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CHAPTER III: CORPORATE FINANCE AND THE QUALITY OF FINANCIAL DISCLOSURE

I – REGULATORY DEVELOPMENTS

Many regulatory changes affected corporate finance in 2004. In the course of the year, the AMF published several policy positions resulting from scrutiny of innovative proposals from issuers and the implementation of new European and French laws and regulations.

A – Order of 24 June 2004: Securities

Order 2004-604 of 24 June 2004, implementing Act 2003-591 of 2 July 2003, simplified France's securities law by unifying the rules governing equity securities. It also authorises the issuance of preferred shares with or without voting rights.

Furthermore, the Order changed the requirements for holding an extraordinary general meeting to approve capital increases and allowed for a broader delegation of powers from the board of directors to the chief executive officer when implementing such increases.

In addition, it granted greater flexibility to the requirements for capital increases without preferential subscription rights. This change was consistent with the recommendations made over several years by the COB and reiterated firstly in a June 2002 report from the working group chaired by Jean-François Lepetit on new forms of capital increases[1] and, subsequently, by the AMF. These recommendations called for a less restrictive reference price in the event of a fall in prices or severe volatility, rather than the average price of ten out of the last twenty trading days before the issue date, which had previously been used for calculating the minimum transaction price. The new reference, established by Decree 2005-112 of 10 February 2005, is the average price from the three trading days preceding the transaction. The implementing decree set the maximum discount from this price at 5%.

Furthermore, the Order gives general meetings the option of authorising capital increases without preferential subscription rights and no minimum price, up to a limit of 15% of share capital per year.

The Order enshrines certain market practices in law, such as the priority period, which has been extended to make it possible to adjust the size of an offering within the 15% limit.

B – Disclosure requirements for issuers

Positive disclosure requirements for issuers and any other entities planning corporate finance transactions were brought together in Book II of the AMF General Regulation adopted in November 2004. The provisions on non-compliance with these requirements and presumptions of legitimacy (safe harbour, accepted market practices) are contained in Book VI[2] of the General Regulation. This chapter presents a brief analysis of Book II.

Book II is entitled "Issuers and financial disclosure". It has five Title headings:
Title I: Public offerings of securities
Title II: Periodic and ongoing disclosure obligations
Title III: Public tender offers
Title IV: Buy-back programmes for equity securities admitted to trading on a regulated market and transaction reporting requirements
Title V: Marketing in France of financial instruments traded on a recognised foreign market or a regulated market of the European Economic Area (EEA) .

Title I, which deals with public offerings, restates the provisions of COB Regulations 98-01, 95-01 and 98-08 on financial disclosure, with no substantive changes.

[1] COB monthly bulletin, issue 371 (September 2002) pages 101 to 117
[2] Book VI is presented in Chapter V of this report, which deals with market supervision and discipline.

Articles 211-1 to 211-42 of Chapter I on the Premier Marché and the Second Marché, along with Articles 212-1 to 212-15 of Chapter II on transactions carried out on the Nouveau Marché, apply to issuers planning to carry out a transaction with a view to admission to a regulated market or issuers planning to issue financial instruments for which they will apply for a listing on a regulated market. Public offerings without a listing on a regulated market are covered by Article 214-1 to 214-21 of Chapter IV.

When the Eurolist single listing arrangement was created on 21 February 2005, it resulted in the repeal of the provisions of Chapter II on the Nouveau Marché, except for Article 212-5 on producing a registration document. Nouveau Marché issuers are still required to produce a registration document for the current year. The provisions in Chapter I dealing specifically with the Nouveau Marché were also repealed on the same date.

Chapter III, which deals with the AMF's right to stop financial instruments from being listed on a regulated market restates COB Regulation 96-01 and adds another case for blocking a listing when the statutory auditors obviously lack the required independence (Article 213-2).

Chapter V (Articles 215-1 to 215-3) restates the provisions of COB Regulations 98-09 and 98-10 with no substantial changes. These Regulations deal respectively with transactions carried out under exemptions from the rules on public offerings and the loss of the right to make public offerings.

Title II deals with periodic and ongoing disclosures. The first section of Chapter 1 is on accounting and financial disclosures (Articles 221-1 to 221-5). It restates the provisions of COB Regulation 87-04 on publishing consolidated half-yearly reports and income statements. It also incorporates COB Recommendation 99-01 on the procedures for preparing and presenting interim accounts for publicly traded companies. The only new provision deals with the requirement that issuers present a pro-forma prospectus if a change in the group structure has an accounting impact greater that 25% (Article 221-1). The second section (Articles 221-6 to 221-8) deals with the disclosures about corporate governance and internal control required by the Financial Security Act.

The first section of Chapter II sets out the public disclosure requirements for issuers and any other entities acting on behalf of issuers planning transactions that are likely to have a significant impact on the price of a security (Articles 222-1 to 222-11). It includes new provisions resulting from the transposition of the European Union's Market Abuse Directive into French law. The main change is that the information that the issuer is required to disclose is now defined via a reference to Article 621-1 of Book VI, which means the disclosure requirements now cover inside information.

Sections 2, 3 and 4 deal respectively with major holdings (Article 222-12), shareholder agreements (Article 222-13) and trading in the company's shares by executives and other persons closely connected to the company under the provisions of the Market Abuse and Transparency Directives, along with the Financial Security Act (Articles 222-14 and 222-15).

Title III reiterates the COB and CMF provisions on tender offers: Title V of the CMF General Regulation and COB Regulation 2002-04 have been recast with no substantive changes, pending the unification of the procedures inherited from the CMF (acceptance opinion) and COB (prospectus review).

Title IV restates part of COB Regulation 98-02 and transposes some of the provisions of the Market Abuse Directive on share buy-back programmes.

Title V restates COB Regulation 99-04 with no changes. This Regulation deals with the marketing in France of financial instruments that are traded on a recognised foreign market or a regulated market in the European Economic Area.

C – Share buy-back programmes

Regulation (EC) No 2273/2003 of 22 December 2003, implementing the Market Abuse Directive as regards exemptions for buy-back programmes and stabilisation of financial instruments, came into force on 13 October 2004 (European Regulation).

It sets the requirements that issuers must meet to benefit from the safe harbour provided for in the Directive. The requirements fall into four distinct categories:

- objectives: the European regulation restricts share buy-back programmes that are eligible for safe harbour protection to those carried out for the purpose of reducing the issuer's share capital or for covering option plans or convertible debt instruments;

- disclosure: in addition to having to disclose the main characteristics of the share buy-back programme before implementing it, the European Regulation introduces a new requirement to disclose the details of the transactions by the end of the seventh trading day after the execution date;
- trading requirements: the European Regulation restricts share buy-back programmes by setting requirements for the trading prices and volumes in share buy-back programmes;
- restrictions: to be eligible for the safe harbour, issuers implementing share buy-back programmes need to comply with two restrictions. The first requires them to refrain from selling their own shares during the programme. The second relates to "closed periods", during which the issuer must not trade in its own shares.

