

## **GENERAL OPINION REGARDING THE CESR PROPOSAL**

Annex I is the response prepared by AIAF (a Spanish regulated market for debt securities) to CESR (Reference CESR/02.185b) consultation paper on its proposed advice to the European Commission regarding technical implementing measures for the proposed directive on "The prospectus to be published when securities are offered to the public or admitted to trading".

Detailed technical opinion is provided to each of the questions contained in the CESR document. However, in spite of the reasoning outlined in many replies, we have found difficulty in expressing through those questions AIAF's overall point of view regarding the CESR proposal. To ensure that the specific opinions outlined in replies to the questionnaire are better understood, an explanation of AIAF overall point of view is included as an introduction to them.

AIAF general approach to Level 2 implementing measures for the Prospectus Directive Proposal can be summarised as follows:

### **Use of the IOSCO information disclosure standards**

It is an adequate starting point to base the draft schedules on the IOSCO Disclosure Standards for cross-border offering. There is an international consensus on this matter and most European countries, including Spain, already base their legislation on of these standards.

However, as the CESR document clearly indicates, the IOSOC standards refer to the content of a prospectus for public share offers which, logically, includes information that is not relevant for those investors that are the target of public offers of debt or derivatives.

CESR proposes to eliminate certain informative blocks in the IOSCO Disclosure Standards to produce specific disclosure standards for instruments other than equity. Analysing the consequences of the elimination of these informative blocks - which contain information items of a wide ranging nature and significance -, one comes to the conclusion that there is a certain incoherence in the final outcome.

Having in mind the reasoning above, an initial conclusion is the need for a more detailed analysis of the content of each information block proposed to be deleted.

### **Basic nucleus of information to be as common as possible**

The complexity and resulting workload involved in the preparation of a prospectus does not depend only on the amount of information requested. This difficulty increases significantly as the assumptions or variations in the types of prospectus multiply, each one with rules applicable that often vary in ways that are difficult to perceive. With the laudable intention of reducing the information demands, great complexity is introduced in the assumptions, which transforms the work of preparing the prospectus into a task that requires the gathering of specialists capable of navigating through a tangle of assumptions and requirements.

We consider that an alternative way of proceeding is to define a basic core of common information for all issuers within the Registration Block, irrespective of the type of securities they are going to issue. This common information is that which refers to the identification of the issuer, those responsible for preparing the prospectus and their advisers, the description and track record of the business, its risks, the financial statements, etc. This basic nucleus of information can be obtained by taking the relevant elements from the IOSCO standards.

In addition to this basic nucleus of information common to all issuers, informative blocks applicable in the case of issuing shares can be prepared. This specific informative block and additional information would reflect the information requirements of special interest to a shareholder. That is, information related to corporate governance and exercising voting rights of shares. This would be an additional informative block, in the same way as proposed for certain types of issuers (mining companies, property companies, etc.).

### **Written presentation of information requirements**

The CESR document oscillates between an extremely detailed presentation and a more generic one, which defines the requirements from the point of view of the contents. This second approach illustrates much better the information to be obtained from the issuer and seems more advisable.

The CESR proposal change the form of presenting different parts of the document in a number of occasions and it is difficult to appreciate if we are witnessing a change in contents or just a different way of saying the same idea. A generic approach to the demand for information does not necessarily mean that less information is required than in the detailed definition. By changing the form of saying things that are apparently very similar, the reader does not know the scope of the questions under each assumption. The way of defining the questions for the different components and assumptions of the Registration Block must be the same for either a detailed list of issues or for a more generic approach.

Some of the replies given to questions raised on the basis of certain texts proposed by the CESR are conditioned by the fact that it is not clear how far they intend to go with the change in the style, from a descriptive style with great detail to the other more general outline.

### **Registration Block for debt instruments**

As we have stated above, the investor in shares is interested in information on corporate governance and the exercise of voting and economic rights of the shares, which are not relevant for the bond investor.

However, the bondholder is interested in knowing everything that may be useful in forming an opinion about the issuer's credit risk. This information refers to both the historical evolution as well as the present and future perspective of the company. In this area, the relevant information is no different from that which the shareholder requires. The need to form a solid opinion on the company's solvency and the outlook for the business is common to both types of investors.

Numerous CESR proposals to delete information for debt instruments, apart from being insufficiently broken down as we have stated above and perhaps due to this, lack economic sense, viewed from the perspective of the worried investors with their credit risk. Given the way in which the questions are raised, one is obliged to some extent to respond negatively to the deletion proposals. On the whole this creates the sense of disagreement with the overall position that a creditor may not need certain information that the shareholder requires.

The solution to this problem is found, as we have noted earlier, in defining a common block of basic information for shares and bonds, based on a better breakdown of the information contents from the different sections in the IOSCO standards document. Added to this common information block would be, in the case of shares, certain information requirements referring to corporate governance and shareholders' rights.

### **Importance of time horizon**

The investor that purchases shares has an unspecified time horizon. The investor that acquires debt instruments normally does so with a well-defined time horizon. Whether the time period considered is longer or shorter is critical in deciding to what extent certain information is relevant or not.

The long term creditor will undoubtedly be interested in knowing the overall track record of the issuer's business, in quite similar terms to the investor in equity. In contrast, the investor in short term debt instruments will not be worried by the general medium and long term outlook of the business, as it is difficult that this will affect his risk. His concern will be

more focused on the balance sheet and the liquidity of the issuer in the current financial year and perhaps in the next financial year. More structural matters of the issuer's business usually lie outside of the focus of the short term creditor's concerns.

Consequently, when defining the information contents of the Registration Block, it is more relevant to differentiate between short term and long term creditors, than between shareholders and long term bondholders.

Based on the points presented above, assuming that there is an informative block specifically for equity, it is necessary to establish a difference in the information requirements for, on the one hand, shares and long term bonds and, on the other hand, short term debt instruments. If the need for greater agility in the issue of short term instruments is taken into account, the proposed solution has a clear practical sense.

### **Issue of different instruments with a single Registration Document**

It seems logical to think that those who have published a Registration Document with the full information content (which would be the case of the Registration Document for issuers of equity) will be able to issue any type of financial instrument, with only the need to complete the Security Note.

Due to the way in which the CESR document is written, doubts emerge as to whether this is the case, as it can be understood that it is necessary to register as many Registration Document models as can finally be adopted. This doubt should be resolved.

Obviously all the simplifications proposed by the CESR, in the case of issuing instruments not considered as capital, would be more than neutralised by the requirement that the issuer of multiple instruments may have to register variants of the Registration Documents.

### **Registration Document for derivatives**

The holder of an investment in derivative products assumes a double risk. The credit risk with the issuer, related to the issuer's capacity to meet its commitments, and the market risk, associated with the nature of the product acquired and the evolution of the underlying asset. The information relating to the credit or counterparty risk should be included in the Registration Block, whereas the information concerning the market risk should be included in the Securities Note.

The position of the investor in derivative instruments with respect to credit or counterparty risk is similar to that held by the investor of debt

instruments of the same term. Consequently, we think that the Registration Block for issuers of debt and issuers of derivatives should be the same.

Owing to the way in which the questions of the CESR are put, it is not easy for this basic position to be clearly expressed.

### **Risks associated with the trading and clearing systems**

The investor in a specified financial instrument is informed of the risks that this instrument involves in the corresponding Securities Note. The proposal of the CESR regarding the Securities Note is incomplete in a matter of great importance: the risks that the investor is exposed to related to the market where the security will be traded and cleared.

At the time of acquiring the financial instrument, the investor should know in detail the characteristics of the market or markets in which it will be traded, as this involves levels of transparency, liquidity and transaction costs that differs from market to market.. This aspect becomes more relevant as transnational offers becomes more extended, and as trading systems multiplies.

The same can be said regarding the clearing mechanisms which the investor will be able to use. The security and the associated costs with the use of one or another clearing procedure varies considerably and, consequently, so does the position of the investor with respect to future trades that he decides to make.

Consequently, we propose that the Securities Note incorporate more detailed information on the markets and clearing systems where the security will be traded.

## **ANNEX I**

### **REPLIES TO CESR QUESTIONNAIRE**



### **Replies to CESR questionnaire**

*The IOSOC Disclosure standards are of direct application to equities and it will therefore be no great surprise that the Core Equity building block for equity issuers draws heavily on those disclosure standards. The Core Equity building block is contained in Annex "A". Various issues have arisen on this Core Equity building block.*

#### **QUESTION**

*44. Do you agree with the disclosure obligations set out in Annex A?*

Annex A reflects the IOSCO standards on the transparency of information in prospectuses. In general, countries are adopting these standards that reflect the international consensus in their internal rules. Accordingly, using these obligations on the provision or disclosure of information as a base appears to be a reasonable proposal.

*CESR decided that a better approach would be to have a disclosure requirement for risk factors. But that CESR would later produce guidance on the sort of risk factors that might be expected to be included under this disclosure requirement. This guidance would be amended in the light of experience and future developments in the market.*

#### **QUESTION**

*47. Do you agree with this approach?*

In practice, on numerous occasions, the section of the prospectus outlining the risk factors for a company becomes a means by which the authors of the prospectus avoid responsibilities, much more than a considered description of the main risks involved in the specific lines of business of the company.

This misconstrued practice could undoubtedly worsen if a list of risk factors were offered as guidance. It would be sufficient for the authors of the prospectus to include all of them, freeing themselves of the obligation to provide a reasoned account of the specific risks of a company. If this practice were to become common place, this section of the prospectus would lose all its informative sense to become, a ritual formula without any positive effect on security price formation.

The proposal of CESR that it would later produce guidance on the sort of risk factors that might be expected to be included under this disclosure



requirement, is sensible. This guidance should establish the need to determine those risk factors which are most specific to the business of the issuing company, providing a reasoned analysis, in language easily understood by the average investor.

### **Question**

*51. Do you agree that pro forma should be mandatory in case of a significant gross change in the size of a company, due to a particular actual or planned transaction?*

The Pro forma financial statements are obtained by adding and subtracting the figures that appear in two or more company's financial statements. In as much as, with a pro forma statement one endeavours to present events such as what would have happened if the companies involved in a merger had previously been merged, or if a division of a company had been spun off previously, it must be kept in mind that this representation will only be close to the real situation if a change of this nature only causes quantitative changes which can be added or subtracted.

What would appear to be more likely is that significant changes in a company are accompanied by substantial changes in its strategy, resources, products or sources of supplies, and the result of all this will vary considerably from the additions and subtractions of the pro forma statements.

In other words, the pro forma statements could be a useful source of information to the investor, if those that took the decision that changed the company prepared them on the basis of the figures that appear in these pro forma statements. Otherwise, it would be more interesting to request that they provide information in the prospectus on the business rationale, data and financial analysis on which the decision was based.

