

European Commission  
DG Internal Market Services

19 May 2006

Dear Sir/Madam


Working Document ESC/16/2006

The International Capital Market Association (**ICMA**) is pleased to respond to the DG Internal Market Services' Working Document ESC/16/2006 on amendment of the Commission Regulation (EC) No. 809/2004 (the **Prospectus Regulation**) regarding "complex financial histories" (the **Working Document**). ICMA is the self-regulatory organisation and trade association representing the investment banks and securities firms issuing and trading in the international capital market worldwide.

We attach our response as an Annex to this letter. Our comments on the Working Document are contained in Part I of the Annex, while specific wording of the proposed changes is in Part II of the Annex.

We would be pleased to discuss it with you at your convenience.

Yours faithfully



Ondrej Petr

## ANNEX

### **Part I: Comments on the Working Document**

#### General approach of the Working Document

We strongly support the general approach of the Working Document which does not attempt to provide exhaustive list of “complex financial histories” and the historical financial information required, but gives competent authorities the flexibility to evaluate, within certain parameters, whether an occurrence results in a “complex financial history” and what supplementary historical financial information should be required.

We do not object to the competent authority having a “duty” to require supplementary historical financial information, subject to the principles set out in the Working Document (as supplemented by those proposed in this response). Despite the differences in terminology, we believe that the approach does not substantially differ from that in the CESR advice of October 2005. This is in particular because we consider “materiality” and “compliance with Article 5(1) of the Prospectus Directive” as equivalent in this context.

#### Scope of application

We are not convinced that the additional requirements on issuers who have “complex financial history” or have made a “significant financial commitment” should apply to the full range of securities which, according to the Prospectus Regulation, require a share registration document. Our view, which we indicated already in our response to the initial CESR consultation, is that they should apply only to shares. Securities such as convertible or exchangeable bonds have a number of distinguishing features. In particular, they are bought and traded only by professional investors and their terms, as well as term on which they are offered and traded, resemble debt securities more than shares. We believe that the pro forma information would in case of these securities generally be sufficient to achieve compliance with Article 5(1) of the Prospectus Directive.

In case the approach of the Working Document is retained, we would suggest that the distinguishing features of convertible and exchangeable bonds are considered by the competent authorities as relevant factors under Article 7 and by CESR when preparing its guidance.

#### Meaning of “complex financial history”

It is apparent from the recitals of the Working Document (e.g. Recitals 4 and 9) as well as from the accompanying working document ESC/17/2006 and the previous CESR papers that the complex financial history regime is intended to apply in case of significant acquisitions or disposals of entities or businesses. The technical definition of a complex financial history in Article 4, however, refers only to “...any acquisition or disposal...” resulting in a situation where “*the entire business undertaking of the issuer at the time that the prospectus is drawn up is not covered by or represented in the historical financial information which the issuer is required to provide under item 20.1 of Annex I*” of the Prospectus Regulation.

It can be safely expected that most issuers will have effected some acquisitions or disposals in the previous three years. Such a wide definition as included in Article 4 leaves therefore open the possibility that the relevant provisions could be interpreted in a much wider sense than intended. Such an interpretation could theoretically lead to some competent authorities requesting (or at least attempting to request) supplementary historical financial information in a much wider range of scenarios than the Working Document is meant to address. That would constitute a significant inroad into the Prospectus Regulation, which only makes carefully defined exceptions from the rule set out in its Article 3 that *"a competent authority shall not request that a prospectus contains items which are not included in Annexes I to XVII."* In effect, this would create an uneven playing field, something that the European legislator intended to avoid by setting out the contents of a prospectus in a regulation.

We would therefore propose a more precise definition under which, in order to result in a "complex financial history", the acquisition or disposal would have to give rise to a "significant gross change" in the assets, liabilities and earnings of the issuer (with reference to the 25% threshold in Recital 9 of the Prospectus Regulation) and, at the same time, be an acquisition or disposal of another entity or its business. The drafting changes reflected in Part II of this Annex suggest amendments to the definition that would achieve this objective.

