CLEARY GOTTLIEB Alert Memo

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Amendments to the Prospectus Directive

The European Parliament recently adopted a resolution [1] (the "Amending Directive") to amend the Prospectus Directive (2003/71/EC). The Amending Directive enacts an amended version of a proposal published by the European Commission (the "Commission") on September 24, 2009.[2]

I. KEY CHANGES

- The rules applicable to the "summary box" in prospectuses will become more challenging. Prospectus summaries will be required to conform to certain format and content requirements and to contain "key information" relating to the issuer and the securities. A new head of civil liability will be introduced for failure to comply with these requirements;

- Offers of securities to company employees may become significantly easier for many non-EEA companies. The employee share scheme exemption from the requirement to publish a prospectus will be extended to cover "equivalent" third-country issuers;

- The minimum denomination to qualify as wholesale debt will be doubled to €100,000 – issuers wishing to take advantage of the concessionary reporting obligations under the Transparency Directive for wholesale debt should consider starting to use €100,000 minimum denominations **now**, but in any event no later than the date of entry into force of the Amending Directive;

- Supplements for listed deals not offered to the public will no longer trigger withdrawal rights;

- Withdrawal rights will be harmonized across the EEA;

- Small offers that do not require a prospectus to be published can be larger than before. Offers will be exempt if made to fewer than 150 persons (previous threshold: fewer than 100 persons) and offers with a total consideration of less than €5,000,000 (previous threshold: €2,500,000) will be exempt;

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1 On May 28, 2010, the EU Council set out the text of the proposed changes to the Prospectus Directive http://tinyurl.com/AmendingDirective, which was then adopted on June 17, 2010 http://tinyurl.com/adoptedtext.

2 http://tinyurl.com/ProposalCommission

- It will become easier, administratively, to make offers to professional investors;
- A reduced disclosure regime for rights offering will be introduced; and
- A requirement to publish prospectuses electronically will alter publication requirements.

II. THE "SUMMARY BOX"

The Amending Directive introduces a number of changes to prospectus summaries to try to make them more retail investor friendly. The changes are intended to (i) harmonize the form and general content of summaries; (ii) ensure that summaries contain "key information"; and (iii) provide for civil liability for issuers that fail to comply with the new requirements.

1. Harmonization of form and content

Due to the length and complexity of a typical prospectus, the summary section is considered to be an important tool to enable investors to reach an investment decision. The Amendment Directive introduces provisions aimed at simplifying prospectus summaries and facilitating comparisons between investment opportunities by reducing inconsistencies in the form and content of summaries for broadly similar products.

The Amending Directive requires the summary to follow a common format, with equivalent information presented in a uniform manner. The greatest uncertainty is that the precise content and form requirements for summaries is yet to be determined. The new requirements may be aligned with those for summaries for Packaged Retail Investment Products, for example, regulated retail funds – the debate around this issue is still ongoing. The challenges in harmonizing summaries for such a wide variety of securities are significant. Many believe this ideal is misconceived and that efforts would be better spent ensuring the retail market is served well by the professionals that advise them on their investment decisions. Furthermore, many believe that it would be inexpedient to apply a summary format designed for retail investors to deals like bond offerings and IPOs marketed to professionals.

2. Requirement to include "key information"

The Amending Directive also requires the summary to be clear and self-contained and to focus on "key information". That term is defined as[3]:

"Essential and appropriately structured information which is to be provided to investors with a view to enable them to understand the nature and the risks of the securities that are being offered to them or admitted to trading on a regulated market and

[3] Article 2(1)(s)

… to decide which offers of securities to consider further. In light of the offer and securities concerned, the key information shall include the following elements:

i. A short description of the risks associated with and essential characteristics of the issuer and any guarantor, including the assets, liabilities and financial position;

ii. A short description of the risk associated with and essential characteristics of the investment in the relevant security, including any rights attaching to the securities;

iii. General terms of the offer, including estimated expenses charged to the investor by the issuer of the offeror;

iv. Details of the admission to trading; and

v. Reasons for the offer and use of proceeds."

