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Appendix D

(ii) Current Developments in the United Kingdom

Linklaters

September 8, 2006

I. Introduction

This appendix summarises the laws and regulations in the United Kingdom that disclosure to be made on the admission of securities to the United Kingdom's securities markets, and the requirements for the production of a prospectus before a public offer of securities is made. It also touches on the continuing disclosure requirements to which issuers are subject once they are admitted to the United Kingdom's securities markets.

The admission and prospectus regimes in the United Kingdom do not exist in isolation. They sit within a web of law and regulation that is designed to ensure that investors are properly protected and that markets inspire confidence.[1] These provisions include a requirement that anyone who sells securities in the United Kingdom must be authorised by the Financial Services Authority (the "**FSA**");[2] and the rules[3] imposed by the FSA on those it authorises, which include detailed provisions governing the way in which authorised persons deal with their customers, together with broad general principles. There is also a statutory regime that prohibits the communication, in the course of business, of an invitation or inducement to engage in investment activity, except where that communication is made by, or is approved by, a person authorised by the FSA.[4]

However, this paper only looks at the part of this protective web that relates to admission of securities to the United Kingdom's securities markets and, in particular, the need to produce a prospectus for the purpose of such admission or the making of a public offer.

Much of the discussion relates to the European Union's Prospectus Directive[5] (the "**PD**") and its related Regulation[6] (the "**Regulation**"), the Transparency Directive[7] (the "**TD**") and the Market Abuse Directive[8] (the "**MAD**"). This is because the laws of the United Kingdom in this area are (or, in the case of the TD, will be) very closely based on these European measures and an understanding of the Directives will assist the reader when looking at the regimes in other EEA jurisdictions. The discussion, however, is limited to the English interpretation of these Directives. Implementation in other European States may be different in some respects (even though, in the case of the PD, the Directive is intended to be implemented in the same way in all States).

The PD and MAD have been implemented in the United Kingdom through amendments to the Financial Services and Markets Act 2000 ("**FSMA**") and rules made by the FSA under powers delegated to it by that Act. The TD is not required to be implemented until 20 January 2007.

[1]See, for example, the statutory objectives imposed on the Financial Services Authority, the regulator of the financial markets in the United Kingdom, set out in section 2(2) of the Financial Services and Markets Act 2000 ("FSMA").

[2]FSMA section 19.

[3]These can be found in the FSA's Handbook at http://fsahandbook.info/FSA/html/handbook/ The rules include detailed requirements for those dealing with retail customers to ensure that they know the customer and his/her circumstances, and that they properly assess the suitability of the product in question for each such customer.

[4]See FSMA section 21 and The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

[5]Directive 2003/71/EC. The Directive has effect in all countries that are members of the European Economic Area (the "EEA"), which comprises the EU together with Norway, Liechtenstein and Iceland.

[6]Regulation (EC) No 809/2004

[7]Directive 2004/109/EC

[8]Directive 2003/6/EC

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II. Public Offers and Admission to Regulated[9] Markets

2.1 EU Background

The regime for the listing and public offer of securities in the United Kingdom changed on 1 July 2005, when the PD was implemented.

One of the principal objectives of the PD is to facilitate the development of a true pan-EEA market in securities.[10] Although the previous Directives had contained mutual recognition provisions permitting the use of prospectuses across borders, to obtain a listing or make a public offer in a number of different EEA countries, these arrangements did not work well in practice. This failure was caused largely by the fact that the "host" state (that is, the state in which the second listing or offer was made) would often insist on a translation of the entire prospectus and on the inclusion of additional disclosure – for example, on the local tax requirements. The cost and time implications of these requirements were serious enough to limit pan-EEA offerings largely to the wholesale markets, where offerings were made in host states under an exemption from the requirement to produce a prospectus (for example, because the offer was to professional investors only).

The Directives discussed in this paper are designed to remove these impediments and introduce a harmonised regime within the EEA. Through the Directives, the European Commission aspires to create a genuine pan-European securities market, which is intended among other things, to facilitate capital raising and enhance public confidence in capital markets.

2.2 The Requirement for a Prospectus

The PD requires that a prospectus be produced, containing certain detailed mandated disclosure, either when a public offer is made in an EEA State; or when application is made to admit securities to the EEA's regulated markets. These requirements do not apply to EEA sovereigns, their regional or local authorities or issues guaranteed by them, public international organisations of which an EEA state is a member, securitised deposits issued by EEA credit institutions and small offers (below €2,500,000 over any 12 month period).[11] The prospectus must be approved by the appropriate competent authority and published, before the offer or application is made.

In both cases, there are exemptions.

[9]EEA Directives distinguish between a number of different types of market. "Regulated markets" are defined by the Investment Services Directive (Council Directive 93/22/EEC), which is shortly to be replaced by the Market in Financial Instruments Directive, and include the EEA's "main board" markets. In addition, partly in response to the introduction of the PD, MAD and TD, various countries have permitted the establishment of markets that are *not* regulated markets (and are therefore outside the scope of these Directives) but *are* "listed" markets – for example, the Professional Securities Market of the London Stock Exchange. "Listed markets", for the purposes of EEA legislation, are those where securities are admitted to a particular country's "official list". To obtain this status, a disclosure document (known as "listing particulars") must be produced, under the Combined Admissions and Reporting Directive (Directive of the European Parliament and of the Council 2001/34/EC). These markets operate in parallel. Securities admitted to some markets, such as the UK's regulated markets, are also admitted to the official list, however.

[10]See, for example, Recital (4) of the PD – "The Directive constitutes an instrument essential to the achievement of the internal market… facilitating the widest possible access to investment capital on a Community wide basis"

[11]PD Article 1.2.

2.2.1 Public Offer

The Directive requires that, where securities are offered to the public in any Member State, a prospectus complying with the Directive and its subordinate legislation must be produced by the person making the offer.[12]

The Directive defines "offer to the public" as "any communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe the securities".[13] This is a very broad definition, which will catch communications that fall short of a contractual offer (that is, an offer that is capable of acceptance so as to form a contract).

There are, however, exemptions that permit such communications without prior production of a prospectus. For example, no prospectus is required:

- where the recipient of the communication is a *qualified investor.*[14] The definition of qualified investors[15] includes authorised persons (such as investment banks, insurance companies and pension funds), supranational institutions and sovereigns. The exemption also includes legal entities which have any two of the following three criteria: (a) at least 250 employees, (b) a "total balance sheet" over EUR 43,000,000 and (c) an annual turnover exceeding EUR 50,000,000. Member States also have an option to include sophisticated individuals in the definition;[16]
- where the communication relates to securities with a denomination of at least EUR 50,000;[17]
- where the securities to which the communication relates can only be acquired for a total consideration of at least EUR 50,000;[18]
- where shares are offered in substitution for shares of the same class (unless the issue involves an increase in issued share capital);[19]
- in the context of a takeover or merger, where shares are offered as part of the consideration and a document equivalent to a prospectus is produced;[20]

[12] PD Article 3.1.
[13] PD Article 2.1(d).
[14] PD Article 3.2(a).
[15] PD Article 2.1(e).
[16] PD Article 2.1(e)(iv).
[17] PD Article 3.2(d).
[18] PD Article 3.2(c).
[19] PD Article 4.1(a).
[20] PD Article 4.1(b) and (c).

- for shares offered free of charge and dividends paid in the form of shares of the same class as that to which the dividend relates, provided there is a document describing the number and nature of the shares and reasons for and details of the offer;[21]
- for certain employee share offers, provided there is a document describing the number and nature of the shares and reasons for and details of the offer;[22]
- where the communication is addressed to fewer than 100 persons per Member State, other than qualified investors.[23]

The last of these exemptions could create an opportunity for avoidance of the prospectus requirement. A person wishing to communicate an offer to 900 non-exempt investors could interpose 10 financial intermediaries, each of whom would offer to 90 of the non-exempt investors, thus bringing them within the exemption. To prevent this, the final sentence of Article 3.2 provides effectively that, in determining whether a prospectus is required, the person originating the communication has to ensure that *all* of the communications to the non-exempt investors would be within an exemption. In the example given, this would not be the case (because there are 900 non-exempt investors) and a prospectus would have to be produced.

