

## Update: Establishment of New Disclosure Regime in the European Union

In 2000, the European Union adopted a strategic plan, referred to as the Financial Services Action Plan, to create a single financial services market and facilitate the widest possible access to capital within the EU. One of the key elements of the Financial Services Action Plan is the establishment of a new EU-wide disclosure regime. The EU is in the process of passing legislation to set the regulatory framework for the new disclosure regime.

The EU actions will change the requirements that capital market participants – issuers and financial intermediaries alike – will be required to meet in order to access the capital markets in the EU. The actions will impact the nature of disclosure that must be provided in connection with the offering or listing of securities and the nature of the disclosure that will be required on an ongoing basis. The actions also seek to provide greater transparency by mandating that financial statements in prospectuses and periodic reports be prepared in accordance with International Financial Reporting Standards adopted by the EU (which will preempt the use of local European GAAP regimes) (“IFRS”) or an “equivalent standard” (yet to be defined).

The new disclosure regime has four key elements:

- the Prospectus Directive, which generally will require any issuer to publish an approved prospectus (including financial statements prepared or restated in IFRS or an “equivalent standard”) in connection with a public offering in the EU or a listing in the EU and to provide an annual disclosure statement to the competent authority in its “home member state” setting forth or referring to all of the information made public by the issuer during the preceding 12 months;
- the Transparency Directive, which generally will require any issuer with securities listed in the EU to publish reports that include audited financial statements annually and unaudited interim financial statements semi-annually in each case prepared or restated in IFRS or an “equivalent standard,” as well as quarterly management reports (which do not need to contain financial statements). It also requires disclosure of large beneficial ownership interests and provides for the equal treatment of holders of debt and equity securities;
- the Market Abuse Directive, which generally will require any issuer with securities listed in the EU to publish promptly “inside information;” and

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- the IFRS Regulation, which establishes the regulatory framework for the adoption of accounting and audit rules that constitute IFRS and requires an issuer incorporated in an EU member state to prepare consolidated accounts in IFRS, generally for years commencing on or after January 1, 2005.

Many aspects of the new requirements are subject to further legislative action at the EU level and at the level of the individual member states. Until this process is completed, there will continue to be uncertainty as to the full impact of the new rules, in particular on non-EU issuers.

This memorandum summarizes the requirements that are likely to affect non-EU issuers with securities (debt or equity) currently listed in the EU and those that may wish to access the EU capital markets in the future.

## Principal Concepts

### *Effectiveness*

- A non-EU issuer with securities already listed in the EU will become subject to the new EU disclosure regime without any further action on its part, unless it delist from all EU exchanges before the Directives become effective.
- The Prospectus Directive entered into force on December 31, 2003, but does not generally become effective until July 1, 2005 and the Transparency Directive is not likely to be adopted until late 2004 and become effective for two years thereafter. Nonetheless, some provisions of the Prospectus Directive are already operative, in particular the provisions governing the establishment of a "home member state" (the EU country with regulatory jurisdiction) for non-EU issuers (including a non-EU finance subsidiary of an EU parent).
- Temporary relief generally will be available through December 31, 2006 for non-EU issuers from requirements to include IFRS financial statements.

### *Home Member State – Prospectus Directive*

- A non-EU issuer of equity or low denomination (less than €1,000 or an amount "nearly equivalent" in another currency) debt securities will have one single opportunity to fix its home member state. Actions that can be viewed as a manifestation of intent to undertake an offering to the public of such securities (even if the action, such as granting of stock options, might be exempt from the prospectus requirement) could trigger the designation of the home member state.
- The home member state of a non-EU issuer of equity or low denomination debt is either the EU country where it first intends to issue such securities or where it first lists securities after December 31, 2003, whichever is sooner. If securities are intended to be offered to the public in one country and listed in another, the issuer has the choice of one of either country.

- A non-EU issuer that has equity or low denomination debt listed in an EU country prior to December 31, 2003 and that does not issue or list securities after December 31, 2003 should be able to designate as its home member state the EU country where its securities are listed (or, if the securities are listed in more than one EU country, select one of those countries) by notifying the relevant competent authority of that state by December 31, 2005. The text of the Prospectus Directive is ambiguous on this point.
- Once the home member state of a non-EU issuer of equity or low denomination debt is determined, it cannot be changed, subject to the following limited exception. If the home member state was determined by the act of a third party (for example, if the first offer was undertaken by a shareholder), a non-EU issuer of equity or low denomination debt may make a subsequent election.
- A non-EU issuer of high denomination (at least €1,000 or an amount “nearly equivalent” in another currency) debt securities and certain convertible securities and derivatives has the choice to select a home member state for each issuance of such securities. Accordingly, a non-EU issuer may have several home member states under the Prospectus Directive with respect to these types of securities. However, each non-EU issuer has only one home member state with respect to its equity or low denomination debt securities.
- The home member state rules of the Prospectus Directive apply to each issuer within a group of companies individually.