Pro forma statements are based on certain assumptions that the prospectus manager does not always identify clearly. For this pro forma information to be fair, it would be necessary to see what would happen if a combination of alternative events occurred. This would make for confusing reading and would prevent the initial objective from being obtained: namely, informing the investor better.

Therefore, it does not appear that the inclusion of pro forma financial statements should be obligatory in the event of a significant change in the company. On the contrary, the pro forma statements should be included in the prospectus by the managers, only if their decisions were based on them. Or in other words, those pro forma statements represent what the managers are committed to achieve as a result of the decision taken.

A distinct case is when, due to a change affecting a company, the position of its shareholders or bondholders is damaged, at least on the face of it, and a pro forma statement is able to quantify the negative impact of the change. In this case, the authors of the prospectus should be obliged to quantify the impact so long as it is material information for investors.

At another level, it is necessary to warn against the inappropriateness of using pro forma statements that limit their scope to only part of the business interests that are considered affected by the change that has taken place, or is due to take place. These partial visions can augment the distortion of reality.

### **Question**

52. Do you agree that pro forma financial information should also be required in all cases where there is or will be a significant gross change in the size of a company?

No, only when due to changes taking place in the company, the position of the shareholders or bondholders is damaged and a pro forma statement is able to quantify the negative impact of the change. In this case, the authors of the prospectus must be obliged to quantify the impact so long as it is material information for investors.

### **Question**

53. Do you agree that 25% is the correct threshold figure? Would a different figure, say 10%, be more appropriate?

A significant change, precisely for being significant, causes variations which are beyond the simplicity of additions and subtractions. Consequently, the greater the change, the less meaningful the figures provided in the pro forma statement. Therefore, the use of a pro forma statement should be limited. That is, it should not be used for changes in excess of 25%, for example.

However, in the event that the pro forma statement had been the base on which management of the company took the decision that led to the change, the percentage limit should be removed. Equally, if as the consequence of a change in the company the interests of shareholders or bondholders is prejudiced, and a pro forma statement is useful to quantify the impact, it should be used irrespective of the percentage change.

### **Question**

55. Do you agree that the competent authority should be able to insist on pro forma information being included where this would be material to investors?

In the event that the pro forma statements have been the basis for the company directors to take the decision which led to the change, it should be considered that this is material information for investors which should be included in the prospectus. The same applies when through the use of pro forma information the negative impact on shareholder or bondholder interests can be displayed.

### **Question**

64. Do you agree with the disclosure requirements in respect of pro forma financial information as set out in Annex B, in particular with the obligation of an independent auditor's report?

The reply to this question is conditioned by the opinion already expressed regarding the extent to which pro forma financial statements can be misleading. In this context, it could be thought that the inclusion of an auditor's report is counterproductive.

As clearly stated in the reference document "The existence of an independent report made by an auditor, which can be the company's auditor, on the pro forma financial information provides readers of the prospectus with a level of comfort that a certain level of due diligence has been undertaken on the issues specifically referred to in the report" (our underlining). There is nothing worse than providing comfort to an investor with figures that don't have to correspond with the reality, for the simple reason that they never existed. The use of an auditor in this task can only contribute to providing an appearance of rigor in something that is no more than a fiction on the basis of which a reasoning is made, if and only if it is considered useful for the issuer's interests.

### **Question**

65. Would it be more appropriate to restrict the disclosure of pro forma information to the occasions where securities are being issued in connection with the transaction and hence require pro forma information in the securities note?

No. The provision of pro forma information makes sense in cases other than the issuing of securities. Especially when management declares that these pro forma statements have been used as the basis for taking a particular decision and when they show the negative impact on shareholders or bondholders of a change in the company. If the decision of the company to make a certain issue is in response to the need to carry out

a certain strategic decision, the prospectus should include adequate information to reach an opinion on the advantages and disadvantages that the decision may have on the company's business.

*In accordance with FESCO 01-045 (paragraph III.11) a profit or loss forecast could be defined as a form of words which expressly or by implication states a minimum or maximum 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 an approximate figure for future profits or losses may be made, even if no particular figure is mentioned and the word "profit" is not used. A dividend forecast must be treated as a profit or loss forecast where the company has a known policy of relating dividends to earnings, or has an insufficient level of retained earnings or the forecast otherwise implies a forecast of profit. A profit or loss estimate is also defined as above with a difference that it covers a financial period which has expired but for which the results have not yet been published.*

### **Question**

73. Do you have any comments at this stage about this preliminary definition of a profit forecast?

No. The definition seems correct.

### **Question**

85. Should issuers be required to repeat or update outstanding ad-hoc profit forecasts in the prospectus?

The inclusion of profit forecasts in the prospectus is not compulsory. So long as the provision is voluntary and normally it is included with the aim of contributing to explain the future operating environment as seen by management, which they have used to define the company's strategy, it is appropriate to consider that any deviation in the forecasts, including that related to profits, is useful information for investors to evaluate the performance of management or the changes in the company's operating environment.

For this reason, it seems useful, when there are forecasts, not only to update the forecasts made, but also to compare the previous forecasts with the results really obtained. These three figures – past estimates, real figures and future estimates – presented together can help investors to judge the management, the accuracy of their forecasts and the degree of optimism of the directors regarding the future. If, additionally, these figures are accompanied with an explanation from the company's directors about

what has happened since the previous forecast, the present situation and the assumptions for the new forecast, the investors will be able to review their judgement which led to them taking a position in the company.

## Question

86. Do you agree with the disclosure requirements in respect of profit forecasts set out in disclosure requirement CESR reference IV.D.3 (a) and (b) of Core Equity Building Block (Annex "A")?

To help the reader form an opinion regarding the accuracy of the profit forecast, in IV.D.3 (b) it could be added that, in the case that the company had made and published estimates of future profits or similar figures in the past, they would be obliged to include them and to inform on the degree to which the forecasts were achieved.

It would be useful for the company to explain in the prospectus their policy and future policy with respect to the publication of profit projections. In the CESR document it is said that the company should maintain a consistent policy on this matter, and any change should be explained. A declaration by the company in the prospectus regarding their policy on publishing profit forecasts would mean making a commitment with the market on this matter, reducing the risk of changes driven exclusively by the positive or negative situation of the business at a certain time.

Amongst the requirements included in section IV.D. 3, is the item referring to differentiating between factors which are under the control of management and those factors which are not. This differentiation, desirable in principle, is in practice exceedingly difficult to establish. Perhaps it would be better to require management of the company to clearly outline the hypotheses on which their profit forecasts are based, so that investors can make their own assessment of whether it is more or less likely that the published estimations will be obtained.

## Question

87. Do you agree with the arguments set out regarding mandatory reporting by the company's financial advisor?

Yes. Curiously in this case there are unfavourable arguments about the use of an independent expert, as it would be seen as conferring an appearance of credibility to what is just accounting estimates. However, these same arguments are not used in the case of pro forma financial statements, even though in our opinion they are estimates to a large extent. Hence the contrary position that we have manifested above regarding the use of auditors and experts in the pro forma financial statements.

## Question

89. Do you agree that such information may be material to an investor's decision to invest? Would the provision of such details breach privacy laws in your jurisdiction?

Yes, without doubt knowing the professional curricula of the company managers is material information. If in the course of their professional career there had been cases related to fraudulent behaviour, bankruptcies or sanctions by the supervisors, this information should not be concealed from potential investors. It would be the investors responsibility to reach an opinion regarding the extent to which these professional careers might represent an additional risk for their investments.

As to whether there is a legal problem in revealing this information of a personal nature, it does not seem reasonable to think that there would be. It should be taken into account that the public interest, that of the investors and the market in general, must be protected. On the other hand, all the information required in the prospectus of a personal nature (such as shareholdings, economic interests, family relationships, earnings, etc.), could also be considered as affecting the right to personal privacy, with the added problem that in certain cases it relates to third parties (for example, family members). Maintaining such a restrictive interpretation would result in eliminating informative content from the prospectus.

Finally, in the event that the revelation of this information were to contravene the law of a country where the prospectus was going to be distributed, any limitation on complete transparency should be highlighted through a warning message in the corresponding section of the prospectus.

## Question

91. Do you think that the additional disclosures of any limiting measures should be required?

The limitations established in the company statutes regarding the voting rights of shareholders are especially relevant – upper limits on votes, irrespective of the number of shares held -; conditions of seniority or of another nature, apart from counting on sufficient shareholder support, to become a board member or chairman; and the requirement of a special quorum to take decisions related to the defence of the company from a hostile take-over. All these dispositions included in the company statutes or in any other legally binding document should be revealed in the prospectus so that the investor can judge the impact that they might have on the security price.

## Question

93. Do you feel that issuers should be required to put on display all documents referred to in the prospectus (as set out in CESR reference VIII in Annex A)? Would this cause problems due to privacy laws or practical problems as a result of having to review lots of documents for commercial information?

It is necessary to distinguish between four types of documents cited in section VIII.F. The documents included in paragraphs a), c) and d) should, without doubt, be available to investors for examination. These are the documents related to the company statutes (a); experts' reports used by the issuer in the prospectus, whose partial publication could be misleading (c); and the audited financial statements of the issuer and the subsidiary companies, where the request to examine them fully would appear to be reasonable (d).

The case of the documents contemplated in paragraph b) which refers to relevant contracts is different. In this case, it may give rise to the situation where, through their full publication, access to commercial information - that may have limited value to investors, but considerable relevance for competitors - is facilitated.

In the case of the documents considered in point b), it appears reasonable to foresee the possibility that the issuer makes a reasoned petition to the supervisor to be exempted from publishing some of these documents in full.

## Question

95. Do you believe that the building blocks in Annexes D, E, F, G and H are appropriate as minimum disclosure standards?

In general, it would appear to be sufficient to differentiate certain cases based on the information requirements. The type of companies which are covered in the above Annexes seems reasonable, as do the specific requirements for each of them. Nevertheless, some suggestions can be made.

Annex D: property companies. The requirement to include valuation reports in the prospectus seems reasonable. However, in point 4), it is required that the valuation for each of these assets is dated within the last 42 days. This seems to be an excessive burden, taking into account that it relates to properties, whose market prices are normally much more stable than other assets. Not only this, but also the valuations are made using a spread of prices, given the lack of a liquid and transparent market; this spread is usually quite wide and always greater than the price variation that the properties may experience in normal conditions in a period as short as 42 days. The burden that this requirement represents is even more clearly



excessive if it is taken into account that individualised asset valuations are required, and these may be numerous. It would appear to be more reasonable to request that the valuations were dated no earlier than the close of the last financial year, or the current financial year if nine months have passed since the close of the previous financial year.