2.2.2 Admission to Regulated Markets

The second trigger for a prospectus under the Directive is where an issuer wishes to be admitted to an EEA regulated market.[24]

There are also exemptions for:

- shares representing, over a period of 12 months, less than 10 per cent of the number of shares of the same class as is already admitted to trading on the same regulated market;[25]
- shares offered in substitution for shares of the same class already admitted to the same regulated market (unless the issue involves an increase in issued share capital);[26]
- shares offered in the context of a takeover or merger as part of the consideration provided a document equivalent to a prospectus is produced;[27]
- shares offered free of charge and dividends paid in the form of shares of the same class as that to which the dividend relates, provided there is a document describing the number and nature of the shares and reasons for and details of the offer;[28]

[21]PD Article 4.1(d).
[22]PD Article 4.1(e).
[23]PD Article 3.2(b).
[24]PD Article 3.3.
[25]PD Article 4.2(a).
[26]PD Article 4.2(b).
[27]PD Article 4.2(c) and (d).
[28]PD Article 4.2(e).

- certain employee share offers, provided there is a document describing the number and nature of the shares and reasons for and details of the offer;[29]
- shares resulting from conversion or exchange of other securities (such as a convertible or exchangeable bond), provided they are of the same class as the shares already admitted to trading on the same regulated market.[30]

In all other cases, if an issuer wishes its securities to be admitted to an EEA regulated market, it must produce a prospectus complying with the Directive.

Where securities are to be admitted to an EEA regulated market and also offered to the public, a single prospectus can serve for both purposes.

2.3 The Format of the Prospectus

The format and content requirements of the PD are the same, whether the securities are to be offered to the public or admitted to an EEA regulated market. The issuer can choose the form of the prospectus, from three options.

The tripartite prospectus. If the issuer accesses the markets on a frequent basis, it may decide to produce a prospectus consisting of three parts.[31] The first part, the Registration Document, contains the description of the issuer and its business, together with its financial statements. The second part, the Securities Note, is produced as and when an issue is made and contains details of the securities being issued. The third part, the Summary Note, is required where the securities have denominations of less than EUR 50,000.[32] The Summary Note must, in a brief manner and non-technical language, convey the essential characteristics and risks associated with the issuer, any guarantor and the securities.[33] It must also contain various warning statements, to the effect that it should only be read as an introduction to the prospectus; that those responsible for the prospectus will only be liable in relation to the Summary if it is misleading when read together with the rest of the prospectus; and that the investor may have to bear the cost of any translation of the prospectus required by the relevant courts in its jurisdiction.[34]

The Registration document remains on the shelf throughout the year and, provided it is up to date, only the short Securities Note and Summary (if required) have to be produced for each issue made during the year.[35]

[29] PD Article 4.2(f).

[30] PD Article 4.2(g).

[31] PD Article 5.3.

[32] PD Article 5.2, final paragraph – although Member States have the right to require in their national law that a Summary be produced in their national language when securities are offered to the public or admitted to regulated markets in their territory (PD Article 19.4). Note also that the EUR 50,000 exemption is not available for equity securities (which do not have a denomination) or certain types of equity-linked securities.

[33] PD Article 5.2.

[34] PD Article 5.2.

[35] PD Article 12.1.

The Summary is an interesting innovation. It is needed because the prospectus, once approved by the home state authority, will have universal validity throughout Europe[36] without translation (provided it is in a language that is "customary in international finance" such as English[37]). However, if the denomination of the issue puts it within range of retail investors, they need to be able to read and understand at least the key points set out in the prospectus. These are required to be set out in a summary, which must not normally exceed 2,500 words.[38]

The single prospectus. Less frequent users of the markets will not wish to produce a shelf Registration Document. The PD therefore also provides that a prospectus may be produced as a single document. This must also contain all the elements that would be in a three part prospectus, including, unless the securities being issued have a denomination of at least EUR 50,000,[39] the Summary.

Programmes. As an alternative to the tripartite format, the PD permits issuers of non-equity securities to produce a base prospectus under an offering programme. A base prospectus must contain all relevant information concerning the issuer and the securities to be offered under the programme[40] other than those which are not known when the base prospectus is approved and can only be determined at the time of an individual issue.[41] This missing information is supplied at the time of each issue under the programme in a document known as final terms.

2.4 Contents of a Prospectus

A prospectus must contain all information which, according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities.[42]

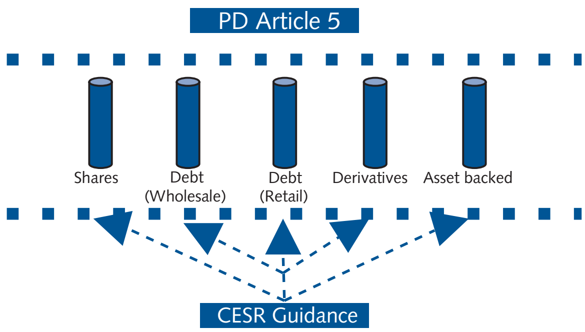
The Regulation adds detail to this general disclosure standard. It contains detailed lists of disclosure requirements for different types of issuer and different securities – for example, for shares (Annexes I and III), retail debt and derivatives (with denominations below EUR 50,000) (Annexes IV and V), wholesale debt and derivatives (Annexes IX and XIII), OECD Banks (Annex XI), States and Regional Authorities (Annex XVI), asset-backed securities (Annex VIII) and depositary receipts (Annex X).

The Committee of European Securities Regulators (CESR) issues guidance from time to time on the interpretation of these provisions.

[36]See paragraph 2.8 below.
[37]PD Article 19.2.
[38]PD Recital (21).
[39]Note that the EUR 50,000 exemption is not available for equity securities (which do not have a denomination) or certain types of equity-linked securities.
[40]PD Article 5.4.
[41]Regulation Article 22.2.
[42]PD Article 5.1.

This disclosure hierarchy is illustrated in the following diagram:

Prospectus contents - Structure



Information can be incorporated into a prospectus by reference, if it is included in a document that has previously been approved by the home state competent authority (for example, another prospectus) or filed with it in accordance with the PD or certain other Directives.[43] As the PD requires information that has been filed with securities regulators in *any* jurisdiction to be notified to the home state competent authority in an annual list,[44] it should be possible to file the information referred to in the list with the competent authority and then to incorporate its contents (or part of them, if desired) in a prospectus.

One of the more important distinctions made in the Regulation is that between wholesale and retail securities. Wholesale securities (defined as securities with a denomination of at least EUR 50,000[45]) benefit from a less stringent disclosure regime, because the professional investors who buy them are presumed to have greater knowledge than retail investors.[46]

It is possible to omit the final offer price and amount of securities from a prospectus (for example, where it is desired to approach retail investors to discover the level of interest in a particular issue before determining these elements). However, if price and amount are not included, the prospectus must either set out the criteria that will be used to determine price and amount; or (in the case of price) set out the maximum price. If it does not, investors who have accepted offers to purchase or subscribe will have the right to withdraw their acceptances during a period of not less than 2 working days after the final price and amount have been determined and filed with the home state competent authority.[47]

The home state competent authority also has the power to permit the omission of information otherwise required to be included in a prospectus where disclosure would be contrary to the public interest, or (but only

[43]PD Article 11.1.

[44]Article 10.1. – see paragraph 3.2 below.

[45]Regulation Article 12. For securities denominated in currencies other than euros, the equivalence of the denominations in euros has to be determined at the date of issue.

[46]Or, in the somewhat obscure language of Recital (14) to the Regulation, they "should be able to make their investment decision on other elements than those taken into consideration by retail investors".

[47]PD Article 8.1.

where the omission would not mislead investors) would be seriously detrimental to the issuer, or where the information is of minor importance only.[48] The competent authority can also dispense with disclosure requirements where the required disclosure is inappropriate to an issuer's sphere of activity or its legal form or to the securities to which the prospectus relates.[49]

2.5 Approval of a Prospectus

To be valid, a prospectus has to be approved.[50] Under the previous EEA regime, an issuer could choose the authority to approve its prospectus. If it liked, an issuer could list one issue on Luxembourg, another on London and a third on Paris – and the authorities in the place of listing were charged with approving the prospectus.

This is no longer so where the securities being offered to the public or admitted to the regulated markets are shares, certain types of equity-linked securities[51] or other securities with denominations below EUR 1,000. Under the PD, an issuer of such securities has to take its prospectus for approval to a single competent authority, known as the "home state" authority, even if it is not making a public offer or applying for admission in that State.