#### *Home Member State – Transparency Directive*

- Under the Transparency Directive, a non-EU issuer may have only one home member state. In the case of a non-EU issuer of equity (including convertible debt and other equity linked securities) or low denomination debt, the home member state will be the same as determined under the Prospectus Directive. For a non-EU issuer of solely high denomination debt, the home member state will be one of the EU countries where such debt is listed, at the election of the issuer. Such election cannot be changed for at least three years unless the non-EU issuer delists in all EU states.

#### *Exemptions*

- Both the Prospectus and Transparency Directives contain exemptions for issuances or listings of debt securities with denominations per unit of €50,000 or more (or if denominated in a currency other than the euro, the value of such denomination per unit at the date of issue, equivalent to €50,000 or more).

#### *IFRS Requirements*

- The Prospectus Directive and the Transparency Directive generally will require financial statements included in EU prospectuses and periodic reports to be prepared or restated in IFRS. Whether US GAAP or other (non-EU) GAAP will be

deemed “internationally accepted standards,” and whether public disclosure documents prepared in accordance with the laws of a non-EU issuer’s home jurisdiction will be deemed “equivalent” to EU disclosure rules, and therefore acceptable in the EU, are far from clear.

- If subject to the prospectus requirements, non-EU issuers will be required to present audited financial statements prepared or restated in IFRS for the latest three years (in case of equity) or two years (in case of debt), and any interim period. In addition, if subject to the periodic reporting requirements, non-EU issuers will be required to publish audited financial statements annually and unaudited interim financial statements semi-annually, all prepared or restated in IFRS.

### The Lamfalussy Process

The EU introduced new legislative techniques to implement the EU disclosure regime. The legislative process, referred to as the Lamfalussy process, comprises four layers of regulations:

- Level 1: EU legislation setting forth framework principles that have the force of law across the EU;
- Level 2: EU legislation containing technical implementing measures that also have the force of law across the EU;
- Level 3: guidelines to be adopted by the Committee of European Securities Regulators (“CESR”) ensuring a consistent interpretation and implementation of EU legislation at Levels 1 and 2 across all member states; and
- Level 4: enforcement at the EU level, ensuring compliance by member states with the regulations at Levels 1-3 and taking legal action when necessary.

While the legislative process setting the framework principles for the new disclosure regime at Level 1 is largely complete (subject to entry into force of the Transparency Directive upon publication in the *Official Journal*), some of the regulations do not become effective for another year or more. Level 2 technical implementing measures and Level 3 CESR guidelines ensuring consistent interpretation and implementation of the EU regulations have not been completed. In addition, the framework principles at Level 1 refer certain matters to the member states for local legislation that too has not been completed. Consequently, the following discussion is not complete and remains subject to change.

### The Directives

In general, each of the Prospectus Directive, the Transparency Directive and the Market Abuse Directive will apply to EU and non-EU issuers alike. The IFRS Regulation directly applies only to EU issuers. However, under the Prospectus Directive and the Transparency Directive, both EU and non-EU issuers generally will be required to present IFRS financial statements.

### *Prospectus Directive*

After July 1, 2005 (by which date the Prospectus Directive<sup>1</sup> must be transposed into national law in each EU member state), issuers and other persons that undertake an offer of securities to the public in the EU, or seek admission of securities to trading on any regulated market located or operating within the EU, must file a prospectus with the competent authority of the issuer's home member state. Subsequent to its approval by the competent authority of the home member state, the prospectus may be used to make offers to the public across the EU, subject to publishing a summary in local languages in member states where the competent authority so requires. Other than the publication of a summary in local language, the host member states (EU countries other than the home member state where an issuer undertakes to do a public offering or list its securities) may not impose any other requirements on an issuer in connection with the prospectus. The issuer must make the prospectus (including any summary) available to the public.

