

The International Capital Market Association

UKLA Implementation of the Prospectus Directive¹

Background

The Prospectus Directive (PD) came into force on 31 December 2003 and was implemented into UK legislation on 1 July 2005. The PD aims to improve market efficiency by enabling companies to gain access to financial markets across the EEA through the production of a single approved prospectus. The PD requires an issuer to produce a PD compliant prospectus whenever an offer of securities is made to the public in the EEA or when securities are being admitted to trading on an EEA Regulated Market.

To assist the international securities market in dealing with the transition from the current regime to the new regime, ICMA, in conjunction with a group of major City of London capital markets law firms, has had a series of meetings with the UKLA with the aim of clarifying certain issues for the market, with a particular focus on the debt markets. Many of the issues discussed at these meetings have subsequently been addressed and publicised by the UKLA in various ways, including through feedback statements.

Other issues discussed, and ICMA's understanding of the way in which the UKLA will implement the PD in relation to the debt markets, are set out below.

This note does not constitute guidance from either the UKLA or ICMA and different practices may evolve as market practice develops.

The UKLA is happy to visit institutions individually to discuss the Prospectus Directive and any issues relating to the new prospectus, listing and disclosure rules. Please contact Graham Walker at the UKLA (graham.walker@fsa.gov.uk) if you would like to arrange this.

Interpretation of the PD and PD Regulation (PD Reg)

What can be included as Final Terms? – The PD has retained the concept of MTN programmes and under the new regime an issuer can prepare a base prospectus, which is approved by the competent authority and is valid for 1 year. When an issuer issues notes, it produces what is known under the PD as “final terms” which contains the final terms of the offer, is filed with the competent authority without the need for approval and is intended to be read in conjunction with the base prospectus. Clarification was sought by ICMA on what would constitute final terms and the UKLA were given the opportunity to review and comment on the forms of ICMA Pro Forma Final Terms prior to their publication on 26 May 2005. The UKLA indicated that in general it was not anticipating that there would be a major change in current market practice.

¹ Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 and Commission Regulation (EC) No 809/2004 of 29 April implementing such directive

Summary – It is ICMA's understanding that the UKLA will assess summaries on an individual basis and will take into account the complexity of the transaction when considering the length of the summary. The UKLA was sympathetic to the fact that the 2, 500 word limit will in some instances be difficult to comply with. Annex IV to the PD contains a list of contents for the summary. It is ICMA's understanding that the UKLA does not view this list as being prescriptive but is for guidance purposes only.

The UKLA also confirmed that issuers would continue to be able to include an overview of key features (for example, key features of an MTN Programme or asset-backed issues), separately from any requirement for a PD-compliant summary, provided that the section should not be called the 'Summary' unless it is intended to be the PD compliant summary.

Incorporation by reference: Article 11 of the PD provides that information contained in one or more previously or simultaneously published documents which have been approved by the competent authority or filed with it in accordance with the PD or with Titles IV and V of CARD can be incorporated by reference into a prospectus. It is ICMA's understanding that in relation to this:

1. A document that has been filed with an authority other than the UKLA and is listed on the issuer's Article 10 annual list which is filed with the UKLA² can be incorporated by reference into a prospectus and the document need not itself be filed with the UKLA. The exception to this is, where all or part of the document being incorporated by reference meets a disclosure requirement under the Prospectus or Listing Rules, the relevant pages (in the case of a debt document) with annotations must be submitted to the UKLA together with the Prospectus being approved. Issuers which are not required by the PD to file an Article 10 annual list can choose to file such a list in any event. If an issuer elects to do this, the list must be in full compliance with Article 10 i.e. it must include all the information published by the issuer over the preceding 12 months and not just a selection of such information which the issuer wishes to be able to incorporate by reference. Issuers that voluntarily submit themselves to the Article 10 regime in this way would have to continue to comply with that regime for as long as they had securities admitted to trading on the UK regulated market.

Issuers can file more than one annual list in any 12 month period.

Where the documents are in a language other than English only the part of the document which is being incorporated by reference must be translated into English.

2. Documents being filed with the UKLA should be filed with the UKLA's Document Viewing Facility. This currently requires that a hard copy of the documents is provided. When a document is filed with the UKLA's Document Viewing Facility the Issuer must also notify an RIS (LR 17.3.1 R).
3. Documents filed with an RIS can also be incorporated by reference.

² In order to file the annual list with the FSA the Issuer must notify the annual list to an RIS (PR 5.2.8).

4. Issuers with securities already admitted to trading on the regulated market on 1 July 2005 can submit an Article 10 annual list at any time from 1 July 2005 if they so choose.

Publication of a Prospectus: Pursuant to its obligation under Article 14(4) of the PD, the UKLA will be maintaining on its website a list of prospectuses which have been approved by the UKLA over the last 12 months, and details of prospectuses approved by other member states which have been passported into the UK. If an issuer has chosen to publish the prospectus on its website, the UKLA will include a link to the prospectus on its list of prospectuses.