The concept of "key information" is particularly significant in light of the introduction of a new head of civil liability in connection with prospectus summaries, which is described below.

3. Introduction of civil liability for summaries

Prior to the Amending Directive, civil liability could only be incurred on the basis of the summary if it was shown to be misleading, inaccurate or inconsistent when read together with the other parts of the prospectus. Pursuant to the Amending Directive, a new head of civil liability will apply if a summary does not "provide, when read together with the other parts of the prospectus, key information in order to aid investors when considering whether to invest in such securities". The change is subtle, and is better than the one originally proposed. However, one potential interpretation of the changed language is that the summary has to contain all the key information, though one can look to the rest of the prospectus for context and further detail, and that failure to comply could result in civil liability for the issuer. We hope that implementation pays greater regard to the recital in the Amending Directive, which replicates the original Prospectus Directive provision, stating that Member States should ensure that no civil liability attaches to any person solely on the basis of the summary unless it is misleading, inaccurate or inconsistent with the relevant parts of the prospectus. If it does, it is difficult to see what the change in the Amending Directive was intended to achieve.

Despite the additional requirements on content and the additional pressure from the amended liability language, the Amending Directive does not abolish or raise the 2,500-word limit for the summary. The summary word limit has been heavily criticized, particularly in the context of multi-issuer and complex programmes, where it can be especially difficult to comply with the 2,500 word limit. It remains to be seen whether this restriction is addressed or amended when the further rules are adopted.

III. OFFERING EXEMPTIONS

A. EMPLOYEE SHARE SCHEMES

The Amended Directive will make it easier for EEA-registered or headquartered companies to offer securities to employees. It might also make it easier for companies established outside the EEA to make offers of securities to employees. The current exemption to produce a full prospectus for offers of securities to employees is only available to issuers with securities admitted to trading on an EEA regulated market[4].

The Amending Directive liberalizes the regime by extending the exemption to public offers and admissions to trading of issuers that do not have securities admitted to trading on an EEA regulated market, but which either:

i. Have their head office or registered office within the EEA; or

ii. Are non-EEA companies which have securities admitted to trading on an EEA regulated market or on a third country market, provided that the Commission has taken a formal decision that the legal and supervisory framework of the regulation of the particular third country market is "equivalent" to that of an EEA regulated market. The Amending Directive sets out certain conditions that any third country market must fulfil if it is to be considered equivalent.

This change is of particular importance to companies listed on non-EEA exchanges, such as the NYSE, with more than 99 (currently) or 149 (after implementation of the Amending Directive) group company employees in any EEA Member State. However, the new regime will allow these companies to rely on the short form disclosure document, rather than requiring a full prospectus, only if the relevant market has been deemed equivalent. A great deal, therefore, depends on how the Commission handles the process of determining equivalence. In particular, it is not clear whether the Commission will consider that the US regulatory regime is equivalent. As has been seen in the context of determining the equivalence of third country GAAPs to IFRS, it is not inconceivable that the process for determining equivalence will be protracted.

B. INCREASE IN WHOLESALE DEBT DENOMINATIONS

Under the current regime, an issuer of debt securities with minimum denominations of €50,000 or the equivalent may offer such securities to the public without publishing a prospectus. Although the obligation to publish a prospectus still arises where such securities are admitted to trading on an EEA-regulated market, they are subject to a concessionary disclosure regime[5]. The Amending Directive doubles the

[4] Article 4(1)(e)
[5] Annexes IX and XII of the Prospectus Regulation

€50,000 threshold to €100,000. The provisions in the Transparency Directive[6] are similarly amended so that concessionary disclosure obligations will only apply to securities with a minimum denomination of €100,000. While the minimum denomination in Euro is still a round number, US dollar denominated securities will no longer be able to follow the current practice of being issued in $100,000 minimum denominations to take advantage of the concessionary EEA disclosure and continuing obligation regimes.

