FEDERATION BANCAIRE DE L'UNION EUROPEENNE

A3053DES
BI
09/08/03

RESPONSE TO THE CESR CONSULTATION ON POSSIBLE IMPLEMENTING MEASURES OF THE PROSPECTUS DIRECTIVE

12 JUNE 2003 DOCUMENT

The European Banking Federation (FBE) represents more than 4,000 banks in Europe with Euro 20,000 billion in assets through the banking associations of 18 countries, including the 15 Member States and Iceland, Norway, and Switzerland. The FBE actively participated in the two-year long deliberations on the Prospectus Directive, accumulating in-depth knowledge of many of the issues that are the subject of the current provisional mandate. The FBE therefore welcomes the opportunity to submit comments on CESR's Consultation Paper (CP) regarding the draft technical advice issued in June 2003.

We welcome the changes made by CESR as a result of the latest consultation. We welcome, in particular, the provisional road map, published for the first time in the CP, which could eventually be helpful in generating some clarity. On the other hand, further work is needed especially on the sections related to derivatives, base prospectus, and the application of the road map, as we outline below.

Remarks about the Consultation Procedure

In drafting its technical advice, CESR should take into account not only the principles outlined on page 5 of the CP, but also the principles listed in the recital 39 of the Prospectus Directive, which are the guiding principles for the Commission's exercise of its right to introduce implementing measures.

As the FBE pointed out in numerous occasions, the use of a staggered timetable for the preparation of CESR's technical advice, while no doubt useful, carries some concrete risks. A key risk is for the market not to be able to evaluate the whole package of proposals (which are inter-linked) in its entirety. On July 31, CESR submitted its first set of advice to the Commission, concerning disclosure obligations for equity securities, retail and wholesale debt issuer's disclosure requirements, asset-backed securities, bank registration document, and depository receipts issued over shares, as well as incorporation by reference and publication of the prospectus. Since this is submitted as "final advice" by CESR, it seems that we will not have the opportunity to provide input on these items to CESR in the context of the ongoing consultation. On the other hand, CESR's feedback statement asserts that certain elements of this advice are subject to further changes. We fully agree with this assertion and hope that there will be the opportunity to submit comments on the July 31 text to CESR directly at a later stage. As an example, the road map itself, which is subject to change, might very well affect one's assessment of the schedules published on July 31; until the road map is finalised, we do not know for sure which instruments are subject to which schedules.

Therefore we would like to highlight once again the importance of the industry having a chance to look at the technical advice, or its result, in its entirety when all of the inter-linked aspects of the advice are finished. While we hope that we will be able to give comments to CESR directly, we also expect that the process of the Commission transforming the technical advice into implementing measures should give the industry a further opportunity to assess the final package. In this sense, the scope of industry assessment should be

Code de champ modifié
Mis en forme : Anglais (Royaume-Uni)
Mis en forme : Anglais (Royaume-Uni)

Rue Montoyer 10 • B-1000 Brussels • Tel: +32 (0)2 508 37 11 • Fax: +32 (0)2 511 23 28
www.fbe.be • info@fbe.be
http://ebf.irisb2b.com (Extranet – members only)

broader than in the case of the Market Abuse Directive, where the Directive went through fewer changes during co-decision and the implementing measures were produced under a simpler structure (involving two mandates with less inter-linked content).

Structure of the response

In the following section, we provide our general observations on the CP. In the subsequent and final section, we provide more detailed responses to the questions in the CP.

GENERAL REACTIONS TO THE CP

1. Minimum Disclosure Requirements

⇒ **General remarks about the proposed approach to derivatives:**

We commend CESR for attempting to find a simple and practical solution to the disclosure for derivative securities. We agree that the solution should enhance market innovation and should not impose undue burdens on derivative issuers. However, the solution proposed does not yet fulfil these objectives.

In the search for simplicity and in the light of the previous consultation, the CP does away with the definition of "derivatives" and states that there will not be a "derivative" registration document (RD). There will be a derivative Securities Note (SN), which could have another name, CESR noted in the hearing; this will essentially be used for all instruments that can not be categorized as either equity or debt for the purpose of the SN. The CP also states that banks will be able to use the Banks Non-equity RD for issue of any kind of non-equity securities, i.e. both for bonds and derivatives and that non-banks will be able to use the retail non-equity RD for any kind of non-equity securities, bonds or derivatives, unless the wholesale regime applies, in which case they can use the wholesale non-equity RD.