On 13 October 2004, the AMF published a news release announcing the entry into force of the European Regulation and setting out the main outlines of the new rules on share buy-back programmes. An article was published in the AMF monthly review[3] to supplement the news release. This article discussed the provisions of the Regulation and two instructions specifying the disclosure procedures and the procedures for reporting trading carried out under share buy-back programmes or stabilisation measures. The article also discussed the general requirements that issuers must meet to sell off treasury shares acquired before 13 October 2004. When the European Regulation came into force, the AMF announced that it recognised two market practices with regard to share buy-back programmes[4]: liquidity contracts and the purchase of shares with a view to keeping them and using them subsequently as consideration in a merger or acquisition. The Market Abuse Directive allows accepted market activities and practices to continue, as long as they do not constitute market manipulation and they meet the list of criteria set out in Directive 2004/72 of 29 April 2004, which sets the implementation procedures for the Directive.

D – Capital increases restricted to certain categories of persons

In light of the preliminary drafts of resolutions to be put to the general meeting to allow capital increases restricted to certain categories of persons, as stipulated in the new provisions introduced by the Act of 1 August 2003, it was necessary[5] to remind issuers that it is up to the general meeting of shareholders to provide a sufficiently detailed definition of the eligibility criteria for such transactions. Merely referring to the category of qualified investors as listed in Decree 98-880 of 1 October 1998 was deemed to be too vague to prevent circumvention of the rules on capital increases with no preferential subscription rights subject to compliance with a minimum price set with reference to market prices.

E – The Dutreil Act and the disclosure of holding period agreements signed by shareholders

The Dutreil Act of 1 August 2003 ("Economic Initiatives") established tax exemptions for shareholders in listed and unlisted companies that sign agreements to hold their shares for a given period. The Act stipulates that if such agreements concern shares listed on a regulated market, they are subject to the provisions of Article L. 233-11 of the Commercial Code on the filing of certain agreements with the AMF and their disclosure. The AMF then clarified these requirements[6]. It considers that the collective holding period agreement signed by the shareholders of a company listed on a regulated market cannot be intrinsically qualified as a clause stipulating preferential terms for acquiring or selling shares, mentioned in Article L. 233-11 of the Commercial Code, as long as it does not confer any special contractual privileges upon the signatories with regard to prices or rights. Consequently, agreements that merely cover the commitment that entitles the signatories to the tax exemption do not have to be filed with the AMF under the provisions of this article and no disclosure by the AMF is required.

On the other hand, if such agreements include additional clauses falling into the category mentioned in Article L. 233-11, such as pre-emption clauses, then they must be filed with the AMF, but only because of the said clauses.

The market needs to be aware of the existence of such holding period agreements and their main characteristics as soon as possible in view of their business significance and their consequences for listed companies in the event of a takeover bid. The disclosures can be made in annual reports, registration documents, prospectuses, securities notes, or in special news releases from the issuer in question. In the latter case, issuers are necessarily aware of such agreements because the tax authorities require an annual certificate confirming that the exemption requirements set out in the Act have been met. The AMF also stipulated the expected content of such news releases.

[3] AMF monthly review, issue 12 (March 2005)
[4] Published in BALO Friday, 1 April 2005 and in the AMF monthly review, issue 13 (April 2005)
[5] AMF monthly review, issue 8 (November 2004)
[6] AMF monthly review, issue 6 (September 2004)

F – Disclosure of directors' dealings

The new transparency rules for directors' dealings in their company's own shares follow an AMF recommendation that the Market Abuse Directive (2003/6/EC) has since made binding.

In 2002, COB published a recommendation[7] urging issuers to disclose directors' dealings at the end of each half-year. There were a few exceptions to the disclosure recommendation, such as the one covering stock options.

In 2003, the Financial Security Act transposed the Market Abuse Directive into French law ahead of schedule by introducing a new article into the Monetary and Financial Code (Article L. 621-18-2). This article requires directors and persons closely associated with them to inform an issuer making public offerings of securities about their dealings in their company's own shares. It is then up to the issuer to submit this information to the AMF and disclose it to the public, in accordance with the procedures and requirements to be set out in the General Regulation and in a Decree of the Council of State.

The procedures for enforcing the transparency rules for trading in a company's own shares by directors and persons closely associated with them have been set out in Articles 222-14 and 222-15 of the General Regulation. Such trading must be reported to the AMF and disclosed to the market within five days. The disclosure threshold for such trading has been set at EUR 5,000 and the content of the news release has been defined.

The AMF clarified the new rules in a news release dated 27 December 2004.

The clarifications incorporated changes in the market abuse laws and regulations and, where possible, closely followed the outline of COB Recommendation 2002-01 on disclosure of directors' dealings.

In particular, they stipulated that issuers must notify the AMF and produce a news release disclosing directors' executed and reported dealings in financial instruments individually and by name within five trading days of being notified of the dealings.

The news release must explain that the 5,000-euro disclosure threshold[8] is calculated per director and per calendar year by aggregating all director's dealings and the transactions carried out by persons closely associated with the director.

Pending publication of the Council of State Decree, which will clarify the meaning of "closely associated persons", directors are urged to notify issuers of dealings reported to them by closely associated persons as defined in European legislation[9], especially spouses and dependent children living at home.

Disclosure is required for the exercise of stock options, even if the acquired shares are not subsequently sold, but some option transactions are not subject to the transparency rules. Such transactions include:

- gifts, gifts inter vivos and legacies, but the rules do apply to acquisitions or subscriptions for shares using the options received;
- transactions carried out by intermediaries under the terms of a portfolio management or asset management contract, as long as the principal has no say in the management;
- dealings by legal entities representing the company in its group.

An AMF Instruction will stipulate the format to be used for reporting such transactions.

G – The 2004 AMF Report on Corporate Governance and Internal Control Procedures

On 13 January 2005, the AMF released its first report on the corporate governance and internal control procedures of issuers making public offerings of securities[10], as required by Article 122 of the Financial Security Act[11].

[7] COB Recommendation 2002-01
[8] Mentioned in the second paragraph of Article 222-14 of the AMF General Regulation
[9] Listed in Article 1, point 2) of Directive 2004/72/EC
[10] AMF monthly review, issue 10 (January 2005)
[11] The AMF General Regulation defines the disclosure requirements for publicly traded companies as regards the chairmen's report, including timing, form and distribution channels.

