
**INTERNATIONAL PRIMARY MARKET
ASSOCIATION**

**Response to CESR's Feedback Statements and
Draft Technical Advice on Level 2 Implementing
Measures for the Proposed Prospectus Directive
dated April 2003 and May 2003**

The International Primary Market Association is the organisation which represents the managers and lead managers of debt and equity securities in the international capital market. A list of IPMA members may be found on its website at www.ipma.org.uk

Date: 16 June 2003

INTRODUCTION

We welcome the publication by CESR of the Feedback Statements dated April 2003 and May 2003 together with the draft technical advice on level 2 implementing measures for the Prospectus Directive of the same dates. We appreciate that CESR has taken on board many of the comments received in response to its previous consultation papers, including comments made by IPMA. We continue, however, to have very real concerns in relation to some of the proposed disclosure requirements. These concerns reflect the views of our members which include many banks and other financial institutions. Several of the institutions we represent have shared concerns with us from their perspective as issuers and investors in their own right.

Many of the issues raised in this paper have been raised in our previous responses. In view of their importance, we have set out our main concerns again here. Where we have previously addressed these issues, we have cross-referred you to the relevant section of our previous response and included the relevant extract in the schedule to this response. We hope that these comments will be helpful in enabling CESR to continue to develop proposals to support the aims of the Prospectus Directive in an appropriate manner and in light of existing market practices.

We have seen the consultation paper CESR/03-170 dated 12th June, but have not yet had time to review it. We apologise if the new document provides answers to any of our questions/comments raised here.

COMMENTS ON APRIL 2003 FEEDBACK PAPER

Non-EU Issuers

Many of the proposed disclosure requirements will act as a significant deterrent to non-EU issuers seeking admission to EU regulated markets. We refer you to Part 1, section 1 of our response to your second consultation paper which sets out some of the proposed disclosure requirements which would make it much more expensive and difficult for many third country issuers to access the EU securities market. The consequences of excluding non-EU issuers will be far-reaching. It will lead to a shrinking of the EU securities market as non-EU issuers go elsewhere to issue securities. This will increase the cost of raising capital within the EU which could have a serious impact upon the EU economy and could damage the EU's competitive position in the global economy. Furthermore, European investors that wish to invest in non-EU issues will be forced to rely on the disclosure standards of less regulated markets outside the EU.

We would highlight, in particular, the following requirements which we believe it is essential to address:-

“True and Fair” View

The requirement that accounts be drawn up to a “true and fair” view standard or an “equivalent” standard will be prejudicial to third country issuers. A restatement of the accounts or a reconciliation exercise would, if required, be very costly indeed for issuers. We have been informed that the cost for one major European bank to restate

its accounts to US GAAP, perhaps a comparable exercise, was EUR 140 million. This figure may be at the highest end of the scale, and may include items such as internal time spent. We are nevertheless advised by accountants that their fees alone for a major international financial services organisation could amount to tens of millions of dollars or euro. Clearly, there would be a spectrum depending on the size and accounting complexity of the issuer. The present uncertainty which surrounds this issue is of great concern to many non-EU issuers. It is of vital importance that clear guidance is issued by CESR on the interpretation of this requirement and that market participants are given the opportunity to comment on any such guidance. Consultations on the April/May advice should not be closed until the guidance and proposed Annex is forthcoming.

We would encourage you to consider adopting an approach that differentiates the solution to this question by reference to issue type. For example, an issuer of equity securities could be required to provide a reconciliation from their local GAAP to the IAS standard required in the EU whereas an issuer of wholesale debt securities should only, at the very most, be required to provide a narrative description of GAAP differences (clearly, this would go beyond the present practice and as such is thought to be unnecessary in the wholesale debt market). We would be pleased to work with you in the drafting of such an Annex. In the light of the relevance of this issue from an international perspective, we would also encourage you to pursue an international direction of mutual acceptance.

Audit Standards

The proposals continue to require that the audit be carried out in accordance with “a comprehensive body of auditing standards”. There is a danger that this proposal will be read by some in conjunction with Part IX of Annex I and Part VII of Annex II to the Directive which specifies “international auditing standards”. Many non-EU issuers do not audit to such a standard. Redoing the audit would be prohibitively expensive and may not be possible for practical reasons. This needs to be addressed by CESR in its proposals.

Transitional Measures

Measures should be introduced to cover the treatment of non-IAS accounts on a transitional basis. It is not clear at present how this issue will be dealt with and guidance should be published for consultation. Clearly, this will be of critical importance also to many EU issuers who will not have the requisite number of years of accounts audited to IAS standards/principles.

What is IAS?

This point is applicable to all issuers under the new proposals. As you are aware, there is much talk about IAS being adopted in the European Union and/or by individual countries both within the European Union and outside on a modified (to a non-material extent) basis. It should be clear in the proposals that references to IAS accounting principles and standards etc apply to the whole range of IAS principles/standards as adopted.