Despite the appeal of the seeming simplicity, the lack of a definition of derivatives will create some problems:

⇒ Derivatives are a substantial and growing market segment for Europe; the regulatory regime governing these instruments should be clear;

⇒ Some instruments defined as equity and some instruments defined as debt in the CESR paper are classified by the market as derivatives, with the result that a Bank Non-Equity RD would not be possible to use for these products (even if a Derivatives SN can be used, which, again, in some cases will not be possible because the instrument will not be recognised as a derivative).

Thus, a working CESR definition of derivatives for the purposes of disclosure obligations would:

⇒ Facilitate the use of the Banks Non-Equity and the Derivatives SN;

⇒ Facilitate the use of the Base Prospectus. (Please see our comments on offering programs for further detail.)

In this respect, we disagree with CESR's (implicit) definition on pages 11-12 of the CP, which is based on whether or not the repayment of 100% of the initial investment is guaranteed. We find this definition inadequate because in many cases derivative products can also incorporate a 100% guarantee of the original investment (for example, where the additional payoff is indexed to an underlying but the investment itself is guaranteed.

We would therefore recommend the following working definition for derivative securities:

"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 underlying is merely a fixed rate or a recognized inter-bank interest rate."

⇒ **Registration Document for derivative products:**

In the majority of cases, derivatives are issued by banks. We generally agree with the assertion that there should be no difference in the disclosure requirements for a derivative and a bank bond RD that could justify a separate RD for derivatives. However, under the current road map, an Equity RD would be required in the case of issuance of some derivative products, which CESR has classified as equity for the RD purposes, but as derivatives for SN purposes.

We understand that this approach is based on the definition of equity securities in the Prospectus Directive. However, as we argue below, we believe that this definition should not prevent CESR from adopting a distinctive approach to derivative products, even if wrongly classified by the Directive as equity securities.

Furthermore, it is necessary to clarify that the Banks RD may be used by any financial institution independently of its corporate and/or issuing practices. Banks may use different types of structures to issue derivative and debt products; for example, some may be issuing using a special purpose vehicle (SPV) with the bank as the guarantor, whereas others issue as banks, with the holding company as the guarantor. In both cases, CESR should contemplate the possibility that the financial statements that are more relevant for the investor are used. For example, in the case of an SPV that issues a derivative product which is fully guaranteed by the bank to which the SPV belongs, the accounts of the bank are of greater relevance to the investor than those of the SPV. In the case of a bank issuing a derivative product which is fully guaranteed by the holding company to which it belongs, it should also be possible only to include the financial statements of the holding (parent) company since this information will be the most up-to-date (for example if the holding is a listed company, but not the bank itself). Both accounts (guarantor and issuer) should not be required in order not to confuse investors. This would allow the information most relevant to the investor to be provided.

In certain circumstances, there could be different entities involved in the process, i.e. the product manager, the SPV, the guarantor, a bank (distribution), so a flexible structure is needed to allow for different models of issuance.

Thus, we believe that CESR should provide further guidance on how these different and flexible current structures can be accommodated in the disclosure requirements to the benefit of greater transparency for the investor.

⇒ **Bank RD (Annex D)**

We believe that 13.7, 15, 16 and 17 are not relevant for banks issuing these products and should not be required in the Bank RD.

⇒ **Derivative SN:**

As for the SN for derivatives, we believe that examples should not be required. Although examples may well be useful in certain situations, in many situations they may not be helpful, and could even be misleading, for the investor. Generally, investors have a far better chance of understanding the key characteristics of the risks they are taking with the

help of a description (ref. 2.2.1). Please see our response to questions 75-83 for more detail. Additionally, it should not be forgotten that there is a significant amount of assistance the customer could get from the manager/financial adviser in clarifying the risk profile of the offer.

Past performance of the underlying and its volatility (ref. 4.2.2) should not be required and their provision should be voluntary for the issuer. Given the competitiveness of these markets, bets practice would evolve toward a solution most favourable to the customer.

⇒ **Offering programmes:**

We agree with the need to maintain flexibility for these structures and the principle that they should contain the same information as that in a stand-alone prospectus. We would especially like to highlight the importance of speed with respect to the issuance under an offering programme, which is generally used by issuers who need to enter the markets in a very short time span.

We agree with the generic rule stated in 100 regarding the line between the final terms and the base prospectus, but with one caveat. Please see our response to question 101 for more detail.

We agree with those CESR members that the final terms cannot form part of the summary and that the final terms do not have to be translated. Please see our response to question 102 for more detail.