Transfer of Competent Authority: Pursuant to Article 13(5) of the PD, the competent authority of the home member state can transfer the approval of a prospectus to the competent authority of another member state provided the transferee member state agrees. It is ICMA's understanding that the UKLA will take decisions on whether to transfer approval on a case-by-case basis. When making this determination, it is our understanding that the UKLA will consider whether the issue of securities is being sold into the UK or has any connection with the UK other than that the UK is the home member state for the securities. Details of how an issuer would apply to have the approval of a prospectus transferred are set out in PR 3.1.12 R. If the UKLA were to transfer approval of a Base Prospectus or prospectus to another competent authority it would wish to transfer approval of any subsequent Supplement relating to the Base Prospectus or Prospectus at the same time, so that it would not be necessary for the issuer to make a separate application for transfer for any Supplement.

Litigation Statement: Under the PD the 'no material litigation statement' is worded slightly differently to the statement required under the previous UK listing rules, in that it also refers to 'profitability'. It is ICMA's understanding that the UKLA does not consider that this requires a change in approach, and that therefore disclosure of litigation is required if it is material to investors, assessed in accordance with the requirements of Article 5.1 of the PD.

Risk Factors: The PD requires that risk factors relating to the issuer and the securities be included in the Prospectus. Risk factors should not be general and should focus on the major risks associated with the issuer and the securities in the context of the issue.

ICMA understands that the UKLA does not expect any change in practice on risk factor disclosure for asset-backed securities and structured notes, on the assumption that issuers were complying with the UKLA's previous policy on risk factor disclosure.

Disclosure

"Road Map" inconsistencies – The UKLA acknowledged that there are some difficulties with the table of combinations known as the "Road Map" which is set out at Annex XVIII to the PD Reg. The UKLA is working on its own road map in an effort to address the inconsistencies where it is able to, which it may publish in due course.

Securities covered by more than one annex – As referred to above, the disclosure requirements for a prospectus are set out in the PD Reg in the form of annexes which cover different types of securities and different parts of the prospectus. A prospectus

is made up of a registration document which contains all the information about the issuer and a securities note which contains information on the securities. As the annexes cover different types of securities, ICMA discussed with the UKLA what an issuer should do when drawing up a prospectus for securities which fall wholly or partly into several annexes, and which parts of each annex should be applied. It is ICMA's understanding that issuers should comply with each relevant annex, but should mark as not applicable any sections of each annex that are not relevant.

Annex I – Share Registration Document

Pro Forma Financial Information: An issuer which is not required to include pro forma financial information under Annex I may choose to include pro forma financial information voluntarily. Where an issuer so chooses it is ICMA's understanding that for non-equity issues the UKLA will not require such financial information to be reported on (i.e. an issuer does not need to comply with item 7 of Annex II), but the UKLA will require that such financial information be presented in accordance with items 1-6 of Annex II of the PD.

Annex III – Share Securities Note

'Amount' of a share: For the purposes of Annex III, Item 5.1.2 of the PD Regulation, what is meant by the 'amount' of a share issue. Is this the number of shares being issued or the amount of the proceeds to be raised by the issue? ICMA understands that the UKLA views this as meaning the number of shares.

Annex V – Retail (denom <€50,000) Debt Securities Note

Retail debt securities note requirement for clear and comprehensive explanation – Annex V, Item 4.7 contains a requirement that the issuer include a clear and comprehensive explanation to help investors understand the effects on the value of the securities of any derivative components. ICMA discussed with the UKLA how this should be interpreted. It is our understanding that the UKLA views this requirement as not needing any additional disclosure to that previously included in prospectuses and listing particulars on derivative components in securities, if the target market is professional investors. If the target market is retail investors, disclosure should be tailored accordingly.

Reasons for the offer and use of proceeds: Annex V, Item 3.2 requires a breakdown of total expenses and net proceeds into principal intended use. It is ICMA's understanding that this requirement does not envisage a detailed list of expenses (e.g. printing costs, taxis, fax costs etc.) and that all that is required is an estimate of total expenses and the net proceeds. If the proceeds are to be used for more than one specific purpose, this should be stated together, with a breakdown of the proportion being used for each purpose.

Annex VII – Asset Backed Securities Registration Document

'Information on direct or indirect ownership of assets': For the purposes of Annex VII, Item 5.2, what is the implication of the requirement for "information on the direct or indirect ownership or control" between the parties to the securitisation programme in the context of asset backed securities? It is ICMA's understanding that this does not

include Trustees and similar parties, and that no information beyond that required under the previous listing regime is required to satisfy the PD disclosure obligations.

Annex VIII – Asset Backed Securities Building Block

Asset Backed Securities structure diagram requirement – Annex VIII, Item 3.1 requires that a structure diagram for the transaction is included. It is ICMA's understanding that this diagram need only cover the part of the structure which the asset backed securities relate to and that the types of diagrams included under the previous listing regime will meet the PD regime requirement.

Asset Backed Securities disclosure on the underlying – Annex VIII, Item 2.2.11 requires that where the underlying assets are comprised of 5 or fewer obligors or an obligor accounts for 20% or more, or a material portion, of the assets, then, unless the obligor has securities listed on an EEA Regulated Market, the issuer must include disclosure on the obligor as if it were an issuer drafting a wholesale securities note. ICMA discussed with the UKLA whether when an obligor has not produced disclosure to this standard, it was necessary for an issuer to "create" such a document itself, and it is our understanding that the UKLA considers that it is necessary.