Annex G: investment companies. It does not appear that a full explanation of the criteria used by the company to value its shareholdings is required, especially when dealing with unlisted companies.

Annex H: companies focused on R&D activities. The possibility of granting exemption from the publication of certain details on investment programs or the launch of new products, when this would damage the company commercially, should be conserved.

## Question

96. What other specialist building blocks (if any) should CESR consider producing in the future?

Perhaps it would be necessary to specify certain requirements in the case of insurance companies should be studied.

## Question

100. Do you agree with the specific disclosure requirement set out in the building block for start-up companies?

Some observations can be made, starting from the principle that in the case of new companies the basic document should be a detailed and reasoned business plan, in which the basic assumptions are clearly specified.

In point II.A.2 a breakdown of the investment and advertising expenses is requested as well as the means of financing them. These expenses and many others which are not less relevant (personnel, leases, distribution, etc.) should be duly explained in the business plan. That is why it is difficult to understand the specific reference to just two items made in the document.

In point IV.B information is required on the company's financing needs for the two years following registration of the prospectus. Given that these are new companies, it will be difficult for them to have reached self-financing in two years. It would seem to be more reasonable to request the next three years (36 months). The business plan should cover a five year period, with a less detailed breakdown for the fourth and fifth year.



In point IV.D an auditor's opinion is requested on the profit forecast, which cannot extend beyond the current year and the next year. The auditor's report on profit forecasts is always arguable, but in the case of high growth, newly formed companies, the auditor's opinion would be misleading.

### **Question**

101. Do you feel that additional disclosure requirements should be included, for example, an independent expert opinion on the products and business plan?

The opinion of an independent expert on the product and business plan of a recently formed company should not be required. As a matter of fact it would be clearly misleading unless it were full of provisos.

Much to the contrary, what should be considered is whether this type of independent report should be allowed to be included in the prospectus.

### **Question**

102. Do you feel that disclosure of restrictions regarding holdings by directors and senior management etc. should be applied to all companies through the core building block? Or should this only be required for all companies where there are such restrictions?

The disclosure of information on whether or not this type of restriction applies should be required. Accordingly, it should be required always.

### **Question**

105. Do you believe that SMEs should only be required to provide details for two years under disclosure requirement II.A?

No. From a practical point of view, the workload involved in the preparation of the prospectus is not reduced significantly merely because the information refers to two years instead of three. In addition, in the case of SMEs, which are presumably companies not well known by the market, it is necessary to extend their track record as much as possible.

### **Question**

106. If so, do you believe that all historical information should be restricted to this two years period?

Information requirements to be fulfilled by companies tapping the market should be very similar whatever their size. Stringent disclosure

requirements would be greatly beneficial for closely held companies. SME's shares are less liquid than bigger ones in stock markets; it will be difficult for them to succeed as publicly listed companies, if a greater level of opacity is added to this fact.

### Question

107. Bearing in mind the materiality tests in the disclosure requirements contained in the Core Equity building block, if you believe that there should be some specific disclosure requirements for registration documents for SMEs, please list them.

In this type of companies the chairman is often the main shareholder and driving force in management, and even the founder of the company. It is important to know in these cases the company's plan should this person pass on or become unavailable, who are the heirs and what preparations for succession might be expected.

### Question

111. Do you agree that valuation reports as set out in Annex D should be required for property companies?

Yes. It would seem important to have these types of valuations.

### Question

112. Do you consider it appropriate that the date of valuation must not be more than 42 days prior to the date of publication?

This demand does not seem appropriate, as it would be an excessive burden. We will repeat the argument that we gave on this matter in the response to question No. 95:

“Annex D: property companies. The requirement to include valuation reports in the prospectus seems reasonable. However, in point 4), it is required that the valuation for each of these assets is dated within the last 42 days. This seems to be an excessive burden, taking into account that it relates to properties, whose market prices are normally much more stable than other assets. Not only this, but also the valuations are made using a spread of prices, given the lack of a liquid and transparent market; this spread is usually quite wide and is always greater than the price variation that the properties may experience in normal conditions in a period as short as 42 days. The burden that this requirement represents is even more clearly excessive if it is taken into account that individualised asset

valuations are required, and these may be numerous. It would appear to be more reasonable to request that the valuations were dated no earlier than the close of the last financial year, or the current financial year if nine months have passed since the close of the previous financial year.”

### Question

113. Do you agree that it would be more appropriate for such reports to be required when securities are being issued by a property company and hence should form part of the securities note?

No. Keeping in mind the advantage of streamlining the issue processes, the convenience of requiring valuation reports at the time of offering the securities does not seem clear. these types of valuation reports are expensive and it takes time to get them. It would seem more logical that they form part of the register documents, although being less demanding with respect to the frequency for updating them.

### Question

116. Do you agree that expert reports should be required for mineral companies? Do you agree that it would be more appropriate for such reports to be required when securities are being issued by a mineral company and hence should form part of the securities note?

The experts report on mining companies should only be able to be demanded when dealing with new companies or those that are accessing the capital markets for the first time. A listed company is normally able to offer a track record. The report of an independent expert should only be requested if there has been a material change in the company’s reserves.

Regarding the possibility of including this type of report in the securities note, it would not seem the most adequate arrangement. The status of the mineral reserves of the company is information of a structural nature, which should be included in the registration documents. On the other hand, the securities note should be document easy to comply with, and it is not convenient to overload it.

### Question

120. Do you agree with the disclosure requirements in registration documents for investment companies set out in Annex G?

Yes, but always bearing in mind the comments made in the response to question No. 95, which are repeated below:

“Annex G: investment companies. It does not appear that a full explanation of the criteria used by the company to value its shareholdings is required, especially when dealing with unlisted companies.”

## **Question**

123. Do you agree with the disclosure requirements in registration documents for scientific based companies set out in Annex H?

Yes, but always bearing in mind the comments made in the response to question No. 95, which are repeated below:

“Annex H: companies focused on R&D activities. The possibility of granting exemption from the publication of certain details on investment programs or the launch of new products when this would damage the company commercially should be conserved,.”

## **Debt instruments**

## **Question**

129. Do you consider that the disclosure requirements for debt securities should be identical to those for equity, as set out in Annex A?

Disclosure requirements for debt securities should not be identical to those for equity in matters where the position between the shareholders (who are the holders of voting rights, for instance) and creditors are different. In contrast, disclosure requirements should be similar with respect to the relevant information necessary to consider the credit or counterparty risk that the creditor assumes. When specifying the information required to determine the credit or counterparty risk that the creditor assumes, one can distinguish between short term and long term debt issues. Only holders of long term debt can be interested in matters related to the general track record of the business or, even, with matters related to corporate governance. These aspects are much less relevant for holders of short term debt.

## **Question**

134. Do you consider disclosure about the issuer's bankers and legal advisers to the extent that the company has a continuing relationship with such entities to be relevant for corporate retail debt?

The legal advisers and bankers play an important role in the life of companies when they has a continuing relationship with them, that is, when the relationship goes beyond merely occasional help in the implementation of decisions taken by the company's management., When the relationship is

permanent, then it is common practice for banks and legal advisers to participate in the manager's decision making process.

Each private investor can have an opinion formed – or they can research to form an opinion – regarding the permanent advisers of the issuer. This opinion will normally be based on the record of successes and failures of the advisers, on the clients for whom they work and on the opinion that they have of them, in their directors and employees and on any consideration formed regarding their honesty or technical knowledge. The investor will be interested in knowing whether the permanent advisers are independent or whether, on the contrary, they are found to be somehow linked to the creation of the company or some of the companies in the group. Of equal interest may be the relationships between the advisers and other independent business groups or competitors of the group which forms part of the issuer.

The issuer's ability to meet its commitments with its creditors will depend on two factors. Firstly, its ability to generate sufficient liquid financial resources to cover interest and principal payments and any other amounts agreed. Secondly, the willingness of the shareholders of the company, and to this effect, the management, to make the payments using the cash resources generated by the company. The answer to both questions will be influenced by the company's advisers. In the event of a company financial crisis, they are the ones who will provide advice on the most appropriate alternative, and the ones to raise the financial resources needed to pay the creditors, if this is the decided response.

However, the relevance of this information is not the same for all creditors. The holder of a long term bond assumes a risk related to the evolution of the issuer's business over a certain number of years. In this sense, a long term bondholder will be more interested in knowing the financial advisers and bankers of the issuer, than a short term bondholder. The possibilities of having to face a liquidity crisis are increasingly greater the longer the time horizon of the investment.

However, for the investor in short term debt instruments, knowing the financial situation of the issuer at the time of issue pretty well covers his risks. For this type of investor, there is much less interest in knowing information about the issuer's bankers and advisers.

For these reasons, we are of the opinion that the investor in long term debt instruments has an interest in knowing who the advisers are. This is not the case for the investor in short term debt instruments.

## Question

135. Do you consider that disclosure relating to the bankers and legal advisers who were involved in the issue of that particular debt instrument to be relevant?

Yes we do.

### Question

137. Do you consider disclosure about a company's past investments in other undertakings to be material for an investor to make an investment decision about investing in the company's debt?

Equity holders should decide whether or not to pay company's debt. This decision depends on today company earnings and expected company value. If company earnings are not sufficient to pay the debt, or expected company value does not justify to maintain the company afloat, equity holders most probably will let the company to go under

Both questions depend to a large extent on past investments of the company and its degree of success. Knowing if the company has invested, and how much, in projects with a doubtful outcome or simply failed projects, is highly relevant information for the investor. Especially if some of these investments there may have been debt re-structuring or receivership, in the past

Nevertheless, we must remember what has been said previously: the situation of the creditor who buys long term debt securities is different from the creditor who buys short term instruments. The time horizon of their risks is different, as is the importance to them of the risks derived from historical investments.

Accordingly, information on historical investments is important in the case of long term debt issues, but not in the case of short term debt issues.

### Question

138. Do you consider that disclosure about a company's current investments in other undertakings to be material for an investor to make an investment decision about investing in the company's debt?

Yes, for the reasons outlined in response to question No. 137 above. But if possible, with greater emphasis, as we are dealing with current investments that generate future commitments, knowledge of them is even more important than in the case of previous or historical investments. That is, provided we are always referring to long term debt issues.

### Question

139. Do you consider that disclosure about a company's future investments in other undertakings to be material for an investor to make an investment decision about investing in the company's debt?

It is a matter of investments which, directly or indirectly, are related to the use of funds raised through the debt issue in the prospectus. The capacity of the issuer to meet their obligations with creditors will depend to a large extent on the financial performance of these investments, as well as their business logic and that of the project or projects for which funds have been raised.

