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499 + 1 = 500? Practical approach on new 500-investor threshold exemption

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Introduction

For many years, unlike EU legislation (in particular the EU Prospectus Directive (2003/71/EC)), Swiss law provided no uniform and comprehensive rules on prospectuses, with regulation scattered throughout a number of different laws and self-regulations. This changed on 1 January 2020 when the Financial Services Act (FinSA) and the Financial Services Ordinance (FINSO) entered into force and established comprehensive rules relating to prospectuses offering securities and the admission of securities to trading, which will apply to all types of financial instrument.

The new act, as a rule, requires any party that offers newly issued or existing securities to the public (Article 35(1) of FinSA) to publish a prospectus that must be reviewed (and approved) by a review body prior to publication. This legislation is based on the general idea of disclosure to mitigate asymmetric information in the market and allow for an equally and sufficiently informed decision, in particular by less sophisticated participants. However, the general idea of 'protection by information' does not always justify the requirement to publish a prospectus. Therefore, the legislature anticipated and exempted certain situations from the prospectus requirement if market participants are assumingly less vulnerable to abusive practices or able to fend for themselves, as well as situations considered to have a minor impact on the market. Those exemptions include the new 500-investor threshold stipulated in Article 36(1)(b) of FinSA which states that: "[a] prospectus does not need to be published if the public offer is addressed at fewer than 500 investors".

This article discusses the 500-investor threshold's practical implications and compliance requirements and its expected impact on the Swiss market.

Investors under Article 36(1)(b) of FinSA

With regard to the prospectus requirement, FinSA distinguishes, based on the client segmentation requirement for financial intermediaries (Article 4(1)), between investors that qualify as professional clients and those that qualify as retail clients. Professional investors include institutional clients, central banks, large companies and private investment structures with professional treasury operations created for high-net-worth retail clients (Article 4(3) and (4) of FinSA). Investors that do not qualify as professional investors are considered retail investors (Article 4(2) of FinSA).

The plain legal wording of the 500-investor threshold allows for a public offering to up to 499 investors of any kind (professional or private investors) without the need for a prospectus. Further, no prospectus is required if a public offer is addressed solely to an unlimited number of professional investors (Article 36(1)(a) of FinSA). If those exemptions are applied alternatively, a public offering of securities to 499 retail investors and one professional investor would not fall under an exemption of the general prospectus requirement, but such offering solely to 500 professional investors would.

It is questionable whether this result reflects the legislature's true aim when drafting those exemptions along the standards of the EU Prospectus Regulation (2017/1129). There are different arguments to support the finding that these exemptions cumulatively apply:

- The Federal Council's proposed draft of FinSA set the threshold for the exemption with limited numbers of investors substantially lower, at fewer than 150, but this was restricted to only retail investors. This initial proposal was in line with EU legislation that allows for prospect-free public offerings to up to 149 non-qualified investors per EU member state. The Federal Assembly preferred less restrictive prospectus requirements and increased this threshold to 499 investors. Inadvertently, it also opened up the scope of this exemption, as it is not limited to retail investors anymore. However, there are no parliamentary debates indicating that the 500-investor threshold will also apply to professional investors and not only retail investors.
- The rationale behind the exemptions that replace a statutory requirement for a prospectus are different. The legislature presumed that:
  - with a limited number of retail investors, each investor would have a sufficiently close relationship to the offeror; and
  - professional investors have sufficient economic to fend for themselves.

  This lowers the risk for abusive practices. For the sake of clarity, these assumptions must not be proven by statistical or empiric data.

- By way of comparison, a similar safe harbour for private offerings under Section 4(a)(2) of the US Securities Act 1933 is regulated by Rule 506(b) of Regulation D and limited to only 35 non-accredited investors (partially comparable to retail investors). Unsurprisingly, this number is calculated (among other things) under the exclusion of any accredited investors (comparable to professional investors) (see Rule 501(e) of Regulation D).

However, the United States applies a narrower scope for non-accredited investors compared to retail investors under Swiss law. Among others, directors and executive officers of the issuer as well as wealthy natural persons with a net worth higher than $1 million or an annual income higher than $200,000 (individual) or $300,000 (with spouse) are exempted. In addition, the Securities and Exchange Commission was announced on 21 August 2020 the adoption of several amendments to the definition of accredited investor, adding new categories of qualifying individuals and entitles in order to simplify, harmonise and improve the exempt offering framework under the Securities Act. As a result, even less investors will qualify as non-accredited investors in the United States.

Further, the legislature provided no guidance regarding the repeated use of the 500-investor threshold exemption by the same issuer (ie, an integration period). It is unclear, for example, whether an offering of shares in January to 499 investors followed by an offering of shares to 499 investors in March of the same calendar year with the purpose of funding the same project can be implemented without a prospectus. Article 36(1)(e) of FinSA stipulates only a 12-month period to calculate the total value of the Sfr8 million threshold exemption (a detailed calculation according to Article 44 of FINSO).

Based on the above, the application of the 500-investor threshold leaves room for discussion and is, unfortunately, not as clear as initially anticipated. From a practical point of view, offerors are expected to act with great caution when relying, fully or partially, on this exemption until a court decision providing for enhanced guidance is available. However, there are valid arguments that professional investors will be considered irrelevant for the count of investors under Article 36(1)(b) of FinSA.

