EUROPEAN SAVINGS BANKS GROUP
GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
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European Savings Banks Group (ESBG)

Response to the Consultation Paper on CESR's Advice on Level 2 Implementing Measures for the Prospectus Directive

Consultation Paper of June 2003
(Ref. CESR/03-162)

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Profile European Savings Banks Group

The European Savings Banks Group (ESBG) represents 25 members from 25 countries (EU countries, Norway, Iceland, Bulgaria, Czech Republic, Hungary, Latvia, Malta, Poland, Romania, Slovak Republic) representing over 1000 individual savings banks with around 66,500 branches and nearly 770,000 employees. At the start of 2002, total assets reached almost EUR 4160 billion, non-bank deposits were standing at over EUR 2012 billion and non-bank loans at just under EUR 2095 billion. Its members are retail banks that generally have a significant share in their national domestic banking markets and enjoy a common customer oriented savings banks tradition, acting in a socially responsible manner. Their market focus includes amongst others individuals, households, SMEs and local authorities.

Founded in 1963, the ESBG has established a reputation as the advocate of savings banks interests and an active promoter of business cooperation in Europe. Since 1994, the ESBG operates together with the World Savings Banks Institute (WSBI, with 109 member banks from 92 countries) under a common structure in Brussels.

1. DERIVATIVE SECURITIES (SECTION III.1)

1.1 General Remarks

In general, the ESBG welcomes that in its September package, CESR strives to increase the flexibility of its proposals, taking into account the need for a practical regulation which does not neglect investor protection.

The ESBG believes however that this flexible approach was not followed when defining the requirements for interim financial information for some particular types of issuers of derivative securities. The ESBG disagrees in particular with CESR's approach to require interim financial information in cases where the issuer does not have to draw up interim financial statements according to the forthcoming Transparency Directive or any other European legislation, i.e. where the issued derivative security is subject to a (regional) public offer only but not admitted to trading on a regulated market.

In this context, the ESBG believes that the "anticipation" made by CESR under section n° 46 is not valid: None of the Commission's consultation papers on the review of capital requirements for banks and investments firms has provided for an obligation for all banks to produce interim financial statements so far. Instead, pursuant to Articles 139 and 136 of the *Third Consultation Paper on the Review of Capital Requirements for Banks and Investment Firms of 1 July 2003*, competent authorities shall require banks to disclose detailed financial information on an *annual basis* (as set out in Annex L2 of the aforementioned consultation paper). Only for international banks acting on a cross-border basis, a more frequent disclosure is recommended (Article 139, paragraph 2, Annex L 1 paragraph 4). It is therefore not justified to *"anticipate banks will be required to make public such interim financial information even where its securities are not admitted to trading on a regulated market"* (n° 46). If such a far-reaching and cost-sensitive new obligation were to be implemented in the Prospectus Directive, this decision should have been taken at Level 1 of the Directive. This has not been the case; as such, the ESBG believes that the definition of such an obligation falls outside the scope of CESR's responsibilities.

In addition, the ESBG does not see a practical need for the disclosure of interim financial statements concerning the issuer of derivative securities from the point of view of an investor in derivative securities. It should indeed be borne in mind that the investor in derivative securities, just as the investor in debt securities, is only interested in information relating to the issuer's ability to fulfil its obligations under the security. If this ability is affected by any event occurring after the date of the latest annual financial statement, it has to be disclosed under the "risk factors" section.

For these reasons, the ESBG does not see a need to additionally provide the investor with interim financial statements, unless such information has to be prepared by the issuer for other reasons (e.g. requirements under the Transparency Directive) and therefore is easily available

for the issuer. This is however specifically not the case for issuers of securities offered publicly to trading but not listed on a regulated market.

As a conclusion, the ESBG believes that there is a danger that small and medium sized banks be driven out of the bonds and derivative securities markets because of the high costs implied by the disclosure of interim financial statements, with no real benefit for the investor.

1.2. Answers to CESR´s questions

32. Do you consider that this disclosure is relevant for these products? Please give your reasons.

A disclosure about the issuer's principal activities is not relevant to investors in derivative securities. Unlike an equity investor, the investor in derivative securities is not interested in the issuer's business but in the issued product, the performance of which is generally not influenced by the issuer's principal activities.

34. Do you consider that disclosure about the principal markets in which the issuer operates is relevant for these products? Please give your reasons.

No. See our answer to question 32.

36. Do you consider that disclosure about an issuer's significant business developments is relevant for these products? Please give your reasons.

No. See our answer to question 32. In addition to that, it should be noted that if any significant business development results in a risk that may affect the issuer's ability to fulfil its obligation under the security it has already to be disclosed under the "risk factors" section (paragraph 4 of the relevant Registration Document).

37. Do you consider that this disclosure is relevant for these products? Please give your reasons.

Since in many Member States the members of the administrative, management and supervisory bodies do not have to inform the issuer of conflicts of interest, such disclosure should be confined to the "best of the issuer's knowledge".

39. Do you consider that disclosure about an issuer's major shareholders is relevant for these products? Please give your reasons.

