

# Employee share plans and the Prospectus Directive

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## Introduction

Due to relatively recent changes in legislation a prospectus may be required if a company offers shares (or other securities) to its employees within the European Economic Area (EEA).

On 1 July 2005 the Prospectus Directive was incorporated into UK law. Before then, there was a clear exemption from the need to produce a prospectus for offers of shares and other securities under employee share schemes. This is no longer the case.

The Directive applies not only to EU companies, but also to non-EU companies, such as US issuers, who offer securities to their employees working in the EEA.

## When will a prospectus be required?

A company will be required to issue a prospectus approved by the Financial Services Authority (FSA) whenever it offers **transferable securities** to the **public** in the UK (and any other EEA state) unless the offer falls outside the requirements of the Directive or within one of the available exemptions.

## What are transferable securities?

Transferable securities are those which are "negotiable on the capital market". These can include shares in companies or options to acquire shares.

Options granted under an employee option plan are securities which give a right to acquire shares, however, employee options are generally not assignable (they are expressed to be personal to the option holder) and are not traded on a regulated market. If they cannot be assigned, they are not thought to be "negotiable" and so cannot be transferable securities.

In the UK the FSA has confirmed that employee share options granted on the usual non-assignable terms do not require a prospectus to be issued. This confirmation from the FSA is, however, non-binding and the FSA's position on this could change. In addition, it is becoming more common for employee options themselves to be traded on an exchange.

In some other EEA states, grants of options to employees may still require a prospectus because the option itself may be treated as an offer of the underlying shares (the shares themselves being negotiable on a capital market). These states are thought to currently include Italy, Germany and Poland.

## Are shares in private companies "negotiable on the capital market"?

The generally accepted view is that shares in non listed public companies and private companies are transferable securities because they are capable of being "negotiable on the capital market" but it is not currently clear whether all shares actually are.

If there are substantial restrictions on transfer in a private company's articles of association (or contractual agreement such as a shareholders' agreement) then it might be possible to argue that the shares are not "negotiable". On the other hand, if there is evidence of an internal market for the shares (perhaps because the company operates an active employee benefit trust with regular trading windows for employees to buy and sell shares) then this may lead to the conclusion that the shares are transferable securities.

There is currently no definitive guidance on this point either from the FSA or other EEA authorities and therefore the status of private company shares is far from clear. Some advisers are taking a cautious approach and advising that all shares in private companies are negotiable on the capital market.

## What is a public offer?

A public offer is a communication in any form and by any means which presents sufficient information on the terms of the offer and the securities being offered to enable an investor to decide whether or not to purchase or subscribe for those securities.

An offer of shares or options to employees under an employee share plan will generally constitute an offer to the public.

## What exemptions are available from the need to publish a prospectus?

The main exemptions to publishing a prospectus that are relevant to employees acquiring shares are:

- offers made to fewer than 100 persons in each EEA state at any time;
- offers with consideration of less than €2.5m;
- offers to existing and former employees where the employer or its parent has securities listed on an EEA regulated market.

In determining the application of the €2.5m limit, all other public offers of transferable securities of the same class made by the company in the EU in the previous 12 months must be taken into account (these must include offers whether to employees or not and whether exempted or not).

## Does an offer of free shares require a prospectus?

Offers of free shares (for example under an HM Revenue & Customs approved share incentive plan, LTIP or restricted share plan) should be able to take advantage of the exemption for offers of shares with a consideration of less than €2.5m.

The Committee of European Securities Regulators has indicated that free share awards should not generally be caught by the prospectus requirements (although this is not a legally binding opinion). Certain other EU states refer to "value" of an offer rather than legal "consideration" (as in the UK) and therefore it is important to seek local advice whenever free shares are offered to employees in EU states outside the UK.

If employees are asked to sacrifice something in return for the offer of shares (for example a cash bonus or salary review) then this could be construed as valid "consideration" and a careful review of the relevant exemptions would need to be made. This may catch deferred bonus plans.

## Partial exemption for offers to employees of listed companies

An employer who offers shares or other securities to existing or former employees may not need to publish a full prospectus if it has securities admitted to trading on an EU regulated market (this excludes the AIM Market, the New York Stock Exchange and the Australian Stock Exchange).

Instead of publishing a prospectus, an "information document" must be issued to participants of the offer which must include information on the number and nature of the securities offered and the reasons for, and detail of, the offer.

In the UK, this partial exemption applies whether or not the securities offered under the employee share plan are the same as the securities which are listed on the regulated exchange. For example, an issuer with only debt securities listed on a regulated exchange would still be able to take advantage of the employee exemption in connection with its employee share plan. In some other EU states, the employee exemption is available only if the issuer offers employees the same type of securities as those it has had admitted to trading.

It is important to note that the partial exemption described above does not apply to US companies who do not have a secondary listing on an EU regulated market. The European Commission is currently considering an amendment to the Prospectus Directive which would extend the partial exemption to certain non-EU issuers.

## What are the penalties for breaching the regime?

There are civil and criminal penalties under UK law for contravening the prohibition of dealing in transferable securities without an approved prospectus. Most EU states have fines of €50,000 or more.

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## Who are we?

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As a member of the HM Treasury employee ownership advisory group, the head of our team, Graeme Nuttall, helped HM Revenue and Customs develop and introduce the share incentive plan (SIP) and the enterprise management incentives arrangement. He also drafted the Employees' Share Schemes Bill, a successful private member's bill enacted as the Employees Share Schemes Act 2002 that increased the tax effectiveness and democracy of SIPs.

The Field Fisher Waterhouse Equity Incentives team has substantial experience in all aspects of employee benefits, including equity incentives. We have particular expertise in advising on creating and sustaining employee ownership solutions for a variety of businesses.

Through our offices in Brussels, Hamburg, London and Paris, as well as our other overseas affiliated and associated offices, we advise on international share plans.



[www.equityincentives.co.uk](http://www.equityincentives.co.uk)

Our Equity Incentives website is a valuable information source on different types of employee share and share option plans and includes a number of briefing papers, case studies and other helpful information.

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