Working Group on the Prospectus Directive
of the Commission of Stock Exchange Experts
(*Börsensachverständigenkommission, BSK*)

at the German Federal Ministry of Finance (*Bundesministerium der Finanzen*)

Response to CESR's Advice on Level 2 Implementing Measures
for the Prospectus Directive
Consultation Paper and Annexes June 2003 (CESR/03-162)

August 2003

The present position paper constitutes the response by the Working Group on the Prospectus Directive of the Commission of Stock Exchange Experts (*Börsensachverständigenkommission*, BSK) to CESR's Advice on Level 2 Implementing Measures for the Prospectus Directive/Consultation Paper and Annexes (CESR/03-162)

The Commission of Stock Exchange Experts is a body appointed by the Federal Minister of Finance and entrusted with the task of advising the German federal government on issues relating to capital markets and stock exchanges. The Commission's membership is made up of stock exchange representatives, representatives from banking, industry and insurance, investors, academics, the Deutsche Bundesbank and those German Laender which host a stock exchange. In October 2001, the Commission established a permanent Working Group on the Prospectus Directive; this Working Group is joined by several legal experts on capital market law with guest status.

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I. General Remarks

We are grateful that CESR has taken our comments on previous Consultation Papers into account, and that it is taking care to ensure an orderly legislative procedure by giving time for an additional consultation especially on derivative securities. Therefore, the Working Group on the Prospectus Directive of the Commission of Stock Exchange Experts at the Federal Ministry of Finance in Germany is highly appreciative of this opportunity to comment on major aspects of the present Consultation Paper.

Derivatives have become one of the major growth factors for financial markets in Europe. They offer a wide variety of investment opportunities, enabling market participants to exactly shape their portfolios according to their individually determined profit-loss-profiles. Derivatives allow to accentuate risk, but also to minimise risk. Institutional investors, but even more retail investors, prefer getting access to this world of modern financial instruments by investing in derivatives in the legal form of securities. These investors buy call warrants, if they expect rising markets, discount certificates, reverse convertibles or bonus certificates for profits on slightly positive or even stagnating markets, guaranteed certificates for hedging against potential capital losses, or put warrants if they are convinced, that markets will fall. The palette of products has shown many nuances, and markets demonstrate their dynamics in implementing many innovations. Furthermore, such growth is reflected in number of issues and turnover.

On the one hand, CESR should allow for innovation and competition between issuers, and on the other hand, CESR should take care of investors being properly informed on the structure and the risk of those products. Our remarks are based on the intention to support CESR in adequately balancing the Level 2 Implementing Measures for the Prospectus Directive between both edges.

II. Derivative Securities

We strongly disagree with the approach that the Derivatives Securities Note should be considered as an "everything else box" (paragraph 194). Referring to the above mentioned relevance of derivative securities for capital markets in Europe the starting point must be a general definition of derivative securities. We would like to make reference to our suggestion for a definition laid down in our previous statements on the Consultation Paper October 2002 and the Second Call for Evidence April 2003. According to the consultation process among market participants from Germany and other countries we suggest the following definition, only slightly modified and clearified compared to our previous statements: "Derivative securities are securities where the payment and/or delivery obligations are linked to an underlying (including but not limited to securities, currencies, commodities, indices or other measures), unless the payment of interest is merely linked to a fixed rate or to a recognized inter-bank interest rate."

III. Examples of the way the instrument works

Question 75:

In our opinion, examples are not necessarily needed in order to clearly describe the product. The most precise way to describe how an instrument works is by setting out the terms and conditions and by eventually using mathematical formulas. The language of the terms and conditions should be clear and comprehensible.

Question 76:

See answer to question 75 above.

Question 77:

In specific cases examples might be useful to explain how the instrument works, in especially how the payout structure works. However, there is clearly a danger that the issuer can mislead investors by using specific assumptions which will raise more positive expectations than those which are realistic. However, this danger could be reduced by giving abstract examples in the base prospectus which are prepared on the basis of abstract figures without giving the impression that the product will have an outstanding performance.

Question 78:

See answer to question 77 above. The use of examples should not be imposed on a mandatory basis but should be up to issuer/offeror who can decide about giving examples depending on the complexity of the products.