Similarly, item 2.2.15 requires that if more than 10% of the underlying assets comprise shares which are not admitted to trading on an EEA Regulated Market or equivalent market, the issuer must include a description of the equity securities and information on the share issuer equivalent to the information the share issuer would have had to include in its registration document if it were applying to have its shares admitted to trading on an EEA Regulated Market. ICMA understands that the UKLA will only allow an exemption from this disclosure requirement on an exceptional basis, and in such circumstances issuers should contact the UKLA to discuss its requirements.

'Small number of obligors': For the purposes of Annex VIII item 2.2.2 of the PD Regulation what is meant by a small number of obligors? How does this work when the initial obligors are few, but there is an intention to diversify the portfolio once the fund is up and running? It is ICMA's understanding that a small number of obligors is 6 to 9. Regarding increases in size of asset pools, it is ICMA's understanding that if the aim is to create a pool, 2.2.2 or 2.2.11 disclosure would not be required just because only a small number of obligors is known at the issue date. The issuer need only describe the characteristics of the pool. However if, for example, the intention is to invest the issue proceeds in one or two obligations for the first year before establishing a pool, 2.2.2 or 2.2.11 disclosure would be required.

Annex IX – Wholesale (denom ≥€50,000) Debt Registration Document

Disclosure of the basis for statements made in relation to competitive position – Annex IX, Item 5.1.2 contains a requirement that the issuer includes the basis for any statements made by it *in the registration document* regarding competitive position. Annex IV, Item 6.3 contains a similar requirement that the issuer include the basis for any statements made by it regarding competitive position. ICMA asked the UKLA if it thought there was any significance in the fact that the italicised words above were omitted from the retail disclosure requirement. It is our understanding that the UKLA

views the disclosure requirement as being the same in both cases i.e. - the issuer must include the basis for any statements made by it in the registration document regarding its competitive position.

Annex XIII – Wholesale (denom \geq €50,000) Debt Securities Note

Expense of the Admission to Trading: Annex XIII, Item 6 requires that issuers include an estimate of the total expenses related to the admission to trading. ICMA understands that for a programme where no securities are being issued at the time the Base Prospectus is approved, it is not necessary to address this disclosure requirement in the Base Prospectus and the relevant information should be included in the Final Terms. The expenses should cover the expenses of the issue and not just the admission/listing fees of the Stock Exchange and the UKLA.

Derogations from the new rules

Derogations – Under the previous listing regime, the UKLA had granted certain types of issuer derogations from particular listing rules. ICMA discussed with the UKLA whether these derogations would be carried forward into the new PD regime. ICMA understands that issuers will need to re-apply for any existing derogations. However, if the level of disclosure required under the PD is the same as the disclosure required under the previous rules, and if the existing derogation would also be within the UKLA's discretion under the PD, any derogations previously given in respect of such disclosure should be granted again. If the level of disclosure required under the PD is greater than that required under the previous rules, the UKLA will make decisions on derogations on a case-by- case basis.

Prospectus Structures

Stand Alone Prospectus which incorporates by reference from the Base Prospectus: In circumstances where a Base Prospectus has been approved by the UKLA and securities are being issued which fall outside Final Terms, one option is to produce a stand alone prospectus. This stand alone prospectus would incorporate by reference everything contained in the Base Prospectus (other than, perhaps, the summary) and would in addition include a responsibility statement, a new summary of the securities being issued, any risk factors which are additional to those which were included in the Base Prospectus and the terms and conditions of the notes in the form of a 'menu picker' similar to a pricing supplement required under the previous regime, containing any additional terms.

As the majority of information contained in this prospectus would have been reviewed and approved already by the UKLA, a reduced timetable for approval and a reduced fee are available, to reflect the fact that in form this is very like the previous supplemental listing particulars route used for structured drawdowns.

Registration Document and pro-forma Securities Note: As an alternative to the above issuers may wish to use a Registration Document and pro forma Securities Note route. Under this approach, a Registration Document would be approved by the UKLA and the pro-forma Securities Note would be approved in principle. For each issue of securities, the issuer would submit a securities note blacklined against the pro forma

or previously approved securities note which would be formally approved by the UKLA.

Listing fees and Timing

Information on the UKLA's fees for such prospectus formats is available from Graham Walker and his colleagues. The UKLA expects to publish more information about its charges in the next edition of List!, currently scheduled for early September.

For asset-backed and other structured transactions, the UKLA is currently applying the PD review periods of 10 days for a new prospectus, and 5 days for revisions. This timing can be reduced if the transaction structure is discussed with the UKLA before a draft document is submitted. For other debt transactions, the UKLA is currently applying 5 and 3-day comment periods, respectively.

Types of Securities

Loan Participation Notes: The PD requires that the issuer must take responsibility for the information contained in the Prospectus. This requirement applies to LPNs notwithstanding that the issuer is effectively just passing through what it receives on the underlying.

For securities admitted to the PSM, the UKLA will continue to accept split responsibility statements, in accordance with its previous practice.