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The analysis of disclosures by listed companies was based on a sample of 118 reports, plus interviews with issuers and their audit firms.

The AMF's first report shows that the provisions of the Financial Security Act[12] have helped to improve shareholder information and encouraged the companies concerned to organise their internal control procedures and put them on an official footing.

The report's main findings focused on:

- corporate governance: the membership, role and meetings of the board of directors, supervisory board and specialised committees, assessment of the board's work and curbs on the chief executive officer's powers;

- internal control procedures: description of internal control procedures, due diligence, assessment of the procedures by managers, and the statutory auditors' reports.

On the basis of its investigations, the AMF reaffirmed its past recommendations on corporate governance and the internal control guidelines that it published for listed companies in January 2004.

More specifically, the AMF reiterated its wish to see companies expand information about how their boards of directors and specialised committees operate, the work that they do, any criteria that they use for decision-making in specific matters, and their periodic assessments. Any restrictions that the board places on the chief executive officer's powers need to be explained in detail.

The interviews that the AMF conducted on internal control procedures showed that preparing a report for public release spurred companies to make special efforts to analyse, assess and, in some cases, improve existing systems. In the future, the reports should provide greater detail about audits and the involvement of the board and the specialised committees in drafting the report; they should also present any projects and progress reports on any improvements being made following the examination of existing systems.

Unlike corporate governance, where securities issuers can now measure themselves against market-wide standards, there is no universally accepted benchmark for internal control. This makes the process harder to describe and could hamper any future assessment of the adequacy and effectiveness of internal control systems. Establishing such a benchmark that is compatible with international standards was presented as a priority for the market as a whole.

Consequently, the AMF proposed setting up a working group to establish a common position on this matter by securities issuers, regulators and auditors, and to take up the matter at the European level as soon as possible.

II – DEVELOPMENTS IN 2004

A – Corporate finance

1 – Admissions, delistings and transfers of equity securities

After declining for three years, initial public offerings (IPOs) on regulated markets increased in 2004, with a total of 29 new listings, as opposed to 11 in 2003 and 19 in 2002.

	2003	2004	Change
Visas for new listings on a regulated market	**11**	**29**	**+ 18**
on the Premier Marché	*7*[13]	*16*[14]	*+ 9*
on the Second Marché	*4*	*13*[15]	*+ 9*
on the Nouveau Marché	*0*	*0*	*0*

Source: AMF

[12] According to Article 117, the chairman of the board of directors or the supervisory board of any *societé anonyme* (public limited company) must now "report" to the annual general meeting, in a report attached to the management report, "on how the board prepares and organises its work and the company's internal control procedures". The reports of *sociétés anonymes* with a board of directors must also state "any restrictions that the board of directors has placed on the chief executive officer's powers".

[13] Including 6 exchange-traded funds

[14] Including 4 exchange-traded funds

[15] Including six transfers from the Marché Libre and one from the Nouveau Marché

Foreign companies accounted for one-third of the transactions, including six European companies that opted to use the "Eurolist" procedure to have their securities listed on a regulated market in France, thus qualifying for exemption from the prospectus requirements under Article 211-13 of the AMF General Regulation. Four of these companies applied for a listing in Paris to be eligible for the special rules applying to listed property-investment companies (SIICs) that came into force in France in 2004.

Except for the "Eurolist" procedures, the IPOs were all made under the new certification ("visa") procedure[16], which did not give rise to any special problems. The companies first registered their offering circulars and then obtained a visa for a securities note when the actual offering was made.

Six companies transferred from the Marché Libre to the Second Marché, one company moved from the Nouveau Marché to the Second Marché and four new exchange-traded funds were listed on the Premier Marché of Euronext Paris in 2004, as compared to six in 2003.

The new listings include SES Global, where, for the first time in France, an IPO was made by listing Fiduciary Depositary Receipts[17] under the provisions of Article 211-36 of the AMF General Regulation.

The number of delistings remained very high in 2004, with 55 delistings, as opposed to 63 in 2003. Nine delistings were the result of bankruptcies, asset sales or liquidations, and seven resulted from mergers and acquisitions, but the vast majority – the 37 other delistings – were the result of squeeze-outs or sales facilities. Eight of the delistings concerned foreign companies. The AMF recommended[18] that, if the shares of such foreign companies are widely held by individual investors in France, then centralised sales facilities should be offered and the procedure should be broken up into two or more centralised offers to limit the market risk incurred by shareholders as a result of the time lag.

[16] COB monthly bulletin, issue 370 (July 2002)
[17] These instruments are bearer securities issued by a depositary institution (usually a credit institution) in exchange for shares that the investor deposits with it. The Master Fiduciary Deposit Agreement governs the contractual relationships between the company, the fiduciary depositary and the various shareholders who have signed the agreement. The fiduciary depositary must comply with the ordinary requirements for depositaries, including segregation of fiduciary assets and other assets. The fiduciary depositary is also required to comply with the specific requirements stipulated in the Fiduciary Deposit Agreement.
[18] AMF monthly review, issue 4 (June 2004)

Primary market transactions also increased, boosted by the performance of the markets in 2004. There were 56 issues in 2004, as opposed to 50 in 2003. They broke down as follows:

	2003	2004	Change
ISSUES AND LISTINGS ON A REGULATED MARKET	**50**	**56**	**+6**
1. With pre-emptive rights	**27**	**29**	**+2**
. SHARES	*23*	*20*	*-3*
. Shares with warrants attached (ABSA)	*2*	*5*	*+3*
. Shares with warrants for the acquisition of existing shares and/or subscription of new shares (ABOASA[19])	*1*	*0*	*-1*
. Bonds with redeemable warrants (OBSAR[20])	*0*	*1*	*+1*
. Subordinated bonds redeemable in shares (OSRA[21])	*1*	*0*	*-1*
. Bonds redeemable in shares (ORA[22])	*0*	*3*	*+3*
2. Without pre-emptive rights	**23**	**27**	**+4**
. SHARES	*2*	*5*	*+3*
. ABSA	*1*	*4*	*+3*
. ABOASA	*1*	*0*	*-1*
. Share warrants (BSA[23])	*0*	*2*	*+2*
. Cooperative investment certificates (CCI[24])	*0*	*0*	*0*
. Bonds convertible into new shares or exchangeable for existing shares (OCEANE[25])	*10*	*7*	*-3*
. Perpetual notes redeemable in shares (TDIRA[26])	*1*	*0*	*-1*
. Convertible bonds (OCA[27])	*1*	*3*	*+2*
. Bonds with redeemable warrants (OBSAR[28])	*5*	*4*	*-1*
. Bonds redeemable in shares (ORA[29])	*1*	*0*	*-1*
. Bonds redeemable in shares or cash (ORAN[30])	*1*	*0*	*-1*
. Other equities	*0*	*1*	*+1*

Source AMF

The number of unlisted public offerings increased slightly from 20 in 2003 to 23 in 2004. Sales through public offerings were down sharply from 13 in 2003 to 3 in 2004. Activity was strong on the Marché Libre with 19 new listings in 2004, compared to 15 in 2003.