It follows from the principles stated above (in fact, from the very basic purpose of a base prospectus) that one should be able to use the same base prospectus for different types of non-equity securities. We were relieved to find out during the hearing that CESR was planning to re-assess its approach to this point in the light of the latest change to the Directive (Recital 12a). Our recommendation would be to enable the use of one base prospectus for all types of non-equity securities, with one approval for the whole program. Please see our response to questions 136 and 137 for more detail.

For the same reasons, we strongly disagree with the proposal to require a separate summary for each product in the multi-product base prospectus. Please see our response to question 115.

We believe that the method of publication of the final terms should not subject to Article 14 (please see our response to 125) and that the base prospectus and final terms should not be required to be published with the same method (please see our response to question 127).

⇒ **Wholesale Debt SN**

As described in our response to question 144, we believe that the wholesale debt SN should not include a disclosure of conflicting interests.

⇒ **Base prospectus underlying equity SN:**

The CP proposes additional disclosure requirements for securities giving the investor the right to convert or exchange the security into shares of the same issuer or group entity. In our view, such requirements are justified only in those cases where the exchange of conversion will result in an actual issuance of the underlying, i.e. if the issuer fulfils its obligations under the terms of the security by delivering newly created shares.

2. Format of the Prospectus

⇒ **Road map:**

The definition of equity securities in the Prospectus Directive, which was above all formulated to tackle the issue of choice of competent authority, has led to some confusion as to what types of products should be classified as equity. We believe that this definition should not prevent CESR from applying a differentiated disclosure to those products that are, in economic and market practice terms, derivative products, specifically **covered warrants** (*bon d'option/Optionsscheine*) on own shares, and **reverse convertibles** (*reverse/Aktienanleihen*)**.** In both cases there is no dilution of capital even when the underlying is shares of the issuer or an entity of the same group, since the issuer will not issue new shares but will buy those shares on the secondary market in order to meet the possible physical settlement of the derivative.

In fact, CESR seems to understand this distinction when proposing a separate base prospectus type proposed for warrants that include issuance of new shares/capital raising activities (page 22).

Accordingly, we believe that the road map should be modified as follows:

The criterion for deciding whether an equity RD is required should be whether new shares are being issued. The equity RD should not be required for bonds that can be exchanged into issuers'/group shares, bonds with warrants to acquire issuers'/group shares, or derivatives giving the right to subscribe/acquire issuers'/group shares. In all of these cases, the retail or wholesale non-equity or bank RD should apply.

3. Annual Information

⇒ **Method of publication**

We favour a deadline of 30 days.

DETAILED RESPONSES TO THE CONSULTATION PAPER

32, 34, 35, 37, 39: Derivative disclosure

We find that the items in question here (32: The information on principal; 34: information on principal markets; 35: Trend information; and 37/39: Conflicts of interest) are irrelevant for derivatives and therefore should not be requested. In so far as the registration document is involved, investors in derivative products are concerned about the ability of the issuer to meet the payout obligations described in the product sheet. Issuers are generally financial institutions which are already supervised and are subject to capital adequacy requirements, thus mitigating the credit risk of the issuer.

40/41: Profit forecasts or estimates

Inclusion of forecasts or estimates should indeed not be required. In our view, CESR's assertion that, where such forecast is included, an auditor's report must be added, will lead to an absence of forecasts. Many issuers will not want to incur the additional costs of the auditor's report. That would clearly be an unwanted effect.

57: SPV guaranteed by a bank

We fear that the use of the retail debt disclosures will lead to increase of costs and loss of efficiency, since the issuer might very well end up having discussion with the Competent Authority about what is and what is not relevant/applicable. We would prefer to have separate schedules for this sort of issue.

61, 64: Investment in wholesale non-equity RD

We agree with the proposal to delete the requirement to describe the investments in the RD for wholesale debt so as to make the wholesale non-equity RD and the bank non-equity RD compatible with one another.

75-83: Examples for derivatives SN

While examples can sometimes be helpful, as a general rule, it would not be correct to state that examples always generate truly valuable information on the product. In fact, since by definition examples highlight certain cases without giving a coherent description, they often mislead investors. The inclusion of examples would draw the investor's attention solely to single scenarios, and fail to present the full economic nature and risks associated with the security.

An additional difficulty is that examples could lead to excessive legal risks for the issuer since they could be seen as the basis of a misleading fact in a prospectus, which is a legal document. In practice, if this were required, issuers would be compelled to provide an impractically large number of examples that do not benefit the customer but raise issuance costs for companies.

