14 February 2023

UK PROSPECTUS REFORM

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ICMA comments on UK draft statutory instrument (8th draft 01/12/22)

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Financial Services and Markets Act 2000 (Public Offers and Admissions to Trading) Regulations 2023

ICMA appreciates the opportunity to provide feedback to His Majesty's Treasury ("HMT") on the illustrative Financial Services and Markets Act 2000 (Public Offers and Admissions to Trading) Regulations 2023 (the "SI"). In a number of instances this note seeks clarification from HMT that ICMA's understanding of the provisions of the SI are correct.

ICMA understands (from prior discussion) that in many areas the intention is to keep the status quo in relation to the existing prospectus regime. ICMA also notes that this is the general approach as set out in HMT's 9 December 2022 Policy Statement (e.g. "the government will not be pursuing change for its own sake" and that "much of REUL will remain appropriate in substance"). This approach informs many of the comments below, particularly where any perceived distinctions with the existing regime are referenced. There are also a few suggestions which seek to amend or clarify the existing regime where this looks to be possible within the new proposed structure of the SI.

Given that the SI does not give a complete picture of how the new regime will look and operate, because much of the detail will be included in FCA or primary MTF operator rules, there are aspects of the regime that ICMA is unable to comment on in depth. ICMA and its members will need to give detailed consideration to the consultation to be published by the FCA on its new rules and how they interact with the SI. The end of this note includes in paragraph 9 a list of areas that the FCA would be expected to address in their upcoming discussion paper.

1. **Relevant securities and transferable securities (Regulations 3 and 4)**

   a. ICMA understands that the starting point for the definition of "relevant securities" was the definition of "transferable securities" as this is defined and used in other legislation, but this has been expanded to capture certain other products such as minibonds. However, this broadened definition might inadvertently capture certain products that are not appropriate to be within the scope of the SI.

b. As drafted the definition of "relevant securities" is capable of catching a whole range of financial contracts that are not securities (or quasi-securities), including certain OTC derivatives, loans and securities financing transactions. For example:

   i. Regulation 4(2)(b), "any other investment that consists of a right to receive payment of principal or interest on indebtedness incurred for borrowed money", would catch loans, but could also potentially catch certain fully funded derivatives such as funded total return swaps; and

   ii. Regulation 4(2)(c) and (e) and regulation 4(4)(d) and (f), which broadly cover rights under a contract to acquire, subscribe or dispose of a range of financial instruments including bonds, shares and loans, would catch call and put options, securities financing transactions and potentially also certain types of other physically settled derivatives.

   There is a list of excluded investments, but none of these would seem to carve out any of the above.

c. ICMA notes that the drafting appears to go further than the stated policy intention. In its accompanying policy note, HMT says:

   "*This SI sets out a definition of 'relevant securities' in order to deliver on a recommendation of the Gloster Review, as outlined above. This definition intends to capture 'minibonds' and other non-transferable securities that may cause harm to investors if their offer is not subject to greater regulation. The government is keen to ensure that <u>business that does not affect retail investors or is already regulated elsewhere is not unintentionally brought within scope of the reformed regime</u>. In particular, HM Treasury <u>expects to modify the current draft of this SI, in particular to allow existing business or market activity</u> in such areas as the wholesale loan markets, building societies, credit unions and cooperative and mutual benefits societies, <u>to continue</u>.*"

d. In addition to being broad the definition of relevant securities is lengthy and can be difficult to follow. A more streamlined definition would be preferable, where possible. For example, in Regulation 4(1)(b) and (c) the language "other than transferable securities" is confusing because Regulation 4(1)(a) explicitly specifies "transferable securities". It would simplify to remove the duplicative reference to "transferable securities" in Regulation 4(1)(b) and (c).

e. ICMA notes that money market instruments having a maturity of less than 12 months are carved out from the definition of "relevant securities", as "excluded securities", but not from the definition of "transferable securities". As money market instruments are carved out of the existing UK Prospectus Regulation definition of "transferable securities" It is unclear if this different approach has been structured to achieve a particular result.

2. **Excluded securities (Regulation 5)**

Issues by qualifying bodies are excluded from the "relevant securities" definition. This includes housing associations but would not cover issues where a housing association uses an SPV structure (which is common) even though the credit is the same. While this reflects the existing UK Prospectus Regulation it is currently problematic for these types of transactions so a clarification to include such SPV structures in the excluded securities definition would be a beneficial change to the existing position rather than maintaining the status quo.