Reserved issues followed by admission of securities to a regulated market fell from 22 in 2003 to 10 in 2004. This signals a slowdown in corporate restructurings involving an issue reserved for one or more acquiring companies.

For the second year in a row, companies made a large number of bonus issues of equity warrants, with 16 such issues being made in 2004.

2 – Visas for issuance and admission of debt securities

The number of visas for issuance and admission of debt securities fell sharply from 291 in 2003 to 239 in 2004. This figure includes 95 visas for issues of warrants, as opposed to 185 in 2003. The real cause of the decline was the implementation of a new issuance procedure for warrants in 2004. The new procedure replaces the visa document with a news release, as long as the company has previously registered a warrant issuance programme. In 2004, the AMF also clarified the eligibility criteria for the equities underlying warrants in conjunction with warrant issuers and in agreement with the objective criteria set by the Paris derivatives exchange, MONEP[31].

[19] ABOASA: *action assortie de bons à option d'acquisition d'actions existantes et/ou de souscription d'actions nouvelles*
[20] OBSAR: *obligation à bons de souscription d'actions avec faculté de rachat des bons*
[21] OSRA: *obligation subordonnée remboursable en actions*
[22] ORA: *obligation remboursable en actions*
[23] BSA: *Bon de souscription d'actions*
[24] CCI: *Certificat coopératif d'investissement*
[25] OCEANE: *Obligation à option de conversion et/ou d'échange en actions nouvelles ou existantes*
[26] TDIRA: *Titre à durée indéterminée remboursable en actions*
[27] OCA: *Obligation convertible en actions*
[28] OBSAR: *Obligation à bon de souscription d'action remboursable*
[29] ORA: *Obligation remboursable en action*
[30] ORAN: *Obligation à option de remboursement en actions ou en numéraire*
[31] AMF monthly review, issue 4 (June 2004)

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3 – Registration documents

	2003	2004	Change
1. Registration documents	**390**	**388**	**-2**
. post-publication review	*218*	*268*	*+50*
. pre-publication review	*172*	*120*	*-52*
2. Updates and corrections	**121**	**82**	**-39**
. Corrections to registration documents (all documents)	*34*	*15*[32]	*-19*
. Updates of registration documents (all documents)	*87*	*67*[33]	*-20*
3. Offering circulars for listing on a regulated market	**2**	**19**	**+17**

Source AMF

Of the 268 registration documents submitted for post-publication review, the AMF asked for corrections or updates to 52 documents, or 19% of the total.

The AMF's examination of registration documents submitted for post-publication review calls for the following remarks.

Information about corporate debt often lacks detail about how financial debt is calculated, about which lines of credit are open and how they are used, and about covenants and their underlying ratios. Companies often claim that information about financial ratios, for which the figures must be given when deemed necessary, is confidential. Nevertheless, it is important to highlight the efforts that will need to be made in this area when International Financial Reporting Standards are adopted. The new standards could have a major impact on the covenants of some issuers and lead them to renegotiate or change the definitions of the financial aggregates used to calculate underlying ratios. These developments need to be properly described in the 2005 registration documents.

The description of general risks, as set out in the AMF report on internal control and corporate governance, means that most companies disclose their main risks, which are market risk and credit risk, environmental risk, legal and tax risk, and the risks linked to the protection of assets and industrial sites. On the other hand, the description of the specific business risks of a company is often insufficient. Once again, few figures are provided. In the specific case of computer services firms, the AMF asked for many updates in order to provide a comprehensive definitions of downtime between contracts and utilisation rates as well as the methods for calculating these metrics.

In addition to the analysis of corporate governance included in the AMF report mentioned above, most of the AMF's requests for further information involved the eligibility criteria for independent directors or the various components of the compensation paid to corporate officers.

In light of the reform of share buy-back programmes following the transposition of European Directive 2003/6/EC on market abuse into French law and the entry into force of European Regulation No 2273/2003 of 13 October 2004 on share buy-back programmes, issuers are encouraged to report on the results and the reallocation of their share buy-backs by objective in their next registration document.

B – Monitoring ongoing disclosures by publicly traded companies

1 – Issuers' communications regarding estimated financial data

Some companies publish financial and accounting data after their year-end close but before the process of compiling and auditing their annual financial statements is complete. The AMF feels that, while such information may be helpful for the market, it raises certain risks that need to be avoided in the interest of both investors and issuers. This subject was addressed in another context by the COB working group on profit warnings, chaired by

[32] Including 14 after publication
[33] Including 54 after publication

Jean-François Lepetit[34]. With the practice becoming more widespread, the AMF wanted to supplement its policy and consult with professionals before issuing a series of recommendations[35].

Its recommendations on issuers' communications concerning estimated financial data are based on five key principles:
- Any financial information, other than turnover, that is published between the year-end or half-year close and the publication date of the financial statements must be flagged as "estimated" results or financial data to prevent any risk of confusion;
- The publication must explain to what degree the financial statements have been approved by the competent body and specify the publication date for the final statements;
- The content must be clear and consistent, especially with the figures from the previous year, which must be provided. If non-accounting aggregates are used, they must be cross-referenced with standard accounting aggregates;
- Published estimates must be produced using a process that ensures the accuracy of the information provided and the progress made in the statutory auditors' work must be clearly specified;
- If discrepancies arise later between the estimated data and the final figures, they must be explained.

2 – Publication of corporate financial statements in the legal gazette

The AMF is responsible for ensuring that companies listed on a regulated market comply with the requirement to publish their financial statements. For the third year in a row, the AMF has initiated court proceedings, pursuant to Article L. 621-17 of the Monetary and Financial Code, against companies that fail to meet their obligations with respect to the publication of their quarterly, half-yearly and annual financial statements drawn up by the board of directors and approved by the annual general meeting. The Commercial Code requires publication of these statements in the legal gazette (Bulletin des Annonces Légales et Obligatoires, BALO). On the basis of the abovementioned article, the AMF referred four cases to the Paris Court of First Instance in 2004 seeking injunctions to publish and penalties. In 2004, 40 companies were served notice to publish their financial statements. About half of them responded as soon as they received the notice and remedied the situation by asking the BALO to publish the necessary information immediately. Companies were given eight days from the date of the order to make the necessary disclosures or face a fine of EUR 1,500 for each day beyond that period.