Furthermore, examples would be difficult to prepare on the basis of base prospectuses, which are almost always used for derivatives and similar products. Given that issuers often issue a large number of derivatives one on day, it would be extremely difficult to provide examples tailored for the economic details of each single product.

We therefore strongly recommend leaving it to the issuer to decide when to use examples (and where to provide them, as it should be possible to provide them outside a prospectus), on a discretionary basis, and to mandate rather a description of the economic nature and risks in general terms.

89: Past performance and volatility for Derivative SN

There should not be a requirement to disclose past performance and volatility of the underlying, and we therefore recommend that CESR adopts option no. 1.

We support discretion on the part of the issuer for disclosure of this kind of information. Issuers will provide this information if they feel that it will be of use to investors. However, like examples, past performance data may not always be relevant or informative for the investor. It is a generally recognised fact that past performance of an asset does not indicate a similar development in the future. Current conduct of business rules in Europe already (as will almost certainly the future conduct of business rules under the forthcoming ISD) require that investors are made aware of this fact in marketing documents. In fact CESR would require the inclusion of a similar disclaimer (ref. 87). Furthermore, where the underlying is a security not admitted to trading on a regulated market, the information on past performance may be difficult to obtain, let alone disclose. On the other hand, where the security is traded, such information will generally be easily accessible to any investor.

101: Generic rule concerning final terms and base prospectus

The generic rule seems to take into account the current practice of using an offering circular in respect of an offering programme and laying out the details of each separate issue in a pricing supplement. We assume that the current market practice will be allowed to continue. On this basis, we agree with the rule. However, we firmly believe (and interpret the generic rule to establish) that the distinction between the BP and the final terms is essentially up to the issuer to make. Furthermore, in our view, it should not be

necessary to list the final items that will be included in the final terms up-front. As long as there is sufficient clarity regarding what will be amended with each individual issue, we believe that there is no additional benefit to be gained from the requirement of a detailed list.

112: Translation of final terms

We agree with the first option. The second approach, according to which certain items of the final terms might have to be translated, seems to us impractical and likely to slow down the issuance of securities in a speedy manner, which the provisions on offering programmes are meant to allow. It also seems hardly possible that something in the final terms would be part of a summary in case of a single issue. The function of a summary is to convey the essential characteristics of a security; regarding the conditions of a security, it can therefore not give more than a brief description of the economic nature. The economics of each security type covered by a base prospectus are known at the time when this is filed and can therefore be included in the summary for the base prospectus; the final terms will never vary from the economics described in the base prospectus.

In principle, we accept that the general features of final terms may be translated; in fact, this will be seen as necessary by the issuer from a purely marketing point of view, since the issuer wants the targeted investors to know the final terms of the individual issues. However, for these markets to continue to function smoothly, we strongly believe that the final terms should not be approved and the terms and conditions should not be translated. This is because each product will have different terms and conditions; it would be very cumbersome to translate these items, even in a summarized form. Such an obligation would make the base prospectus format even more cumbersome than a regular prospectus.

115: Summary

We believe that the issuer should be able to determine the composition of the summary, as every other aspect regarding the content of the summary. Requiring a summary for each product would contradict the rationale of a summary, which can, by definition, at most provide a brief description of the economic nature, which will be more or less identical for many derivative products.

122: Form of final terms

In our view the form of final terms should allow the current market practice to continue with respect to issuance under offering programmes.

125: Method of publication

While Article 14 of the Directive provides for a broad range of methods, we do not think one should be limited to these methods, as long as the base prospectus contains information as to where/how the final terms are published. Therefore we agree with the view of those CESR members who think that the method of publication should not be determined according to Art. 14. Given the need for a method that allows issuers an easy and speedy access to information and the fact that it is in the mutual interest of issuers and investors to facilitate such access without which the product would simply not be sold, all methods of publication should be allowed.

127: Method of publication

No.

131: Additional disclosures concerning programmes

We generally agree with these requirements. However, regarding the requirement No. 2, it should be clarified that the identification of line items can be fulfilled in different manners including by producing a full document with blanks regarding the final terms (see our answer to question 101). Further, we are curious as to what is meant by a general description of the programme. Normally, offering circulars of offering programmes contain a description of the programme on the cover page. Is that what is meant by general description?

132:

No.

