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Position on

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

Consultation Paper
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Introductory Remarks

As a member of the Consultative Working Group to advise CESR Expert Group on Prospectuses I have accompanied the process of the Level 2 and Level 3 implementation of the Prospectus Directive. Based on the thoughts which I submitted in previous positions, the call for evidence and the discussion at the hearings regarding the consultation paper in Paris on 6 September 2005 I am pleased to present my position on a possible amendment to Regulation (EC) 809/2004 regarding the historical financial information in prospectuses. As a consequence of the Paris hearings I have structured my comments not according to the list of paragraphs in the consultation paper, but according to priority aspects.

Basic principle (paragraphs 36 to 38)

If the authorities are convinced that some amendment to the Regulation regarding the historical financial information is necessary, it could only be a general guideline. As I will explain in subsequent paragraphs there is no chance to cover any exemption to a straightforward three year historical financial information of an issuer by predefined examples or cases. Therefore, I would suggest to add to section 20.1. of Annex I of the Regulation a section 20.1.2. (the present text becoming section 20.1.1.) which states as follows:

“If the issuer is not able to present three year historical financial information according to section 20.1.1. describing the economic situation of the issuer at the time of the prospectus due to significant changes in the corporate structure over the three years period, the competent authority is entitled to require equivalent financial information based on the principles of materiality and reasonability. The information could include historical financial information from companies or institutions which legally did not belong to the issuer on the date of the relevant information. Any such information must be accompanied by a report prepared by independent accountants or auditors.

The differences of the historical financial information according to this section compared to section 20.1.1. shall be explained under section 4. (risk factors) in a plain and easy understandable language.”

Such basic principle would allow for flexibility in a triangle situation. The competent authority must outweigh what would be possible according to the relevant GAAP standards or simply to available data, what should be acceptable to the issuer based on cost and time and what should be necessary to ensure investor protection. Any concrete requirements would make such necessary flexibility impossible.

The competent authorities shall take into account that any serious issuer with a complex financial history will certainly contact the authority prior to the submission of a prospectus to get a decision on the necessary content. The competent authority should make a binding decision to avoid double work and further discussions when the prospectus would be submitted for approval at a later stage.

Cases and examples (paragraphs 40 to 81)

The limitations concerning cases and examples become obvious at a detailed glance of the cases presented in the consultation paper. For example, regarding case 1 the following scenarios would have to be treated in the same manner:

- ⊘ Establishing a new holding company over 10 legal entities formerly owned by different persons immediately prior to the launch of the securities.
- ⊘ Corporate restructuring three years ago with two consolidated annual reports according to section 20.1. already available.

Similar examples could be made regarding case 2:

- ⊘ Carve out with shares to be placed with new investors against payment (raising new money).
- ⊘ Carve out with bonus shares distributed to the existing shareholders of the previously common company.

In my opinion, the level of information required is significantly higher for the first alternatives than for the second alternatives. The second alternatives could either disclose an almost sufficient financial history for two years or are of low risk to investors as they only change their legal position in the issuer (basket of shares compared to a single share).

Therefore, I am convinced that a sufficient list of cases including subsequent specific disclosure requirements for complex financial history could never be identified. On the one hand, such list would never be complete due to the long term structural shifts in an economy, on the other hand the competent authorities should even avoid that the disclosure requirements could enable issuers to disclose a “more beautiful picture” on their past performance. The competent authorities should take into consideration the diversity of corporate transactions which have recently taken place in Europe.

The aspect of the three years period leads me to another important point. It will be extremely difficult – close to practically impossible – to create new “old” financial information for a period covering two or three years in the past.

Role of auditors/applicability of respective GAAP

Any complex financial historical information shall be accompanied by a qualified statement of auditors or independent accountants. It is important that this statement corresponds with the typical standards of other auditor’s statements and that the auditors would and could accept liability for the correctness of the statement. Otherwise the parties which would have to accept liability for the prospectus, for example the banks accompanying a transaction, could not rely on such information and would have to do their own additional due diligence regarding the complex financial history. Any narra-

tive comment by auditors should not be sufficient. If information is specifically prepared for the prospectus, however, in most cases a review scope should be sufficient.

