



**CESR's technical 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**

Consultation Paper

June 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 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.
8. The European Commission (“The Commission”) has 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 has 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 will be undertaken by the CESR Expert Group on Prospectuses, which is 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.



Purpose

10. The purpose of this consultation document from CESR is to seek comments on the draft technical advice that CESR proposes to give to the Commission.

Public consultation

11. 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).
12. The public consultation on the present paper will close on 15 September 2005. Responses to the consultation should be sent via CESR's website (www.cesr-eu.org) under the section "Consultations".
13. As part of the consultation process on this paper, a public hearing will be held in Paris, at CESR premises, on 6 September 2005 (starting at 10:30). An agenda for the hearing will be available on the CESR website. Inscriptions to the open hearing can be made via the CESR website (www.cesr-eu.org) under the section "Hearings". A meeting with a targeted consultative working group will be held on the same day.



INDEX

I. INTRODUCTION

(Paragraphs 14-25)

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)

European Commission's mandate

(Paragraph 25)

II. SCOPE OF THE ADDITIONAL REQUIREMENTS

(Paragraphs 26-35)

Preliminary remark

(Paragraphs 26-27)

Types of securities

(Paragraphs 28-32)

Possibility of an exemption for small and medium-sized enterprises

(Paragraphs 33-35)

III. FLEXIBILITY FOR COMPETENT AUTHORITIES

(Paragraphs 36-38)

IV. ADDITIONAL REQUIREMENTS FOR ISSUERS WITH A COMPLEX FINANCIAL HISTORY

(Paragraphs 39-83)

Issuer is a newly incorporated holding company inserted over established businesses

(Paragraphs 42-64)

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

(Paragraphs 65-70)

Issuer has made a significant acquisition or disposal during the three year historical record or subsequent to the last audited consolidated financial information

(Paragraphs 71-81)

Issuer changed its accounting reference date during the three year period (Paragraphs 82-83)

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.



European Commission's mandate

25. The Commission has invited CESR to provide technical advice by 31 October 2005 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.

II. SCOPE OF THE ADDITIONAL REQUIREMENTS

1. Preliminary remark

26. 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.

27. Q: Do you agree with this approach? Please give your reasons.

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?

28. 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.

29. 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.

30. 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.

31. 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.

32. *Q: Do you consider that the scope of the requirements for issuers that have a complex financial history should apply in relation to public offer or admission to trading on a regulated market of any equity security to which the Shares Registration Document applies or should it be restricted only to a prospectus published in relation to a public offer or admission to trading on a regulated market of shares? Please give your reasons.*

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.

33. 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.
34. 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 shares issuers.

35. *Q: Do you consider that, in relation to additional requirements for issuers with a complex financial history, there is a need to distinguish between different types of issuers? Please give your reasons.*

III. FLEXIBILITY FOR COMPETENT AUTHORITIES

36. 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.
37. 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.

38. Therefore, CESR considers that its members should retain flexibility.

IV. ADDITIONAL REQUIREMENTS FOR ISSUERS WITH A COMPLEX FINANCIAL HISTORY

39. This section sets out CESR's proposals in relation to the cases described in the Commission's mandate.

40. *Q: Do you believe that the cases described below should be considered as a comprehensive list? If not, please provide examples of any other cases you would consider convenient to address and of the additional requirements you would consider appropriate to require in those examples.*

41. CESR would like to clarify that in relation to the following requirements article 23.4 of the Regulation is also applicable. Accordingly, in the cases where one of the information requirements requested or equivalent information is not pertinent to the issuer, to the offer or to the securities to which the prospectus relates, that information may be omitted.

CASE 1: The issuer is a newly incorporated holding company inserted over established businesses.

42. 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.

43. Therefore, CESR considers that, in this case, it is necessary to require the issuer to provide in the prospectus historical financial information for the significant businesses or subsidiaries for each year during the required periods (in case of share prospectuses, the last three years or such shorter period that the business or subsidiary has been in operation).

44. 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 the issuer's business.

