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CESR consultation on disclosure standards
Comments by ABN AMRO
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I. INTRODUCTION

We would like to congratulate CESR for the enormous consultation and transparency efforts on the implementing measures on the Prospectus Directive. We very much hope that these efforts will lead to a future European regime that is flexible and affordable for issuers and more transparent and informative for investors.

Our comments on this consultation focus on derivative products and are based on our experience as issuers of derivatives in various European markets, in particular Germany, The Netherlands, Belgium and Italy. In this context, we believe that CESR's proposals on derivatives need still further work and focus. We would recommend that CESR's approach in this respect take as a working basis the following elements:

- the majority of issuers of derivatives are banks, particularly large banks subject to strong capital requirements and with a sophisticated risk management structure;
- those issuers may issue as a bank or as a special purpose vehicle, in either case, with a guarantee from the mother company; only one set of accounts -most updated ones- should be required in those cases in order not to mislead the investor;
- although in theory the prospectus should be the basis of an investment decision, in practice investors in derivatives decide on the basis of the particular payout description of each issuer and market conditions of the underlying;
- in markets like Germany and The Netherlands there is a great demand from retail investors for derivative products;
- a large part of derivative products are issued under an offering programme, which presents the flexibility needed to issue new products on a daily basis;
- under an offering programme, the issuer may include terms and conditions for a large number of different products that range from covered warrants, reverse convertibles, exchangeables, capital guaranteed products, certificates;
- any proposal to summarise –and translate- each of those terms and conditions for each different product – which may or not may be offered- would simply jeopardise a current dynamic market

If those basic elements are to be taken into consideration, our optimal scenario for a pan-European disclosure for offering programmes for derivatives would consist of the following:

- a base prospectus based on the proposed banks' registration document and the proposed derivatives securities note, except for the final terms –incorporating the proposed changes discussed below-;
- that base prospectus could be used to issue all types of derivative products and not only those that CESR's qualifies as not being "equity or debt"; thus the need for a working definition of what constitutes a derivative product, as proposed below;
- CESR should not dictate what elements of the base prospectus should be summarised –and certainly not all the terms and conditions- but should leave this choice to the issuer, taking into account the guidelines of the Directive. It should be the issuer's decision as to what extent it will take specific prospectus liability risks.

We note that CESR has provided to the Commission its advice on the Banks' Registration Document on 31st July, despite the fact that the contents of such Registration Document for the issuance of derivatives is the subject of the current consultation. We would like to assume however that that particular schedule can still be modified as a result of the current consultation and in line with CESR's statement on its advice to the Commission that an adaptation of some items may still be necessary.[1]

[1] Advice to the Commission, paragraph 25, Ref: CESR/03-208, 31st July.

II. CONCEPT OF DERIVATIVE SECURITIES AND USE OF THE BASE PROSPECTUS

We believe that it is essential that CESR develops a working definition of derivatives in order to design in an appropriate way the future road map, in particular in relation to the scope of application of the Equity Registration Document. In this respect, we particularly disagree with CESR's use of the definition of equity securities in the Prospectus Directive for the purposes of establishing which products should be using the Equity Registration Document. We understand from the public hearing that there may be disagreements among CESR members as to the extent of discretion by CESR in designing disclosure requirements that deviate from the definitions in the Directive.

In our view, CESR is not bound by the definitions of the Directive in respect of disclosure requirements. Firstly, the Prospectus Directive is quite clear in requiring a distinctive approach for derivatives in its article 7.2.a[2]. Secondly, the mandate by the Commission of January explicitly mentions the need for "schedules adapted to the particular nature of derivative securities such as covered warrants, certificates or reverse convertibles". Thus, the Commission is considering those type products as derivatives, despite the classification of some of those products[3] as "equity securities" in the Prospectus Directive.

Furthermore, in relation to the base prospectus -which CESR proposes to build as a combination of a particular Registration Document and Securities Note-, we would need to have a different disclosure (Equity Registration Document) if we choose to include in our offering programme warrants and reverse convertibles on our own shares. This will indeed considerably disturb our current market practices and eliminate choice of underlying for investors since we will probably then exclude those products from our derivatives' programmes.