3. **Necessary information test (Regulation 21)**

a. ICMA's feedback to the HMT Consultation on the UK Prospectus Regulation requested that this test be refined for debt securities to make it clearer that the information required related to the issuer's credit. The HMT Review Outcome in March 2022 seemed to accept that such a modified necessary information test based on the issuer's creditworthiness rather than prospects would be appropriate for debt securities (paragraph 13). It is therefore disappointing that this did not translate into the drafting of the SI.

b. The revised formulation of this test in the SI providing that "prospects" should be "read as including, where appropriate, a reference to the creditworthiness of the issuer and of any guarantor" is likely to make the test less clear, rather than more, and possibly harder for issuers to interpret. If there is no possibility to revisit the approach (to line up with ICMA's stated position), the test should remain as it is under the existing regime and Regulation 21(3) be removed. Amendments to the necessary information test which introduce uncertainty could result in additional compliance burdens for issuers. An example of where this could be relevant is for issuers with multiple issuance platforms across different jurisdictions who traditionally seek to harmonise disclosures.

c. It is unclear why the SI has introduced the changes in Regulation 21(4) as regards asset-backed securities and structured products. The accompanying policy note (A.18) suggests that this is a clarification and that in the case of asset-backed securities, the necessary information includes information about the assets backing the security. The drafting of this new provision in the SI is not very helpful (both in terms of the definition of an asset-backed security and in the necessary information test applicable to asset-backed securities). Whilst the proposals may be intended to be clarificatory and some of the wording (e.g., paragraph 21(4) of the SI) is lifted directly from the UK Prospectus Regulation Delegated Regulation, the approach of including it in the legislation seems to be too blunt given that asset-backed securities encompass a wide range of different products (for example, there are deals that are both asset-backed and guaranteed) and may have unintended consequences that the FCA may not be able to fix when it comes to make its detailed rules/guidance. Furthermore, looking at asset-backed securities by way of example, relevant considerations are already covered in the necessary information test in Regulation 21(1) because 21(2) anticipates that the information will vary depending on, e.g., the nature of the issuer (in the case of an SPV issuer information disclosed will therefore focus less on the SPV and more on the pool of assets and underlying borrowers etc). Other aspects of Regulation 21(2) also allow for adjustments to the necessary information test to cater for appropriate disclosure for these types of non-equity securities. It would be preferable to rely on the test in Regulation 21(1) and (2) and then to address asset-back and structured product specifics in the FCA rules which would provide for necessary flexibility.

4. **Withdrawal rights (Regulation 29)**

a. This provision applies in relation to **all** public offers of relevant securities notwithstanding that the circumstances and manner in which those withdrawal rights can be used will be specified in the applicable rules, namely those of the FCA (for securities admitted to a regulated market), the primary MTF operator (for securities admitted to a primary MTF) or the FCA rules made in accordance with Regulation 15. The relevant rules will presumably relate the withdrawal right to the production of a supplemental prospectus in accordance with the existing regime.

b. This broad application in the SI mirrors the level 1 application of the withdrawal right provision in the existing UK Prospectus Regulation which – by virtue of the wide definition of "offer of securities to the public" - applies to **all** offers of securities to the public, including exempt offers (Article 23.2), following the publication of a supplement. However, there is a technical mismatch between this level 1 text and the ESMA interpretation that withdrawal rights should not apply in relation to admission only supplements (ESMA Final Report on Draft regulatory technical standards under the Prospectus Regulation of 17 July 2018). The market has typically understood the application of withdrawal rights on the basis of the ESMA interpretation, which has been informally confirmed by a number of national competent authorities.

c. There is therefore an opportunity to clarify the position in the SI by confirming the ESMA approach thus providing greater certainty on the point that would be welcomed by the debt market. This could be achieved by confirming in the SI that any public offers that benefit from any of the exemptions in Schedule 1, Part 1, paragraphs (1) – (5) and paragraph (14), would not be subject to Regulation 29 even if the securities the subject of such offers are intended to be admitted to trading on a regulated market or a primary MTF.

d. Is it the intention that the rules referred to in Regulation 29(3)(c) will be made in relation to offers made on regulated platforms and/or in other circumstances? It would be useful to have clarification on this.