Information on the taxes to be paid by investors

This language is unclear. It cannot be too strongly stressed that neither an issuer nor its underwriters are in a position to provide investors with comprehensive tax advice,

for instance, income tax advice. Such advice will always depend on the specific position of the investor as to which the issuer and underwriters neither have nor can have the relevant information. It would be reasonable to make a limited statement relating to, say, any withholding by the issuer and stamp duty in the jurisdiction of the issuer. Any gross up and/or call will, of course, be in the terms and conditions. Assuming that the limited statement is the type envisaged, we suggest the language in the last sentence of Annex C 4.11 be clarified. If required, we would be happy to provide drafting on this point.

Risk Factors

“Risk factors” are by their nature a summary “conclusion” of some aspects of the more general description of the business and need to be seen in that light. The disclosure of risk factors should be made as part of the summary which would (under the Directive) be exempt from civil liability. This would also have the advantage that the risk factors would be subject to the translation requirements which would be clearly beneficial to investors. We note in support of the view that risk factors should be included in the summary is that risk factors are currently included in the list of items which should be considered in the preparation of the summary of the prospectus as set out in Annex IV of the proposed Directive. For further detail, we refer you to our previous comments in Part 1, section 9 of our response to your second consultation paper.

Pro Forma Financial Information

Requirement that information must be prepared with a manner consistent with the accounting policies adopted by the issuer

Paragraph 4 of Annex B requires that the pro forma be prepared with a manner consistent with the accounting policies adopted by the issuer. Provision should be made for the case where the accounting policies of the issuer are changing or being added to as a result of the transaction. We would suggest the following amendment:

“The pro forma information must be prepared with a manner consistent with the accounting policies adopted by the issuer in its financial statements or to be adopted as a result of the significant transaction...”

Requirement that adjustments are directly attributable to the transaction

The requirement in paragraph 6(b) of Annex B that any pro forma adjustments must be directly attributable to the transaction is too limited. There may be circumstances where adjustments are required for other reasons in order to present the financial information fairly and this flexibility should be built into the proposals. We would suggest the following amendment:

“Pro forma adjustments related to the pro forma financial information must be ...

(b) directly attributable to the transaction (or necessary to ensure that the presentation of the pro forma financial information is in accordance with the requirements of Article 5 of the Directive)”.

Issuers required to produce pro forma accounts on a different basis

Provision should also be made for issuers who are required to produce pro forma accounts on a different basis to that set out in Annex B.

Definition of “Significant Gross Change”

Pro forma financial information is required to be produced where there is a “significant gross change”. A definition of what constitutes a significant gross change should be included in the Annex. This should be in line with the definition suggested

by CESR in its feedback statement and its previous papers.

Period covered by the pro forma accounts

Paragraph 5 of Annex B clearly states that pro forma information may only be published for the current or most recent financial period. However, paragraph 20.2 of Annex A requires a description of the effect of the change on the assumption that “the transactions had been undertaken at the commencement *of the period being reported on*”. Under paragraph 20.1 of Annex A, the period being reported on is the latest 3 financial years. There appears, therefore, to be an inconsistency in the requirements.

Deletion of Blanket Clause

We note that you have dropped the proposal to include a ‘blanket clause’ and are relying instead on the provisions of the Directive. We see that this point has been addressed in the June 12th consultation to which we will respond in detail. We believe that it is very important to make clear at Level 2 that information which is not applicable to a particular issuer or issue should not be required to be disclosed in the prospectus.

Securitised Issues

The disclosure requirements for securitised issues should cover the full range of securitised issues. The present proposals appear to be aimed at mortgage-backed issues only and are not appropriate to the wide variety of other types of asset-backed issues both as to the underlying assets and to structure. For further detail, we refer you to Part 1, section 7 of our response to your second consultation paper. The securitisation market is large, thriving and very important to EU companies and must be accommodated. This is not a core activity for IPMA and there are other associations, for instance, the Bond Market Association, who may comment in more detail; nevertheless we do urge you to take steps to devise a structure that will work for securitisations. Again, if this is dealt with in the June 12th consultation, we apologise.

Guaranteed Issues

Where an issue is guaranteed, the focus of the disclosure requirement should generally be on the guarantor and not the issuer, and there should be correspondingly reduced disclosure requirements in relation to the issuer of the security itself. Discretion should be given to the home competent authority to decide which elements of the disclosure regime should apply to which party. Contrary to the view set out in paragraph 164 of the CESR Feedback Statement dated April 2003, this is in accordance with current market practice and is supported by the approach taken in the listing rules of several European stock exchanges including London and Luxembourg. We would ask CESR to reconsider its position on this point. We would suggest a general rule along the lines that the information required on the issuer should be very limited where full information is given on the guarantor.

Application of the Building Blocks

Where a particular issue or instrument does not fall within a building block, it would be helpful if CESR made clear that the building block most appropriate to the issuer or instrument should be used. We are concerned that some competent authorities may take the view that if there is no clear building block a particular issue or instrument cannot therefore be listed. If this is dealt with in the June 12th consultation, we apologise.

