

**ICMA's response to 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**

General matter

We believe that CESR's suggested approach is too prescriptive for a Commission Regulation. A detailed Regulation would build unnecessary inflexibility in to the disclosure regime, and potentially prevent issuers accessing the capital markets when there is no good reason to do so. This would be counter to one of the key objectives of the Financial Services Action Plan of broadening issuers' options for raising capital. The sheer breadth of possible complex financial history circumstances means that it is impossible to develop a comprehensive set of rules that is helpful to investors and issuers and addresses all possible situations.

The current approach described in paragraph 24 of the consultation paper, whereby competent authorities take into account the materiality of the historical financial information, is one that should be retained to a great extent and we support CESR's conclusion in paragraph 38 of the consultation paper that its members should retain flexibility.

We strongly recommend that only a limited change be made to the Regulation that would allow competent authorities to look beyond issuers under Article 20.1 of Annex I of the Prospectus Regulation for meaningful financial disclosure where there were complex financial histories. This should be combined with non-exhaustive recommendations and examples at Level 3 for the type of additional financial information that would satisfy the requirements for meaningful financial disclosure in a given set of specified complex financial histories. This approach would allow competent authorities to address other complex situations that are likely to arise, as well as protecting investors and issuers from the anomalous and potentially very costly disclosures which could result from a prescriptive set of requirements. For example, if a business forming part of a group in respect of which a prospectus is being prepared has undergone a number of disposals, a number of acquisitions, then a division from that is carved out and a holding company is put in place on top as an IPO vehicle, it would be impossible to determine what financial statements should be included in a prospectus from the proposals in CESR's consultation paper.

We note that Article 5 of the Prospectus Directive requires inclusion, *inter alia*, of all information that is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position and losses and prospects of the issuer. It is important that any CESR determination is made in the context of this overarching disclosure requirement. It reduces significantly any perceived risk of not having fully comprehensive requirements. Furthermore, given the terms of Articles 5 and 21 of the Prospectus Directive, it is important that competent authorities have the discretion to require meaningful financial disclosure taking into account the specifics of a particular case. Following a prescriptive approach without sufficient flexibility would undermine the general disclosure obligation in Article 5 and the duties of the competent authority under Article 21 and national legislation.

We note CESR'S comment in paragraph 22 of the Consultation Paper that the Commission wishes to amend the provisions of the Regulation, among other things, to ensure that the requirements for historical financial information extend to the entire range of information which may be necessary. We do not consider this to be an achievable objective, nor do we consider it necessary, for the reasons we give above. But if the Commission were to continue to take this approach, at a minimum, it is essential that competent authorities are given the discretion to depart from specific requirements set out at Level 2 if alternative meaningful financial disclosure could be given in the particular circumstances of any case. This discretion must be broader than the derogation power already in Article 8.2 of the Prospectus Directive. Article 8.2 requires the competent authority to determine that the information being omitted is of minor importance only (which is very unlikely to be the case). Instead, the discretion should be based on the ability of the issuer to provide alternative meaningful financial disclosure. However, this would be a much less satisfactory solution than limited changes to Article 20.1, supported by CESR work at Level 3.

We welcome CESR's search for information on the costs of various proposals, and agree that a cost benefit analysis is an essential part of such a consultation. As ICMA is not an accountancy body, we regret that we are unable to provide estimates of costs in this particular instance.

Q32

The scope of the requirements for issuers that have a complex financial history should apply in relation to the public offer or admission to trading on a regulated market only of **shares**. In particular, we do not believe convertible or exchangeable securities fulfilling the conditions in paragraph 31.2 of the consultation paper should trigger the requirements under the complex financial history rules as they are customarily bought and traded only by professional investors. Furthermore, pro forma financial information would, where appropriate, be required to be given in any event for those types of securities.

Q35

We agree there may be a need to distinguish between different types of issuer, but we do not think it is possible to foresee all the situations where this would be necessary.

Q45, Q77, Q78

Cases I and III

Firstly, we believe most of the examples in cases I and III should be treated together. Case I, if it is intended to deal with putting in place a new holding company, can be simplified as set out below, and all of the more complicated situations dealt with in that Case can be dealt with as Case III (subject to the discretion of the competent authority, where appropriate).

