UK prospectus reform: FCA engages on a streamlined approach

In the latest step in the bid to reform UK capital markets, the UK Financial Conduct Authority (FCA) has published a series of engagement papers regarding reform of the prospectus regime aimed at generating discussion with market participants. The FCA has requested comments by 29 September 2023. The engagement papers cover the following topics:

- admission to trading on a regulated market
- further issuances of equity on regulated markets
- protected forward-looking statements
- non-equity securities

We expect further papers to be published on multi-lateral trading facilities such as AIM and the new public offers platforms regime and understand that there will be initial FCA feedback in autumn 2023 with a formal consultation paper published in early 2024. It is likely that the final rules will not come into force until 2025.

This note covers the impact on the prospectus regime for commercial companies with equity shares only.

Key points

Prospectus content

The FCA states that it intends to retain the majority of the current content requirements, bearing in mind that these are accepted on the global markets. In terms of areas for improvement, it notes that there have been criticisms of the current summary requirement (although perhaps more in relation to debt prospectuses) and suggests that either the summary could be deleted or the requirements be less prescriptive.

The FCA is assuming that the current financial information requirements should be retained (including in relation to complex financial histories where companies have made significant acquisitions or disposals) but does also suggest including quarterly information in prospectuses. This is perhaps surprising given that the EU abolished mandatory quarterly reporting in 2013 because of the view that it led to a short term approach from investors.

In addition, the FCA acknowledges that there may be arguments to make regarding changing the financial information requirements following the proposed deletion of the current three year financial information eligibility requirement for the proposed new listing segment for equity shares in commercial companies (ESCC). Although this statement is somewhat ambiguous, it is possible that the FCA may be open to reducing the historical financial information requirement for prospectuses from three years to two years. Either way, none of this will cut across the ability for an issuer with a shorter (or no) financial history from listing on the ESCC category; an issuer will only be required to satisfy these requirements to the extent that it has been in existence for the requisite amount of time.

The FCA is also considering whether more specific disclosure requirements are needed in relation to ESG. The only specific requirements currently are around disclosure of governance

structures and a requirement to describe environmental issues that may affect an issuer's utilisation of its tangible assets as the current regime was perhaps drafted when ESG concerns were not so high up the agenda for investors.

Given that the FCA is now requiring more ESG disclosure in annual reports (i.e., TCFD and diversity statistics), it therefore suggests that it may make sense to align the prospectus regime to other ESG disclosure obligations an issuer has once listed. It also suggests that certain ESG disclosure aspects could be included within the category of protected forward looking statements (see below) in order to encourage disclosure.

ESG disclosure has no doubt been brought more into the spotlight following ClientEarth's attempted (but unsuccessful) judicial review against the FCA on the basis that a prospectus should not have been approved as it contained inadequate risk disclosure in relation to certain environmental matters.

Takeovers

The FCA's intention is to retain an exception from the requirement to produce a prospectus for takeovers similar to the current exception which requires a prospectus equivalent document. It does, however, ask a number of questions around the form and content of any documentation required, including whether it would be helpful if the documentation more closely aligned with that required by the Takeover Code and whether FCA approval should be required. There is helpful clarification that the takeovers exception will also apply to schemes of arrangement as well as contractual offers.

Notwithstanding the above, the FCA does confirm (unsurprisingly) that a prospectus will be required for a readmission by a listed company following a reverse takeover. Any other approach could create a back-door route to listing without the need for a prospectus.

Secondary offers

The FCA's assumption is that prospectuses should not be required for the admission of further shares after IPO unless there is a need to protect investors.

Options for streamlining the current regime for secondary offers are:

- setting a higher percentage threshold of existing issued share capital as a requirement for when a prospectus should be published. Currently the threshold is 20 per cent., the Secondary Capital Raising Review (SCRR) suggested 75 per cent., whilst the EU is currently proposing 40 per cent. The FCA does not offer its view on what the threshold should be
- considering whether a simplified prospectus only or a full prospectus would be required above this percentage level
- considering other types of offer documents in certain situations, for example, for an issuance of between 50 and 75 per cent. of existing issued share capital. There could be minimum content requirements for non-prospectus offer documents, for example, including links to MAR disclosures, most recent financial information, and a working capital statement
- making a distinction between the level of disclosure required for pre-emptive and non-pre-emptive offers

- setting conditions on when exemptions could be used such as having been listed for 18 months and not being in serious financial difficulty

Whilst there is not much meat on the bones of these suggestions, they do raise a number of questions that will need to be addressed:

- Acquisition-related fundraisings: with the proposed changes to class transactions, it is possible that a company could acquire a target that is 99 per cent. of its size and finance the transaction through an equity raise without the need to publish a prospectus or a class 1 circular. The company would be required to make an announcement in relation to the transaction, including all the information currently in the class 2 requirements and anything else that needs to be disclosed under MAR, but is that really sufficient for an investor in making their decision as to whether to invest?

  The FCA says that when a company is already listed there should be less need to publish a full prospectus because the information is already available. In this example, however, an investor would be very familiar with just over half of the listed business unless there was prospectus-type disclosure on the target.

