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26 August 2003

Mr. Fabrice Demarigny
The Committee of European Securities Regulators
17 Place de la Bourse
75082 Paris Cedex 02
France

Re: CESR's "Advice on Level 2 Implementing Measures for the Proposed Prospectus Directive" and the "Annexes to the Technical Advice" (Ref. CESR/03-162)

Dear Mr. Demarigny:

The European Advocacy Committee ("EAC" or the "Committee") of the Association for Investment Management and Research ("AIMR")[1] is pleased to comment on The Committee of European Securities Regulators' ("CESR") consultative paper, *Advice on Level 2 Implementing Measures for the Proposed Prospectus Directive* and its associated annexes (collectively referred to as the "Proposal"). The EAC is a standing committee of AIMR charged with reviewing and responding to major new regulatory, legislative, and other developments that may affect investors, the investment profession, and the efficiency and integrity of European financial markets. The Committee has 15 investment professionals volunteering from throughout Europe, providing a variety of viewpoints that is based on its members' market experience and expertise and draws upon the collective knowledge of AIMR's global network of investment professionals.

General Comments

The Committee reiterates its support for the efforts of the European Commission and CESR to create a common format for securities prospectuses applicable to all Member States of the European Union. Investors, issuers and European markets, alike, will benefit from the uniform structure this process intends to create. Accurate, complete and convenient information about companies' financial, operational and corporate governance activities will provide significant benefits to investors over the long term.

[1] With headquarters in Charlottesville, VA and regional offices in Hong Kong and London, the Association for Investment Management and Research® is a non-profit professional association of more than 65,000 financial analysts, portfolio managers, and other investment professionals in 116 countries of which 50,439 are holders of the Chartered Financial Analyst® (CFA®) designation. AIMR's membership also includes 127 Member Societies and Chapters in 46 countries.

Common Format

This ultimate goal is, in the view of the Committee, best achieved through the creation of a two-tiered prospectus structure, as noted in the Committee's 3 June 2003 letter to CESR regarding its initial query about implementing measures for the Prospectus Directive (the "Directive"). The first tier would apply to all company-specific securities, including equities, all forms of debt securities and derivative instruments. It would use a common prospectus containing all the disclosures required in CESR's proposed equity securities prospectus and would not reduce these disclosures on the basis of the denomination size of the securities offered. The second tier would relate only to derivatives not related to a specific company, including commodity, currency, index, interest rate and other such instruments. The type of instrument and the type of underlying pricing mechanism would determine the information requirements of this tier.

The Committee's comments in this letter consider the questions in the context of this two-tiered prospectus structure. Nonetheless, the Committee believes that the views expressed are as applicable in the context of CESR's proposals as they are under the preferred structure.

Other Suggested Features

Based upon the Proposal, the Committee believes that CESR should consider requiring regular updates to the registration document to ensure that the information it contains remains relevant and timely. To help investors determine the relevance of this information, the Committee further suggests that CESR require issuers to provide "date stamps" to go along with any changes, updates or edits in the electronic versions of their RDs.

And finally, the Committee suggests that one way to prevent investor confusion regarding the dissemination of the various documents relating to an offering is to require issuers to help investors find this information. For example, issuers can easily incorporate hyperlinks into electronic documents that take the reader directly to the registration document, securities note or summary that are associated with that offering. Likewise, issuers should provide instructions for users of paper copies on how to obtain the additional documentation.

Specific Comments and Responses

Derivative Securities

Question 32: Do you think that disclosing information about an issuer's principal activities and any significant new products and/or activities is relevant to derivatives?

Question 34: Do you consider that disclosure about the principal markets in which the issuer operates is relevant to these securities?

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

Question 37: Do you consider that disclosing conflicts of interest regarding administrative, management and supervisory bodies is relevant to these products?

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

In its discussion regarding derivatives, CESR states that because it did not have an agreed-upon definition of derivative securities, it designed its proposals for a "basic derivative issued by a bank," such as a covered warrant. This example still leaves open the question of whether investors can exercise this hypothetical covered warrant to purchase shares of the issuing bank or the shares of another company, to purchase another type of security issued by either the bank or a third-party issuer, or to buy some other contractual obligation. The example also leaves open the question of whether the disclosures referenced in the queries above relate solely to the issuer of the derivative or to the issuer of the underlying securities.