The following are possible recommendations for Level 3 for CESR'S consideration (not legislation at Level 2):

The issuer and the competent authority should have regard to the accounting treatment under relevant accounting principles in respect of any particular complex financial history. This may affect the appropriateness of any particular form of presentation of financial information suggested below, and may lead to modifications having to be

agreed with the competent authority. It may even lead to not having to provide any additional financial information if the relevant transaction is adequately reflected in the financial statements of the issuer.

Case I – putting in place a new holding company:

1. If a holding company is put in place over an existing business, the following financial statements should be included in the prospectus:

A. if accounting rules allow, the new holding company should be able to give “successor”, or “combined”, financial statements presented as if the new holding company had been the holding company from the beginning of the period for which historical financial statements have been included; or

B.(a) financial statements that substantially cover the business of the group over which a holding company has been put in place (see Case III for the requirements for these financial statements); and

(b) a balance sheet of the company or companies put in place above the existing business, if there are any material assets or liabilities (other than direct or indirect shareholdings in the companies in respect of which financial statements have been included under (a) above).

Case III – the issuer has made a significant acquisition or disposal during the three year historical record or subsequent to the last audited consolidated financial statement information on the issuer

If the issuer has made a significant **acquisition** during the three year historical record or subsequent to the last audited consolidated financial statement information on the issuer, which would, tested at the time of the acquisition and based on the most appropriate financial information available at that time or obtained subsequently, constitute a “significant gross change”, then separate historical financial statements should be included in respect of the acquired company for a number of years as determined below (provided that no such financial information shall be required for any period during which it has (for the whole of that period) been consolidated in other financial statements included in the prospectus). For the avoidance of doubt, this recommendation should apply to any company which has been “acquired” by putting in place a new holding company (for example where two existing separate groups are “merged” by being acquired by a single new holding company) and the significant gross change tests shall be applied for that company in comparison to the other companies that form part of the group at the time of the acquisition.

We suggest that the number of years for which separate financial years should be required could be determined by the level of significance under the tests for significant gross change set out in existing level three recommendations for the consistent implementation of the Prospectus Directive. If any of the tests cross, for example, 75%, then three years’ historical financial statements would be included for the acquired entity. If any of the tests cross 40% (but not 75%), then the latest two years’ historical financial statements would be included for the acquired entity. If any of the tests cross 25% (but do not cross 40%), the latest year’s financial statements would be included for the acquired entity.

The competent authority should retain the discretion to require or permit an alternative approach to the financial statements required to be included in the prospectus if the approach set out above would lead to an anomalous result, particularly where the

financial statements included in the prospectus would not show the results of the substantial majority (say 75%) of the business that forms part of the group at the date of the prospectus. Furthermore, where financial statements for the acquired entities represent a substantial majority of the business of the group covered by the prospectus, it may well be appropriate not to require financial statements in respect of the entities involved in the rest of the business.

If the issuer has made a significant **disposal** during the three year historical record or subsequent to the last audited consolidated financial statement information on the issuer, which would, tested at the time of the disposal and based on the most appropriate financial information available at that time or obtained subsequently, constitute a “significant gross change”, then we suggest **no** separate financial statements should be required to be included in respect of the disposed assets. In the case of a disposal since the beginning of the last financial year which constitutes a significant gross change, the pro forma financial information which would be required to be included in the prospectus, together with any financial statement adjustments reflecting the business disposed of as a discontinued operation under applicable accounting principles (if applicable), will provide investors with all of the information that is material to their investment decision. (We note, for instance, that the comparable U.S. rules contained in Regulation S-X adopted by the U.S. Securities and Exchange Commission do not require separate financial information for entities being divested.) The competent authority should retain the discretion to require or permit an alternative approach to the financial statements required to be included in the prospectus if the approach set out above would lead to an anomalous result.

