



THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/05-582

CESR's advice to the European Commission on a possible amendment to Regulation (EC) 809/2004 regarding the historical financial information which must be included in a prospectus

OCTOBER 2005



EXECUTIVE SUMMARY

Background

1. The Commission adopted Regulation (EC) 809/2004 of 29 April 2004 (the Regulation) which specifies, among other things, the information items which must be included in a prospectus. That information varies according to the type of securities which is the subject matter of the prospectus.
2. The Regulation contains requirements relating to historical financial information. The primary purpose of including financial information in a prospectus is to enable investors to understand the financial position of the issuer.
3. Normally, the historical financial information of the issuer reflects the business of the issuer as a whole throughout the required period, including significant acquisitions or disposals. However, there are certain circumstances in which the issuer has not prepared its historical financial information as a single business during the whole of the period for which the historical financial information is required under the Regulation (these types of issuers are therefore considered to have a “complex financial history”).
4. Market participants, specially the representatives of the accountancy profession, encouraged CESR to provide recommendations in order to provide clarity and convergence as to what is required when issuers have a complex financial history.
5. With a view to determining whether there was a consensus between its members on the need, in case of an issuer with a “complex financial history”, for a prospectus to contain financial information which goes beyond that directly relating to the issuer, CESR undertook a fact finding exercise.
6. From the work that CESR carried out, it emerged that some CESR members required in their current practices historical financial information not only of the legal entity which issues or proposes to issue securities (which would be the issuer for the purpose of the Regulation) but also in relation to the companies or businesses the issuer has acquired during the period for which historical financial information is required on the issuer.
7. CESR did not issue Level 3 recommendations mainly because the European Commission noted that there was some uncertainty about the extent to which the provisions of the Prospectus Regulation relating to historical financial information will enable competent authorities to require the inclusion of the range of financial information which they would currently require in a case of an issuer with a complex financial history.
8. The European Commission (“The Commission”) considered it desirable to eliminate uncertainty as to the scope of those provisions and to ensure that the requirements in relation to historical financial information meet the needs for adequate investors protection in the case of an issuer with a complex financial history. Therefore, the Commission published on 2 June 2005 a mandate to CESR for technical advice (included as an Annex to this document). The deadline set by the European Commission for the submission of CESR advice is 31 October 2005.



9. The preparation of CESR's advice on this mandate has been undertaken by the CESR Expert Group on Prospectuses, which has been chaired by Professor Fernando Teixeira dos Santos, Chairman of the Portuguese Securities Market Commission (CMVM). A member of CESR Secretariat, Javier Ruiz del Pozo, assists the Chairman and acts as rapporteur of the Expert Group.
10. Following receipt of the mandate from the Commission, CESR began its work on 3 June 2005 by launching a call for evidence for interested parties to submit comments by 20 June 2005. The submissions can be viewed on CESR's website (www.cesr-eu.org).
11. As part of the process of producing its advice CESR published a consultation paper (Ref: CESR/05-428) on June 2005, giving all market participants until 15 September 2005 to submit their views. In addition, a public hearing was held in Paris, at CESR premises, on 6 September 2005.
12. CESR received around 26 responses to the consultation paper and these can be viewed on CESR's website.
13. In addition, under the terms of CESR's Public Statement of Consultation Practices (Ref: CESR/01-007c), a Consultative Working Group (the "CWG") was established to advise the Expert Group. The Prospectus Group has met once with the CWG and its members have provided written contributions to the group that were taken into account when this paper was prepared. The members of the CWG are the following:
 - Ms Deborah ter Beek, ABN Amro Rothschild.
 - Mr Kevin Desmond, Price Waterhouse Coopers London.
 - Mr Axel Forster, Luxembourg Stock Exchange.
 - Mr Wolfgang Gerhardt, Sal. Oppenheim jr. & Cie. KgaA, Frankfurt am Main.
 - Mr Alain Gouverneyre, Ernst & Young Paris.
 - Ms Eva Maria Sattlegger, Raiffeisenzentralbank.
 - Mr Nunzio Visciano, Italian Stock Exchange.
 - Mr Martin Pföhler, KPMG Berlin.
 - Mr Jan Buisman, Price Waterhouse Coopers Stockholm.
 - Mike McKersie, Association of British Insurers.



INDEX

I. INTRODUCTION

(Paragraphs 14-24)

Historical Financial Information and Pro Forma Information in the Regulation (EC) 809/2004

(Paragraphs 14-18)

Is there a need to amend the Commission Regulation?

(Paragraphs 19-22)

What is the current practice in the European Union concerning complex financial histories?