Article 4(2)(2)(b) of the PD Regulation: Article 4(2)(2)(b) of the PD Regulation states that securities which can be converted or exchanged into shares or transferable securities issued by the issuer of the securities where the shares or transferable securities are not already admitted to trading on an EEA Regulated Market must comply with the share disclosure annex (Annex IV). It is ICMA's understanding that the reference to the shares being admitted to trading on a regulated market refers to the class of shares, not to the actual shares which the securities could be converted into. Only AIM listed shares or classes of shares which were only being listed at the time of issue of the securities need to comply with the Share Annex.

'Purple Book' rules 3.25 and 3.26 have been carried over into the new rules as LR2.2.12 and LR2.2.13. Therefore the position on listing convertibles when the underlying shares are not listed, and there is no intention to list, them is unchanged. This means that it is not possible to list convertibles if the underlying shares are not listed and there is no intention to list them, unless the issuer of the underlying shares agrees to comply with the UKLA's continuing obligations as if the shares were listed. In these circumstances the UKLA has retained the discretion to list the convertible securities.

Continuous Subscription Programmes: ICMA understands that the UKLA will treat such programmes as one offer for purposes of the PD and so one prospectus would be required to be approved.

Types of Issuer

Guarantor: The UKLA's feedback statement on the Listing Review includes a statement (in paragraph 5.40) that in the UKLA's view the definition of guarantor in the PD is wider than that under the [previous] regime and that this may result in

additional disclosure being required on entities which would not previously have been viewed as guarantors, such as swap counterparties.

ICMA understands that the UKLA normally intends this to cover entities such as providers of monoline financial insurance policies (or wraps) and credit protection under credit derivatives structures, rather than swap counterparties in the context of swaps entered into in the normal course of an issuer hedging its liabilities under the securities (unless there are unusual circumstances), or customary hedging in repackaging and securitisation structures (in the latter case, Annex V111 of the PD Regulation already provides for additional disclosure in relation to such hedge providers – e.g. see paragraph 3.8). Issuers and their advisers are encouraged to talk to the UKLA, if they are uncertain how the requirements may be applied in a particular case.

Financial Reporting Requirements

Article 35: Please see Schedule 1 to this note for ICMA's understanding of how the UKLA will interpret the Article 35 provisions. Schedule 1 has been discussed with the UKLA.

Interim Financial Statements: Annex IV, Item 13.5.2 requires that if a registration document is to be dated more than 9 months after the end of an issuer's last audited financial year, the issuer must include interim financial information covering the first 6 months of the financial year. It is ICMA's understanding that if a registration document is dated earlier than the 9 month cut off (and so interims had not been included) but a securities note is prepared after the 9 month date, there would be no requirement to include interim figures in the securities note if the issuer did not ordinarily produce them – though if the issuer did produce interims it may chose to include them, pursuant to the power given under Article 12(2) of the Directive.

The requirement would apply however to an issuer who was preparing a stand alone prospectus which was to be dated more than 9 months after the end of the issuer's last audited financial year.

Financial History Worked Examples: Schedule 2 sets out a series of worked examples showing how we understand the annual historical financial information requirements for prospectuses set out in the PD would be applied in practice. Schedule 2 has been discussed with the UKLA.

General Points

Programme Limit: There is no requirement in the PD that a programme must have an issuance limit. The UKLA does not require that MTN programmes specify an issuance limit, although issuers are free to include a limit if they so chose. If an issuer chooses to include a programme limit and decides to increase the limit, the issuer will need to produce a Supplement for regulated markets listed programmes or supplementary listing particulars for PSM listed programmes.

The London Stock Exchange has also amended its requirements so that a programme does not require a maximum size (July 2005 Admission and Disclosure Standards).

Use of a PD compliant prospectus on the Professional Securities Market (PSM): ICMA understands that both the UKLA and the LSE will accept a PD compliant prospectus for use on the PSM.

Article 10 annual list filing: Article 27 of the PD Reg requires an issuer to file the annual list required by Article 10 within 20 working days after the publication of its annual accounts. Graham Walker confirmed that this requirement did not apply to issuers whose annual accounts were published prior to 1 July 2005 but where the date 20 days from the date of publication fell after 1 July 2005. The requirement applies only to accounts that were published on or after 1 July. This is a revision of the guidance in List!

The date of publication is taken to be the date the accounts were audited.

Disclosure Rules: The Disclosure Rules require that issuers which have shares or securities admitted to trading on an EEA Regulated Market must report (a) managers' activities as regards the issuer's shares and (b) price sensitive information which is sensitive as regards the issuer's share price. For issuers that only have debt securities listed on a regulated market, ICMA understands that the requirement to report managers' activities and price sensitive information should be looked at in the context of the securities which are listed with the UKLA, and information which is relevant to those securities should be disclosed.

In respect of depositary receipts, the information that must be reported is that relating to the issuer of the underlying shares and not the depositary.

August 2005

Schedule 1

Linklaters

Memorandum of discussions between IPMA PD Working Group and the UKLA

11 August 2005

To James Anderson and Graham Walker, UKLA

From IPMA PD Working Group

Meeting Date: 8 June 2005

PD Financial Reporting Requirements

This memorandum sets out the main points discussed with James Anderson (JA) and Graham Walker (GW) in relation to the UKLA's implementation of the PD financial reporting requirements and sets out our understanding of the UKLA's position.

