

Morgan Lewis

GLOBAL PUBLIC COMPANY ACADEMY

SECURITIES OFFERINGS IN EUROPE BY US COMPANIES

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Agenda

Section 1: Introduction and overview of applicable regime

Section 2: When is a prospectus required?

Section 3: Preparing a prospectus

Section 4: Market rules and local law restrictions

Section 5: Upcoming changes and Brexit

Section 6: US securities laws issues

Questions

SECTION 1

INTRODUCTION AND OVERVIEW OF APPLICABLE REGIME

Introduction

Financial Services Action Plan

- Goal of harmonisation across the EU in relation to financial services legislation.
- Develop a common set of rules and standards in relation to certain aspects of the regulation of the offering or listing of securities in the EU and continuing obligations for listed companies

Areas covered by EU-wide framework

- Offering of securities to the public within the EU
- Listing securities on EU regulated markets
- Continuing obligations for companies with EU listed securities
- Insider dealing and market abuse
- Takeovers

Not wholly governed by EU regime

- Local law rules
- Exchange rules

Directives and Regulations

- EU Regulations have direct effect in EU jurisdictions
- Directives require separate implementation in each member state
 - Discrepancies in application across member states
 - Directives being replaced with regulations (e.g. Prospectus Regulation, MAR)
- ESMA (European Securities and Markets Authority)
 - Promote common approaches and practices
- Differing scope of application
 - EU Regulated Markets, MTFs (e.g. AIM)
 - Certain types of security (e.g. equity, debt)
- Other differences still remain across member states

Scope of today's talk

- Prospectus regime
 - When is a prospectus required
 - Preparation of prospectus
 - Not covering listing process in any detail
- Local law issues and market rules
- Upcoming changes and Brexit
- US securities laws issues
- Questions

SECTION 2

WHEN IS A PROSPECTUS REQUIRED?

Introduction

- EU Prospectus Directive (2003/71/EC). Attempt to standardise the requirements across the EU for:
 - When a prospectus is required
 - The contents requirements of such a prospectus
- Implemented by local regulations in each EU member state (e.g. FSMA 2000 and Prospectus Rules in UK)
 - Discrepancies in application, especially as to when a prospectus is required
 - ESMA Recommendations, FAQs and Opinions
- Prospectus Regulation (Regulation 2017/1129)
 - Repeals and replaces the directive with effect from 21 July 2019
 - Will require amendment to existing legislation and regulation across member states
 - Some provisions already in effect
- Other EU regulations with regards to e.g. supplementary prospectuses

When is a prospectus required?

- Two trigger events:
 - Are transferable securities being offered to the public in a member state?
 - Are transferable securities to be admitted to trading on a regulated market situated or operating in the EU?
- “Transferable securities”:
 - classes of securities which are negotiable on the capital market, except instruments of payment
 - includes shares, depositary receipts, bonds or other forms of securitised debt, other securities giving the right to acquire or sell such transferable securities (e.g. tradable warrants) and certain derivatives
 - Certain very specialist types of security excluded (e.g. shares in central banks, or shares in management companies linked to ownership of real property)
 - Employee share options normally not considered to be non-transferable securities

Trigger events

- "Offer of securities to the public": wide definition
 - communication to any person which presents sufficient information on the securities to be offered and the terms on which they are to be offered to enable an investor to decide to acquire the securities in question.
 - The communication can be made in any form and by any means
 - If there is no element of choice for the recipient, including no right to repudiate, there is no "offer of securities to the public"
- "Regulated market"
 - Member states are required to provide a list of their regulated markets, and ESMA is required to publish a list of all regulated markets on its website
 - Only certain EU markets are "regulated markets", e.g. in UK
 - LSE main market: regulated
 - AIM: not regulated