In general, the Committee believes that derivatives securities can be viewed as either a) related to a specific company or b) some other contractual obligation such as a physical commodity, an index, government bonds, a currency or some other formula. The distinction is important because investors will need different kinds of information based on the type and characteristics of the derivative.

A derivative based upon the performance of a specific company, for example, calls for the same kind of information that is provided in the proposed equity securities building block. The reason for this is that the performance of the derivative is based almost exclusively on the performance of the underlying security which, in turn, is largely dependent on the performance of the company that issued the underlying security. Therefore, to gauge the potential performance of the derivative, the investor will need to assess the potential performance of the company issuing the underlying security.

To do this, the investor will need not only financial information about the company issuing the underlying security, but also about its principal activities, its principal markets, significant business developments, conflicts of interest and major shareholders, as mentioned in the questions above, as well as information about pending legal issues, and current or expected investigations by government authorities.

If this kind of information about the issuer of the underlying security is not included in the prospectus for the derivative, however, less-sophisticated investors might conclude that there is not a link between the performance of the issuing company and performance of the derivative. This kind of confusion is troublesome not only for the individual investors, but also for the integrity of the financial markets as a whole.

Even those that recognize and understand the link would be disadvantaged by not having such information available in the derivatives' prospectus. Such an omission would force them to take additional steps to find, review and analyze the relevant information about the issuer of the underlying security. Investors should not have to undertake costly and burdensome searches for essential information.

As this view relates to the five questions listed above, the Committee believes that all of the disclosures proposed are always relevant when the derivative relates to a specific company. Because other types of derivatives are not dependent upon the financial and operational performance of a specific security issued by a specific company, they would not need this kind of information.

On the other hand, the bank issuing the derivatives – company-specific or otherwise – acts as the principal or only counterparty in many derivatives transactions. As a result, investors in such instruments are required to make a credit decisions about the ability of the offering institution to fulfill its obligations under the contract. In order to make such an assessment, investors will need the same kinds of disclosures referenced in the questions above, even if the underlying securities are not issued by the bank.

Question 59: Do you agree with the revised approach CESR proposes in relation to retail non-equity securities and wholesale non-equity securities?

The approach CESR has taken with regard to non-equity securities is described in paragraphs 55 through 58 of the Proposal. Specifically, CESR proposes that the disclosure requirements set out for debt (retail and wholesale) securities must be used for all non-equity securities, except those issued by banks. However, a bank-guaranteed special-purpose vehicle would have to provide the information set out in the retail debt disclosures.

The Committee agrees with CESR that the information needs of investors in company-specific derivatives are similar to those of investors in other company-specific securities. Furthermore, as we have suggested above and in our earlier letter (dated 3 June 2003), we believe retail and wholesale debt investors need the same amount and type of information that equity investors need.

However, the Committee disagrees with CESR’s proposal to reduce the disclosures available to investors in bank-issued derivatives. Because these institutions are the primary issuers of such instruments, as pointed out in the Proposal, it is particularly important that investors, particularly less-sophisticated retail investors, receive adequate information to allow them or their advisers to make better investment decisions.

Equally troubling is the fact that reducing the disclosure requirements gives banking institutions an unfair competitive advantage relative to other derivatives issuers such as derivatives exchanges, who would presumably have to provide either the wholesale or retail debt disclosures. Projecting this advantage into the future, it could result in banks obtaining a monopoly on such instruments, to the detriment of retail and wholesale investors alike.

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

Question 64: Do you consider that information on investments is relevant for wholesale debt securities?

In its proposals, CESR requires all non-bank issuers of large-denomination debt securities – those with denominations above €50.000 – to disclose how much the issuer has spent on past, present and future investments. CESR projects that if the approach proposed in Question 59 is adopted that a provision will be required to clarify that where a bank issues wholesale debt it would not have to provide such information.

The Committee strongly disagrees with this proposal. For one thing, not all investors buying bonds in such large denominations are either institutional or sophisticated. Indeed, many investors in such products are retail investors who need more information about such offerings.

Regardless of their size, investors in bank-issued securities need this kind of information as much as investors in securities issued by any other type of company. In fact, investors need this kind of information from a bank issuer more than they might from a retailer or a wholesale distributor for the following reasons. First, banks increasingly are dependent upon technology to operate efficiently and to manage their risks across product lines and across the institution as a whole. Disclosures about how much institutions have invested in technology upgrades will help the financial markets assess their ability to accomplish these goals.