(Paragraphs 23-24)

II. SCOPE OF THE ADDITIONAL REQUIREMENTS

(Paragraphs 25-40)

Preliminary remarks

(Paragraph 25-26)

Types of securities

(Paragraphs 27-31)

Possibility of an exemption for small and medium-sized enterprises

(Paragraphs 32-34)

Clarification of the meaning of “complex financial history”

(Paragraphs 35-40)

III. ADDITIONAL REQUIREMENTS FOR ISSUERS WITH A COMPLEX FINANCIAL HISTORY

(Paragraphs 41-54)

Additional requirements

(Paragraphs 41-45)

Principles

(Paragraphs 46-52)

Change of accounting reference date

(Paragraph 53-54)

IV. COSTS TO THE ISSUER

(Paragraphs 55-59)

V. CONCLUSION

(Paragraphs 60-62)

ANNEX

Mandate from the European Commission to CESR for technical advice



I. INTRODUCTION

Historical Financial Information and Pro Forma Information in the Regulation (EC) 809/2004

14. The Regulation (EC) 809/2004 of 29 April 2004 contains requirements relating to historical financial information. For example, Annex I to the Regulation, which contains a schedule of disclosure requirements in relation to shares, requires the inclusion in a prospectus of “audited historical information covering the latest 3 financial years (or such shorter period that the issuer has been in operation), and the audit report in respect of each year” (Item 20.1). Similar requirements are set out in other Annexes adapted to the different types of securities.
15. The primary purpose of including financial information in a prospectus is to enable investors to understand the financial position of the issuer. The historical financial information should therefore provide a record of the issuer's business as operated and accounted for by the issuer during the period for which historical financial information is required at the date of the prospectus.
16. Normally, the historical financial information of the issuer reflects the business of the issuer as a whole throughout the required period, including significant acquisitions or disposals. However, there are certain circumstances that arise mainly in relation to public offers or admission to trading of shares, in which the issuer has not prepared its historical financial information as a single business during the whole of the period for which the historical financial information is required under the Regulation (issuers with a “complex financial history”).
17. In addition to the obligation to include historical financial information, where there has been a significant gross change in the assets of the issuer, the Commission’s Regulation requires pro forma financial information in shares prospectuses. The purpose of pro forma information, as stated in item 20.2 of Annex I of the Regulation, is to provide a description of how the transaction might have affected the assets and liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported. According to item 1 of the Annex II of the Regulation, pro forma information is prepared for illustrative purposes only and, because of its nature, it addresses a hypothetical situation and, therefore, does not represent the company’s actual financial position or results.
18. The pro forma information may only be published in respect of the current financial period or the most recently completed financial period and/or the most recent interim period. This means that pro forma information should be included in the prospectus if there has been a significant acquisition or disposal which is not fully (i.e. for the entire twelve months period) reflected in the historical financial information of the most recent financial period. For example, in case of a public offer prospectus to be published in July 2005, pro forma information should only be provided if there has been significant acquisitions or disposals during 2004 and 2005. The pro forma financial information must be accompanied by a report prepared by independent accountants or auditors which must state that in their opinion the pro forma financial information has been properly compiled on the basis stated and that the basis is consistent with the accounting policies of the issuer.

Is there a need to amend the Commission Regulation?

19. Once the Commission Regulation was adopted, CESR considered, under Level 3 of the Lamfalussy process, the possibility of issuing recommendations on how to address situations where an issuer has a complex financial history in prospectuses. Some CESR members believed that the Level 3 guidance should be used to clarify how an issuer should present its historical financial information in relation to a situation where the issuer's business has factually existed for period requested in the Regulation (normally three financial years), but it existed within a different legal entity other than the one that has an obligation to prepare prospectus. That objective was based on current regulatory practice in those Member States.
20. CESR did not issue Level 3 recommendations mainly because the European Commission noted that there is some uncertainty about the extent to which the provisions of the Prospectus Regulation relating to historical financial information will enable competent authorities to require the inclusion of the range of financial information which they would currently require in a case of an issuer with a complex financial history.
21. In the Commission's view since Article 3 of the Regulation prohibits competent authorities from requesting the inclusion of information which is not included in the Annexes, it is essential to clarify the scope of the provisions relating to historical financial information to ensure that competent authorities have the ability to require all the information which is necessary in any particular case, and that issuers and their advisers can be certain about what is properly required of them. The provision of the full range of financial information which is relevant in a particular case is necessary to ensure proper investor protection. Furthermore, any lack of legal certainty about the scope of a statutory or regulatory requirement could be detrimental to the efficient functioning of markets.
22. Accordingly, the Commission has considered it desirable to amend the relevant provisions of the Prospectus Regulation so as to eliminate uncertainty as to the scope of those provisions and to ensure that the requirements in relation to historical financial information extend to the entire range of information which may be necessary to enable investors to make an informed assessment of the issuer and the securities, in any case where financial information relating to legal entities other than the issuer may be relevant to the financial condition and prospects of the issuer itself.

