Title: UK implementation of the amended EU Prospectus Directive IA No: Lead department or agency: HM Treasury Other departments or agencies:	**Impact Assessment (IA)** **Date:** 04/04/2012 **Stage:** Final stage consultation **Source of intervention: EU** **Type of measure:** Secondary legislation **Contact for enquiries:** Matthew Fisher

Summary: Intervention and Options

RPC Opinion: AMBER

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£5.42m	£5.42m	-£0.63m	Yes	OUT

What is the problem under consideration? Why is government intervention necessary?

The Prospectus Directive (2003/71/EC), which came into effect across the EU in 2005, was introduced to support issuers raising capital. It was also designed to ensure the provision of adequate information to EU investors, in a consistent manner. These two objectives supported the development of the single market with respect to raising capital.

The Directive was updated via Amending Directive (2010/73/EU), to improve and simplify its application - principally by reducing the administrative burden on issuers (while maintaining adequate investor protection) and by increasing legal certainty. The deadline for implementation is 1 July 2012.

What are the policy objectives and the intended effects?

The European Commission had a duty, under Article 31, to review the Prospectus Directive five years after it came into force. The Prospectus Directive was also identified through the Commission's wider policy work as an area that could be simplified in order to reduce the regulatory burden faced by companies raising capital. The Commission's aims when conducting the review were to: provide greater legal certainty, reduce burdensome requirements in the capital-raising process, and ensure the regime still provided adequate protection to investors. The government supports the EC's goals.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The nature of EU legislation is such that updating the Financial Services and Markets Act 2000 - which brings the requirements of the Prospectus Directive into UK law - is the only policy option available to the UK.

The PD is also a maximum harmonisation directive to ensure consistency of application across the EU so that investors are adequately protected and issuers enjoy the full benefits envisaged of a single, cross-border capital-raising regime. As a maximum harmonisation directive, Member States have very little discretion as to its method of implementation.

Moreover, as these amendments are designed to simplify the regime, create more certainty, and reduce regulatory burden, they are welcome. Copy-out principles will be used, wherever possible, in the transposition of the Amending Directive into UK law.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 07/2017

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: Date: 12. April 2012

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** +£5.42m

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£1.8m		-	-
High	£2.9m		-	-
Best Estimate	£2.4m			**£2.4m**

Description and scale of key monetised costs by 'main affected groups'

As only small changes are being made to the Prospectus regime, a modest familiarisation cost to issuers is calculated. This updates previous FSA cost-benefit analysis when the Prospectus Directive was first introduced in 2005. It was further updated from the previous iteration of this impact assessment based on industry responses to our consultation.

Other key non-monetised costs by 'main affected groups'

In terms of a tightening of the current regime, the Amending Directive increases the amount of capital a single investor must provide if the issuer is to benefit from an exemption from producing a prospectus. This threshold will rise from €50,000 to €100,000. The Commission viewed €50,000 as too low a threshold to ensure adequate consumer protection. Our consultation sought to establish if the cost of increasing this threshold could be monetised, but received no response from industry.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	-		-	-
High	-	10	-	-
Best Estimate	0		+£0.9m	**£7.8m**

Description and scale of key monetised benefits by 'main affected groups'

More proportionate disclosure requirements will now be permitted in certain instances, particularly for rights issues. This will reduce the weight of disclosure and cost of producing a prospectus by around £0.9m annually, for UK businesses. This may indirectly benefit existing shareholders too by encouraging issuers to undertake more rights issues, rather than private placements, helping avoid shareholder dilution. No detrimental consumer impact is expected from proportionate disclosure.

Other key non-monetised benefits by 'main affected groups'

In addition to the proportionate disclosure regime, the chief benefits of the amendments are increases in the thresholds that determine when the regulatory requirement to produce a prospectus applies. Additionally, the regime has been altered to provide greater legal certainty for issuers and financial intermediaries, which will help simplify and make more attractive the raising of equity capital. No detrimental impact is expected on consumers.

