

July 2005

Share Schemes

Employee Share Incentives and the EU Prospectus Directive

The PD is part of a package of European Union legislation intended to facilitate the operation of the single market. It changes the law throughout the EU on offers of transferable securities to the public.

Penalties for non-compliance include criminal liability and the possible cancellation of any non compliant offer.

Which Companies Are Affected?

- All companies with employees resident in any state in the EU are potentially bound to comply with the PD if they offer share based incentives to those employees.
- It applies wherever a company is based and whether the company has shares listed on an EU regulated market, a listing on another market, or is unlisted.

The PD came into force on 1 July throughout the EU although each country is adopting separate implementation rules, many of which have still not been published.

In the UK the Treasury has published regulations amending the Financial Services and Markets Act 2000 (FSMA) with section 85 now providing that (in the absence of an applicable exemption) it is an offence to offer transferable securities to the public in the UK without first making an approved prospectus available. Compliance with the PD will be policed by the Financial Services Authority (the FSA). The existing Public Offers of Securities Regulations (the POS Regs) are abolished and replaced by the Prospectus Rules published by the FSA.

Action Points

- Review all proposed future offers, grants or awards of shares or options to employees.
- If the arrangements are within the PD, and compliance will entail substantial cost, consider restructuring or phasing employee participation so as to come within an exemption.

How does the PD affect Share Incentive Arrangements?

The PD applies whenever an offer of transferable securities is made to the public in the EU unless the value of securities involved is less than €2.5 million (aggregating offers made in the EU over a 12 month period). Offers of securities below this limit are outside the PD.

If the value of securities in respect of which the offer is made in the UK exceeds the €2.5 million level, a prospectus will be required to be made available in the UK, unless an exemption is available. The view of the UKLA is that under UK domestic law, only offers in the UK count towards the €2.5 million limit. This is so even for offers confined to employees, since there is no equivalent to the old blanket exemption for offers of securities under employees' share schemes in the POS Regs.

There are various exemptions from the PD. The most common situations in which an employee share incentive arrangement might benefit from an exemption are set out below.

Share Offers not caught by the PD

- The grant of non-transferable share options (whether market value or discounted).
- Offers to fewer than 100 persons (excluding qualified investors) per member state.
- Share awards at no cost to the employee (eg free shares under an HMRC approved share incentive plan or restricted stock or conditional share awards at nil-cost).
- An offer of transferable securities with a total value of no more than €100,000 (aggregating offers by the same issuer in a rolling 12 month period).

So, whenever share purchase arrangements (eg partnership shares under an HMRC approved Share Incentive Plan, restricted stock agreements and conditional share awards where an exercise price is payable) are offered to more than 100 UK employees the impact of the PD must be considered.

If a particular share offer does not fall within any of the exemptions, the consequences will vary depending upon the status of the company.

Companies with a full listing on the London Stock Exchange

If shares are offered solely to employees by a company which has, or an affiliated undertaking of which has, securities of any description which are already admitted to trading on a regulated market, a prospectus is not required if an information document is made available to the offerees giving summary information about the securities and the reasons for the offer (the 'Employee Exemption').

Companies with securities listed on another EU regulated market

Such companies can also rely on the Employee Exemption and provide an information document to the offerees giving summary information about the securities and the reasons for the offer rather than a prospectus.

AIM Companies

Shares listed on AIM are transferable securities, but as AIM is not a regulated market, the Employee Exemption is not available. A prospectus must be prepared and formally approved by the FSA.

Non-EU Companies

Companies based outside the EU must prepare a prospectus which complies with the rules of their EU home member state - normally the first EU state in which transferable

securities are offered to the public in the EU after 1 July 2005.

Companies whose shares are traded on a public market outside the EU for whom the UK is their home member state can apply to the FSA for approval of a prospectus which complies with international standards as containing equivalent information to a prospectus drawn up under the Prospectus Rules.

Grey Areas

There are still significant areas of uncertainty including:

- The treatment of options granted to employees in other EU member states. Some jurisdictions may regard options as within the PD, but this is unclear until the relevant local rules are published.
- The position of private companies. The loose definition of a transferable security set out in EU legislation could catch some private companies, especially those with active internal markets or employees' trusts.
- Whether, for the purposes of applying the €2.5 million exemption in any EU state it is necessary to count shares which are the subject of an offer in that state only or across the EU.

How we can help

- We can advise on the detailed exemptions available and ways to structure arrangements so as to avoid triggering requirements under the PD where possible.
- For companies listed on an EU regulated market, we can assist in the preparation of summaries of key information for employees, whether as separate documents or as enhancements to the usual employee communications literature.
- For companies without a listing on an EU regulated market we can assist with preparing a prospectus, reviewing the contents of an existing prospectus and obtaining UKLA approval of a prospectus.

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This update does not constitute legal advice and specific legal advice should be taken before acting on any of the topics covered.

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