What is the current practice in the European Union concerning complex financial histories?

23. With a view to determining whether there was a consensus between its members on the need, in case of an issuer with a "complex financial history", for a prospectus to contain financial information which goes beyond that directly relating to the issuer, CESR undertook a fact finding exercise. Examples of issuers with a "complex financial history" covered by that exercise were cases where:
 - the issuer is a newly incorporated holding company inserted over an established business;

- the issuer seeking admission to trading or making an offer consists of companies that were under common control or ownership but which never formed a legal group;
- the issuer has made a significant acquisition (representing more than 25% of the group) during the three year historical record or subsequent to the last audited consolidated financial information on the issuer, including specific reference to cases where the acquired target has different accounting policies;
- the issuer has disposed of a significant part of its business since the last audited accounts;
- the issuer has changed its accounting reference date during the three year period.

24. The fact finding showed that the practice in majority of the Member States is that where historical financial statements do not reflect the substance of the concerned issuer, requests for additional information are decided on a case-by-case basis. In such cases, the competent authority makes its decision taking into account whether the transaction or restructuring not reflected in the historical financial information is material in relation to the issuer's group.

II. SCOPE OF THE ADDITIONAL REQUIREMENTS

1. Preliminary remark

Explanatory text

25. CESR would like to clarify that the proposed requirements are in addition to the requirements already set in the Regulation. In particular, it is important to highlight that issuers with a complex history, will need to comply with item 20.1 of Annex I and with Annex II, should this be applicable, in addition to the proposed requirements.

26. It is important to differentiate between pro forma requirements and any requirements on complex financial histories that the Regulation could impose on issuers if amended by the Commission. For example, in case the issuer is a newly incorporated holding company inserted over an established business in June 2005, two set of financial information requirements could be necessary in addition to item 20.1 of Annex I of the Regulation:

- a. "Pro forma information" portrays the issuer as a hypothetical parent company of the whole business as from the commencement of 2005 or 2004.
- b. On the contrary "Complex Financial Histories information" provides the (historical and actual) individual accounts of each of the businesses for 2005,



2004 and 2003. Pro forma and Complex financial Histories requirements are cumulative and do not have the same nature/time coverage.

2. Types of securities

Extract from the European Commission's mandate

Taking in to account the 'building-block' organisation of the Regulation and the objective of proportionate regulation, would it be appropriate to take a different approach in relation to different kinds of securities?

Explanatory text

27. Following the Commission's mandate, CESR has analysed the need to follow a different approach in relation to different kinds of securities issued by issuers that have a complex financial history.
28. After analysing market practices and taking into account the option reflected in the Regulation in relation to the inclusion of pro forma information, that is only requested of in the Shares Registration Document, CESR has decided to follow the same approach as for pro forma information.
29. Therefore, CESR considers that the additional requirements being proposed in the case of issuers that have a complex financial history, should only be requested in those cases where the Shares Registration Document applies according to article 4 of the Regulation.
30. Consequently, the requirements should only apply to a prospectus published in relation to a public offer or admission to trading on a regulated market of the following:
1. shares and other transferable securities equivalent to shares;
 2. other securities which comply with the following conditions:
 - (a) they can be converted or exchanged into shares or other transferable securities equivalent to shares, at the issuer's or at the investor's discretion, or on the basis of the conditions established at the moment of the issue, or give, in any other way, the possibility to acquire shares or other transferable securities equivalent to shares; and
 - (b) provided that these shares or other transferable securities equivalent to shares are or will be issued by the issuer of the security and are not yet traded on a regulated market or an equivalent market outside the Community at the time of the approval of the prospectus covering the securities, and that the underlying shares or other transferable securities equivalent to shares can be delivered with physical settlement.

ADVICE

31. The additional requirements for issuers that have a complex financial history, should only be requested in those cases where the Shares Registration Document applies according to article 4 of the Regulation.

3. Possibility of an exemption for small and medium-sized enterprises

Extract from the European Commission's mandate

CESR is also invited to advise whether any amendment recommended in accordance with 3.1 above should apply in relation to all issuers, irrespective of their size and the nature of their business. In particular, CESR is asked to consider whether an exemption from the requirements, or any part of the requirements, relating to historical financial information for small and medium-sized enterprises (as defined in Article 2(1)(f) of the Prospectus Directive) would compromise the investor-protection objectives of the Directive.

