
**INTERNATIONAL PRIMARY MARKET
ASSOCIATION**

**Response to CESR's Advice on Level 2
Implementing Measures for the Proposed
Prospectus Directive dated June 2003**

Date: 12th August 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

INTRODUCTION

We welcome this latest consultation paper from CESR and the further development of level 2 implementing measures for the Prospectus Directive. The key issues arising out of this present response are as follows:

Architecture

- There are a number of difficulties with the present suggested architecture. We have highlighted some of these difficulties in this paper and have suggested solutions. Our suggestions derive from the importance of getting the architecture right at the outset for the present and the future rather than insurmountable problems with the proposed disclosure at Level 2 (subject to the comments made herein and in previous response papers). This is essential to ensure that there is a sound basis upon which to cater for future developments both at level 2 and beyond.
- Wholesale treatment should clearly extend beyond pure debt securities to other non-equity securities. This is required by the Directive. Even though there may be few differences between the disclosure requirements for “debt”, “derivatives” and other non-equity securities at Level 2, the absence of a wholesale regime for derivatives and other non-debt/non-equity securities is inconsistent with the Directive and will constrain and/or confuse guidance at Level 3 and beyond. Non-equity securities other than debt (especially as presently defined) do have “denominations” (see further below) and are therefore entitled under Level 1 to have the wholesale regime extended to them. Our suggested approach to the architecture deals with this issue – we emphasise that by creating “additional” building blocks we are not creating additional work as the content of the blocks can, for the present, be compiled by copying building blocks that already are proposed.
- The proposed definition of debt as a security which provides for 100% capital return is too narrow and will not work well in practice for several reasons. For example, some professional investors have guidelines and/or portfolio limits on “derivatives” holdings. Such issues will be confused and potentially distorted by a prospectus regime that categorises products that are clearly debt in nature (e.g. a bond issued at a price of 101% ie a 1% premium) as a derivative security. If CESR does not accept the extension of the wholesale regime to all non-equity securities, an over narrow definition of debt will exclude various types of regular debt from the wholesale regime completely – contrary to the intent of Level 1. While we do not agree at all with CESR’s proposals to have separate base prospectus’ for different products (see our comments below), it will be the case if CESR maintains a requirement to have different programmes for “debt” and “derivatives”, defined as currently proposed, that all current MTN Programmes would have to be split into two programmes, as most issuers issue, or may plan to issue, debt which would fall outside the definition of debt as proposed. We are particularly concerned that the disclosure requirements may be inappropriate to the detriment of issuers and investors if securities are categorised in the manner proposed as differences emerge at level 3 and beyond.

- We believe a different approach could be adopted which would address some of the difficulties without requiring major changes to the disclosure requirements CESR is proposing or requiring additional drafting of new disclosure building blocks. We have suggested two alternatives:

- *Structure A*

Under this structure, there would be separate registration documents and securities notes for equity securities, retail debt/derivative securities, wholesale debt/derivative securities, banks debt/derivatives securities and asset-backed securities. There would not be a separate building block for derivative securities but if the securities had a derivative element additional disclosure would be required. This structure has the advantage that it avoids the need for a definition of debt securities and wholesale treatment would clearly extend to derivative securities. Although the name of the building block has changed, new non-equity products would fall within the debt/derivatives building block.

- *Structure B*

As an alternative structure, we would suggest that there should be separate registration documents for equity securities, retail debt securities, wholesale debt securities, retail derivatives, wholesale derivatives, bank debt, bank derivatives and asset backed securities. This structure should be replicated for securities notes. A definition of debt securities would be required under this structure which we have suggested. Securities which do not fall within our wider definition of debt would be considered derivative securities ie there would still be a “catch all” basket as presently proposed by CESR (but smaller). By creating “additional” building blocks we are not creating additional work as the content of the blocks can, for the present, be compiled from building blocks that already exist.

- Under both structures, clarification on what “denomination” means in the context of securities without a conventional denomination will be required. We recommend that any securities which can, on issue, only be acquired for a total consideration of at least €50,000 or above per investor (a ‘lot’) at the issue price and which cannot thereafter be split for trading purposes should be considered wholesale securities having a “denomination” over €50,000 and benefit from wholesale treatment. In order to deal with changes to the value of securities without a conventional denomination (by reason of currency fluctuation or otherwise), the relevant number of securities which form a ‘lot’ for these purposes should be fixed by reference to the issue price. So, if at the time of pricing, 10 relevant securities equals a total consideration of at least €50,000 (or its equivalent at that time), the ‘lot’ would consist of 10 securities. Once the relevant number is determined, this should be fixed for the life of the issue notwithstanding future changes in the value of the securities as is the case for securities with a “conventional” denomination.

- Under both structures, GDRs over non-equity securities would fall either within the debt/derivatives building block (structure A) or the derivatives building block (structure B).
- We are aware that several respondents from Germany are proposing a structure along the lines of our proposed Structure B. If CESR were minded to adopt Structure B, we would support this.
- We are also aware that respondents from Germany are proposing that the derivatives building block should cover not only non-equity securities but also certain equity securities. We support their views. Securities which have an ‘economic rationale’ – see article 7 of the Directive – more similar to derivatives than equity securities should be subject to appropriate disclosure requirements. For example, reverse convertibles and warrants/certificates on own shares which are not for capital raising are derivative securities and derivative disclosure standards should apply.