The size of the pending investments and the periods in which to make them, outlined in relation to the company's finances, will indicate if the issuer will be faced with liquidity crunches in the future that will prevent it from meeting its commitments with creditors.

Knowledge of future investments is relevant for the investor, provided that we are referring to long term debt issues.

### **Question**

142. Do you agree that these different interests should be reflected by different disclosure standards and in particular that retail bondholders do not need the same disclosures as shareholders in respect of these sections of the IOSCO IDS?

It is possible that the level of disclosure need not coincide.

In the case of sections V.A. and V.B of the IDS, the first thing to be highlighted is that they are two blocks with very different scope. In the first (V.A.) what the issuer is required to determine is the impact of significant variations in external economic indicators, such as inflation, exchange rates or monetary and fiscal policy, on the main numbers for the business. In the second, what the issuer is required to determine is its outlook for cash flow, debt levels, financing expenses and related matters, questions which are all essential for the investor to be able to evaluate if the issuer will be in a position to meet loan payments.

For these reasons, it would seem prudent to maintain section V.B of the IDS as part of the prospectus and recommend the elimination or synthesis of section V.A. In this respect we are referring to long term debt issues.

### **Question**

145. Do you consider it necessary for a disclosure requirement that stipulates when interim financial statements should be disclosed in the

registration document, to also stipulate what the form and content of the statements should be?

Point VII.H.1 of the CESR document establishes the obligation to provide the interim financial statements of the issuer when more than nine months have passed since the last financial year audited financial statements. These interim financial statements must cover the first six months of the current financial year. These obligations are common for the case of prospectuses registered by issuers of capital and debt, which seems reasonable when we refer to the issue of long term debt.

On the other hand, point VII.H.2 of the registration document for issuers of shares, is deleted for issuers of debt instruments. This point specifies the minimum content of the interim financial statements to be included in the registration in the case foreseen in VII.H.1. The question revolves around whether the form and content of the interim or provisional financial statements should also be specified for issuers of debt. In this respect, the following points should be highlighted:

- Both in the case of the issuers of shares and debt instruments, a different method could be used. Namely: instead of the detailed information in point VII.H.2, it would be sufficient to say that the interim or provisional financial statements of the issuer (balance sheet, profit and loss account, and cash flow statement) will be provided with the same breakdown as the end of year financial statements, using the same accounting criteria; that they must be provided for the same time period as the previous financial year; and in the event that more recent financial information has been published, this should be included in the registration document. A more general form of establishing this obligation certainly seems more appropriate than such a casuistic method as the one outlined in point VII.H.2 of the CESR proposal.
- But question No. 145 makes the specific reference that, in the case of issuers of debt, it will not be necessary to specify the content of the interim financial statements. In this sense, the response is, if it is considered necessary to specify the form and content of the interim financial statements for the issuers of shares, it should also be required to specify its form and content for the issuers of debt. The reasons of comparability and definition of minimum standards that endorse the need to regulate the form and content of the interim financial statements are equally valid for issuers of shares and issuers of long term debt.
- In most cases, issuers of corporate retail debt are publicly listed companies and therefore subject to the obligation to provide regular financial information. The requirement to provide financial information every six months, with a breakdown similar to the year end information, is an internationally widespread regulatory practice . Accordingly, this requirement is not an additional load.



## Question

146. If you consider that the reduced level of detail is more appropriate, should the same approach be taken for equity?

Given the response to the previous question, the response to this question is that the requirements regarding the form and content of interim financial information should be the same for issuers of shares and issuers of long term debt. However, the method of establishing these requirements regarding form and content should be more general, which does not mean less strict.

## Question

148. Do you feel that issuers should be required to put on display all documents referred to in the prospectus (as set out in CESR reference VIII in Annex A)? Would this cause problems due to privacy laws or practical problems as a result of having to review lots of documents for commercial information?

Please refer here to the response given to question No. 93, with the difference that the response in point b) varies in the case of the registration document for issuers of debt from that for issuers of shares.

Noting that we are always referring to issuers of long term debt, it would be necessary to distinguish between the four types of documents listed in section VIII.E. The documents included in paragraphs a), c) and d) must, without any doubt, be made available to investors. These documents are the company statutes (a); the reports of experts included in the prospectus, whose partial publication could be misleading (c); and the audited financial statements of the issuer and subsidiary companies, full audit report of which would seem reasonable to ask (d).

The documents contemplated in paragraph b) are a case apart, as they refer to relevant contracts, in the case of issuers of shares, and trust deeds for issuers of debt. It is not explained here the different wording given to this specific requirement in one type of prospectus and the other. In the first instance, it seems reasonable that the general requirement to publish any relevant contract would also cover the more specific case of trust deeds, if these were relevant.

In the situation contemplated in b), it could occur that, by publishing their full contents, company's competitor could take advantage of sensitive information. In the case of the documents referred in b), it seems reasonable to foresee the possibility that an issuer could make a reasoned request to the supervisor to be exempted from the publication of some of these documents in full, when they are of limited interest to investors.

## Question

150. Please give views on which if any of the documents that are not in the language of the country in which the public offer or admission to trading is being sought should be translated.

. With the objective of making the requirements more flexible, it could be established that the documents to be made available to the home country market will be presented in their original language, if this is the official language of the home country or a language generally used in the financial world. Only if the original documents were written in a language other than the official language of the home country or in another language not generally used in the financial world, should their translation be requested.

## Question

153. On a review of the equity disclosure requirements (CESR ref. VIII.G of the Core Equity Building Block) set out in Annex A, please advise which if any of these requirements you consider to be relevant for retail corporate debt. Please give your reasons.

Section VIII.G refers to the information that must be included in the registration document on relevant financial shareholdings of the issuer in other companies. In reference to the general question raised, it is not clear what could be the arguments to consider this information relevant to shareholders but not to bondholders or long term creditors.

The financial capacity of the issuer to make debt payments is affected by the evolution of the business in the whole group. It should be taken into account that the parent company may be giving financial support to subsidiary and associated companies, thus affecting its capacity to meet its obligations to creditors. Or the case could arise where the parent company withdrew resources from its subsidiary companies, even in an illegal manner, to meet obligations to creditors of the parent, which does not cease to be relevant to the creditor.

Nor should the risks of problems spreading between the parent and associated or subsidiary companies be understated, even when there is no control. This effect may spread even beyond the strictly legal obligations of the companies, as can easily be appreciated in the workings of markets.

The list of information requirements contemplated in the cited paragraph VII.G is missing an entry regarding the possible existence of guarantees given by the issuer to its subsidiary or associated companies. This information is without doubt relevant to the issuer's creditors.

Consequently, the specific reply to the question raised is that all the information on subsidiaries that is relevant for shareholders is also relevant for the holders of long term debt.

## Question

154. Do you agree with the CESR disclosure proposals for corporate retail debt as set out in Annex I?

No, not if we are referring to long term debt. The chosen approach is to define the content of the corporate retail debt registration document by suppressing disclosure items from equity registration document. The logic that underlies these eliminations is not readily understood. Neither from the point of view of the different risk factors that a long term creditor assumes, compared to the shareholders; nor from the perspective of making the prospectus significantly lighter.

In the first place, it is difficult to establish a clear frontier regarding information that is only of interest to shareholders. The factors that affect the appreciation by the market of the specific risks of an issuer of long term debt and, therefore, with effects on the costs at the time of the issue and subsequently on the price of the debt in the secondary market, are intimately linked with the general evolution of the issuer's business. We can briefly set out a series of circumstances that illustrate how the factors to be taken into account in the case of shares and long term debt instruments are mixed up:

- The market value of the shares affects the value of long term debt instruments. One form of valuing corporate bonds which is widely used involves considering them as an instrument valued as the price of the risk free bond plus the price of a "short put". The strike price of this option will be calculated by taking the difference between the market capitalisation of the company and the value of its debt. In this way, the position of the bondholder is directly affected by the evolution of the price of the shares.
- The interest rate of the bond on issue and the evolution of its price in the secondary market is directly affected by the rating given by the rating agencies. Experience shows the great sensibility of the rating agencies, when modifying the rating, to the evolution of the market capitalisation. And the market capitalisation depends on the evolution of the business and the trustworthiness of the management team.
- Frequently, the capacity of a company to meet its obligations with its creditors is conditioned by the capacity to refinance. This capacity to refinance is strongly influenced by the evolution of the market capitalisation and, therefore, the general evolution of the business.

- It is difficult to determine if a particular factor will not be relevant to a bondholder. We are less likely to be mistaken if we start from the hypothesis that nearly everything that is important to the shareholder is also important to the creditor, at least as far as structural aspects are concerned, which are those covered in the registration document.
- There is always a conflict of interests between shareholders and bondholders. Under normal circumstances, when determining how to finance the business, there is a conflict between the dilution of the shareholders and guarantees to creditors. This underlying conflict is brought to the fore much more clearly in the case of a financial crisis.

If it proves difficult to establish what information related to the issuer which is irrelevant to long term creditors, it would seem to be advisable to start from the assumption, exceptions apart, that most information requirements should be common for shareholders and (long-term) bondholders.

On the other hand there are practical arguments to be taken into account. The large majority of issuers of corporate retail debt are listed companies, and therefore already subject to the registration requirements for shares. Normally, unlisted companies with the capacity to place debt instruments with retail investors are big corporations, and complying with the standard requisites established for issuers of shares does not represent a significant problem for them.

Finally, the informative elements that are eliminated in the registration document of debt issuers do not appear to have a great impact either from the perspective of the work load in preparing the documentation or from the perspective of simplifying the document to be consulted by the public.

### Question

155. Please advise which if any items of disclosure should not be required for corporate retail debt. Please give your reasons.

In line with the opinions expressed so far, the information referring to shareholders rights could be removed.

### Question

156. Please advise if there are items of disclosure for corporate retail debt that are not set out in the schedule, but should be. Please give your reasons.

In accordance with the opinion expressed in response to question No. 154, we think that a more logical and practical approach would be to

consider that the elements of information required in the registration document should be unified, for issuers of both long term debt and equity. Perhaps there would be some information in the registration document that could be included in the securities note, or additional elements of information identified that only affect the rights of shareholders to be required in the Registration Block for shares.

Our specific opinions regarding a series of informative elements required of issuers of shares which have been proposed to be deleted for issuers of debt instruments are as follow:

- **Selected financial data (II.A).**

- In II.A.1 data for 2 years is requested, instead of 3 years in the case of shares. The reason is not clear. The historical financial performance should be common (2 or 3 years) for shares and long term debt.
- In II.A.2 the financial data per share is eliminated, as is the information on dividends. The former is irrelevant, as it is no more than a simple process of division. But omission of the second is incomprehensible. The dividend policy and the pay out rate of the issuer is a very relevant figure for the holder of long term debt.