Second, if, however, banks are not required to disclose this information to investors – particularly those taking large debt positions – it will either force investors to attempt to obtain the information directly from management, the least efficient way of providing such information, or to accept that they do not know whether these institutions can compete and effectively manage their risks. In the long run, such opacity could make it more costly – not less costly – for banks to raise capital.

Therefore, the Committee strongly recommends that CESR require banks to disclose this information.

<u>Derivatives Securities Note Schedule</u>

Question 75: Do you consider that examples are necessary in order to fulfill the principle that the prospectus must contain a clear and understandable explanation of how an investor's return is calculated and how the instrument works?

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

Question 77: If you do not consider that examples are necessary to provide investors with a clear and understandable explanation of how an investor's return is calculated and how the

instrument works, do you consider that the provision of examples in the prospectus is useful for investors?

Question 78: Do you consider that the use of examples in the prospectus is dangerous and misleading and should not be mandatory?

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

Question 80: If your answer to the previous question is yes, do you think that examples should also fulfill other requirements (for example: the need to insert the break-even point for the investor)?

Question 81: Do you consider that examples should be provided for derivatives?

Question 82: If yes, for which types of derivatives should examples be provided?

Question 83: Are there any other types of securities for which you consider examples should be provided; for example structured debt instruments that have a derivative component?

The Committee believes that examples are a useful way to communicate how complex financial instruments work. Consequently, the Committee believes that issuers of all types of derivatives should provide them in their prospectuses. Furthermore, issuers of convertible bonds, asset-backed securities and other structured instruments would benefit from providing examples to help investors understand how their instruments work.

The Committee also believes that CESR should provide basic principles like those suggested in Question 79 to guide issuers in creating these examples. Such principles also would provide a basis for enforcement should an issuer fail to adhere to such principles.

Beyond that, the Committee believes that examples should include the following:

- at least one positive and one negative scenario to give investors an indication of how they might incur losses as well as gains;
- visual representation of such factors as break-even point, time frame and volatility that may affect the value of the instrument;
- an indication of the impact that early redemptions will have on investor returns;
- visual representation of a sensitivity analysis of the critical risks and assumptions used in the example, such as interest rate risk, price risk and market risk;
- a supplementary description of how the products work, including a discussion of the factors mentioned above, together with a discussion of the mechanics of the instrument depicted in the example and the economic, financial and market forces that may affect its performance; and
- a clear, concise and easily noticed statement next to the examples warning that investors' actual experience may be significantly better or worse than the scenarios described.

Past performances and volatility

Question 89: Which of the options do you consider should be adopted?

The options mentioned in Question 89 refer to a proposal in item 4.2.2 of the Securities Note for derivatives. This item requires that the issuer state the "past performance of the underlying – in a practical form or otherwise – and its volatility over a period corresponding to at least the maturity of the derivative security; in any case a period of two years is sufficient."

CESR presents three options in the Proposal regarding this information:

1. No past performance and no volatility information should be required;
2. Mandatory indication of where information about past performance and volatility can be found or, if not easily accessible, indication by the issuer of the past performances and the volatility;
3. Mandatory indication of past performance and volatility only where the issuer has composed the underlying of the derivative instrument.

CESR suggests that if past performance is included that it should be accompanied by a clear warning "stating that past performances and volatility do not give reliable guidance on the future performance of the security."

In general, the Committee supports the use of Option #3 because it is the most informative of the three. Furthermore, the Committee supports the inclusion of the warning about past performance not providing reliable guidance about the future.

However, the Committee prefers that issuers provide information about past performance and volatility even if they did not compose the security/index/commodity underlying the derivative instrument. This information is relevant to the pricing of such securities and without it investors will have a difficult time determining whether the quoted price is acceptable. Moreover, the Committee suggests that CESR include as part of this disclosure a discussion of the effects changes in key assumptions and risks may have on the relative returns of these instruments to help investors understand the forces affecting the performance of such instruments.

Base Prospectuses

The base prospectus in the Proposal is intended for use with multiple securities offerings issued from the same securities registration document and securities note. While the Committee anticipates that the information contained in this document will be supplemented regularly with date-stamped updates as required elsewhere in the Directive, an issuer can rely upon an existing base prospectus through which it can issue more securities.