The aim of the amendment is to address the Commission's concern that the €50,000 threshold was too low and had resulted in retail investors investing in products that the Commission had treated as a policy matter as being directed at professionals. The Commission believed an increased threshold was necessary even though controls on the sales of investments are already a feature of the MiFID regime. Under MiFiD, non-advised sales are subject to various "appropriateness" obligations, while firms which make personal recommendations to clients are subject to "suitability" obligations, both of which focus on the particular characteristics of the investor and the nature of the proposed investment.

Securities with a minimum denomination of €50,000 or more that have been admitted to trading prior to the date of entry into force of the Amending Directive will be grandfathered. However, the Amending Directive does not address how further issuances of the same line of securities with existing minimum denominations of at least €50,000, but less than €100,000, (i.e. tap issues) will be treated. As a result, it may be advisable to increase the minimum denominations of new securities now rather than waiting for the Amending Directive to come into force.

C. SMALL OFFERS EXEMPTIONS

Under the current regime, the obligation to publish a prospectus does not apply if the offer to the public is addressed to fewer than 100 natural or legal persons per Member State, other than qualified investors. The Amending Directive will now permit fewer than 150 non-qualified investors per Member State to be targeted in an offering on an exempt basis[7].

Securities in an offer where the total consideration of the offer in the EEA is less than €5,000,000, calculated over a 12-month period, and across the EEA, will be exempted. The threshold has been raised from the current maximum of €2,500,000[8].

D. DEFINITION OF "QUALIFIED INVESTOR"

The Amending Directive has widened the definition of "qualified investor", giving firms the opportunity to invite their professional clients to participate in a private placement of securities without the need to rely on the limited information available in the national register of qualified investors.

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6 2004/109/EC
7 Article 3(2)(b)
8 Article 1(2)(h)

For the purposes of private placements of securities, the Prospectus Directive does not currently require the publication of a prospectus where an offer is addressed solely to qualified investors. The Amending Directive now defines "qualified investors" as persons classified either as professional clients or as eligible counterparties in accordance with Annex II of MiFID[9]. The new harmonized definition would therefore include retail clients who have consented to being "opted up" to professional client status in relation to that particular type of investment.

The harmonization of the definitions of "qualified investor" and "professional client" is a welcome one, and is likely to simplify the process by which investment firms and credit institutions market securities to their own customers. However in the United Kingdom, where sales to individuals will generally fall within the scope of the super-equivalent "financial promotion" regime, the new exemption may be of limited practical assistance.

E. MERGER EXEMPTION

The existing exemption from the requirement to publish a prospectus for securities offered to the public in connection with a merger has been extended to include securities offered or allotted in connection with a demerger, or "division". It remains to be seen whether the scope of the extended exemption will apply only to divisions effected by way of a distribution to existing shareholders or whether it might be of broader application.

IV. SUPPLEMENTARY PROSPECTUS

The Prospectus Directive provides that a prospectus supplement must be published if any new significant factor, material mistake or inaccuracy arises in relation to the information provided in, or omitted from, the prospectus. The Amending Directive seeks to clarify (in line with the current interpretation in the United Kingdom) the requirements for supplements, proposing that the obligation to publish one should apply only until the close of the offer or the admission of securities to trading, whichever is later.

It also proposes that the right to withdraw an acceptance should only be applicable if:

- The prospectus relates to an offer of securities to the public (and not to an admission to trading) – this takes many deals marketed only to professionals, such as many bond deals and initial public offerings, outside the ambit of withdrawal rights;
- The new factor, mistake or inaccuracy, giving rise to the publication of the supplement, arose before the final closing of the offer and delivery of the securities; and

[9] 2004/39/ED

- The right to withdraw is exercised within two working days of publication of the supplement (instead of a minimum period of two days, which Member States previously had the discretion to extend).

The supplement is also required to specify when the right to withdraw ends. This provision ensures that there is greater legal certainty with regards to withdrawal periods and that these are harmonized across the EEA.

