Z E N T R A L E R K R E D I T A U S S C H U S S

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Response of the *Zentraler Kreditausschuss* to the Addendum to the Consultation Paper

(Ref. CESR/03-210b)

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

October 2003

Ref.: 413-CESR-Prosp

Dear Mr Demarigny,

As Zentraler Kreditausschuss[1] we would like to thank you for the opportunity to comment on CESR's advice on Level 2 implementing measures for the Prospectus Directive (Ref. CESR / 03- 210b).

EXECUTIVE SUMMARY

We welcome once again some changes made by CESR in its advice sent to the Commission at the end of October as a result of the latest consultations. With regard to this new consultation paper we are very much concerned about CESR´s proposals on historical financial information requirements. We believe that in this respect CESR takes a direction which will bring technical implementing measures on level 2 in conflict with level 1-regulation, especially the IAS-regulation (EC/1606/2002). We would, therefore, very much appreciate if CESR carefully reconsiders whether its approach of a two- or even three-years restatement of local GAAP accounts prior to the expiring of the transposition periods provided for in the IAS-regulation is really favourable.

- **Historical Financial Information**

  - Any requirement on level 2 of the Prospectus Directive concerning the restatement or reconciliation of previous financial statements of the issuer to IAS should not overrule the flexibility rendered to Member States and issuers under Art. 5 and 9 of the IAS-Regulation. These Articles provide that equity-issuers do not have to prepare their consolidated accounts in conformity with IAS before 1 January 2005 and Member States may permit issuers of debt securities to draw up their financial statements according to national GAAP even until January 2007. An infringement upon said provisions of the IAS-regulation would inevitably occur with options 1,

[1] The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the public-sector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Hypothekenbanken (VDH)*, for the mortgage banks. Collectively, they represent more than 2,500 banks.

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2 and 3 as set out under no. 47 to 49 - at least if these requirements are put into force without any transitional period.

- The requirement set out in Annex E providing that the audited financial information of the last two years must be presented and prepared in a form consistent with that which will be adopted in the issuer´s next annual financial statements is not feasible for issuers planning to switch from local GAAP to IAS in the financial statements for the current financial year and who want to issue securities in that financial year. Such issuers do not have audited restated IAS-financial statements in place at the time of the issue since their financial statement for the previous business year has necessarily been drawn up according to local GAAP without any restatement. We therefore recommend replacing this requirement.

- Cash flow statement

Furthermore, many firms do not issue any listed bonds but offer their titles for public trading. Due to the absence of a relation to the capital market, the IAS are not pertinent to these undertakings. The CESR proposal partially takes this into consideration since, on principle, also national accounting rules are viewed as permissible. Nevertheless, these undertakings stipulate an additional information requirement which relates to the cash flow statement. In the absence of national accounting provisions, a cash-flow statement is only drawn up in the event of group accounting. Thus, the prospectus requirements would introduce an additional requirement beyond the existing European accounting standards. In our view, principally the prospectus directive should refer to the existing IAS/IFRS and the national GAAP instead of setting new standards for accounting purposes.

- Blackout periods

Finally, by imposing blackout periods, the practical importance of a prospectus would be overestimated; following the publication of a prospectus, investors still have sufficient time available to inform themselves about the securities, even if they learn about the planned issue (by way of an advertisement) at a time when the prospectus is not yet

available . In contrast, blackout periods are based on a concept according to which the prospectus should function as the only source of information for the investor including a requirement to hand out the prospectus (or at least to offer this to the investor) and a prohibition of producing other informational documents about a security. This is not the general concept of the Prospectus Directive.

QUESTIONNAIRE

Question 30: Do you agree with this approach? If not, please give your reasons.

It should be asked why institutions like IMF, World Bank, EIB and so on are not included in this building block. In our view, the scope of this schedule should be extended to ”non-commercial administrative bodies responsible to states or regional or local authorities or authorities which exercise the same responsibilities as regional or local authorities”, as such entities carry the same remote insolvency risk and do not fit in under the general schedules. It could also be thought of a special guaranty building block for these kinds of institutions which are backed up by a multitude of national governments.