Explanatory text

32. Following the Commission's mandate, CESR has analysed whether the same requirements should apply to all issuers irrespective of their size and the nature of their business.

33. CESR acknowledges that the Regulation, when requesting financial information on the issuer, does not provide for different requirements based on the size or nature of the business of the issuer. Also the request for pro forma information is applicable for all types of issuers using the share's RD.

ADVICE

34. The additional requirements for issuers that have a complex financial history should not make any distinction between different types of issuers.

4. Clarification of the meaning of "complex financial history".

Explanatory text

35. CESR considers that it would not be appropriate for the Regulation to provide a definitive list of cases of complex financial histories. In general, CESR considers that such cases would be those where the issuer has not prepared its historical financial information as a single business during the whole of the period for which the historical financial information is required under the Regulation. Therefore, the historical financial information included in the prospectus does not reflect the issuer's whole business throughout the required period. For example, it is not uncommon for issuers making a public offer or being admitted to trading on a regulated market to insert a newly incorporated holding company over established businesses in order to effect a restructuring of the businesses. In this case the statutory accounts of the newly



incorporated company (which would be the issuer for the purpose of the offer or admission to trading) would not reflect the actual financial position for the last three years of the group that is being sold to investors through the public offer or is being admitted to trading.

36. It is not possible to provide a comprehensive list of cases that would be included under the concept of issuers with a complex financial history. It is likely that new variations would be developed that would fall outside the defined cases. This is why CESR considers more appropriate to provide an illustrative list of the most commonly encountered cases of issuers with a complex financial history:
- a. The issuer is a newly incorporated holding company inserted over an established business.
 - b. The issuer seeking admission to trading or making an offer consists of companies that were under common control or ownership but which never formed a legal group.
 - c. A division of an existing business has been separated to form a different entity, which then makes a public offer or seeks admission to trading on a regulated market (so called carve out).
 - d. The issuer has changed its accounting reference date during the three year period.
37. Acquisitions or disposals during the three year historical record or subsequent to the last audited consolidated financial information of the issuer are considered by some CESR members as cases of issuers with a complex financial history. Other CESR members would not treat them as such, considering that where the significant acquisition or disposal is already fully reflected (i.e. for the entire twelve months period) at least in the historical financial information of the last period, no additional information would be necessary. If this is not the case, annex II of the Regulation on Pro forma information would apply and would be considered as sufficient information.
38. CESR considers that transactions where there is a firm commitment or an agreement to acquire or dispose a significant entity or business, even if not completed yet at the date of the approval of the prospectus, should be subject to the same requirements applicable to the acquisitions or disposals already completed, as long as the issuer has sufficient access to the financial information of the target component.
39. An illustration of the case described in the previous paragraph would be where the business being acquired by the issuer is the subject matter of the prospectus for which approval is required.

ADVICE

40. CESR considers that it would not be appropriate for the Regulation to provide a definitive list of cases of issuers with a complex financial history. In general, CESR considers that such cases would be those where the issuer has not prepared its historical financial information as a single business during the whole of the period for which the historical



financial information is required under the Regulation. Therefore, the historical financial information required by the Regulation to be included in the prospectus might not sufficiently reflect the issuer's whole business throughout the required period. The same applies in cases where there is a firm commitment or an agreement to perform the relevant transactions.

III. ADDITIONAL REQUIREMENTS FOR ISSUERS WITH A COMPLEX FINANCIAL HISTORY

Explanatory text

41. The results of the fact finding exercise undertaken by CESR clearly showed that most competent authorities currently adopt a flexible approach when dealing with situations of issuers with a complex financial history. In addition, a significant finding of the exercise was that the majority of regulators valued their current flexibility to require additional information where appropriate in the circumstances of the case.
42. When dealing with issuers with a complex financial history, there are many factors and situations that competent authorities will have to assess. Based on the experience of the competent authorities, CESR considers that it would be neither practicable nor efficient to set detailed rules that would have to be applied in all cases. The need to ensure, on the one hand, that disclosure requirements are effective and proportionate and, on the other hand, that investors protection is adequately satisfied, demands a flexible approach. In addition, this flexible approach has been requested by most market participants.
43. Notwithstanding Article 3 of the Regulation, CESR considers that competent authorities should retain their current flexibility subject to a set of principles defined by the Regulation. This would provide certainty for issuers and ensure convergence in the different Member States, while at the same time enabling competent authorities to take into account the circumstances of each specific case.