For European issuers, the home state authority is the competent authority in the state of registration of the issuer.[52] Non-EU issuers have a choice between the state where they first intended to offer such securities to the public after 31 December 2003 (the date on which the PD entered into force) and the state where they first applied for such securities to be admitted to a regulated market.[53]

For other types of security, there is a wider choice. An issuer can effectively choose where it wants to list and go to that competent authority for approval of its prospectus. But for some EU issuers, it may be relatively hard to see why they should go outside their state of registration (where they will often already have an approved prospectus or registration document thanks to their equity listing).

The PD sets out deadlines within which a decision on approval must be given by the home state competent authority,[54] although it does not require them to give approval within a given period – merely that they must respond. If they respond with questions, or requests for further information, the deadlines are set running afresh.

The PD also permits the home state competent authority to transfer the approval of a prospectus to another state's competent authority, by mutual agreement.[55] The Regulation goes further, saying that in the context of a base prospectus for a programme under which several entities may issue, but each has a different home

[48] PD Article 8.2.
[49] PD Article 8.3. Recital (24) of the Regulation appears also to give an issuer a right to omit information in such cases.
[50] PD Article 13.1.
[51] where the issuer of the underlying and the overlying securities are in the same group.
[52] PD Article 2.1(m)(i).
[53] PD Article 2.1(m)(iii).
[54] PD Article 13.2 to 13.4.
[55] PD Article 13.5.

state competent authority, the relevant authorities should cooperate and, where appropriate, transfer the approval of the prospectus to one of their number.[56] However, most EEA competent authorities are proving reluctant to exercise these rights of delegation.

2.6 Publication of a Prospectus

Before it can be used for a public offer or admission to a regulated market, a prospectus must be filed with the home state competent authority[57] and published.[58] Various methods of publication are permitted, including by insertion in a newspaper with wide circulation in the country where the public offer is made or admission is sought; by being made available in printed form at the offices of the issuer and the financial intermediaries placing the issue; in electronic form on the issuer's and placing bank's website; and in electronic form on the website of the home state competent authority or the relevant regulated market.[59]

In the United Kingdom, the most frequently used method of publication is the electronic news service of the London Stock Exchange.

2.7 Updating the Prospectus

If any significant new factor arises after a prospectus is approved and before the final closing of the public offer, or the admission to the regulated market, to which it relates, a supplement to the prospectus must be produced.[60] The supplement is subject to the same approval and publication requirements as the prospectus.

Investors who have already agreed to purchase or subscribe securities before the supplement is produced have the right during a period of not less than two working days to withdraw their acceptance.[61]

2.8 Use of the Prospectus Outside the Home State – the Passport

Perhaps one of the most important aspect of the PD is its simplification of the procedures that permit the use of a prospectus that is approved in one country (the "home state") for a public offer or admission to a regulated market in another country (the "host state").

The PD provides that a prospectus that is approved by the home state competent authority is valid for a public offer or admission to a regulated market in any other EEA state, provided it has been notified in accordance with the PD.[62] Competent authorities in host states cannot themselves undertake any approval or administrative procedures relating to the prospectus.[63]

To obtain a passport for a prospectus, the issuer must request its issue by the home state competent authority. Within 3 working days, that authority must provide the competent authority of the host state with

[56]Regulation Recital (27).
[57]PD Article 14.1.
[58]PD Articles 3.1 and 3.3.
[59]PD Article 14.2.
[60]PD Article 16.1.
[61]PD Article 16.2.
[62]PD Article 17.1.
[63]PD Article 17.1, final sentence.

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a certificate of approval attesting that the prospectus has been drawn up in accordance with the PD and setting out any derogations it may have permitted from the disclosure requirements under the Regulation.[64] The certificate must be accompanied by a copy of the prospectus.

2.9 Documents Equivalent to a Prospectus

The PD contains powers for the home state competent authority to accept certain disclosure documents of non-EEA issuers as being equivalent to a PD prospectus.[65] Such equivalent documents must have been drawn up in accordance with international standards set by international securities commission organisations (such as IOSCO) and the information in the documents must be equivalent to the requirements of the PD and the Regulation.

Once accepted as equivalent, such documents can make use of the passporting arrangements as if they were a prospectus.[66]

2.10 Pre-Marketing

2.10.1 Advertisements

In addition to requiring the production of a prospectus when securities are offered to the public or admitted to regulated markets, the PD also contains provisions that regulate the content of advertisements relating to securities. For this purpose, "advertisement" is broadly defined as an announcement (a) relating to a specific offer to the public of securities or to an admission to trading on a regulated market; and (b) aiming specifically to promote the potential subscription or acquisition of securities.[67] No definition of "announcement" is given.

Article 34 of the Regulation sets out a non-exhaustive list of the means of communicating advertisements, including oral and written communications such as telephone calls, seminars and presentations, e-mail and standard letters.

Under Article 15 of the Directive advertisements must:

(a) state that a prospectus has been or will be published and indicate where investors are or will be able to obtain it;

(b) be clearly recognisable as such;

(c) not contain information that is inaccurate or misleading; and

(d) ensure that the information they contain is consistent with that which is (or will be) in the prospectus.

In this context it is important to remember what a prospectus is required to contain. Article 5 of the PD requires that the prospectus for an issue should contain all information which, according to the particular

[64] PD Article 18.1 and 18.2.
[65] PD Article 20.1.
[66] PD Article 20.2.
[67] Regulation Article 2(9).

nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and loss, and prospectus of the issuer and of any guarantor, and of the rights attaching to such securities.

It is important, therefore, that any pre-marketing materials that are circulated in the context of a new offering are consistent with the prospectus. In particular, such materials should not contain any information additional to that which is in the prospectus – unless such information is immaterial to investors. If significant additional information is circulated, the issuer may be open to attack on the basis that it did not fulfil its disclosure duties under Article 5 of the Directive.

The PD also requires that, even where *no* prospectus is required to be produced, material information provided by an issuer or offeror to qualified investors (professionals) or special categories of investors, including information disclosed in the context of meetings relating to offers of securities, must be disclosed to all such investors to whom the offer is addressed.[68] This means, for example, that all material information given out at road shows should be given to investors who do not attend the road show. If that information is material, it must also be included in the prospectus, if there is one. For these purposes also, the test of materiality is that set out in Article 5 of the Directive.

The Directive's advertising regime has been implemented in the UK through the FSA's Prospectus Rules. Prospectus Rule 3.3 copies out the provisions of the Directive and gives some additional guidance. PR 3.3.3G says that the advertisement should contain "a bold and prominent statement to the effect that it is not a prospectus but an advertisement and investors should not subscribe for any transferable securities referred to in the advertisement except on the basis of information in the prospectus".

Advertisements need not be approved or authorised by the FSA, so long as they comply with the content requirements referred to above. In the United Kingdom, breach of the rules may result in the imposition of a fine or public censure by the FSA.

The home Member State is given the power to "exercise control over the compliance of advertising activity, relating to a public offer of securities or an admission to trading on a regulated market".[69] In plain language, this means that the home competent authority might seek to check that advertisements for the issue are consistent with what is said in the prospectus and are not inaccurate or misleading, wherever those advertisements are issued. This could result in some Member States saying that advertising (including terms sheets and preliminary or pathfinder prospectuses) must be submitted to them for review before they are issued.

2.10.2 Financial Promotion

There is a somewhat inconvenient overlap in the United Kingdom between the PD advertising regime and the financial promotion regime under FSMA. Section 21 of FSMA prohibits the communication of an invitation

[68] PD Article 15.5.
[69] PD Article 15.6.

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or inducement to engage in an investment activity, except where the communication is by, or approved by, a person authorised by the FSA under the Act. "Engaging in an investment activity" is defined broadly to include a variety of activities in relation to securities, including dealing and arranging deals.[70]

In many international securities transactions, persons authorised by the FSA are reluctant to approve financial promotion materials produced by the issuer (such as a preliminary prospectus) because, by doing so, the render themselves subject to provisions contained in the FSA's Conduct of Business Rules. These include compliance checks to be carried out by the authorised person before approval and maintenance by it of records.[71] While most banks involved in securities offerings will carry out such checks for their own purposes, many wish to avoid taking on additional liability towards their regulator.

The financial promotion regime contains exemptions – notably in relation to promotion made to professional investors.[72]

III. On-going Disclosure Requirements for Regulated Market Issuers

3.1 Overview

Once admitted to an EU regulated market, an issuer has a number of continuing disclosure obligations. These are contained in the PD, the TD[73] and MAD respectively.