ISIN Number of Securities

Given that it is typical to disclose the ISIN number (or other generally recognised securities identification number) of the securities being issued or the underlying securities in the case of depository receipts or any other reference securities, we would suggest that disclosure of the number should be required (and is probably generally most appropriate in the Securities Note). The ISIN or other number is useful information for potential investors as it is the clearest method of identification of the relevant securities. In the case of an asset-backed issue where the underlying is a basket of securities, the numbers may be particularly helpful.

Disclosure of ratings

We do not agree that issuers should be *required* to disclose ratings. The rating is given to an issuer or to an issue by a third party over whose professional judgment or methods the issuer has no control, even where it has sponsored the rating. Sometimes the issuer is not involved at all. There is generally no obligation on an issuer to maintain a rating even when it has been involved yet, if the information is to be included in the prospectus, the issuer will have a responsibility for it to investors. There is no requirement to include references to analyst's views (rightly so); so why should rating agencies be treated differently?

Some time ago IPMA had extensive discussions on whether ratings should be shown on offering programmes. We then issued a Recommendation saying that they should not. One major consideration was that ratings can apply on a product by product basis, and the securities actually being issued might be either differently rated or not rated at all. Indeed, in an offering programme the securities for which a rating is shown might actually be those of a different issuer. To show a rating that was so irrelevant or of such limited application might be misleading to investors.

As a practical point, in the context of an offering programme, where a rating has become out of date, it would not be feasible mechanically for an issuer to update the programme (and seek approval for the updated document) to reflect all changes in all the ratings of all its securities. This would create a series of blackout periods for the issuer; at the same time, unless the rating was directly relevant to the securities being issued, there would be no benefit to investors.

Finally, to include information explaining the meaning of ratings would be to increase its length significantly.

COMMENTS ON MAY 2003 FEEDBACK PAPER

Annex 1 – Minimum Disclosure Requirements for the Wholesale Debt Registration Document

The current proposals appear to interpret the Directive as only requiring separate wholesale treatment in the context of pure debt securities. The Directive, however, distinguishes between equity and non-equity securities. It is not only debt securities that have denominations. Derivative securities and global depository receipts, for example, may also meet the threshold requirement. Recommendations should therefore be made in relation to the wholesale treatment of all non-equity securities, not just pure debt. For further detail, we refer you to our previous comments in Part 1, section 2.1 of our response to your second consultation paper.

Annex 2 – Minimum Disclosure Requirements for the Depository Receipts issued over shares

Depository Receipts are non-equity securities for the purposes of the Directive. As such, the wholesale disclosure regime anticipated by Article 7(1)(b) of the Directive should be applied to them whenever the minimum denomination of the Depository Receipt is €50,000. This needs to be built into the proposals. In general terms, wholesale depository receipts should be subject to reduced disclosure requirements. For further detail, we refer you to our previous comments in Part 1, section 10 of our response to your second consultation paper.

Annex 3 – Minimum Disclosure Requirements for the Banks Registration Document

Cases where the principal business of the group is a bank

Where the relevant issuer is a subsidiary or holding company of a bank but not itself a bank, we believe that the same specialist treatment should apply to such an issuer. It would be helpful, therefore, if it was made clear that the Banks Registration Document also applied to an issuer where the principal business of its group is a bank.

Cases where a bank is issuing equities

We understand that when a bank is issuing equities, it will be required to disclose information based on the core equity building block. The requirements of the core equity building block will, however, need to be modified to cater for banks as opposed to corporates. For example, the requirements as to indebtedness, working capital and contingent liabilities would need to be modified. Contingent liabilities are a particular problem for banks because they form a significant part of their day-to-day business (for example in issuing cheque guarantees) and therefore vary on a daily (in fact minute by minute) basis. In this regard, we refer you to our previous comments in response to question 43 in your second consultation paper.

Other regulated entities

The special treatment given to banks should also extend to other regulated entities such as insurance companies. Regulated entities are similarly under close regulatory control and prudential supervision. The appropriate information about them would be more similar to that for banks than that for a base case corporate issuer. Not to recognise this would be effectively to distort the competitive position between banks and other regulated entities operating in the same markets.

Specialist Building Blocks

We welcome the decision to withdraw advice in relation to specific industries, such as shipping (paragraph 72 of the May Feedback Statement). However, we are concerned by the language proposed to replace it in paragraph 11 of the May Advice. We believe that this will create considerable uncertainty in the minds of prospective issuers. The advice contemplates a valuation report for *any* issuer where someone (the home state competent authority?) believes that its activities are such that the accounts do not give enough information on its value. This could catch, for example, a railway operator,

which has substantial holdings of land that could have a redevelopment value. Indeed, most companies that account on the basis of the historic cost convention will have assets on their balance sheet that do not reflect current market value. The rules should not operate in such an arbitrary manner. We encourage you to provide guidance on the normal situation where non-financial information would be expected to be provided in order to minimise the risk of inconsistent application of the provision.

