**The requirement for a prospectus**

This element outlines the requirement for a prospectus

**Introduction**

A key issue on both primary and secondary issues is whether a prospectus will be required for the transaction the company is contemplating.

Where a prospectus is required, producing the document entails substantial time, effort and cost: this can be seen as the price the company and its directors must pay in return for being able to obtain capital from public investors.

**The legal framework**

The three key regulations which govern prospectuses are:

* the UK Prospectus Regulation (which is derived from Regulation (EU) No 2017/1129) (‘UK Prospectus Regulation');
* the UK Prospectus Delegated Regulation (which is derived from Commission Delegated Regulation (EU) 2019/980) which governs the format, content, scrutiny and approval of prospectuses (‘UK PR Regulation'); and
* the UK Prospectus RTS Regulation (which is derived from Commission Delegated Regulation (EU) 2019/979) which addresses a range of ancillary issues including advertisements and supplementary prospectuses (‘UK Prospectus RTS Regulation').

Each of these regulations forms part of the retained EU law which was adopted directly into English law when the UK left the European Union.

Other important law and regulation in the context of prospectuses is found in the following sources (those highlighted are explained further in the following pages):

* **Financial Services and Markets Act 2000 ('FSMA');**
* **the Prospectus Regulation Rules ('PRRs'):**
* the UK Listing Rules ('**UKLRs**');
* the Disclosure Guidance and Transparency Rules sourcebook ('**DTRs**');
* materials relating to the European prospectus regime published by the European Securities and Markets Authority ('**ESMA**')**;**
* the UK Market Abuse Regulation (derived from Regulation 2014/596/EU) (‘**UK MAR**’); and
* the Financial Services Act 2012 ('**FS Act'**).

**FSMA**

Key elements of the UK Prospectus Regulation are also reflected in and supplemented by Part VI of FSMA. In particular, FSMA is the authority for the FCA's enforcement powers in relation to the UK Prospectus Regulation and associated rules.

**PRRs**

The relevant provisions of the three key regulations are 'copied out' for ease of reference in the PRRs, alongside additional rules and guidance which are issued directly by the FCA. The reproduced regulation provisions are identified in the PRRs with the label 'UK'; rules have the label 'R' and guidance has the label 'G'.

**ESMA**

ESMA's role is to promote the integrity, transparency, efficiency and orderly function of European securities markets and to protect investors. For example, ESMA publishes Guidelines on Disclosure Requirements under the EU Prospectus Regulation which are intended to ensure that market participants have a common understanding of the disclosure which is required to be made in a prospectus.

ESMA no longer has direct jurisdiction in the UK and its functions under the EU Prospectus Regulation regime have been transferred to the FCA with respect to the retained UK version of the regulation. However, the FCA is gradually adapting its own guidance to reflect ESMA’s materials and, until this process has been completed, the FCA expects market participants to continue to apply the ESMA guidelines to the extent to which they remain relevant.

**Requirement for a prospectus**

It is necessary to consider whether a prospectus is required both:

* when a company first seeks a listing of its shares; AND ALSO
* when it subsequently issues shares to raise additional equity finance.

A diagram is included on the next page to help you determine when a prospectus is required. Follow through the diagram with the help of the explanation in the pages that follow it.

**Diagram:** Text box reading ‘Are the securities **transferable securities**?’ If the answer is ‘No’ there is ‘**No need to publish** a prospectus’. If the answer is ‘Yes’ apply ‘**Test 1** – Is there an **offer** of transferable securities **to the public** in the UK?’ If the answer to Test 1 is ‘Yes’, ask ‘Does the offer come within an **exemption**?’ if the answer is ‘No’ ‘**Publish** a prospectus’. If the offer **does** come within an exemption, apply ‘**Test 2** – Are transferable securities **being admitted to trading on a regulated market** in the UK?’