45. *Q. Do you agree with the proposed approach? Please give your reasons.*

46. The following paragraphs discuss the meaning of the “historical financial information” that would be required.

a. Accounting standards

47. CESR has considered three alternative options in relation to the requirements on accounting standards that the historical financial information of the significant businesses or subsidiaries have to follow:

Option 1

48. Following the same approach as included in item 20.1 of Annex I, one option is to require the financial information to be prepared according to Regulation (EC) No 1606/2002, or if not applicable to a Member State national accounting standards for issuers from the Community. For third country issuers, such financial information must be prepared according to the international accounting standards adopted pursuant to the procedure of Article 3 of Regulation (EC) No 1606/2002 or to a third country's national accounting standards equivalent to these standards. This would mean that where a company acquired several businesses with different accounting standards or policies, it would be possible to present the historical financial information on those businesses or subsidiaries in the prospectus using an accounting standard or policy which is different from that used by the issuer. For example, under this option it would be possible to have in the prospectus the issuer's historical financial information prepared according to IFRS, the historical financial information of subsidiary A prepared according to German GAAP and the historical financial information of subsidiary B prepared according to French GAAP. If the subsidiary C, however, would have prepared its financial statements according to e.g. Indian GAAP (third country issuer), these would have to be restated to IFRS or to a third country's national accounting standards equivalent to these standards.

Option 2

49. Like under option 1, under this alternative only the accounting standards mentioned in option 1 would be acceptable for the presentation of the financial information of each of the significant businesses or subsidiaries. But if those accounting standards are different from that used by the issuer, issuers would have to conform in some way (restatement, a reconciliation or narrative description of the differences) for the required periods the financial information of the significant subsidiaries to its accounting standards, so investors can have comparable information. For example, under this option it would be possible to have in the prospectus the issuer's historical financial information prepared according to IFRS, the historical financial information of subsidiary A prepared according to German GAAP and the historical financial information of subsidiary B prepared according to French GAAP. However, it would be necessary to conform in some way the financial information of subsidiaries A and B to IFRS (issuer's GAAP).

Option 3

50. The financial information of the significant businesses or subsidiaries may be presented according to any accounting standards besides those accepted under item 20.1, but if those standards are different from the ones used by the issuer, issuers would have to conform in some way (restatement, a reconciliation or narrative description of the differences) for the required periods the financial information of the significant subsidiaries to its accounting standards, so investors can have comparable information. For example, under this option it would be possible to have in the prospectus the issuer's historical financial information prepared according to IFRS, the historical financial information of subsidiary A prepared according to Russian GAAP and the historical financial information of subsidiary B prepared according to Indian GAAP. However, it would be necessary to conform in some way the financial information of subsidiaries A and B to IFRS (issuer's GAAP).

51. Q. Which of the three options proposed do you prefer? Please give your reasons.

52. Q. If option 2 or option 3 is preferred, how would you request the issuer to conform the information given to the issuers' accounting standards?

- a. Restatement
- b. Reconciliation
- c. Narrative description of the differences?

Please give your reasons and provide input on the costs that each of the options would imply for issuers.

b. Minimum content of the financial information

53. CESR has considered three alternative options in relation to the minimum content that the financial information of the significant businesses or subsidiaries would include:

Option 1

54. Following the same approach as included in item 20.1 of Annex I for the historical financial information of the issuer, where the financial information has been prepared according to national GAAP, it would have to include at least:

- a) balance sheet;
- b) income statement;
- c) a statement showing either all changes in equity or changes in equity other than those arising from capital transactions with owners and distributions to owners;
- d) cash flow statement;
- e) accounting policies and explanatory notes.

Option 2

55. Following the same approach as included in item 2 of Annex II on pro forma information, the financial information required would include at least:

- a) balance sheet;
- b) income statement;
- c) accounting policies and explanatory notes.

Option 3

56. If explanatory notes are already required for the pro forma information which will also be inserted in the prospectus, the financial information required would include at least:

- a) balance sheet;
- b) income statement;
- c) accounting policies.

57. Q. Which of the three options proposed do you prefer? Please give your reasons.

If you support option 1, please provide input on the costs this option would mean, specially if a cash flow statement or a statement showing changes in equity would have to be produced only for the purposes of the prospectus.

c. Auditing standards

58. Regardless the option followed in relation to the accounting policies to be accepted for the historical financial information of the significant subsidiaries, CESR considers, in principle, that the involvement of an independent accountant or auditor in relation to the financial information of the significant businesses or subsidiaries is necessary. In principle, CESR would request the information to be audited or reported on as whether or not for the purposes of the prospectus it gives a true and fair view, in accordance with auditing standards applicable in a Member State or an equivalent standard.

59. However, CESR considers that the final advice in relation to the need to have a full audit of the financial information of the significant businesses or subsidiaries, will depend on the final decision taken in relation to the minimum content of the financial information.
60. If an audit is to be required, CESR considers that, as requested for the issuer under item 20.4.1 of Annex I, the prospectus should include in relation to the financial information of the significant businesses or subsidiaries a statement that the historical financial information has been audited. If audit reports on the historical financial information have been refused by the statutory auditors or if they contain qualifications or disclaimers, such refusal or such qualifications or disclaimers must be reproduced in full and the reasons given.