Key assumptions/sensitivities/risks | **Discount rate (%)** 3.5

(i) Transition costs will be low as the regime is already familiar to market actors and its basic structure is not being changed. Our calculation assumptions have however been refined through the consultation process. (ii) An adequate balance has been struck in revising the PD, to enable investor protection to remain strong while reducing the regulatory burden on issuers. Our confidence in this balance has been reaffirmed through consultation responses and level 2 decisions.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £0.3m	**Benefits:** £0.9m	**Net:** £0.6m	Yes	OUT

Evidence Base (for summary sheets)

A. Background & policy objectives

The Prospectus Directive first came into force in 2005. It is implemented in UK law through provisions in the Financial Services & Markets Act (FSMA) 2000, for which HM Treasury has responsibility, and Prospectus Rules, for which the Financial Services Authority (FSA) has responsibility. This Impact Assessment covers only the areas of implementation for which HM Treasury has responsibility. The FSA has provided its own separate cost/benefit assessment for areas covered by its Prospectus Rules.

The Prospectus Directive provides for two scenarios where a prospectus is required: firstly, when securities are admitted to trading on a regulated market, and secondly, when an offer of securities is made to the public. The purpose of the Directive is to harmonise requirements for the drawing up, approval and distribution of the prospectus, establishing a series of requirements with which companies must comply in terms of the content and format of the documentation given to investors.

The Directive's principal objectives are to enhance investor protection through the provision of high-quality, consistent information to investors, and to improve the efficiency of the single market. The key innovation brought about by the Directive for companies is that a prospectus approved in one Member State is valid across the EU, giving issuers a 'passport' across the EU capital markets.

On 9th January 2009, the Commission undertook a three-month public consultation to help inform how the Prospectus Directive could be improved. On 24th September 2009, the Commission published its proposal to review the Prospectus Directive. A final text was agreed following EU negotiations, was published in the Official Journal of the European Union, and came into effect on 31st December 2010.

HMT and FSA launched a joint three-month consultation in December 2011 which set out the way in which the UK intended to take forward the implementation of the Directive, (enclosing the previous iteration of this impact assessment), and sought industry views on this approach. It should be noted that the consultation was launched prior to publication of level 2 detail by the European Commission.

B. Rationale for review

The European Commission had a duty, under Article 31 of the Prospectus Directive, to review the effectiveness of the Prospectus Directive five years after it came into effect. Additionally, the Prospectus Directive was identified in the Commission's 'Action Programme' of January 2007 as an area where simplification was possible to alleviate the regulatory burden on companies seeking to raise capital.

The main objectives of the Commission in undertaking the review of the Prospectus Directive were to:

- Evaluate the overall success of the regime and the protection afforded to investors;
- Identify ways to reduce the obligation on companies, without compromising investor protection;
- Improve and simplify the regime to ensure greater clarity and legal certainty.

Changes to the Prospectus Directive are generally welcome in that the review has identified areas of cost reduction and given greater legal certainty to businesses seeking to raise capital. No detrimental impact on consumers is envisaged.

C. Policy options

- **Policy Option 1:** **Do Nothing – (See page One for explanation as to why this is not an option)**

- **Policy option 2:** **Implement changes to the Prospectus Directive in the UK in accordance with the EU deadline**

The Prospectus Directive is a maximum harmonisation directive, which means that Member States are unable to go beyond the requirements of the Directive and have very limited discretion. Not to implement the changes to the regime runs the risk of the UK being infracted. The deadline for implementation is 1 July 2012.

Furthermore, the changes to the prospectus regime are broadly welcome. The revisions provide a rare example of deregulation at an EU level, simplifying and reducing regulatory burden on issuers while maintaining sufficient and high levels of investor protection.

Changes to the Prospectus Directive require amendments to the relevant areas of statutory legislation (FSMA) and regulatory requirements (FSA Prospectus Rules). This Impact Assessment covers only the areas of implementation for which HM Treasury has responsibility.