3 – Transfer of companies from the Nouveau Marché to the single Euronext market

The transfer of companies to the single Eurolist market was a collective process involving an amendment to the AMF-approved Euronext rules. Before the transfer, the AMF conducted a disclosure compliance audit of the companies in question. More specifically, Euronext transferred the shares listed on the Nouveau Marché to Eurolist on 18 February 2005, on the condition that the issuers had fulfilled the regulatory requirement of filing or registering a registration document. In 2004, the AMF had to send out many reminders to issuers that had not fulfilled this requirement, and a list of delinquent issuers was posted on the AMF website.

C – Exemptions from mandatory filing of a proposed tender offer

In 2004, 38 exemptions from the requirement to file a proposed tender offer were granted under the terms of Articles 234-6 to 234-9 of the General Regulation. These included six cases of shareholders taking coordinated action under the terms of Article 234-6 (ibid.). Seven of the exemptions were granted to companies in financial difficulty, pursuant to Article 234-8, point 2. In addition, seven decisions were published following examination of a mandatory buyout offer (Article 236-6).

Note that the AMF received several queries, both in 2003 and in 2004, about mandatory buyout requirements under Article 236-6, paragraph 1, [36] in connection with a possible early dissolution of a company.

[34] COB monthly bulletin, issue 367 (April 2002)
[35] AMF monthly review, issue 7 (October 2004)
[36] Article 236-6 of the AMF General Regulation (formerly Article 5-6-6 of the CMF General Regulation)
"The natural or legal persons that control a company must inform the AMF:

Article 236-6 does not explicitly mention companies that cease trading and are wound up. In principle, however, dissolution could be seen as a radical change to the agreement with shareholders. This is equivalent to a significant amendment to the articles of association or bylaws, which is provided for in the article.

For example, in the case of NetValue an exemption was granted at end-2003 because the main shareholder made a commitment to ensure that, when the company was wound up, the minority shareholders would receive the same amount as had been offered in a takeover bid several months earlier.

In the case of Cac Systèmes, a mandatory buyout offer and squeeze-out, which also took place at end-2003, was initiated after the company had recapitalised. This was part of the liquidation procedure approved by an extraordinary general meeting called before the offer. All these transactions were conducted at the same price (change of control, standing offer, recapitalisation, mandatory buyout and squeeze-out).

The AMF also considered the case of a financially distressed company. Here it seemed that, assuming collective insolvency proceedings and a bankruptcy filing, shareholders would fare best with voluntary liquidation. Under these circumstances, the AMF deemed that a mandatory buyout offer would not provide them with better protection and, accordingly, the planned liquidation did not lead to such an offer.

D – Disclosure of major holdings

The AMF deemed it was necessary to remind shareholders in listed companies about the time limits for disclosures of major shareholdings[37].

Article L. 233-7 of the Commercial Code sets forth disclosure requirements when shareholders' interests exceed set thresholds. Although the law establishes time limits for disclosing major holdings as defined by legislation, it sets no such limits for major holdings as defined in company by-laws, which may require disclosure whenever a tranche of 0.5% of the share capital or voting rights is acquired. Consequently, the AMF had to confirm that the five-day time limit set out in the Act of 1 August 2003 for statutorily defined major holdings does not automatically apply to holdings that are defined as major in a company's by-laws. The disclosure rules for the latter are established solely by a decision of the extraordinary general meeting of shareholders.

Furthermore, the AMF received an application for authorisation of a temporary shareholding of more than one-third of the voting rights in a listed company. The shareholder making the application argued that another shareholder was about to obtain double voting rights, which would dilute the applicant's shareholding and reduce it to less than one-third of the voting rights.

The applicant made an undertaking to exercise no more than one-third of the voting rights at the company's next general meeting. However, it appeared that the applicant was primarily seeking to control its shareholding in order to keep it as close as possible to the one-third level whenever the voting rights in the company changed.

The AMF reminded the applicant of the rules on temporary major holdings set out in Article 234-4 of the AMF General Regulation[38]. In fact, this article is rarely used and was intended to deal only with accidental breaches of the one-third threshold, which did not apply to the case in hand, since the applicant was aware of the situation

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1) when they intend to ask an extraordinary general meeting of shareholders to approve one or more significant amendments to the company's articles or bylaws, in particular the provisions concerning the company's legal form or disposal and transfer of equity securities or the rights pertaining thereto;
2) when they decide in principle to (i) proceed with the merger of that company into the company that controls it, (ii) sell or contribute all or most of the company's assets to another company, (iii) reorient the company's business, or (iv) suspend dividends for a period of several financial years.
The AMF evaluates the consequences of the proposed changes in the light of the rights and interests of the holders of the company's equity securities or voting rights and decides whether a buyout offer should be made."

[37] AMF monthly review, issue 9 (December 2004).

[38] The AMF may authorise a temporary shareholding in excess of the one-third threshold stipulated in Articles 234-2 and 234-3, subject to public disclosure of the conditions, if the excess represents less than 3% of the shares and voting rights and the excess shareholding does not last more than six months. The person(s) concerned shall refrain from exercising the attached voting rights during that period.

and was deliberately controlling its shareholding. Accordingly, the applicant was told to bring its holding back below the one-third threshold immediately and keep it there.

III – ACCOUNTING DEVELOPMENTS

A – Transition to IFRS

The European Union adopted the bulk[39] of International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) in preparation for the changeover required as of 1 January 2005 by Regulation (EC) No 1606/2002 of 19 July 2002, which applies to the consolidated financial statements of European companies listed on regulated markets.

1- Existing regulatory requirements

Issuers published statements under the French standards alone up until 2004, based solely on the requirements set out in IFRS and EU Regulations. In 2005, they will prepare their consolidated financial statements under IFRS, but these will not be published until 2006. Since IAS 34 is not mandatory, issuers are not required to publish their interim statements under IFRS. This means that investors will not see full IFRS-compliant annual financial statements until 2006. Yet, because issuers are required to present annual financial statements under both accounting standards for comparison purposes, the actual date of the transition to IFRS is 1 January 2004, the first day of the financial year used for the comparison.

Until 2004, issuers published statements under the French standards, according to regulatory requirements. The introduction of IFRS in Europe as of 1 January 2005 means that consolidated financial statements for 2005, to be published in 2006, will follow the new standards, which do not require the publication of interim accounts[40]. This means that investors will not see full IFRS-compliant consolidated annual financial statements until 2006. Yet, because issuers are required to present consolidated financial statements for 2004 for comparison with the 2005 statements, the actual transition to IFRS will start with the opening balance sheet on 1 January 2004.