If the answer to Test 2 is ‘No’ there is **no need to publish** a prospectus. If the answer to Test 2 is ‘Yes’, ask ‘Does the admission come within an **exemption**?’. If ‘No’, publish a prospectus. If ‘Yes’ there is ‘No need to publish a prospectus’.

If the answer to Test 1 was ‘No’, apply Test 2. If the answer to Test 2 is ‘No’, there is **no need to publish** a prospectus. **End of Diagram.**

**When is a prospectus required?**

There are two tests which determine whether a prospectus will be required. These are set out in PRR 1.2.1/Art 3(1) and 3(3) UK Prospectus Regulation and also in s.85 (1) and (2) FSMA).

If **either** test is satisfied then the company will have to publish a prospectus (unless an exemption applies).

A prospectus will need to be published **whenever:**

* An offer of transferable securities is made to the public in the UK (TEST 1) and/or
* Transferable securities are admitted to trading on a regulated market in the UK (TEST 2).

**Transferable securities**

This regime only applies to securities which qualify as 'transferable securities'. The key consideration in ascertaining whether a security is a 'transferable security' is whether it is capable of being negotiated on a capital market. Certain 'transferable securities' then fall out of scope of the requirement for a prospectus under both Tests – see PRR 1.2.2UK/Art. 1(2), UK Prospectus Regulation, which is also referred to in ss. 85(5) and (6) FSMA.

The application of this regime to a range of transferable securities means that a prospectus could be required in respect of a range of transferable securities which are beyond the equity shares which are considered in this workstream: for example, a company may need to produce a prospectus in relation to the issuing of bonds.

For the purposes of the Equity Finance module, the **key point to retain is that equity shares do fall within the definition of 'transferable securities', and do not fall out of scope as a result of PRR 1.2.2UK/Art. 1(2), UK Prospectus Regulation**.

**Interaction between UK Prospectus Regulation and FSMA**

**Arts. 3(1)** and **(3)** of the **UK Prospectus Regulation** provide that:

* 1. Securities shall only be offered to the public after prior publication of a prospectus (**TEST 1 – UK Prospectus Regulation**);

**AND/OR**

* 2. Securities shall only be admitted to trading on a regulated market after prior publication of a prospectus (**TEST 2 – UK Prospectus Regulation**).

Breaches of the UK Prospectus Regulation and the PRRs allow the FCA to impose penalties on the person who has committed the breach under s. 91 FSMA, but do not constitute a criminal offence.

**ss. 85(1) and (2) FSMA**

However, ss. 85(1) and (2) FSMA create their own version of Tests 1 and 2 and provide that breach of these tests will cause a person to be guilty of an offence under s. 85(3) FSMA, and liable to imprisonment or a fine.

**Ss. 85(1) and (2) FSMA provide that it is unlawful:**

* 1. For securities to be offered to the public unless an approved prospectus has been made available to the public before the offer is made (**TEST 1 – FSMA**);

**AND/OR**

* 2. To ***request*** the admission of securities to trading on a regulated market unless an approved prospectus has been made available to the public before the ***request*** is made (**TEST 2 – FSMA**).

As the provisions of ss. 85(1) and (2) FSMA actually require a prospectus to be made available at the same time as or, in the case of Test 2, in advance of the equivalent provisions of Art. 3(1) and (3) of the UK Prospectus Regulation (i.e. at the point that an application is made for admission, not just before admission occurs), this means that compliance with s. 85 FSMA will also ensure compliance with PRR 1.2.1UK/Arts. 3(1) and (3), UK Prospectus Regulation.

Despite the slight differences between the tests as set out in the UK Prospectus Regulation and in FSMA, it is important to note that the exceptions to Tests 1 and 2 are the same across both the UK Prospectus Regulation and FSMA.

**TEST 1: Offer of transferable securities to the public**

An **'offer of transferable securities to the public'** for the purposes of Test 1 is very broadly defined.

‘There is an offer of transferable securities to the public if there is a **communication to** **any person** which presents sufficient information on (a) the transferable securities to be offered, and (b) the terms on which they are offered,’

The definition can cover **any form of communication**, provided that the communication presents sufficient information on the terms of the offer and the securities to be offered to enable an investor to decide to buy or subscribe for those securities.