#### Meaning of "significant financial commitment"

The Working Document does not align the definitions of a "significant financial commitment" and a "complex financial history". We believe that the meaning of these two definitions should be aligned, based on the concept of "significance" or "significant gross change" in assets, liabilities and earnings of the issuer. A reference in the definition of a "significant financial commitment" to "complex financial history" resulting if the transaction is performed is in our view the easiest solution and we recommend that it is adopted. We see no reason why different standards should be applied for pending and completed transactions when defining the scope of the new regime.

Another concern, which we raised already in our response to the CESR consultation, relates to the meaning of a "binding agreement." Acquisition agreements as a matter of practice always make the acquisition subject to a number of conditions, the competition clearance and other regulatory or internal approvals being the most important examples. Until such conditions are satisfied, the agreement should not be considered binding and giving rise to a "significant financial commitment." The Working Document appears to recognise this by explicitly stating that an agreement where the commitment is conditional on the outcome of the offer of securities that are the subject matter of the prospectus should be treated as binding. This may be seen as implying that other pending conditions do not make the agreement binding. In order to avoid excessive detail when trying to distinguish between pending conditions which do not make the relevant agreement binding and those that do, we suggest, in Part II of the Annex, a more flexible test of "reasonable certainty" that the commitment will be completed.

### Supplementary financial information

We suggest that the words "*and [(if applicable)] Annex II*" in Article 3 be deleted. The obligation to provide pro forma financial information under Annex II is created by Annex I. Additional reference to Annex II in the body text is unnecessary and may be confusing.

In our response to the CESR consultation we suggested that, depending on circumstances of the transaction in question, the competent authority might require the supplementary historical financial information for a period shorter than the general time period of three years. We find it very important that the competent authorities be given this flexibility and suggest that this is made clear in Article 6 or the relevant recitals of the Working Document.

### Modifications of requirements of Annex I

The principles which the competent authority must take into account when deciding what supplementary historical information to require (Article 7) should in our view be supplemented with the "*nature and range of information already included in the prospectus*" and "*existence of the financial information.*" Currently, these principles appear only in Recitals 12 and 13 which might suggest to competent authorities that they are less relevant than those expressly listed in Article 7.

It should also be made clear that the power of the competent authority to make modifications to the requirements set out in item 20.1 of Annex I of the Prospectus Regulation does not include the power to make these requirements more extensive and/or onerous.

### Uniform application and CESR guidance

We fully support the intention of the Commission to ask CESR for guidance regarding uniform application of the new requirements. However desirable the flexibility offered by the Working Document is, the risk of divergent interpretation and application among the competent authorities of the 25 Member States is substantial. The only alternative to such guidance would be detailed and prescriptive provisions and/or recitals of the amending legislation, which solution we do not support for its lack of flexibility. We would encourage the Commission to give CESR a mandate to commence work on such guidance as soon as possible. It would be highly desirable if such at least an initial guidance was in place already at the time the amendment to the Prospectus Regulation comes into force.

In this response, we have deliberately avoided detailed suggestions as to what historical financial information should or should not be required, both generally and in particular instances of "complex financial histories" and "significant financial commitments." We are prepared to engage in discussions with CESR on such suggestions once it commences its work on the guidance.

We would, however, like to make one specific observation already at this point. It will sometimes be the case that the requested supplementary historical financial information has been prepared using other accounting standards than the financial

information already contained in the prospectus. Such a difference in itself should not allow the competent authorities to request that they are restated or reconciled. Pending any specific guidance by CESR, this requirement (as well as the extent to which the differences between the two sets of accounting principles should be explained) would be supported by the principles of taking into account the *"nature and range of information already included in the prospectus"* and *"existence of the financial information"* suggested above.

## **Part II: Wording of proposed changes**

The changes which we suggest to be made to the proposed amendment are highlighted in track changes in the original text below.

