City of London Law Society and Law Society response to HM Treasury: UK Prospectus Regime Review – Consultation

24 September 2021

1. **INTRODUCTION**

1.1 The views set out in this response have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (the **CLLS**) and the Law Society of England and Wales (the **Law Society**).

1.2 The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

1.3 The Law Society is the professional body for solicitors in England and Wales, representing over 170,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

1.4 The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to equity capital markets.

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2. **QUESTIONS**

Q1. Do you agree with our overall approach to reforming the UK prospectus regime?

The Committees are supportive of the overall approach to reforming the UK prospectus regime. The regime in its current form is complex and inflexible and shaped by overlapping duplicative requirements. It also fails to respond dynamically to the changing circumstances in which a prospectus is needed and the different forms this document needs to take. A simplification of its statutory anchoring and the provision for a more nimble rule-making function underpinning the regime are welcome developments.

Q2. Do you agree with the key objectives that we are seeking to achieve?

Yes. The Committees agree with the key objectives but note that it is important that they are achieved in the context of high standards of investor protection as well as competitiveness, as set out in Lord Hill's UK Listings Review Report.

Q3. Do you have any views on the underlying purpose of a prospectus when seeking admission to a regulated market?

The Committees consider that a prospectus has an important role to play in the context of a company seeking admission to a regulated market (both in respect of an IPO and a secondary offering) and agree with the perspectives summarised in the Consultation Paper, which serve to underline this importance.

Q4. Do you agree the FCA should have discretion to set rules on when a further issue prospectus is required?

In relation to the "offer to the public" prospectus trigger pursuant to section 85(1) of FSMA, the circumstances under which a prospectus would be required under this statutory limb of the test will be extremely limited (effectively, only where a private unlisted issuer offers shares to members of the public other than its existing shareholders and no other exemption is available). The Committees agree that this residual statutory regime is necessary to protect potential retail investors. Beyond this, the requirement for a prospectus for a further issue will be determined by regulation set by the FCA. The Committees believe that this is the right approach. These requirements can be set and amended rapidly and flexibly in the context of consultation processes akin to the present one. As set out above, the Committees believe that the prospectus should continue to play a central role in IPOs and further offerings on regulated markets. They welcome the clarity this provides as to the responsibilities, liabilities and protections available to the parties involved.

Q5. Do you agree the Government should grant the FCA sufficient discretion to be able to recognise prospectuses prepared in accordance with overseas regulation in connection with a secondary listing in the UK?

Yes. The Committees would be supportive in principle of this proposal for the reasons set out below. However, in view of the relatively limited use of the passporting regime that applied until the end of the Brexit transition period, which this proposed recognition process seeks to replicate to some degree, there is a question about whether establishing a framework which permits this process would be proportionate to the benefit. The Committees would note in this context that currently, public offerings into the UK by issuers whose shares are listed on an overseas exchange are typically made pursuant to the "qualified investors" exemption. Whilst the Committees appreciate that this mechanism could be preserved going forward, the Committees acknowledge that this would run contrary to one of the key objectives - encouraging broader participation in companies - and can be seen as punishing retail investors who hold shares in an overseas company as they are effectively prevented from participating in further offerings and thereby benefitting from relevant discounts. In the event that this proposal were adopted, the Committees believe that the FCA should use such discretion within an appropriate regulatory framework to protect UK investors from loss against an issuer domiciled overseas.

Please also see the responses to questions 16 and 17 below.

Q6. Do you agree with our approach to the 'necessary information test'?

The Committees believe that a residual overarching standard of prospectus preparation is appropriate and that this overall standard should be anchored in statute. The Committees do not however think that it is appropriate for detailed prospectus content requirements to form part of the statutory architecture; these should instead be left to the FCA to determine in the context of a regime that is able to respond dynamically and flexibly.