Prospectuses prepared by non-EU issuers must generally comply with the same form and content requirements applicable to EU issuers. A prospectus may be drawn up either as a single document or as three separate documents: a registration document, a securities note and a summary note. (If the prospectus consists of one single document, the summary is part of the main document.) In either case, the specific disclosure requirements are determined using a "building block" approach. The First Level 2 Prospectus Regulation<sup>2</sup> contains a number of schedules that set out the detailed disclosure requirements for various types of securities (for example, equity, low and high denomination debt, depository receipts and derivative securities) being offered and, to a very limited extent, specific disclosure requirements for certain issuers (for example, credit institutions, sovereign issuers and municipalities<sup>3</sup>). The Regulation also includes additional building blocks that provide for detailed disclosure requirements for certain specified features, for example where pro forma information is required or where securities are guaranteed. The information required by the relevant schedules and building blocks must be combined to create the prospectus.

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<sup>1</sup> Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (the "Prospectus Directive"). The Prospectus Directive entered into force on December 31, 2003, the day on which it was published in the *Official Journal of the European Union* (the "Official Journal"). The Prospectus Directive must be transposed into national law in each member state by July 1, 2005, upon which it will become effective in each such state.

<sup>2</sup> Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (the "First Level 2 Prospectus Regulation"). The First Level 2 Prospectus Regulation came into force May 20, 2004, but will only apply from July 1, 2005.

<sup>3</sup> EU member states and their regional and local authorities are exempt from the Prospectus Directive altogether. Non-EU sovereign issuers and their municipalities are subject to the Prospectus Directive.

For debt securities offered pursuant to an offering program, the prospectus may consist of a base prospectus to be supplemented with the final terms of the specific issue under the program. The base prospectus can be used for 12 months. Each supplement must be filed with, but is not reviewed by, the appropriate competent authority. Supplements must be provided to investors as soon as practicable and if possible in advance of the beginning of the offer.

Once securities are admitted to trading on a regulated market in the EU, the Prospectus Directive requires issuers to provide an annual disclosure statement to the competent authority in the home member state containing or listing all information that they have published or made available to the public in the previous 12 months in compliance with securities laws in any EU or non-EU state.

Since the Prospectus Directive is a “maximum harmonization” directive, member states, including the home member state, may not impose any additional disclosure requirements on issuers in connection with an offering or listing in the EU. However, the Directive is applicable only to prospectuses and does not govern listing requirements imposed by individual EU exchanges. Accordingly, EU exchanges may continue to impose higher standards for their admission criteria.

The Prospectus Directive provides for various exemptions from the prospectus requirements. Certain types of issues and securities are exempt from the Directive altogether.<sup>4</sup> Certain offers are not subject to the prospectus requirements (assuming the securities are not also being admitted to a regulated market).<sup>5</sup> These exempt offers are non-exclusive and can be combined. In addition, the offer to the public of certain types of securities is also exempt from the prospectus requirements.<sup>6</sup> However, even if one of these exemptions is available, a concurrent listing of the securities would trigger the prospectus requirements unless a separate exemption is available for the listing.<sup>7</sup> Conversely, if one of the listing exemptions is available but there is a

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<sup>4</sup> For non-EU issuers, the most commonly available exemption is likely to be the small offer exemption – securities in an offer with a total consideration of less than €2.5 million on a rolling 12 month basis.

<sup>5</sup> Offers (1) to qualified investors only; and/or (2) to fewer than 100 people per member state (other than qualified investors); and/or (3) to investors who each acquire securities of at least €50,000; and/or (4) of securities with denominations of at least €50,000; and/or (5) with a total consideration of less than €100,000 on a rolling 12 month basis.

<sup>6</sup> (1) Securities offered in connection with a takeover by means of an exchange offer or statutory merger (assuming a document is published having substantially equivalent information as in a prospectus); (2) stock splits; (3) scrip dividends and bonus share issues to shareholders; and (4) securities offered to directors or employees by their employer (assuming, in the case of (3) and (4) that a document is published containing information on the number and nature of the securities and the reasons for and details of the offer).

<sup>7</sup> The Prospectus Directive also exempts from the prospectus requirements the listing of the following types of securities: (1) shares representing less than 10% of the shares of the same class already admitted to trading on the same regulated market (on a rolling 12 month basis); (2) securities offered in connection with a takeover by means of an exchange offer or statutory merger (assuming a document is published

public offer of securities at the same time, an issuer must find an exemption for the offer as well, otherwise a prospectus will still have to be published.

The Prospectus Directive and the First Level 2 Prospectus Regulation exempt non-EU issuers from having to include financial statements prepared or restated in IFRS in a prospectus for the public offering or admission to trading on a regulated market of securities (debt, asset backed or depositary receipts) with a denomination per unit of €50,000 or more (or if denominated in a currency other than the euro, the value of such denomination per unit at the date of issue, equivalent to €50,000 or more). Instead, in those circumstances, non-EU issuers will be allowed to include in the prospectus their home country GAAP financial statements and a narrative description of the major differences between IFRS and such home country GAAP.