COMMENTS ON THE ANNEXES TO THE TECHNICAL ADVICE

Comments which apply to all Annexes

- (a) The requirement to disclose the persons responsible for the registration document (see, for example, Annex A, paragraph 1.1) should be amended to make clear that it is either personal liability or the liability of legal persons at the choice of the issuer. Although we appreciate that it is a question for the competent authority, the Level 2 rules should permit maximum flexibility and should not override the competent authority's discretion. We would suggest therefore that the following amendment should be made:

“Names and functions of natural persons and/or of members’ of the issuer’s administrative, management or supervisory bodies and/or the name and registered office of persons responsible for the registration document and, as the case may be, for certain parts of it, with, in the latter case, an indication of such parts.”

- (b) We would suggest the following amendment to the requirement to disclose risk factors (see, for example, Annex A, paragraph 4):

“Prominent disclosure of risk factors that are specific to the issuer or its industry, which make the offering unusually speculative or high risk, in a section headed ‘Risk Factors’”.

- (c) The requirement to disclose the important events in the development of an issuer’s business (see, for example, Annex A, paragraph 5.1.5) should be limited to its present business. We would suggest the following amendment:

“The important events in the development of the issuer’s present business”.

- (d) The requirement to disclose details of investments (see, for example, Annex A, paragraph 5.2.1 and 5.2.2) should be amended to make clear that only investments which are material to the business or issuer as a whole need to be disclosed. Furthermore, in the case of investments which are currently in progress (see, for example, Annex A, paragraph 5.2.2), this should be limited to those investments on which firm commitments have been made (this is consistent with the approach taken elsewhere in the drafting). We would suggest the following amendments:

“A description (including the amount) of the issuer’s principal investments to the extent that they are material to the issuer or its business for each financial year for the period covered by the historical financial information up to the date of the registration document.

A description of the issuer’s principal investments that are currently in progress to the extent that they are material to the issuer or its business and on which its management bodies have already made firm commitments, including the distribution of these investments geographically (home and abroad) and the method of financing (internal or external).”

- (e) We would suggest the following drafting amendment to the section on Profit Forecasts and Estimates (see, for example, Annex A, paragraph 13.a):

“A profit forecast which is defined as a form of words which expressly states, or by clear and necessary implication indicates, a figure or a minimum or maximum figure for the likely level of profits or losses for the current financial period and/or financial periods subsequent to that, or contains data from which a calculation of such a figure for future profits or losses may be made, even if no particular figure is mentioned and the word ‘profit’ is not used.”

- (f) The requirement to disclose information on major shareholders (see, for example, Annex A, paragraph 18.3) needs to be limited in some way or else it will apply to all shareholders. We would suggest the following amendment:

“To the extent known to the issuer, state whether the issuer is directly or indirectly, owned or controlled to a material extent by a single shareholder (or a related group of shareholders) and by whom and describe the nature of such control and *describe the measures in place to ensure that such control is not abused.*”

In addition, we would suggest that the meaning of last phrase should be clarified as its meaning is not clear to us.

- (g) The references to “Memorandum and Articles of Association” in various places (see, for example, Annex A, paragraph 21.2) should be amended to “Constitutional Documents” to capture other types of constitutional documents.
- (h) We would suggest the following drafting amendment to the section on Documents on Display (see, for example, Annex A, paragraph 24) to ensure that the requirement to indicate where the documents may be inspected is limited to those documents which are required to be displayed:

“An indication of where the aforesaid documents ~~concerning the issuer which are referred to in the registration document~~ may be inspected, by physical or electronic means”.

- (i) The breakdown between permanent and temporary employees is not relevant to investors (see, for example, Annex A, paragraph 17.1).

COMMENTS ON PARTICULAR ANNEXES

Annex A (Equity Registration Document)

- (j) Paragraph 20.1 (d) of Annex A appears to mandate a “cash flow” statement. The Transparency Obligations Directive does not require such cash flow statements and many EU issuers would be unable to comply with this requirement at present (as has been noted Mr Tiedje of the Commission).
- (k) The requirements of paragraph 20.7.1 of Annex A should be clarified. It is not clear to us whether paragraph 20.7.1 means that there can be no incorporation by reference. Furthermore, it is not clear to us whether both the quarterly and 6-monthly statements should be included. Clearly, the 6-monthly statements will include the statements for the first quarter. Similarly, the position if third quarter numbers are available is not clear. We would ask for clarification on all these matters.