Furthermore we do not think that the general schedules are suitable for describing the relevant details of public international bodies. These entities, like states, have a far lower risk of insolvency, so that less information could be required. As they do not pursue a commercial business, most of the information required under the general schedules could not be given to them. We would, therefore, take the view that the sovereign schedule should also cover public international bodies. For this purpose, the proposed requirements should, where necessary, be amended so that they are suitable for such entities (for example, item 3.1 could require disclosure of ”the legal name of the issuer and a brief description of its legal basis and functions”, and items 3.4 and 3.5 should not apply).

Question 32: Do you agree with this list as more fully described in Annex D?

We agree with the list as such, except for points h and i.

Regarding these and the specific proposals made in Annex D, we have the following comments:

3. 2 Given that countries as issuers do not have a contact address or telephone number, the words ”or its governing body” should be added after ”of the issuer”.

3.4 Given that this schedule will be used by industrialised countries as well as emerging market states, only a ”brief description of the issuer’s economy, including the gross domestic product” should be required here. This would give the competent authority the possibility to adapt the amount of information required under this point to the risk of the respective issuer.

4 As for 3.4, we think that this requirement should be restricted to a general requirement to give a ”brief description of the issuer’s current financial situation, including debt, income and expenditure figures, and its development”. This would leave room to adapt the amount of information to the specific issuer. There should not be a requirement to present the information ”for the two fiscal years prior to the date of the registration document”, as the issuer will have these figures available only several months after the expiry of the last fiscal year, and the issuer would not be able to issue securities in the meantime if this requirement applied.

7 As the accounting requirements for companies do not apply to sovereign and quasi-sovereign issuers, we do not see how statements or reports of experts could be relevant in such cases. This requirement should therefore be deleted.

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8 As set out for no. 7 above, experts will not be involved in such issues. The requirement under (b) should therefore be deleted.

For the same reason, it would seem to us that the requirement under (a) relating to financial and audit reports does not make sense for such issues and should also be deleted. As for the budget, this constitutes publicly available information, so there should not be a requirement to put this on display for investors. In order to help foreign investors, the prospectus should only have to specify how information about the budget can be obtained.

Question 33: Is there any other information which you consider relevant for Member States and their regional or local authorities and should be included in the Annex?

No.

Question 35: Do you consider that it is appropriate to have such a disclosure requirement? If so, do you believe that the selected indicators are those relevant to make an investment decision? Please give your reasons.

Please see our answer to question no. 32, item no. 4.

Question 40: Do you deem that Investments and development plans should be included in the Annex for Member States and regional and local authorities? If so, please give your reasons.

We do not think that such plans generally have a material effect on the issuer's solvency. This may be the case for certain emerging market countries; in this case, however, disclosure of such plans could be covered under the general requirement for item 4 proposed above (see our answer to question no. 32).

Question 42: Do you consider that potential conflicts of interest should be disclosed? If so, do you consider that the wording used will be sufficient to capture such conflicts?

Please see our answer to question no. 42 on item no. 7.

Question 56: What are your views on the costs of providing reconciliation as compared with a full restatement?

We do agree that the costs of reconciliation or restatement are of great importance. We also agree that CESR's decision for a certain option may have great effect on an entity's profit and loss account. Nevertheless we want to point out that an entity that has to adopt IAS in accordance with the EU-Directive 1606/2002 has to include in its first IAS financial statements at least one year of comparative information under IAS's (see IFRS 1.36). Recognition and measurement of assets and liabilities in the previous year are in accordance with IAS's respectively IFRS's. Therefore, we are convinced that there is no need for reconciliation or restatement.

All other entities that do not fulfil the conditions of EU-Directive 1606/2002 to adopt IAS may not be obliged to an IAS-reconciliation or IAS-restatement by CESR.

Question 57: What are your views on the most appropriate way to present the financial information?

Question 58: What are your views on the importance of comparability both within the audited historical track record and with the reporting standards that are to be adopted?

Question 59: What are your views on how this should be achieved ?

Question 60: Do you agree with the approach taken in relation to issuers of debt securities? If not, please state your reasons.

We generally agree with the idea underlying CESR's proposals: that EU issuers, when having securities listed on a regulated market and therewith falling under the scope of the IAS Regulation, should be obliged to prepare their financial figures so that investors can assess the issuer's situation on the basis of IAS. In our view, this indeed follows from the function of IAS as the accounting standard for all companies which have securities listed, which also lies behind the IAS Regulation. We also agree that the requirement of a restatement on the basis of IAS serves this purpose best.