Question 101: Do you agree with the generic rule described?

The generic rule mentioned in this question refers to CESR's proposal to differentiate between the information relating to the final terms of a specific offering, and the information which is included in the base prospectus prior to final pricing of the offering. The proposed generic rule reads as follows:

> *The base prospectus shall:*
>
> *a) contain all information required by the applicable schedules and building blocks except for that which can – due to the issue's nature – only be determined at the time of the individual issue and is not known when the base prospectus is filed (so-called "final terms"); and*
>
> *b) set out which line items of information will be included as final terms.*

The Committee believes that the generic rule is appropriate.

Question 112: Which of the two approaches described do you think should be applied to base prospectuses?

CESR offers two approaches relating to whether an issuer must include and translate the summary of a securities offering, including final terms. One approach suggests that the final terms do not form part of the base prospectus and, because they are not approved, need not get translated. The other approach takes the view that the summary conveys the essential risks and characteristics of the offering and, as a result, needs translation.

The Committee believes that regardless of whether the final terms are part of the summary, issuers should translate the final terms of the offering. These data are necessary if investors are to assess whether the offering price and other terms meet their investment objectives and criteria. At the very least, the Committee suggests issuers translate documents into English, an official language of the EU and the one most commonly used and understood in the world of finance.

The reason is that if investors, including institutions, cannot find a translation for these terms it will force them to choose among:

a) abandoning the current offering in favor of offerings that are translated, thereby reducing the potential value to the issuer;

b) investing blindly with the hope that the terms are acceptable; or

c) incurring additional costs to translate the summary, resulting in inefficiency for the investor and the economy and ultimately a higher cost of capital for the issuer and reducing the ability of the investors to earn their required rates of return.

To avoid such problems, the Committee suggests that CESR adopt the second approach and require that issuers translate the summaries. At the same time, the Committee suggests that CESR require issuers to provide a) hyperlinks for electronic users or b)instructions for paper users that help both groups find the other constituent parts to the current offering.

Question 115: Which of the views described do you consider should apply to base prospectuses with multiple products?

The Committee's response is predicated upon its interpretation of the term "product." In the context of Question 115 noted above, a base prospectus "may cover more than one product." Some CESR members wanted to stipulate that an issuer must complete a summary for "each product."

This definition is further refined in paragraph 134 when CESR quotes from Article 2(1)(k) of the Directive, which defines an offering programme as: *"the issuer's plan for the issuance of non-equity securities, including warrants in any form, having a similar type and/or class, in a continuous or repeated manner during a specified issuing period."*

This definition suggests that a "multi-product base prospectus" refers to multiple securities offerings, all of a specific type or class such as warrants, mortgage bonds or asset-backed securities, issued under the same base prospectus.

With this interpretation in mind, CESR is interested in whether it should require issuers to create a separate summary for each product – in other words, each issue of new, yet similar securities – or let issuers determine how to comply with the summary content required by the Directive.

In general, the Committee believes that issuers should provide a summary for each offering from a base prospectus, even though the securities are materially similar to those offered previously under the same base prospectus. The primary reason for requiring a new summary is to ensure that the terms of the current offering are reflected into the information available to investors.

Of equal importance, however, is the need to remove a potential source of confusion. If less-sophisticated investors are considering the purchase of one offering of securities and are forced to review a summary from a previous offering, it is possible they will make erroneous judgments because of the out-of-date summary. An updated summary will ensure that all investors are clear about the terms relating to the securities they are purchasing.

Question 122: Which of the views do you consider should apply to the form of final terms?

CESR presents three views on how to present the final terms of an offering to the competent authority:

a) issuers are free to replicate in the final terms some information already included in their base prospectuses;

b) if issuers are permitted to replicate the same previously reported information in the final terms, the information replicated, together with the final terms, can only be information from the Securities Note; or

c) issuers may choose whether to file the full prospectus (base prospectus plus final terms) or only the final terms, but issuers should not be allowed to file a document which replicates only "some" information already provided in the base prospectus because it may create difficulties over how "such information" will be selected and the risk of giving a misleading impression.

One of the principal roles of the Committee is that of an advocate for the interests of investors. This includes not only institutional investors but also retail investors with little sophistication in financial markets. As such, the Committee advocates positions that not only provide maximum transparency but also positions that avoid or prevent undue confusion on the part of investors.