Annex C (Equity Securities Note)

- (l) We are not convinced that the requirements of paragraph 3.3 are practical as drafted. For instance, underwriters may also be investors in their own right or may act on behalf of investors. We would question whether this would constitute a conflict for the purposes of paragraph 3.3. Also, a guarantor will necessarily have different interests from that of its beneficiary (for instance, an insurance company credit provider might refuse to pay a claim even though the issuer might prefer it to do so). And in many third country jurisdictions conflicts of interest are differently interpreted and difficult to identify.
- (m) Paragraph 4.4: You cannot have an “indication” of a currency.
- (n) The requirement in paragraph 4.7 should be amended to reflect the fact that the issue date of the securities may change. We would suggest the following amendment:

“In the case of new issues, the expected issue date of the securities.”
- (o) The requirements in paragraph 5.2.3 appear to assume that all equity offers are public offers of retail securities. This is not always the case.
- (p) In paragraph 5.4.2 we find the reference to “each country” confusing and suggest that it should be deleted. Furthermore, the reference to depositaries should be deleted as the depositaries are outside the control, or even the knowledge, of the issuer.

- (q) The whole of paragraph 6.5 – 6.5.4 has to do with stabilisation disclosure. This should be dealt with under the Market Abuse Directive. Indeed, Article 8 of the draft Regulation under that Directive already contains detailed disclosure requirements.
- (r) In relation to paragraph 10.2, we would note that auditors produce a number of different documents in relation to an issuer. It should be made clear which particular documents are intended to be covered by this requirement.

Annex D (Debt Registration Document)

- (s) There should be a materiality test in paragraph 5.1.5. We would suggest the following:

“Any recent events particular to the issuer and which are relevant, to a material extent, to the evaluation of the issuer’s solvency”.
- (t) The requirement in paragraph 5.2 to disclose information on a company’s investments should be deleted. There may be circumstances where this is material information in which case the general duty of disclosure in article 5 of the Directive will drive disclosure. There should not be a requirement to disclose such information in all cases.
- (u) Paragraph 11.2: Although superficially this requirement seems reasonable, there may be large numbers of very lengthy codes which may apply to issuers and which are not compulsory, so that to set them out in full with an explanation may not actually help investors. In addition, while the “comply or explain why not” approach has worked well in the UK, it may not work so well in other jurisdictions.
- (v) Paragraph 13.1: Our comment on Annex A, paragraph 20.1 applies equally here.
- (w) What is the purpose of paragraph 14? Investors in debt securities do not have rights of shareholders, so the contents of the Memorandum and Articles of the company are of little or no interest to them. Equally, it is of very little relevance to them whether the company has different classes of share capital or what the characteristics of the shares are. If the corporate structure is so exceptional that it is relevant, then disclosure will be driven by the overriding duty to disclose.
- (x) We would request clarification of the requirements of paragraph 17(c). Is this intended to mean that an issuer must have 2 years financial accounts in order to file a Registration Statement? If so, what would happen with SPVs?

Annex E (Debt Securities Note)

- (y) Paragraph 14.6: It would not be practicable to set out all the standard terms and conditions for fixing LIBOR, PIBOR and the multitude of other rate types. This would be a particular issue in the case of an offering programme where it would be necessary to disclose the fullest possible range which would come to hundreds of pages. A reference to the appropriate data source should be sufficient.
- (z) Paragraph 14.9: The yield will be calculable on the date of issuance but will never be “indicative”. This requirement should be amended.
- (aa) Paragraph 14.10: We would note that in the case of international debt, it is rare for there to be an organisation representing investors.
- (bb) The requirements of paragraph 15.1 assume a public offer carried out in equity style. This is not often the case.
- (cc) Paragraph 16.2: “Regulated market” is defined. As such, we do not understand how it can have an ‘equivalent’. We would ask for clarification on this point.

Annex 1 (Wholesale Debt Registration Document)

- (dd) Paragraph 4.1.5: Please see our comment on paragraph 5.1.5 of Annex D which applies equally here.
- (ee) Paragraph 4.2: Please see our comment on paragraph 5.2 of Annex D which applies equally here.
- (ff) Various other comments on the April annexes apply equally to equivalent provisions in this annex.
- (gg) Paragraph 11.6: The version of December 2002 was better than this current version. Paragraph VII.I of the December version limited disclosure to litigation that could have a “significant effect on the issuer’s ability to meet its obligations under the proposed issue of debt securities”. We believe this to be the proper test.

Annex 2 (Depository Receipts over shares)

- (hh) The requirements of this Annex assume that the issuer is involved which is not often the case. Furthermore, as presently drafted, this annex assumes a public offer with public offer equity style allotment which, again, is not often the case.