A) Article 35 PD Reg - Historical Financial Information: Transitional Arrangements

1 Article 35(1)

"The obligation for Community issuers to restate in a prospectus historical financial information according to regulation (EC) No 1606/2002, set out in Annex I item 20.1, Annex IV item 13.1, Annex VII item 8.2, Annex X item 20.1 and Annex XI item 11.1 shall not apply to any period earlier than 1 January 2004, or, where an issuer has securities admitted to trading on a regulated market on 1 July 2005, until the issuer has published its first consolidated annual accounts in accordance with Regulation (EC) No 1606/2002"

Pursuant to the first part of this article, an EU Issuer which is admitted to an EU regulated market for the first time after 1 July 2005 and which is including disclosure under any of the annexes specified, will not have to include in its prospectus historical financial information restated on an IFRS basis for any period earlier than 1 January 2004. For issuers which have a financial year which is not the calendar year "period" in Article 35(1) above is thought to refer to the annual period and so an issuer wouldn't need to restate for the broken period from 1 January 2004 until its year end date.

Example:

An EU Issuer with no securities admitted to trading on an EU regulated market which prepares consolidated accounts, is admitting depositary receipts over shares to trading for the first time on 1 August 2005 and has a year end of 31 December. Such an issuer must

include in its prospectus financial information for the year ended 31 December 2002 and 31 December 2003 in accordance with the issuer's member state GAAP and financial information for the year ended 31 December 2004 in accordance with IFRS.

Analysis:

Prior to admitting these securities to trading on an EU regulated market the issuer falls outside the Accounts Regulation (Regulation (EC) No 1606/2002) but once it has admitted these securities to trading it will fall within the Accounts Regulation and accordingly its next financial statements (i.e. those for the year ending 31 December 2005) must be presented in accordance with IFRS. Annex X requires that the most recent two years financial information contained in a prospectus must be consistent with that which will be adopted in the issuer's next published annual financial statements (i.e. the 2005 IFRS statements) and therefore the financial information for the years ending 31 December 2003 and 2004 would need to be included in the prospectus in accordance with IFRS. However Article 35(1) states that a first time issuer to an EU regulated market will not have to include in its prospectus historical financial information restated on an IFRS basis for any period earlier than 1 January 2004, therefore the issuer need only restate the 31 December 2004 figures and not the 31 December 2003 figures.

Annex IX is not referred to in Article 35(1) because the only restatement obligation in Annex IX is that **the most recent year's** accounts must be prepared in a form consistent with that which will be adopted in the issuer's **next** published annual financial statements. As only one year's accounts would therefore need to be restated there would never be an obligation to restate for a period earlier than 1 January 2004 in any event.

Pursuant to the second part of Article 35(1) EU Issuers, regardless of the disclosure annex they are using, which produce consolidated accounts and already have securities admitted to an EU regulated market on 1 July 2005 and which issue further securities that are to be admitted to trading on an EU regulated market do not have to include accounts in accordance with IFRS until they are required to produce IFRS accounts under the Accounts Regulation.

Example:

An EU Issuer which produces consolidated accounts and has outstanding securities admitted to trading on an EU regulated market on 1 July 2005, is admitting securities to trading on 1 August 2005 and has a year end of 31 December must include in its prospectus financial information for the years ended 31 December 2003 and 31 December 2004 in accordance with the issuer's member state GAAP.

Analysis:

The issuer already had securities admitted to trading on a EU regulated market and so it was caught by the Accounts Regulation, regardless of this issue of securities and its next published financial information, for the year ending 31 December 2005, will be in accordance with IFRS. Annex IV requires that the most recent financial information contained in a prospectus must be consistent with that which will be adopted in the issuer's next published annual financial statements (i.e. the 2005 IFRS statements) however the second part of Article 35(1) provides that issuers do not have to include financial information in accordance with IFRS until they are required to produce IFRS accounts under the Accounts Regulation, therefore it doesn't need to include IFRS financial information until it publishes it's IFRS accounts for the year ending 31 December 2005.

The CESR advice suggests that Issuers should consider providing IFRS disclosure even when not required to by the PD though this is on a purely voluntary basis.

2 Article 35(2)

“Where a Community issuer is subject to transitional national provisions adopted pursuant to Article 9 of Regulation (EC) No 1606/2002, the obligation to restate in a prospectus historical financial information does not apply to any period earlier than 1 January 2006, or, where an issuer has securities admitted to trading on a an EU regulated market on 1 July 2005 until the issuer has published its first consolidated annual accounts in accordance with Regulation (EC) No 1606/2002”

Under Article 9 of the Accounts Regulation member states can choose to allow issuers, which (i) only have debt securities admitted to EU regulated markets or (ii) have securities admitted to non EU public markets and have been using internationally accepted standards³ since September 2002, an extra two year grace period and not require such issuers to produce IFRS accounts until the financial year starting on or after 1 January 2007.

EU issuers incorporated in member states which choose to take up either of these options, which are admitting securities to an EU regulated market for the first time after 1 July 2005, will not be required to include IFRS accounts in their prospectuses for any financial period starting before 1 January 2006 (being the comparative year that will be required under IFRS to be included in the financial statements for the financial year starting on or after 1 January 2007).

