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Significant Changes to UK Prospectus Regime

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Litigation, Financial Services

The UK Government has published changes it intends to make to the UK's prospectus regime[1]. Drafting has been delegated to the UK's regulator for financial services, the Financial Conduct Authority ("**FCA**")); however, it is clear these changes will have a significant impact on how and when prospectuses are prepared, and what they contain.

The changes may well also have wider impacts, for example: reducing the potential for shareholders to bring successful claims for loss suffered as a result of untrue or misleading statements in prospectuses; encouraging larger unlisted public companies to access capital via crowdfunding platforms; facilitating more retail investment in public companies; and, potentially, boosting the attractiveness of raising funds via a traditional UK initial public offering ("**IPO**"), as compared with fundraising through other means, such as via special purpose acquisition companies ("**SPACs**")[2].

This article outlines the changes proposed, discusses the potential wider impacts, and assesses where this fits into the UK Government's broader strategy for financial services, post-Brexit.

Background

The UK Government's proposed changes to the prospectus regime are set out in a Review Outcome document published in March 2022[3], following a consultation which ran from July to

[1] The rules governing the publication of prospectuses where companies: (i) make an offer of securities to the public in the UK, or (ii) request admission to trading on a regulated market of transferrable securities in the UK.

[2] UK Rules and regulations applicable to SPACs have also recently undergone changes designed to increase the attractiveness of the UK as a SPAC destination, as compared with (historically more attractive) U.S., Asian and European alternatives.

[3] Accessible here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1058438/UK_Prospectus_Regime_Review_Outcome.pdf

September 2021. This consultation was launched on the recommendation of Lord Hill in his March 2021 report[4], which set out proposed reforms to the UK listing regime.

The stated objectives behind the prospectus regime reforms, and the Hill Report reforms more generally, are to attract the most innovative and successful companies to the UK for IPOs, optimise the capital raising process for large and small companies on UK markets, and generally to take advantage of the UK's new freedoms following Brexit and enhance the UK's position as a leading global financial centre.

What are the key proposed changes?

- Regulation of admissions of securities to trading[5] will be separated from regulation of public offers of securities[6]. Prospectuses will remain relevant to trading securities (where required by the FCA), but not to public offers.
  - A prospectus may still be required where securities are to be admitted to trading on a UK regulated market. The FCA will have rule-making responsibilities including deciding whether a prospectus needs to be reviewed and approved by the FCA before it is published, but it will no longer be a criminal offence to request admission to trading without having first published an FCA-approved prospectus.
  - A prospectus will not be required where securities are offered to the public in the UK (unless there is a contemporaneous admission to trading). There will now be a general prohibition on public offerings of securities, unless one of the exemptions[7] from the expanded list derived from Article 1(4) of the existing Prospectus Regulation applies.
- The threshold for bringing claims against issuers related to inaccurate or misleading forward-looking information within - or omissions from – prospectuses, will be raised.
- The existing statutory "necessary information" test setting out the basic standard of preparation for a prospectus will remain in place, but with three key alterations:
  - All equity securities will be treated in the same way (i.e. removing the current differentiation between the treatment of those over and under €100k).
  - Clarification that necessary information may vary according to whether an offer of securities relates to a first-time admission to a market or is a secondary issuance.

[4] Accessible here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966133/UK_Listing_Review_3_March.pdf
[5] Admission to trading is the process by which an exchange permits members of the exchange to enter into transactions in that investment under and subject to the rules of the exchange.
[6] I.e., offers of securities made to the public and described in the Public Offers of Securities Regulations 1995.
[7] The exemptions will be expanded to include: (i) offerings of securities which are, or will be, admitted to UK regulated markets; (ii) offerings of securities to existing shareholders pro rata (subject to other, as yet unspecified, conditions); (iii) offers made to certain multilateral trading facilities; (iv) the introduction of a threshold below which offers of securities from private companies are exempt from the prohibition on public offers; and (v) public offerings from certain designated overseas stock markets.

- A modified necessary information test will apply to debt securities which focuses on the issuer or guarantor's creditworthiness, rather than prospects (which the Government views as more relevant to allow investors to make an informed assessment).

- Removal of the current requirement for an FCA-approved prospectus for publication of offers of securities by unlisted companies to the public of over €8m, provided the offer is made via a platform operated by a specially authorised firm.
- A new regime of regulatory deference, permitting securities listed on certain designated overseas stock markets to be offered in the UK on the basis of the offering documents used overseas.
- Generally, a greater degree of rule-making responsibility delegated to the FCA.