3.2 The Prospectus Directive

As originally drafted, the PD required all issuers that were admitted to a regulated market to update their prospectus every year. After consultation with the market, this provision was modified, to require such issuers to provide a list every year of all information they have provided to the public, whether in the EEA or elsewhere, in accordance with laws and rules dealing with the regulation of securities, issuers of securities and securities markets.[74]

Essentially, this list involves setting out a reference, usually only one line per item, indicating what has been filed with securities regulators and stock exchanges around the globe, and giving an indication of where that information can be found.

The list must be filed with the competent authority of the home state, after the publication of the issuer's financial statements.[75]

[70]FSMA section 21(8) and The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 Article 4

[71]See FSA Conduct of Business Rule 3.12.2.

[72]The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 Articles 19 and 49.

[73]The TD has not at the date of writing been implemented in Member States – it is only required to be so implemented from 20 January 2007. Until it is implemented, on-going disclosure obligations for issuers admitted to regulated markets will continue to be dictated by CARD.

[74]PD Article 10.1.

[75]PD Article 10.2.

3.3 The Market Abuse Directive

Issuers whose securities are admitted to EEA regulated markets must inform the public as soon as possible of inside information which directly concerns such issuers.[76] Information so disclosed must be included on the issuer's website for an appropriate period.[77]

"Inside information" is defined as information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.[78]

3.4 Transparency Directive

Under the TD, issuers of shares that are admitted to an EEA regulated market will have to produce and publish in the EEA an annual report, a six-monthly interim report and (during the first and third quarters) an interim report.[79]

Debt-only issuers will not have to produce quarterly reports.[80] Further, if they only have debt in denominations of at least EUR 50,000 admitted, they are exempt from the reporting regime altogether.[81]

States, regional and local authorities, public international bodies of which at least one EEA state is a member, the European Central Bank and EEA national Central Banks are also exempt from the TD reporting requirements.[82]

3.4.1 Annual, Semi-Annual and Quarterly Reports

The annual report must contain the audited financial statements, a management report and a responsibility statement.[83]

The six monthly report must contain condensed financial statements (unaudited) based on the requirements of IAS for interim financial reporting together with a report disclosing important events that have occurred during the first six months of the financial year and a responsibility statement.[84]

The interim statements between the annual and half year reports must either take the form of a quarterly financial report (if the issuer's national legislation requires one) or a narrative, explaining material events and transactions during the period, together with a general description of the financial position and performance of the issuer during the period.

[76] MAD Article 6.1.
[77] MAD Article 6.1, second paragraph.
[78] MAD Article 1.1.
[79] TD Articles 4.1, 5.1 and 6.1.
[80] TD Article 6.1 only relates to issuers whose *shares* are admitted to a regulated market.
[81] TD Article 8.1(b) – although some Member States, including the United Kingdom, may seek to require publication in the EEA of the annual report that such issuers prepare under their home jurisdiction's laws, as a super-equivalent measure.
[82] TD Article 8.1(a).
[83] TD Article 4.2.
[84] TD Article 5.2.

The **financial statements** must be prepared on the basis of International Financial Reporting Standards (IFRS) where the issuer is required to prepare its accounts on a consolidated basis. In other circumstances, the accounting standards required by the law of the member state in which the issuer is incorporated must be used.[85] The annual financial statements must be audited in accordance with EEA standards.[86]

The **narrative report** in the annual report must contain at least a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces. The review must be a balanced and comprehensive analysis of the development and performance of the company's business and of its position, consistent with the size and complexity of the business. To the extent necessary for an understanding of the company's development, performance or position, the analysis must include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters. The report must also give an indication of any important events that have occurred since the end of the financial year; and of the company's likely future development

The six-monthly report must disclose important events that have occurred during the first six months of the financial year and their impact on the financial statements, together with a forward looking description of the principal risks and uncertainties facing the company for the next six months.

The TD provides a mechanism for mutual recognition of non-EEA accounting and audit standards[87] although it is not yet known how this will be operated. The TD also contains various transitional arrangements for some non-EEA issuers that were already admitted to EEA regulated markets when the TD came into effect.[88]

The responsibility statement should be noted. This is the EU's answer to the US Sarbanes-Oxley Act. The company's management has to certify that the information is correct. Each Member State has to ensure that such persons are liable if it is not.[89]

3.4.2 Regulated Information

In addition to disclosing regular reports, all issuers whose securities are admitted to an EEA regulated market must disclose regulated information.[90] This is defined as all information which the issuer is required to disclose under the TD, under Article 6 of the MAD or under the laws, regulations or administrative provisions of a Member State, as adopted under the TD.[91] Although this provision is limited to information required to be disclosed under EEA laws and rules, Recital (27) makes it clear that the intention is that all EEA regulated

[85] TD Article 4.3 and 5.3.

[86] TD Article 4.4. The standards are set out in the Fourth Council Directive 78/660/EEC and Article 37 of Directive 83/349/EEC.

[87] TD Article 23.1.

[88] TD Article 30 provides that the home state may exempt issuers from the annual report requirements provided that (a) they have only issued debt securities, (b) those issues were all prior to 1 January 2005, (c) the issuer's GAAP gives a true and fair view (in the opinion of the home state), and (d) the Commission has not made a decision in relation to the equivalence (or absence of equivalence) of that GAAP. The home state may also exempt issuers from the half-yearly reporting requirements for a period of 10 years, provided that (a) they have only issued debt securities, (b) those issues were all prior to 1 January 2005, and (c) those securities were all listed under the wholesale regime under CARD.

[89] TD Article 7.

[90] TD Article 21.1.

[91] TD Article 2.1(k).

market issuers, whether they are EEA entities or not, should also make available to the EEA market whatever information is required to be published outside the EEA.

3.4.3 Publication

Regulated information (which includes the annual, semi-annual and quarterly reports) must be disclosed in a manner that ensures fast access to such information on a non-discriminatory basis, using such media as may reasonably be relied upon for the effective dissemination of the information to the public throughout the EEA.[92]

3.4.4 Nature of Reports

The TD makes it clear that the purpose of the reporting provisions described above is to inform investment decisions. For example, recital (1) states that "the disclosure of accurate, comprehensive and timely information about security issuers builds sustained investor confidence and allows an informed assessment of their business performance and assets." Recital (2) refers to the objective of ensuring "appropriate transparency towards investors through a regular flow of information." Recital (5) states that "greater harmonisation of provisions of national law on periodic and ongoing information requirements for security issuers should lead to a high level of investor protection throughout the Community." Recital (7) states that "a high level of investor protection throughout the Community would enable barriers to the admission or securities to regulated markets situated or operating within a Member State to be removed." Article 6 adds further weight to this by stating that the Commission will examine in future whether the transparency of reporting "meets the objective of allowing investors to make an informed assessment of the financial position of the issuer".

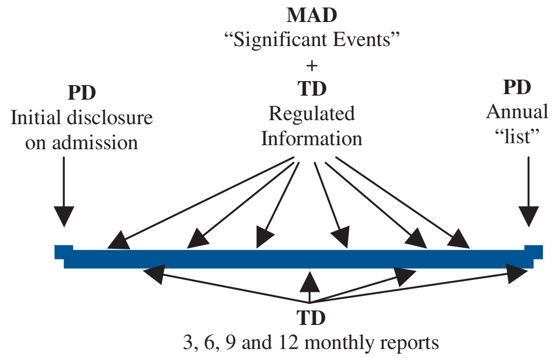
The TD requires Member States to ensure that responsibility for the information that it requires to be published lies at least with the issuer or its management and that national laws impose liability on such persons for breach of their obligations.[93]

[92] TD Article 21.1.
[93] TD Article 7.

IV. Summary of Disclosure Requirements

The following diagram summarises the disclosure requirements of the PD, MAD and TD that have been described above.

The EEA information regime



V. Some Problem Areas

5.1 Liability

There is little point in a disclosure regime unless the information disclosed is reliable, accurate and complete. To ensure that this is so, most disclosure regimes impose liability on those producing the information. The PD, MAD and TD are no exceptions to this general rule. However, there is no attempt in any of these Directives to harmonise EEA liability regimes. It is left to Member States to decide who should be liable and what the grounds for liability, and the penalty, should be.