The Committees agree that there should not be a separate test for further issues and would note that the standard of preparation for further issues set out in article 14 of the UK Prospectus Regulation has been applied in a regulatory framework in which both the overarching and specific content requirements are located in statute, whereas the Committees are supportive of the adoption of a more flexible position, as set out above. The Committees believe however that it should be made clear that the circumstances of the issuer, which are referenced in the current form of the necessary information test, include the fact that the issuer is listed and is subject to regulatory requirements, including disclosure requirements.

Q7. Do you agree the FCA should have discretion to set out rules on the review and approval of prospectuses?

Whilst the Committees are supportive of a flexible regime which would allow the FCA to establish criteria for the prospectus review and approval process, the Committees believe that this process should be retained and that the FCA should maintain a central role in this process. The view of the Committees is that a review and approval process in this form provides certainty to both issuers and investors. Further, the Committees believe that removing the requirement for prospectuses to be reviewed by the FCA would risk diluting the value of a prospectus as a public document, running contrary to the aim of ensuring that UK capital markets represent high standards of investor protection and market integrity, and would be inconsistent with the practice in the main competitor jurisdictions.

Q8. Do you have any comments on what ancillary powers the FCA will need in order to ensure admissions of securities to Regulated Markets function smoothly? (See list of potential powers in Annex A.)

The Committees consider all ancillary powers set out in Annex A to be necessary and would suggest that incorporation by reference also be added to the proposed list.

Q9. Do you agree with our proposed change to the prospectus liability regime for forward looking information?

The Committees support the proposal to introduce a less strict standard of liability for forward looking information in a prospectus. The Committees agree that this could help to encourage issuers and directors, as those responsible for the contents of a prospectus, to include such information in the prospectus (as opposed to the current practice of forward looking information being provided indirectly via research reports) and that this will support the objective of improving the quality of information that investors receive through the publication of the prospectus. Nevertheless, concerns about liability in other jurisdictions, and other potential liabilities for prospectuses, including liability for sanctions for breach of the FCA's rules, may also inform the level of concern that issuers, directors and others have when considering including information in a prospectus that cannot be objectively verified.

The Committees agree with the proposal to model the new liability regime for forward looking information on the existing knowledge/recklessness standard of liability for information (including annual reports and ad hoc disclosures) published to UK markets under section 90A and Schedule 10A of FSMA. However, the Committees have a number of comments as set out below. The Committees would be happy to discuss these further with HMT and the FCA and/or to comment on a draft of the new liability provisions in due course.

<u>Definition of forward looking information</u>: The meaning of "forward looking information" for these purposes will need to be clearly defined, although the precise definition may be better dealt with by FCA rules and guidance rather than being set out in statute.

For transparency to investors and ease of reference, it may make sense for the information subject to the lesser liability regime to be contained, or at least clearly identified, in a distinct section of the prospectus, but even if this approach is taken there should be clarity about what information is permitted to benefit from the reduced liability regime and included in the relevant section of the prospectus.

The Committees believe that "forward looking information" should be construed broadly to include profit forecasts, other prospective financial information and targets and also projections on non-financial key performance indicators (for example, climate and net zero transition plans; or, for high-growth companies, projections regarding the roll-out of new technology which may be important to understanding a company's prospects while being subject to significant uncertainties).

Paragraph 5.13 of the Consultation Paper states "for the avoidance of doubt" that the regime would not apply to working capital statements in a prospectus. The Committees accept this as a policy position but an express carve-out of working capital statements should be included in any definition, to avoid any doubt.

<u>Reliance and updating of information</u>: The Committees agree with the approach stated in paragraph 5.15 of the Consultation Paper that there should be no requirement for an investor to demonstrate reliance on the prospectus for liability to arise, as the information in the prospectus is used to form the market price. However, given that some forward looking information may cover a period of years, and to avoid the risk of information in the prospectus being perceived as immutable, the manner in which changes may be communicated so that there is no longer liability in respect of the prospectus should be clarified.