In addition, the Prospectus Directive and the First Level 2 Prospectus Regulation grant temporary relief to non-EU issuers by allowing them to continue to use their current financial statements in any prospectus filed prior to January 1, 2007. Following January 1, 2007, non-EU issuers must present in a prospectus historical financial information following the establishment of equivalence.<sup>8</sup>

### *Transparency Directive*

Two years after its publication in the *Official Journal* (by which date the Transparency Directive<sup>9</sup> must be transposed into national law in each EU member state), issuers whose securities are already admitted to trading on an EU exchange will be required to file annual and semi-annual financial reports as well as, in the case of equity securities, interim management statements with the competent authority of the issuer's home member state. In general, non-EU issuers will be

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having substantially equivalent information as in a prospectus); (3) stock splits; (4) scrip dividends and bonus share issues to shareholders; (5) securities offered to directors or employees by their employer (assuming, in the case of (4) and (5) that a document is published containing information on the number and nature of the securities and the reasons for and details of the offer); (6) shares resulting from the conversion or exchange of other securities or from the exercise of rights conferred by other securities; and (7) securities already admitted to trading on another regulated market, provided certain conditions are met.

<sup>8</sup> See "Key Concepts – Internationally Accepted Standards and Equivalence."

<sup>9</sup> Directive of the European Parliament and of the Council of Ministers on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (the "Transparency Directive"). Although the final text of the Transparency Directive has been adopted by the European Parliament it will enter into force upon publication in the *Official Journal*, which will take place after the official text is translated into all 20 languages of the EU, a process currently expected to be completed by the end of 2004. Once the Transparency Directive is so published in the *Official Journal*, it will have to be transposed into national law in each member state within 24 months of the date of publication, upon which it will become effective in each such state.

subject to the same requirements as EU issuers under the Transparency Directive, including the form and content requirements of periodic reports filed pursuant to the Directive.<sup>10</sup>

More specifically, the Transparency Directive will require:

- an issuer of equity or debt securities to publish an annual financial report within four months of the end of each financial year, which must include (i) audited financial statements prepared or restated in IFRS, (ii) a management report and (iii) a certification by “the persons responsible within the issuer” that, to the best of their knowledge, the financial statements give a “true and fair view” of the issuer’s financial position and results of operations and that the management report includes a “fair review” of the development and performance of the issuer’s business, together with the description of the principal risks and uncertainties that it faces;
- an issuer of equity or debt securities (subject to, in the case of debt securities, a transitional exemptive period of 10 years if members states so decide) to publish a semi-annual financial report as soon as possible (and no later than two months) after the end of the first six months of the financial year, which must include (i) unaudited condensed financial statements prepared or restated in IFRS, (ii) an interim management report and (iii) a certification substantially the same in scope as the year-end certification; and
- an issuer of equity securities (with the exception of issuers who already publish quarterly financial reports that comply with national legislation) to publish interim management statements during the first six-month period and the second six-month period so that the first interim statement is published between week 10 and 20 and the second interim statement is published between week 36 and 46 of the financial year covering the period from the beginning of the relevant six-month period to the date of publication. While the interim management statements must contain a written statement on the financial position and performance of the issuer, no actual financial information is required. However, the statement must also include an explanation of material events and transactions that have taken place during the relevant period and their impact on the consolidated financial position of the issuer.

Issuers will be also subject to the continuous disclosure regime of inside information pursuant to the Market Abuse Directive.

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<sup>10</sup> The periodic reporting requirements of the Transparency Directive will not apply to member states, local and regional authorities of member states, the European Central Bank and national central banks of member states and issuers of only debt securities with a denomination of at least €50,000 (or if denominated in a currency other than the euro, the value of such denomination per unit at the date of issue, equivalent to €50,000 or more).



Shareholders will be required to report to the issuer any transaction that results in the proportionate voting right of such shareholder to exceed, or fall below, 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%.

An issuer will also have to file reports relating to changes in treasury shares, total outstanding share capital, rights attaching to equity and debt securities and new loan issues, as well as ensure equal treatment for all holders of securities of the same class by, for example, providing proxy materials ahead of shareholders meetings.