While it is difficult to determine how an issuer might create a misleading impression with material published elsewhere in the registration document or securities note, there is little doubt that it can be done if permitted. As a result, the Committee's view is that the best way to prevent confusion among investors is to apply the third method.

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

The question refers to paragraph 2 of Article 14 of the Directive, which states that the prospectus "will be deemed available to the public when published either":

- by insertion in one or more widely circulated newspapers in the Member States in which the offer of securities is made or where the securities will trade; or
- in printed form and available for free to the public at the offices of the issuer or the market where the securities will trade, and at the registered offices of the firms acting as intermediaries for the offering; or
- in electronic form on the Web sites of the issuer, the bank underwriting the offering, the paying agents or the Competent Authority of the home Member State, if the Authority offers the service.

In general, the Committee believes that if issuers ensure that the documentation is consistently available in pre-determined places like those described above there is no need for limitations on the methods of dissemination, so long as the content is unchanged and the issuer and its agents remain bound by the regulations of this and other relevant Directives. Ultimately, though, the Committee continues to believe that a Central Repository is the best long-term answer to this question.

Question 127: Do you agree that the method of publication (listed in the response to Question 125 above) used for the base prospectus does not need to be the same method used for publication of the final terms?

This question relates to paragraph 5 in Article 14 of the Directive which reads:

> *In the case of a prospectus comprising several documents and/or incorporating information by reference, the documents and information making up the prospectus may*

> *be published and circulated separately provided that the said documents are made available, free of charge, to the public, in accordance with the arrangements established in paragraph 2. Each document shall indicate where the other constituent documents of the full prospectus may be obtained.*

Some CESR members contend that this paragraph implies that the publication method used for the base prospectus does not need to be the same method used for the publication of final terms, provided the methods used are one of the methods proscribed in Article 14 (see Question 125 above).

The view of the Committee is that the paragraph suggests that the securities note and the base prospectus need not be bundled into one package. However, the Committee cannot determine whether the intention is to permit dissemination through different forums.

However, if CESR were to permit the latter – that different forms could be published in different venues – it would create enormous confusion even for sophisticated investors. Moreover, it could affect the ability of investors to track the progress and pricing of an offering.

To prevent confusion, therefore, the Committee suggests the following:

- issuers should continue publishing the relevant documents through the same methods as chosen for the first document of a specific offering;
- issuers should provide a) hyperlinks for electronic users or b) instructions for paper users that help both groups find the other constituent parts to the current offering; and
- the Committee reiterates its call for a Central Repository to avoid such confusion.

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

Question 132: Are there any other disclosure requirements that are not specified that you consider necessary for base prospectuses?

These questions relate to content used for offering programs, as stipulated in Article 7, paragraph c) of the Directive. The reference deals with "the format used and the information required in prospectuses relating to non-equity securities, including warrants in any form, issued under an offering programme." In its Proposal, CESR suggests including the following additional disclosure requirements for base prospectuses:

a) Information regarding how the final terms will be published; in the event that the issuer is not able to determine the method of publication when the base prospectus is filed the issuer has to set out how the public will be informed about which method will be used for the publication of the final terms.

b) Identification of line items that are to be included in the final terms.

c) Include a general description of the programme.

If CESR requires issuers to disseminate their registration documents, securities notes and final terms through the same venues, as the Committee suggests in the preceding question, then the first requirement will become redundant. Nonetheless, in the absence of a Central Repository for such information, disclosures of this type would reinforce investors' understanding of where to go for these documents.

Regarding the latter two disclosures, the Committee supports CESR's proposals.

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

Question 137: Are there any other types of base prospectuses that you consider are necessary?

The types of base prospectuses mentioned in Question 136 include the following non-equity securities types:

- Debt securities
- Warrants
- Non-warrant derivatives
- Asset-backed securities
- Mortgage-backed securities

While most of the proposed base prospectuses are appropriate, the Committee is concerned that a bank, for example, may issue index-based, commodity, currency, company-specific and other types of derivatives under the non-warrant derivatives base prospectus. The problem with this is that the information needs of investors vary greatly for each of the different instruments.

For example, the information needs of investors in a FTSE 100 index option will differ greatly from the information needs of investors in universal stock futures. Similarly, the information needed to make a knowledgeable decision about investing in a stock index futures contract is vastly different from the information needed to invest in currency futures or a put option on a specific company.