EU issuers incorporated in member states which choose to take up either of these options, which already have securities admitted to an EU regulated market on 1 July 2005 and which issue further securities which are to be admitted to trading on an EU regulated market do not have to include accounts in accordance with IFRS for any financial period starting before 1 January 2006 (being the comparative year that will be required under IFRS to be included in the financial statements for the financial year starting on or after 1 January 2007).

It should be noted that the UK Government has indicated that it does not intend to take up either of the options under the Accounts Regulation and that therefore the transitional provisions under Article 35(2) will not apply to UK incorporated issuers.

3 Article 35(3)

“Until 1 January 2007 the obligation to restate in a prospectus historical financial information according to Regulation (EC) 1606/2002, set out in Annex I item 20.1, Annex IV item 13.1, Annex VII item 8.2, Annex X item 20.1 and Annex XI item 11.1 shall not apply to issuers from third countries:

- 1. who have their securities admitted to trading on a regulated market on 1 January 2007; and*
- 2. who have presented and prepared historical financial information according to the national accounting standards of a third country.*

³ For example issuers who report in accordance with US GAAP because their securities are registered under the US 1933 Securities Act.

In this case, historical financial information shall be accompanied with more detailed and/or additional information if the financial statements included in the prospectus do not give a true and fair view of the issuer's assets and liabilities, financial position and profit and loss."

Non-EU issuers, who prepare their accounts in accordance with a third country's national accounting standards, and which are admitting to an EU regulated market, after 1 July 2005, securities, with a maturity date after 1 January 2007, will not be required to include IFRS accounts in their prospectuses for any financial period starting before 1 January 2007. However if the financial statements do not give a true and fair view, additional information must be included. It is thought that in this context true and fair view does not mean IFRS and nor does it mean that there can only be one true and fair view.

In order to facilitate any passporting of the prospectus, the issuer should include an undertaking that it will not issue securities which are to be offered to the public or for admittance to trading on an EU regulated market unless, at the time of issue of such securities, it has, or will have as a result of such issue, securities admitted to trading on an EU regulated market with a maturity date after 1 January 2007.

Example:

A non-EU issuer admitting retail securities, with a maturity date later than 1 January 2007, to trading on 1 August 2005 and which has a year end of 31 December must include in its prospectus financial information for the years ended 31 December 2003 and 31 December 2004 in accordance with the issuer's local GAAP.

Analysis:

The issuer is a non-EU issuer and so would never fall within the Accounts Regulation. Annex IV requires that a non-EU issuer must include financial information to a standard equivalent to IFRS. Assuming the non-EU issuer's local GAAP is not equivalent to IFRS it would need to restate its financial information for both the year ending 31 December 2003 and 31 December 2004 in accordance with IFRS. However Article 35(3) provides that issuers with securities admitted to trading on 1 January 2007 do not need to restate any financial information until the year starting 1 January 2007 provided the accounts give a true and fair view. Assuming that its accounts do give a true and fair view, the issuer can include its financial information for the years ended 31 December 2003 and 31 December 2004 in accordance with its local GAAP.

It should be noted that as Article 35(3) does not refer to Annex IX it is thought that issuers of wholesale securities will not be able to rely on this provision. This produces the result that non-EU issuers who issue retail securities, with a maturity date falling after 1 January 2007 do not need to include IFRS accounts until 2007, whereas non-EU issuers of wholesale securities will have to consider IFRS from 1 July 2005 in order to produce a narrative of the differences between IFRS and their national GAAP.

4 Article 35(4)

"Third country issuers having prepared historical financial information according to internationally accepted standards as referred to in Article 9 of Regulation (EC) 1606/2002 may use that information in any prospectus filed before 1 January 2007, without being subject to any restatement obligations."

This provision allows non-EU issuers which prepare their accounts in accordance with internationally accepted standards to use these accounts without the need for re-statement until 1 January 2007⁴. It is not necessary for the non-EU Issuer to be using internationally accepted standards because of a listing it has on a public market outside the EU.

'Internationally accepted standards' is not defined but would include all accounting standards where evidence can be produced to the satisfaction of the FSA that such standard has been accepted by the FSA or other regulatory bodies as being an acceptable standard.

As Article 35(4) refers to re-statement, JA said that it cannot be relied on to avoid the requirement in Annex IX that a narrative description of the differences between IFRS and the accounting principles being used by the issuer where different. This causes the same result as with Article 35(3) above in that non-EU issuers which issue retail securities, and which produce accounts in accordance with internationally accepted standards do not need to include IFRS accounts until 2007, whereas non-EU issuers of wholesale securities will have to consider IFRS from 1 July 2005 in order to produce a narrative of the differences between IFRS and their national GAAP.

B) Equivalence of other forms of US GAAP

The question was raised as to how other forms of US GAAP e.g. the form of US GAAP other regulated entities such as banks use would be treated under the PD. JA confirmed that this had not been discussed in the CESR Equivalence working group, and will have to be addressed on a case-by-case basis.

C) International Audit Standards

We have the IAASB but currently there is no EU auditing standard. Non-EU issuers must include an audit which is equivalent to any EU member state's audit standards. Once an EU standard is established equivalence will be judged against such a standard. The UKLA views 'true and fair view' and 'fairly presents' to be equivalent standards. If the issuer's auditing standards are not equivalent it must include a statement of significant differences, this statement need not be issuer specific but would need to be signed off on by the issuer's accountants.