61. *Q. Do you agree with this approach? Please give your reasons.*

62. In addition, if option 2 or option 3 (under the heading accounting standards) are to be followed, issuers would have to conform in some way (restatement, a reconciliation or narrative description of the differences) for the required periods the financial information of the significant subsidiaries to its accounting standards. In this case, CESR considers that there should be auditors involvement.

63. *Q: Do you agree that there should be auditor's involvement concerning this additional information given in case of reconciliation or narrative description? Please give your reasons.*

64. Q: What kind of assurance should the auditor provide in relation to the restatement, reconciliation or narrative description:
- a) a full scope audit
 - b) a review scope
 - c) a report, as in item 7a) of the pro forma annex, stating that in their opinion the financial information has been properly compiled on the basis stated?

CASE 2: 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. This case would include where 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)

65. Where the entity that has been separated had the obligation to produce statutory accounts, no additional information besides that required under item 20.1 would be required..
66. Where a business is separated to form a different entity, the newly incorporated company (which would be the issuer for the purpose of the offer or admission to trading) would not have statutory accounts for the period requested.
67. **Therefore, CESR considers necessary to require the issuer to provide, for all years for which the historical financial information is required when no statutory accounts are available, all reliable information available taken from the internal or management accounts of the issuer (if possible, balance sheet, income statement, assets and cash flow attributable to that business). In addition, the issuer should provide the basis upon which that information has been prepared.**

68. Q. *Do you agree with this approach? Please give your reasons and provide input on the costs that each year of drawing up of historical financial information would imply for issuers.*

69. CESR considers, that the involvement of an independent accountant or auditor in relation to this financial information is necessary. However, different options in relation to the level of assurance that the auditor or accountant should provide have been considered:

- a) a full scope audit
- b) a review scope
- c) a report, as in item 7a) of the pro forma annex, stating that in their opinion the financial information has been properly compiled on the basis stated

70. Q. Which of the above options proposed do you prefer? Please give your reasons and provide input on the costs that each of the options would imply for issuers.

CASE 3: The issuer has made a significant acquisition or disposal during the three year historical record or subsequent to the last audited consolidated financial information on the issuer.

71. CESR considers that normally, an acquisition or disposal 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 for the purposes of determining whether pro forma financial information is required. Therefore, CESR would normally consider an acquisition or disposal to be “significant” if it represents a variation of more than 25% relative to one or more indicators of the size of the issuer’s business, in the situation of an issuer due to a particular acquisition or disposal.

72. In relation to this situation two options have been analysed by CESR:

Option 1

73. If the significant acquisition or disposal is already fully (i.e. for the entire twelve months period) reflected at least in the historical financial information of the last period, no additional information would be necessary. If this is not the case, as Annex II of the Regulation 809/2004 on pro forma information would apply, no additional information needs to be provided by the issuer.

Option 2

74. In addition to Annex II of the Regulation on pro forma information, the issuer should comply with the same requirements as set out in cases 1 and 2. That would mean the need to provide historical financial information on the acquired or disposed entity or business.

75. Nevertheless, the above information will not be necessary if the significant businesses or entities have been consolidated at least in the consolidated historical financial information of the issuer for the whole of the last two financial years. Where the historical financial information has not been consolidated for at least two years, the issuer should provide pre-consolidation or pre-acquisition information on the businesses or subsidiaries.



76. In cases where the acquired target has different accounting standards or has followed different policies, CESR would advice the same approach as the one that would be followed for case 1 (see letter a) on accounting standards).

77. *Q. Which of the alternatives proposed do you prefer? Please give your reasons.*

78. *Q. Would you propose any other option to deal with these situations? Please give your reasons and provide input on the costs that each of the options would imply for issuers*

79. CESR thinks that the requirements proposed above for acquisitions or disposals already completed should also apply where there is a firm commitment or an agreement to acquire or dispose a significant entity or business, but the transaction has not been completed yet at the date of the approval of the prospectus. This is without prejudice to the requirement for pro forma information in such cases according to the Regulation as currently drafted.

80. An illustration of this case would be where the business being acquired by the issuer is the subject matter of the prospectus for which approval is required.

81. *Q. Do you agree with this approach? Please give your reasons.*

CASE 4: The issuer has changed its accounting reference date during the three year period.

82. CESR considers that in those cases where there has been a change in accounting reference date, the historical financial information should be presented for at least three calendar years.

83. *Q. Do you agree with this approach? Please give your reasons.*



ANNEX TO THE CONSULTATION PAPER



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.