Exemptions – both triggers

- Shares issued in substitution for shares of the same class
- Takeover exemption
 - transferable securities offered over by means of securities exchange offer
 - document containing “equivalent information” required.
- Merger or division exemption
 - transferable securities offered in connection with a merger or demerger
 - document containing “equivalent information” required
- Scrip dividend exemption.
 - Dividends in form of shares of the same class as the shares on which dividend is paid
 - For regulated market trigger, the shares of the same class as those admitted to trading
 - Document containing information on the number/nature of shares and reasons for offer
- Employee offer exemption
 - Only applies to EU companies or where securities listed on EU regulated market
 - Securities are offered to existing or former directors or employees
 - Information document required
 - Upcoming changes

Exemptions – offers to the public

- Offer made to, or directed at, "qualified investors"
 - persons treated as professional clients or recognised as eligible counterparties under MiFID
- Offer made to fewer than 150 persons (other than qualified investors) in each EEA state.
- Minimum consideration payable by any person at least EUR100,000.
- Securities denominated in amounts of at least EUR100,000 (wholesale debt).
- The total consideration payable for the securities being offered does not exceed amount specified by relevant member state
 - Specified amount cannot exceed EUR 8 million or be less than EUR 1 million
 - Aggregate offers within the previous 12 months that relied on the exemption

Exemptions – admission to regulated market

- <20% of existing class admitted to trading (calculated over 12 month period)
- Securities offered free of charge to existing shareholders
 - same class as shares already trading on same regulated market
 - information document: number/nature of shares and reasons for offer
- Shares arising from conversion or exchange rights
 - same class as shares already admitted to trading on same regulated market
 - shares represent, over a period of 12 months, less than 20% of shares of same class already admitted to trading on same regulated market
 - N/A if prospectus was drawn up for offer or admission of securities with conversion/exchange rights or such securities issued pre 20 July 2017
- Shares already admitted to trading on another regulated market for at least 18 months
 - Shares subject of a prospectus when previously admitted (unless pre-2003)
 - Summary information document

SECTION 3

PREPARATION OF PROSPECTUS

Prospectus approval and publication

- Prospectus must be filed and approved by competent authority in home member state and must be published
- Home member states
 - Wholesale debt: choice between registered office location or where securities will be listed or offered to public
 - Retail debt or equity (EEA issuer): where issuer's registered office located
 - Retail debt or equity (non-EEA issuer): where securities first offered or listed
- Passporting regime
 - An approved PD prospectus in one member state can be “passport” into other EEA member states for offers to public or listing without further approval
 - Need to translate summary into local language

Prospectus format

- Format and content prescribed by PD and incorporated into specific country law (e.g., UK Prospectus Rules)
- Prospectus can be a single document or tri-partite separate documents comprising:
 - Registration document (information about issuer)
 - Securities note (information about securities)
 - Summary note (essential information about issuer and securities and risks)
- Base prospectuses for debt securities issued in a programme
- Supplements required if a significant new factor arises or to correct a material inaccuracy between date of approval and closing

Prospectus content

- Content requirements:
 - Article 5 of PD (General duty of disclosure)
 - Disclosure annexes to PD implementing regulation
- Annexes contain detailed disclosure requirements applicable to different types of securities and issuers
- Selected examples of disclosure annex requirements:
 - Retail debt securities (denominations < EUR 100k): Summary, risk factors, 3 years financial statements (IFRS or equivalent), interim financial statements, description of issuer, conflicts of interest, summary of material contracts, investments, description of securities and underwriting arrangements
 - Wholesale debt securities (denominations ≥ EUR 100k): Same as retail *except*: summary not required, only 2 years financial statements (no requirement for IFRS or equivalent, but would need description of differences), information on investments not required, information on underwriting arrangements not required
- Can incorporate by reference if the relevant documents filed and approved by same competent authority

SECTION 4

MARKET RULES AND LOCAL LAW RESTRICTIONS

Market rules

- If securities to be admitted to trading on a EU market, relevant exchange's rules must also be considered
- Certain EU markets are not EU regulated markets
 - Examples: EuroMTF (Luxembourg); GEM (Dublin); PSM (London); AIM (London)
 - Prospectus only required if offer to the public
 - Exchanges have their own rulebooks, published and supervised by the Exchanges themselves, e.g. AIM Rules for Companies
 - Rules govern documentation requirements for securities to be admitted to those exchanges (e.g. admission document for AIM)

Local law restrictions on marketing

- Many EEA jurisdictions will also have rules governing the marketing of securities to certain types of persons:
 - Aimed at protecting retail investors
 - Vary across EEA member states
- In UK, prohibition on “financial promotions”
 - invitation or inducement to engage in investment activity
 - must be issued or approved by FCA-authorized person
 - Numerous exemptions, including investment professionals, high net worth investors, employee share schemes, existing shareholders, etc.