D) Professional Securities Market (PSM)

As the UKLA is applying the wholesale PD requirements to the PSM, it would appear that the statement of narrative differences between IFRS and the issuer's national GAAP required by Annex IX would apply to the PSM. The UKLA were asked if they would apply this requirement to the PSM.

GW confirmed that the UKLA will adopt the approach it operated under Chapter 23 of the Purple Book, i.e. a narrative description of differences is only required if the GAAP concerned is unusual.

⁴ This would also cover the obligation that an issuer restate its most recent year's historical financial information in a form consistent with that which will be adopted in its next published accounts.

E) Guarantors

In determining the financial statement requirements for guarantors the UKLA will use the same criteria as if the guarantor were the issuer of the securities.

When looking at the requirement to include the most recent years financial statements in a form consistent with that which will be adopted for the next financial statements it is also necessary to look at the guarantor as if it were the issuer so for EU incorporated guarantors it is necessary to consider whether the guarantor would be subject to the Accounts Regulation for its next financial statements if it were issuing the securities.

GW confirmed that, for the purposes of the transitional provisions in Article 35 (1), if a guarantor which had not itself issued securities admitted to trading on a regulated market, had guaranteed securities which were admitted to trading on a regulated market, the UKLA would treat the guarantor as an existing issuer of securities. In this case, a guarantor can therefore use national GAAP-based financial information.

F) Annex IV, 13.1 – Cash Flow Statements

Annex IV 13.1 requires issuers who report according to national accounting standards (including IFRS equivalent standards) to include a cash flow statement, if the national accounting standards do not require it. It was noted that this was a potential problem for some issuers as German GAAP does not require a cash flow statement in all circumstances.

Schedule 2

Prospectus Directive

Minimum Annual Historical Financial Information Requirements for Prospectuses⁵

Worked Examples

1

Facts	EEA issuer of shares / first listing on an EEA regulated market / reporting under Home Country GAAP/ listing in 2010 <u>after</u> 2009 financials published
Prospectus Disclosure	2009 financials - restated to IFRS as IFRS will be applied in the issuer's next published financials, subject to paragraphs 65-67 of the Level 3 Recommendations 2008 financials - restated to IFRS as IFRS will be applied in the issuer's next published financials, subject to paragraphs 65-67 of the Level 3 Recommendations 2008 financials – at discretion of issuer, home country GAAP 2007 financials - home country GAAP
Analysis	<ul style="list-style-type: none">- Next published financials will be for 2010, prepared in accordance with IFRS- Second paragraph of item 20.1 requires latest two years of financials disclosed in the prospectus to be comparable with next published financials. This is essentially interpreted to mean that only 2 years' financials need to be restated to IFRS and also that the IFRS to apply should, subject to paragraphs 65-67 of the Level 3 Recommendations, be IFRS effective at the balance sheet date of the next published financials.- Paragraphs 56-59 of the Level 3 Recommendations advocate presenting the middle period on the basis of home country GAAP to provide a bridge between the first and third years.

2

Facts	EEA issuer of shares / first listing on an EEA regulated market / reporting under Member State GAAP/ listing in 2010 <u>before</u> 2009 financials published
Prospectus Disclosure	2008 financials - Member State GAAP 2007 financials - Member State GAAP 2006 financials - Member State GAAP

⁵ Note that this does not deal with interim financial information, which will also be required in certain circumstances.

Analysis

- Next published financials will be for 2009, prepared in accordance with home country GAAP
- Second paragraph of item 20.1 requires latest two years of financials disclosed in the prospectus to be comparable with next published financials.

3**Facts**

Non-EEA issuer of shares / first listing on an EEA regulated market / reporting under Third Country GAAP/ Third Country GAAP not equivalent to IFRS / listing in 2010, regardless of whether before or after 2009 financials published

Prospectus Disclosure

2009 financials (or 2008, if listing before 2009 financials are published) - restated to IFRS as IFRS will be applied in the issuer's next published financials, subject to paragraphs 65-67 of the Level 3 Recommendations

2008 (or 2007) financials - restated to IFRS as IFRS will be applied in the issuer's next published financials, subject to paragraphs 65-67 of the Level 3 Recommendations

2007 (or 2006) financials - restated to IFRS. If being restated in connection with the offering, it would make sense for these also to be restated to IFRS as it will be applied in the issuer's next published financials, subject to paragraphs 65-67 of the Level 3 Recommendations

Analysis

- UKLA will not apply analysis in 1 (for EEA issuers) in the same way to non-EEA issuers.
- Although, second paragraph of item 20.1 requires latest two years of financials disclosed in the prospectus to be comparable with next published financials, for a non-EEA issuer this is essentially interpreted (in conjunction with the last two sentences of the first paragraph of item 20.1) to mean that all 3 years' financials need to be restated to IFRS and also that the IFRS applied to the last two years should, subject to paragraphs 65-67 of the Level 3 Recommendations, be IFRS effective at the balance sheet date of the next published financials. Earliest year is also likely to be restated, as stated above.