SCHEDULE 1

Extracts from the IPMA response to the addendum to the consultation request made by CESR on 19th December 2002 on possible implementing measures on the proposed prospectus directive (the “second consultation paper”) dated 6th February 2003

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1. COMMENTS ON APRIL 2003 FEEDBACK PAPER

NON-EU ISSUERS

NON-EU ISSUERS MUST NOT BE PREVENTED FROM USING THE EU'S CAPITAL MARKETS

Importance of non-EU issuers to the EU securities market

1.1 Non-EU issuers play a vital role in the economy of Europe. Taking the automobile sector as an example, regular non-EU issuers such as Toyota, Nissan, General Motors and Ford are significant contributors to the EU economy. Recital 33 stresses their importance and provides that in adopting Level 2 legislation the Commission shall “respect... the need to foster the international competitiveness of the Community’s financial markets”. Issues by non-EU issuers accounted for 52% of the global debt securities market as at September 2002.¹

The consequences of excluding non-EU issuers will be far-reaching

1.2 The thrust of CESR’s proposals as they currently stand will make it much more expensive and difficult for many third country issuers to continue to access the EU securities market. This will lead to a shrinking of the EU securities market as non-EU issuers go elsewhere to issue securities. This will increase the cost of raising capital within the EU as the capital market contracts and loses economies of scale and liquidity, which could have a serious and far-reaching impact on the EU economy as a whole and especially the EU labour market, and could damage the EU’s competitive position in the global economy. The aim of benefiting EU investors by imposing a disclosure requirement on issuers at too high a level will end up harming those investors as the economy suffers and those that need to diversify and wish to invest in non-EU issues will be forced to rely on the disclosure standards of less regulated markets outside the EU. This is clearly not consistent with the objective stated at the Lisbon European Council that the EU become the world’s most competitive economy by 2010.

Many of the proposed disclosure requirements will deter non-EU issuers

1.3 Many of the disclosure requirements as proposed will act as a significant deterrent to non-EU issuers seeking admission to EU regulated markets – even in relation to wholesale non-equity securities. We have set out some of these below:

CESR proposal reference	Summary of proposal	Reasons why it deters
Annex 1, paragraph V.B	Management conflicts of interest	Expensive to gather information because non-EU issuers are subject to different legal and regulatory practices and requirements in relation to conflicts of interest.

¹ Source: Bank for International Settlements, Quarterly Review, December 2002.

Annex paragraph V.C	1, Disclosure of corporate governance compliance	These disclosure requirements fail to recognise differences in corporate governance practices. The provisions as to the audit and remuneration committees could be interpreted as imposing a requirement to have such committees (rather than simply disclosing their absence) thus acting as a barrier to admission for issuers that do not have them.
Annex paragraph VI.A	1, Disclosure of major shareholdings	Often local law will not provide for extensive shareholding registration requirements, so it will often be difficult, if not impossible, for non-EU issuers to obtain information as to shareholdings. Limiting the requirement to “the extent known to the issuer” will not help much, because there will be an assumption that the issuer should make reasonable enquiries. Cost of preparing this information will not normally bear any relation to the benefit to investors.
Annex paragraph VI.B	1, Related Party Transactions	In the context of a wholesale non-equity issue, such transactions are only relevant where they deprive the issuer of value to such an extent that its credit basis is affected, which is unusual. Wholesale investors are aware that in many non-EU countries related party transactions are normal. Specific disclosure would normally be unnecessary and costly to make.
Annex paragraph VII.A	1, Format of Financial Statements	Not all non-EU issuers produce all of the items listed here (e.g. a cash flow statement). To require them to do so would add considerably to the expense of admission to EU markets.
Annex paragraph VII.C	1, Audit standards	The proposals require that the audit be carried out in accordance with “a comprehensive body of auditing standards”. This proposal will be read in conjunction with the Annex to the Directive (which specifies IAS for audit). Many non-EU issuers do not audit to this standard – and wholesale investors are well aware of this when they assess investment risk. Redoing the audit would be prohibitively expensive and may not be possible for practical reasons.
Annex paragraph VII.E	1, Requirement that accounts be drawn up to “true and fair” view standard as mandated by EU accounting Directives	This is prejudicial to those countries which do not draw up their accounts in accordance with IAS. The application of this provision will involve difficult questions of interpretation and is unlikely to be useful in practice. Any restatement of the accounts or reconciliation exercise will be very costly for issuers.
Annex paragraphs VIII.A and C	1, Display of material contracts	Many non-EU issuers’ material contracts will be in a language other than that of the Prospectus. If there were a requirement that they would be required to be translated before they are displayed, this would be prohibitively expensive.
Annex paragraph V.B.1	5, Disclosure of directors’ compensation	Does not fit with corporate practices in many non-EU countries. Only useful if investors can affect directors’ compensation packages through their voting power, which is not always the case in non-EU jurisdictions.

		Often an extremely sensitive matter in non-EU states, giving rise to serious security concerns. Not normally relevant to wholesale investors in non-equity securities.
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It should be noted that, while some of these requirements are carried over from the existing Directive (2001/34/EC), they are not typically required for issues of wholesale securities because many competent authorities currently make use of the power of derogation contained in Article 27 of that Directive. Thus it is no argument to say that the new proposals simply adopt the old. Similarly, if there is a material issue in these areas, it would be disclosed under the general duty of disclosure under Article 5 of the proposed Directive.