Wider impacts of the changes

1. **Reducing the potential for shareholders to bring successful claims for loss suffered as a result of untrue or misleading statements within - or omissions from - prospectuses.**

In particular, three of the proposed reforms are likely to have this effect: (i) the reduction in the number of situations where prospectuses are required, (ii) the raising of the threshold for liability for forward-looking information in prospectuses, and (iii) modifications to the 'necessary information' test.

i. Reduction in the number of situations where prospectuses are required

As noted above, the Government intends to give the FCA more powers in determining if and when prospectuses are required for securities listings[8] and to remove the criminal offence which currently prohibits requesting admission to trading on UK regulated markets without first having published an FCA-approved prospectus. It is expected that the FCA will use its new rule-making responsibilities to reduce the number of prospectuses published in future.

By definition, if fewer prospectuses are published this will reduce the potential for claims against issuers on the basis of untrue or misleading statements made in – or improper omissions from – prospectuses. Liability may still arise from untrue or misleading statements in information published by an issuer by other means, e.g. via a recognised information service, or for omissions or delays in publishing required information.

ii. Raising of the threshold for liability for forward-looking information in prospectuses.

The current standard of liability for information published in a prospectus[9] roughly equates to a negligence standard. Any person responsible for the prospectus is liable to pay compensation to a person who has acquired the securities and suffered loss in respect of them as a result of any untrue or misleading statement or for any omission of 'necessary information' (see (iii) below),

[8] For example, the FCA will have flexibility to decide whether to require a UK prospectus for a secondary listing or whether an overseas prospectus is sufficient.
[9] See Financial Services and Markets Act 2000 ("**FSMA**"), Section 90.

unless an exemption applies. One of these exemptions provides that liability does not arise where a person reasonably believed the statement to be true and not misleading, or that the omission was properly made[10].

This is a low fault standard, allowing investors to bring claims against issuers with relative ease. For this reason, it dissuades issuers of prospectuses from meaningfully disclosing forward-looking projections and other information, given the risk that projections do not materialise and this exposes them to claims.

The Government intends to raise the fault standard for forward-looking statements to that of recklessness. This would mean that an issuer of a prospectus would only be liable to pay compensation if: (i) he knew the statement to be untrue or misleading; and (ii) was reckless as to whether it was untrue or misleading; or (iii) in the case of an omission, knew the omission to be a dishonest concealment of a material fact.

In principle, this raised threshold should make claims against issuers in respect of forward-looking statements in prospectuses more difficult and thereby make issuers more comfortable in providing investors with their own views on the future prospects of their companies rather than relying on research analysts to model future prospects (which is often what happens).

However, it should also be noted that as public offerings become more global, with UK IPOs frequently tapping into the EU and US markets, the liability regimes of overseas jurisdictions may still limit the extent to which the raised threshold is capable of being fully embraced by public companies. Similarly, the raised threshold will only apply to certain categories of forward-looking information, which are as yet to be identified, but could relate to financial information and key performance metrics. Such information will need to be clearly labelled as forward-looking information to which that threshold applies, which is likely to result in having two sets of forward-looking disclosures in prospectuses (and, in turn, two sets of disclaimers for forward-looking disclosures).

iii. Modifications to the 'necessary information' test

Currently, the disclosure requirement for UK prospectuses is the 'necessary information' test, which provides that prospectuses must contain necessary information which is material to an investor for making an informed assessment of: (a) the assets and liabilities, profits and losses, financial position, and prospects of the issuer and of any guarantor; (b) the rights attaching to the securities; and (c) the reasons for the issuance and its impact on the issuer[11].

The Government intends to retain this test as a basic standard, but with certain changes, including (a) clarification that 'necessary information' may vary according to whether an offer of securities relates to a first-time admission to a market or is a secondary issuance, and (b) modification of the test as it relates to debt securities, with a new focus on the issuer or guarantor's *creditworthiness*, rather than *prospects*. The stated intention is to ensure that prospectuses contain information that investors need to make an informed assessment.

[10] FSMA, Schedule 10.
[11] UK Prospectus Regulation, Article 6(1).

The details of these modifications are yet to be published. However, to the extent they result in less or different information being provided to investors than is currently the case, this could reduce the potential for claims under section 90 FSMA.

2. **Encouraging larger unlisted public companies to access capital via crowdfunding platforms**

As part of its commitment to ensuring that the UK securities-based crowdfunding industry continues to thrive, the Government proposes to remove the current requirement for an FCA-approved prospectus to be published on offers by unlisted companies over €8 million. Unlisted companies will be able to offer securities to the public without limit through a platform operated by an authorised firm (under a new regulated activity covering the operation of an electronic platform for the public offering of securities).