4**Facts**

Non-EEA issuer of shares / already listed on an EEA regulated market / reporting under US GAAP in accordance with TOD / US GAAP determined to be equivalent to IFRS / listing in 2010 after 2009 financials published

Prospectus Disclosure

2009 financials- US GAAP

2008 financials- US GAAP

2007 financials- US GAAP

Analysis

- Next published financials will be for 2010, prepared in accordance with US GAAP
- In interpreting the second paragraph of item 20.1, CESR advice explains that for an existing issuer where the same set of accounting standards in the last and next published accounts is being applied, the issuer should follow the requirements of the applicable set of accounting standards relating to changes in accounting policies and/or the transitional arrangements in new standards. Following this advice means that there is unlikely to be any restatement requirement.

5**Facts**

EEA issuer of shares / already listed on a EEA regulated market / listing shares in 2005 after PD comes into force (July 2005) and after published 2004 financials in accordance with Member State GAAP / Issuer has not published, voluntarily or otherwise, financials in accordance with the IAS Regulation

Prospectus Disclosure

2004 financials - Member State GAAP

2003 financials - Member State GAAP

2002 financials - Member State GAAP

Analysis

- Next published financials will be for 2005, prepared in accordance with IFRS under the IAS Regulation
- Second paragraph of item 20.1 requires latest two years of financials disclosed in the prospectus to be comparable with next published financials
- However, under Article 35(1), there is no obligation to restate financials until the issuer has published its first consolidated financials in accordance with the IAS Regulation (i.e. early 2006). Article 35(2) might also apply to provide relief from IFRS restatement.

6**Facts**

EEA issuer of shares / listed on an EEA regulated market / offering shares in 2005 after PD comes into force and after published 2004 financials in accordance with IFRS / voluntarily adopted IFRS for 2004 financials

Prospectus Disclosure

2004 financials – IFRS (plus, at the discretion of the issuer, Member State GAAP, using “bridge” presentation)⁶

2003 financials - Member State GAAP

2002 financials - Member State GAAP

Analysis

Voluntary publication of 2004 IFRS financial information does not constitute publishing “first consolidated annual accounts in accordance with Regulation 1606/2002” (i.e. IAS Regulation) and therefore transitional provisions in the first limb of Article

⁶ Impact of IFRS 1 first time adoption rules need consideration but should not result in a qualification to the audit opinion.

35(1)⁷ can be used.

7

Facts	Non-EEA issuer of shares / already listed on an EEA regulated market / listing in 2005 <u>after</u> PD comes into force (July 2005) and <u>after</u> published 2004 financials in accordance with Third Country GAAP
Prospectus Disclosure	2004 financials - Third Country GAAP 2003 financials - Third Country GAAP 2002 financials - Third Country GAAP
Analysis	<p>Article 35(3) states that the obligation to restate historical annual financial information does not apply until January 1, 2007 if the issuer has securities admitted to trading "on" Jan 1, 2007 – as long as securities have a maturity that would take them to January 1, 2007, should be able to rely on Article 35(3).</p> <p>The same financial statements would also be required if the issuer was not already listed on an EEA regulated market. However, in these circumstances, the third country GAAP would need to be consistent with the issuer's next published annual financials, subject to paragraphs 65-67 of the Level 3 Recommendations.</p>

8

Facts	EEA issuer of shares / first listing in 2005 <u>after</u> PD comes into force and <u>after</u> published 2004 financials in accordance with Member State GAAP
Prospectus Disclosure	2004 financials - IFRS ⁸ as IFRS will be applied in the issuer's next published financials, subject to paragraphs 65-67 of the Level 3 Recommendations (plus, at the discretion of the issuer, Member State GAAP, using "bridge" presentation) ⁹ 2003 financials - Member State GAAP 2002 financials - Member State GAAP
Analysis	<ul style="list-style-type: none">- Next published financials will be for 2005, prepared in accordance with IFRS under the IAS Regulation- However, under Article 35(1), there is no obligation to restate financials for any period prior to January 1, 2004. See also footnote 9.

9

Facts	EEA issuer of shares / first listing on an EEA regulated market / listing in 2006 / EEA issuer is a newly incorporated holding company
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⁷ See Footnote 6 above

⁸ See footnote 6 above.

⁹ Article 35(2) might apply if the issuer is from a jurisdiction which has implemented the transitional provisions pursuant to Article 9 of the IAS Regulation – if it does, issuer can use Member State GAAP for all periods (starting) prior to January 1, 2006.

of a Non-EEA company / Non-EEA company has historically reported under US GAAP/ EEA issuer has been incorporated for less than a year and has not published any financials.

**Prospectus
Disclosure**

UKLA would generally look through the new holding company in this situation and look at the business. UKLA would look to show flexibility in accepting US GAAP if US GAAP had been determined to be equivalent, although some IFRS may be required. The treatment will also depend on the results of CESR's advice on complex financial histories. Otherwise, financial statements under IFRS as IFRS will be applied in the issuer's next published financials, subject to paragraphs 65-67 of the Level 3 Recommendations, subject to be required. UKLA may well accept US GAAP for first year, even if it had not been determined to be equivalent. Issuer would not get the benefit of the transitional provisions for non-EEA issuers in Article 35 of the Regulation.