Currency Fluctuations

- Guidance is needed in a number of areas to deal with the effect of fluctuations in exchange rates when a currency other than the euro is issued, and/ or included in a base prospectus. These are principally questions of timing.
- For example, how do changes in exchange rates affect an issuer’s choice of home member state (which applies at €1,000 or a *near equivalent*) during the period of validity of a base prospectus if at the time of a new issue under the programme, the euro equivalent of the currency to be issued is below €1,000? What happens if an issue which qualifies for the wholesale treatment of non-equity securities at the time a prospectus is submitted to the competent authority for approval, and/or at the time it is priced and sold to investors, falls just below the €50,000 threshold at the prospectus approval and/or payment date for the issue. We give a number of further examples and suggestions in our General Comments at the end of the paper.
- We do not believe that the Directive can intend to disrupt markets and expose issuers and investors to significant risks and uncertainties in this area; but this present lack of clarity will create problems for issuers, investors and regulators unless it is addressed.

Programmes

- We welcome and strongly support the adoption of a generic rule to determine those items which may be classified as “final terms”. Such a rule should ensure that current market practice is not interrupted.
- There should not be a requirement for separate programmes for different products. This would increase cost for issuers without any related benefit for investors. Indeed, investors frequently express a desire to see all the information in one place; clearly a master programme meets this investor preference where it

is relevant. Provided it is clear which terms and conditions apply to which product and the requirements of Article 5 are met, issuers should be free to combine different products into a single base prospectus.

- Where there are multiple issuers from different Member States under a base prospectus, guidance must be given as to how the home state competent authority is determined if the Programme includes denominations of less than €1,000. If issues under the Programme are guaranteed, we suggest that the home competent authority should be that of the guarantor. In other situations we think that the issuers should be allowed to choose from one of the ‘relevant’ Member States.
- There should not be a requirement to translate any of the final terms into a host Member State’s language as the final terms do not form part of the summary.
- CESR’s advice should make it clear that unlisted/non-public offer trades off a programme are permitted without requiring any approval from any competent authority.

Annual Information Document

- Clear guidance should be given by CESR on the question of liability for the annual information document. For example, it should be made clear that there is no assumption of liability beyond that of the original filing. It should be clearly accepted that issuers may include in the annual information document a disclaimer to this effect and also to highlight that some of the information on the list may now be out-of-date and should not be relied upon by investors.
- Guidance should also be given by CESR to deal with those cases where there is an issuer who may have different home member states for different issues. It is not clear at present which is the relevant home member state for the purposes of the annual information document.
- It should be made clear that if publication is made in compliance with local requirements (for example, publication through EDGAR) a statement noting where the published document is available will suffice.

Examples and Past Performance Figures

- Issuers should have discretion on whether to include examples. Examples on how a particular instrument works and how an investor’s return is calculated can be useful to investors in certain circumstances but there are also dangers in including examples including the possibility of misleading investors, oversimplifying the working of products and raising expectations. Although we are strongly against the mandatory use of examples in any circumstance, this is particularly the case in relation to wholesale non-equity securities and we were pleased to hear at the CESR Open Hearing held in Paris on 9 July that CESR does not believe that this provision should apply in such circumstances. This is an example of why it is important to get the architecture right at level 2.

- Inclusion of past performance and volatility figures should not be mandatory. Past performance figures do not give any reliable information regarding future performance, information on past performance can be misleading, investors may place undue reliance on it and this information is expensive and difficult to produce. CESR itself has recognised the dangers including this information. This is the case for both wholesale and retail securities. We were pleased to hear at the CESR Open Hearing that CESR does not believe that this should apply to wholesale securities.

Banks and other regulated entities

- We assume that banks for these purposes includes regulated firms such as investment banks that have substantial experience in the securities market. Where the relevant issuer is the holding company of a bank but not itself a bank, we believe that the same specialist treatment should apply to such an issuer – we would accept there might be a proviso that the banking business must not be merely incidental to the business of the group. The present disclosure which would otherwise apply would be inappropriate. For example, the requirement to disclose contingent liabilities would be a particular problem in this case. Contingent liabilities would form a significant part of the consolidated day-to-day business of the holding company (for example, in issuing cheque guarantees) and therefore vary on a daily basis.
- The special treatment given to banks should also extend to other regulated entities such as insurance companies and securities firms.

Other CESR Consultation Papers

- We would note that in the time available to prepare our response to this consultation paper we have not had the opportunity to analyse in detail either the Final Advice on Level 2 Implementing Measures submitted by CESR to the Commission on 31 July (Ref. CESR/03-208) nor the Consultation Paper on Level 2 Implementing Measures for the Proposed Prospectus Directive (Ref. CESR/03-162). We note, however, that one point which arises from the Final Advice is that CESR has acknowledged that where third party information is included in a prospectus, the issuer is only responsible for the proper extraction of that information and not the information itself. This acknowledgement needs to be reflected in the responsibility statements section of the disclosure requirements. Our responses to the current consultation may be modified further when we have been able to consider the CESR's 31st July publications in more detail.