Unlike in the case of the Prospectus Directive, a member state may impose requirements more stringent than those imposed by the Transparency Directive but only with respect to issuers for which such member state is the home member state under the Directive. Accordingly, an EU country may not impose disclosure requirements more stringent than as set forth in the Directive with respect to issuers for which such EU country is not the home member state.

The Transparency Directive provides that issuers of only debt securities with a denomination per unit of €50,000 or more (or if denominated in a currency other than the euro, the value of such denomination per unit at the date of issue, equivalent to €50,000 or more) are exempt from the periodic reporting requirements of the Directive altogether. In addition, for a transitional period of 10 years, a home member state may exempt issuers (EU and non-EU issuers alike) of debt securities listed prior to January 1, 2005 from the semi-annual reporting requirements if the debt may be purchased by professional investors only.<sup>11</sup>

In addition, the Transparency Directive grants temporary relief to non-EU issuers by allowing them to continue to use their current financial statements in periodic reports prior to January 1, 2007 as long as they are prepared in accordance with “internationally accepted standards.” The Transparency Directive also allows EU countries to exempt permanently, on the basis of “equivalence,” non-EU issuers subject to their home member state jurisdiction from the requirements to report under the Directive and instead allow such non-EU issuers to file in the EU the same documents that they file in their home jurisdiction.<sup>12</sup>

### *Market Abuse Directive*

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<sup>11</sup> Issuers of such high denomination debt securities are exempt from the requirement to prepare and file annual and semi-annual financial reports and first- and third-quarter management statements. In addition, a home member state may exempt the following entities from the semi-annual reporting requirements: (1) non-public credit institutions acting as small-size issuers of debt securities (total nominal amount of all debt to remain below €100,000); (2) issuers of debt securities guaranteed by the home member state or by one of its regional or local authorities; and (3) for a transitional period of 10 years issuers of debt securities listed prior to January 1, 2005 if the debt may be purchased by professional investors only.

<sup>12</sup> For a discussion of the concepts of “internationally accepted standards” and “equivalence,” see “Key Concepts – Internationally Accepted Standards and Equivalence.”

After October 12, 2004 (the date by which the Market Abuse Directive<sup>13</sup> is to be transposed into national law in each EU member state), non-EU issuers of financial instruments that are admitted to trading on an EU exchange (or for which a request for admission to trading on an EU exchange has been made) will become subject to, among other things, the continuous disclosure regime of the directive, requiring the publication as soon as possible of inside information which directly concerns such issuer. Executive officers of such issuer will be required to file reports for any transaction they undertake with respect to securities issued by the issuer.

### *IFRS Regulation*

The IFRS Regulation<sup>14</sup> requires that for financial years commencing on or after January 1, 2005 companies governed by the law of (i.e., incorporated in) an EU member state whose securities are listed on an EU exchange prepare their consolidated accounts in accordance with IFRS.<sup>15</sup>

Although the IFRS Regulation does not apply to non-EU issuers, the Prospectus Directive and the Transparency Directive will each require that, unless an exemption is available, financial information included by non-EU issuers in prospectuses and periodic financial reports be prepared or restated in IFRS.

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<sup>13</sup> Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse). The Market Abuse Directive entered into force on April 12, 2003. The Market Abuse Directive must be transposed into national law in each member state by October 12, 2004, upon which it will become effective in each such state.

<sup>14</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (the "IFRS Regulation"). The IFRS Regulation entered into force on September 14, 2002. The IFRS Regulation is binding and directly applicable in all member states without further action by member states.

<sup>15</sup> The IFRS Regulation allows member states to defer application of this requirement only for financial years commencing on or after January 1, 2007 with respect to EU companies whose securities are admitted to public trading outside the EU and which, for that purpose, have been using "internationally accepted standards" for financial years that commenced prior to September 9, 2002.

## Key concepts

### *Home Member State*

A key concept of the Prospectus Directive is that each issuer of securities has a “home member state,” and that the competent authority of such home member state will approve all prospectuses, except for high denomination (at least €1,000 or an amount “nearly equivalent” in another currency) debt securities and certain convertible securities discussed below, published by the issuer in the future, regardless of where in the EU the issuer may offer securities or where in the EU the securities are admitted to trading.

Similarly, each issuer whose securities are listed on an EU exchange will have a “home member state” for purposes of the Transparency Directive. An issuer’s home member state will be typically the same under both the Prospectus Directive and the Transparency Directive, except for issuers of high denomination debt.

Different rules apply for determining the home member state of EU issuers and non-EU issuers.

***EU issuers.*** An EU issuer’s home member state will be the member state in which it has its registered office (in other words, its country of incorporation), except for issuances of high denomination debt and issuances of certain convertible securities.