- **Risk factors (II.B)**

- Replace the expression “*make an offering speculative*” in the case of shares, for “*any other factor that may affect the company’s ability to fulfil its obligations under the debt securities to investors*”
- In reality both expressions refer to the same thing. They can be unified by referring to any factor that may affect the risk of the instruments offered or seeking to be listed.

- **History and development of the company (III.A)**

- The wording of point III.A.5 is changed to limit it in the case of debt to “recent” relevant events that may affect the evaluation of solvency.
- It is not clear why in the case of debt it is limited to “recent” events.
- The information that is required in the case of shares and that which is deleted for debt refers to events such as mergers, acquisitions, sale of assets, product and name changes, changes in the business model. Once again it is not understood why if these facts are relevant for the shareholder, they would not also be to value the risk of the long term creditor.

- **Investments (III.B)**

- Historical investments (III.B1). The requirement is 3 years data, contradicting the request for only 2 years on other points. The wording changes, but the content is similar. Except in the elimination of references not only to investments, but also divestments.
  - Investments in progress (III.B.2) and main future investments (III.B.3). The text varies, but the content is substantially similar. This practice of altering text when there is no significant change in the content, which is found in numerous parts of the document, proves to be confusing for users of the rules and dangerous for the supervisors, as the interpretations that an issuer in bad faith may make are unpredictable.
  - Point III.B.4 of the registration document for shares is deleted, which refers to public offers made or received by the issuer. Nor is the motive for deleting this information in the case of long term debt issuers understood, if it deals with relevant facts. For example, the holder of public debt can form an opinion on the risk assumed, be it positive or negative. An offer received by the issuer can represent an important valuation of the company's assets and accordingly a greater guarantee for its debt in the event of liquidation. Conversely, the fact that a company has had an aggressive take-over policy may be information that is relevant to the creditor, whose risk may increase due to this type of policy.
- **Business overview (III.C)**
- Main activities (III.C.1). The reference to 3 years used in the case of shares is eliminated. What period should be used, 2 or 3 years? In our opinion the time period of reference should be the same for equity and long term debt. Apart from this, there is a change in the text, without an evident change in the content, which creates confusion.
  - Principal markets (III.C.2). The content is identical in equity and bonds. Except in the case of issuers of debt, where 2 years data is required instead of 3 years. The reasons for this change in the time period are ignored. If the objective is to simplify requirements, the main difficulty lies in the breakdown by business lines and markets requested. Not in whether the period is 2 years or 3 years.
  - Requirements III.C.3 to III.C.8 of the register document for equity are deleted. Amongst other things, these points refer to: exceptional circumstances that have affected the businesses, seasonal nature of the business, risks associated with raw materials, dependence on patents and licences, etc. It is not understood why matters such as those listed are relevant for shareholders but not for long term creditors. For example, wouldn't the interruption in the production process due to a break in the supply chain or the loss of a licence

affect the capacity of the business to meet its obligations with creditors? Isn't the seasonal nature of the business an important factor in determining the cash flow requirements?

- **Organisational structure (III.D)**

- The text on points III.D.1 and 2 varies with respect to the case of shares, but once again the change in the text does not make it clear what is the difference in the information requirements in one case and the other. The impression obtained is that in the case of debt the same information is required, but in more generic terms.
- Here the importance of the structure of a group and the risks of the spread of financial stress and the diversion of funds should again be noted.

- **Property, plants and equipment (III.E)**

- The simplification of the text compared to the same point in the block referring to the issue of equity involves the deletion of details such as: the form of holding assets, environmental risks, growth plans and methods of financing these investments, etc.
- Once again the criteria employed to conclude that these factors do not affect the risk of long term debt holders is inexplicable.

- **Operating results**

- The contents referring to operating results covered in points IV.A of Annex A on equity are deleted.
- Amongst the subjects included in the points highlighted above are: significant variations in sales and profits, exchange rate risk and political or regulatory risks. It is unsustainable that these types of factors do not affect the risk of long term creditors.

- **The company's capital expenditure commitments (IV.A)**

- Limited to a request for information on the obligations assumed related to investments.
- The proposed deletion of information requested in points IV.B.1 to IV.B.3 is surprising. All the information requested in these points for the issuers of equity refer to the disclosure of the company's liquidity risks and its financing methods.

- **Research and development, patents and licences**

- This information, required in point IV.C of the document on equity, is deleted.

- **Trend information (IV.B)**

- The information required is exactly the same as in the case of shares.
- The option to keep it the same is correct, always referring to long term debt.

- **Directors and senior management (V.A)**

- The information required is vastly reduced compared to the corresponding section in the registration document for equity.
- Amongst the subjects deleted are: key personnel for the company, family relationships, professional background, including information on fraud or bankruptcies, fines or punishments imposed by regulators, etc.
- The criteria used to decide that the professional background of management and information that might affect their credibility is not relevant to the long term creditor has not rational support, their fraud or bankruptcy track record or family and business ties are highly relevant for bondholders.

- **Compensation**

- The information requirements (point V.B of Annex A) related to retributions, bonuses and pension contributions for directors and managers are deleted.
- This would be a case where it is possible to defend the direct interest of shareholders in these matters, that the bondholder does not have. The interest of the creditor would only be indirect: if compensation practices were to bring into question of the management team ethical behaviour.

- **Board practices (V.C)**

- The request for information on the term for directors and senior management, and the economic consequences should they be made redundant is deleted. The second matter could become a significant unexpected liability that would affect the creditors' risk. The first is important, only so far as knowing the composition and renovation of the board of directors.
- On the other hand, the request for information regarding the functioning of the issuer's compensation committee is maintained. The criteria used is surprising, as information regarding retributions, pensions and redundancy payments to senior management is excluded, but that regarding the form and functioning of the



compensation committee is included. This information could be deleted.

- **Employees**

- This section in the Registration Block corresponding to issuers of equity is deleted.
- It would seem that the number of employees in the company and the evolution over time is not relevant to the creditor. Under legislation such as the Spanish legislation, in the event of receivership or bankruptcy, the workers are preferred creditors.

- **Major shareholders (VI.A)**

- The same information is requested as in the case of shares, except for the evolution of shareholders over the last 3 years.
- Providing this information is hardly a complication for the issuer but, however, it may be of interest to know the recent evolution of the core shareholders. If the evolution of the financial statements and the business in general is requested, it makes sense to know of a possible connection with significant changes in the shareholding structure.

- **Interests of experts and counsel**

- Section VI.C of Annex A is eliminated. This section requests information on the existence of financial interests in the company or group held by the experts or advisers. It also requests information on whether their retribution is linked to the success of the offer.
- In order to judge the independence of the experts and advisers it is important to know their financial interests. Retribution linked to the success of the operation may occur both in share issues and bond issues. Consequently, it does seem justified to eliminate this information requirement in the case of bond issuers.

- **Standard of account preparation (VII.C)**

- Reduces the comparison of financial statements to 2 years, instead of the 3 years required in the case of shares.
- As previously stated, the criteria to reduce the time period of the required data is not understood. If 3 years is considered to be a relevant period for shareholders, why is it only 2 years in the case of bondholders? Is it thought that this will significantly lessen the workload involved in preparing the prospectus? We think that it is preferable to unify periods.

- **Interim financial statements (VII.H)**

- The requirement to present interim financial statements is maintained, but the description of their contents is eliminated. The change in the text is once again confusing with respect to its objectives.
- The request for information on changes in the dividend policy is deleted. As has been said previously, the pay out policy of the company is relevant to the creditor.

- **Share capital (VIII.A)**

- In the case of bond issues, there is a deletion of information required which is as relevant to creditors as: the issue of shares against assets or the company's own share portfolio. Both types of information may affect the financial soundness of the company and consequently the creditors' risk.
- The request for information regarding the existence of convertible bonds or warrants, or regarding the issue of share and stock options is also omitted. In this case, effectively, it can be considered that such factors do not directly affect creditors holding bonds.

- **Exchange controls**

- Point VIII.D in Annex A is deleted for issuers of debt.
- In this section information is requested on the existence of legal norms regarding the movement of capital, which could affect the repatriation of capital, or the payment of interest and dividends.
- It is obvious that the contents in point VIII.D of Annex A should be maintained for issuers of bonds. It is information that directly affects the situation of the creditors.

### **Derivative Instruments**

#### **Question**

160. Do you consider it necessary to have specific derivative registration document requirements, or do you consider this unnecessary as the registration document requirement for debt securities should be used for derivative securities as well? Please give your reasons

We have argued in our replies about the Registration Block for long term debt issuers that the type of information required coincides to a large extent with that requested from issuers of shares. Those bondholders who

evaluate the issuers' long term risks would be interested in knowing generally the same information as shareholders, with the exception of information specifically related to the voting rights of shareholders, which doesn't apply to bondholders. In line with this argument, we would raise the possibility of defining a common Registration Block for shares and long term bonds, allowing for an additional information block that applies specifically to the issue of shares. This procedure could be much clearer than that proposed in the CESR document, as the system of deleting blocks of information has some real disadvantages, from an economic perspective.

By adopting this approach, when the investor in derivatives assumes a credit risk with an issuer that is similar to a bondholder, the Registration Block for derivatives should be the same as that used for issuers of debt. The market risks that this investor is exposed to would be detailed in the securities note, which describes the characteristics of the instrument.

However, the situation of the issuer of derivatives could be very different. There are three cases:

- Companies that issue convertible bonds, which can be exchanged for a set number of shares in the company (convertible bond, warrants). In this case the relevant information about the issuer is the same as that required from the issuer of shares, with the distinction that investors hold an option. The investor certainly needs to know how the issuer's business is developing to make a well founded judgement on whether it is interesting to convert bond for shares in the issuing company.
- Companies that issue derivative instruments that include an option or future on securities issued by another company, with the possibility of cash settlement in many cases. In this case, the registration document of the issuer of the derivative instruments should include special reference to its solvency and capacity, if the investor were to exercise the options acquired. It may also be interesting to have details of the issuer's experience and resources. Information on the underlying asset, usually a listed company, will be covered through references in the securities note.
- A company that issues derivative instruments where the underlying is an index, an interest rate or a specified exchange rate. This third case has much more in common with the second than the first. Information about the underlying should also be included in the securities note.

Taking into account the special case of the issuer of derivatives to raise funds for its own business, our conclusion is that in the other two cases the Registration Block should be the same as the issuer of debt.

## **Question**

170. Do you think it is useful to provide some form of definition for these securities?

Maybe. If the information requirements vary depending of the type of instruments being issued, a definition will be necessary. If the information is the same as that provided for debt instruments, it would not be necessary.