RESPONSE TO SPECIFIC QUESTIONS

DERIVATIVES

Disclosure Requirements

Many of the questions put are difficult to answer given the very broad “definition” of “derivative”. For example, the definition would catch a bond where the principal repayment at maturity can be 1% more or less than par, depending on the performance of a share index. However, it would not catch a bond which provides for a 100% return of capital with a maturity of 25 years but where interest payments are linked to performance of a share index and where the overall rate of return could vary enormously – this would be treated as debt. It is difficult to argue in such a case that disclosure about the issuer should be any different than that for a straight bond. On the other hand, if a derivative is issued by a single purpose vehicle and is secured on assets, detailed disclosure about the issuer is generally not relevant. If disclosure is relevant to investors in any particular case, the information will be disclosed in accordance with the general duty under Article 5. It should not however be generally required.

Debt/Derivatives distinction

We agree that debt and derivative securities may require different types of disclosure. Rather than a distinction based on a narrow definition of debt and a “catch all” category for derivatives, we have suggested two alternative approaches to the structure of the building blocks which would avoid the problems caused by the approach presently suggested by CESR. We refer you to our response to question 59 which sets out the suggested approaches.

Principal Activities

Question 32: Do you consider that this disclosure [about the issuer's principal activities] is relevant for these products? Please give your reasons.

We do not consider such disclosure to be generally relevant to investors in ‘true’ derivative securities. As indicated above, the importance of such disclosure will depend on the nature of the issuer and the credit risk taken on the issuer. Investors are typically concerned to understand the nature of the underlying and the structure of the security, and do not expect “equity” style detailed disclosure on the issuer of the security. Disclosure of the issuer’s principal activities will not generally be relevant. If disclosure is relevant to such investors in any particular case, the information will be disclosed in accordance with the general duty under Article 5. It should not however be required in all cases. It should certainly not be required for wholesale non-equity securities.

Principal Markets

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

We do not consider such disclosure to be generally relevant for investors in derivative securities. This should certainly not be required for wholesale securities. For our reasons, please see our introductory comments on derivatives and our response to question 32.

Trend Information

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

No, and it should certainly not be required for wholesale securities. For our reasons, please see our introductory comments on derivatives and our response to question 32.

Administrative, management and supervisory bodies conflicts of interest

Question 37: Do you consider that this disclosure [administrative, management and supervisory bodies' conflicts of interest] is relevant for these products? Please give your reasons.

No, and it should certainly not be required for wholesale securities. For our reasons, please see our introductory comments on derivatives and our response to question 32.

Major Shareholders

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

No, and it should certainly not be required for wholesale securities. For our reasons, please see our introductory comments on derivatives and our response to question 32.

Interim and other financial information

Paragraphs 43- 47

It is also not the case that the majority of issuers of derivatives (certainly as 'defined' in CESR's consultation paper) will be banks. Many corporates issue securities which would not be classified as 'debt' as proposed (but also on a more realistic definition of derivatives). There are also a large number of SPVs issuing such securities. Even if the line between debt and derivatives is drawn differently, there are currently many issuers of financial products which are not 'banks', but are regulated entities such as securities firms.

We do not therefore agree that all issuers should be required to produce up-to-date financial information at the time an offer is made – the reference to 'banks' being required to do this is both, as stated before, wrong and an inadequate justification. We are of the view that interim financial information should only be required where the issuer has already published interim financial information. We understand from the present consultation paper that most of the respondents agreed with this proposal. We do not understand why CESR has changed its view on this issue and is now proposing up-to-date financial information about the issuer at the time an offer of

retail securities is made. The Prospectus Directive needs to be consistent with the spirit of the Transparency Obligations Directive and the requirements in relation to the preparation of interim reports.

We are not clear on what is meant by paragraph 46 which states that “CESR anticipates that banks will be required to make public interim financial information even where its securities are not admitted...”. We would ask for clarification on this.

A new approach to derivatives

Question 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.

As mentioned above, we do not think that CESR has a consistent approach in relation to wholesale non-equity securities. The only wholesale products recognised by CESR are a limited range of debt securities. For reasons given, we do not believe that this will work; and we believe that it deprives the market of an entitlement it has under the Directive, namely, for there to be separate disclosure regimes for all types of non-equity securities with a “denomination” of €50,000 or above.

We do not agree with the approach suggested. It may solve some difficulties raised to date but it also creates a number of further difficulties and illogicalities. Whilst we recognise that there has not been agreement amongst market participants on the definition of derivatives, we think it is nonetheless necessary to develop an approach which captures “true” derivative type products and ensures appropriate disclosure for such products and which enables this dynamic market to continue to develop whilst recognizing “true” debt products and dealing with them appropriately also.

By defining debt as a security which provides for 100% capital return, some securities which are “true” debt will be excluded from this definition, for example, a security whose issue price is above par. Similarly, securities with a derivative element may nonetheless fall within the debt building block. The disclosure requirements will be inappropriate as a result and this approach will give rise to general confusion. Although the differences between the disclosure requirements at Level 2 are minimal, more significant differences may emerge at Level 3 and beyond. A further reason for requiring an appropriate approach to derivatives is that some investors are restricted from investing in “derivatives”. By classifying certain true debt securities as derivatives, investors may no longer be able to hold or invest in such securities and/or doubt may be cast thereon.