### **1. [Subject Matter]**

### **2. The following new paragraphs shall be inserted after paragraph (2) of Article 4 of Commission Regulation (EC) No 809/2004:**

"3 Notwithstanding the restriction in the second paragraph of Article 3, where the issuer of a security falling within paragraph 2-

(a) has a complex financial history; or

(b) has made a significant financial commitment.

the competent authority of the home Member State shall require that the registration document include, in addition to the information items included in the schedule set out in Annex 1, such supplementary financial information as is necessary to ensure that the prospectus complies with the requirements set out in Article 5(1) of Directive 2003/71/EC.

4. For the purposes of paragraph 3, an issuer has a complex financial history if, as a result of one or several acquisitions or disposals of one or several legal entities or their business undertakings undertaken by the issuer, the entire business undertaking of the issuer at the time that the prospectus is drawn up is not covered by or represented in the historical financial information which the issuer is required to provide under item 20.1 of Annex I, and any such acquisitions or disposals undertaken by the issuer, individually or in the aggregate would, if measured using appropriate financial information with respect to the acquisition or disposal, represent a significant gross change.

5. For the purposes of paragraph 3, an issuer shall be treated as having made a significant financial commitment if it has entered into a binding agreement to undertake a transaction which is reasonably certain to complete and following the completion of such transaction the issuer will have a complex financial history as defined in paragraph 4. above. For the purposes of this paragraph, an agreement shall not be treated as not being reasonably certain solely by virtue of the firm commitment of the parties being conditional on the outcome of the offer of the securities that are the subject matter of the prospectus.

6. The supplementary financial information mentioned in paragraph 3 may include –

(a) financial information relating to significant subsidiaries of the issuer covering up to the preceding three financial years but shall not be required to cover any period for which the subsidiary has not been in operation;

(b) financial information on a consolidated or combined basis presenting the results of operations and financial condition of the issuer and its group as in existence at the time that the prospectus is drawn up as if the issuer had

operated such group from the beginning of any of the preceding three fiscal years or such shorter period of time that the group has been in operation;

- (c) financial information relating to the relevant part of the business undertaking of the issuer which, at the time when the information was drawn up, was carried on by an entity other than the issuer or an entity controlled by the issuer;
- (d) financial information relating to an entity or business undertaking which the issuer has undertaken to acquire pursuant to a significant financial commitment of a kind mentioned in paragraph 5.

7. When deciding how the obligation imposed by Article 5(1) of Directive 2003/71/EC should be satisfied in cases covered by paragraph 3, and in particular the extent of the supplementary financial information which should be required and the form in which it should be presented, the competent authority shall take into account the requirements set out in items 20.1 of Annex 1 as regards the content of financial information and the applicable accounting and auditing principles, subject to any modification which is appropriate in view of –

- (a) the facts of the case, including the economic substance of the transactions by which the issuer has acquired or disposed of its business undertaking or any part of it, the specific nature of that undertaking, whether or not such financial information exists at the time that the prospectus is drawn up and the nature and range of the information that is already included in the prospectus; and
- (b) in cases where the issuer has made a significant financial commitment or has a complex financial history relating to an acquisition, the availability to the issuer of financial information relating to an entity other than the issuer or the business undertaking while not controlled by the issuer, and underlying supporting documentation and information which would go to the reliability of any financial information that could be or has been prepared.

Where the obligation imposed by Article 5(1) of Directive 2003/71/EC may be satisfied in more than one way, the competent authority shall take into account the actual or potential costs to and burden on the issuer and shall not require that the obligation is satisfied in a way that is or could be more costly or onerous than an adequate alternative.”

**3. The following sentence shall be inserted after the first sentence of the first paragraph of item 20.1 of Annex 1 to Commission Regulation (EC) No 809/2004:**

“If the issuer has changed its accounting reference date during the period for which historical financial information is required, the audited historical information shall cover at least 36 months (or, if shorter, the entire period for which the issuer has been in operation).