This is a welcome change that may encourage larger unlisted companies to raise finance via crowdfunding platforms; although, it must be said that the Government is still considering the threshold below which offers of securities by unlisted companies will be exempt from the prohibition on public offers. Additionally, the Government has not proposed to remove the restriction under the Companies Act 2006 whereby private limited companies are prohibited from offering their securities to the public, which means that in practice offerings via these crowdfunding platforms may only be available to unlisted companies that are incorporated or re-registered as public limited companies.

3. **Facilitating more retail investment in listed public companies**

Retail platforms had called for the arbitrary €8 million limit to be scrapped wholesale because this can constrain the level of retail participation in follow-on equity fundraisings by listed companies. While this exemption is being removed for offers by unlisted companies as described above, in practice, listed companies will be able to undertake retail offers in reliance on the new exemption from the general prohibition on public offerings where the retail offer shares are to be admitted to UK regulated markets (without such retail offer having to also fall within the €8 million limit exemption). This, of course, will be subject to the FCA's granular rules on when a prospectus will be required, including for a further issuance by a listed company; but these developments are certainly promising from a retail-investor perspective.

4. **Boosting the attractiveness of raising funds via a traditional UK IPO, including as compared with fundraising through SPACs**

The proposed changes to the UK prospectus regime and connected changes to the listing rules are designed, among other things, to boost the attractiveness of the UK as a destination for IPOs. The detail of the proposed prospectus regime changes will be important; however, in general it seems likely that these changes will serve to make UK IPOs relatively more attractive, compared with IPOs in other major financial centres.

This may also be the case as regards the relative attractiveness of a UK IPO as opposed to financing and access to public markets via a SPAC transaction. This is because one of the historic perceived attractions of SPACs, at least in the US (for the time being[12]) has been that parties to – and directors and officers involved in – a SPAC transaction, may benefit from a safe harbour to protect themselves against liability arising from inaccuracies in projections and other forward-looking statements in connection with the transaction (assuming there was a reasonable basis for the statements). Such a safe harbour would not be available for traditional IPOs, at least in the UK. The proposed changes to the liability regime for forward looking information in prospectuses for UK IPOs reduces the extent to which SPACs now present a materially more attractive position, as regards limiting liability. That said, there are of course many and substantial differences between an IPO fundraising and a SPAC-related fundraising, such that this one change alone may not often serve to determine a choice between these (and other) fundraising options.

Conclusion

The proposed changes to the UK prospectus regime are significant and wide-ranging. Whether they will have the desired impact of substantially boosting the attractiveness of raising funds via a traditional UK IPO remains to be seen and, as ever, the devil is likely to be in the detail, which will come in the form of the FCA's proposals (to be published following an FCA consultation).

However, on their face, the changes should be attractive to issuers, streamlining the listing process by reducing the number of circumstances in which prospectuses are required, reducing the potential for shareholders to bring claims against issuers in relation to forward-looking statements, and encouraging more retail investment in public listed companies.

More generally, these changes are strategically aligned with wider UK Government objectives post-Brexit, particularly to focus divergence from the EU on those sectors (such as financial services, artificial intelligence, and renewable energy) where the UK has a perceived competitive advantage, pushing for greater modernisation and innovation to attract more and new business to London and using Brexit to diverge aggressively from EU norms with the aim of setting the global regulatory agenda.

These are politically important objectives for a UK Government under pressure to deliver tangible benefits from Brexit. Whether the UK can leverage regulatory divergence effectively to maintain its competitive advantage in the financial services sector in the medium-to-long term, depends, to a certain extent, on how intense the competition with the EU in the financial services sector becomes. The fact that the EU has granted the UK only two equivalence decisions so far (in contrast to the UK's grant of decisions in 28 out of 32 possible sectors) tends to suggest that the EU also views Brexit as an opportunity: to lure financial service companies away from London.

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[12] It has often been suggested by market participants that a safe harbours exists for such statements made in connection with SPACs under the Private Securities Litigation Reform Act of 1995. However, the House Financial Services Committee of the United States Houses of Congress proposed draft legislation, and the SEC has proposed new rules which if, either are passed, will expressly prohibit this safe harbour applying to SPACs. The legislation and proposed rules are accessible at https://www.congress.gov/117/bills/hr5910/BILLS-117hr5910ih.pdf and https://www.sec.gov/rules/proposed/2022/33-11048.pdf, respectively.

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