Our proposed approach

We believe a different structure could be adopted which would address these difficulties. We have suggested two alternative approaches below.

Structure A

Under this structure, there would be separate registration documents for:

- equity securities;
- retail debt/derivative securities;
- wholesale debt/derivative securities;
- banks debt/derivative securities; and
- asset-backed securities.

This approach should also apply at the securities notes level. Additional disclosure would be required where securities had a derivative element. The additional disclosure would relate to risks factors (section 2 of the current derivative securities note) and information concerning the underlying (section 4.2.2 of the current derivatives securities note) (please see our mark-up of those sections in Schedule 1 to this note). We believe that these are the only differences between the debt building block and derivatives building block.

In order to determine when securities have a derivative element we would suggest the following test.

“A security would be considered to have a derivative element where the payment (or a portion thereof) and/or delivery obligations in connection with the security are linked to an underlying (including but not limited to securities, currencies, commodities, indices or other measurables or deliverables), but excluding securities where the payment of interest is merely linked to a fixed rate or to a recognised inter-bank interest rate provided that if the security falls within a specific building block regime it will be dealt with under that building block”.

This approach has the advantage that it does not require a definition of debt securities because all securities are dealt with in the same way, save for some additional disclosure requirements where there is a derivative element. It also ensures that wholesale treatment extends beyond pure debt securities. This approach allows for development of the market and differences emerging between the building blocks at Level 3 and beyond.

Under this structure, although the name of the building block has changed, new non-equity products which were developed would fall within the debt/derivatives building block.

Structure B

As an alternative structure, we would suggest that there should be separate registration documents for:

- equity securities;

- retail debt securities;
- wholesale debt securities;
- retail derivatives;
- wholesale derivatives;
- bank debt;
- bank derivatives; and
- asset backed securities.

This structure should be replicated in the securities note.

Under this structure, a broader definition of debt would be required. We would suggest that debt should be defined as “securities which do not have a derivative element and which do not otherwise fall within a specific building block regime”. A derivative element would be defined as “where there is a payment (or a portion thereof) and/or delivery obligations are linked to an underlying (including but not limited to securities, currencies, commodities, indices or other measurables or deliverables), excluding the payment of interest that is merely linked to a fixed rate or to a recognised inter-bank interest rate”. This would avoid the need for a ‘pure’ debt definition and the problems which result from such an approach.

Securities which do not fall within the definition of debt above would be considered derivative securities i.e. the rest. They would fall within the derivatives building block.

We are aware that several respondents from Germany are proposing a structure along the lines of our proposed Structure B. If CESR were minded to adopt Structure B, we would support this.

Denomination

Under both structures, clarification on what “denomination” means in the context of securities without a conventional denomination will be required. We recommend that any securities which can only be acquired on issue for a total consideration of at least €50,000 or above per investor (a ‘lot’) at the issue price and which cannot thereafter be split for trading purposes should be considered wholesale securities having a “denomination” over €50,000 and benefit from wholesale treatment. In order to deal with changes to the value of securities without a conventional denomination (by reason of currency fluctuation or otherwise), the relevant number of securities which form a ‘lot’ for these purposes should be fixed by reference to the issue price. So, if at the time of pricing, 10 relevant securities equals a total consideration of at least €50,000 (or its equivalent at that time), the ‘lot’ would consist of 10 securities. Once the relevant number is determined, this should be fixed for the life of the issue notwithstanding future changes in the value of the securities as is the case for securities with a “conventional” denomination.

GDRs

Under both structures, GDRs over non-equity securities would fall either within the debt/derivatives building block (structure A) or the derivatives building block (structure B).

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

We assume for the purposes of question 61 that banks includes not only credit institutions but also regulated firms such as investment banks that have substantial experience in the securities market. CESR should make this clear. We agree with the approach suggested by CESR that information about investments should not be required for banks issuing wholesale securities. As banks are regulated entities and the credit exposure is accordingly reduced, extensive disclosure on the issuer should not be required to be disclosed.

Where the relevant issuer is the holding company of a bank but not itself a bank, we believe that the same specialist treatment should apply to such an issuer – we would accept there might be a proviso that the banking business must not be merely incidental to the business of the group. The present disclosure which would otherwise apply would be inappropriate. For example, the requirement to disclose contingent liabilities would be a particular problem in this case. Contingent liabilities would form a significant part of the consolidated day-to-day business of the holding company (for example, in issuing cheque guarantees) and therefore vary on a daily basis.

The special treatment given to banks (including regulated firms such as investment banks that have substantial experience in issuing securities) should also extend to other regulated entities such as insurance companies and securities firms. Such 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 corporate issuer. Not to recognise this would be to effectively distort the competitive position between banks and other regulated entities operating in the same markets.

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

No. We do not believe that this is relevant to investors in wholesale debt. If such disclosure is relevant to such investors in any particular case, the information will be disclosed in accordance with the general disclosure obligation under Article 5 of the Directive. It should not, however, be generally required.