### **Question**

*If so, which of the two approaches set out above do you prefer? Please give your reasons.*

A broad definition of the concept of derivative seems advisable, as outlined in the first approach. Such a detailed description as contemplated in the second approach would not seem to be appropriate for a norm designed to remain in place for any period of time, especially in the case of derivatives which are highly creative. On the other hand, in the case of the descriptive definition (second approach), it should be considered whether all the requirements need to be met, and which are essential.

The risk that certain financial products will incorrectly fall into the category of derivatives as a result of adopting a broad definition is not considered important. In any case, it is possible to leave the supervisor with a margin of judgement.

### **Question**

*172. If you prefer the approach based on a wide definition of derivatives, do you have any comments on the proposed definition?*

The wide definition will cover the case where derivative issues are used to raise capital for the issuer itself: that is, companies that issue convertible bonds or warrants on their shares.

Point 2-b of the second approach (descriptive definition) excludes the case of the issuer of derivatives who is also issuer of the underlying instrument, whose objective is to raise additional capital. This exclusion seems reasonable, as does the proposed solution provided in point No. 169 for this case.

Consequently, it should be added to the wide definition proposed in point No. 166 that the registration norms for issuers of derivative instruments will not apply when the issuer of the derivative and the underlying instrument are the same and the objective of the operation is to raise additional capital.

### **Question**

173. If you prefer the approach based on fundamental features, are there other features that should be but are not included in the above list?

We prefer the first approach, so we will ignore this question.

### **Question**

179. Do you agree with the above broad sub-categorisation of derivative products?

No, not given the objectives of the CESR document. Our arguments are as follows:

What is important for the investor is to get an information block fulfilling his risk concerns. Sub-categories such as "non guaranteed return derivatives" and "guaranteed return derivatives" are somewhat artificial and there is not a clear-cut distinction between them.

- The situations in between are complex, as in some cases they are closer to one of the sub-categories than the other. Consequently, for the investor to form an opinion, very different information is required.
- Depending on the point of view adopted, multiple classifications can be established, which are equally relevant when considering what information needs to be available to the investor. For example, the difference between fixed income derivatives (market risk related to the evolution of interest rates) and derivatives on stocks or stock exchange indexes (market risk related to share price movements).

### **Question**

180. Do you agree with the approach of having two distinct registration document building blocks to reflect this sub-categorisation?

No, for the reasons explained in reply to the previous question. This does not seem to be the most relevant distinction. There are many intermediate positions between the two categories.

### **Question**

185. Do you agree that the nature of the decision that an investor is making about the issuer in the case of a non guaranteed derivative is different to the one an investor is making in the case of a guaranteed derivative? Please give your reasons.

No, for the following reasons:

- In the first place, note the objections we made in response to question No. 179, where we argue that the differentiation proposed does not seem to be the only one that is relevant as there are intermediate positions between the two proposed categories.
- To determine the credit risk or counterparty risk that the investor assumes, which is the focus in the CESR document, the two proposed categories are insufficient. Following the rationale proposed by the CESR, it would be necessary to judge the risk carried by the issuer of derivatives with one product or another, which is undoubtedly a very complex matter. What cannot be sustained in advance, however, is that the risk that an issuer carries against its own balance sheet is greater in the case of the issuer of derivatives with a guaranteed minimum yield than that of the issuer of a derivative with no guaranteed minimum yield.
- In any case, irrespective of the complexity involved, the investor could be interested in knowing how the issuer manages the risks carried on issuing derivatives. Not only in relation to the specific issue, but also with respect to the total risk carried in the management of its portfolio.

### Question

190. Do you consider that disclosure about the issuer's senior management, as set out in IOSCO reference I.A, is relevant for these products? Please give your reasons.

The investor in a derivative instrument takes on a credit or counterparty risk with the issuer, in the same way as an investor in debt does, for example. If, in order to determine counterparty risk it is important to have detailed information on the directors and management, then this information should not be withheld in the case of derivative issuers.

One way of making the preparation and supervision of the prospectus easier is to standardise them as much as possible. The introduction of additional distinctions, often poorly justified, which require little effort to comply with, only makes the registration of a prospectus more complicated.

Consequently, the inclusion of information on directors and management in the registration documents of derivative issuers is as important as in the case of bond issuers.

### Question

192. Do you consider disclosure about issuer's advisers, as set out in IOSCO reference I.B, to be relevant for these products? Please give your reasons.

Working from the point made above that an investor in derivatives will have a credit or counterparty risk, the inclusion of information about the issuer's advisers is just as important in this case as it would be in the case of bond issuers.

Furthermore, as we have said before, the counterparty risk carried by the investor in derivatives depends to a large extent on the capacity of the issuer to manage this type of risk in its portfolio. Given the complexity involved in the risk management of an institution's derivatives portfolio, it may be useful for the investor to know if the issuer is receiving advice of quality in this area.

Once again we note our opinion expressed in response to numerous questions. In order to simplify the disclosure process, it is advisable to avoid using multiple information standards.

### **Question**

195. Do you have any views at this stage about CESR's provisional guidance in this area?

It is necessary to differentiate between two types of risk, as is made clear in the CESR document. On the one hand, risk associated with the issuer's capacity to meet its obligations. It is logical that this counterparty risk is considered in the Registration Block of the issuer.

The second type of risk is that which the investor faces due to price variations in the derivative instrument they acquire (market risk). It would not be logical to include this in the Registration Block. It is a matter that should be covered in the securities note. The securities note should explain the characteristics of the security that is offered and the risks involved. Information on market risks associated with the security should not be included in the Registration Block, as the same entity can issue different instruments with very different characteristics and risks whilst the prospectus period is valid.

Point No. 194 in the CESR report also recommends including a warning note regarding the nature of the risks that the instrument may have. This recommendation, such as the inclusion of a paragraph indicating that the investor needs to understand the nature and risks of the instrument being acquired, would be included in the securities note, not in the Registration Block.

### **Question**

196. Are there any other sections of key information in section III of IOSCO that you deem as being relevant disclosure for these products? Please give your reasons.

The selection of financial data on the issuer, as provided for in section III, summarising the position of the issuer, would be applicable to issuers of derivatives, just as it is to other types of issuers.

### Question

197. Are there any sections of key information in section III of IOSCO you consider superfluous as regards the disclosure of the products? Please give your reasons.

Certainly the financial information per share or the capital dilution resulting from a change in the number of shares are not relevant for the investor in derivatives.

In any case, as we have indicated on other occasions, the deletion of certain information like that cited above, would not be a notable simplification for the issuer. Instead it would mean having a variety of required information models, creating confusion and making the preparation of a prospectus a subject for specialists.

### Question

199. Do you consider the level of details set out in IOSCO disclosure standard IV.A to be inappropriate for the products? Please give your reasons.

Certainly some of the information on the historical evolution of the issuer is not relevant for the product being offered. In contrast, there are other aspects which might be. For example, the record of the issuer's activity in the area of derivatives.

However, in response to the question, our opinion is that it is preferable to have a Registration Block that is as similar as possible for all types of issuers. This will ensure simplicity and clarity in the norms and, this way, the issuer will have a Registration Block that allows him to issue whatever instrument is most suitable.

200. Which particular items of IOSCO disclosure in this section do you consider to be relevant for these products? Please give your reasons.

In accordance with what's been expressed previously, it might be of interest, when it comes to describing the issuer's previous activities, to detail the track record of their activities as an issuer of derivative products.

### Question



202. Do you consider that a general description of what the issuer's principal activities are is a more appropriate level of disclosure for these products? Please give your reasons.

In point No. 201 of the CESR document, as an argument in favour of simplifying the informative demands over the issuer's business contemplated in IV.B, it's stated that the investor is not investing in the issuer. However, as is well set out in other parts of this document, this doesn't mean that the investor is not assuming counterparty risk with the issuer. In this sense, the issuer's general performance is a relevant fact in weighing up the risk of non-fulfilment by the issuer, as it is for the bond buyer.

In any case, rather than opting for a more generic description of the issuer, one could request more specific information about the issuer's activity regarding their business of issuing derivative products. One could take the trouble of reading the requirements contemplated in point IV.B of IOSCO, adding an expression along the lines of "of special interest in connection with its activity as issuer of derivative products".

The solution we propose is, as always, to keep one common registration block for the different types of issuers, specifying that, in the event that the issuer wants to launch derivative products onto the market, it should provide more detailed information concerning that line of business.

## Question

203. Please advise what, if any, other items of Section IV, B of IOSCO you consider to be of relevance for these products. Please give your reasons.

See the reply to the previous question no. 202.

## Question

205. Do you consider that a brief description of the issuer's group and the issuer's position within it, as set out in IOSCO reference IV.C, to be an appropriate disclosure requirement for these products?

Point IV.C of IOSCO requests, without going into great detail, a description of the structure of the group to which the issuer belongs. As the investor assumes a counterparty risk with the issuer, it makes sense to know the characteristics of its group, in the same way that it does for the investors in long-term bonds.

Apart from which, once again insisting on the already repeated position, it's preferable that the format of information requirements be as identical as possible so that the registration document allows the issuer to issue one security or another. In the case of issuers of derivatives, usually

financial entities with a very varied activity in all types of issues, the possibility of having one single registry document is without doubt an advantage.

### **Question**

207. Do you consider Section IV.D of IOSCO to be relevant disclosure for these products? Please give your reasons.

Point IV.D requests information on the issuer's installations, plants and property. Once again, the investor in derivatives has no specific interest in having a detailed knowledge of this kind of information. However, insofar as it's useful to allow him to come to an opinion about the issuer's solvency, it's as important for the investor in derivatives as it may be for the bond investor

To insist: it's better to have a common registration block for the issuers.

### **Question**

209. Do you consider Section V.D of IOSCO to be relevant disclosure for these products? Please give your reasons

Point V.D of IOSCO refers to the information on trends in the development of the issuer's business. In as far as the investor assumes a counterparty risk with the issuer, he has an interest in knowing how the business is going. If it's not going well, he may believe that when the moment comes, the issuer may be unable to honour his commitments.

We repeat the convenience of having similar information in the registration block for the different types of issuers.

### **Question**

212. Do you consider that the name and function of the directors of the issuing company to be appropriate level of disclosure for these products?

Knowledge about the issuer's directors and senior management is an important element in evaluating the counterparty risk that the investor contracts with the issuer.

Compliance with this information is quite simple. It's preferable to have common reporting requirements in the registration block.

## Question

213. Please advise what if any other items of Section VI of IOSCO you consider to be of relevance for these products. Please give your reasons.