In this last respect we wish to disagree with the statement by some CESR members during the public hearing that considered that full equity disclosure for derivatives on own shares should not be a fundamental problem for this type of issuance since the issuer has already this information – as opposed to another type of underlying where there is only 3rd party information-. Contrary to an equity offering, in a derivatives offering, the issuer will not undertake a due diligence process since there will not be dilution of the capital of the issuer. However, if new capital is created such disclosure should be provided, independently whether the derivative is linked to own or 3rd party shares.

Thus, we believe that CESR needs to re-consider its approach to derivatives offerings as follows:

1. A working definition of derivatives is needed to ensure that the Equity Registration Document does not apply to derivative products and that a derivatives base prospectus can be used for all types of derivatives, irrespective of the type of underlying, the type of settlement and the capital return. Thus we join those market participants that propose the following definition of derivatives:

   "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".

2. Covered warrants and reverse convertibles on own shares should thus be considered as derivative products not subject to the Equity Registration Document disclosure. Indeed, issuers of this type of products are currently using the same type of disclosure as for any other type of underlying, since the economic rationale is exactly the same as with a 3rd party underlying: no issuance of new shares (no dilution of capital) in case of physical settlement.

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2 Article 7. 2. In particular, for the elaboration of the various models of prospectuses, account shall be taken of the following:
(a) the various types of information needed by investors relating to equity securities as compared with non equity-securities; ***a consistent approach shall be taken with regard to information required in a prospectus for securities which have a similar economic rationale, notably derivative securities;***

3 Namely covered warrants and reverse convertibles on shares of the issuer or an entity belonging to the issuer's group.

3. The type of settlement should not be used as a classification method, as proposed in the road map for derivatives with cash settlement. The majority of derivative products (independently of the underlying) will include both types of settlement (cash and physical) and the information on the underlying will be exactly the same (3rd party information). The proposal in the road map indeed does not specify which type of disclosure is thus required for derivatives with physical settlement (for example in bonds).

4. The only circumstances where additional equity information may be warranted should only include those cases where the product may entail the creation of new shares. In this respect, we note that CESR has already made that distinction in relation to the base prospectus ("warrants to subscribe for new shares base prospectus") but we note that this distinction should only be applied in respect to "warrants issued for the purpose of capital raising that give the investor the right to receive newly created shares"[4] but not on the fact that those warrants are "issued by the same issuer as the issuer of the underlying shares or by an entity belonging to the group of the said issuer"[5]. Thus, the determining test should be the issuance of new shares that entails the raising of capital – as in the case of an equity offering-.

III. DERIVATIVE SECURITIES – REGISTRATION DOCUMENT

1. SCOPE

In the advice to the Commission CESR notes that the banks Registration Document is to be used by credit institutions, including both banks and investment banks. CESR further notes in the feedback statement (par. 223 and 224) that the use of this Registration Document cannot be extended to holding companies of banks, unless such entity is treated as a bank.

In this respect and taking into consideration our introductory comments, we believe that CESR needs to clarify this approach by clearly allowing flexibility to the issuer to decide which information is most appropriate from an investor's point of view. For example, we believe that if the issuer is a bank which fully belongs to a holding, it would be more appropriate from an investors' point of view to include in the Banks' Registration Document the financial statements of the holding (if the holding fully guarantees the issue of the bank) since this will normally be the most updated information (for example, since the Holding will normally be the listed company and not the bank).

2. SPECIFIC QUESTIONS (32, 34, 36, 37, 39)

Despite the feedback statement in CESR's advice to the Commission, we still consider that disclosure about principal activities and markets of the issuer, is of no relevance for investors in derivative securities and would certainly entail a significant burden compared to current market practices. Indeed, we do not see in which way an investor in a derivative product needs a description of the categories of products sold and/or services performed and the markets in which the issuer competes. Such type of disclosure is relevant in respect to an equity offering since the investor needs to assess the growth opportunities of the issuer in order to understand the potential capital appreciation of its investment. In the case of a derivative offering, its investment appreciation does not depend on the growth potential of the issuer but simply on the movement of the underlying (which clearly does not depend on the services sold by the issuer). Such disclosure is not relevant either to assess the credit risk of the issuer – its ability to meet the payout obligation of the derivative- since those depend on the capital adequacy and risk mitigation techniques of banks that are highly supervised by banks' regulators.