The information regime under the TD has caused particular concern in the United Kingdom, in two respects. First, it will lead to an important change in the liability attaching to reports, such as annual reports, issued by companies that are admitted to regulated markets. Under this change, issuers and their directors will, for the first time, have liability to investors who lose money because the rely on any misstatements in such reports. Secondly, the fact that the TD requires that reports and regulated information be published using media that ensure pan-EEA distribution raises the possibility that, if the reports are wrong, the issuer and its officers may be subject to litigation in any (or indeed all) of the EEA jurisdictions.

5.1.1 Liability for Reports

The leading English case on liability for annual reports[94] establishes the position that, in the absence of special circumstances,[95] auditors do not owe a duty of care to individual shareholders, or to the general public, in respect of their investment decisions.

[94]*Caparo Industries plc v. Dickman* [1990] 1 All ER 568

[95]For example, if the company hands the report to a bank from which it has requested a loan, saying that the report will provide all the information the bank needs to decide whether to make the loan.

This decision was based, in part, on the conclusion that the purpose behind the statutory requirement to produce such reports was to provide shareholders with information to enable them to exercise their rights as shareholders – such as questioning management and voting at meetings. The purpose was not to enable shareholders (or others) to decide whether to retain their shares, or to acquire further shares.

The decision was also based on policy considerations, set out by Lord Bridge of Harwich, quoting a New Zealand case:[96]

> "It does not seem reasonable to attribute an assumption of responsibility unless the maker of the statement ought in all the circumstances, both in preparing himself for what he said and in saying it, to have directed his mind, and to have been able to direct his mind, to some particular and specific purpose for which he was aware that his advice or information would be relied on. In many situations that purpose will be obvious. But the annual accounts of a company can be relied on in all sorts of ways and for many purposes".

Lord Bridge went on to say:

> "I should in any event be extremely reluctant to hold that the question whether or not an auditor owes a duty of care to an investor buying shares in a public company depends on the degree of probability that the shares will prove attractive either en bloc to a take-over bidder or piecemeal to individual investors or to lend money to a company".

The *Caparo* decision has, however, a second limb that acknowledges that auditors *can* owe a duty of care to others for other purposes, such as banks proposing to lend money to a company, if they act in such a way as to allow those persons to rely on their skills and knowledge for that purpose. For example, if an auditor gave a copy of his report to an investor knowing that the investor was going to use it as a basis for his investment decision, that might be sufficient to extend the duty of care to the investor for this purpose.

Although these authorities deal with the liability of auditors in relation to the annual report, most people assume that, if the question ever arose, the principles would apply equally to the company issuing the report and its directors.

The provisions of the TD quoted in paragraph 3.4.4 fundamentally change the way in which the decision in *Caparo* applies in the context of annual reports. It is no longer possible to say that the statutory purpose of a company's reports is to enable shareholders to exercise their rights, when the TD says that it is to protect investors and inform their investment decisions. On the contrary, it is entirely possible to say, instead, that the issuer and its officers must know that the report will be relied upon by investors (because that is the purpose of it, according to the TD) and that, applying Caparo's second limb, they will be liable to investors when they do rely on it and lose money as a result.

[96] *Scott Group Ltd v McFarlane* [1978] 1 NZLR 553 at 566.

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The Companies Bill, currently being debated in Parliament, acknowledges this change, and attempts to reduce its impact on United Kingdom companies that are admitted to the regulated markets in the United Kingdom. The latest version of the provision that will be inserted in the Bill[97] essentially provides that an issuer of securities admitted to a regulated United Kingdom market is liable to compensate a person who acquires its securities and suffers a loss in respect of them as a result of any untrue or misleading statement in, or omission from, any of the information required by Articles 4, 5 or 6 of the TD. To obtain compensation, the claimant must show that he acquired the securities in reliance on the information in the report and that he did so at a time when, and in circumstances in which, it was reasonable for him to do so.

It goes on to say that the issuer is only so liable if a "person discharging managerial responsibilities within the issuer in relation to the publication" knew the statement was untrue or misleading, or was reckless as to whether it was, or knew the omission to be a dishonest concealment.

The Bill also negates any other liability the issuer might otherwise owe to anyone else in respect of such losses. In other words, liability for negligent misstatement is (among other heads of liability) excluded. However, certain rights of the FSA to take action in such a situation are preserved.

The Bill contains[98] back-to-back arrangements that allow the issuer to obtain compensation from a director of the company for any amounts it pays out to investors as a result of any untrue or misleading statement in, or omission from, the directors' report. Again, the rights of all other persons to sue are abrogated.

These provisions are in many ways helpful, in that they make it clear to companies what their responsibilities are; and they give a degree of comfort and protection to those who prepare and produce annual and other reports, by establishing a relatively high burden of proof. But the change in the United Kingdom liability regime for reports may result in significant changes in the ways in which they are written, involving more due diligence and thus higher costs and (perhaps) a more cautious approach to disclosure, leading to issuers being less forthcoming in their reports. The Chairman or Directors may, when they write "Dear Potential Investors" rather than "Dear Shareholder" at the start of their reports pause for rather longer before putting a more cautious pen to paper. It is entirely possible that the same procedures as are applied in the production of a prospectus for a new issue will be adopted for the production of annual, semi-annual and even quarterly reports.

There is, at the time of writing, an on-going debate as to the desirable scope of this statutory regime. There are arguments that support the extension of the regime to other disclosures made by issuers whose securities are admitted to regulated markets – such as the *ad hoc* disclosure of inside information under Article 6 of MAD, disclosures mandated by the UK Listing Authority's rules and perhaps even voluntary disclosures made by issuers to foster good investor relations. These arguments include the fact that these disclosures (apart from voluntary disclosures) are themselves made subject to the TD regime, because they are caught by the TD definition of "regulated information",[99] and are therefore subject to the same provisions of that Directive as necessitated the proposed statutory regime for annual and other reports. There is also an argument that the

[97]See the proposed text for Clause 1234 attached to HM Treasury's consultation paper of 9 August 2006 entitled "Extending the scope of the statutory damages regime for disclosures required under the Transparency Directive".
[98]Clause 447.
[99]TD Article 2.1(k).

information that is disclosed under the MAD and the listing rule regimes will very often be repeated in the annual or semi-annual report. For example, a fire at a company's main production facility may trigger disclosure under the MAD regime (because it could significantly affect the market price of the company's shares); and it may also trigger disclosure in the next annual or semi-annual report, because the management report will be required to describe "important" events that occurred during the period covered by the report. If the consequences of the fire are under-estimated in both the MAD disclosure and the report, the result would be anomalous. The investor who bought having read the MAD disclosure may have a right to sue under the common law tort of negligent misstatement (where the threshold of proof would be reasonable care); while the investor who bought having read the semi-annual report would have a right to sue only under the statutory regime, with the higher threshold of proof of knowledge or recklessness. However, some investors are less happy about any extension of the statutory regime – not least because they are unhappy with the statutory threshold of liability.

Commentators have also noted that the proposed statutory provision only provides for compensation where an investor *acquires* securities, while it is equally possible that an investor will *dispose* of securities and suffer loss – for example, if the information is misleading because it is over-negative. The fact that *existing securityholders* are not given statutory rights to compensation has also caused comment. There is no reason why a shareholder who disposes of his shares at a loss as a result of misleadingly negative information should not have the same right to compensation as a new investor who acquires securities as a result of misleadingly positive information. It is more difficult, however, to see how securityholders who remain passive in the face of misleading information would be treated. By continuing to hold their securities, they may suffer loss if the issuer publishes misleading information. But it may be undesirable to extend the scope of the statutory provision to them, because of the evidentiary difficulties in proving a negative – that they would have sold, had they known the truth.

5.1.2 Pan-EEA Liability

The jurisdictional scope of liability within the EEA has also given grounds for concern. Article 21.1 of the TD requires Member States to ensure that regulated information is disseminated using such media "as may reasonably be relied upon for the effective dissemination of information to the public *throughout the Community*" (emphasis added). This requirement contrasts with the previous reporting regime, which only required issuers admitted to an EEA regulated market to publish their reports in the country of that regulated market.

The purpose of the pan-EEA publication requirement is explained in Recital (25) to the TD, which says that "investors who are not situated in the issuer's home Member State should be put on an equal footing [to those that are] when seeking access to such information". In other words, the purpose is to ensure that all investors throughout the EEA have an equal opportunity to profit from the information that is disseminated by issuers admitted to regulated markets. In itself, this objective is laudable.