The other reporting points required in section VI of IOSCO refer to directors' remuneration, rules on corporate governance and to employees. Some of them are of clear interest to the investor in derivatives, as may be the case of practices in corporate governance.

Specifically, on the question of corporate governance, it could be of special interest to know the systems of risk control and the responsibility of the directors on this subject.

In any case, the previous comments are still applicable to section VI. If these reporting details are important in judging the issuer's potential solvency, they should not be eliminated in the case of issuing derivatives. We insist on the idea of a common registration document in all areas for issuers, apart from requesting some additional item for certain types of issuers.

## Question

215. Do you consider that a statement setting out whether or not the company is directly or indirectly owned or controlled by another entity and the name of that entity to be appropriate level of disclosure for these products?

It's appropriate to the same extent that it is for investors in bonds, as a counterparty risk exists.

We repeat the convenience of having a single registration block for issuers that in reality are issuers of different types of securities. This is the real way of simplifying the task of registering issuers.

## Question

217. At this stage do you have views whether the following types of financial information about the issuer are relevant and as such should be disclosed in the registration document for these products? Please give your reasons.

Point 216 says: "CESR considers that information about the solvency of the issuer and its ability to meet its obligations to an investor is relevant for these products". If solvency is relevant, why believe that the investor in derivatives needs less information on the issuer's solvency than the investor in bonds? If any of these items provides the investor with little information, they should be eliminated from the registration document in all cases.

What's more, an issuer of derivatives, in carrying out this activity, normally applies levels of financial leverage in excess of those used by a traditional issuer of bonds and shares. The supervision of these debt levels, in the case of issuers of derivatives, demands much more and better financial information, not less, as the CESR document seems to suggest.

We insist that the most reasonable approach consists of defining a single registration document for issuers of bonds and derivatives. With regard to the information necessary to weigh up the counterparty risk, what's more relevant is the criterion of the period of issue (bonds) or expiry (derivatives). For short term instruments, many requirements concerning the issuer's business and corporate governance can be suppressed.

### **Question**

218. For how many years should the above disclosure be given?: a) for the last year, or b) for the last two years.

The financial information should refer to the same number of years as is considered appropriate for bonds. The relevant period should be the same. It's more important to differentiate by issue terms.

The argument is the same as in previous replies. It's not possible to find a valid theoretical argument sustaining that the investor's position of counterparty risk towards the issuer should be less when investing in derivatives. The risk for bondholders and investors in derivatives varies with the term. In addition, we insist on the idea of the convenience of defining a common registration document.

### **Question**

219. Do you think that there should be a disclosure requirement that the notes to the accounts be included in the registration document for these products? Please give your reasons.

The inclusion in the registration document of explanatory notes accompanying the audit is doubly important in the case of an issuer of derivative products. Normally it's only by reading through these notes that one can come to comprehend the nature of the risks in derivative products assumed by the issuer, as well as the manner of accounting for them.

### **Question**

220. Please advise which (if any) of other CESR disclosure standards set out in Sections VII.C-VII.I of the Corporate Retail Debt building block Annex I

you deem to be relevant disclosure for these products. Please give your reasons.

The points to which the question refers cover the following subjects: accounting standards, consolidated accounts, audit reports, time elapsed since the last annual accounts, internal financial reports and legal proceedings.

As in previous questions, it's worth asking a question in reply: for what reason would the investor in derivatives not need to have information on such important aspects as those set out in the previous paragraph? The need to really appraise the issuer's solvency, through this type of information, is no less relevant in the case of an investor in derivatives than for an investor in bonds.

### **Question**

222. At this stage do you have views about which of the following sections of IOSCO regarding the issuer's share capital you consider to be relevant information to be disclosed in the registration document for these products? Please give yours reasons. (Sections X.A.1 to X.A6)

The subjects covered by the points mentioned are very varied. Among them we find areas of scarce interest for investors in derivatives but others are significant to appraise the issuer's solvency. In any case, the best way to deal with the subject seems not to consist in eliminating some informative points for issuers of derivatives. The disadvantages of maintaining the same information are outweighed by the advantages of simplicity and clarity in having a common standards.

From the points mentioned above, the following are of potentially greater interest for the investor in derivatives because they affect subjects related to the issuer's solvency:

- Point X.A.1. Information on shares issued and not fully paid and shares issued against assets. Here the information deals directly with issuer's shareholder equity.
- Point X.A.2. Shares that don't represent capital. As in the previous point, depending on how they're accounted for, it may be relevant to evaluate shareholder equity.
- Point X.A.3. Treasury shares. This is a concept that directly affects the amount of shareholder equity, which has an impact on the issuer's cash position.
- Point X.A.4. Data on subscription rights and stock options granted. New accounting standards tend to consider these as an additional cost to the

company. If the profit figure is relevant for the investor to make an opinion, information on how it's calculated should also be so.

- Point X.A.5. Recognised options in favour of shareholders, bondholders or employees. Volumes and exercise prices. For the same reasons as previously stated.
- Point X.A.6. Changes experienced in capital structure and in voting rights. This does not have a direct impact in helping an investor come to an opinion but an indirect one and in the same way as it may interest an investor in debt of the same term.

### Question

222. At this stage do you have views about which of the following sections of IOSCO regarding the issuer's Memorandum and Articles of Association you consider to be relevant information to be disclosed in the registration document for these products? Please give yours reasons.(Sections X.B.1 to X.B.10)

The points referred to in the question cover a wide range of matters related to registration data, articles, shareholder rights, rules for shareholder meetings, limitations on investing in the company's securities, measures of protection against a take-over, information on major shareholdings, etc.

Without doubt, this deals in general with important information for those considering the possibility of becoming shareholders in the company though less so for holders of bonds and derivative products. Nonetheless, there is information of general interest for anyone connected with the issuing company: registration data, directors' powers regarding indebtedness, preferential rights in a liquidation, etc.

Once again, the consideration worth making consists in offsetting the suppression of some parts of the data, under criteria difficult to justify, with the possibility of having a single registration block establishing common obligations for the issuers in matters of disclosure. This single block can be complimented with additional information requirements that, in the case of certain contents of epigraph X.B, would correspond to issuers of shares as it touches on very specific areas on rights as regards the shareholders.

### Question

224. In relation to Section X.C of IOSCO which sets out the Material Contracts disclosure requirements, at this stage do you have views about which material contracts for these products should be summarised in the registration document for these products? Please give your reasons.

One possible criterion, if a differentiation in registration blocks were insisted upon, would be to demand the disclosure of any contracts, when materially important for the issuer's solvency and liquidity, that imply any type of privilege in the event of the company's liquidation, or that may create any sort of conflict of interest in the management of the risks connected with the derivatives being issued.

### **Question**

225. Do you consider Section X.D of IOSCO which sets out the Exchange Controls disclosure requirements to be relevant for these products? Please give your reasons.

In this point information is requested on the possible existence of laws restricting the use of funds for the payment of dividends or interest to non-residents, or in general to the free use of the issuing company's funds.

Obviously, knowledge of the possible existence of limitations of this kind is of unquestionable importance to the holder of derivatives, in a direct sense as regards legal reasons preventing the payment of rights accruing to the holder and indirectly regarding the management of risks assumed by the issuer that may be affected by limitations on the movement of capital.

### **Question**

226. Do you consider that the information about the issuer's dividend policy as set out in Section X.F of IOSCO to be relevant for these products? Please give your reasons.

In an indirect way it's as relevant for the investor in derivatives as it is for the investor in bonds, depending on the terms. The issuer's pay out policy affects the creditors' risks. The creditors' position is strengthened by the company holding profits as reserves in the balance sheet. On the other hand, a policy of distributing most of the profits generated weakens the creditors' security.

### **Question**

227. In relation to Section X.H of IOSCO which sets out the Documents on display disclosure requirements, at this stage do you have views about which documents should be put on display for these? Please give your reasons.

Relevant documents should be available for potential investors to consult when their content has been the subject of total or partial inclusion in the registration document. This general rule must be applied to anyone

who registers a prospectus, regardless of the type of securities being issued.

### **Question**

228. Do you consider that information about the issuer's subsidiaries as set out in Section X.I of IOSCO to be relevant disclosure for these products? Please give your reasons.

Information on subsidiaries, if these are materially relevant, must be a subject for inclusion in the registration document as they can affect the issuer's solvency or liquidity, even for reasons that go beyond legal obligations, given the importance of the knock-on effects in the event of a financial crisis of one of the companies in the group.

### **Question**

249. Do you consider it an appropriate approach to obtain flexibility by creating specific building blocks on particular characteristics of some issuers, offers, markets and securities?

Yes, the system of building blocks is appropriate. Nevertheless, two observations should be made. Firstly, except with the different types of issuers (mining companies, of portfolio etc) in the case of representative values of participation in the share capital, the only differences handled in the consultation refer to three types of security. Areas of such importance as the markets in which the security or offer is going to be traded have not been used to build the blocks.

It's of major importance to dedicate a block for markets. Most of the changes that have occurred in the world of securities concern the variety of mechanisms available to trade in them. This variety has been made possible both by advances in communications and the handling of information and also through the liberalisation of European legislation concerning demands to use traditional markets as the only way of trading.

This variety of markets or trading platforms that exists or may exist tends to act as a permanent mechanism to introduce competition into the broking industry and as such it should be preserved. But variety, by its very nature, implies that investors' knowledge in the rules of operation, transparency and clearing of transactions in the different dealing platforms is not homogeneous, nor should one suppose that it's widespread.

This fact requires that together with information on the issuer and security an informative block must figure on the market or markets where permission to be quoted is to be sought and the markets where predictably it is to be quoted, regardless of whether the issuer seeks a listing or not.



There are many differences between the dealing mechanisms which may affect such questions as:

- Market directed by orders or by price.
- Rules for order matching.
- Transparency pre-trade and post -trade.
- Liquidity existing in the market.
- Immediacy
- Mechanisms to clear transactions.

These differences give rise to different risks that no longer depend exclusively on the issuer – and that basically would be defined as credit and price risks - but rather specific risks would appear of the market and clearing system in which the trading and clearing of the securities took place.

All this influences the importance of ensuring the development of a specific information block for the markets, which must include among its questions those considered relevant to the clearing of transactions.

### **Question**

250. Format of the Schedules - Is the format of the three main schedules suitable? These schedules are composed of (i) common items and (ii) specific items for each type of securities, amalgamated in one single document. Is this approach sensible or should the common items and the specific items form distinct blocks?

A third schedule iii) should be introduced for specific items for each market or trading platform in which the security will be quoted or quotation requested. The need to have such a schedule is due to the multiplicity of markets and platforms, each one of them with different trading and clearing risks, and a different degree of transparency and immediacy demands that such information is itemised in the note on the securities.