In relation to trend information, we welcome CESR's change (as presented in its advice to the Commission) to require only a statement that there has not been a material adverse change regarding the business of the issuer as a whole as opposed to the previous requirement on the description of trends in production, sales, etc.

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4 Paragraph 135.2 a) in the consultation paper.

5 Paragraph 135.2 b) in the consultation paper.

In respect to the administrative, management and supervisory bodies' principal activities outside the issuer and conflicts of interests of management, we cannot see in the advice to the Commission in which respect CESR has amended its proposals (as claimed in the feedback statement) and acknowledging comments that requested deletion of such disclosure. For the reasons stated above, we do not see why an investor in a derivative product can benefit from this type of disclosure.

In relation to major shareholders we agree that this disclosure is important in terms of corporate governance of the issuer (as claimed by some respondents and stated by CESR in its feedback statement to the advice to the Commission). However, we fail to see why corporate governance of the issuer is important for an investor in a derivative product since corporate governance rules are not going to influence the credit risk of the issuer or the movement of the underlying of the derivative product.

3. OTHER ITEMS IN ANNEX D

In relation to organisational structure (item 7): we hope that this line item will simply be restricted, as currently stated, to a brief description of the legal organisation of the group, without a need to describe in full the whole organisation of the group.

We believe that the following items should also be deleted since they do not affect the investor's assessment of the credit risk of the issuer and the movement of the underlying:

- legal and arbitration proceedings (item 13.7). In the case that there is a major legal proceeding that could lead to an eventual bankruptcy of the issuer, this will certainly be incorporated in the risk factors of the issuer section.
- material contracts (item 15);
- statements by experts (item 16)
- documents of display (item 17)

IV. DERIVATIVE SECURITIES –SECURITIES NOTE

1. EXAMPLES (questions 75 to 83)

We agree with those CESR members that believe that the inclusion of examples can be misleading for the investor and that investors may place undue reliance on examples. If issuers will be forced to provide examples, they will need to undertake an event risk analysis listing all types of assumptions that may or may not occur and which thus may or may not alter the payout profile of a derivative product. The prospectus should include a clear and understandable description of all terms and conditions (legal information) so as to enable the investor to judge how the payout profile may be altered depending on the circumstances described in those conditions. Examples are per se not legal information and should thus not be considered as a prospectus requirement, at the risk of misleading investors.

Finally, in the case of offering programmes, those examples will only be able to be provided in the final terms (since the base prospectus will not anticipate which specific underlying will be used). We think it will be basically impossible to provide those type of examples in the final terms since those can be decided within hours, and to work out specific examples for a product with a complete event risk analysis could not be done within that timing. Otherwise only very general examples will be included which do not have any added value for the investor. In any event, the product's mode of operation and the associated specific risks will be disclosed in the final terms.

2. PAST PERFORMANCE AND VOLATILITY (question 89)

We actually would prefer an option 4 where past performance could be required but not information about the volatility of the underlying. We think that information about the past performance can be useful from an investor point of view only to judge that the issuer was able to meet the settlement price in the past. In relation to the volatility of the underlying, we support option 1 (not inclusion) since such volatility may or may not reflect future volatility.

V. SUMMARY

We think that while the Prospectus Directive may be relatively clear as to what could be summarised for products issued under a single prospectus or a Registration Document and a Securities Note, we find it extremely difficult to ascertain what could be summarised under an offering programme since we do not want to be in a worst situation than currently where terms and conditions of products will have to be summarised (and translated) in the investors' language. This will involve an incredible time consuming and expensive exercise which is currently not done (even for the case of retail investors). An offering programme may include up to 20 different products, each with different terms and conditions.

We would agree however to translate the final terms of the issue since those can be produced in a standardised form and are the main information on which the investor will decide to buy a derivative product.