Examples

Question 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.

We do not 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 and we were pleased to hear at the CESR Open Hearing on 9 July that this provision was not necessary for wholesale securities. In some cases, examples can assist in fulfilling this principle but there are other ways in which this can be achieved including through a clear description in the terms and conditions. There are also dangers associated with the use of examples (as noted by CESR in paragraph 74) including the possibility of misleading investors, oversimplifying the working of products and raising expectations. With more complex products, it becomes almost impossible to give meaningful examples – there are so many possible outcomes, that one would end up giving the worst case (that the investor gets nothing back) and the best case (that the investor gets an optimum return). The “normal case” does not exist and might be seen by investors as a guarantee of a certain return which may result in litigation claims. Examples, therefore, can be helpful but will not always be so and should not therefore be mandatory. Current market practice illustrates this point as examples are sometimes, but not always, included. We would also strongly disagree with any requirement or suggestion that a prospectus should contain examples of alternative investments.

Question 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.

Clearly drafted terms and conditions can provide investors with an understandable explanation of how an investor's return is calculated and how the instrument works. Indeed, we would suggest that if an investor cannot understand clearly drafted terms and conditions, there must be a question as to whether he should be investing in that particular product. In other words, the issue becomes one of suitability rather than one of disclosure.

Question 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 can in some cases be useful for investors. Examples are another tool to use to explain instruments and the calculation of an investor's return. As is noted by CESR in paragraph 74, examples can be misleading and investors may place reliance on the examples. As such, an issuer should have discretion on whether to include examples or not in fulfilling its obligation under article 5 of the Directive. To do otherwise undermines the basic rights of the issuer and others responsible for the prospectus to write it in the way that best discharges the duty imposed on them under article 5. It is similarly wrong to force the issuer and other persons into “disclosure” in a way that creates a litigation risk.

Question 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.

We do not believe the inclusion of examples should be mandatory. Because of the dangers associated with examples as noted by CESR in paragraph 74, issuers should

not be required to include examples. They should have a discretion on whether to include examples or not. This is particularly the case in relation to wholesale products where investors are able to understand the product and we were pleased to hear that CESR does believe that this provision is relevant to wholesale products.

Question 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?

If examples are required, further guidance from CESR would be helpful on the nature of the examples to be included. The guidance should be general and high-level in nature. It is very dangerous to use concepts such as “realistic” and “neutral”. Examples will create a breeding ground for litigation, particularly in highly structured markets where an investor (having lost all) has nothing more to lose and everything to gain by suing. The “realism” of the examples will be judged with hindsight (potentially differently in as many jurisdictions as the product was sold). What seemed realistic at issue will be easily shown to be unrealistic by those with knowledge of the actual outcome. “Neutrality” is equally hostage to fortune.

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

We agree with those CESR members who are of the view that an issuer should be free to decide on whether to include examples in any particular case. Investors in wholesale securities do not need detailed examples to understand the product. Investors in retail products who do not understand clearly drafted descriptions of the product should not be buying in the first place (and should be protected under conduct of business rules).

Question 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?

We consider that an issuer should have discretion on whether to include examples in any particular case. It should have the ability to decide how best to fulfil its obligations under Article 5.

Past Performance and volatility

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

We consider that the first option should be adopted by CESR, namely, that no past performance and no volatility should be required. As you note in paragraph 85(a), past performance does not give any reliable information regarding future performance, information on past performance can be misleading, investors may place undue reliance on it and this information is expensive and difficult to produce. In many cases, past performance figures can only be given by making a number of assumptions and are therefore particularly unsatisfactory. Issuers should be given the

option on whether they wish to include such information in any particular case. If they do so, we agree that there should be a clear warning to investors stating that past performance and volatility figures do not give reliable guidance on the future performance of that security. There mere fact that there would be a requirement to include an appropriate warning is illustrative of the fact that this information should not be required to be included in all cases. This point is underscored by the fact that when such figures are included in other regulated situations a warning is invariably required.

BASE PROSPECTUS

Division between final terms and base prospectus

Question 101: Do you agree with this generic rule?

We were pleased to hear at the CESR Open Hearing on 9 July that CESR agrees that, following the finalisation of wording in the Prospectus Directive, its approach can be adapted to ensure that it is consistent with current market practice. In answering this question, we have assumed that the reference to ‘line items’ is a reference to the information that will be included in the final terms. We have assumed that this is intended to be descriptive of what will be included in the final terms and that it will not be restricted or mandated in any way. If this is not the case, we would be grateful for clarification.

We agree with the adoption of a generic rule to determine those items which may be classified as final terms and those items which should be included in the base prospectus. Final terms, following this approach, will include any information which cannot be determined at the time when the base prospectus is filed. As the Directive makes clear, the prospectus consists of the base prospectus (and any supplements) and the Final Terms. It would be helpful if CESR included in its advice to the Commission the reasoning it sets out in paragraph 100, namely, that a generic rule would accommodate current market practice and ensure that the necessary flexibility for innovation continued.