As a result, the Committee recommends that CESR require different prospectuses based on:

- The type of contract – options, futures, swaps;
- The underlying basis for the contract – stock index, commodity, currency, company-specific or other type of derivative; and
- The underlying instrument, for example:
    - FTSE 100 index, EuroTop 300 index;
    - Euro, Swiss Francs, Sterling;
    - Gold, silver, wheat;
    - Options on Vivendi, Barclays, ABN AMRO;

While such a system is potentially complex in that it will base the disclosure requirements of each on the type of instrument, the underlying basis and the specific formula for calculating value of the instrument, it will serve the needs of investors much better than a standard solution. It is only by breaking the products into their constituent parts that investors will receive the kind of information they need to make educated investment decisions.

Wholesale Debt

Question 143: Do you agree with the approach suggested?

In taking account of the "appropriateness of information to investors in non-equity securities having a denomination per unit of at least €50.000, CESR proposes to use a Wholesale Securities Note for such offerings. It says that the only difference between this note and the securities note for retail debt offerings is that the wholesale note excludes all references to offers.

The Committee does not agree with this approach. Instead, it reaffirms the view it has taken elsewhere in this letter and in its 3 June 2003 letter that the information needs of debt investors are the same regardless of whether the bonds are issued in large or small denominations. It is imperative that investors making larger investments be aware of all of the issues affecting specific securities given the size of the risk they are taking.

In the long run, requiring large-denomination offerings to include all relevant information in a prospectus is a more efficient use of issuers' time and money than is the proposed blind offering. Without a fully inclusive prospectus, investors are forced either to call the company directly to get what they need, to invest with insufficient information, or to not invest. In many cases, this due diligence process can be a time-consuming and labor-intensive exercise for both the investor and the issuer. Putting most of this information into a prospectus will ultimately save time and money for the issuer.

Question 144: Do you consider that the information provided for in Annex F is adequate for wholesale investors?

Question 145: Are there any other items included in the retail debt securities note that should be included for wholesale investors?

Annex F of the Proposal contains the proposed Securities Note for wholesale debt offerings.

As stated previously, the Committee believes that investors in all sizes of traditional debt securities need the same kind of information about an issuer as is required in equity offerings.

In response to the specific proposals contained in Annex F, the Committee has the following suggestions:

- As discussed above in response to Question 127, the securities note should provide investors with hyperlinks for electronic users or instructions for paper users that help them find the other constituent parts to the current offering.

- *Section 4* – The securities note should discuss any guarantees backing the issue of bonds, together with the name of the entity or individual providing the guarantees and provide the same kinds of hyperlinks and instructions to help investors find information about the guarantor as discussed in the above suggestion. Likewise, this section should include information about any tranches that comprise the offering.
- *Section 4.1* – Issuers should provide information about the amount of securities – either in Euros or local currency, as the case may be – they are attempting to get admitted to trading.
- *Section 5.1* – The text would be more inclusive if it started by saying, "Indication of all the markets…" rather than, "Indication of the market…"

Closed End Investment Funds

Question 151: Do you agree with the disclosure obligations set out in Annex G as being appropriate for this type of issuer?

Annex G sets out a four-page series of disclosure requirements specifically tailored for closed-end investment funds.

In general, the Committee agrees with the proposed disclosures and supports their incorporation in a registration document for closed-end investment funds. However, the Committee suggests that CESR make these disclosures a supplement to a more thorough prospectus based on the one proposed for equity securities. The Committee believes investors in these types of investment vehicles need substantially the same kinds of information as required by equity investors.

To that end, the Committee suggests that CESR supplement the disclosures described in Annex G of this consultation with quarterly and annual releases of the following:

- A detailed statement showing changes in net assets occurring over the most recent quarter or fiscal year;
- Detailed balance sheet as of the most recent period end;
- Detailed statement of changes in cash flow for the most recent quarter or fiscal year;
- Detailed notes to the financial statements to help investors put the information in the financial statements into context;
- A detailed description of holdings in each of the primary asset categories – for example, lists of specific equity holdings, physical commodities, real property, derivatives/money market instruments/ currencies, government securities and index-tracker funds owned – together with estimates of their current value as of quarter or year end; and
- Trends in pricing for the stock and its primary asset classes.