See both the UK Prospectus Regulation definition which is copied out in PRR Appendix 1, Relevant definitions and the definition in s. 102B FSMA (as above).  The definition in both cases specifically applies to an offer that is made through a financial intermediary.

It is important that you use this definition of 'offer to the public' when you are considering Test 1 and do not confuse it with any other definitions or uses of 'offer to the public' that you may come across elsewhere (for e.g. in the UKLRs.)

Note that this definition is wider than the contractual concept of offer and acceptance.

**TEST 2: Admission of securities to trading on a regulated market**

The Main Market of the London Stock Exchange ('LSE') is a regulated market and therefore any securities being admitted to the Main Market of the LSE will be caught by Test 2. AIM, however, is not a regulated market. Consequently, the only time a prospectus may be required for an AIM company is where an offer of securities is made to the public (Test 1) and none of the exemptions apply.

**Exemptions from the requirement to produce a prospectus**

There are different exemptions for Test 1 and Test 2 which are set out in PRR 1.2.3/Art. 1(4) UK Prospectus Regulation and PRR 1.2.4/Art. 1(5) UK Prospectus Regulation respectively. In most cases, these different exemptions may be combined together (PRR 1.2.5/Art. 1(6) UK Prospectus Regulation)

**Test 1 exemptions (offer of transferable securities to the public)**

The Test 1 exemptions are set out in PRR 1.2.3/Art. 1(4) UK Prospectus Regulation (as referred to in s.86 (1)(aa) FSMA. The key exemptions are:

* **Offers addressed solely to qualified investors (Art. 1(4)(a) UK Prospectus Regulation)**. The definition of 'qualified investor' is set out in Art. 2(e) of the UK Prospectus Regulation and covers various types of professional investor. This exemption would apply to most, if not all, investors in a placing.
* **Offers addressed to fewer than 150 natural or legal persons in the UK, other than qualified investors (art. 1(4)(b) UK Prospectus Regulation)**. The effect of this exemption is to remove the requirement to produce a prospectus from various offers where the persons (or the non-institutional investors) to whom the offer is being made can be specifically identified and counted. Therefore, an offer structured as a placing could well also take advantage of this exemption.

Other available exemptions include:

**Exemptions for offers of substituted shares or scrip dividends to existing shareholders (Arts.1(4)(e) and (h) UK Prospectus Regulation)**

There are exemptions for dividends paid out in the form of shares of the same class as the shares in respect of which the dividends are paid (scrip dividends), subject to certain conditions.

**Exemptions for equity securities offered in connection with certain types of transaction such as takeovers or mergers** **(Arts.1(4)(f) and (g) UK Prospectus Regulation)**

Equity securities offered by an existing issuer in connection with a takeover offer or merger (and which are fungible with equity securities that are already listed) will generally be exempt provided that a document is made available containing information describing the transaction and its impact on the issuer.

**Securities offered to directors or employees, or former directors or employees (Art.1(4)(i), UK Prospectus Regulation)**.

This might be applicable to an offer being made to employees of the issuer alongside an institutional placing, subject to compliance with certain conditions.

Except in relation to the employee exemption, ***none of these other available exemptions*** would be relevant to an IPO.

In addition to the above, certain very small offers to the public would also be either outside the prospectus regime (first bullet) or exempt from the requirement to publish a prospectus (second bullet). These are as follows:

* An offer of securities to the public with a total consideration of less than €1,000,000, calculated over a 12 month period (PRR 1.2.2UK/Art.1(3), UK Prospectus Regulation).
* An offer where the total consideration for the securities being offered cannot exceed €8,000,000 (s. 86(1)(e) FSMA)

Each of these size limits applies to securities offered in the UK.

**Test 2 exemptions (admission of securities to trading on a regulated market)**

The Test 2 exemptions are set out in PRR 1.2.4/Art. 1(5) UK Prospectus Regulation) (as referred to in s.86(4A) FSMA).