- Offers of shares into the US: The SCRR raised the issue that issuers and investment banks may require a prospectus to make an offer into the US because the UK does not have a sufficiently robust continuous disclosure regime to adequately protect issuers and investment banks. Broadly speaking, UK annual reports are not the same beasts as their US equivalents, particularly with regard to the way that risks and commentary on the financial results are disclosed. Whatever is done to streamline the process in the UK, where an issuer wishes to raise finance in the US, they may well still conclude that a prospectus is needed.

- Attracting retail: If an offer is non-pre-emptive, it will typically be limited in the most part to institutional investors. The FCA's suggestion that an offer to institutional investors might legitimately attract a more light touch disclosure regime may well encourage less retail offerings as they will be more costly and time-consuming to execute. This runs counter to the FCA's stated aim to increase retail participation in UK capital markets generally.

- Offer document liability: There is no suggestion that legislation be amended to have a bespoke liability regime for offer documents that are not prospectuses. On that basis, we assume that such documents would fall within section 90A of the Financial Services and Markets Act 2000 meaning that liability would be for an issuer only and would be on a "recklessness" standard rather than the prospectus negligence standard which applies to issuers and to persons responsible for a prospectus. In our view this is helpful although we query what this means for investment banks who might be named in an offer document and whether it exposes them to more risk.

Protected forward-looking statements

The draft new legislative regime sets out a recklessness and dishonesty liability standard (rather than negligence) for protected forward-looking statements (PFLS), however, these are broadly defined in the draft legislation with the FCA being expected to define these further in FCA rules. The FCA suggests some alternative approaches to defining PFLS, with one possibility being setting broad criteria with non-exhaustive examples and another being setting prescriptive requirements. One possibility is to apply minimum criteria such as those used in IAS 1 which relates to the fair presentation of information in financial statements.

The FCA currently considers that PFLS should include both quantitative and qualitative information as well as financial and non-financial information. Its assumption is that PFLS will be optional, however, it is considering to what extent certain mandatory disclosures could be considered PFLS where there is an element of forward looking content. For example, it suggests that certain disclosures around business plans and strategies in an operating and financial review could be considered to be PFLS.

The FCA specifically confirms that working capital statements and certain types of forward looking information published by specialist issuers such as mineral companies (for example progress on mineral extraction) will not be considered to be PFLS but profit forecasts will be. The FCA also suggests that it may be appropriate to include within the scope of PFLS forward-looking sustainability information as issuers may then be more willing to elaborate on sustainability plans and their anticipated impact within a prospectus.

Finally, the paper looks at the presentation of PFLS, noting that disclaimers will be required. The FCA also suggests that for certain types of PFLS key assumptions should be set out in the accompanying statement, in the same way that profit forecasts are required to set out the principal assumptions upon which they are based and that the disclaimer should warn investors that the issuer may not be obliged to update the market if the PFLS proves to be inaccurate.

Retail

The FCA suggests that it is in favour of reducing the "six day" rule when an IPO prospectus is available to the public from six days to three days as recommended by the SCRR which may assist with making IPOs accessible to retail investors. Retail investors are currently often excluded from IPOs as the "six day" rule lengthens the IPO timetable.

In addition, the FCA is asking for views as to whether there should be a requirement that at least 10 per cent. of any offer is made to retail investors although this appears to relate to secondary offers rather than IPOs. It is not clear why this would not apply to IPOs given the desire for more retail participation in UK capital markets generally.

EU Listings Act

The FCA refers to the current EU proposals to reform EU capital markets in several places in the papers but interestingly it clearly does not feel the need to follow the EU, particularly on areas such as the percentage threshold for a secondary issuance prospectus where the EU is currently suggesting it should be set at 40 per cent.

Divergence between the UK and EEA regimes could be unhelpful to issuers wishing to offer shares to retail in the EEA and for those companies that have a dual listing in UK and the EEA.

Other changes

The FCA's assumption is that there should not be changes to adjacent regimes such as the advertisements regime or COBS 11A as part of any proposed changes to the prospectus regime although it is asking for views on whether it should do so. Given that Lord Hill's Listing Review in March 2021 recommended that COBS 11A be reviewed we think it is likely that the regime will be looked at in any event whether as part of the prospectus reform process or another reform strand, perhaps following the Investment Research Review currently being conducted by Rachel Kent.

Conclusions

It appears that the FCA's intention is that this engagement process marks the beginning of the prospectus reform agenda from the FCA's point of view with the process of listing reform now taking priority. There are numerous moving parts in the current reform agenda and we note the efforts of the Capital Markets Industry Taskforce to draw these together and produce a definitive model for reform. These engagement papers move the process of prospectus reform forward and we think there will be many areas of agreement between stakeholders on aspects of the proposals.

The complex part of prospectus reform is what to do about secondary issuances. The engagement paper has floated a number of options for streamlining the current regime, but these are little more than jumping off points for what will no doubt be a lively and vigorous debate.