Question 79:

If examples were to be required in a prospectus specific rules have to be given how examples have to be prepared. Apart from the generic rules set out in the question ("…examples should be realistic, not misleading and should provide a neutral view of how the instrument works") it should be set out that examples should only be required for setting out how the payout structure works. There should be no examples which refer to the time period before maturity – this means that there should be no assumptions on the development of the price of the security.

Question 80:

See question 79. There should be no requirement to calculate the break even point for the specific product as this calculation could only be given in the final terms.

Question 81:

No examples should be asked for in the disclosure rules. The danger that examples are misused for advertising purposes is higher than the added value for investors. It has to be noted that investors have to be advised individually and very carefully by their banks when buying securities. Therefore the costs caused by the requirement of giving examples in the prospectus are not outweighed by the achieved limited investor protection.

Question 82:

See answer to question 81.

Question 83:

See answer to question 81.

IV. Past performance and volatility

Question 84:

No past performances and no volatility should be required. This information is potentially misleading as it does not give any reliable information concerning the future performance. It seems strange to require information in the prospectus on which the investor cannot and should not rely on. Furthermore, the prospectus cannot contain information which will be used as decision support which security to choose out of similar ones. Last but not least, past performance and volatility could only be given in the final terms as the underlying will usually be determined only shortly before the offer. Therefore, the information given on past performance and volatility cannot be approved by the competent authority.

V. Base prospectuses

Question 101:

We welcome the generic rule as this has worked very well in the German market. However we suggest to delete the words "line items of" under para. (b). If not deleted this could be understood as meaning that only the figure of the disclosure requirement has to be given (e.g. "No. 4.1.10."). It will be more precise to actually name the information missing (e.g.: "the exercise date"). In addition this technique is more in line with the current practice of leaving a blank behind the missing information, such as "exercise date: (•)".

Question 112:

From a technical point of view the final terms do not form part of the base prospectus and therefore cannot be considered in the summary. As only the summary has to be translated the final terms do not have to be translated. However, the problem might be solved on a practical basis as most issuers do have an interest to make their final terms understood in the market. If the product is addressed to retail investors, the issuer will have an interest in translating the term sheet with the final terms into the language used by the respective investors.

Question 115:

A new separate summary for every product described in the prospectus is neither necessary nor does it add much value for investors. Therefore, as a general rule, no extra summary for each product should be required. This having said, in the case of a base prospectus with a multitude of different products, an issuer will have an interest in separate summaries as one summary should not exceed 2500 words according to the recitals of the Prospectus Directive. Therefore, it should be decided by the issuer on a case by case basis how to structure the summary. In any case, if one summary contains several products it should be very clear by wording and by printing particulars which part of the summary refers to which product.

Question 122:

As it is current market practice in Germany it should be possible to reproduce the terms and conditions together with the final terms. Of course, there should be a notice that this document is not the full prospectus and it should contain a reference as to where the prospectus will be obtained.

Question 136:

In any case, debt and derivative securities should possibly be described within the same base prospectus. This has been made clear by the European Parliament in the new recital 12a. Anyway it is not quite clear why debt instruments with a derivative component in their interest structure are not regarded as derivatives. They should be described by the Derivatives SN.

VI. Summary

Paragraph 186

The last bullet point ("when drafting the summary, the issuer should keep in mind the fact that the summary might be the only document published in investors' language") should be deleted since this principle undermines the whole concept of the summary. The summary cannot – by definition – contain all the information which is necessary for an informed investor decision. Therefore, if the issuer kept in mind that the summary might be the only document published in the investor's language, he could possibly make no summary.

VII. Road Map and Annex I

We do not find it convincing nor necessary from an investor's point of view that the issuer is required to produce an Equity RD in case of bonds exchangeable or convertible into the issuer's or its group shares and for bonds with warrants to acquire the issuer's or its group shares and for derivatives giving the right to acquire the issuer's or group shares. These products have the same risk structure as their counterparts where the underlying is from a third party issuer. The information in the Equity RD is specifically not necessary where the underlying shares are already in the market and the information is available to the public.

The decision might be different where the issuer issues newly created shares. In such a case but only in such a case of a capital increase the issuer should be required to set up an Equity RD. In such a case the issuer is similar to the one which offers its own new shares immediately. CESR has already made this distinction between newly created shares and shares already in the market in the section on types of base prospectuses. This distinction should also be made generally in the road map.