There is no need for a prescriptive approach particularly in relation to non-EU wholesale issues

1.4 The issue of the treatment of non-EU issuers is particularly relevant in the context of wholesale issues. The wholesale regime in the Directive is intended to provide investors with continuing access to a diverse range of issuers and investments. There is no need to be prescriptive about disclosure requirements in such a market. Investors in wholesale securities need such disclosure as will enable them to make a sufficiently well informed investment decision. They do not need standardised disclosure. For example, it may be that a non-EU issuer's accounts are not prepared on a "true and fair" basis – we understand that this is as true of issuers using US GAAP as of issuers using systems of GAAP current in non-OECD countries. But wholesale investors should be able to buy the securities of such issuers on the EU's markets, provided the accounting basis is properly disclosed. They should be permitted to make their own risk assessments and to take their own risks.

RISK FACTORS

9. THE DISCLOSURE REQUIREMENTS FOR RISK FACTORS SHOULD BE REDUCED

Disclosure of risk factors should not be mandatory

9.1 We continue to be strongly opposed to the inclusion of a mandatory disclosure requirement for risk factors. Risk factors should highlight those important and unusual risks associated with a particular issue and disclosure should be driven by the general disclosure requirement, not by a mandatory risk disclosure requirement. A mandatory disclosure requirement for risk factors will lead to the development of standardised wording for risk factors, which will be of limited use to investors.

There should not be liability for any disclosure of risk factors

9.2 A mandatory requirement to disclose risk factors will also expose issuers to an unduly high risk of litigation. Risk factors are always judged in hindsight. Investors may seek to impose liability on an issuer by arguing that an issuer did not fully disclose all possible risk factors in the risk section. For this reason, we believe that if disclosure of risk factors is mandatory, disclosure should be made as part of the summary which would (under the Directive) be exempt from civil liability. As you will appreciate, “risk factors” are by their nature a summary “conclusion” of some aspects of the more general description of the business and need to be seen in that light. It would be wrong for issuers to be fully liable for risk factors which are by their nature “summaries” and which must be read in the context of the prospectus as a whole. We note in support of this view that risk factors are currently included in the list of items which should be considered in the preparation of the summary of the prospectus as set out in Annex IV to the proposed Directive.

SECURITISED ISSUES

7. THE DISCLOSURE REQUIREMENTS FOR SECURITISED ISSUES MUST BE MORE GENERAL

The securitised market in the EU is important

7.1 The market in securitised issues as a whole across the EU is growing rapidly by volume and by the introduction of new types of securitisation transaction. Last year it increased by 29% to €347bn. There are large markets in the UK (€57bn of activity), Italy (€37bn), and Germany (€30bn, a 105% increase on 2001). There was 42 per cent growth in collateralised debt obligations (CDOs), which are now the biggest securitised sector. The other growth areas were commercial mortgage-backed securities, up by 40 per cent to €29.1bn, and residential mortgage-backed securities, up by 31 per cent to €88bn.² Given its importance and dynamism, it is vital that this market is not stifled by an over-prescriptive approach to prospectus disclosure requirements.

The disclosure requirements should be general

7.2 What is important in relation to asset-backed securities in the majority of cases is disclosure as to the underlying assets (whether present or future) and their originator, the management of the assets on an ongoing basis and the security arrangements, not disclosure as to the issuer. Such issues demonstrate very wide variety, both as to the underlying assets and as to structure. For an analysis of the diversity of the market in securitised issues, see an article by Orazio Mastroeni of the European Central Bank entitled “Pfandbrief-style products in Europe”.³ Accordingly, what is needed in relation to the disclosure requirement for the underlying assets is a very general disclosure requirement which can be adapted in a flexible manner to suit the characteristics of the particular issue. Any more detailed approach will not work for issuers or investors because it is not possible to anticipate what types of asset-backed transactions will develop in the future. We suggest that such requirement be worded as follows:

“The issuer shall provide appropriate disclosure on the underlying assets and their originator. Such disclosure shall be adapted appropriately if the issue is to investors in wholesale securities only.”

Similarly, there needs to be a general disclosure requirement on the management of the assets on an ongoing basis and the security arrangements. Where there is recourse to the issuer, disclosure requirements as to the issuer could be added, as appropriate. Otherwise, there should be no disclosure requirements for information on the issuer.

² Source: Moody’s Investors Services.

³ Bank for International Settlements, Papers No 5 (Quarterly Review, December 2002).

The disclosure requirements should cover the full range of securities issues

7.3 The CESR proposals appear to be aimed at mortgage-backed issues only. They are not appropriate to the wide variety of other types of asset-backed issue such as repackagings or CDOs. The various types of asset-backed securities should be capable of being dealt with under one generally worded “building block”. We are not advocating the introduction of different annexes to cover different types of asset-backed issue.

