

## Capital Markets Union – Hit or Miss?

### Key Points

- Green Paper on Capital Markets Union ([CMU Green Paper](#)) and Consultation on Prospectus Directive Review ([PD Consultation](#))
- Consultation Period runs until 13 May 2015
- Prospectus Directive Review - areas of focus include:
  - Harmonising treatment of EU wide offers below €5m
  - Modifying requirements for prospectuses on secondary offers
  - Imposing limits on the length of prospectuses
  - Requiring applicants to MTFs to produce vetted prospectuses

### Prospectus Directive Consultation – Our Thoughts

The EU Commission has recently published its much heralded Green Paper on Capital Markets Union (CMU) ([CMU Green Paper](#)). As part of this initiative, the Commission launched an expedited review of the Prospectus Directive ([PD Consultation](#)) with the aim of lowering barriers to accessing capital markets.

For further information on the CMU Green Paper itself see “CMU – Further Information” (below).

### Introduction

In launching its review of the Prospectus Directive, the Commission has brought forward its planned consultation which was due by 1 January 2016. The Prospectus Directive was previously reviewed and amended in 2010, at which time attempts were made to implement a proportionate disclosure regime including for small and medium-sized enterprises (SMEs) to facilitate access to the capital markets. The thrust of the relevant Consultation Paper suggests that there is a widespread feeling that these amendments have not been successful.

### Key Points in the Prospectus Directive Consultation

We set out below a number of points which struck us as being particularly key in the context of the Prospectus Directive review:

- **Offers below €5 million - the wisdom of the crowd** There is much discussion of the thresholds which were amended in 2010. In particular, the Consultation Paper notes that for offers below €5

million within the EU which do not require a prospectus, member states currently remain free to impose disclosure requirements for such offers. The Consultation Paper seeks views on whether such thresholds should be increased and whether a uniform standard should be imposed across the EEA. The Consultation Paper also notes that a lack of consistency around such small offers is relevant in the context of crowd funding and that the development of this might be discouraged in those member states where the prospectus requirement applies below the €5 million threshold. These concerns highlight the fundamental tension, which permeates many areas of the Consultation Paper, between investor protection requirements and the desirability of allowing companies to access funding sources. One can foresee some interesting regulatory debates around this. Indeed the FCA has already raised the concern that aspects of Capital Markets Union being discussed raise consumer protection concerns; they are unlikely to be the last to do so.

- **Modifying the requirements for a prospectus on secondary issues** The Consultation Paper opens up a debate on whether a prospectus should be required at all for follow-on offerings or whether it is sufficient to rely on information already in the market, released pursuant to the transparency and disclosure requirements to allow sufficient investor disclosure. As a fall back, there is a consideration raised as to whether the current prospectus exemption for secondary issues admitted to trading on a regulated market should be raised from 10 percent of its existing issued share capital to 20 percent. Abolishing prospectuses for rights issues/follow-ons altogether seems to be counter-intuitive and unlikely to find favour in many quarters. See, however, “Some more radical suggestions” below.
- **Limiting prospectus length – how long is too long?** The Consultation Paper repeats the often made complaint that prospectuses have grown too long. There can be no doubt that we have all seen examples where the volume of disclosure alone in a prospectus renders it largely indigestible. Suggestions open for discussion are limiting the overall length of a prospectus and respondents are asked to quantify the maximum page count. Alternatively, the risk factor section is seen as being particularly to blame and a suggestion is made of limiting the number of risk factors. Whilst the purists among us may balk at the idea of a “one-size fits all” size limit on disclosure documents there does not appear to be any better way to bring the size of the prospectus, or particular sections of it, back to a reasonable length. We have been able to work within the confines of the word limit imposed on prospectus summaries. If there is genuine desire to shorten the prospectus then perhaps imposing certain word limits is the least bad option.
- **Requiring approved prospectuses for admission to trading on MTFs - taking aim at AIM!** Interestingly, the consultation notes that there is no consistency across the 150 registered MTFs which currently operate in the EU. There is no level playing field between the levels of disclosure depending on the MTF where admission to trading occurs. The suggestion is raised as to whether in order to level the playing field it may be appropriate to harmonise the disclosure requirements, potentially by extending the scope of the Directive to such markets. In stark terms, this would require an AIM admission document to be approved by the UKLA where there is currently no requirement to do so. In a consultation aimed at facilitating access for SMEs to the capital markets, imposing additional burdens for access to the EU’s most successful growth market strikes a slightly odd note. As we suggest below, we think there may be a bolder approach which should usefully be explored.