In addition, it is hoped that clear judicial guidance (ie, safe harbour) regarding the integration period of the 500-investor threshold exemption (and the other exemptions under Article 36(1) of FinSA) will be published. Applying the 12-month period of Article 36(1)(e) of FinSA by analogy seems too extensive. Again, US securities law provides for an integration safe harbour if there are more than six months between two private offerings (Rule 502(a) of Regulation D) and for general integration principles if this safe harbour does not apply (with the relevant factors including a single plan of financing, the same class of securities, the same time period, the same type of consideration and the same general purpose).

Restricted communication

Compliance with Article 36(1)(b) of FinSA is established if every communication that qualifies as an offer is addressed to fewer than 500 (retail) investors. As a result, the actual number of (retail) investors participating in an offering is irrelevant but the number receiving an offer is decisive.

Therefore, it is important to understand the actions and communication that qualify as an offer. The legal definition of an offer does not focus on the form or number of recipients but on its purpose and level of detailed communication. It can be summarised as follows (Article 3(g) of FinSA and Article 3(5) of FINSO):

> *Any invitation to acquire a financial instrument that contains sufficient information on the terms of the offer and the financial instrument itself, and that is customarily intended to draw attention to a certain*

financial instrument and to sell it.

The law also provides for the following non-exhaustive list of communication that do not qualify as an offer (Article 3(6) FINSO):

> *a. the making available of information at the request or initiative of the client, which information was not preceded by advertising within the meaning of Article 68 FinSA provided by the offeror or an agent of the latter relating to the concrete financial instrument;*
>
> *b. the mentioning by name of financial instruments without or in conjunction with factual, general information, such as ISINs, net asset values, prices, risk information, price performance or tax figures;*
>
> *c. the mere making available of factual information;*
>
> *d. the preparation and making available of legally or contractually required information and documents on financial instruments to existing clients or financial intermediaries, such as corporate action information, invitations to general meetings and the associated requests to issue instructions, as well as the forwarding of such information to the mentioned group of persons and the publication thereof.*

Consequently, a communication can be either written or oral to qualify as an offer. However, it must contain the relevant terms (eg, subject of purchase and price or price range (*essentialia negotii)*) of a binding offer or a solicitation to an offer (*invitatio ad offerendum*) concerning a specific financial instrument that allows for an individual investment decision by the recipient. That being said, early and non-binding interactions with even more than 500 potential (retail) investors (eg, pilot fishing, testing-the waters or pre-sounding) will usually not trigger the level of communication outlined above but road shows (to the extent that they are not pure no-deal road shows) usually will.

Nevertheless, those guidelines do not fully provide for legal certainty. It is therefore recommended to evaluate all communication by offerors on a case-by-case basis, taking into consideration the progress of the offering process, the communication's level of detailed information and its general purpose.

Equal information in absence of prospectus

In offerings without a requirement for a prospectus (including those to fewer than 500 (retail) investors), all investors receiving such offer must have equal conditions to access material information provided (Article 39 of FinSA). This requirement is new and its practical implications are untested.

Any information is likely to be deemed material if there is a substantial likelihood that a reasonable investor would consider it important for its decision of whether to invest. Such a standard does not only cover information provided in formal solicitation materials but might also include due diligence proceedings or results or even a Q&A or similar documentation.

Besides the fact that all investors will receive the same material information, offerors must also focus on equal time of access and access conditions to such information. Distribution of the summarised offering memoranda to specific (usually smaller) investors may be possible only if it is sufficiently comprehensive (ie, still containing all material information). However, elaborating or summarising information (written or oral) already covered in existing materials to individual investors is possible. Material information must be distributed to all investors substantially at the same time or, in case of an investor joining the process at a later stage, without delay, but in any event sufficiently prior to the offering acceptance deadline. Allowing regular investors to review material information at the offeror's registered domicile while sending out this information to anchor investors by email is not compliant.

Best practice proposal to comply with 500-investor threshold exemption

If offerors wish to rely on the 500-investor threshold exemption under Swiss law, they should consider the following guidelines:

- Structure and plan such offering ahead in detail. Once started, it might become difficult to adapt the offering process to comply with the 500-investor threshold exemption.
- Keep a continuously updated record of (respective information may have to be obtained by financial intermediaries representing the investors):
  - retail investors receiving restricted communication;
  - professional investors receiving restricted communication (including information and documentation about the qualification of such investors); and
  - material information distributed to each of those investors (ie, subject, date and way of access).
- Include appropriate selling and distribution restrictions in any written communication that might be

considered an offer.

- Ensure that restricted communication is not publicly available. Access to websites must be protected by personal logins and come with the selling and distribution restrictions as contained in written communication that could qualify as an offer.
- Consult latest precedents available or scholars on the practical implementation of this exemption.

Comment

The operational efforts required to comply with the 500-investor threshold could eventually offset the expenditure of time and costs accompanied with the process of preparing and filing for prospectus reviews. However, in a first step, an offeror should consider relying on additional, maybe less burdensome, exemptions (eg, offers directed only at professional investors, a required minimum investment per investor of Sfr100,000 and a limited volume of the offer at Sfr8 million) and structure the offering accordingly. Even though most scholars advocate a liberal interpretation of the 500 (non-retail) investor exemption along the lines described above, the adaption of the 500-investor threshold by the market will also heavily depend on the first court decision addressing this topic.

Nevertheless, the legislature has intentionally set the threshold of fewer than 500 investors substantially higher than the European Union and the Unites States. This might act as a booster for placements in the Swiss market.

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