No. The ESBG believes that when making an investment decision about derivative securities, the issuer's major shareholders or other features of Corporate Governance are not relevant, as long as this information does not directly affect the issuer's ability to fulfil its obligations

under the security. If so, the fact has already to be disclosed under the "risk factors" section (paragraph 4 of the relevant Registration Document).

59. *Do you agree with CESR's revised approach in relation to retail non-equity securities and wholesale non-equity securities? If not please give your reasons.*

We only partly agree with CESR's revised approach:

Concerning the question of the inclusion of a definition of derivative securities, the ESBG has doubts if such a definition is really redundant, as suggested by CESR through its proposal not to define derivative securities (section n° 22). CESR's "everything else box"-approach assumes that a differentiation between debt and derivative securities can be based on whether the security repays 100% of the capital or not.

The ESBG does not believe that this is the case. On the one hand, there are cases where even if an investor is guaranteed a repayment of 100% of his capital (denomination or nominal amount?), the security is structured in such a complex way (e.g. by linking the non-guaranteed amount to one or more underlyings) that it demands specific information provided only under *Derivatives SN* (Annex). On the other hand, *subordinated bonds* with no derivative feature at all might qualify as derivatives simply because the investor runs the risk not to get all his money paid back.

For these reasons, the ESBG recommends to further elaborate on a proper definition of derivative securities based on the proposal the ESBG already made in its response to the consultation paper of October 2002, sent to CESR on 31 December 2002:

> "*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 to a recognized inter-bank interest rate.*"

The ESBG does however agree with CESR's proposal in n° 56.

61. *Do you agree that information about investments should not be required for banks issuing wholesale debt securities? Please give your reasons.*

Yes. Such information is not relevant for the investor.

64. *Do you consider that information on investments is relevant for wholesale debt securities? Please give your reasons.*

No. Information on investments is neither relevant for the investor in retail debt nor for the investor in wholesale debt.

75. Do you consider that examples are necessary in order to fulfil the principle that the prospectus must contain a clear and understandable explanation of how an investor's return is calculated and how the instrument works? Please give your reasons.

No. Examples are not necessary. There are other means to explain how the investor's return is calculated and how the instrument works (see below our answer to question n° 76).

76. What other methods (if any) do you consider can be used to provide investors with a clear and understandable explanation of how an investor's return is calculated and how the instrument works? Please give your reasons.

Another method to provide the investor with a clear and understandable explanation of how the return is calculated is the drafting of clear terms and conditions and/or a description of the features of the security in abstract terms in the general section of the prospectus. From an investor's point of view it is much more important to be informed about the risks of the security than seeing best case scenarios (which will hardly ever realise). The risks of the security should be described in the section about the risk factors. Furthermore, it should be borne in mind that when a bank sells a derivative to an investor it has to inform him about the risks and the functioning of such type of security already under the conduct of business rules (Investment Services Directive). Thus, the prospectus is not the only source of information for the investor.

77. If you do not consider that examples are necessary to provide investors with a clear and understandable explanation of how an investor's return is calculated and how the instrument works, do you consider that the provision of examples in the prospectus is useful for investors? Please give your reasons.

Yes, examples might be useful for investors in particular cases. However, they may also be dangerous for the investor if the investor relies exclusively on the examples and on the figures used by the issuer. The use of examples should therefore not be mandatory but left to the issuer’s due discretion.

78. Do you consider that the use of examples in the prospectus is dangerous and misleading and should not be mandatory? Please give your reasons.

The use of examples in the prospectus may be misleading. Since they do not even have the function of a forecast, the examples given will hardly ever reflect the actual return. Still, investors tend to believe in the examples especially if the result shown in the example is a profit. For this reason, examples should not be mandatory.

79. If examples are to be included in the prospectus, do you consider that CESR should stipulate how the examples should be prepared, for example that they should be realistic, not misleading and should provide a neutral view of how the instrument works?

No. It should be left to the issuer's due discretion to decide how to prepare the examples. A potential prospectus liability is a sufficient incentive to do it in a proper form.

81. Do you consider that examples should be provided for derivatives? Please give your reasons.

No. See answer to question n° 75.

83. Are there any other type of securities for which you consider examples should be provided, for example structured debt instruments that have a derivative component?

No. See answer to question n° 75.

89. Which of the above options do you consider should be adopted by CESR (1, 2 or 3)? Please state your reasons.

Option n°1 should be adopted: no past performance and no volatility should be required, for the reasons given in section n° 85.a).

The ESBG also believes that most of the arguments in favour of the inclusion of past performance as set forth in n° 85.b) are not correct. Since the description of the past performance only relates to the past and not to the future, it does not help to understand the product and to assess its risk. For example, warrants issued in 2000 on listed shares had very often an extraordinarily good past performance. One or two years later though, it was extremely poor. If in such a case the issuer had to produce the past performance, it would have completely misled the investor and would not have helped him to assess the real risk.

Finally, also the pricing made by the issuer is not based on the past performance of the underlying and therefore is no argument in favour of the inclusion of past performance.