The reason for that is as follows: Financial information is considered by most investors as a disclosure of an extremely high quality and independently checked by external auditors. Any inclusion of vague elements to the financial information section in a prospectus should not - but could - hamper such impression. This, however, would be in line with the basic principle, that the provision of the full range of financial information which is relevant in a particular case is necessary to ensure proper investor protection.

As a consequence, the disclosure requirements for the complex financial history shall be based on such standards and methods which are available according to the respective accounting standards and other European guidelines laid down in directives, like the Transparency Directive. Involving auditors would therefore mean that no disclosures should be required by the competent authorities which are not covered by the relevant GAAP rules. Furthermore, there should be no use of internal or management accounts (paragraph 67) which do not comply with the relevant GAAP standards.

Reasonability and materiality

Both aspects refer to cost and time. The cost and time aspect is of higher importance than for any other disclosure requirements in the Regulation as in most cases any restatements require additional work by the issuer, the auditors and the banks. Therefore, it should be reduced to the minimum necessary to ensure an appropriate level of information of the potential investors. The competent authorities should avoid that double information with no additional value will be contained in the prospectus (paragraphs 26 to 27).

Explanation of differences

In practice, any complex historical financial situation will result in the fact that the investor will be confronted with an “unusual” set of financial information in the prospectus. Therefore, I suggest presenting to him some kind of “guidance” regarding the reasons for the complex historical financial situation and the potential economic and/or legal effects of the deviations from the “usual” situation. Such guidance could provide support for the evaluation of the nature of the differences. According to the character of such information it should be located in the risk section.

Level 3 advice

Although it is important that the competent authorities act in a harmonized and coordinated manner, especially to avoid any regulation differences among the authorities – taken also into account that an equity issuer is obliged to submit the prospectus to its home member state authority – CESR should not prepare any Level 3 advice in the near

future. Otherwise, such Level 3 advice would have to cope with the same problems and discussions having appeared in the consultation paper.

Instead of that I would like to suggest a cooperative progress regarding that feature: the competent authorities should create an internal information and discussion flow for “complex financial history” decisions. Thereby, other competent authorities could apply or comment on the requirements already taken place. At a later stage, after sufficient market practice will have been available, CESR should work on a Level 3 example analysis (not a paper based on theoretical cases) to discuss the decisions made by the competent authorities with market participants publicly on a formal level and to give guidance to the markets and the authorities for future prospectuses.

Small and medium sized enterprises (paragraphs 33 to 35)

In principle, there should be no exemption for small and medium-sized enterprises. The basic principle should be applied in a manner that it is applicable to small and medium sized in the same way as to big issuers. However, the competent authorities should take into account that the cost and time for the specific requirements should meet with the expected revenues from the suggested securities transaction in order to avoid that such issuers would refrain from equity capital markets for cost and time reasons.

Applicability to equity transactions (paragraphs 26 to 27)

The rules should only focus on complex financial history disclosure for shares and related securities taking into account the specific profit potential and risk profile of such securities. It should be taken into account that pro forma information has only to be prepared for equity offerings. With regard to debt securities, a narrative explanation on the reasons and potential effects of not presenting the historical financial information as suggested by the respective annex, shall be sufficient.

Thresholds (paragraph 44)

If the competent authorities decide for any thresholds, they should take into account that reference shall only be made to revenues and total assets, but not to profits. The figure “profits” is the most volatile number which could lead to the applicability of any rules simply for the fact that an issuer had been faced with weak results for a certain period of time.

Applicability to international placements

The requirements shall be in a form, that the prospectus approved for a placement in the Member States could also be used for example for a private placement in other jurisdictions, especially in the U.S.

Calendar year (paragraphs 82 and 83)

I disagree that the calendar year aspect should be considered as an own case, but in general I agree to the suggestion that the three year period for financial information should be interpreted as a period of three calendar years. Exemptions should only be possible, if there is a small deviation from that period, for example two or three months.