For each of such issuances, the issuer will be able to choose as its home member state:

- the member state where the issuer has its registered office; or
- the member state where the securities were (or are) being admitted to trading on a regulated market for the first time; or
- the member state where the securities are being offered to the public for the first time.

***Non-EU issuers.*** Non-EU issuers include issuers organized outside the EU as well as non-EU finance subsidiaries of EU companies.

A non-EU issuer of equity securities (other than certain convertible securities) or low denomination (less than €1,000 or an amount “nearly equivalent” in another currency) debt securities will have one single opportunity to determine its home member state.

A non-EU issuer of equity or low denomination debt securities already admitted to trading on one or more regulated market within the EU prior to December 31, 2003 has the choice between the member state where such securities are first offered to the public or where securities are first admitted to trading in the EU after December 31, 2003. To do so, it must notify the competent authority of its chosen home member state by December 31, 2005.

If a non-EU issuer of equity or low denomination debt securities already admitted to trading on a regulated market within the EU prior to December 31, 2003 does not issue or list securities after December 31, 2003, it should be able to designate as its home member state the EU

country where its securities are already listed (or, if the securities are listed in more than one EU country, select one of those countries) by notifying the relevant competent authority of that state by December 31, 2005. The text of the Prospectus Directive is ambiguous on this point.

For a non-EU issuer of equity or low denomination debt whose securities are not admitted to trading on any EU regulated market, the home member state will be the EU country where such securities are intended to be offered to the public for the first time or where the first application for admission to trading on a regulated market is made in each case after December 31, 2003.

Once the home member state of a non-EU issuer of equity or low denomination debt is determined, it cannot be changed, subject to the following limited exception. If the home member state was not determined by the non-EU issuer's choice, the Prospectus Directive provides that non-EU issuers may subsequently elect a new home member state. However, neither the Prospectus Directive nor the First Level 2 Prospectus Regulation expand on this general principle. Thus, this concept will need to be clarified in the forthcoming Level 2 implementing measures and the Level 3 guidelines.

A non-EU issuer may choose its home member state for each issuance of high denomination debt and for each issuance of certain convertible securities. This means that with respect to such offering an issuer (whether EU or non-EU) may have more than one home member state. However, for purposes of the Transparency Directive an issuer may choose only one member state as its home member state.

The home member state rules of the Prospectus Directive apply to each issuer within a group of companies individually.

#### *Are Grants under Stock Plans Considered an "Offer to Public"?*

Subject to the limited exception for smaller offers, the offering of shares (as opposed to options) to EU-based employees under a non-EU issuer's stock plan will likely constitute an "offer to the public" and thereby fix the non-EU issuer's home member state. This is the case whether or not the shares are listed in the EU.

Subject to the same exception for smaller offers, grants of options to EU-based employees under a non-EU issuer's stock plan could also be deemed an "offer to the public" and, thus, fix the non-EU issuer's home member state, even if the shares underlying the options are not listed in the EU. Whether grants of options are deemed an "offer to the public" must be ascertained in each case on the basis of the terms of the plan and the facts and circumstances of the grant. For example, the granting of options for no consideration where the options are not immediately exercisable upon granting is less likely to (but could still) be deemed an "offer to the public."

Once the Prospectus Directive becomes effective, a non-EU issuer's stock plan(s) will be generally exempt from the EU prospectus requirements, but only if the issuer or another member of the group has a listing in the EU. However, this exemption from the prospectus requirement does not prevent an offer of shares or grant of options under a plan from being an "offer to the public" and thereby fix an issuer's home member state.

Even if a share issuance or option grant under a stock plan involves an “offer to the public,” the aggregate consideration (i.e. exercise prices) of such issuances or grants may fall within the small offer exemption of the Prospectus Directive (less than €2.5 million on a rolling 12 month period). For this purpose, issuances and grants under stock plans with different terms should be treated separately.

#### *Internationally Accepted Standards and Equivalence*

Unless an exception is available, non-EU issuers must prepare financial information to be included in a prospectus and in periodic reports in accordance with, or restated to, IFRS. Notwithstanding this general requirement, the Prospectus Directive and the Transparency Directive provide for certain exemptions applicable to non-EU issuers on the basis of the concepts of “internationally accepted standards” and “equivalence.”

While the concept of internationally accepted standards allows temporary relief from the IFRS requirements, the “equivalence” concept establishes permanent exemption from the IFRS, and other content, requirements.