D. Scope and impact

The Prospectus Directive affects the following parties:

- **Issuers** – firms and organisations looking to access capital markets and/or make public offers of securities.
- **Third-party service providers** – e.g. lawyers and financial institutions such as investment banks. These groups must be familiar with the regime in order to provide their advisory services
- **Investors** – who benefit from the protection afforded to them of having a single EU regime setting out the information with which they must be provided when issuers raise capital

The review of the Prospectus Directive sought only to update, rather than reform, the regime. No fundamental changes were made as the Commission's analysis found that the Prospectus Directive was operating well. The amendments that were made reflect small revisions to the thresholds that determine when the requirement to produce a prospectus applies, as well as the introduction of more proportionate disclosure for certain types of offers in order to reduce the cost-burden on issuers. Finally, the revised Prospectus regime provides greater legal certainty, codifying market behaviour and interpretation of the original Directive.

On this basis, the cost of changing the regime, and the impact on the market, is assumed to be small. This reflects the fact that only minor improvements are being made to the existing regime, essentially to put the framework on a better legal footing and to codify existing market behaviour.

The impact of the revised regime on affected parties may be summarised as follows:

- **Issuers** – will benefit from greater legal certainty, increasing market confidence in raising capital. They will benefit from small changes in the numerical limits at which point the Directive applies, meaning a small number of offers no longer require a prospectus to be produced. Issuers will benefit from reduced, proportionate disclosure for certain types of qualifying offers, notably involving rights issues. A small transition cost is expected in order for this group to familiarise itself with the updated regime.
- **Third-party service providers** – familiarisation will be needed with the updated regime by those providing advisory services. The changes to the regime are slight, however. Furthermore, this group will by its nature monitor regulatory developments as part of the day-to-day cost of providing advisory services.
- **Investors** – may benefit in particular from changes to rights issues, where proportionate disclosure may result in more relevant prospectuses being offered to them, and the risk of their dilution is reduced (cheaper rights offers are more attractive to issuers). As the changes to the Prospectus regime are slight, and proportionate disclosure will apply only where investors are not affected, their protection should not change *(See also 'risk assessment'.)*

E. Outcome of the review – further detail

(i) Proportionate disclosure regime

One of the changes to the Prospectus regime is the creation of a reduced or 'proportionate' disclosure regime for certain kinds of public offer, based on current disclosure requirements.

The Directive makes provision for a proportionate regime to apply in three cases: (i) SMEs and companies admitted to trading on regulated markets with reduced capitalisation; (ii) for certain lenders undertaking repeat issues of debt securities (totalling up to €75m EUR per year); and (iii) for companies raising second round equity finance through rights issues of shares.

The proportionate regime will draw on existing disclosure requirements under the Prospectus Directive but specify that certain information need not be provided. The intention is to reduce the weight of the prospectus without affecting investor protection. Its creation will not impose any new cost on issuers either as it simply reduces what is already required under a 'full' prospectus today[1].

Level 2 work has demonstrated that the most significant cost savings in terms of the proportionate disclosure regime, will apply to rights issues. Certain reduced disclosure standards apply in the other two scenarios, but must be balanced with the investor protection objective of the original Prospectus Directive. As rights issues necessarily apply only to *secondary* capital raising, more substantial disclosure reduction is possible here without affecting investor protection.

For this reason, the cost-savings provided in this impact assessment focus only on a proportionate disclosure regime for rights issues. Whilst there will be incremental cost savings from proportionate disclosure for points (i) and (ii) above, the modest nature of these savings combined with the lack of any other estimates to monetise such savings make it extremely difficult to accurately and fairly predict cost reductions to business.

(ii) Thresholds and exemptions

The Commission's review also made revisions to the thresholds and exemptions which determine when the obligations of the Prospectus Directive apply. The majority of this work was deregulatory in its focus, aiming to lift a number of small offers (typically made by small companies) outside of the Prospectus regime altogether. Notably, the UK has already brought two of these deregulatory changes into effect, on 31 July 2011, in order for small companies to benefit at the earliest possible opportunity. These relate to the number of investors to whom an offer can be addressed (increased from 100 to 150) and the overall size of the offer (which has risen from €2.5 million EUR to €5 million EUR), before triggering the requirement to produce a prospectus. **These measures, worth an annual £12m a year to the UK, have already been subject to consultation and cost-benefit analysis, and are not considered further here.**

Further deregulatory threshold revisions have been introduced: increasing the exemption threshold for debt securities issued over a 12 month period, from €50m EUR to €75m EUR, and a new provision made so that offers involving securities that are guaranteed by a Member State may omit information about the guarantor.