Investors may be unsettled if they have to wait until 2006 to see the impact of the new regulations, since the markets would not have had time to acclimatise to the expected changes. Therefore, the Committee of European Securities Regulators (CESR) initiated further discussions in 2002 on the financial reporting calendar for this complex and unprecedented accounting period.

In addition, Article 221-5 of the AMF General Regulation requires issuers in France to publish full interim financial statements, including notes. Since these requirements apply to the 2005 financial year, the procedures for compiling the 2005 interim financial statements needed to be spelled out.

2 – CESR and AMF recommendations for transition to IFRS

On 10 February 2004, the AMF adopted CESR's recommendation for transition to IFRS[41]. It asked companies listed on regulated markets to apply the recommendation or explain why they would not do so.

The recommendation was drafted by European securities regulators and published on 30 December 2003. CESR identified four milestones in the transition process.

- First milestone

[39] IAS 39 has been adopted with the following carve-outs:
- the full fair value option has been removed from the Regulation because it is contrary to Article 42 of the Fourth Directive, which bans fair value recognition of liabilities;
- the sections on hedge accounting restrict the recognition of demand deposits.

Between 16 July 2003 and 30 November 2004, the Accounting Regulatory Committee (ARC) adopted all of the IAS from 1 to 41 (with some improvements), along with IFRS 1, 3, 4 and 5, and IFRIC Interpretation 1. IFRS 2 (share-based payments) was taken up by ARC on 20 December 2004 and adopted on 7 January 2005.

[40] Regulation 1606/2002 does not cover interim accounts.

[41] AMF monthly review, issue 1 (March 2004)

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In 2003, listed companies were asked to provide narrative explanations of their transition plans and the differences between their current accounting policies and the ones that they will have to apply in 2005.

- Second milestone
The regulators asked issuers to provide quantified information about the impact of the IFRS transition on their 2004 financial statements as soon as possible.

- Third milestone
To prevent the market from being misled by the publication of interim statements[42] under local standards, CESR deemed that issuers should apply the same methods and principles for their interim statements in 2005 as for their 2005 consolidated annual financial statements. Accordingly, if half-yearly statements are mandatory, they should be prepared under IFRS. The 2004 interim statements are to be restated under IFRS for comparison.

- Fourth milestone
At the beginning of 2006, the consolidated financial statements for 2005 and the comparative statements for 2004 must be published under IFRS. The 2003 financial statements do not have to be restated to IFRS in registration documents or prospectuses, but it must be clearly stated that the information pertaining to 2003 is presented under different accounting standards.

In practice, when companies present financial statements for 2003, 2004 and 2005 for a prospectus or a registration document, they must show four columns, with the information for 2003 and 2004 under French GAAP and the information for 2004 and 2005 under IFRS.

In his letter to issuers dated 2 July 2004[43], the AMF's chairman stressed:
- the importance of issuers' efforts to educate users so that the greatest number can come to grips with the new standards. The aim must be to curtail the period of uncertainty stemming from the sweeping changes in accounting standards. If the issuers' explanations are inadequate, analysts and investors are likely to be wary due to ignorance;
- the need to organise the collection of financial data on 30 June 2004, so that adequate figures are available for comparison with the data from 30 June 2005;
- the possibility for companies with different financial years (to 31 March 2004, for example) to follow CESR's recommendations with a lag in the various milestones. For example, such companies could explain their plans for the transition to IFRS on 31 March 2004 and present a comparative table of financial data for the financial year ending 31 March 2005.

3 – Monitoring the IFRS transition

Throughout 2004, the AMF published [44]recommendations for the transition from existing GAAP to the international standards.

In December 2004, France's Institute of Statutory Auditors (CNCC) produced a methodology manual to define auditors' tasks during preparations for the transition to IFRS, having regard to disclosures about the impact of the new standards.

AMF personnel regularly received queries from companies wishing to discuss specific problems encountered with their disclosures about the transition to IFRS. In the January 2005 edition of its monthly review, the AMF published an article that surveyed French regulations and business practices and put forward a summary of the positions adopted in the closing months of 2004. The article concluded with a reminder to the companies concerned by the IFRS transition on 1 January 2005 that they had to comply with the following key principles in their disclosures about the impact of changing accounting standards:

- disclosures should not contain unaudited data (or data that are presented as unaudited). To avoid having to correct figures retroactively, data should be submitted for review and approval by both the audit committee and the statutory auditors before being released, and these reviews should also be disclosed;

[42] If local regulations or market practices require interim statements.
[43] AMF monthly review, issue 5 (July-August 2004)
[44] At various events, in press articles, in educational articles on the AMF website, etc.

- in light of the above principle, the AMF deems that it is preferable for an issuer to delay publication – and to explain the delay – rather than release incomplete and unreliable data, which may therefore be biased, when presenting its 2004 financial statements. In such a case, the issuer will have until the publication date for the half-yearly financial statements to provide the figures in question;

- There should be the greatest possible transparency concerning the choices made during the IFRS transition. This means that users of the financial statements must be informed of all of the choices made, due to the impact of these choices over time;
- The AMF ended the article by underlining the educational efforts that will be required, particularly because of the complexity of some of the standards. Failing that, the AMF feels that the information given to users might be oversimplified and fail to provide all the relevant information, or else only a handful of experts will be able to understand it.

B – Oversight of the audit industry

New institutional architecture for auditor oversight was gradually put into place in 2004, in accordance with the Financial Security Act of 1 August 2003.

1 – Regulatory developments in the French audit industry

The creation of a high council of auditors (Haut Conseil du Commissariat aux Comptes, HCCC) under the provisions of the Financial Security Act was part of a general movement at international level, prompted by a spate of accounting scandals, to end self-regulation in the audit industry. The new system establishes two levels of accountability in France:

- the HCCC is responsible for general supervision of audit firms in order to defend the public interest. Its opinions and decisions are contributing to the development of a rigorous and exacting set of standards for the audit industry;
- France's Institute of Statutory Auditors (CNCC) will assist the HCCC in performing some of its duties.

After the official induction of its members by the justice minister in December 2003, the HCCC started work on the three major areas entrusted to it under the Financial Security Act: conduct of business rules and, more specifically, auditor independence, quality control and standardisation of tasks.

The preliminary results of the HCCC's work are discussed below in the analysis of the opinions and decisions that it has handed down.

The HCCC also has powers of sanction in its capacity as the appeals body for disciplinary and registration decisions taken by regional boards.

Under the Financial Security Act, the CNCC provides the HCCC with the assistance and resources needed to fulfil its objectives. More specifically, the CNCC conducts the periodic and occasional reviews called for in Article L. 821-7 of the Commercial Code. Furthermore, it is still responsible for developing standards of professional conduct, to be submitted for approval by the justice minister.