ADVICE

44. CESR considers that competent authorities should be able to require issuers with a complex financial history to provide in the prospectus historical financial information for the significant businesses or subsidiaries, for each year during the required periods (the last three years or such shorter period that the business or subsidiary has been in operation).
45. When deciding on the need and the extent of the historical financial information of the significant businesses or subsidiaries, competent authorities should take into account the requirements as set in item 20.1 of Annex I of the Regulation for issuers as regards to accounting and auditing principles and content of the financial information in light of the principles set out below.

46. When deciding whether an issuer with a complex financial history should provide additional information in the prospectus, competent authorities must take into account the **principles** set out in the following paragraphs. This would provide certainty for



issuers and ensure convergence in the different Member States, while at the same time enabling competent authorities to take into account the circumstances of each specific case.

A reflection of the economic reality

47. The additional information should reflect the economic substance of events and transactions and not merely their legal form. Investors should receive the same information if the economic realities are the same, irrespective of the chosen legal form.

Materiality

48. Additional information on the significant business or subsidiaries should be required only if it is material in relation to the totality of the issuer's business. at the time the prospectus is drawn up.

49. CESR considers that normally, a subsidiary or business is “**significant**” if it gives rise to or would have given rise to a significant gross change as defined in recital (9) of the Regulation 809/2004 for the purposes of determining whether pro forma financial information is required. Therefore, CESR would normally consider a subsidiary or business to be “significant” if it represents more than 25% relative to one or more indicators of the size of totality of the issuer's business.

50. Competent authorities should have flexibility when applying the materiality test in the context of each case. For example, when an issuer is formed as a holding company for a number of subsidiaries or business which are not individually significant, a literal application of the abovementioned test could lead to insufficient information being presented. Similarly, the use of just one indicator of size might lead to an anomalous situation.

Reasonability

51. Competent authorities must take into account the cost that the additional requirements will imply for issuers. The additional information should not duplicate information already provided in the prospectus.

ADVICE

52. When assessing the need and the extent of the additional information on the significant businesses or subsidiaries, competent authorities should have flexibility to decide on the requirements, taking into account the requirements set by item 20.1 of Annex I of the Regulation in light of the principles of economic reality, materiality and reasonability.

53. Finally, CESR has analysed one of the specific cases of a complex financial history included in the Commission's mandate which refers to the case where the issuer has changed its accounting reference date during the three year period. Following the



consultation, CESR considers that in these cases the historical financial information of the issuer should be presented for the issuer's financial periods necessary to show at least 36 months.

ADVICE

54. In the case where the issuer has changed its accounting reference date during the three year period, CESR considers that the historical financial information of the issuer should be presented for the issuer's financial periods necessary to show at least 36 months.

IV. COSTS TO THE ISSUER

55. The Commission invited CESR to advise on the additional costs an issuer with a complex financial history is likely to incur in preparing a prospectus as a result of any amendment to the Regulation which CESR may recommend.
56. For this purpose, CESR included questions in its consultation paper asking market participants to provide input on the costs that the different proposals would imply for issuers. In general, auditors and other respondents argued that it would be difficult to estimate the cost of any of the proposals, since the question will depend on the precise details of the case (size of the issuer or entities involved, type of transactions, availability of information, degree of involvement of auditors, etc).
57. CESR thinks that this argument from market participants is even more valid if the amendment of the Regulation is based on principles instead of consisting of a detailed set of rules as CESR initially suggested in its consultation paper. It is indeed difficult to estimate costs, as competent authorities will have flexibility to decide on the application of any requirements subject to the principles set out in this document.
58. The results of the responses to the questionnaire CESR initiated before starting this work showed that there were different practices in the Member States before the Regulation became effective. This also makes it difficult to assess how any amendment of the Regulation might affect the cost of raising capital as it would vary depending on the different jurisdictions.

The responses to the questionnaire indicated that the practice in a majority of the member states prior to the coming into force of the regulation was that where the historical financial information did not reflect the substance of the concerned issuer, requests for additional information are decided on a case-by-case basis. In some Member States however, no additional information is required.

Since the Regulation became effective, some competent authorities in those Member States where additional information was previously required have encouraged issuers to voluntarily continue with this practice. This is on the basis that it is appropriate to do so for investor protection and also because such issuers also believe that the relevant transactions would be more attractive to investors since they get a comprehensive picture of the transaction. These competent authorities have however not been able to compel



issuers to include such additional information. Other competent authorities on the other hand have felt that they could not require additional information, to the detriment of investor protection, since it is not possible to do so under the Regulation as it currently stands.

In those jurisdictions where issuers continue to provide additional financial information, there would be no incremental cost to them if the regulation were amended whereas in jurisdictions where additional information is not provided, a change in the Regulation may result in an increase in cost.