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However, publication of information in any jurisdiction can trigger liability there. Whether it does so or not is, of course, a question of the law of that jurisdiction. But most EEA jurisdictions have within their laws of tort the concept of negligent misstatement, making those responsible for statements liable to those to whom they hold them out if they turn out to be wrong. Indeed, the main provision of a new conflicts provision[100] put forward by the European Commission makes it clear that the proper law for claims in tort (such as negligent misstatement) is that of the country in which the damage was suffered.[101] In the context of publication of TD regulated information, this would result in investors being able to sue under the law of the country in which they read and relied on the information.

In other words, if any regulated information turns out to be incorrect (or, perhaps worse, is alleged to be so) the issuer and perhaps its officers could potentially be sued in every EEA State, under local laws in each such State; and, because it *must* publish its regulated information in every EEA State, it cannot avoid liability by omitting publication in any jurisdiction.

This will no doubt, in time, produce anomalous and undesirable results. For example, the cost of multiple litigation will add to the cost of capital – initially only for those that suffer it; but eventually, through insurance costs and increased due diligence, for the whole market. Some investors may seek to invest from those jurisdictions that are seen to have liability regimes most favourable to them. This in turn may lead to the curious result that a company may be liable in an obscure EEA country when it is *not* liable in its State of incorporation. If litigation in this context becomes a real threat, issuers may become more and more cautious about what they say to the market, so that less useful information is provided to investors; and, in saying what they do say, they will increasingly resort to lawyers and accountants to check the information before publication, with the result its dissemination will be less timely and its content more defensive.

5.2 Offers to Non-Exempt Persons

5.2.1 Removal of Exemptions

Unlike the PD, the previous EEA public offer regime[102] provided four important exemptions from the requirement for a prospectus, on which the markets in some Member States relied heavily to facilitate offers to retail investors. The first was an exemption for securities that were admitted to listing on a stock exchange in the State of the retail investors.[103] The second was an exemption for offers to "a restricted circle of persons",[104] which, as interpreted in some States, permitted some financial intermediaries such as banks to offer securities to all of their customers without prior publication of a prospectus. The third was a statement

[100]The Commission's Proposal for a Regulation of the European Parliament and Council on the Law Applicable to Non-Contractual Obligations ("Rome II").[101]Rome II Article 3.

[102]Council Directive 89/298/EEC (the "89 Directive").

[103]89 Directive Article 1.1.

[104]89 Directive Article 2.1(b).

that a prospectus was only required when securities were offered to the public *for the first time*,[105] which made it clear that a second public offer of securities did not require a prospectus. The fourth was an exemption for "eurosecurities", which were not the subject of a generalised campaign of advertising or canvassing.[106]

These exemptions no longer exist under the PD.[107] Consequently:

- an offer of securities that are admitted to a regulated market (and have been, perhaps, for years) will have to be made within an exemption or after publication of a prospectus by the person making the offer;
- it is no longer possible[108] to achieve retail distribution of a new issue by selling to a financial intermediary on an exempt basis, who then on-sells to its customers, also on an exempt basis.[109]

These changes will lead to significant changes in the ways in which securities are offered to non-exempt persons and may, in some cases, make it unattractive for financial intermediaries to continue offering certain types of securities to such investors.

5.2.2 Wider Meaning of "Public Offer"

There is a further important difference between the old and new public offer regimes, in relation to the definition of "offer to the public". As has been seen (paragraph 2.2.1), the definition in the PD is extremely broad and catches not just contractual offers, but communications to persons in any form presenting sufficient information on the terms of the offer to enable an investor to decide to purchase or subscribe the securities.

The practical effect of this change is to introduce greater uncertainty into the law of certain countries. For example, in the United Kingdom, the previous prospectus regime only applied to offers capable of acceptance to form a contract or invitations to a person to make such an offer.[110] Under the new definition, a communication containing the terms of an offer that was purely for information purposes was not necessarily caught. Under the new definition, it might well be.

Indeed, the definition is so wide that the United Kingdom, in implementing the PD, provided an exemption[111] from the requirement for the production of a prospectus for those posting bid prices on the stock exchange. The necessary implication is that, but for this provision, posting prices on the exchange *would* require the prior publication of a prospectus by the person doing it. Fortunately the draftsman realised in time that such a requirement would lead to the closure of the exchanges in the United Kingdom.

[105] 89 Directive Article 1.1.

[106] 89 Directive Article 2.2(l). "Eurosecurities" were defined as transferable securities which were underwritten and distributed by a syndicate from at least two Member States; were offered on a significant scale in a Member State other than that of the issuer; and could be subscribed or initially acquired only through a credit or other financial institution (89 Directive Article 3(f)).

[107] Although it appears that implementing legislation in at least one EEA Member State has preserved a form of the first exemption.

[108] This is an instance of where the situation may be different in other countries. For example, in Germany, the definition of public offer only applies where there is an offer to the public (*publikum*), so that it is possible to argue that targeted communications to named individuals are outside the definition, even if they exceed the 99 persons allowed by the PD exemption.

[109] Unless the financial intermediary relies on the PD exemption in Article 3.2 and only offers to fewer than 100 non-exempt persons; and even then, the person offering to the financial intermediary will have to ensure that the number of non-exempt persons receiving offers from all of the financial intermediaries to whom it offers amount to fewer than 100 non-exempt persons per Member State in total – see the anti-avoidance provision in PD Article 3.2.

[110] Public Offers of Securities Regulations 1995 Regulation 5.

[111] FSMA section 102B(5).

5.2.3 Prospectus Disclosure for Non-Exempt Offers

The PD has also introduced a degree of confusion as to how a prospectus can be written so as to comply with the Regulation for certain types of non-exempt offer.

As noted in paragraph 2.2.1, the definition of "offer to the public" in PD Article 2.1(d) is very broad. There has to be:

- a communication to any person;
- containing sufficient information on the terms of the offer and the securities to be offered;
- to enable an investor to decide to purchase or subscribe the securities.

An "offeror" is defined as a person who makes such a communication.[112] Each such communication is regarded as being a separate offer[113] and (unless it is made within an exemption) has to be the subject of an approved and published prospectus.[114] That prospectus has to comply with the Regulation;[115] and the Regulation makes it clear that the required information includes a description of the offer to which the prospectus relates.[116]

Essentially, therefore, there has to be a prospectus for every separate offer (although clearly one prospectus can cover several offers, if it says that it does and contains the required information on those offers).

To put this into a practical context, where the issuer offers to Bank A, as manager of a new issue, and Bank A offers to Private Bank B, who in turn makes a number of non-exempt offers, there will be at least three levels of offers and three different offerors. To comply with the PD and the Regulation, it would seem that each of these must be described in a prospectus (unless an exemption applies).

Given this requirement, those planning the offer can, in theory, either prepare the prospectus so that it covers all of the offers contemplated through the chain of distributors; or they can prepare it for offers by only some of those in the chain (say, only their own offer to Bank A) and can leave others in the chain to produce their own prospectus to cover their offers. The latter approach is unlikely to work well – partly because (presumably) the issuer *wants* the non-exempt offers to go ahead (after all, the better pricing it achieves is dependent on such offers being made) and Private Bank B is not going to be enthusiastic if it has to prepare its own prospectus; and partly because (thanks to the final sentence of PD Article 3.2) the issuer and Bank A may be placing the securities through Private Bank B, and therefore implicated in its non-exempt offers, whether the prospectus is expressed to apply to those offers or not.

[112] PD Article 2.1(I).

[113] PD Article 3.2, penultimate sentence.

[114] PD Article 3.1.

[115] PD Article 7.1.

[116] See, for example Regulation Annex V paragraph 5.1. At first sight, PD Article 9 seems to contradict this, by providing that a prospectus shall be valid for 12 months after its publication for offers to the public or admissions to trading on a regulated market. However, this provision is almost certainly not saying that anyone can make a public offer using the Issuer's prospectus. Rather, it is saying that the Issuer can continue to use its own prospectus to make further issues, provided it updates it with a supplement (e.g. with details of its new offer); but that it must produce a new prospectus after 12 months. In other words, this is more of a limiting provision, preventing the use of the same prospectus for a period of some years. It does not avoid, or override, the disclosure requirements set out in the Regulation.