### **Some More Radical Suggestions**

The Consultation Paper poses the fundamental questions as to whether (i) a prospectus is required for admission to trading to a regulated market or an offer to the public and (ii) if all prospectuses should be subject to regulatory review. We would not expect the Commission to abolish either the prospectus

requirement or the need for regulatory review altogether. However, why not consider abolishing the requirement for any regulatory review of the prospectus for a broad range of transactions?

We recognise that for an IPO or the most potentially dilutive of secondary offerings the additional protection of full regulatory scrutiny may be appropriate. However, given that the requirements for prospectus content are clearly set out in the Prospectus Rules and that companies and directors assume responsibility for prospectuses, it seems legitimate to query whether for other transactions a regulatory review adds much beyond an additional layer of costs and up to four to six weeks to the timetable. For years offer documents published in connection with takeover offers in accordance with the UK Takeover Code have been subject to a far lower level of regulatory review than a prospectus without impacting negatively on shareholders.

We would propose a three tier system comprising:

- Fully exempt offerings where no prospectus is required in much the same way as currently exists but with potentially higher thresholds (see “*Modifying the requirements for a prospectus on secondary issues*”);
- Secondary offerings of, for example, up to 50 percent of the issued share capital of the company, where a prospectus must be published but without the requirement to obtain regulatory approval; and
- IPOs and other large offerings which would require an approved prospectus in the usual way.

Were the requirement for a regulatory review to be abolished in this way, a month and significant costs would be shaved off many European offerings. Clearly, there will be views either way but if the paper is about blue sky thinking then this is surely worth considering.

## Consultation Process

Responses to the online questionnaire on the Prospectus Directive consultation are due by 13 May 2015.

## CMU – Further Information

As part of the EU’s overarching plan for jobs and growth, it has determined that one of its priorities is to develop a stronger European-wide capital market to mitigate reliance by EU businesses on bank finance. The Green Paper states that in the US, medium-sized companies receive five times more funding from capital markets than they do in the EU. Much of the focus in the Green Paper is around expanding sources of funding for SMEs. The stated objective of the Green Paper is to put in place the building blocks for a fully functioning Capital Markets Union by 2019.

The Green Paper recognises that any efforts at achieving convergence of insolvency and tax regimes, which may ultimately be beneficial for creating a unified Capital Markets Union are likely to be longer term goals. However, the paper identifies a certain amount of “low hanging fruit” which can be picked over the short term. The paper highlights five main priorities for early action:

- Lowering barriers to accessing capital markets - a review of the Prospectus Directive (see above)
- Widening the investor base for SMEs - setting up a common minimum set of comparable information for credit reporting and assessment on SMES

- Building sustainable securitisation - noting that (unsurprisingly perhaps) securitisation in 2014 was well under half the amount it was in 2007, the Green Paper states that a sustainable, high quality securitisation market based on simple, transparent and standardised securitisation instruments could bridge banks and capital markets
- Boosting long term investment – part of a wider EU plan to boost infrastructure and projects for long term growth
- Developing European private placement markets

Longer term specific objectives appear to include potential introduction of a new IFRS accounting system for SMEs and encouraging a higher level of direct retail participation in the capital markets.

## What Next?

### High Level Project

- Responses to Green Paper questions should be submitted by **13 May 2015**
- **Summer 2015** – the Commission will organise a conference to draw the consultation to a close
- **Later in 2015** – action plan on Capital Markets Union to be published

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