GUARANTEED ISSUES

11. THE POSITION OF GUARANTEED ISSUES SHOULD BE CLARIFIED

Disclosure on the issuer should be reduced

11.1 This is an important issue because a significant number of issues are guaranteed. Where an issue is guaranteed, the focus of the disclosure requirement should be on the guarantor and not the issuer, and that there should be correspondingly reduced disclosure requirements in relation to the issuer of the security itself.

Disclosure on the guarantor should be determined by the corresponding building block

11.2 Furthermore, the disclosure requirements on the guarantor should be tied to the requirements that would be required of an issuer issuing the type of security which is the subject of the guarantee. For example, if the guarantor were a bank, it would make the disclosure requirements currently required by annex 2 of CESR's proposals.

2. COMMENTS ON MAY 2003 FEEDBACK PAPER

ANNEX 1 – MINIMUM DISCLOSURE REQUIREMENTS FOR THE WHOLESALE DEBT REGISTRATION DOCUMENT

A differentiated wholesale disclosure regime for all non-equity securities is mandatory

2.1 A differentiated disclosure regime for investors in wholesale securities is mandated by the Directive. The Directive distinguishes between equity (basically shares and mandatory convertibles) and non-equity securities (everything else). Recital 33 and Article 7(1)(b) require that account be taken of the different requirements of investors in all non-equity securities having a minimum denomination of €50,000. CESR's proposals appear to interpret the Directive as only requiring separate wholesale treatment in the context of pure debt securities. They do not even extend to convertible bonds, which the Directive specifically states are debt securities (see Recital 11 inserted by Ecofin). It is not only debt securities that have denominations. Derivative securities and global depository receipts may meet the threshold requirement. Recommendations should therefore be made in relation to the wholesale treatment of all non-equity securities, not just pure debt.

ANNEX 2 – MINIMUM DISCLOSURE REQUIREMENTS FOR THE DEPOSITORY RECEIPTS ISSUED OVER SHARES

10. THE DISCLOSURE REQUIREMENTS FOR DEPOSITORY RECEIPTS REQUIRE SOME MODIFICATIONS

Principles of disclosure for DRs

10.1 We agree with CESR's approach set out in paragraph 100 that the disclosure requirements in relation to DRs will generally be in relation to the issuer of the underlying security. There will generally be need for only very limited disclosure as to the issuer of the DR itself because this issuer will usually be a trustee or bank, and to this extent we agree with the disclosure requirements in relation to the issuer of the DR set out at paragraph IX of Annex 5. Furthermore, the issuer of the underlying security is not always involved in the issue of the DR. Where it is not, disclosure as to the issuer of the underlying security should be restricted to publicly available information. It is very important that this modification be built into the proposals.

Reduced wholesale disclosure regime should apply

10.2 The Ecofin Council specifically provided in Recital 11 of the Directive that DRs are non-equity securities for the purposes of the Directive, so the reduced wholesale disclosure regime anticipated by Article 7(1)(b) of the Directive should be applied to them. Accordingly, whenever the minimum denomination of the DR is €50,000 the wholesale disclosure regime should be applied to them. This is the case whether the underlying security is debt or equity. This needs to be built into the proposals.

DRs can be issued over any type of underlying security

10.3 Annex 5 as it is currently drafted appears to apply to DRs issued over equity. DRs can be issued over any type of underlying security, debt, equity, preference shares etc. Where the DR is issued over debt, the disclosure requirements should track the debt annexes, with appropriate adjustments to reflect the fact that where the issuer of the underlying security is not involved in the issue of the DR, the disclosure obligations in respect of that issuer shall be limited to publicly available information. This needs to be built into the proposals.

ANNEX 3 – MINIMUM DISCLOSURE REQUIREMENTS FOR THE BANKS REGISTRATION DOCUMENT

Paragraph 37 – definition of “bank”

Holding companies of banks should be added to the definition of banks as proposed by CESR at paragraph 37. Such holding companies often are the entity within the group from which the issue is made and the disclosure regime will require similar modification in respect of such companies as for banks themselves. For example, holding companies will have the same difficulties as banks with the requirement to produce a capitalisation and indebtedness statement. To reflect this, holding companies should be included within the definition of bank to bring them within the special disclosure regime which applies to banks.

Question 43: Having reviewed the disclosure obligations set out in Annex [2], do you consider that a specialist building block for banks is justified?

We believe that specialist treatment for banks is justified. As banks are under close regulatory control and prudential supervision, less information about the issuer is required to be disclosed.

It is not clear how the disclosure requirements as presently conceived by CESR would apply to a bank issuing, for example, equity securities. To the extent that the disclosures required by annex 1 would apply in whole or in part, those requirements would need to be modified to cater for banks as opposed to corporates. For example, the working capital requirement should not apply to banks, and the requirements as to indebtedness, contingent liabilities, plant and equipment and other inappropriate disclosures would need to be modified. Contingent liabilities are a particular problem for banks because they form a significant part of their day-to-day business (for example in issuing cheque guarantees) and therefore vary on a daily (in fact minute by minute) basis.