5. **Public offer exemptions (Schedule 1, Part 1)**

a. There does not seem to be any logical rationale for the total consideration exemption to have a £100k threshold while the minimum denomination exemption has a £50k threshold. These exemption thresholds are aligned under the existing UK Prospectus Regulation. If the higher exemption consideration threshold remains there would be a potential mismatch between a person seeking to rely on the equivalent EU exemption (Euro 100k) in respect of the same offer. It would be helpful if the reasoning behind the distinction could be shared.

b. ICMA would like to confirm its understanding of the public offer exemption for issues of transferable securities that are "conditional" upon the admission to trading on a regulated market or a primary MTF. It is clear that any low denomination offer of debt securities that does not fall within one of the general exceptions in Schedule 1 Part 1, such as the Qualified Investor or less than 150 persons exemption, (i.e. what the market understands as 'retail' offers) will be required to be admitted to trading on a regulated market or a primary MTF (unless offered via a regulated platform) in order to be exempt from the general prohibition in Regulation 11. 'Retail' offers typically start some time prior to the admission to listing. There is a concern that the word "conditional" in the exemption could therefore be problematic given the structure of these offers or if (for a technical reason) the admission to trading is not given on the anticipated date or for some other reason the timing slips. Would there be a risk in this circumstance of the offer becoming unlawful? It would be helpful to have some background to the thinking behind "conditional". Perhaps it is included to emphasise that any offer that is made must make clear in its terms that it is conditional on admission to trading on the relevant market, such that if admission did not happen the offer would lapse? It would be helpful to clarify this in the drafting.

c. Currently primary MTFs in the debt markets, such as the ISM and PSM, are institutional only markets. However, the public offer exemptions in Part 1 Schedule 1 theoretically envisage that 'retail' offers of transferable securities could be admitted to trading on a primary MTF by way of exemption to the general prohibition in Regulation 11. In the context of primary MTFs the FCA only has the authority to make light touch rules (Regulation 14) including the ability to require the operator to include a provision requiring the publication of a document described as a prospectus as a condition of admission. However, as these powers do not seemingly extend to specifying prospectus content or when the prospectus needs to be prepared, the FCA does not look to have the authority to mandate that a prospectus is available for the start of any such retail offer or what it must contain. It is unclear how this aspect of the regime is envisaged to work if primary MTFs expand their services to include retail offers. While there may be a restriction on primary MTFs admitting retail offers to trading, which would address the point, ICMA is not aware of one.

d. The definition of “qualified investor” in Part 2 of Schedule 1 includes reference in paragraph (2) to “investment firm” and “qualifying credit institution”. ICMA notes that they would be as currently defined in Sections 424A and 417 of the Financial Services and Markets Act 2000, though this could perhaps be made a bit clearer.

6. **Forward looking statements (Schedule 2, Part 2)**

The new forward looking statement provisions could be useful, but this is subject to how they are developed under the FCA rules. On cross-border transactions however, issuers will also need to consider the potential liability that may arise in other jurisdictions in connection with such statements.

The liability exemptions only apply in respect of persons responsible for a prospectus. Underwriters would not therefore benefit from the different standard of liability should, for example, a misrepresentation claim be successful against them in relation to forward looking statements in a prospectus. ICMA queries whether this was the intended outcome and is aware that ECM market participants are also considering the impact of this.

7. **Listing Particulars regime under FSMA**

The proposed changes to FSMA imply that there will continue to be a separate regime for "listing particulars" e.g., sections 79 – 82 and section 90. Is the intention that the FCA will continue to use listing particulars for admission to the PSM?

8. **Further changes to come**

a. The Illustrative SI suggests that there will be further changes to come in relation to FSMA e.g., relating to section numbers in square brackets in Schedule 3 of the SI *(“[Amendment of section 87M.]” or “[Amendment of section 97]”*). It would be helpful to know whether the market will see a draft of these provisions for comment before the SI is finalised.

b. In addition, there also seem to be words missing in Regulation 16(1)(c) as it is unclear what this provision is intending to achieve.

9. **Areas expected to be addressed by the FCA rules**

a. **Potential admission to trading exemptions**

Presumably, the FCA will develop 'admission to trading' exemptions that mirror the "excluded securities" definition set out in Regulation 5. This would be consistent with the existing UK Prospectus Regulation which excludes from its scope (i.e from both the admission to trading and public offer regimes) non-equity securities (i) issued by sovereigns, local authorities (Regulation 5(b)), (ii) guaranteed by sovereigns or local authorities (Regulation 5(d)) and (iii) securities issued by a qualifying body (Regulation 5(e)), amongst others. Furthermore, if money market instruments having a maturity of less than 12 months are not carved out from the definition of "transferable securities" in the SI, then the FCA would be expected to make it clear that the FCA's admission rules do not apply to them.