Translation of summary

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

We agree with the approach suggested in paragraph 110. The Directive provides that a host Member State may only require that the summary be translated into its official language(s). As the final terms do not form part of the summary, host Member States do not have the ability to require the final terms or items of the final terms to be translated. We question the basis of the proposal in paragraph 111 which does not seem consistent with the provisions of the Directive.

Summaries and multiple products in the same base prospectus

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

We agree with those CESR members who consider that it should be left to the issuer to decide how to comply with the general requirement of summary content as set out in articles 5(1) and 5(2). Responsibility for the prospectus attaches to the issuer and as such the issuer should decide on how it should discharge its obligations under the Directive and general law. To do otherwise undermines the basic rights of the issuer and others responsible for the prospectus.

Form of the Final Terms

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

We agree with the view expressed in paragraph 118 that the issuer is free to replicate in the final terms some of the information included in the base prospectus. We also agree with the view in paragraph 121 that if information is included in addition to the final terms, the final terms should be easily identifiable and that it must be made clear that the final terms are to be read in conjunction with the base prospectus. The issuer is responsible under the Directive and general law to disclose information to the market. We would reject the view that the issuer should not be allowed to replicate some of the information in the base prospectus as this approach undermines the issuer's ability to discharge its obligations under the Directive and general law.

Publication of the base prospectus and final terms including the notice

Question 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 the issuer is given discretion on which of those methods of publication it adopts. We note however that Article 5(4) does not require publication of the final terms, but that they be provided to investors and filed with the competent authority.

Question 127: Do you agree with this analysis?

We agree that the method of publication used for the base prospectus does not need to be the same method used for the publication of the final terms. As stated in response to question 125, the methods of publication could be limited to one of those methods set out in Article 14 provided the issuer has freedom of choice between these methods.

The content of the prospectus to be used for offering programmes

Question 131: Do you agree with the additional disclosure requirements in relation to base prospectuses?

Yes, subject to the point that it should be made clear that if a notice is required to be published in relation to final terms the issuer can choose the method of publication from the options set out in Article 14.

Question 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.

Types of securities that can be issued under the same base prospectus

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

We do not agree that separate programmes should be required for different products. Issuers should be free to combine different products in a single base prospectus. Including different products in a single base prospectus leads to efficiency and reduced costs. Requiring separate base prospectuses for different products would involve a change from current market practice and would lead to increased costs for issuers without any related benefit for investors. Indeed, investors frequently express a desire to see all the information in one place; clearly a master programme meets this investor preference where it is relevant. Recital 12a in the Directive clarifies the point that different products should be capable of inclusion in a single base prospectus. We consider it particularly important that separate programmes are not required for debt and derivatives. We note also the continuing uncertainty about the scope of the asset backed schedules, particularly in relation to synthetic securitisations. Issuers currently include both types of securitisation in the same offering programme, and should continue to be able to do so. Introducing artificial requirements to maintain different programmes for different products will increase such problems of use and interpretation. There will be increased costs for issuers without any corresponding benefit to issuers.

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

No. Please see our response to question 136. Issuers should be free to insert into a single base prospectus all the types of securities they may issue.

Number of issuers per base prospectus

Paragraph 138

We welcome the fact that there will be no restriction on the number of issuers and/or guarantors that can issue securities under a base prospectus. Where there are multiple issuers under a base prospectus, guidance must be given as to the appropriate home state competent authority. We would suggest that, where the issuers are resident in different Member States, they are free to choose one of those States for prospectus approval purposes, even though the denominations capable of being issued under the programme are lower than €1,000. Provision could be made for one home member state to delegate its authority to another member state in these circumstances. If issues under the Programme are guaranteed, we suggest that the home competent authority should be that of the guarantor. This guidance should also make clear that once a home state competent authority is chosen, currency fluctuations do not force a change in the competent authority during the period of validity of the base prospectus.

Mortgage Bond Issues

Paragraph 139

We would note that a mortgage bond could be construed differently in different markets. For example, we would question the distinction between a mortgage bond and a bond secured on mortgages.

WHOLESALE DEBT SN

Question 143: Do you agree with this approach?

Yes. The wholesale regime should extend beyond pure debt securities to other types of non-equity securities. This is required by the Directive. For our reasons, please refer to our response to question 59.

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

We refer you to our mark-up of Annex F attached to this response.

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

No. Investors in wholesale securities need less extensive disclosure than retail investors, given their far greater level of knowledge and experience.

CLOSED ENDED INVESTMENT FUNDS

Question 151: Do you agree with the disclosure obligations set out in Annex G as being appropriate for the type of issuer? Please give your reasons.

Please see our mark-up of Annex G.

Question 154: Do you consider there is a distinction to be drawn between these two types of activities, as set out above. Please give reasons for your answer.

Question 155: What would you consider to be an appropriate and sustainable distinction between both activities.

We accept that a distinction is appropriate – for example, the London listing rules presently draw a distinction. We do not think that an approach based on a distinction between capital and income is valid as funds can be based on either capital growth or income generation. Similarly, it is difficult to use an active/passive distinction – this may work when a company is the asset but not when it is real estate. While the London listing rules are not entirely satisfactory, they could form a good basis for developing proposals which reflect market reality.

SN BUILDING BLOCK FOR UNDERLYING EQUITY SECURITIES

Question 162: Do you agree with this approach?