*“Internationally accepted standards.”* The concept of granting temporary relief on the basis of “internationally accepted standards” was established in the IFRS Regulation.<sup>16</sup> The concept was adopted in the Prospectus Directive and the Transparency Directive with respect to non-EU issuers.

The First Level 2 Prospectus Regulation provides that non-EU issuers will be exempt from the requirement to restate their accounts to IFRS and may continue to use their historical financial information in prospectuses filed before January 1, 2007, as long as

- the historical financial information is prepared in accordance with internationally accepted standards as referred to in the IFRS Regulation; or
- the securities of such issuer are admitted to trading on a regulated market on January 1, 2007, the issuer has historically prepared consolidated financial information in accordance with the national accounting standards of a non-EU country, and, to the extent such historical financial information does not give a “true and fair view” of the issuer’s financial position and operating performance, “more detailed and/or additional information” is provided in the prospectus.

Similarly, under the Transparency Directive, for periods commencing prior to January 1, 2007, non-EU issuers may continue to use their current consolidated accounts in annual and half-yearly financial reports as long as the accounts are prepared in accordance with internationally accepted standards as referred to in the IFRS Regulation.

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<sup>16</sup> The IFRS Regulation permits EU member states to exempt EU issuers with securities listed outside the EU that, for the purpose of such listing, have been preparing financial information in accordance with internationally accepted standards from the IFRS requirements and, instead, allow such issuers to continue to use such standards until January 1, 2007.

However, none of the IFRS Regulation, the Commission Comments<sup>17</sup> or the initial proposal of the Commission for the IFRS Regulation<sup>18</sup> specifies who identifies internationally accepted standards.

*“Equivalence.”* Each of the Prospectus Directive, the First Level 2 Prospectus Regulation and the Transparency Directive makes the availability of significant concessions to non-EU issuers conditional on the “equivalence” between the provisions of EU rules and regulations and those of non-EU countries.

The Prospectus Directive provides that the securities regulator of a non-EU issuer’s home member state may approve a prospectus prepared in accordance with the legislation of a third country as long as

- the prospectus has been prepared in accordance with IOSCO disclosure standards<sup>19</sup>; and
- the information requirements, including information of a financial nature, are “equivalent” to the requirements under the Prospectus Directive.

The First Level 2 Prospectus Regulation provides, that after January 1, 2007, non-EU issuers must present historical financial information following the establishment of equivalence pursuant to a mechanism to be set up by the EU Commission. This mechanism is to be set up with the assistance of the European Securities Committee (“ESC”), failing which financial information included in a prospectus after such date must be prepared or restated in IFRS.

Similarly, the Transparency Directive provides that the competent authority of a non-EU issuer’s home member state may exempt the issuer from the periodic filing requirements (including the annual and semi-annual financial reports, first and third quarter management statements and certain other reports, such as reports relating to changes in share capital and rights attaching to securities) as well as the requirement to provide shareholders with proxy statements before a shareholders meeting, as long as the non-EU issuer is subject to equivalent requirements in its country of origin or such issuer complies with the regulations of another non-EU country which the securities regulator in the issuer’s home member state considers equivalent. In each such case, a non-EU issuer may instead file in the EU the same documents that it files in its home jurisdiction.

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<sup>17</sup> Comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting (“Commission Comments”).

<sup>18</sup> Proposal for a Regulation of the European Parliament and of the Council on the application of international accounting standards (presented by the Commission, Dated February 13, 2001, COM (2001) 80 final, 2001/0044 (COD))

<sup>19</sup> International disclosure standards for cross-border offering and initial listings by foreign issuers, Part I, International Organization of Securities Commissions (“IOSCO”), September 1998.

In addition, the Transparency Directive allows a non-EU issuer's home member state to exempt a non-EU issuer of debt securities already listed on an EU exchange prior to January 1, 2005 from the requirement to include in its annual report financial information prepared in accordance with IFRS as long as

- the competent authority of the home member state acknowledges that annual financial statements prepared by issuers from such third country give a "true and fair" view of the issuer's financial position and operating performance;
- the third country where the issuer is incorporated has not made mandatory the application of IFRS; and
- the EU Commission has not taken a decision about the equivalence between IFRS and the accounting standards of the third country where the issuer is incorporated or the accounting standards of a third country such issuer elected to comply with.

As with the First Level 2 Prospectus Regulation, the Transparency Directive requires the EU Commission to set up procedures to determine, with the assistance of the ESC, the "equivalence of information" between EU and non-EU countries, among other things, with respect to financial information included in periodic reports. If the EU Commission and the ESC determine that equivalence does not exist, they may allow the issuer concerned a transitional period.