59. Notwithstanding, one of the principles advised by CESR is that competent authorities should consider the costs that any requirement would imply for issuers (reasonability).

V. CONCLUSION

60. Overall, having taking into account all the aspects reflected in the previous sections, CESR considers that it would be appropriate to amend the Regulation in the sense described in this advice. CESR thinks that, on balance, the benefits in terms of investor's protection would out weigh the costs to issuers, taking into account that one of the objectives of the principles suggested by market participants and included by CESR in this advice is to protect issuers against excessive or costly requirements from competent authorities that would not add a proportionate benefit in terms of investor's protection.

61. In line with CESR general objective to promote convergence of the practices of its members and in order to ensure adequate legal certainty for cross border activities in the single market, CESR will assess what level 3 work is needed in respect of the requirements relating to complex financial histories. Once the Regulation is amended CESR members will continue their current practice of sharing practical experience of the application of the Prospectus Regulation to ensure that regulators exercise the necessary flexibility in a way that is consistent and predictable for issuers.

ADVICE

<p>62. The Regulation should be amended to include an additional provision to deal with situations of issuers having a complex financial history, as detailed above.</p>
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ANNEX TO THE ADVICE



EUROPEAN COMMISSION
Internal Market and Services DG

Brussels,
MARKT/G3

FORMAL MANDATE TO CESR

FOR TECHNICAL ADVICE ON A POSSIBLE AMENDMENT TO THE REQUIREMENTS IN COMMISSION REGULATION (EC) 809/2004 REGARDING THE HISTORICAL FINANCIAL INFORMATION WHICH MUST BE INCLUDED IN A PROSPECTUS

This mandate requests CESR's advice on a possible amendment to Regulation (EC) 809/2004 implementing Directive 2003/71/EC (the Prospectus Directive) in order to ensure that a prospectus is required in every case to include the historical financial information which is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer, as is required by Article 5(1) of the Prospectus Directive.

The legal base for any such amendment is Article 7 of Directive 2003/71/EC. Regulation (EC) 809/2004 was adopted in accordance with that provision by the Commission on 29th April 2004, and comes into force on 1st July 2005.

The present mandate takes into full consideration the agreement on implementing the Lamfalussy recommendations reached with the European Parliament on 5 February 2002. In this agreement, the Commission committed itself to a number of important points, including full transparency. For this reason, this request for technical advice will be made available on DG Internal Market's web site once it has been sent to CESR. The European Parliament has also been duly informed.

1. BACKGROUND

Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading ("the Prospectus Directive") came into force on 31st December 2003, the date of its publication in the Official Journal of the European Communities. Member States are required to transpose the Directive by 1st July 2005 at the latest.

The Prospectus Directive requires the publication of a prospectus drawn up in accordance with the Directive and any implementing measures where securities are offered to the public or admitted to trading on a regulated market, unless an exemption from that obligation applies in a specific case. Article 5(1) of the Directive imposes the general requirement that a prospectus must contain "all information which, according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position,



profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities”.

The Prospectus Directive follows the four-level approach (essential principles, implementing measures, co-operation and enforcement), as endorsed by the Stockholm European Council in March 2001 and the European Parliament in February 2002. The Commission can be assisted by CESR, in its capacity as an independent advisory group, in its preparation of draft implementing measures.

Pursuant to the provisional mandates for technical advice, given to CESR by the Commission on 18th March 2002 and 31st January 2003, and formalised on 1st October 2003, CESR issued its advice on Level 2 measures for the Prospectus Directive in three separate stages, published in accordance with the deadlines imposed by the Commission: 31 July 2003, 30 September 2003 and December 2003. In accordance with the mandates, CESR provided advice on, among other things, the detailed implementing measures, required by Article 7(1) of the Directive, regarding the specific information which must be included in a prospectus. That advice recommended disclosure requirements based on the basic structure and typical main features of different types of securities.

Having regard to that advice, the Commission adopted Regulation (EC) 809/2004 of 29 April 2004 which specifies, among other things, the information items which must be included in a prospectus. That information varies according to the type of securities which is the subject matter of the prospectus. Article 3 of the Regulation prevents competent authorities from including in a prospectus information items which are not specified by the Regulation. The purpose of that restriction is to ensure a harmonised application of the directive and its implementing measures.