**Securities fungible with securities already admitted to trading on the same regulated market (i.e. certain secondary issues of shares) (Art. 1(5)(a) UK Prospectus Regulation)**

This is an exemption for the admission of securities that are fungible with (i.e. are the same class as) securities already admitted to trading on the same regulated market, provided that they represent, over a period of 12 months, less than 20% of the number of securities already admitted to trading on the same regulated market.

This means that a listed company can issue new shares equalling less than 20% of its existing listed share capital without having to produce a prospectus, so long as the offer of shares does not fall within Test 1 (i.e. shares are not being offered to the public or the offer falls within a Test 1 exemption).

You should note that this exemption is **not available** on an IPO, as there will be no shares that are already admitted to trading at that point.

**Exemptions in similar circumstances to those set out above relating to offers to the public (e.g. relating to takeovers, mergers, issues to employees etc.) (Arts. 1(5)(d), (e), (f), (g) and (h), UK Prospectus Regulation)**

The points made above about these various exemptions would also be relevant here. As above, these will also not be relevant on an IPO.

**Example: Retail offer (IPO/ primary issue) on the Main Market**

TEST 1

A retail offer will fall within Test 1 as it will be caught by the definition of 'offer of transferable securities to the public'. It is therefore necessary to find an exemption to Test 1. If the offer is being made to fewer than 150 non-qualified investors or is for a maximum consideration of €8,000,000, then it will be an exempt offer for the purposes of Test 1 and no prospectus will be required under that test. However, this is unlikely for a primary retail offer which is likely to be on a much larger scale. No other exemptions are likely to apply.

TEST 2

A retail offer will fall within Test 2 if the shares will be admitted to trading on a regulated market. The Main Market of the LSE is a regulated market and therefore a retail offer on the Main Market will be caught by Test 2. None of the exemptions is likely to apply so a prospectus will be required in relation to Test 2.

CONCLUSION

If the public element of the offer is small, there may be an exemption to Test 1 although this is unlikely. However, for a primary issue, there would not be an exemption to Test 2 so a prospectus will be required (regardless of whether a Test 1 exemption is applicable). **End of Example.**

**Example: Placing (IPO/ primary issue) on the Main Market**

TEST 1

A placing will fall within Test 1. The definition of 'offer of transferable securities to the public' is very wide and will include an offer to placees. It is therefore necessary to find an exemption to Test 1. A placing will generally be an exempt offer under PRR 1.2.3/Art. 1(4) UK Prospectus Regulation as the offer will be directed at 'qualified investors' only and/or fewer than 150 non-qualified investors. A prospectus will therefore not be required in relation to Test 1.

TEST 2

The Main Market of the London Stock Exchange is a regulated market and therefore a placing on the Main Market will be caught by Test 2. It is therefore necessary to find an exemption to Test 2. None of the exemptions (set out in PRR 1.2.4/Art. 1(5) UK Prospectus Regulation is likely to apply to an IPO. For e.g. the less than 20% ISC in a 12-month period exemption will not apply here.

CONCLUSION

Although a company is unlikely to need to produce a prospectus for an IPO placing under Test 1, as there are no exemptions to Test 2, a prospectus will still be required for an IPO. **End of Example.**

**Summary**

* Prospectuses are regulated by numerous different sets of regulations and rules.
* It is necessary to consider whether a prospectus is required both on first seeking a listing and on subsequent issues.
* Two key tests (either of which will lead to a requirement for a prospectus but both of which have numerous exemptions) are:
  + Is there an offer of transferable securities to the public in the UK? (Test 1);
  + Are transferable securities being admitted to trading on a regulated market in the UK? (Test 2).
* Exemptions in relation to Test 1 include those for offers addressed to solely to qualified investors or to very limited numbers of other investors.
* Exemptions in relation to Test 2 include those for securities of the same class as securities **already admitted to trading** on the same market.