A *stricter* threshold was introduced during the review, relating to the minimum sum that an individual investor must make in order for the offer not to require the issuer to produce a prospectus. Currently, an investor may make a minimum contribution of €50,000 EUR per investor for the issuer to benefit from not needing to produce a prospectus. This is based on the assumption that this high level of capital means that the offer will be targeted at sophisticated, professional investors. The amending Directive will now require a minimum contribution of €100,000 EUR per investor for the issuer to continue to benefit from not needing to produce a prospectus. It was felt that at the lower threshold, some retail investors may inadvertently **be treated as professionals, and thus the intentions of the Directive with respect to investor protection may not** always be realised

[1]Article 7(2)(e) of the original Prospectus Directive 2003/71/EC provided for a proportionate disclosure regime for SMEs. However, when it was implemented in 2005, the Commission did not put in place a proportionate disclosure regime for SMEs. The Amending Directive changes Article 7(2)(e) so that it allows for proportionate disclosure regime not only for SMEs but also for the new category of "*companies with reduced market capitalisation*" (Small Caps). The Commission's mandate to ESMA of January 2011 instructed ESMA to provide the Commission with technical advice on proportionate disclosure regimes for SMEs and for Small Caps.

(iii) Simplification and legal certainty

Other changes to the Prospectus regime were designed to improve its application and provide greater legal certainty. These changes:

- Make explicit that no new Prospectus is required when companies issue securities through intermediaries so long as a valid prospectus is available and the issuer consents to its use. (This is still to be finalised at level 2)
- Improve the comparability of different prospectus via the prospectus summary. The liability attached to the summary has also been clarified;
- Clarify investors' rights to withdraw from an offer and the time period in which a supplement should be produced;
- Clarify the relationship between final terms and the base prospectus;
- Align the Prospectus Directive with subsequent financial services legislation, in particular the definition of a 'qualified investor' in MiFID. (This is still to be finalised at level 2)

F. Costs and benefits

Costs

(i) Compliance / transition

The first of these costs is the overarching cost of compliance with a change to the Prospectus regime. These costs relate to transitional business costs for market actors to understand and comply with the slight modifications to a Prospectus regime with which they are already familiar.

The transitional cost across the UK is assumed to be small – costing £1.8m to £2.9m. This reflects the fact that only small changes are being made to the Prospectus regime, mainly to codify existing market behaviour. This estimate is higher than the one provided in the previous iteration of this impact assessment, (£0.4m) as it has been informed by industry response to our consultation. It should however be noted that industry recognised the inherent difficulty of estimating these figures, and that the amount would vary on a company by company basis.

The estimated range for transition cost per company is £700 - £1100.

Further familiarisation may be expected from third-parties offering related advisory and legal services – but familiarisation by this group is intrinsic to their monitoring of all kinds of relevant regulatory developments. It is impossible to disaggregate familiarisation with the Prospectus Directive from their day-to-day following of market developments and provision of expert advice. We asked if this was a fair assessment of third party costs as part of our consultation with industry, as this was an area of concern raised by the RPC on the previous version of this impact assessment. We received no response from industry which indicated that it was not possible or practical to calculate such third party costs. On this basis we have maintained our approach of not calculating non issuer costs.

The cost to investors is expected to be nil, as the Prospectus regime is simply being updated and experiencing minor, rather than substantial, change.

Calculating the transitional cost

In 2005, when the Prospectus Directive first came into effect, a fairly small transitional cost of £2.3 million was estimated by the FSA for issuers familiarising themselves with the new regime.

This figure was calculated on the basis of two days of compliance officer time, at a rate of £400/day, for the 2,910 companies then listed on the London Stock Exchange.