The AMF plays two roles in this new system:

- The chairman of the AMF is a statutory member of the HCCC and is thus involved in the regulation of the audit industry.
- The AMF also has direct relations with the statutory auditors of publicly traded entities. Article L. 621-22 of the Monetary and Financial Code defines the specific rights and duties of these auditors with regard to keeping the AMF informed at all times about matters such as appointments and reappointments, problems with certifying financial statements, the alert procedure, and notification of irregularities and inaccuracies[45].

[45] A full explanation of these provisions can be found in the AMF's 2003 annual report.

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2 – HCCC opinions

a) Conduct of business

- Opinion of 1 July 2004 on the draft standard for services performed as part of the tasks related directly to the statutory auditor's engagement

The Financial Security Act repealed Article L. 225-224 of the Commercial Code, which prohibits statutory auditors from receiving a salary or compensation of any kind from the company or its managers for any other activity except auditing, with the important exception of special audits conducted for the company in respect of undertakings that it consolidates or intends to consolidate. Henceforward, the statutory auditor is allowed to carry out any task on behalf of the company, its parent company or its subsidiaries, as long as that task is related directly to the statutory auditor's engagement, as defined by the standards of professional conduct. The HCCC Opinion of 1 July 2004[46] provides an important clarification of the definition of the tasks directly related to the auditor's engagement:

"The HCCC recalls that the standards of professional conduct that determine the tasks related directly to the statutory auditor's engagement are different from the standards that define the tasks that are part of the actual mission of certifying the financial statements, which are contained in the existing CNCC code of conduct.

"This difference means that the CNCC code of conduct includes standards that correspond to two categories of tasks: those that are part of the auditor's statutory engagement and those that are directly related to this engagement.

"Therefore, it shall be up to the CNCC to supplement or modernise its code of conduct by introducing standards on the tasks to be performed in the event of:

- takeovers,
- asset disposals,
- consultations requested of the statutory auditors that have a direct impact on the accounts,
- audits to be conducted in the event of fraud,
- preparation of the report on internal control,
- statutory auditors' audits of a distressed company,
- statutory auditors' audits with regard to environmental issues.

"The HCCC states that this list is by no means exhaustive.

"The HCCC also recalls that the code of conduct shall specify which engagements are prohibited for statutory auditors."

Thus, the opinion provides a preliminary idea of which tasks are directly related to the statutory auditor's engagement, i.e. the tasks between the usual statutory tasks and the prohibited tasks.

- Opinion of 27 December 2004 on the preliminary draft of conduct of business rules drawn up by the CNCC

The drafting of conduct of business rules is a key step in implementing the Financial Security Act. It also makes a major contribution to organising the relationship between statutory auditors and companies and, more specifically, publicly traded groups. The HCCC's opinion – the result of six months' intensive work – is especially important. It highlights the close attention HCCC pays to four themes featured in the draft (fundamental principles of conduct, networks, prohibitions and incompatibilities), and proposes a rewritten version for approval by the justice ministry. It is now up to the ministry to finalise the text that will be approved by decree.

The AMF helped to draft the opinion through its participation in the HCCC's work. The AMF also had to make a direct pronouncement on the draft conduct of business rules, since its opinion[47] is required under the terms of Article L. 822-16 of the Commercial Code. This is because the rules apply to the statutory auditors of publicly traded entities.

[46] On a proposed standard for services included in the tasks directly related to the statutory auditor's engagement
[47] Not published

A comparison of both opinions with regard to the crucial issue of non-audit services provided by entities belonging to the statutory auditors' networks for French and foreign subsidiaries of companies, including listed companies, shows that the two institutions' points of view are broadly the same. For the AMF, the strict separation between the statutory audit of financial statements, on the one hand, and consulting services provided by a network to the same customer, on the other hand, should extend to other non-audit services provided either to the parent company or to its French and foreign subsidiaries; and this separation should be spelled out in the code, as stipulated in the Financial Security Act. For the HCCC, the draft code "is too restrictive, since it does not consider the group in which these incompatibilities arise or the network in its capacity as a service provider". The new wording of Article 25[48] of the draft rules suggested by the HCCC in its opinion provides an appropriate response to these concerns by giving a detailed list of network-sourced services that affect the independence of statutory auditors. For the HCCC, "the proposed incompatibility rules are extremely innovative and unprecedented in the auditing industry. Yet, they are fully in line with the Financial Security Act."

The HCCC "does not consider that networks should be defined in the conduct of business rules, since the distinctive characteristics are set out in the Act". The AMF backs the CNCC's proposal that the definition of networks should be based on a "significant and lasting community of economic interest". It should be noted that the proposed amendment of the Eighth European Company Law Directive on statutory audits includes a definition of networks. The European Parliament is currently debating the proposed amendment. The amendment is expected to pass in 2005 and it is bound to have an impact on the definition of networks in France.

b) Quality control

- Decision 1 on the guidelines, framework and procedures for reviewing statutory auditors' quality control in 2003-2004

The CNCC defined the guidelines for statutory auditors' quality control in May 2003 and, starting in September 2003, the reviews were conducted under the new guidelines. In its decision of 13 May 2004, the HCCC approved the continuation and completion of the quality reviews for 2003-2004. It also decided to monitor periodic and occasional quality reviews conducted by the CNCC during 2003 and 2004. Consequently, it asked the CNCC to submit its quality control findings.

The HCCC did not make these findings public.

- Decision 2 on the guidelines, framework and procedures for supervision of the periodic quality reviews of statutory auditors in 2004-2005.

On 10 June 2004, the HCCC decided on the guidelines, framework and procedures for supervision of the periodic quality reviews of statutory auditors in 2004-2005. It asked the CNCC to submit the conditions under which it planned to conduct the quality reviews, pursuant to the terms of this decision.

The decision introduced major changes in the quality control structure for statutory auditors compared to the way it operated before the Financial Security Act became law.

- The multiple levels of quality control (regional, multiregional and national) have been replaced by a single level, "National Quality Control". The HCCC has asked the CNCC to coordinate and harmonise quality control nationally.
- The HCCC has asked the CNCC to combine "horizontal[49]" and "vertical[50]" quality reviews and to apply both approaches in all cases.

More specifically, quality reviews of statutory auditors engaged by publicly traded entities have undergone the following changes.

- The National Audit Review Committee has been replaced by a Quality Commission for "public interest entities".
- The HCCC has declared null and void the framework agreement between the COB and the CNCC[51].

[48] With regard to the provision of services by a member of a network to a controlled entity or to an entity that controls the entity being audited

[49] Horizontal reviews are reviews of the audit firm's procedures, plus verification that the procedures are applied in certain cases. These reviews are conducted according to a set calendar.