Accordingly, the most likely conclusion that the issuer and the lead manager will reach is that there should be a prospectus for the issue that covers the non-exempt offers.

The problem, however, is that the Regulation appears to require detailed disclosure in relation to all of the offers in the distribution chain. For example, information is required on:

- The conditions to which the offer is subject;
- The total amount of the issue/offer;
- The time period during which the offer will be open and description of the application process;
- A description of the possibility of reduction of subscriptions;
- Details of the minimum and/or maximum amount of applications;
- The method and time limits for paying up the securities and for delivery of the securities;
- The procedures for the exercise of any pre-emption rights, the negotiability of subscription rights and the treatment of subscription rights not exercised.[117]

It appears that this information has been developed in the context of placings through intermediaries of equity securities. The assumption seems to be that there will be a general offer, inviting the public at large to tear off an application form and send it in. Some debt offerings to retail investors will, indeed, be made on this basis; but many will not.

In many cases, debt securities will be offered to non-exempt persons under the PD by a group of intermediaries, not by the issuer itself. These intermediaries buy the securities from the issuer and then make their own offers to the non-exempt investors. They will need time to contact their non-exempt clients; and their non-exempt clients will need time to gather together their savings to take up offers of securities. As a result, there will be numerous offers by the intermediaries over a prolonged period which may extend to a number of weeks, both before and after the date on which the securities are issued and the proceeds are paid to the issuer. During that period, the price of the debt securities in the grey market will fluctuate in accordance with market conditions (which will include both supply and demand factors and general perceptions as to future movements in interest rates) and the price at which the intermediaries offer the securities to their customers will fluctuate, sometimes many times a day, in line with these secondary market prices.

In the context of this type of offering, it is difficult to see how those writing the prospectus can easily comply with the provisions of the Regulation referred to above. For example, they will not know all of the offer prices at the time the prospectus is produced; and, even if they did, there will be very numerous different prices over

[117] Regulation Annex V Paragraph 5.1.

the initial offer period, as the intermediaries sell to their customers, and it is difficult to see what purpose would be served by inserting pages of such different prices in the prospectus.

5.2.4 Duration of Offer Periods

A further difference between the old and new public offer regimes relates to the duration of the offer period. Under the previous regime, an issuer's obligation to keep the prospectus up to date terminated once the issue was listed (which usually occurred on the day after the issue of the securities).[118] This is no longer so. The obligation to produce a supplement continues for as long as offers to which the prospectus relates are open.[119]

There will be a tension between issuers (who will want the period during which they have to update the prospectus to be as short as possible); and those persons who are permitted by the issuer to make offers under the prospectus (who will want the offer period to be long enough to enable them to sell all of the securities they have bought). This will be a commercial matter for negotiation at the outset of each transaction. But it is very likely that issuers will want the prospectus to specify the duration of the offer periods of those distributing the securities, to crystallise the date on which their update obligations cease.

5.2.5 Contractual Control of Distribution Chain

In certain cases, issuers may have an additional concern – to ensure that those people who are authorised in the prospectus to use it for the purpose of making non-exempt offers are bound by contractual restrictions. Reasons for imposing such restrictions will vary, depending on the type of securities being offered, but they may be based on a desire to protect the issuer against attack by regulators for having caused others to do something which it should not have done itself. So, for example, if the securities to which the prospectus relates are highly structured and carry significant risks,[120] the issuer (being a bank) may be subject to conduct of business rules that require it to take a view as to the suitability of these securities as an investment by certain categories of investors. It will not wish to be attacked by regulators if those securities are missold to investors outside this group by people authorised by it to make offers of securities under the prospectus.

In such cases, the issuer may wish to control the actions of its distributors by imposing contractual restrictions on them.[121]

5.3 Operation of Programmes

Another area where the PD is causing some confusion in the market is in the context Programmes that permit the issue of securities on a repetitive basis. The problem here is that there appears to be a different understanding among different competent authorities and different market participants as to what can, and what cannot, be included in final terms.

[118]This was because the public offer prospectus regime under the 89 Directive did not apply to listed securities (see Article 1.1 of the 89 Directive).

[119]PD Article 16.1.

[120]In relation to more ordinary securities, such as straightforward fixed or floating rate notes for investment grade Issuers, a view may be taken that the securities are suitable for any investor, given the risk warnings and other contents of the prospectus. In such cases, no further contractual control of those in the identified distribution chain may be required.

[121]For example, requiring them only to sell within a particular jurisdiction rather than in every country to which the prospectus has been passported; or prohibiting sales to certain categories of investors, such as individuals below a certain net worth.

As has been seen, the PD permits frequent issuers of non-equity securities to prepare a base prospectus, containing the required disclosure on the issuer and as much as possible of the required disclosure relating to the securities to be issued under the offering programme. This information is completed at the time of an issue under the programme by final terms.

As final terms are not technically part of the prospectus, they do not require the prior approval of a competent authority before they can be used in the context of an offer of securities. They cannot, however, contain *any* information; only information that is deemed not to require approval of the competent authority can be included. If other information is included, the document will be turned into a supplemental prospectus which does need to be approved, if it is used in connection with admission to a regulated market or a public offer in the EU. Failure to obtain such approval will result in the commission of an illegal act.

The problem is that there is no clear line between what can and what cannot be included in final terms. The PD states that "the information given in the base prospectus shall be supplemented, if necessary, in accordance with Article 16, with updated information on the issuer and on the securities to be offered to the public or to be admitted to trading on a regulated market".[122] This clearly indicates that there will be some information required in relation to the securities being issued that is so significant that it needs to be included in a supplemental prospectus, rather than final terms (and thus subject to scrutiny and approval by the home state competent authority).

Article 16 gives some indication of when information has to be included in a supplemental prospectus rather than final terms. It states that "every significant new factor… relating to the information included in the prospectus which is capable of affecting the assessment of the securities and which arises or is noted between the time when the prospectus is approved and the final closing of the offer to the public or, as the case may be, the time when trading on a regulated market begins, shall be mentioned in a supplement to the prospectus".[123]

In order to trigger a requirement for a supplemental prospectus, the information has to be "new". As the purpose of a prospectus is to inform the users of the regulated market to which the securities are being admitted (rather than the initial subscribers for the securities), an item will be "new" if it is not contained in the base prospectus.[124]

In addition to being "new", the information has to be "significant" before a supplemental prospectus is required. There is no definition of "significant" in this context; but it is likely that it should be read in conjunction with Article 5 of the PD, which says that "the prospectus shall contain all information which, according to the particular nature of the issuer and of the securities…, is necessary to enable investors to make an informed assessment of… the rights attaching to such securities".[125]

[122]PD Article 5.4.

[123]PD Article 16.1.

[124]The Directive clearly implies this, for example, in Recital (18) when it says that the provision of full information promotes the "protection of investors" – (not the "initial" investors) – and contributes to the "proper functioning of the markets" – (which, given that the regulated markets are platforms for trading securities, implies a concern for investors trading in the market, not just initial investors). In addition, Recital (19), says that "safeguards for the protection of the interests of actual and potential investors are required… to enable them to make an informed assessment… and thus take investment risks in full knowledge of the facts".

[125]PD Article 5.1.

It must be the case that final terms can be used to fill in certain "blanks" in the base prospectus – for example, the issue price and coupon. It must also be capable of being used to indicate which of the alternative terms set out in the base prospectus is to apply to the issue in question (for example, fixed rate rather than floating). But there remains a question as to how wide those blanks can be and how much filling in there can be. This is a question of judgement. Ultimately the judgement that counts is that of the relevant competent authority, because the consequence of using a document that purports to be final terms but is, in the eyes of the competent authority, an unapproved supplemental prospectus is (at least in the United Kingdom) that the person so using it, and its advisers, will have committed an illegal act.[126]

5.3.1 The Competent Authority Dimension

Competent authorities are proving reluctant to give guidance on what is, and what is not, capable of being included in final terms. Perhaps this is inevitable, given the fact-specific nature of the question, to which it is impossible to give a generic answer that will always be valid. Too much depends on the nature of the specific information that is to be included.

It is becoming clear, however, that different EEA competent authorities take different approaches. Some competent authorities have said informally that they do not expect any change to market practice that existed prior to 1 July 2005. This would permit a reasonably liberal approach to filling in the blanks in final terms – for example, reasonably complex redemption formulae with definitions of the algebraic terms used would be possible.