The Regulation contains the following requirements relating to historical financial information:

- Annex I to the Regulation, which contains a schedule of disclosure requirements in relation to shares, requires the inclusion in a prospectus of “audited historical information covering the latest 3 financial years (or such shorter period that the issuer has been in operation), and the audit report in respect of each year” (Item 20.1);
- Annex IV, which contains a schedule of disclosure requirements in relation to debt and derivative securities with a denomination per unit of less than €50,000, requires the inclusion in a prospectus of “audited historical information covering the latest 2 financial years (or such shorter period that the issuer has been in operation), and the audit report in respect of each year” (Item 13.1);
- Annex VII imposes a similar requirement in relation to asset backed securities (Item 8.2);
- Annex IX imposes a similar requirement in relation to debt and derivative securities with a denomination per unit of at least €50,000 (Item 11.1);
- Annex X to the Regulation imposes a similar requirement in relation to depository receipts issued over shares (Item 20.1);
- Annex XI imposes a similar requirement in relation to debt and derivative securities issued by banks (Item 11.1).



A possible deficiency in relation to some or all of these provisions became apparent shortly after the adoption of the Regulation. Some CESR members wished to use the Level 3 guidance relating to the Prospectus Directive to require the disclosure of financial information relating to entities other than the issuer in cases where the issuer has a complex financial history. That objective was based on current regulatory practice in those Member States. However, views were divided as to whether the requirement under the relevant provisions of the Regulation is restricted to financial information relating to the issuer, or whether it extends to historical financial information in respect of entities which are legally separate from, but which are closely linked to the issuer, in cases where that information is necessary for a proper assessment of the issuer and the securities in question.

With a view to determining whether there is a consensus between its members on the need, in case of an issuer with a “complex financial history”, for a prospectus to contain financial information which goes beyond that directly relating to the issuer, CESR has undertaken a fact finding exercise. Examples of issuers with a “complex financial history” covered by that exercise were cases where:

- the issuer is a newly incorporated holding company inserted over an established business;
- the issuer seeking admission to trading or making an offer consists of companies that were under common control or ownership but which never formed a legal group;
- the issuer has made a significant acquisition (representing more than 25% of the group) during the three year historical record or subsequent to the last audited consolidated financial information on the issuer, including specific reference to cases where the acquired target has different accounting policies;
- the issuer has disposed of a significant part of its business since the last audited accounts;
- the issuer has changed its accounting reference date during the three year period.

The results of that exercise indicated that the majority of regulators currently require the inclusion of financial information relating to entities other than the issuer in some or all of the kinds of cases covered in the exercise. Practice varied between regulators, but similarities emerged. For example, where a newly incorporated holding company has been inserted over established subsidiaries, the current practice in most of the Member States is to require three years of historical financial information or key figures extracted from the statutory accounts in respect of the enlarged group. This variously takes the form of a three year pro-forma or combined accounts of the enlarged group, or a one year pro-forma on the enlarged group together with three years financial information on material subsidiaries. Similarly, where there is a carve out, the practice is normally to require three years of historical financial information or key figures in respect of the entity that has been carved out. However, three years of financial information is not always available, and in such cases competent authorities may adopt a flexible approach. A significant finding of the exercise was that the majority of regulators valued their current flexibility to require additional information where appropriate in the circumstances of the case.

There is some uncertainty about the extent to which the provisions of the Prospectus Regulation relating to historical financial information will enable competent authorities to require the



inclusion of the range of financial information which they would currently require in a case of a kind considered in CESR's fact-finding exercise. Since Article 3 of the Regulation prohibits competent authorities from requesting the inclusion of information which is not included in the Annexes, it is essential to clarify the scope of the provisions relating to historical financial information to ensure that competent authorities have the ability to require all the information which is necessary in any particular case, and that issuers and their advisers can be certain about what is properly required of them. The provision of the full range of financial information which is relevant in a particular case is necessary to ensure proper investor protection. Furthermore, any lack of legal certainty about the scope of a statutory or regulatory requirement could be detrimental to the efficient functioning of markets.

Accordingly, the Commission considers it desirable to amend the relevant provisions of the Prospectus Regulation so as to eliminate uncertainty as to the scope of those provisions and to ensure that the requirements in relation to historical financial information extend to the entire range of information which may be necessary to enable investors to make an informed assessment of the issuer and the securities, in any case where financial information relating to legal entities other than the issuer may be relevant to the financial condition and prospects of the issuer itself.

2. THE PRINCIPLES TO WHICH CESR SHOULD HAVE REGARD

2.1 The working approach agreed between DG Internal Market and the European Securities Committee

As regards its working approach, CESR is invited to take account of following principles:

- The principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001;
- CESR should provide comprehensive advice on the matters described below covered by the delegated powers included in the relevant comitology provision of the level 1 Directive, in the corresponding recitals as well as in the Commission request included in the mandate. That advice should be consistent with the general format and organisation of Regulation (EC) 809/2004;
- CESR should address to the Commission any questions which arise in the course of its work concerning the clarification on the text of the Prospectus Directive and Regulation (EC) 809/2004 or other parts of Community legislation, which are considered relevant to the preparation of its technical advice;
- The technical advice given by CESR to the Commission should not take the form of a legal text. However, CESR should provide the Commission with an “articulated” text which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, and which is presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level;
- CESR should provide advice which takes account of the different opinions expressed by the market participants (practitioners, consumers and end-users) during consultations. CESR



must provide a feed-back statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation.