No. We welcome the fact that CESR has simplified its approach to securities which can be converted or exchanged into the issuer's own shares or shares of a group entity by creating a building block to be combined with other building blocks.

The determination of the disclosure requirements should relate to the economic character of the securities. Such securities should only be subject to the proposed disclosure requirements where their issuance corresponds to the issuance of the respective underlying security in economic terms ie the issuance of new shares. The disclosure requirements (and the responsibility statement) should take account of this fact.

We welcome the approach that CESR appears to be taking which is that disclosure should not be required on the underlying security to the extent that it is publicly available e.g. where the underlying equity securities are listed (whether on an EU or non-EU exchange).

Question 163: Do you agree with the disclosure requirements of the building block concerning the under for equity securities as set out in Annex H.

No. See our comments in response to question 162 above and in response to question 165 below.

Question 165: Do you deem the Working Capital Statement and the Information on Capitalization and Indebtedness necessary for an informed assessment of the securities in case of products which can be converted or exchanged in newly created shares? Please give your reasons.

We do not believe that this information should be required. We agree with those CESR members who believe that this information will add no value because it will be outdated at the time when the investor finally receives the shares.

Question 167: Do you agree with this approach?

Yes, subject to our comments above.

Question 168: Do you agree with the combinations set out in the table?

Yes, subject to our comments above.

FORMAT OF THE PROSPECTUS

The prospectus: single document or separate documents

We would request clarification on the scope of article 19(4) of the Directive. We do not believe that it is intended to mean that an admission to trading in any one EU

Member State triggers the right of every other Member State to require that a summary be drawn up in their official language(s). As this is not clear from the present drafting, however, we would request clarification in CESR's advice that this is the case.

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

We agree with the CESR members who consider that issuers should be able to choose the best way to present the information which meets the disclosure obligations. This approach allows issuers to choose a way to present information which meets its obligations under the Directive. As issuers and securities are not all the same, it is not appropriate to prescribe the order of disclosure. Doing so would remove the issuer's ability to meet the requirements of Article 5 of the Directive and could result in the imposition of liability for the issuer. Issuers should have the right to present information in a way that allows them to comply with their requirements under the Directive and avoid liability. Furthermore, the Directive makes provision to mutually recognise third country prospectuses. The requirement to present information in a certain way would inhibit this provision and is unhelpful.

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

We agree with those CESR members who believe that there should be no specific order to the prospectus. Please see our response to question 172 for our reasoning.

Cases in which the summary has to be supplemented

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

CESR should not be prescriptive about the way in which the summary should be supplemented. Issuers should be free either to integrate the new information into the original summary or to produce a supplement to the summary which is limited to the new information. Issuers will choose the most appropriate manner to supplement the prospectus in view of their obligations under the Directive, in particular article 5. To do otherwise undermines the right of the issuer and others responsible for the prospectus to write it in the way that best discharges the duty imposed on them under article 5.

Guidelines for the drafting of a summary at Level 2

Paragraphs 183 and 186

We agree with the approach by CESR of avoiding detailed guidance in this area. Detailed guidance is unlikely to be helpful. On the guidance suggested, we object to the final indent in paragraph 186 which states that when drafting the summary, the issuer should keep in mind the fact that the summary might be the only document published in investor's language. A summary is by its nature an overview of key points and should be seen in that light. This is consistent with the Directive and

paragraph 183 which requires that the summary should contain a warning that it should be read as an introduction to the prospectus and any decision to invest in the securities should be based on consideration of the prospectus as a whole by the investor.

It would be helpful, though, if the guidance included a statement that the summary can take into account the types of investor who are likely to buy the securities being offered.

We also believe that the final paragraph of paragraph 183 should be included in the guidance to emphasise that the summary schedule provided in annex IV to the Directive is indicative only.

ROAD MAP

We welcome the introduction of a roadmap which we believe will be useful in understanding the application of the various building blocks to any particular issue. We particularly support the approach in paragraphs 214 and 215 (but see our comment below on the drafting of paragraph 214).

The roadmap illustrates two of our concerns, namely: (i) the proposed architecture which we have addressed in this response; and (ii) various points on the proposed disclosure requirements, including, the narrow scope of the proposed asset backed securities building block and the fact that where an issue is guaranteed the focus of the disclosure requirement should 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.

Paragraph 214

The “should” in the final sentence of this paragraph should be changed to “will”. Where there is no appropriate building block for a particular issue and the competent authority decides what information should be included in the prospectus in order to comply article 5 of the Directive, this prospectus must benefit from the European passport.

Paragraph 218

We welcome CESR’s confirmation of the general principle, that all requirements in the schedules are ‘if any’.

ANNUAL INFORMATION

Level 2 Advice

Question 237: Do you agree with the method of publication proposed?

We agree that issuers should be able to choose the method of publication of the annual information document.

Clear guidance should be given by CESR on the question of liability for the annual information document. For example, it should be made clear that there is no assumption of liability beyond that of the original filing. It should be clearly accepted that issuers may include in the annual information document a disclaimer to this effect and also to highlight that some of the information on the list may now be out-of-date and should not be relied upon by investors.