Now, in 2012, market actors are familiar with the Prospectus regime. Considering that the introduction of the Prospectus Directive required only two days of time in 2005, our initial assumption (in the previous Impact assessment) was that familiarisation would require two hours of compliance office time in total. As a result of industry responses to our consultation, we have changed these assumptions to generate a more informed estimate. Our prevailing assumption is that it will take four hours of Compliance Officer (or equivalent) time for issuers to familiarise themselves with the amended regime. This provides a transition cost of £718,480 or approximately £0.7 million, based on the 2,566 companies currently listed on the London Stock Exchange (as of 29 February 2012). The cost of the Compliance Officer has been increased by the FSA to £70/hour to reflect earnings inflation since 2005.

Furthermore, it was suggested by industry that there would be an ongoing compliance cost of two hours a month for three to six months, in order to ensure that the new requirements were being fulfilled. The range of estimates given in this IA reflects the values for three months and six months, namely £1.8m to £2.9m. The £2.4m estimate provided on the front page is the median value based on that range (£2.35m) rounded to £2.4m in order to calculate NPV figures in accordance with the standard IA methodology.

(ii) Specific costs

The second layer of costs relates to where the regime has been *tightened* with respect to the minimum amount of capital an individual must commit for the offer to be deemed to have been made to a professional investor (and not require a prospectus to be produced). Issuers will now need to make exempt offers to investors of at least €100,000 EUR per investor. Previously, this threshold was set at €50,000 EUR per investor – meaning that offers to investors between €50,000 EUR and €100,000 EUR will now require a prospectus, where previously they did not. In the same vein, a threshold increase was also made, from €50,000 to €100,000, for offers of non-equity securities. Only offers made at or above €100,000 will now continue to qualify for reduced disclosure under the prospectus regime.

The impact on the market is unclear. While offers between €50,000 EUR and €100,000 EUR will now require a prospectus, the reality of the way in which market participants use the thresholds in the Directive suggests that the same offers that would be made at €50,000 EUR will now simply be addressed to those, or most of those, same investors for a minimum sum of €100,000 EUR. Consequently, the impact may in fact be intangible, where market dynamics simply adjust to the requirements of the new regime.

This is also hard to judge in view of the fact that the definition of a professional investor is being aligned with the Markets in Financial Instruments Directive (MiFID), which should allow businesses to access a wider pool of qualifying investors. Industry has welcomed this alignment with MiFID, consultation responses reiterated this support, highlighting the reduction in bureaucracy and potential for encouraging investment as a result of this alignment.

Further clarity on transitional and specific costs, and market impact of the threshold changes highlighted above, was sought from industry as part of our consultation, as suggested by the RPC comments on the previous iteration of this impact assessment. We received no response to questions regarding these issues, and therefore have left our assumptions unchanged.

Benefits

(i) The benefit of legal certainty

Changes made to the Prospectus regime provide greater legal certainty to those involved in the raising of capital. It is difficult to assess whether these translate into direct cost-savings – for example, if the average amount of legal advice for producing a Prospectus was reduced by, say, two hours per offer – or whether the benefits are more intangible, generally helping the capital-raising process be more navigable.

Considering that the revisions to the Prospectus Directive essentially codify existing market behaviour, it is most likely that the impact will be more intangible, providing increased market confidence in capital raising on the part of issuers.

Further information was sought on the benefits of legal clarity through consultation. Responses acknowledged that the changes largely codify current market interpretation of the directive, and that there were not likely to be any significant cost reductions as a result. No responses contested this view.

(ii) Specific cost-savings

Specific cost reduction will arise from having a proportionate disclosure regime for certain public offers.

Indicative cost-savings from developing a proportionate disclosure regime were provided in the Commission's Impact Assessment. However, estimates previously used in this impact assessment were calculated prior to Commission level 2 publication. Subsequently, this impact assessment uses revised estimates based in part on the Commission's estimates on costs to businesses, and in part on the new detail from level 2 publications, specifically on the content of the proportionate disclosure regime, which provide a more informed basis on which to calculate benefits.

However, it should be noted that actual benefits to firms are still difficult to calculate on the basis that the costs will vary on a firm by firm (and issue by issue) basis, and therefore these figures should be treated as indicative best estimates.

The proportionate disclosure regime for rights issues appears to offer the greatest saving for market participants. Here, broad estimates of the cost reduction possible were provided to the Commission as a result of the work of the UK's *Rights Issues Review Group*. The Commission in turn based their estimates on these figures.