As for the number of years for which the accounts should be restated, we would, however, see a difference between the issuance of equity and non-equity securities. For the former, a restatement of the previous two accounts seems necessary, but also sufficient to us. For this, we would not refer to the need to give investors, in the following (two) years, some historical track record, as investors in the secondary markets (for which the following accounts will be relevant) generally can not reasonably expect the same amount of information as those subscribing to newly issued securities. On the basis of the above described function of IAS, we do however think that investors have to be able to assess at least the current financial situation of the issuer according to IAS, so that the latest account should always be restated.

For equity securities, we also think that investors should be able to assess the issuer's financial development on the basis of IAS; we therefore agree that the issuer should also have to restate the previous accounts. On the other hand, for non-equity, in particular debt securities, we would regard the same requirement as too burdensome and would not give the interest of investors in obtaining comparability within the IAS figures the same weight as for equity. We would therefore regard it as sufficient that investors have the possibility of comparing the issuer's (restated) IAS figures with those of already listed companies,

and at the same time have, for the issuer, a track record in the previous accounting standard available, with the possibility of non-IAS and IAS financial statements in the last year. This is in line with the IFRS 1 on first time adoption of international financial reporting standards dated June 2003, which requires a restatement for one comparison year. In this regard, we would like to point out that, in our understanding, IFRS 1 is the relevant provision for the preparation of annual accounts. We assume that a restatement of the financial accounts of previous years, which is required by CESR, is in form and content identical with the requirement in IFRS 1.36 to provide "comparative information".

Although we agree in principle that the issuer should have to restate the previous accounts, the conversion to another accounting regulation – in particular the IAS transition in 2005/2007 - has to be taken into account. IFRS 1 provides comprehensive transition rules concerning the first-time adoption of IAS. If – in consequence of the date of conversion – IAS accounts are not available, the accounts based on national GAAP should be sufficient for the prospectus. Therefore, we reject the requirement that audited financial information must be presented and prepared in a form consistent with that which will be adopted in the issuer`s next annual financial statements. If an issuer intends to switch over to IAS by the end of 2005, then it could only tap the market in late 2005 with IAS financials for 2003 to 2004 (equity) and 2004 (debt), respectively. Therefore, this principle will impair capital market activities for those issuers.

Especially in light of the IAS Regulation, the time between now and 1 January 2005 (when the IAS Directive, and consequently the proposed requirements, would become effective at least for equity securities) would not be long enough for a smooth transition. During the period of transition to IAS/IFRS, the companies should not be imposed with additional requirements. Otherwise, a clean conversion to the international accounting rules might be jeopardized.

Furthermore a lot of firms do not issue any listed bonds but offer their titles for public trading. Due to the absence of a relation to the capital market, the IAS is not pertinent to these undertakings. The CESR proposal partially takes this into consideration since, on

principle, also national accounting rules are viewed as permissible. Nevertheless, these undertakings stipulate an additional information requirement which relates to the cash flow statement. In the absence of national accounting provisions, a cash-flow statement is only drawn up in the event of group accounting. Thus, the prospectus requirements would introduce an additional requirement beyond the existing European accounting standards. In our view, principally the prospectus directive should refer to the existing IAS/IFRS and the national GAAP instead of setting new standards for accounting purposes.

Question 69: What are your views on extending this treatment to EU issuers for the types of securities identified?

It would not be justified, in our view, to exclude for example banks from non-EU countries with an equivalent level of prudential and regulatory supervision from the European market. CESR should consider that inappropriate disclosure requirements with respect to accounting standards and historical financial information for non-EU banks could prevent or deter such issuers from listing on EU markets. That would have a number of adverse consequences. The EU market would lose a significant volume of issuance. Therefore we agree with CESR that financial information requirements for non-EU issuers should generally follow the requirements for EU issuers.

Nevertheless, whilst we agree with the requirement proposed in Annex E to include, in the cases where the financial information, or the audit, is based on standards which are generally not accepted for the purposes of the Prospectus Directive, a description of the relevant differences (under (b) in both cases), we think that this obligation should be restricted to a ”brief narrative description” and a ”brief explanation”; this is due to the fact that a comparison between the standards could prove to be very complex and the prospectus should not be overloaded with technical details which do not help the investor to assess the financial situation of the specific issuer.