Q51, Q52

Accounting principles

We suggest flexibility will be necessary for the GAAP requirements for separate financial statements in Cases I and III. It will not always be appropriate to require financial statements on the same basis or reconciled to the same basis as that of the issuer. For example, if pro forma financial statements have been included that show the effects of the relevant acquisition, it does not seem necessary to require separate financial statements for the acquired business as well on a consistent basis. In addition, if the acquisition occurred during the first two of the three years (and so pro formas are not required) given that the effect of the transaction is reflected in a full year of financial statements and any financial statements for any subsequent interim periods, it would seem reasonable not to require the financial statements to be included on the same basis or reconciled to the same basis of the issuer. If anything is required in respect of GAAP differences, a narrative description of significant differences between the relevant GAAPs would be sufficient. This narrative disclosure does not need to be as detailed as the proposed requirements in CESR’s advice to the Commission on equivalence of GAAP. A narrative description of the differences along the lines of those disclosed in many prospectuses for offerings in the United States should suffice. However, in certain circumstances, for example, if the acquired entity represents the substantial majority of the business of the group, it may well be appropriate to treat the acquired entity as the issuer for the purpose of financial statement requirements.

Q57

We believe that in some cases Option 1 would be appropriate (for example, where the acquired entities represent the substantial majority of the business of the group). However, in many cases Options 2 or 3 will be more appropriate (for example, where the acquisition of the entities has triggered a requirement for pro forma financial

statements and the pro forma financial statements include nothing more than the balance sheet, income statement, accounting policies and explanatory notes, it would be meaningless to require anything more in any separate financial statements). A standardised approach will not satisfy the information requirements of investors, or facilitate companies' access to the markets.

Q61

As a general principle, we agree that if additional financial statements are required, it is likely in most cases that it would be appropriate for them to be audited or reported on. But we are concerned that if this requirement were mandated by Level 2 legislation, there may be specific situations in which some flexibility might be desirable which could not then be addressed. For example, if pro forma financial statements have been included that show the effects of the relevant acquisition and these have been reported on, it does not seem necessary to require the financial statements for the acquired business to be audited or audited to any particular standard. In addition, if the acquisition occurred during the first two of the three years (and so pro formas are not required) given that the effect of the transaction is reflected in a full year of financial statements and any financial statements for any subsequent interim periods, it would seem reasonable not to require the financial statements to be audited. However, in certain circumstances, for example, if the acquired entity represents the substantial majority of the business of the group, it may well be appropriate to treat the acquired entity as the issuer for the purpose of financial statement requirements and therefore require audited financial statements for the full three-year period.

Q63

If additional financial information is required, we agree that auditor involvement is desirable. We note, for example, that auditors in the UK currently give properly compiled opinions on reconciliations. However, while there may be circumstances in which a description of narrative differences would be appropriate, we suggest that auditors may not agree to provide formal assurance on such a description.

Q68

Case II

We do not agree that in all instances financial statements for the carved out entity should be included separately. For example, if the absence of the rest of the business were treated as a disposal, and that disposal would not represent a significant gross change, it would not seem appropriate to require financial statements that covered the carved out business separately. It may also be appropriate to include the financial statements of the larger group and, if the assets not forming part of the new group were treated as a disposal and represented a significant gross change, include pro forma financial statements in respect of the part that no longer forms a part of the group as if it were disposed of at the beginning of the latest year for which financial statements are included. Carved out financial statements should, however, be permitted in the circumstances described by CESR. The appropriate solution should be dealt with on a case-by-case basis.

Inclusion of information from internal or management accounts referred to in paragraph 67 is unlikely to be possible – issuers (and underwriters in underwritten deals) will be unwilling to include information from such sources in a prospectus because of potential

liability concerns, and we suggest auditors will be unlikely to give assurance on it.

Q70

Case II

For similar reasons to those described above, whether a full scope audit, a review scope or a proper compilation report is appropriate will depend on the circumstances of the case.

Q81

We suggest that any recommendations dealing with acquisitions or disposals already completed should not automatically apply in all cases where a firm commitment or an agreement to acquire or dispose has been entered into. There may be circumstances, such as where the prospectus relates to an offering of securities the proceeds of which are intended to be used to finance the relevant acquisition, the completion of the acquisition is not subject to significant contingencies and the information can be obtained by the acquirer or is readily available, in which it is appropriate to impose such a requirement. In other cases, however, agreements may be subject to fundamental conditions, such as obtaining competition approvals, for example. In addition, it may in certain circumstances be impossible for an acquirer to obtain from the acquired entity the information necessary to prepare the required information before the date of completion (for practical or legal reasons, such as in the case of competition regulation.)

Q83

We agree with this approach.