Our latest estimates update the Commission's figures, based on the aspects of the proportionate disclosure regime that were actually taken forward in level 2 (whilst using the same underlying methodology as before). Our work suggests that the revised benefit to UK firms is approximately £51,385 for issuers in an average of 18 cases annually (roughly £925k a year across the UK). The first figure above is converted to Sterling from €61,500 Euros[2] which is derived from a pan EU benefit of approximately €21m for issuers in an average of 343 cases annually across the EU. (This revised benefit to UK firms represents a significant cost reduction, considering that separate industry and Treasury analysis suggests that the cost to UK issuers of producing a 'full' prospectus is typically between £350,000 and £600,000 per offer). The estimated benefit of £925k has been rounded down in our final calculations of NPV on the front pages of this Impact Assessment, in accordance with standard IA NPV methodology.

Our consultation sought to establish industry's views on the estimates used by the Commission for the benefits of the proportionate disclosure regime, and whether they had any estimates themselves. One respondent agreed with the Commission's estimates given the available information; another commented that it was difficult to calculate any figures, and that any cost saving was welcome. No alternative estimates or methodology were offered by industry.

A proportionate disclosure regime for rights issues may also benefit investors. Previous research by the UK's *Rights Issues Review Group* and the European Securities Markets Expert Group, *ESME,* discovered that the length and complexity of the prospectus means that most investors do not use the prospectus to inform their investment decisions for rights issues. Unlike with a new company being admitted to trade, for rights issues substantial information is already available to investors in the marketplace. Proportionate disclosure may therefore be more relevant to them. Additionally, the reduced cost for issuers of going ahead with rights issues

under the new proportionate regime may encourage them to undertake more rights issues, rather than private placements. This provides better value for existing investors currently at risk of dilution if secondary offers are not made to them by issuers.

Calculating the cost saving of a proportionate disclosure regime for rights issues in the UK

London Stock Exchange data shows that between July 2005 (when the Prospectus Regime was first introduced) and July 2011, 105 rights issues took place on the main market and AIM that fall within the scope of the updated Prospectus Directive – i.e. offers totalling €5 million EUR or more. This provides an average figure of **18** qualifying UK rights issues per year. The threshold was previously set at €2.5m, so raising it has allowed more firms to benefit from the proportionate disclosure regime.

This figure could potentially be slightly conservative, as this is based on LSE data only. The benefit in the Prospectus Directive applies only to companies admitted to trading on regulated markets or Multilateral Trading Facilities (MTFs), and not to private companies undertaking secondary financing.

This means that the 150+ companies on the stock exchange of the Plus Markets Group could, however, also benefit, in addition to the 2500+ companies on the LSE. Yet it is likely that the majority of these constituents would undertake offers below the €5 million EUR threshold (and therefore would not need to produce a prospectus at all) as the market specialises in very small companies. LSE data is therefore a useful proxy for the benefit to UK companies of the proportionate disclosure regime for rights issues.

Therefore:

- **Saving for issuers in Sterling =£51,385** ***(Converted from €61,500 on 03 April. 2012, via currency conversion site www.xe.com)***
- **18 annual offers in the UK x £51,385 (rounded down) = annual benefit of approximately £925,000 for the UK.**

[2]To reach this figure, the Commission assumed in its Impact Assessment of the 24th September 2009 that the costs related to external and internal auditor work was reduced by 100%, transaction counsel (time and legal cost) reduced by 30%, publication reduced by 20%, and the time of the issuer (the lead manager, and senior personnel) reduced by 50%.

This figure was reached by the Commission drawing heavily on the work of the UK's *The Rights Issue Review Group*, from 2009. This work outlined the (then) current disclosure regime, and highlighted requirements which could be removed based on the premise that the information was already publically available. The Commission used these removals as the basis for its costing assumptions. We have subsequently amended the Commission's estimates to reflect what actually transpired as level 2 changes to the proportionate disclosure regime (PDR) for rights issues:

- As both internal and external auditing costs were included in the PDR at level 2, we are unable to deduct them, raising the figure by 100% and reversing the Commission's reduction entirely.