Separately, one would also expect the FCA to provide for appropriate exemptions and alleviations in relation to fungible securities admitted to trading on a regulated market (under Regulation 13(1)(a)(ii)). In particular, while issues of securities to be fungible with securities already admitted to trading are exempt from the public offer prohibition (Schedule 1, Part 1, Paragraph 6(b)) they are nevertheless subject to the FCA's admission rules and the FCA would be expected to adopt a threshold test to allow for fungible issues to be exempt from these. When determining the appropriate threshold, the FCA would presumably consider the existing UK Prospectus Regulation provisions (Article 1.5(a)). The FCA may also decide to provide for an alleviated disclosure regime for fungible or secondary issuances similar to that under the existing UK Prospectus Regulation (Article 14).

b. **Wholesale vs retail disclosure differentiation**

Having an appropriate disclosure regime for wholesale debt securities is fundamental to ensure the continuation of the current well-functioning and efficient pan-European primary wholesale bond markets. ICMA's review of the FCA Discussion Paper will be particularly focused on ensuring that the new rules do not impose more onerous requirements than those which currently apply in a wholesale context. This is particularly because an increase in disclosure requirements could act as a disincentive to seeking admission to trading on a UK market contrary to the FCA’s new secondary objective relating to competitiveness.

c. **Retail offer prospectuses**

As noted in paragraph 6(c), the SI is structured so that any offer of debt securities that does not benefit from the general exceptions in Schedule 1 Part 1 (i.e. what is understood to be a 'retail' offer) must fall within the exemption in paragraph 6 of Schedule 1, Part 1 (i.e. the securities offered will need to be admitted to trading on a regulated market or a primary MTF) to be exempt from the general prohibition on public offers. As regards securities admitted to trading on a regulated market, the FCA will presumably provide (potentially under Regulation 16(1)(b)) that a prospectus must be prepared prior to the start of any such 'retail' offer, which would be consistent with the provisions of the existing prospectus regime. However, it is important to note that 'retail' offers typically start some time prior to the admission to listing and this should be reflected in the rules.

It would also be good to understand further how the regulated public offer platform is expected to operate and whether it is anticipated that 'retail' offers of debt securities might also be admitted to that platform.

d. **Exemption from disclosure (Regulation 22)**

Regulation 22(2) provides that information contrary to the public interest is exempt from disclosure and that the FCA is granted power to authorise further omission of information from a prospectus in Regulation 22(1). One would expect the FCA rules will reflect the current omission from disclosure exemptions in the UK Prospectus Regulation (Article 18), which would align with the existing Listing Particulars regime under section 82 of FSMA.

e. **Financial Promotion Order (FPO) amendment**

Schedule 3 Part 2 paragraph 25(3) removes Article 70(1A) of the FPO (thereby deleting an exemption for final terms). This may be because there is no longer reference to final terms in legislation and these will instead fall to be required under admission rules. In which case one would expect to see final terms covered by Article 70(1)(d)(ii) of the FPO, as amended by the SI.

f. **Regulatory deference**

ICMA's understanding is that the FCA will develop rules setting out the circumstances and requirements by which a third country prospectus may be used to obtain admission to trading on a regulated market (this looks to be possible by virtue of the powers given to the FCA under Regulation 16).

10. **Primary MTFs**

One would expect the operators of primary MTFs will make similar provisions in their rules, where appropriate, to address the points raised above in Paragraph 9. It will be important that the flexibility that is currently afforded to issuers admitting securities to the ISM in particular is retained and that the new regime does not imply any additional burdens for issuers seeking admission to trading on the ISM.

ICMA contact
Ruari Ewing: Ruari.Ewing@icmagroup.org

International Capital Market Association
ICMA Brussels I Avenue des Arts 56, 1000 Brussels I T: +32 2 801 13 88
ICMA London I 110 Cannon Street, London EC4N 6EU I T: +44 20 7213 0310
ICMA Hong Kong I Unit 3603, Tower 2, Lippo Centre, 89 Queensway, Hong Kong I T: +852 2531 6592
ICMA Paris I 62 rue la Boétie, 75008 Paris I T: +33 1 70 17 64 72
ICMA Zurich I Dreikönigstrasse 8, 8002 Zurich I T: +41 44 363 4222
www.icmagroup.org