SECTION 5

UPCOMING CHANGES AND BREXIT

Further implementation of Prospectus Regulation

- Majority of Prospectus Regulation will come into effect on 21 July 2019
 - Many provisions are unchanged from the existing PD regime (but NB direct effect)
- Exemptions for securities to be admitted to regulated market.
 - No longer permitted to combine 20% admission exemption and exemption re exercise of conversion or exchange rights if may lead to the immediate or deferred admission to trading over a period of 12 months of >20% of shares of same class already admitted to trading on same market without a prospectus.
- Takeover, merger and division exemptions:
 - contents requirements of information document now limited to information on number and nature of shares and the reasons for and details of offer
- Exemption for shares offered to directors and employees
 - no longer limited to EU issuers and issuers with securities admitted to trading on an EU regulated market

Brexit

- European Union (Withdrawal) Act 2018
 - EU legislation with direct effect implemented into UK law on and after exit day
 - Gives UK government power to amend UK and domesticated EU legislation to ensure that it is legally operative after the UK leaves the EU
 - Only applies to EU laws in effect on Brexit day (29 March 2019), therefore implications in context of Prospectus Regulation unclear
- Loss of passporting rights for EU prospectuses in UK, and vice versa
- Possibility of “equivalence” rules being agreed post-Brexit

SECTION 6

US SECURITIES LAWS ISSUES

US Companies Listing Abroad: The Numbers

- For the period **1991-1999**: Two US companies IPO'd abroad
- For the period **2002-2011**:
 - Almost 100 US companies conducted IPOs outside the US (compared with almost 1,500 on US markets)
 - Principal markets were UK and Canada, trailed by Australia and Netherlands
 - Total raised: about \$16 billion (compared with \$325 billion in the US)
- For the period **2012-2016**:
 - Almost 20 US companies conducted IPOs outside the US (compared with almost 1000 on US markets)
 - Total raised: about \$1 billion (compared with around \$250 billion in the US)

Why Go Public Outside the US?

- Cost of listing process – somewhat cheaper outside US
- Cost of ongoing compliance – generally much cheaper outside the US
- More appetite in some markets for smaller, earlier-stage companies, particularly in certain industries
- Geographic, industry, peer focus
- Interim step before US IPO

The US Legal Angle

Background – Scope of US federal securities laws.

- Securities Act of 1933: public offerings
- Exchange Act of 1934: public company life and stock exchanges
- General Rule: offers and sales to the public requires registration, unless an exemption applies
- US securities laws generally have extraterritorial effect, but, for fraud purposes: “transactional test” (*Morrison case*)
- Regulation S governs offers and sales outside the US

Regulation S

- Regulation S (Rules 901-905): a safe harbor that allows securities to be offered and sold outside the U.S. without SEC registration
- Two safe harbors
 - Issuer safe harbor (Rule 903): covers sales by the issuer, a distributor (a party that has entered into a contractual relationship with the issuer to sell the securities) any of their respective affiliates or any person acting on their behalf
 - Resale safe harbor (Rule 904): covers resales by non-affiliate third parties

Regulation S – Primary Offerings (Issuer Safe Harbor)

- Rule 903
 - Two basic conditions:
 - The offer and sale must be made in an “offshore transaction”
 - No “directed selling efforts” may take place in the U.S.
 - Defined as any activity for the purpose of, or that could reasonably be expected to have the effect of, conditioning the U.S. market for the securities being offered
 - Implications for offering publicity
 - Implications for dual listings
 - Additional requirements
 - Issuers/offerings are classified into three categories, and depending on category, additional requirements may apply

Regulation S – Primary Offerings (Issuer Safe Harbor)