- The reduction in corporate information (e.g. about the issuer's property plants and equipment, and capital resources) would result in the amount of legal due diligence ("transaction counsel") also being reduced. However less was excluded in level 2 than the Commission's original estimate, so the figure has been reduced by two thirds accordingly, to **10%,** based approximately on the realised reduction compared to the originally envisaged reduction.

- Printing, distribution and publication costs would also be reduced by reduced disclosure. While more than a tenth of information is excluded in the model of a short-form prospectus, there will necessarily be certain fixed costs attached to production, irrespective of how much disclosure is reduced. A **10%** saving therefore feels appropriate, and is reduced from the Commission's original 20% estimate.

- The combination of reduced third-party and legal work and the reduction in the volume of material included in the rights issue prospectus, results in the estimation that issuer-related costs are reduced by **25%**. This revised figure is halved from the Commission's original estimate to reflect the fact that a lot of issuer time (and cost) is related to transaction counsel, (which was reduced by two thirds) but that other factors would require less of a reduction, in line with some of the more modest reductions finally provided for in level 2, compared with the Commission's ambitious original IA.

- Lead manager costs have been reduced by half from the Commission's original estimate (to **25%),** again to reflect the close relationship between lead manager time, transaction councel work, and general issuer costs.

The introduction of a proportionate regime for rights issues provides a clear benefit for issuers – particularly combined with the new exemption for offers below €5m EUR (previously €2.5m EUR). This change to the PD, brought into effect early in the UK, is worth an annual £12m saving for UK issuers, lifting all offers between €2.5m EUR and €5m EUR out of the Prospectus regime and the need to produce a prospectus. **It is helpful to note that these two changes combined create an environment to boost secondary fundraising via rights issues, benefitting investors and issuers alike**.

No cost-saving has been possible to calculate for the marginal benefits provided by deregulatory changes to the thresholds and exemptions in the Prospectus regime. These are: raising the exemption threshold for debt securities issued over a 12 month period from €50m EUR to €75m EUR, and removing the need for prospectuses to disclose information about the guarantor where the guarantor is a Member State. Further information was sought from the consultation, but we received no reply from industry on this issue.

Further cost savings will be enjoyed by industry due to changes being made to the Prospectus Directive that are reflected in FSA Prospectus Rules. These, and measures which the Treasury has implemented early (worth £12 million per year), are subject to separate cost-benefit analysis. They are not included here.

G. Risk assessment

Due to the technical nature of the changes being made to the Prospectus regime, it is difficult to assess the monetised impact on firms. The extent of the costs and benefits was further explored through the consultation in order to inform our calculations. Responses acknowledged the difficulty monetising impacts, as a result of the heterogeneity of firms and offers.

Investor protection: As changes are being made to the thresholds at which the Prospectus Directive applies and 'proportionate' (reduced) disclosure is being introduced, the question arises of whether the same levels of investor protection apply. Further information was sought from our consultation, all responses to the relevant question felt that investor protection would either not materially change, or would be strengthened. This confirms the view of previous Treasury analysis from implementing aspects of the Directive.

Principally, the changes to the Prospectus regime are slight and thus investor protection will not materially change. It is true that a few smaller and specialist offers will now be outside the scope of the Directive. However, these affect very small undertakings and thus the main benefit will be enjoyed by much smaller companies undertaking mainly secondary fundraisings (e.g. AIM listed companies). It is fair to assume that the nature of these offers – made to small numbers of investors, of small value – will be made to more sophisticated investors who typically do not rely on a prospectus to make their investment decisions. The thresholds in the Prospectus Directive therefore strike a fair balance regarding very small offers made to targeted investors (which would not require a prospectus), versus larger offers above the thresholds to a wider, retail investor balance (at which point the Prospectus Directive would apply). The new thresholds have not increased materially to suggest that this balance has been disrupted by the Prospectus Directive being reviewed, as has been reflected in the positive feedback provided by various market participants, including investor groups.