136, 137: Derivatives, MTN Programmes and BP

We are in principle opposed to the idea of different types of base prospectuses. We find the proposed scheme of different base prospectuses completely at odds with the very purpose of an offering programme, which must be quick and efficient. We therefore believe that the paragraph 135 should be deleted.

Requesting different types of base prospectuses for debt and derivative products, for example, would create a host of difficulties. Currently, issuers of derivatives use base prospectuses that allow them to issue a great variety of product types, including products providing a capital guarantee while at the same time having derivative features. As discussed previously, under the definition of debt securities proposed by CESR, the latter securities would need to be issued on the basis of a separate debt securities base prospectus, which would be additional to the derivative securities base prospectus needed for the rest of the products. Issuers of debt using Medium Term Note Programmes would have to face considerable difficulties as such issues also often contain derivative elements. Separate base prospectuses would clearly not be helpful for the investor but would only slow down the issuance of offering programs.

To avoid these problems and to ensure that the base prospectus fulfils its objectives, it should be possible for derivative securities and debt securities (as well as others falling within the scope of the base prospectus) to be issued under the same base prospectus, with one approval.

143: Wholesale Debt Securities Note based on Retail Securities Note

We do not agree. The Wholesale Debt SN should take into account the sort of investor targeted. Some items in the Wholesale Debt SN are not relevant to this investor. See 144.

144: Conflicts of interest

For retail debt, Annex L to the first Consultation Paper contained a requirement to disclose ”Conflicts of interest in the issue/offer”. In the previous consultation, many market participants suggested to delete this requirement, on the grounds that conflicts of interest are sufficiently dealt with by other (regulatory) requirements, and that the term appears too vague. In principle, we agree with these views. Annex F now contains a requirement to disclose ”any interest, including conflicting ones that is material to the issue/offer” – which is worded even more ambivalently than the previous one, providing no guidance to determine interests which are material to the issue/offer.

We find that it is not relevant to include this information in relation to the issuer and therefore recommend that it be deleted.

162: Building block on the underlying and the Road Map

As argued above, we believe that the Directive does not constrain CESR in determining what RD schedule should apply to derivatives. We strongly recommend that, for example, derivatives giving the right to acquire shares of the issuer not be subject to a retail RD.

167: Apply item 4.2.2 of Derivative SN to underlying

Yes, we could agree, provided that the past performance and volatility may be added at the discretion of the issuer (see 89 above).

165: Working Capital Statement and the information on Capitalisation and Indebtedness

We agree that Working Capital Statement and Capitalisation and Indebtedness could be useful in certain cases, but agree with those CESR members which believe that such information will not add value for investors as it will be outdated by the time the investor finally receives the shares.

172, 176: Order of information

The majority of our members believe that issuers should be fully free to choose the order in which the required information is presented in a prospectus. For example, some issuers may want to present information on risks related to the issuer and risks related to the issue together. We believe that the issuers should be free to do so. One can expect that there will be a convergence towards certain common practices, such as placing the summary up-front, but overall, the issuers should be given discretion over the order.

182: Options for supplementing the summary

Again, we believe that this decision should be left to the issuer. In certain cases the first option might appear to be the simpler solution, while in others the latter might be the more feasible option. CESR should not mandate any restriction.

186: Guidelines for the summary

It is not entirely clear to us what the role of CESR's guidelines in this respect will be. Assuming that they are aimed at providing general guidance to issuers, we find some useful elements in the first two guidelines, but disagree with the latter two.

The proposed third guideline, potential risk/return considerations, would contradict disclosure requirements in certain cases where such information may not be required to be in the main part of the prospectus. Therefore it would not be sensible to require this item in the summary.

The proposed forth guideline, concerning the fact that in many cases the summary may be the only document published in the investor's language, is self-evident and as such does not provide any guidance to the issuer beyond what is already laid out as a requirement for the content of the summary. On the other hand, it could be misleading if taken as a signal that the summary should be packed with the same information as in the rest of the prospectus (which would contradict the other requirements at Level 1). Given that one of the main practical objectives of the formulation of the summary obligations in the Directive is to ensure that the summary does not lead to excessive legal risks (and consequently, an unreasonable length) we believe that this guideline would not be helpful.

237: Method of publication

Yes.

238: CESR to limit choice of method of publication

No.

239: Deadline for publication of document containing or referring to annual information

We do not oppose a deadline as such, but members feel that a period of seven business days is definitely too short as a standard that will apply in all European markets. A period of 30 business days seems to be more appropriate.