Guidance should also be given in cases where there is an issuer who may have different home member states for different issues. It is not clear at present which is the relevant home member state for the purposes of the annual information document. It should be made clear that if publication is made in compliance with local requirements (for example, publication through EDGAR) a statement noting where the published document is available will suffice.

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

No. Issuers should be free to choose the method of publication.

Where information required under the Prospectus Directive is made available on the issuer's website, we believe that it should be available in a separate area which warns a user as they leave that section that other material on the website does not form part of the prospectus. In addition, it is important to ensure that the requirements on the availability of information fit in with international securities law. For example, issuers must be able to password protect certain areas of their website to avoid breaching applicable securities legislation, for example, US tax and securities laws. Guidance should be given on this point.

Question 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 your reasons for your answer.

We agree that a deadline should be defined. The requirement that the document be filed and made available within 7 business days after the publication of the annual financial information is, however, too short a time-frame. Where issuers are complying with a number of different disclosure regimes in a whole range of countries, particularly those, such as non EU issuers who are subject in the first instance to the requirements of their own home state, gathering and presenting the information will take time. We would suggest that 30 days is a more appropriate timeframe. In this regard, we would also ask for clarification on the exact meaning of the phrase "publication of the annual financial information" as it is not clear to us.

GENERAL COMMENTS

Exchange Rate Fluctuations

Guidance is needed to deal with the effect of fluctuations in exchange rates where a currency other than the euro is used. It is not clear at present how changes in exchange rates would affect an issuer's choice of home member state (which applies at €1,000 or a *near equivalent*) or the wholesale treatment of non-equity securities

(which applies to non-equity securities in a denomination of €50,000 or above). For example:

- An issuer submits its draft prospectus to its chosen competent authority six weeks before the expected launch date of its issue on the basis that its USD denominated securities are equivalent to €1050. The exchange rate changes so that, on the day approval would have been given, the USD denomination is €900. Would the issuer have to start the process all over again with the competent authority in its state of registration?
- An issuer and the competent authority work on a prospectus, using the wholesale annex. The issue is launched, priced and sold to investors. The exchange rate moves and, just as the issue is to close (and the prospectus is to be approved) significant additional disclosure has to be added, because the denomination has fallen to the equivalent of €49,999. If the payment date of the issue had to be delayed to enable the additional disclosure to be prepared, the issuer, investors who had made commitments with respect to the bonds, providers of hedges, such as swaps, to issuers and investors, underwriters of the issue, and any third parties to whom the issuer was expecting to pay the proceeds, would face significant losses. Issuers and regulators need to be clear that they will benefit from wholesale treatment when preparing the prospectus. Investors do not want to take the risk that the issue might be redenominated, delayed or even cancelled as a result of a movement in exchange rates and a minor difference to the €50,000 limit.
- Would the home member state for a Medium Term Note Programme change automatically if the exchange rate fluctuated such that a new issue under the Programme was no longer considered nearly equivalent to €1,000 and the issuer's choice of home member state no longer valid?

We would suggest that it is worth considering an approach similar to that adopted in other Directives (for example, an approach similar to that in article 58 of Directive 2001/24/EC). Adopting such an approach, the Commission would, from time to time, set the relevant exchange rates which would apply until further notice. These rates would apply to determine whether an issuer had the choice of home member state and whether the retail or wholesale disclosure regime applied. Any future change to the rates would not have an effect on existing choices of the home member state or further issuances of securities under an existing programme - these would still be valid. Issues not under a Programme and new programmes would be subject to the new exchange rates. There should also be a transition period during which the old rates apply but the market is on notice that they will change at a certain date in the future.

SCHEDULE 1

Additional disclosure for securities with a derivative element

2. Risk Factors
'Risk factors' is to include a risk warning to the effect that investors may lose the value of their entire investment, and/or, if the investor's liability is not limited to the value of his investment, a statement of that fact, together with a description of the circumstances in which such additional liability arises and the likely financial effect
[Risks involved in purchasing the derivative securities. This sections should include:
Examples of the way the instrument works*]

4.2.2 Information concerning the underlying
The exercise price or the final reference price of the underlying.
<p>A statement setting out the type of the underlying and details of where information on the underlying can be obtained:</p> <p>[- past performance of the underlying – in a practical form or otherwise – and its volatility over a period corresponding to at least the maturity of the derivative security; in any case a period of two years is sufficient]*</p> <ul style="list-style-type: none"> - where the underlying is a security <ul style="list-style-type: none"> • the name of the issuer of the security • the ISIN (International Security Identification Number) or other such security identification code - where the underlying is an index <ul style="list-style-type: none"> • the name of the index and a description of the index if it is composed by the issuer - where the underlying is an interest rate <ul style="list-style-type: none"> • a description of the interest rate <p>where the underlying does not fall within the categories specified above the securities note must contain equivalent information.</p> <ul style="list-style-type: none"> - where the underlying is a basket of underlyings <ul style="list-style-type: none"> • disclosure of the relevant weightings of each underlying in the basket <p>A description of any market disruption or settlement disruption events that affect the underlying</p> <p>Adjustment rules with relation to events concerning the underlying</p>

* This disclosure should not required for retail or wholesale securities.