- Category 1 (Low-risk offerings)
 - Who qualifies?
 - Foreign issuer
 - No SUSMI (“Substantial U.S. Market Interest”) if a non-governmental issuer
 - Overseas directed offering
 - Additional requirements
 - None

Regulation S – Primary Offerings (Issuer Safe Harbor)

- Category 2 (Medium-risk offerings)
 - Who qualifies?
 - equity securities of a reporting non-US issuer
 - debt securities of a reporting US or non-US issuer
 - debt securities of a non-reporting non-US issuer
 - Additional requirements
 - Distribution compliance period (“DCP”)
 - 40 days
 - includes requirement that no offers and sales can be made to a U.S. person other than a distributor
 - Notice requirement
 - Offering restrictions
 - Written agreement by dealers to comply with DCP; legends in prospectus

Regulation S – Primary Offerings (Issuer Safe Harbor)

- Category 3 (High-risk offerings)
 - Who qualifies?
 - All others Including US companies listing abroad
 - Additional requirements
 - DCP – 40 days for debt; 1 year for equity (non-reporting issuer)
 - Additional transaction restrictions and offering restrictions
 - Debt securities must be represented by a temporary global note not exchangeable for definitive securities during the 40-day DCP

Simultaneous U.S./Non-U.S. (Global) Offerings

- Rule 144A/ Reg S Offerings
 - Aggregation and Fungibility Issues
- Registered U.S./Regulation S Offering
- Directed Selling Efforts
- Effect of Elimination of General Solicitations on Private U.S. Offerings.

Regulation S – Secondary Transactions (Resale Safe Harbor)

- Resales under Regulation S (Rule 904)
 - Applies to securities acquired in U.S. offerings or non-U.S. offerings if being resold outside U.S.
 - Cannot be used by the issuer, a distributor, any of their respective affiliates (except any officer or director who is an affiliate solely by virtue of holding such position) or any person acting on behalf of any of the foregoing (as such persons need to utilise Rule 903)
 - Basic requirements
 - Resale must be made in an “offshore transaction”
 - Resale must not involve “directed selling efforts”

Regulation S – Secondary Transactions (Resale Safe Harbor)

- Additional restrictions for Regulation S resales:
 - For resales by participating dealers (securities firms and persons receiving selling concessions or fees) in an offering by a Category 2 or 3 issuer:
 - No resales to U.S. persons during distribution compliance period
 - Confirmations provided to purchasers who are dealers
 - For resales by certain affiliates (an officer or director of the issuer or a distributor who is an affiliate of the issuer or distributor solely by virtue of holding such position):
 - Restrictions on selling fees/commissions

Rule 905 – Status of U.S. Equity Securities

- “Pirates in the Safe Harbor” – Abuses of Regulation S and SEC Reaction
- Rule 905 – Restricted Nature of U.S. Equity sold under Regulation S
- Effect of Rule 904 Resales on U.S. Equity Securities
- Effect of Rule 904 Resales on Non-U.S. Equity Securities
- Fungibility Issues Prevent Seasoning
- Off-Shore Sales by Affiliates Start New Holding Period
- Effect on Ability to List Outside the United States

Regulation S Challenges for US Issuers

- Distribution Compliance Period: Liquidity / trading challenges
 - Legend and certification requirements: physical certificates / electronic notice of resale restrictions
- EU now requires book-entry settlement through central securities depository
- LSE amended rules to facilitate Reg. S offerings
- CREST procedures incorporate legending, certification and stop transfer requirements of Reg S
- Implications still to be seen

Potentially still caught in the US Web

- Exchange Act Registration Requirements:
 - Must register a class of equity securities (other than exempted securities) within 120 days after fiscal year end if, on the last day of fiscal year, issuer has total assets of more than \$10 million and a class of equity securities “held of record” by either (i) 2,000 persons or (ii) 500 persons who are not accredited investors. (Section 12(g)(1) of the Exchange Act)
 - “Held of record”: does not include securities held by persons who received the securities pursuant to an “employee compensation plan” in transactions exempt from registration requirements

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