2.2 Consultation of the public

The Stockholm European Council endorsed the Lamfalussy recommendations on consultation and transparency. In particular, it invited the Commission to make use of early, broad and systematic consultation with the institutions and all interested parties in the securities area, especially by strengthening its dialogue with consumers and market practitioners. It also stated that CESR should “consult extensively, in an open and transparent manner, as set out in the final report of the Committee of Wise Men and should have the confidence of market participants”.

Article 5 of the Commission Decision establishing the CESR provides that “before transmitting its opinion to the Commission, the Committee [CESR] shall consult extensively and at the early stage with market participants, consumers and end- users in an open and transparent manner”.

In this context, DG Internal Market draws CESR’s attention to the European Parliament’s Resolution on the implementation of financial services legislation of 5 February 2002 and the Commission’s formal Declaration in response.

DG Internal Market will ensure that the Stockholm European Council recommendations on consultation have been fully met. In particular, it will satisfy itself that CESR has consulted all interested parties on its technical advice in accordance with the CESR Public Statement on Consultation Practices. This mandate will also be posted on DG MARKET website.

Once the Commission has received the CESR’s advice, it may draw up draft working documents to put forward to the ESC and the European Parliament. It simultaneously publishes those texts on its Internet site. If the Commission amends its draft to reflect discussions in the ESC, those amended drafts will also be made public on the website.

2.3. Investor Protection and Proportionate Regulation

In giving its advice, CESR should take full account of the following principles and objectives:

- the need to encourage and build an efficient, cost-effective and competitive pan-European capital market on the one hand, and to provide the necessary levels of investor protection on the other;
- the need to ensure that disclosure requirements are effective and proportionate, to ensure that an EU prospectus contains all the information required by an investor in order to make an informed decision whether to subscribe for or purchase the securities, while not going beyond what is necessary for that purpose;
- the principles mentioned in Recital (41) of the Prospectus Directive.

3. CESR IS INVITED TO PROVIDE TECHNICAL ADVICE BY OCTOBER 2005



3.1 Amendment of Commission Regulation (EC) 809/2004 in order ensure that a prospectus includes the historical financial information which is necessary to enable an investor to make an informed assessment of the issuer and securities in question

CESR is invited to provide technical advice on a possible amendment to Commission Regulation (EC) 809/2004 in order to ensure that the Regulation requires, or enables competent authorities to require, the inclusion in a prospectus of all the historical financial information which is necessary, in a case where the issuer has a complex financial history, to enable an investor to make an informed assessment of the financial condition and prospects of the issuer. In formulating that advice, CESR is invited to consider in particular the following matters –

- (1) In what kinds of cases might it be necessary for a prospectus to include historical financial information relating to legal entities other than the issuer? Do all the kinds of cases considered in CESR's fact-finding exercise on this topic require the inclusion of such information in a prospectus? Are the examples of an issuer with a complex financial history considered in that fact-finding exercise a comprehensive list, or is it possible that information relating to legal entities other than the issuer might also be required in other cases?
- (2) Taking in to account the 'building-block' organisation of the Regulation and the objective of proportionate regulation, would it be appropriate to take a different approach in relation to different kinds of securities?
- (3) Define what historical financial information must be included in a prospectus relating to securities the issuer of which has a complex financial history, taking into the account the necessity of balancing investor protection with the need to avoid imposing unjustified costs on issuers, as competent authorities currently have the flexibility to do.

3.2 Possibility of an exemption for small and medium-sized enterprises

CESR is also invited to advise whether any amendment recommended in accordance with 3.1 above should apply in relation to all issuers, irrespective of their size and the nature of their business. In particular, CESR is asked to consider whether an exemption from the requirements, or any part of the requirements, relating to historical financial information for small and medium-sized enterprises (as defined in Article 2(1)(f) of the Prospectus Directive) would compromise the investor-protection objectives of the Directive.

3.3 Costs to the issuer

CESR is invited to advise the Commission as to the additional costs an issuer with a complex financial history is likely to incur in preparing a prospectus as result of any amendment to the Regulation which CESR may recommend.

CESR is requested to provide technical advice on all the matters mentioned above by 31 October 2005.