Neither the Prospectus Directive nor the Transparency Directive sets a deadline for the determination of equivalence, with one exception. The Transparency Directive imposes a deadline of five years after 24 months from the day on which the directive is published in the *Official Journal* by which day equivalence must be determined with respect to the exemptive relief applicable to debt securities of non-EU issuers already listed on January 1, 2005. We understand that the EU Commission will commence the process by giving a mandate to CESR. Currently, it is not expected that this procedure will be completed in 2004, leaving non-EU issuers with uncertainty with respect to their future obligations within the EU.

### *Language*

Each of the Prospectus Directive and the Transparency Directive provides for the language or languages in which disclosure documents may be made. The language regime of the Directives is based on the principles of "home member state" and "language customary in the sphere of international finance."

Under the Prospectus Directive, if an issuer (EU or non-EU) makes a public offering in its home member state and other EU countries, it will be required to prepare a prospectus in a language accepted by the home member state and, at the issuer's choice, either the languages of other EU countries in which the offering occurs or a "language customary in the sphere of international finance." (English is generally accepted as such a language.)

If a prospectus is used in an EU country, and the language of the prospectus is not accepted by the competent authority of that country, the competent authority may require that the summary, but not the whole prospectus, be translated into its official language(s). If indeed member states will exercise their option to require issuers to prepare and publish summaries in

multiple languages, this may expose issuers to additional liability that is not addressed in the Prospectus Directive or its implementing measures. See “– Liability” below.

Under the Transparency Directive, an issuer (EU or non-EU) whose securities are admitted to regulated markets in more than one EU country is required to prepare periodic reports in a language accepted by its home member state and, at the issuer’s choice, a language customary in the sphere of international influence or the languages of other EU countries where its securities are listed. An issuer whose securities are only listed in one member state may not choose between languages. Shareholders may notify an EU issuer of changes in their ownership of shares in a language customary in the sphere of international influence instead of the official language of the issuer’s home member state.

### *Liability*

The Prospectus Directive and the Transparency Directive refer to the member states the regulation of responsibility for the accuracy of the information included in public disclosure documents and civil liability of the persons responsible for any breach of their responsibilities. The persons responsible for the accuracy of the information included in the prospectus must be clearly identified by name and function and must declare that to the best of their knowledge, the information in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its import.

To support the requirement that only the summary but not the whole prospectus must be published in local languages, if so required by a host member state, the Prospectus Directive declares that no civil liability attaches solely on the basis of the summary, including any translation, unless it is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus. However, the summary is required to contain a warning that “it should be read as an introduction to the prospectus and any decision to invest in the securities should be based on consideration of the prospectus as a whole by the investor.” This is impossible if the investor cannot read the rest of the prospectus.

The Prospectus Directive further states that the summary should convey the essential characteristics of, and risks associated with, the issuer, any guarantor and the securities. This task should be accomplished, according to the Directive, in not more than 2,500 words. The Directive and its implementing measures do not provide further detail on how the summary can serve its purpose in languages in which there is no full prospectus.

In light of the above, it remains to be seen how willing issuers will be to rely on the liability safe harbor of the Directive to sell securities in a member state solely on the basis of a summary translated into the local language of that member state, in particular when the question of liability will be governed by the local law of such member state and likely be adjudicated by local courts.

Notwithstanding the current provisions of EU regulations on liability, the EU Council and the EU Commission have recently stated that the law on non-contractual liability need to be examined with regard to corporate liability for the accuracy of information included in public disclosure documents. It remains to be seen what the EU Commission may propose in this regard.



**Observations**

A number of threshold questions remain to be answered, particularly as the rules relate to non-EU issuers. In the meantime, various exchanges such as the SWX in Switzerland, and exchanges in Hong Kong and Singapore, are seeking to attract listings away from EU exchanges by offering greater flexibility and certainty. In addition, trade associations and governments have been lobbying the EU Commission (a recent example of this involves efforts on behalf of Japanese issuers to have Japanese GAAP accepted along with US GAAP).

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This memorandum provides only a general overview of various elements of the EU Financial Services Action Plan and is not intended to provide or constitute legal advice, and no legal or business decision should be based on its contents.

Any questions concerning the foregoing should be addressed to members of the Paul Weiss Securities Group (see below). In addition, memoranda on related topics may be accessed under Securities Group publications on our web site ([www.paulweiss.com](http://www.paulweiss.com)).

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