FSMA Schedule 10, paragraph 1(3) makes bringing "a correction to the attention of persons likely to acquire the securities" a condition of an exemption from liability. It should be made clear that announcements or other reporting to the market by the issuer (through annual reports or other market announcements) will be sufficient for this purpose. Expectations about forward looking information may change quite quickly, and issuers and directors need to be confident that they will not be bound by the content of a prospectus (after the period when a supplemental prospectus is required) and can "correct" the information in the market by means of an announcement under the UK Market Abuse Regulation or in reports under DTR4.

<u>Form of warning</u>: The Committees think it would be helpful for the FCA to set out standard wording for the warning on the lesser liability standard as set out in paragraph 5.16 of the Consultation Paper.

As noted above, a UK prospectus may be used for marketing securities in, or to investors from, other jurisdictions. For this reason, the standard wording regarding "forward looking statements" which gives protection from liability under US securities laws and is commonly included in UK prospectuses should continue to be permitted.

<u>Consistency of liability regimes</u>: There are some differences in approach between section 90/Schedule 10 of FSMA and section 90A/Schedule 10A of FSMA which is perhaps only because the provisions have different histories and were drafted at different times. Consideration should be given to reviewing the two regimes to ensure consistency. For example, section 90 is without prejudice to other sources of liability (section 90(6)) whereas Schedule 10A expressly excludes liability in relation to in-scope information except as set out in paragraph 7 of that Schedule. Paragraph 7 expressly refers to a number of different sources of liability, including civil and criminal penalties and restitution orders under FSMA, but is helpful in expressly excluding civil liability of the issuer on a negligence basis.

As noted in the Consultation Paper, there is a linkage between Schedule 10A of FSMA and section 463 of the Companies Act 2006. As the Committees have noted in responses to the BEIS and FCA consultations on TCFD reporting and to the White Paper on Audit and Corporate Governance, it is important to ensure that these provisions remain aligned and also are broad enough to cover new statutory reporting and disclosure requirements such as climate change reports.

<u>Other documents</u>: As part of the overall reform of the disclosure regime for public offers and admission to trading of securities, the Committees believe that it would be appropriate to review the form and basis of liability for documents other than prospectuses and market announcements.

Q10. Do you think that our proposed changes strike the right balance between ensuring that investors have the best possible information, and investor protection?

Please see the response to question 9 above.

Q11. Which option for addressing companies admitted to MTFs do you favour and why?

As set out above, the Committees are supportive of the proposed change to the prospectus liability regime for forward looking information which seeks to encourage issuers and directors to disclose information of this type directly to investors via prospectuses. The Committees believe that this is an important aim, not only in the context of regulated markets but also and possibly even more so, in the context of growth markets, and the Committees agree that a solution needs to be found such that issuers are encouraged to disclose forward looking information in admission documents.

The Committees are concerned however that deeming a document to be a form of prospectus for some purposes such that it falls within the scope of section 90 of FSMA, including the proposed change to the standard of liability in respect of forward looking statements (Option 2), is a sub-optimal solution and runs the risk of undermining the value of a prospectus as this form of prospectus would not be a document approved by the FCA in all circumstances. The Committees would prefer the adoption of a more holistic approach to determining liability in prospectuses and equivalent documents, as set out above.

Q12. Do you agree there should be a new exemption from the public offer rules for offers directed at existing holders of a company's securities?

Subject to the points set out below, the Committees agree with the proposed new exemption from the public offer rules for offers to existing holders of a company's securities and are supportive of the flexibility that establishing powers to vary the exemptions to the public offer rules via secondary legislation would create.

The Committees consider that the logic of treating share-for-share exchanges in the same way as an offer to the issuer's own shareholders is not clear. The Committees appreciate that reliance may be placed on information disclosed under other regulatory regimes but, for example, the exclusion of "all share-for-share offers", as set out in paragraph 7.10 of the Consultation Paper, including those by an unlisted offeror, would potentially mean there was very little provision of information to shareholders in the case of offers not governed by the City Code on Takeovers and Mergers. The Committees therefore believe that consideration should be given to all types of offer situations to ensure that adequate information is provided to investors.

