News Bulletin

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# The FSA and ESMA Get Technical on Prospectuses

The Prospectus Directive (the "PD")[1] and the Prospectus Directive Regulation (the "PD Regulation")[2] were recently amended, in each case with effect from 1 July 2012. These new rules introduced a number of significant changes relating to the way in which both final terms and base prospectuses are prepared and used by issuers of debt and structured products. As we move further into 2013 and the market familiarises itself with the new legislation, we consider three key clarifications to the new prospectus regime that have recently been provided in the form of two consultations by the Financial Services Authority ("FSA")[3] and the European Securities and Markets Association ("ESMA")[4]:

**What information should be included in final terms and / or the base prospectus?**

The Prospectus Directive Regulation specifies in Article 22.4 that only the following can be included in final terms:

1. Category B and C information set out in Annex XX;
2. Any additional voluntary information allowed by Annex XXI; and
3. Replicated or referenced options that have already been provided for a base prospectus.

To the extent that information does not fall into any of the categories above, it cannot be included in final terms. As such, the FSA are keen to stress that certain information which may previously have been included in final terms (such as guidance notes in italicised text or disclosure obligations under other EU regulations, such as MiFID) is no longer welcome. In addition, only base prospectus items consisting of different options relating to a security may be replicated in the final terms (as per item 3 above). Any other reproduction of base prospectus drafting is prohibited.

*Yields and Formulae*

Payout formulae for structured securities can be included in a base prospectus algebraically, although issuers still need to represent how the return on an investment takes place in understandable and comprehensible language. The final terms can then include the formula with issuance-specific details, for review by the competent authority.

[1] The Prospectus Directive (2003/71/EC) was amended by an amending directive on 31 December 2010 (2010/73/EU), with Member State implementation required by 31 July 2012.
[2] The Prospectus Regulation ((EC) No. 809/2004) was amended by the Commission Delegated Regulation (EU) 486/2012 and the Commission Delegated Regulation (EU) 862/2012.
[3] http://www.fsa.gov.uk/library/policy/guidance_consultations/2013/consultation-bulletin-no5. The consultation remains open until 8 April 2013.
[4] The consultation remains open until 14 June 2013.

For retail bonds, yield information must also be included, although the FSA only requires presentation of a simple yield formula (*e.g.*, current yield).

*Issuance-Specific Summaries*

Article 24 of the PD Regulation (as amended), provides that a summary in the base prospectus may leave placeholders for the incorporation of issuance-specific information. However, the FSA have clarified that the issuance-specific summary should not be included as a separate section in the base prospectus. Instead, the relevant sections derived from the base prospectus summary should be attached to the final terms to form the completed issuance-specific information.

If a single document comprises both a retail and wholesale base prospectus and it is clear which parts of the document relate to which prospectus, then an issuance-specific summary is only required for the retail final terms. If, however, the base prospectus containing both wholesale and retail elements has been drafted collectively as one document, then an issuance-specific summary will be required for either retail or wholesale final terms.

**Limiting disclosure of risk factors to 'key' information in a prospectus summary**

There has been some market concern regarding the different risk factor disclosure requirements in respect of the base prospectus itself and in the prospectus summary. While the PD requires that all 'material' risks be disclosed in the risk factor section of the base prospectus, the PD Regulation requires only that key information on the key risks to the issuer need to be included within the prospectus summary. The disparity has prompted concern by some issuers that failure to highlight certain risks as being 'key' will expose them to potential liability. As a consequence, these issuers are sometimes taking the view that all risks should be included in the prospectus summary as key risks.

The FSA, however, has firmly rejected this practice and made clear that it is not acceptable to include non-key risks in the summary. Instead, to assuage issuers' concerns, it has provided the following suggested language for inclusion in the risk factor section of a prospectus:

"*Prospective investors should note that the risks relating to the Group, its industry and the Ordinary Shares summarised in the section of this document headed "Summary" are the risks that the [Directors believe/the Company believes] to be the most essential to an assessment by a prospective investor of whether to consider an investment in the Ordinary Shares. However, as the risks which the Group faces relate to events and depend on circumstances that may or may not occur in the future, prospective investors should consider not only the information on the key risks summarised in the section of this document headed "Summary" but also, among other things, the risks and uncertainties described below*."

In addition, the FSA has highlighted some examples of situations where it will challenge risk factors during the review process. These include:

- Where disclosure conflicts with or undermines other rule requirements or an issuer's eligibility or continuing obligations;
- Where disclosure is contradictory to the Listing Principles;
- Where sufficient prominence is not given to a material risk;
- Where there is disclosure elsewhere in the prospectus which clearly presents a risk that has not been disclosed in the risk factor section; or

- Where the risk factors simply state the facts but fail to clarify the risk in the context of the issuer's business or the issue of securities in question.

Further, risk factors should be grouped in a coherent manner, with those of greater immediate significance being prominent at the beginning of each section. Mitigating factors can be referred to, although these should not detract from the nature of the risk.

**Supplementary Prospectuses**

Article 16 of the PD requires that a supplementary prospectus ("SP") be prepared for "*every significant new factor, material mistake or inaccuracy, relating to the information included in the prospectus which is capable of affecting the assessment of the securities...*". However, not every new factor, mistake or inaccuracy should require the publication of a supplementary prospectus and as a consequence, the FSA have provided some further guidance as regards the use of a SP. Four examples are provided:

1. **Drafting amendments** – The FSA do not consider it appropriate to use a SP for the purpose of clarifying or revising non-material drafting in the base prospectus.

2. **Amending the terms and conditions** – Terms and conditions should generally not be altered through the use of a SP and nor should any new features be added to a base prospectus in this way. Most changes of this type will require a new prospectus to be produced, although the FSA concedes that there are some very limited circumstances where it would accept changes to the terms and conditions, so long as the changes do not render the securities manifestly different securities from those described in the base prospectus.

3. **New events** – The disclosure of new events (such as the sale of a subsidiary) are disclosable via issuance of a SP but only if the relevant event is considered to be material.

4. **Amendments relating to offer period or amount** – A SP may be used when making amendments to the period or amount of the original offer.

As to timing for submission of a SP, Rule 3.4.3 of the Prospectus Rules requires such submission as soon as practicable after the new factor, mistake or inaccuracy arose. In addition, the FSA has stated that it considers it best practice to suspend the offer between the trigger event and the publication of an approved SP, and that it will endeavour to fast-track the SP approval process to allow publication as soon as possible.

*ESMA Consultation*

Further guidance on SPs has also been provided by ESMA. On 18 March 2013, ESMA published a consultation paper[5] (the "ESMA Consultation Paper") in respect of proposed regulatory and technical standards that would "*establish the minimum situations where a supplement is required*"[6]. In the consultation, a number of examples are provided, including a change of control of the issuer, the publication of new audited financial statements, the occurrence (and outcome) of a takeover bid for equity securities, or an increase in the aggregate nominal value of the programme. The requirement to publish a SP will not only arise with respect to the examples provided, however, and the issuer, the offer or the person asking for admission to trading on a regulated market should assess the significance or materiality, without prejudice to the powers of the competent authority of the home member state[7].

[5] http://www.esma.europa.eu/system/files/2013-316.pdf.
[6] Recital (4) of Draft Commission Delegated Regulation supplementing Directive 2003/71/EC of the European Parliament and of the Council with regard to regulatory technical standards for publication of supplements to prospectuses.
[7] Clause 28 of the ESMA Consultation Paper.

## Authors

Jeremy Jennings-Mares
London
+44 20 7920 4072
jjenningsmares@mofo.com

Lewis Lee
London
+44 20 7920 4071
lewislee@mofo.com

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