European Commission's New Initiative Aims to Promote Access to Capital Markets

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In early 2015, the European Commission (Commission) launched the Capital Markets Union (CMU), one of its flagship initiatives, to address its perception that capital markets-based financing in the European Union could be further developed and that businesses in the EU are too reliant on banks as a source of financing. The CMU objectives are to: (1) develop European capital markets as alternative sources of financing to banks, (2) produce a single market for financial services that is deeper, more liquid and more competitive, and (3) promote growth and financial stability throughout the EU. The Commission is aiming to fully implement the CMU initiative by 2019.

As part of the initiative, the Commission intends to replace the European Prospective Directive, which currently governs the prospectus required when securities are offered to the public or admitted to trading on a regulated market. The new regulation would make it easier for companies to prepare a prospectus and access the capital markets. Following a public consultation earlier this year, the Commission published a draft of the regulation on November 30, 2015.

The proposed amendments to the European prospectus regime constitute the most significant and wide-ranging changes for the preparation and publication of prospectuses since the current regime came into force in 2005. It remains to be seen how compatible the regulation, once approved, will be with the requirements and practices of key non-EU jurisdictions into which securities are marketed.

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Highlights of the Proposed Regulation

Prospectus Contents. The summary section at the beginning of a prospectus would be limited to a maximum of six sides of A4-sized paper (currently, it is limited to 7 percent of the length of the prospectus or 15 pages, whichever is longer). It would contain three sections covering key information on the issuer, the securities and the offer/admission. Each section would have a general heading and an indication of the underlying content, but issuers would be free to develop brief narratives.

The regulation would allow the issuer to incorporate a greater amount of information by reference in a prospectus, provided that the information is published electronically and complies with the regulation's language requirements. This information may include material from other prospectuses and regulated information that issuers are required to disclose under the Transparency Directive and the new Market Abuse Regulation.

In order to prevent issuers from including a multitude of generic risk factors in a prospectus that obscures the more important ones, only risk factors that are material and specific to the issuer and its securities would be permitted. The issuer would be required to categorize its risk factors and differentiate them by their relative materiality and probability of occurrence.

High-Denomination Nonequity Securities. In an attempt to remove the incentive to issue debt securities in high denominations because they benefit from a lighter

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disclosure regime, the amendments would remove the existing prospectus exemption for offers of securities with a denomination above €100,000. A uniform prospectus disclosure requirement would be introduced for all nonequity securities offers regardless of denomination. This would be based on existing disclosure standards for high-denomination debt but would call for additional information to ensure retail investor protection. Issuers that restrict their offerings of debt securities to qualified investors would still benefit from a prospectus exemption and avoid the regulation requirements.

Disclosure for Secondary Issuances and SMEs. A "proportionate disclosure regime" currently exists for secondary issuances and small- and medium-sized enterprises (SMEs), allowing a reduced level of disclosure in prospectuses from these issuers. Although this regime was intended to reduce the administrative burden and cost for such issuers, the Commission views it as unsuccessful and has proposed a replacement. Under the proposal, an existing issuer that: (1) already has been admitted to trading on a regulated market or an SME growth market for at least 18 months and (2) wishes to make an offer of securities or apply for the admission of securities, would be permitted to produce a short-form "alleviated prospectus" with the minimum financial information covering the last fiscal year. In certain circumstances, SMEs also would have more flexibility in the format of their prospectuses and could, for instance, adopt a question-and-answer format.

Universal Registration Document. The regulation introduces the concept of an annual universal registration document (URD), a form of "shelf" registration document for use by companies that frequently access the capital markets. This would contain all the necessary information on a company that wants to list shares or issue debt. Issuers that regularly maintain an updated URD with their regulators would benefit from a five-day fast-track approval process when they wish to issue shares, bonds or derivatives.

Exemption for Further Issuances of Shares. Any existing issuer already admitted to trading on a regulated market would not need to produce a prospectus for the subsequent admission of shares of the same class to that market, provided that such shares represent less than 20 percent (up from 10 percent) of the existing shares already admitted over the previous 12 months. This would facilitate the listing of further shares issued by existing issuers.

Prospectus Publication. Certain changes would be made to how prospectuses must be published. In addition, the European Securities and Markets Authority would be tasked with developing an online storage mechanism for all prospectuses, with a free search tool for EU investors.

Next Steps

The draft regulation will next be sent to the European Parliament and the Council of the EU for discussion and adoption and would come into force by mid-2017 at the earliest. Despite the remaining steps before implementation, the proposals provide clear evidence of the Commission's intention to simplify the working of, and therefore hopefully improve access to, the capital markets in Europe. All clients seeking to offer securities to investors in Europe or list those securities on markets in Europe will need to be mindful of the proposed changes.