



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 MARKT 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.