Further, the Committees note that the existing exemptions are useful specifically where option exchange (roll-over) offers are made to share plan participants on takeovers. Not all share plan participants are already shareholders, and the employee offer exemption may not assist if the roll-over offer is being made by the bidder (as it usually is). To avoid having to issue a prospectus in these situations, the Committees suggest that a takeover-type exemption could be retained for roll-over offers for these types of arrangements. Alternatively, the definition of "existing holders of securities" in the proposed new exemption could include anyone holding a right to acquire such securities.

More broadly, in relation to the proposed changes to the public offer framework, the Committees note that HMT's approach gives rise to a potential detriment for investors (if a reduction in the number of prospectuses owing to the proposed reduced scope of application of the public offer rules also removes investors' ability to bring a claim under section 90 of FSMA) and may result in a direct or indirect increase in risk profile for issuers, directors or underwriters of non-IPO equity capital raisings, if such offers are prospectus-free and then made available to retail investors. The Committees also recommend that careful consideration be given to the interaction of the financial promotions regime and the proposed changes to arrangements for public offers.

Q13. Do you agree we should retain the 150 person threshold for public offers of securities and the 'qualified investors' exemption? Do you have any comments on whether they operate effectively?

Yes. The view of the Committees is that the 150 person threshold and the "qualified investors" exemption work well.

Q14. Does the exemption for employees, former employees, directors and ex-directors work effectively?

Yes. The view of the Committees is that the exemption for employees, former employees, directors and ex-directors operates effectively, but the Committees note the following:

- It would be helpful to expand the exemption to use a broader "worker" definition in order that non-employees who provide services to the group, such as consultants, are covered.
- It would be useful to extend the exemption to include offers by trusts principally for the benefit of employees covered by the exemption. This is already allowed, for example, to exempt communications from "relevant trustees" to employees from the financial promotions restrictions under article 60 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005/1529.
- "Affiliated undertaking" is not defined and although its flexibility may be useful, the Committees believe that it would be helpful to clarify what is meant by "affiliate" in order to achieve legal certainty while retaining sufficient flexibility.

Q15. Which option for accommodating the right of private companies to offer securities to the public do you favour?

The Committees are in favour of a variant of Option 2 pursuant to which a private company seeking to raise capital from the public in excess of a specified threshold (which should be above the current €8 million threshold) would be required to register the offer with a firm authorised to operate a platform for the public offering of securities pursuant to a new bespoke FCA permission under the Financial Services and Markets Act 2000 (Regulated

Activities) Order 2001 (SI 2001/544) (the **RAO**), provided that this mechanism would only apply to offerings up to a maximum threshold. The Committees consider that offerings by private companies in excess of this threshold should remain subject to the prospectus regime.

The Committees' rationale is as follows:

- The Committees agree that, in order to enable private companies to raise amounts of capital in excess of €8 million through public offers whilst also providing for appropriate investor protection, both Options 1 and 2 could be accommodated to a large extent by the existing regulatory framework. Such offerings could be regulated through the MiFID II rules, the RAO, the financial promotions regime and related provisions in the FCA Handbook. The Committees note that these regulations broadly focus on regulating the intermediary or platform, whereas the prospectus regime provides for investor protection through the imposition of disclosure requirements.

- The Committees have a preference for Option 2 on the basis that it would establish a clearer regulatory perimeter for the FCA to regulate offerings of unlisted securities, which typically have a higher risk profile. The Committees consider it appropriate and necessary for the FCA to be granted oversight over the platforms which would facilitate these types of offerings and to impose appropriate and proportionate standards on disclosure, due diligence and assessment of risk. Further, there should be a specific disclosure regime which is tailored for investors seeking to invest through these platforms. Rather than a full prospectus, the FCA could impose minimum disclosure requirements with respect to financial statements, constitution, summary of shareholder rights and potentially risk factors, for example. To this end, the Committees recommend further consultation with the FCA and market participants. The financial promotions regime should also be reviewed in consultation with the FCA to consider whether the various exemptions (particularly for high net worth individuals and sophisticated investors) would remain fit for purpose if the prospectus regime is disapplied for offerings conducted through the proposed bespoke FCA permission.

