuses will also have to adhere to the "necessary information" test.

Forward-looking statements

The SI introduces a new liability carve out for protected "forward-looking statements", defined as a statement containing a projection or estimate, a statement of opinion as to future events or circumstances, or a statement of intention. For such a statement, subject to compliance with certain FCA rules, rather than the standard negligence threshold, liability will not attach unless a higher threshold is met – namely, knowledge or recklessness as to whether something was untrue or misleading, or knowledge that an omission was dishonest concealment of a material fact. This carve out is specified to only

Article 6(1) of the UK Prospectus Regulation

… a prospectus shall contain the necessary information which is material to an investor for making an informed assessment of:

(a) the assets and liabilities, profits and losses, financial position, and prospects of the issuer and any guarantor;
(b) the rights attaching to the securities; and
(c) the reasons for the issuance and its impact on the issuer.

That information may vary depending on any of the following:

(a) the nature of the issuer;
(b) the type of securities;
(c) the circumstances of the issuer;
(d) where relevant, whether or not the non-equity securities have a denomination per unit of at least EUR 100,000 or are to be traded only on a market, or a specific segment thereof, to which only qualified investors can have access for the purposes of trading in the securities.

apply to a person “responsible” for a prospectus. It remains to be seen whether those involved in preparing a prospectus would want to include such forward-looking statements on this basis.

The FCA Engagement Paper 3 "Protected forward looking statements" seeks feedback from market participants on how protected forward looking statements ("**PFLS**") should be defined and how they should be presented. In particular, comments are sought in relation to what should be allowed as PFLS (and what should be excluded from scope), should sustainability-related disclosures be considered PFLS and how should PFLS be presented in a prospectus.

Withdrawal rights

The SI provides that a person who has agreed to buy relevant securities may withdraw that acceptance in circumstances specified in the “appropriate rules”, which will be determined by the FCA or the MTF operator, as applicable. We assume the withdrawal rights will be connected to the publication of a supplemental prospectus as is the case under the current regime. It is worth noting that the withdrawal rights are specified as relating to all offers of relevant securities to the public. While this is the same as under current UK and EU prospectus legislation, the informal view in both markets (based on ESMA guidance) has been that withdrawal rights should not apply in relation to prospectuses prepared for admission purposes only. Therefore, it has been noted by market participants that it would be useful if the FCA could similarly clarify in its rules that if any of the other public offer exceptions exist, e.g. minimum denominations or offers to qualified investors only, the withdrawal rights provisions need not apply.

There is no discussion of this particular point in the FCA Engagements Papers. Separately though, the FCA notes that withdrawal rights will need to be considered should its rules be changed to allow for incorporation of future information by reference in a prospectus. In this case it would result in a change to the existing practice of an issuer publishing a supplement in relation to regular financial information and investors would no longer have the benefit of the walkaway rights connected to such publication.

Other Aspects of the Regime

There are provisions in the SI in relation to the FCA’s powers (such as to refuse approval of a prospectus, to suspend or prohibit public offers, to suspend or prohibit trading or admission to trading), penalties for breach of rules and censure and provisions around liability and compensation that are not discussed.

These broadly speaking replicate existing FCA powers under the Financial Services and Markets Act 2000 (“**FSMA**”) and will be removed from FSMA once the SI is passed. In addition to these types of amendments to FSMA the SI will also make some necessary amendments to the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005.

What is still an unknown is whether a prospectus or offering document approved by a third country regulator could be acceptable for either admission to trading or for the purposes of a public offer in the UK. The 9 December 2022 Policy Note and the UK Prospectus Regime Review Outcome paper of March 2022 suggest that this type of “regulatory deference”, may be considered by the Government, but certainly does not seem a priority at this stage.

Conclusion

Although the architecture of the regime may be changing, it is comforting for market participants to know that, as is the case under the existing UK prospectus regime, the new proposals mean a prospectus will still be required (a) to make a public offer of securities in the UK, unless an exception applies, and (b) to admit securities to trading on a regulated market (plus a primary MTF). The FCA Engagement Papers certainly suggest that the new rules will not be too disruptive to the wholesale debt markets. It is not in the FCA's interest to be so. However, as has been made clear, the Engagement Papers only represent the starting position of the FCA and there is room for change following discussions with stakeholders. It is also likely that there will be at least some changes, even if only at the margins of current practice, for example on incorporation by reference, the use of forward looking statements and ESG disclosure and requirements. An optimist would also hope that the stated aim of rulemaking being quicker, more agile and undertaken by the regulator who is 'closer to the action' than lawmakers will be achieved. But clearly, we are entering new territory as, even if the differences prove to be 'form over substance', the new approach will, inevitably, distinguish the UK regime significantly from its European counterpart.

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