

The Prospectus Regulations 2018

HM Treasury

RPC rating: fit for purpose

Description of proposal

“The Prospectus Regulations 2018” are the latest regulations on Prospectuses. The most recent edition before these were the 2005 UK Prospectus Regulations. Prospectuses are formal legal documents issued alongside public offers for securities by a business. These documents are meant to provide investors with detailed information on the finances of a business. A public offering is an offer available to the general public, not just financial institutions or venture capitalists. In such an offer, individuals are given either a promised return (in the form of a bond, which is called debt security), or are given shares in a company (in the form of equity securities).

Under the current 2005 UK Prospectus Regulations, which implements the 2003 EU Prospectus Directive, the Financial Services and Markets Act 2000 has been amended via an Amending Directive, which:

- sets a mandatory threshold that exempts the requirement that businesses must issue a Prospectus on offers of securities to the public below €100,000; and
- exempts offers of securities to the public below €5 million from the scope of the regime entirely, which allows member states to raise the threshold of exemption on public offers of securities from the mandatory €100,000 to €5 million.

This means that businesses aiming to raise funds under the amounts outlined above will not have to provide a Prospectus to investors, as commissioning a Prospectus can be expensive.

With the aim of reducing administrative burdens on issuers, the Amending Directive gave member states the discretion to set their own domestic exemption threshold between €100,000 and €5 million.

Following consultation, the EU established the (EU) 2017/1129 ‘Prospectus Regulation’. This brings about a change to the previous Prospectus Directive.

The new (EU) 2017/1129 'Prospectus Regulation':

- exempts all offers of securities to the public from the entire scope of the regime, with a total consideration within the EU of less than €1 million (where previously this was €5 million); and
- permits member states to exempt offers of securities to the public, below €8 million, from the obligation to publish a prospectus.

HMT is proposing to implement the discretionary increase (as allowed by the Prospectus Regulation) at €8 million in the UK.

Impacts of proposal

The Prospectus Regulations will impact businesses making public offers of security between €5 million and €8 million. HMT estimates this amounts to approximately 13 offers per year, with each offer incurring a saving of £490,000 to £845,000. These figures are based on estimates provided by respondents to the Government's 2010 Green Paper consultation, *Financing a Private Sector Recovery*, where respondents' estimates of the cost of producing a prospectus ranged from 7 to 12 per cent of the funds raised for consideration (for sums below £10 million).

These regulations aim to reduce costs on SMEs, through a reduction in the financial burden that is brought about by the requirement to provide prospectuses when issuing public offers of securities. HMT sought views from a range of key stakeholders (including the Quoted Companies Alliance, Crowdcube, the UK Crowdfunding Association, the London Stock Exchange Group, and the Association for Financial Markets in Europe) and has received feedback supporting raising the threshold to €8m. The Department says no significant risks from raising the threshold were identified during this industry outreach.

It also has the indirect benefit of allowing smaller businesses the option to raise funds publicly as opposed to institutionally - the latter being less likely to lead to the dilution of shares belonging to existing shareholders (institutionally would involve the company receiving funds from a large financial institution like a bank, whereas publicly allows any member of the public to invest).

The EU also assessed a risk that there could be an indirect cost to investors, as a consequence of a reduction in information available to investors. HMT states that, as investors will not be forced to take up an offer, the risk to investors is minimal.

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of -£9 million. This will be a qualifying regulatory provision that will score under the Business Impact Target.

Quality of submission

The Department's assessment of the impacts of the measure is fit for purpose. It has engaged with industry to ensure that it makes an informed decision on where to set the thresholds for exemption. It does not, however, share the views of businesses in detail, though it argues that industry is overwhelmingly positive about the policy. Although the Department has sought views from parts of the financial industry that will be directly affected by the Prospectus Regulations, it is not clear whether it has sought views from businesses that are not immediately concerned with issuing shares through public offers.

The Impact Assessment would have been strengthened by discussing the minimum required information offers that fall below the prospectus need to supply.

The Department has considered and rejected an alternative to its preferred option (compliance with the Directive's mandatory minimum threshold, with no use of the freedom to set a higher threshold) and has explained why this second option will not provide the same benefits to industry.

The IA could be improved by presenting a clearer evidence base for the assertion that additional risk to investors is minimal, as they are not forced to take up an offer. It would be especially beneficial to quantify the minimal risk created by the change. This assumption does not warrant the Impact Assessment omitting a discussion on the potential cost arising from the differential in information between offers of securities with a prospectus and the statutory minimum information (as set out in common law). The RPC does however recognise it would not be proportionate to try to calculate these costs.

The IA could also be improved by adding a clear discussion of other member states' implementation plans, and by setting out all the costs and benefits considered in the EU's impact assessment (for example, as noted above, the Department does not discuss the potential indirect costs on investor protection in much detail).

It is not completely clear how the value of the EANDCB was reached. It might have been beneficial to look at the exact amount raised by the firms falling between €5 and €8 million, for the time period the Department used, and then providing a best estimate based on the typical value the Department found for costs of producing a prospectus.

The EANDCB calculation also omits discussion of whether the 13 offers that would fall below the new threshold were offers made across the EU, rather than within the UK. If this were the case, the firms concerned might not be helped by the regulations, as they would then need a prospectus which could be passported across the EU. The IA would have benefited from further discussions on changes in the volume of offers of securities. Due to the raised threshold, businesses that previously may not have considered public offers of securities, due to prospectus costs, may now be interested in issuing a public offer of security (for example by consulting a wider range of business groups, as suggested earlier).

There is also no mention of any first-mover advantage, where it is possible that companies outside the UK seeking finance between €5 and €8 million would move to the UK for their public offer. This may lead to further benefits to industry.

The Department outlines a sound and proportionate monitoring and evaluation plan. However, it may wish to measure the success of investments in firms affected by the new discretionary threshold as an additional success criterion.

Departmental assessment

Classification	Under the 2015-17 framework: Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	–£9.0 million (final estimate)
Business net present value	£86 million (over 10 years)
Overall net present value	£86 million (over 10 years)

RPC assessment

Classification	Under the 2015-17 framework: Qualifying regulatory provision (OUT)
----------------	---



Anthony Browne, Chairman