V. REDUCED DISCLOSURE REGIME FOR RIGHTS OFFERING

Rights offerings are currently subject to an extensive disclosure regime. The Amending Directive intends to reduce the disclosure requirement to increase the efficiency of capital raising by this method. The Amending Directive suggests a "proportionate disclosure regime" for pre-emptive issues which would apply to those shares offered which are of the same class as the shares of the issuer already admitted to trading on an EEA regulated market or on a multilateral trading facility[10], provided that the facility is subject to appropriate ongoing disclosure requirements and rules on market abuse. The new regime will also only apply to issuers that apply "statutory" pre-emptive rights.

The specific requirements of the reduced disclosure regime have yet to be determined. Once the relevant requirements have been introduced, the Commission provides that ESMA should issue guidelines to ensure that a consistent approach is adopted by competent authorities across the Member States.

The practical impact of these amendments on market practice will ultimately depend on how issuers respond to the reduced disclosure burden. It is possible that issuers will wish to continue to provide disclosure that exceeds the minimum requirements, for marketing and liability management purposes. Similarly, underwriters may continue to require documents containing all material information that look more like a complete prospectus.

VI. ELECTRONIC PUBLICATION

The Amending Directive has altered issuers' publishing obligations with the aim of enhancing investor protection. The Prospectus Directive currently permits publication of a prospectus in electronic form on the issuer's website **and** on the website of the financial intermediaries. The Amending Directive provides that a prospectus will be deemed available to the public if published on the issuer's website, **or** the website of the financial intermediaries placing or selling the securities. Furthermore, it provides that all prospectuses that have been made available in hard copy (for example, through publication in a newspaper or in printed form in accordance with Article 14 (2)(a) and (b) of the Prospectus Directive) must also be made available electronically.

[10] As defined in Article 4(1)(15) of MiFID

The amendment is likely to put an end to publication of prospectuses by making them available at the offices of underwriters and lead to publication on issuers' websites behind "screens" designed to keep the prospectuses away from the eyes of investors in jurisdictions in which adverse regulatory consequences could arise, such as the United States.

VII. RETAIL CASCADES

The Amending Directive contains a helpful clarificatory provision in relation to the "retail cascade" issue – the retail cascade is a means of selling securities to retail investors through financial intermediaries such as retail banks. The amending provision will allow financial intermediaries to use the issuer's approved prospectus for their follow-on distribution of securities, rather than making them use one of their own, provided that: (i) the issuer consents in writing to the use of that original prospectus; and (ii) the relevant sales are made within 12 months of the date on which the prospectus was approved.

VIII. TIME PERIOD FOR PROSPECTUS VALIDITY

Under the Amending Directive, a prospectus will be valid for 12 months from the date of its approval for offers to the public or admission to trading on a regulated market. This decision is contrary to arguments put forward during the consultation process to extend the validity to 18 or 24 months.

IX. ABOLITION OF ANNUAL INFORMATION UPDATE

The Amending Directive has abolished the Prospectus Directive requirement for issuers to publish an annual information statement containing information made available to the public over the preceding 12 months. The requirement was considered unnecessary and duplicative in light of the disclosure requirements under the Transparency Directive.

X. PASSPORTING

The Prospectus Directive provides that once a prospectus is approved by the home Member State, it is valid for public offer or trading in any Member State, provided that any requirement to translate the summary into the language of the host Member State has been complied with. Under the existing regime, there is no standard requirement or practice in relation to the notification of the issuer that passporting has taken place.

Accordingly, the Amending Directive will require that the competent authority of the home Member State responsible for approval of the prospectus notify the issuer of the certificate of approval at the same time as it notifies the competent authority of the host Member State. This provision will provide certainty as to whether and when a notification has taken place.

XI. NEXT STEPS

The Amending Directive is expected to come into force in September or October 2010. Thereafter, EEA Member States will be required to implement the Amending Directive into national law within 18 months, i.e. by March or April 2012.

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For additional information, please feel free to contact any of your regular contacts at the firm on +44 (0) 207 614 2200.

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