The difficulty, though, with this liberal approach is its uncertainty. There have been instances where a competent authority has looked at the equivalent of a final terms document and required that it be re-presented as a supplement, for their approval. This raises the question of what would have happened if they had *not* looked at those documents – (under the previous legislation, they were not required to, just as, under the new legislation, they are not required to look at final terms). In that situation, a document would have been used to sell securities that should have, but had not, been approved.

This may lead some issuers and financial intermediaries to adopt a reasonably conservative approach to filling in the blanks. If in doubt, they may say, prepare a supplement. Others, however, may take a more robust approach, and use final terms for relatively complex securities, where lengthy amendments to the terms and conditions contained in the base prospectus have to be made through the final terms at the time of drawdown.

This approach may work well, provided it falls within practices allowed by the competent authority of the home state and those of the state in which the final terms are used to sell securities (although, as mentioned above, it will be difficult to establish such practices with any precision). However, when sales of securities are made in other countries, the practices and interpretations of the home state competent authority will be irrelevant. All that will count in this situation is the law in the country where the document is used. If under that law the document constitutes a supplemental prospectus, then that is what it will be, regardless of the fact that in the home state it is final terms. This is because there is no passporting of final terms under the

[126]Financial Services and Markets Act 2000 section 86(3).

Directive. The host state will look to see whether the document was approved as a supplemental prospectus in the home state; and whether it had been passported to the host state as such. If there was no such approval and passporting, the use of the document will have breached the law in the host state.

This cross-border problem may result in even those who take a more liberal approach to final terms in their home state being more conservative in cross-border transactions.

5.4 Operation of the Passport

So far as the prospectus goes, and its contents, the home state's decisions are final. They cannot be attacked or reopened by the host state when the prospectus is passported to it. But the Directive does not expressly prevent the host state from imposing additional requirements beyond what goes in the prospectus – and many states have done just that.

So, for example, some states have required that, before a public offer to retail investors can be made in their jurisdiction, a notice confirming that a prospectus is available and stating where it may be obtained must be published in the local press. From a consumer protection viewpoint, this is perhaps understandable – retail investors should be able to obtain the prospectus before being invited to buy the securities. But from the perspective of someone trying to ensure that retail offers in several countries are made simultaneously, it is a nuisance. In some countries, the required journal is not published daily; and accordingly the offers in different jurisdictions either have to proceed on different timetables; or they have to proceed at the speed of the slowest jurisdiction.

Other examples of impediments to cross border transactions include the requirement imposed by one state for the issuer to translate its Articles of Association into the local language before a public offer can be made; and the insistence of some competent authorities that all marketing materials be pre-approved by them, as host state, before they can be used in a retail offer. None of this helps to create a seamless pan-EEA retail market.

In addition to these complications, it should be understood that the PD only deals with the requirement to produce a prospectus before making a public offer or obtaining admission to an EEA regulated market. However, if securities are offered in a particular country the offeror must, in addition to producing a prospectus, observe the full panoply of laws that regulate that activity, which may include authorisation requirements, financial promotion regimes, conduct of business rules and consumer protection laws. None of these are harmonised in the EEA.

5.5 Denominations

It will clearly be important for some issuers to ensure that denominations are at or above EUR 50,000. The availability of the somewhat easier wholesale disclosure regime for the prospectus depends on this,[127] as will the exemption from the on-going reporting requirements under the TD.[128]

[127] Regulation Article 12.
[128] TD Article 8.1(b).

Canada Steps Up
Canada Steps Up
Canada Steps Up

It is easy enough to achieve the required denomination when an issue is in definitive form – simply insert a condition into the bond saying so. But most issues in the euromarkets are produced in global form and are held through clearing systems. In these cases it is uncertain whether simply limiting denominations in the terms of the bonds is sufficient to obtain the necessary PD and TD exemptions. The market is assuming, for the avoidance of any doubt, that in such cases it is necessary to go further and limit trading amounts in the clearing system to a minimum of EUR 50,000.

Many issuers have been doing this. But there are practical difficulties. For example, while the more important clearing systems can limit minimum trades in this way, they cannot prevent a participant from selling securities so as to leave a rump of less than EUR 50,000 in its account (for example, by transferring EUR 100,000 of a total holding of EUR 147,000). What is to be done with those holding such rumps? Are they to be prevented from transferring them? Most would say so. Are they to be disenfranchised and deprived of the right to receive payments in respect of the rump? Most would say not.

The point is, however, that the EU legislation does not contemplate this situation, very common though it is; and the market is having to improvise a solution in order to preserve for issuers some very important exemptions.

5.6 Equivalence

The EEA disclosure regime relies very heavily on information provided by the issuers admitted to the regulated markets being made on a roughly equivalent basis. The aim is to facilitate investment decisions of investors dealing in those markets by enabling them to compare like with like.

The problem is that, whereas EEA issuers are increasingly being forced to produce information on a common basis,[129] non-EEA issuers have to comply with their very different domestic disclosure regimes and are very unwilling to suffer a dual-compliance burden as the price for admission to the EEA's regulated markets. This difficulty is presented in its most acute form in relation to audit and accounting standards. CESR has carried out a comparison of the accounting standards of Canada, Japan and the United States of America[130] and has found that there is broad equivalence between these standards and IFRS, but recommends certain "remedies" to be adopted in relation to some areas of the accounts. According to some accountants, these remedies would require substantial work to be undertaken by the issuer and its accountants, at significant cost.

The EU Commission has announced that it will propose a Council decision, under which the requirement for issuers reporting under the TD to use accounting standards that are equivalent to IFRS will be postponed until the financial year beginning on 1 January 2009,[131] subject to certain conditions. This postponement is in expectation that some countries (particularly the USA) will in the intervening two years move closer towards convergence with IFRS, thus enabling the Commission to treat their financial reports as fully equivalent to IFRS without further costly disclosures.

[129] See, for example, Regulation (EC) No 1606/2002, which imposes international financial reporting standards on all EEA companies that prepare accounts on a consolidated basis and that are admitted to EEA regulated markets.

[130] CESR – "Technical advice on equivalence of certain third country GAAP and International Financial Reporting Standards" 5 July 2005.

[131] http://ec.europa.eu/internal_market/securities/docs/transparency/td_decision_rev1_en.pdf

5.7 Uncertainty of Home State Choice

Finally, to be valid, a prospectus has to be approved by the home state competent authority. If the offer involves equity or any other securities with a denomination below EUR 1,000 or its near equivalent in another currency, issuers have *no choice* as to which competent authority approves their prospectuses.

Non-EEA issuers that were admitted to the EEA regulated markets on 1 July 2005 were required to choose a "home" state by 31 December 2005. Their choice was restricted to the state in which they made their first public offer after 31 December 2003; and the state in which they first listed their securities in the EEA.

At first sight, this appears clear enough, perhaps. There is confusion, though, over what "public offer" means for this purpose – does it have the meaning set out in the *pre-Directive* law; or does the definition used in the Directive apply? And what if an issuer had several listings made simultaneously in different EEA countries? And does one have to count listings made before the Directive came into effect (say, a listing made in 1920)? The answer to the home state question will vary depending on the answer to these questions.

The Commission has issued some helpful notes on this subject clarifying some elements in this unhappy provision.[132] But it is not helpful (although it is entirely understandable) that the notes are headed by a paragraph in italics saying that the views expressed in it are not binding, because only the European Court can give binding interpretations of EC legislation; and that the Commission reserves the right to take another view in any future judicial proceedings.

Non-EEA issuers deserve greater certainty than this, particularly given the fact that getting the choice wrong opens them to liability – and perhaps even criminal proceedings.

VI. Conclusion

The European initiatives described in this paper have made significant changes to the ways in which securities are offered to the public and admitted to securities markets in Europe. As with any initiative that is designed to bring together disparate national laws and regulations, there are compromises, many of which are significant and some of which are inelegant or even damaging. A number of these have been illustrated in the foregoing pages. It is to be hoped that these problem areas will be resolved as the new regime settles down and that the promise of a true pan-EEA securities market, where one offering document in a single language has universal acceptance within European jurisdictions, will become a reality. The European regulators and the European Commission itself will have a very important role to play in helping to achieve this important result.

[132] http://ec.europa.eu/internal_market/securities/docs/prospectus/art-30-1_en.pdf