THE LAW SOCIETY'S COMPANY LAW COMMITTEE

THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS' ADVICE ON LEVEL 2 IMPLEMENTING MEASURES FOR THE PROPOSED PROSPECTUS DIRECTIVE – DRAFT APRIL 2003 AND ADDITIONAL DRAFT MAY 2003

Introduction

1. We welcome the opportunity to comment on CESR's further advice on Level 2 implementing measures for the Prospectus Directive. A number of the comments we set out below have been made in response to previous consultation on proposed Level 2 implementation measures or on the proposed Directive. We consider that the concerns behind these comments are sufficiently significant for them to bear repeating.

Building Blocks Approach

2. Generally, we consider that the building blocks approach is an effective and sensible way of mandating disclosure for different situations. However, we consider that the use of building blocks can lead to a result which is over prescriptive. The existence of the disclosure "override" in Article 5 of the Directive means that it is not necessary to have a separate block tailor-made for each different type of issuer.

3. At the same time, greater flexibility is required within the building blocks to recognize that disclosure in certain areas simply may not be material to investors in some companies and to take account of differences between an Initial Public Offer (IPO) and secondary market issues. The first point could be dealt with by applying the approach used in paragraph 6.4 of Annex A ("if material to the issuer's business or profitability") generally, throughout the building blocks. If for some reason it was not felt appropriate to introduce this as a general interpretative principle, there are a number of specific items where it is required, for example paragraphs 5.2.2 and 5.2.3, to cater for the fact that any issuer will have "principal investments" but for companies with a low asset base they may be of no material interest to investors. The second point could be dealt with by making it clear that certain items would only apply on an IPO and other items would only apply on a secondary issue. By way of illustration, paragraph 20.8.1 of Annex A is unlikely to reveal any useful information on an IPO.

Applicability

4. It should be clarified whether negative statements are required whenever particular disclosure items are not applicable. In some cases (see paragraphs 5.1.7 and 5.2.3(f) of Annex C) it is clear that no negative statement is required. In others (see, for example, paragraph 5.1.5) it is not. The best approach for issuers and investors would be to specify explicitly where a negative statement should be made. Again, this would be most effective if done on a general basis – e.g. “unless otherwise stated there is no need for a negative statement to be included”.

International Accounting Standards

5. The combined effect of paragraphs 20.1 and 20.4 is that local GAAP will only be acceptable if it requires companies to draw up accounts to what is considered an equivalent standard to a true and fair view. Given the enormous deterrent of having to produce IAS accounts for a non EU issuer, and the effect this could have on EU markets' ability to compete globally, this needs to be clarified. One way to do so

would be to maintain an official list of jurisdictions where local GAAP is considered to provide an equivalent standard to the true and fair view.

Risk Factors

6. We would be very reluctant to see the adoption of standard, formulaic risk factors of the kind used in the US. Paragraph 4 of Annex A should be amended to cover only unusual or exceptional risks that are specific to an issuer or its industry and, by the addition of "if any", it should be made clear that there may be no need for disclosure of this nature. Similarly "if any" should be inserted into paragraph 2 of Annex C. Blanket risk factor disclosure of the type that would be encouraged by the current wording is of no value to investors and can mask items of real significance, which get lost in the general disclosure.

Managements' External Interests

7. Paragraph 14.1(i) excuses disclosure of all subsidiaries of the issuer of which the director is also a director; it does not excuse disclosure of subsidiaries of another company of which he or she is also a director. Where a director of the issuer is also a director of a large group, this could involve unhelpful disclosure of a long list of subsidiaries of the other group. It would be preferable if, as is currently the case with the UK Listing Rules, the exclusion applied to or the subsidiaries of any company of which the person is a director.

Working Capital

8. We consider that it would be helpful to specify how long the "issuer's present requirements" should be taken to be. There is a danger that without guidance, different competent authorities may adopt different durations for the working capital review and the desired level paying field would not be achieved in this area.

Pre-emption Rights

9. Paragraph 4.5 of Annex C provides for the disclosure of pre-exemption rights in offers "for subscriptions of securities of the same class". In fact, investors will be concerned not only with offers of securities of the same class but also offers of securities of a different class which compete with, or rank ahead of, their securities. The existence or absence of statutory pre-emption rights is of such significant to investors that we consider that it should be disclosed in the equity registration statement. This is important also because, in the UK, pre-emption rights do not attach to securities of a particular class but apply to any equity securities issued by the company for cash.

Taxation

10. The last sentence in paragraph 4.11 in Annex C needs to be restricted in its scope or deleted. It would not be possible for an issuer to provide sensible advice to investors in a pan-European offer on their tax treatment. There would be too many variables depending on different jurisdictions and investors' individual circumstances.

Interests of Persons Involved in the Issue/Offer

11. We do not understand what is intended by paragraph 3.3 of Annex C. This could include the interests of all relevant investors as potential subscribers or purchasers. Is it intended to be restricted to interest to persons connected with the issuer?

Selling Securities Holders

12. We are not clear what is intended by the phrase “other material relationship” in paragraph 7.1 of Appendix C and what form disclosure would be expected to take where the selling shareholder was simply an independent investor who had held a significant stake in the issuer for the previous three years. Would a significant shareholding in itself amount to a material relationship?

Debt Related Building Blocks

13. We have seen a copy of the comments proposed to be submitted by the International Primary Market Association and we agree with, and endorse, the comments made in their submission relating to wholesale debt, depositary receipts, guarantees, asset backed securities and banks.