2. BASE PROSPECTUS (SECTION III.2)

101. Do you agree with this generic rule?

The ESBG fully agrees with the rule set out in n° 99.a). However, the ESBG has some problems with CESR's proposal in n° 99.b). Setting out line item numbers in a base prospectus may confuse an investor. Any information which cannot be given at the time of the publication of the base prospectus because it will be determined only at the time of the individual issue should be marked for example with a bold bullet point, so that the investor can easily identify any missing item.

112. Which of these two approaches do you think should be applied to base prospectuses? Please give your reasons.

The ESBG firmly supports the approach set out in n° 110. Article 19 of the Directive states that only the summary may be required to be translated. As the final terms do not form part of the summary, the final terms are not subject to a mandatory translation. Furthermore, the ESBG has serious doubts regarding whether the approach taken in n° 111 is really practicable.

115. Which of these views do you consider should apply to base prospectuses with multiple products? Please give your reasons.

It should be left to the issuer to decide how to comply with the general requirement of the content of a summary. However, CESR should clarify that a limitation to 2,500 words applies only with regard to each product such that a summary covering for example three products would be allowed to contain up to 7,500 words.

122. Which of these views do you consider should apply to the form of final terms? Please give your reasons.

If the issuer does not want to limit the final terms to the parts which had previously been left blank, the issuer should only be free to replicate in the final terms either the whole base prospectus, the whole securities note or the entire Terms and Conditions. Giving the issuer the right to decide arbitrarily that other parts of the base prospectus may be replicated would indeed create the risk of misleading investors.

125. In relation to the publication of the final terms, should the method of publication be restricted as set out in Article 14?

The method of publication could be restricted to the methods set out in Article 14, provided that the issuer may decide which of those methods to use.

127. Do you agree with this analysis?

Yes.

131. Do you agree with the above additional disclosure requirements in relation to base prospectuses?

We agree that information regarding how the final terms will be published should be given (see n° 130.1.). Any other information is not necessary. Regarding the requirement of the identification of line items, see our answer to question n° 101 above. Furthermore, a general description of the programme is not necessary if the only missing information is visibly marked (e.g. with a bold bullet point).

132. Are there any other disclosure requirements that are not specified above that you consider necessary for base prospectuses? If so, please specify what these are and give your reasons for why you think they are necessary.

No.

136. Do you agree with the above types of base prospectuses?

Yes, however the ESBG believes that this approach is still not sufficiently developed. The approach may make sense for such cases where issuers choose to use a base prospectus as single document - which presumably will be only in exceptional cases. Problems arise when the issuer makes use of the base prospectus as tripartite document and uses the Banks RD as registration document. Why should that investor not be allowed to combine this RD with different types of Securities Notes (e.g. for retail debt and derivative securities)? The ESBG understands n° 135 in a way that in such a case the issuer has to draw up two separate but identical Banks RD´s - one for the debt securities and the other for the derivative securities. In our view, this does not make much sense. Therefore, we recommend that issuers should be free to use the Banks RD for a base prospectus in the same way as for a "normal" prospectus, i.e. combine it with a SN for debt securities as well as with a SN for derivative securities subject to the provisions in the Road Map.

137. Are there any other types of base prospectuses that you consider are necessary? Please give your reasons.

No. See also our answer to the question above.

3. WHOLESALE DEBT SN (SECTION III.3)

143. Do you agree with this approach?

Yes.

144. Do you consider that the information provided for in Annex F is adequate for wholesale investors? Please give your reasons.

The information provided for in Annex F is adequate for wholesale investors except for the requirement of information on investments when the issuer is a bank (see our answer to question n° 61).

145. Are there any other items included in the retail debt SN that should be included for wholesale investors? Please give your reasons.

No. Wholesale investors need less extensive disclosures than retail investors due to their greater knowledge and experience.

4. SN BUILDING BLOCK ON UNDERLYING FOR EQUITY SECURITIES (SECTION III.5)

No comments.

5. FORMAT OF THE PROSPECTUS (SECTION IV)

172. Which of the options set out above do you support? Please give your reasons for your choice.

We do not support any of the options specifically. The reasons given for any of the options sound acceptable.

176. Which of the options set out above do you support? Please give your reasons for your choice.

No specific order should be set. If one however has to decide in favour of one option, the ESBG would prefer the second one (n° 176), as it reflects the common market standard in many Member States.

182. Which of the options set out above do you support? Please give your reasons for your choice.

The ESBG prefers the approach of integrating the new information into the original summary because this is easier for the investor to read and it is not too cumbersome for the issuer to produce.

6. ANNUAL INFORMATION (SECTION VI)

237. Do you agree with the method of publication proposed?

Yes.

238. Do you consider CESR should limit the issuer's choice to one or more methods of publication? Which ones?

No.

239. *Do you consider that a deadline should be defined? If so, do you agree with the proposed deadline or would you suggest a different one? Please give reasons for your answer.*

The ESBG is of the opinion that the proposed deadline of seven business days is too short. A somewhat longer deadline would be more appropriate.