- As set out above, this mechanism should only accommodate offerings to the public up to a maximum threshold, in excess of which the prospectus regime would apply. A key reason for the Option 2 mechanism is to enable private companies to raise capital (in excess of the current €8 million threshold) without needing to incur disproportionate costs of preparing a prospectus. This rationale is not relevant to substantial capital raisings. Further, the Committees consider it appropriate that, from an investor protection perspective, companies seeking to raise substantial amounts of capital should be encouraged to submit to the full regulatory burden of being a publicly listed company and be subject to the prospectus regime.

The Committees assume in all of this that offerings by private companies to "qualified investors" would remain exempt from the requirement to publish a prospectus.

Q16. Which of the options above do you prefer? (Please state reasons)

The Committees understand the proposals in Chapter 9 of the Consultation Paper would apply to issuers of securities admitted to overseas exchanges, regardless of whether they are incorporated in the UK or overseas.

As set out above, in practice, it is not very common for issuers with shares listed on an overseas market to extend an offer to 150 or more investors in the UK who are not "qualified investors" (i.e. make an offer to UK retail investors). The main circumstances when this tends to occur are:

- Where an overseas listed company seeks to raise new equity funding from its existing shareholders (i.e. a pre-emptive secondary issue of shares) and its share register includes 150 or more UK retail investors. Recent examples include the rights issue by Irish-incorporated C&C Group plc, where the prospectus was approved by both the FCA and the CBI and the rights issue by UK-incorporated easyJet plc, where there were two prospectuses, one approved by the FCA and the other approved by the AMF (with the latter being passported from France into Germany, Italy and Spain).

- Where an overseas listed company makes a takeover offer for a UK listed company and offers its own shares as consideration. A recent example is the share-for-share offer by Takeaway.com for Grubhub, where the prospectus was approved by the AFM and the FCA. Although in this scenario the takeovers exemption is potentially available, producing a takeover exempt document is still onerous and, if the FCA were prepared to recognise an EEA-approved prospectus as equivalent to a UK prospectus, such a bidder might opt to produce a prospectus rather than a takeover exempt document.

When such circumstances do arise, the requirement to publish a UK-approved prospectus, as well as a prospectus or other offering document approved by an overseas regulator, is likely to lead to overseas listed companies seeking to exclude UK investors from their offers wherever possible. If the FCA were to recognise a prospectus or other offering document that has been approved by an overseas regulator as equivalent to a UK prospectus, such companies would be more likely to choose to include UK investors in their offers and where such companies have no choice but to include UK investors, having an equivalence mechanism would save significant time and cost. The Committees therefore welcome the introduction of some form of equivalence mechanism to replace the current mechanism in articles 29 and 30 of the UK Prospectus Regulation which has limited effect in practice. The Committees suggest that the revised mechanism should work as follows:

- For offers by overseas companies with securities listed on an EEA regulated market (or, perhaps, an MTF) that publish an EEA-approved prospectus, Option 2 (regulatory deference) should be taken – i.e. such companies should be able to make an offer to the public in the UK (i.e. to UK retail investors) without having to publish a UK-approved prospectus or having to satisfy the FCA that the information in their EEA-approved prospectus is equivalent to the information that would be required for a UK prospectus. This would work broadly as follows:

    - HMT would make regulations specifying that a prospectus approved by an EEA competent authority is equivalent to a UK-approved prospectus and can therefore be used for an offer to the public in the UK. The regulations would need to specify the types of prospectus that would be treated as equivalent: for example, that a full prospectus published in connection with an offer of equity shares that is drawn up in accordance with articles 6 and 7 of the EU Prospectus Regulation and Annexes 1, 11 and, where relevant, Annex 20 of Commission Delegated Regulation 2019/980 on the format and contents of a prospectus would be treated as equivalent to a UK prospectus drawn up in accordance with articles 6 and 7 of the UK Prospectus Regulation and Annexes 1, 11 and, where relevant, Annex 20 of the UK version of Commission Delegated Regulation 2019/980.