Investors also have the right not to invest in an offer without a prospectus, and issuers will themselves consider for a capital raising whether or not a prospectus should be produced, dependent on the needs of their investor base. It would not be in the interests of a successful capital raising not to do so. Investors also continue to be protected through the UK's financial promotion regime, which continues to apply where a prospectus is not required. Lastly, investor protection has been strengthened elsewhere in the review of the Prospectus Directive – regarding the threshold for offers made to professional investors. Currently, any offers made above €50,000 per investor do not require issuers to produce a prospectus. This will now only be available to issuers for offers they make above €100,000 per investor. Industry comments on this particular change were supportive, suggesting that retail investors will get a better understanding of investment as a result.

A question is posed over whether proportionate disclosure affects investor protection. It was not possible to consult on this particular aspect of investor protection because level 2 work had not been completed, and therefore the extent of proportionate disclosure was unknown. Level 2 work has developed a more substantial proportionate disclosure regime for secondary financing (rights issues), and a less substantial proportionate disclosure regime for SMEs and companies with reduced market capitalisation, (the latter regime being less substantial as a result of ESMA concerns about potential investor protection issues). This is because ESMA takes the view that companies are already familiar to investors at the time of secondary fundraising. Investors may find more targeted information more relevant than a full prospectus in this scenario, and existing shareholders may benefit from a reduced threat of dilution (as issuers may become more attracted to rights issues being made less burdensome, in place of private placements).

Consequently, this impact assessment calculates the cost saving of having a proportionate disclosure regime for rights issues only. Savings made to firms from proportionate disclosure for SMEs and firms with reduced market capitalisation is incremental, and impractical to calculate given the lack of previous analysis or attempt to monetise the benefits. This smaller reduction for the SME and reduced market capitalisation reflects the fact that investor protection has not been reduced in any material way.

H. Wider impacts

Competitiveness: Given that the Directive will introduce largely incremental change to the existing Prospectus regime, it should not have a significant effect on competition. The Prospectus Directive establishes tightly defined criteria as to its application for qualifying public offers of securities, and when companies are admitted to trading. As it applies across the EU and is a maximum harmonisation directive, the regime did not pose concerns relating to the competitiveness of UK markets on its introduction in July 2005, nor does it now.

Small firms: The Directive captures those companies which have securities admitted to trading on regulated markets and these tend to be substantial businesses. In addition, in relation to 'public offers' of securities, small companies are likely to be able to use the exemptions within the Directive that enable them to avoid production of a costly prospectus.

However, small companies do not enjoy exactly the same benefits under the Prospectus regime as large companies. This is because they are highly unlikely to engage in cross-border offers due to the small sums of capital they typically look to raise. Additionally, the relative cost of compliance with the regime, commensurate with the sums raised, will necessarily be higher than for large fundraisings undertaken by bigger companies.

For these reasons, having a series of thresholds to lift small offers and secondary fundraisings outside of the Prospectus regime is highly important. In this area, small companies will benefit in particular from the size of qualifying offers being doubled to €5 million EUR as a result of changes to the Prospectus Directive, and from the proportionate disclosure regime being created for rights issues which will reduce the cost of further secondary offers.

Microbusinesses: The Prospectus Directive applies only above a series of thresholds, and particularly only for offers above €5 million EUR. Consequently, it is highly unlikely that microbusinesses would in practice be caught by the Prospectus Directive, albeit that the wide application to 'public offers' means technically microbusinesses are in scope. Microbusinesses are a group less likely to raise finance from the public, typically relying on seed capital, that of family, friends, banks and experienced angel investors.

I. Summary and implementation

The UK supports the implementation of the revised Prospectus Directive and envisages an overall cost-saving to industry based on the introduction of a proportionate disclosure regime for rights issues, increased exemptions from the Prospectus regime, and greater legal certainty.

The thresholds in the Prospectus Directive strike a fair balance regarding very small offers made to targeted investors (which would not require a prospectus), versus larger offers made above the thresholds to a wider, retail investor balance (at which point the Prospectus Directive would apply). Investor protection is not affected by changes to the regime.

An implementation plan is included within the consultation paper, and provision is made within the FSMA regulations for the UK's implementation to be reviewed in five years, in line with Better Regulation principles. The consultation paper, including this implementation information can be found at:

http://www.fsa.gov.uk/pages/Library/Policy/CP/2011/11_28.shtml