Question 70: Are there any other types of issuer where you believe that different requirements should apply?

No comment.

Question 84: Do you agree with the scope of the present consultation paper on advertising? Please give reasons for your answer.

We agree with what is said under No 80, first indent. Under the second indent we agree with the statement that an advertisement is not a prospectus. However, it is not made clear why advertisements with marketing literature should be riskier than other (simpler) types. If this is meant to have a stricter control, this could influence the marketing policy to the contrary, i.e. favour advertisements with a low level of information.

Furthermore, it should be mentioned explicitly that the publication of the reports of financial analysts will not be regarded as an advertisement.

Question 85: Do you believe that blackout periods should be imposed for the dissemination of any advertisements when a prospectus has not been made available? Please give reasons for your answer.

We do not think that blackout periods should be imposed. In our view, such imposition would contradict the principles behind the general prospectus rules. As long as an advertisement does not constitute an offer, it should be allowed, even in the absence of a prospectus. By imposing blackout periods, the practical importance of a prospectus would be overestimated; following the publication of a prospectus, investors still have sufficient time available to inform themselves about the securities, even if they learn about the planned issue (by way of an advertisement) at a time when the prospectus is not yet

available. In contrast, blackout periods are based on a concept according to which the prospectus should function as the only source of information for the investor and which also includes a requirement to hand out the prospectus (or at least to offer this to the investor) and a prohibition of producing other informational documents about a security. This is not the general concept of the Prospectus Directive.

Question 87: Do you consider that control over compliance of advertising activity with the principles referred to in paragraphs 2 to 5 of Article 15 of the Directive should be harmonized? If so, do you think that competent authorities should exercise the above mentioned control? Please give reasons for your answer.

No, we do not think that such control should be harmonised. As national practices in this field currently diverge to a great extent, such harmonisation would be difficult; we also think that the introduction of harmonised rules is not required by the interests of the European capital market.

Art. 15 (6) of the Prospectus Directive makes it very clear that control over the compliance of advertising activity with the rules laid down in this article, or level 2 provisions based on it, lies exclusively with the relevant home country authority. In our view, this also means that all procedural questions, e. g. concerning a requirement of prior approval of advertisements, can only be determined by the home country authority. Otherwise, the home country authority would have to apply the procedure determined by the relevant host country, which we would regard as practically impossible. CESR should especially keep in mind, that the Directive takes into account the necessity for issuers to have a fast issuance process by having introduced the concept of the Base Prospectus. Issues under a Base Prospectus can only be done very quickly without any prior approval. This important feature of the Directive must not be foiled by the supervision of advertising activities which would cause delays. Authorities will still have the right to review advertisements and check their contents, however, this should be done *after* they

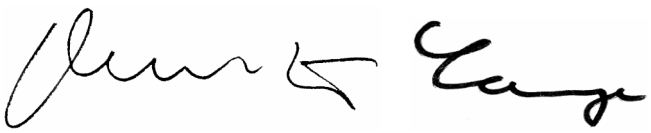
are published. This still enables the competent authorities to prohibit inaccurate or misleading advertisements and to act against those responsible.

In addition, we think that Art. 15 (6) implicitly also gives the home country authority the right to determine the material rules specifying the requirements laid down in paragraphs 2 to 5 of Art. 15. Generally, under the Prospectus Directive, the competent authority also has the right to establish implementing rules for the provisions of the directive, if a question is not covered by level 2 or level 3 provisions; this, for example, is totally out of question for rules on the content of prospectuses, even if they are only to be used outside the relevant home country.

However, harmonised rules might make sense in one respect: regarding the question how control will be exercised by the home country authority for advertisements to be used in other countries. In particular, it should be made clear specifically that advertisements do not have to be translated in a language accepted by the home country authority for this purpose.

Yours sincerely,
For and on behalf of the Zentraler Kreditausschuss
Federal Association of German Cooperative Banks/
Bundesverband der Deutschen
Volksbanken und Raiffeisenbanken e.V.

by proxy



(Dr. Pleister) (Dr. Lange)