[50] Vertical reviews focus on specific tasks with regard to the guidelines laid down by the HCCC.

[51] The 1985 agreement, which was renewed in 1989, 1994 and 2000

The main effect of these changes has been to harmonise quality control for the audit industry at the level supervised by the National Audit Review Committee (CENA) under the old system. Accordingly, the reform has had very little impact on quality reviews of audits of listed companies.

c) Due professional care

- Opinion of 8 June 2004, on best practices and due professional care by statutory auditors with regard to financial disclosures during the transition to compulsory application of international accounting standards.
- CNCC Technical Opinion on financial disclosures during the transition to IFRS – Due professional care by statutory auditors with regard to the 2003 financial statements

The technical opinion was drafted following the AMF recommendations urging French companies affected by the transition to IAS/IFRS in 2005 to adapt their accounting and financial disclosures gradually for the 2003, 2004 and 2005 financial years. It was intended to inform statutory auditors about the steps they must take with regard to these disclosures for FY2003 and to explain how their findings would affect their reports. It describes the four milestones in the system stipulated by the AMF for IFRS transition and explains the following points with regard to auditing financial statements and management reports for the 2003 financial year:

- The statutory auditor must be informed of the company's progress on preparing for the transition to the new accounting standards. The auditor must review the actions undertaken or planned in order to identify any difficulties and risks that need to be pointed out to the board.
- The auditor must ensure that accounting changes made to prepare for the transition comply with French accounting regulations.
- The auditor must read the explanations about the transition given in the management report to identify any information that is obviously inconsistent and to ensure that any quantitative information about differences under the two standards is fair and consistent with the financial statements.

HCCC opinion

Although the HCCC did not have sufficient time, following the referral, to render an opinion on the specific items to be included in the 2003 annual report, its comments upheld the choices made in the technical opinion. Among other things, statutory auditors are required to comment in their report on the Chairman's report on internal control procedures, where the procedures established by the company are inadequate for a satisfactory transition to IFRS. The HCCC also stressed the need for statutory auditors to be vigilant throughout the IFRS transition.

Two opinions dated 4 March 2004[52] dealt with best practices with regard to:

- the requirement that statutory auditors "justify their assessments" of the financial statements being audited;
- the new statutory auditor's report on the chairman's report on internal control procedures.

3- The AMF's contribution to supervising the industry

Regulation of the audit industry makes a valuable contribution to building investor confidence. Yet, the Financial Security Act also gives the AMF a specific role in supervising statutory auditors, because the Authority has an ongoing relationship with the statutory auditors of publicly traded companies. This relationship is embodied in the rights and obligations of statutory auditors in the performance of their tasks, set out above, as well as in their work on reviewing prospectuses and auditing issuers' disclosures or in the audits stipulated in Article L. 821-8 of the Commercial Code.

Based on parliament's preparatory work for the Financial Security Act, the AMF considers that its relationship with statutory auditors, governed by Article L. 621-22 of the Monetary and Financial Code, should encourage statutory auditors to approach it with any queries that arise in the performance of their tasks and could influence financial information relating to a listed company[53]. This proactive approach by statutory auditors could limit their liability in the event of an ex-post review of their work by the AMF or in case of an inspection or investigation. It is absolutely necessary to apply both the letter and the spirit of the Financial Security Act with regard to periodic reviews of statutory auditors' work. This means recognising the major contribution that the COB has made to the successful operation of the national audit review since 1985. The new agreement to be signed with the CNCC to organise the AMF's legal involvement in quality reviews of statutory auditors certifying the financial statements of publicly traded entities must take this contribution into consideration.

[52] See the 2003 AMF Annual Report
[53] This is the case, for example, when auditors have reservations about accounting treatment choices.

It should also be noted that the development of European legislation strengthens the position of financial regulators with regard to auditors, since both Directive 2003/71/EC on prospectuses and Directive 2004/109/EC on the harmonisation of transparency requirements for issuers stipulate that regulators can require auditors to produce information and documents.

The spreading of false, inaccurate or misleading information by a statutory auditor in its reports may render the firm liable to sanctions under AMF regulations[54].

IV – THE AMF REPORT ON RATING AGENCIES

On 26 January 2005, the AMF published its first report on credit rating agencies[55] (CRAs) under the terms of the Financial Security Act of 1 August 2003, which requires the AMF to publish "an annual report on the role of rating agencies, their rules of conduct, the transparency of their methods and the impact of their activity on securities issuers and financial markets"[56].

The credit rating market, and the three market leaders – Fitch, Moody's and Standard & Poor's – have seen many changes since the end of the 1990s, owing to the growing issuance of private-sector debt securities by non-financial and financial corporations and the expansion of credit risk-transfer instruments, such as securitised debt funds and credit derivatives. The contribution of securitisation to the expansion of the credit rating industry can be seen in the income structure of the three main agencies, which have grown increasingly dependent on the business generated by securitisation.

Users, and particularly asset managers, frequently rely on agency ratings. More specifically, a survey of asset management companies shows that ratings are seen as a key factor in defining fund managers' strategies for investing in debt securities. Similarly, bank loan contracts often refer to agency ratings in contingency clauses. These clauses may stipulate a revision of the loan terms, such as the repayment schedule or interest rate, if the borrower's rating changes.

The report deals with some of the issues relating to the way CRAs operate and their relationships with market players.

- The main threat to the quality of ratings lies in potential conflicts of interest stemming from the system in which issuers (and not investors) pay CRAs for their ratings.
- The rating process means that agency analysts have access to confidential information, which issuers do not disclose to the market. Managing this information calls for due consideration of the need to inform the market fairly and to protect corporate interests (non-disclosure of information about strategic and industrial plans, etc.).
- Some CRAs provide related services, such as strategic project assessments. These services, which involve forecasting rating changes in the event of a merger or a takeover, may create a conflict with the basic credit rating services. Some agencies issue unsolicited ratings. This practice raises the question of how to ensure the quality of such ratings, which sometimes rely solely on public information with no input from the issuer.

CRAs have established internal rules of conduct that deal with all of these matters as part of the self-regulation process. The economic independence that the agencies enjoy as a result of their oligopoly is also a factor that helps them withstand pressures that could be brought to bear by various players, such as issuers or investors. Their independence bolsters compliance with such internal rules. However, the report stresses that these rules are not uniform and concludes that the Big Three should seek greater harmonisation. All these elements will help inform European and international discussions on the subject of CRAs.

[54] See Chapter VI, sanction decision of 18 November 2004 against Jacques Point, Dominique Donval and Denis Emonard
[55] AMF monthly review, issue 11 (February 2005)
[56] Article L. 544-4 of the Monetary and Financial Code