- The FCA would need to have entered into effective arrangements for cooperation with the competent authority of each EEA state in relation to prospectus requirements. The Committees believe that the FCA has in fact already concluded cooperation arrangements with the relevant supervisory authorities.

- The overseas listed company would have to notify the FCA that it intends to use its EEA prospectus in the UK, make it available to the public in the UK and provide a copy to the FCA, but it would not need to obtain any approval or consent from the FCA.

- The FCA would have a reserve power to block an offer to the public in the UK if it considers the offer would be detrimental to the interests of UK investors.

- For offers by overseas companies that either (i) have securities listed on a non-EEA market or (ii) publish an offering document that is filed with and/or approved by a non-EEA market regulator, Option 1 (the status quo option) should be taken for the time being – i.e. the overseas company would be able to extend an offer to the public in the UK only if an FCA-approved prospectus is approved. However, if the equivalence mechanism for EEA-approved prospectuses outlined above were found to function effectively, HMT could in future consider extending it to other jurisdictions on the basis of a country by country assessment. In the event that any equivalence mechanism were to be extended on this basis, the Committees consider that it would be appropriate for the FCA to have the power to require "wraparound" additional information for UK investors – for example, additional warnings or explanations of the difference between the rights of a UK shareholder and a shareholder of a company incorporated in the issuer's jurisdiction.

The Committees suggest the approach outlined above primarily on the basis that the EU rules on disclosure in prospectuses (and more widely) are currently very similar to the UK rules and are likely to remain broadly closely aligned in the near term. These rules are also well understood by UK investors. As a result, there is a relatively low risk of retail investors suffering losses as a result of failing to understand the investment they are making, the rights they will have (and not have) and the types of information that the company will disclose going forward. Conversely, US and other non-EU rules on disclosure in prospectuses or offering documents (and more widely) are rather different to UK rules and are less well understood by UK investors. There is therefore a higher risk of retail investors suffering losses as a result of failing to understand such issues. In addition, it would be much more difficult for HMT or the FCA to satisfy themselves that the disclosure obligations of companies under US or other non-EU rules are, overall, equivalent to UK rules because the landscape of company law, regulatory obligations and investor protections in respect of such jurisdictions will, in some cases at least, be markedly different to the UK.

Whilst the Committees would be supportive of an equivalence mechanism along the lines outlined above being introduced as soon as possible, we acknowledge that this might not be an issue of top priority. In view of the significant changes that may be made to the UK prospectus regime relatively shortly, the Committees acknowledge that there may be merit in waiting until the UK prospectus regime has been amended before deciding on the approach that should be taken to equivalence.

Finally, the Committees do not think that, as a matter of law and regulation, it is necessary that the EU should introduce a corresponding regime (i.e. to recognise UK-approved prospectuses as equivalent to EEA-approved prospectuses).

Q17. Do you have any further thoughts or considerations over how a new deference mechanism (Option 2) should operate?

Please see the response to question 16 above.

Q18. Do you agree there should be no mechanism to allow public offerings of securities by overseas unlisted companies? (Please state reasons)

The Committees agree that the Government should not provide a facility enabling such companies to make offers to the public in the UK (i.e. the Government should not attempt to create a mechanism that enables such a company to offer securities to the public in the UK using an information memorandum or other offering document drawn up under overseas rules). The Committees note however that some provision should be made in the proposed framework for overseas unlisted companies to make offerings in the UK (for example, permitting such offerings through an FCA-authorised platform as proposed in the response to question 15 above, or requiring the production of a full prospectus, such that the process is generally regarded as a prohibition rather than a facilitation) as there could be legitimate reasons for a company that is not incorporated in the UK to make an offering into the UK and for UK investors to be able to access such offerings.