The differences between the dealing mechanisms are multiple and may affect such questions as:

- Market directed by orders or by price.
- Rules to match orders.
- Transparency pre-trade and post -trade.
- Liquidity existing in the market.
- Immediacy.
- Mechanisms to clear transactions.

These differences give rise to different risks that no longer depend exclusively on the issuer – and that basically would be defined as credit and price risks - but rather specific risks would appear of the market and clearing system in which the trading and clearing of the securities took place.

All this influences the importance of ensuring the development of a specific block for the markets, which must include among its questions those considered relevant to the clearing of transactions.

### Question

251. Complex financial instruments - In order to ensure adequate disclosure for securities that do not fall within just one of the three main types, do you agree that the Competent Authority should (as envisaged by Article 21(4)(a) of the amended proposal for a Directive of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, be able to add specific items of another schedule to the main schedule chosen, that it considers necessary having regard to the characteristics of the securities offered, as opposed to their legal form?

Both the article referred to in the question and the regulations of European countries recognise the power of any supervisor to request from the issuer any information he considers necessary for the investor to take decisions with all necessary information at his disposal. This approach is applicable to both simple and complex financial instruments. Therefore, in the case that concerns us, it doesn't seem fitting to define the general capacity of the supervisor to request information over and above the questions contained in the schedule of another type of security.

Apart from this, to the extent that the financial instrument becomes more complex, the probability that the applicable questions can be found in one of the three designated schedules will be predictably lower.

### Question

252. Section I.2. - Should advisers be mentioned in all cases, or only if they could be held liable by an investor in relation to the information given in the prospectus?

It's anticipated that advisers of a permanent nature, or those that have a stable relationship with the issuer, will be included in the registration block. Therefore it doesn't seem necessary to repeat the same information in the securities note.

Those advisers who do actually intervene in the issue covered by the securities note should be mentioned.

As regards differentiating advisers with or without responsibility, it seems that this would introduce too much complexity into the prospectus.

The criterion should be rather that of informing about the advisers of the specific operation, leaving it to the courts, when necessary, to settle the scope of the responsibilities of one or another.

### Question

253. Section 1.5. - Under Section 1.5., the securities note should mention any other information in the prospectus besides the annual accounts, which have been audited or reviewed by the auditors. Should the securities note contain the "auditors report relating to this information"?

This question is, to practical effects, one to which incorporation is applied by reference.

### Question

254. Sections 1.6. and 1.7. - Sections 1.6. and 1.7. both concern the responsibility attached to drawing up a prospectus. Although under the proposed directive it is possible to choose a format consisting of three documents (Registered Document, Securities Note and Summary), these three documents are considered to make one prospectus. Is it therefore correct to assume that responsibility for each of these three parts must rest with the same persons?

When the schedule talks of parts of the prospectus it seems to refer to any part of the securities note, not to each one of the three documents (registration, security note and summary) of the prospectus, each one being understood as a "part" of the prospectus. In fact, it shouldn't be any other way because questions 1.6 and 1.7 correspond to questions of the schedule referring to the security note, a block of common questions.

With the previous point explained, it seems necessary to predict the possibility of the existence of specific responsibilities in the case of the security note.

Nevertheless, one should avoid situations that bring about wide responsibilities or those making difficult or impossible demands. What should also be avoided is a situation in which, via partial responsibilities, nobody takes responsibility for the integrity of the note or the prospectus as a whole.

### Question

255. Section III.A.- Under Section III.A., all security notes must contain a statement of capitalisation and indebtedness. Is such a statement necessary for derivatives?

An issuer's solvency depends in good measure on its degree of leverage. Awareness of this leverage and the details and characteristics to be found in the form, nature, term, guarantees and similar questions of the debt, will contribute to the investor forming an opinion about his exposure to the credit risk with the issuer.

### **Question**

256. Section III.B. (III.B.1. for the derivatives schedule) - Section III.B. asks to list the reasons for the offer and the use of proceeds. While this is an important item for shares and bonds, is it also the case for derivatives?

In the issue of derivatives one should differentiate three situations:

- Issues aimed at raising capital for the issuer itself. In this instance we're dealing with a similar situation to the issue of stocks and bonds. Its peculiarity lies in the more or less conditional way of raising funds.
- Issues aimed at hedging certain risks in the issuer's core business. Here it's not a question of explaining the use of the resources raised, more of clarifying the purpose of the issue, related to the transfer of certain risks to third parties.
- Issues making up a line of business in themselves. This would be typical in the case of financial issuers. In this instance, the receipts are more similar to trading income.

Consequently the scope of the explanation about the use of the receipts from an issue differs greatly between one situation and another.

### **Question**

257. Section III.C.2.(d) – Section III.C.2.(d) requires inclusion of a worked example of the “worst case scenario”.1) Does this information provide material information for investors? 2) Are there circumstances in which an example of the worst case scenario is not appropriate?3) Would the disclosures as set out below be an appropriate alternative: a) a risk warning to the effect that investors may lose the value of their entire investment, and/or b) 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.

This question refers to derivatives. Experience indicates that the users of derivative instruments allege not to understand the working of these instruments under certain circumstances. In fact, pleas based on an insufficient understanding on how the instrument worked have allowed cases against issuers or traders of this type of security to prosper in the law courts. This type of risk for the investor – not understanding the product – and for the issuer – that the investor alleges not to understand – advise the use of extreme examples, which could demonstrate the heavy losses that can be incurred.

### Question

258. Section IV.A. – Under Section IV.A., the interests of experts in the issue or offer must be disclosed. These interests encompass those of any expert or adviser who “has a material, direct or indirect economic interest in the company”. Is it necessary in the case of derivatives?

It's important to know the economic interests of experts and advisors to evaluate their independence. Remuneration linked to the operation's success can be stated, both in an offer of shares, bonds or derivatives.

### Question

259. Section V.A. - Section V.A. lists the items to be disclosed in order to give a description of the securities that are offered or admitted to trading. Should the following additional items be added to Section V.A.: a) Legislation under which securities have been created; b) Court competent in the event of litigation; c) Redress Service available for investors, if any”? Should information about the rating of the issuer or of the issues be mentioned under that item? If yes, which one of the following wording would be more appropriate:

- “Rating assigned to the issue or to the securities by rating agencies and /or commercial bank lenders pointing out the name of the rating organisation whose rating is disclosed and explaining the meaning of the rating. If a rating does not exist, to the knowledge of the issuer, it is required to disclose the fact that there is no rating”, or
- “Rating assigned, at the issuers requests or with its co-operation, to the issue or to the securities by rating agencies and /or commercial bank lenders, pointing out the name of the rating organisation whose rating is disclosed and explaining the meaning of the rating”.

Point (a) doesn't seem necessary - it's taken up in V.A.2 and V.A.12. Points (b) and (c) contribute useful information if it figures in the security note.

Unrequested credit ratings are not the responsibility of the issuer and it must not be obliged to include them.

260. Section V.B.12, first indent of Annex M – Section V.B.12, first indent of Annex M requires a statement concerning the past performance of the underlying and its volatility. Is this disclosure necessary? Should the requirement for disclosure vary depending upon whether the underlying instrument is admitted to trading on a regulated market and the nature of the market? Should the requirement for disclosure vary depending upon the nature of the underlying instrument?

Knowledge on the past performance of the underlying instrument and its volatility help in understanding the product. Similarly, it would also help to know the derivative's performance over the same period. This is particularly true in the case of complex derivatives.

It seems unfitting to establish differences on disclosure of information for reasons connected with the type of market in which the underlying instrument is quoted or its nature.

### **Question**

261. For the three main schedules, please identify those items that you deem unnecessary.

None.

262. For the three main schedules, please list those items that are missing and that should be in the security notes.

Characteristics of the market where the security will be traded, explaining how the price will be set, post- and pre-trading transparency, liquidity and immediacy

Characteristics of the clearing systems of trades in the markets where it will be quoted.

Risks assumed by the investor as a consequence of the type of market where the product will be traded and of the type of system used for clearing.

### **Incorporation by reference**

“According to the above listed characteristics the following documents may be incorporated by reference in a prospectus:

- annual and interim financial statements;
- merger and de-merger documents;
- auditor's report;
- memorandum and articles of association;
- earlier approved and published prospectuses;
- press releases."

### **Question**

281. Do you think that the above illustrative list is acceptable?

Yes, the list is acceptable.

### **Question**

282. Should further technical advice be given on the documents that can be incorporated by reference in the prospectus? In the case of an affirmative answer please indicate which technical advice should be given.

We have no additional comments to make.

### **Question**

287. Should other aspects concerning the accessibility of the documents incorporated by reference be considered?

In the prospectus there should be an index of everything incorporated by reference and an explanation of the link between the documents and the information contained in the prospectus and other documents incorporated by reference.

### **Question**

288. Should CESR give other technical advice on further aspects of incorporation by reference? In the case of an affirmative answer please indicate which technical advice should be given.

We have no suggestions to make.

### **Question**

307. Should there be technical implementing measures at Level 2 further defining what is deemed to be "easy access" and which specific file formats are accepted for this purpose?

Yes, this type of formats and systems for accessing the prospectus easily should be harmonised. In particular, a detailed index should be supplied permitting access to just the part of interest to the investor, tables of text should be separated, and really measures taken to speed up the process and allow information sought to be found with ease. This is particularly relevant when incorporation by reference is used.

In addition, it's not convenient to discard the use of search browsers for use in a set of documents from the same issuer.

### **Question**

314. Are there any additional factors and/or requirements that should be taken into account at Level 2 concerning the availability via the press?

No.

### **Question**

325. Do you consider appropriate the requirement to publish the said notice in the absence of a specific provision in the Directive proposal?

Yes.

### **Question**

326. Should the minimum content of the notice be determined at Level 2 legislation?

Yes.

### **Question**

327. When the prospectus is made available by its insertion in one or more newspapers or in the form of a brochure, besides the publication of a specific notice, should the list available at the website of the competent authority (see Introduction) mention where the prospectus is available?

Yes.

### **Question**

328. In case of an affirmative answer to the previous question, should the indication in the website of the competent authority be considered enough and, consequently, should it be considered as an alternative to the publication of a formal notice by the issuer/offeror?



No.

**Question**

331. Which other issues regarding the availability of the prospectus in the form of a brochure should be covered by CESR's technical advice?

There are no suggestions.

**Question**

334. Do you agree that the issuer should not ask the investor for payment of delivery or mail costs?

The prospectus should be totally free, so mail costs should not be charged.

**Question**

335. Should additional issues regarding the delivery of a paper copy of the prospectus be dealt with by Level 2 legislation?

Yes.