Deregulation of Public Offering Prospectus Requirements

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The Prospectus Regulations 2011/1668 (the Regulations) came into force in the United Kingdom (the UK) on 31 July 2011, allowing companies—particularly smaller ones—to raise equity finance more cost-efficiently. The Regulations will achieve this by increasing two key thresholds, below which it is no longer necessary to create expensive prospectuses. The beneficial nature of the deregulatory provisions means they are being implemented almost one year before the European Union (the EU) deadline of 1 July 2012. The Regulations amend the Financial Services and Markets Act 2000 (FSMA), which provides for the implementation of Directive 2003/71/EC (the Prospectus Directive) in the UK.

The Prospectus Directive

The Prospectus Directive establishes when and how a prospectus must be published upon securities being offered to the public, or admitted to trading on a regulated market, in the EU. The Prospectus Directive also stipulates the form a prospectus must take and its contents. It must contain all of the information necessary to allow investors to make an informed assessment of the financial position and future prospects of the offeror, as well as setting out the risks involved in, and the rights attaching to, the securities offered.

The Prospectus Directive is designed to: (i) protect investors by ensuring that they have access, through detailed prospectuses, to adequate information, and that they understand the investment they are making; and (ii) improve the efficiency of the single market by implementing a EU framework, allowing companies to use the same prospectuses as a "passport" for their offerings across the EU.

Prospectus Costs

Responses to the UK Government Green Paper consultation "Financing a Private Sector Recovery" outlined the costs involved in producing a prospectus. For fundraising below the £10 million mark, prospectus costs were estimated at between 7 and 12 per cent of funds raised. Since the implementation of the Prospectus Directive in July 2005, the London Stock Exchange (the LSE) estimated that Alternative Investment Market (AIM) companies have raised approximately £28 billion through further fundraisings, approximately 98 per cent of which was through private placements. Companies are opting to raise funds through private placements, rather than public offerings, to avoid the significant costs attached to producing a prospectus. While this method of raising capital may reduce costs, it can also result in the dilution of existing shareholders' holdings.

The Amending Directive and the Regulations

In November 2010, following a review by the European Commission, Directive 2010/73/EU (the Amending Directive) was adopted, amending the Prospectus Directive. The Amending Directive is designed to simplify the application of the Prospectus Directive and reduce the level of administration borne by issuers, whilst maintaining investor protection.

Two deregulatory provisions of the Amending Directive will be brought into effect in the UK by the Regulations on 31 July 2011. The outstanding part of the Amending Directive remains to be implemented before the 1 July 2012 deadline. The deregulatory provisions implement:

- **an increase from 100 to 150 of the number of investors for which a prospectus is required.** The Regulations increase the number of persons, other than qualified investors, to whom an offer of transferable securities may be made, or directed at, before a prospectus is required. The amendment relates to section 86(1)(b) of FSMA; and
- **an increase from €2.5 million to €5 million of the consideration threshold.** The Regulations increase the total size of the offer that may be made in the EU before a prospectus is required. The amendment relates to paragraph 9(1) of Schedule 11A of FSMA.

HM Treasury's consultation paper on the early implementation of these changes contained statistical analysis of public offerings on the main market of the LSE and AIM that required a prospectus from 2000 to 2010. It concluded that approximately 26 public offerings per year could have benefited from this higher fundraising threshold.

Cross-Border Offers

The Regulations are most beneficial in relation to offers made entirely in the UK. As the UK is implementing these two reforms early, unlike other Member States, companies will need to be careful when undertaking cross-border offers. In particular, the consideration threshold limit applies to the total consideration of the offer in the EU. For example, where an offer with a consideration between €2.5 and €5 million is made in the UK and another Member State that has not yet implemented the measure, the offer may not be exempt under the law of that Member State.

Practically, this means that it may be more cost-effective and less risky for cross-border issuers to elect not to use the wider exemptions introduced by the Regulations until other Member States also implement the changes into their law.

Comment

Smaller companies, undertaking secondary fundraising, are the most likely beneficiaries of these measures. In particular, the threshold changes are designed to encourage smaller companies to conduct rights issues, rather than private placements, which will help to protect minority shareholders. The measures achieve this by allowing smaller companies more efficient access to equity finance, as offers can now be made to wider sets of investors to raise larger amounts of capital, without the need to produce a costly prospectus. The impact on larger companies will be negligible, as these businesses usually make capital raisings and/or approach investors in numbers in excess of the adjusted thresholds.

HM Treasury estimates that these changes to prospectus thresholds will save UK businesses approximately £12 million annually.

The Regulations can be read at: http://www.legislation.gov.uk/uksi/2011/1668/pdfs/uksi_20111668_en.pdf

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