Investors need this kind of information, in conjunction with the information set out in Annex G, if they are to understand the risks and opportunities available from a specific fund. By putting this mosaic of information together into one prospectus, institutional and individual investors can determine whether specific funds meet their risk tolerances and return requirements.

Property investment companies

Question 154: Do you consider there is a distinction to be drawn between these two types of activities?

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

The two questions refer to a distinction between investment companies that invest exclusively and passively in real property assets for capital gain, and those that engage primarily in short-term rental, development, refurbishment and other similar income generating activities. CESR categorizes the latter group as trading companies, which would require them to apply "normal RD disclosures" relating to equity and/or debt securities.

The Committee agrees that companies in the latter group are, in effect, trading companies. Furthermore, regardless of the distinction, investors need the same basic kind of information (see the response to Question 151 for this) on the companies engaged in these activities. Therefore, the Committee reiterates its suggestion that CESR require issuers of all company-specific securities to issue a registration document similar to those required for equity issuers.

Securities Note Building Block on Underlying for Equity Securities

Question 162: Do you agree with this approach?

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

CESR's approach in this instance distinguishes between securities that permit investors to convert into shares of the issuer itself and those that convert into shares of an entity belonging to the same group as the issuer. CESR proposes to require information on the issuer of "own" shares in line with the disclosure requirements of its equity registration document. For conversions into the shares of affiliated entities, the proposal is to require the issuer of the convertible security to disclose where investors can find further information on the affiliated entity.

In general the Committee agrees with the distinction CESR has made. It also supports CESR's proposal that investors in securities convertible into the "own" shares of the debt securities issuer have the same informational needs as investors who put their money directly into the shares.

When the securities are convertible into the shares of an affiliated entity, though, investors will need information about both the issuer of the convertible/exchangeable securities and the issuer of the underlying securities into which the debt instruments are convertible. They will need information about the convertible issuer to help them determine whether it can fulfill its obligations, if any, prior to conversion. They will need information about the issuer of the underlying securities to determine whether the conversion option has value and, if so, what it is. From the combination of these separate analyses, investors will determine the value of the convertible instrument.

However, the proposal contains potential risks. First, it does not consider how to handle a situation where the securities are convertible into shares of an affiliated private entity that does not provide the information investors need. Second, by using building blocks that have varying levels of disclosures, issuers may interpret their offerings as those having reduced information requirements.

An example of this might be a real estate management company issuing debt securities which are convertible into the shares of a bank that is also owned by the entity that owns the real estate firm. In this case, the bank affiliate might have lower disclosure requirements than the real estate affiliate, making it difficult for investors to determine the true value of the securities offered.

Requiring all types of firms to provide the same type of information as required under an equity registration document would prevent this potential problem by ensuring that investors get the financial data and company descriptions they need to make appropriate decisions. It would also eliminate the ability of issuers to use technical language to issue their securities under a less-onerous reporting model.

Regarding the disclosure requirements set out in Annex H, the disclosure requirements are appropriate. The Committee suggests that CESR make it clear that the list of shareholder rights is not exhaustive.

Question 165: Do you deem the Working Capital Statement and the information on Capitalization and Indebtedness necessary for an informed assessment of the securities in cases of products which can be converted or exchanged in newly created shares?

The Committee strongly believes that such information is necessary for investors to make an informed assessment of such products. The reason is that at the time of investment, the imbedded derivative carries a value based upon the projected performance and current financial condition of the newly issued equity security. The performance and value of the security underlying the conversion will depend a great deal upon the financial and other resources its issuer has available at the time of the offering. This is particularly true for a company with newly created shares that presumably will depend greatly on the capital it has received to commence operations.

Question 167: Do you agree with this approach?

The approach CESR proposes would require the issuer of a security convertible into the shares of another, unaffiliated entity to supplement the information required in section 4.2.2 of the

Derivatives Securities Note with the relevant debt securities note schedule. All other derivatives would require the disclosures of section 4.2.2 of the Derivatives Securities Note.

Section 4.2.2, shown in Annex E of the Proposal, requires a statement setting out the type of the underlying securities and details where information on the underlying can be obtained, in addition to the following:

- Description of past performance of the underlying and its volatility corresponding to the maturity of the derivative;
- Where the underlying is a security, the name of the issuer and its International Security Identification Number;
- Where the underlying is an index, the name and description of the index if it is composed by the issuer;
- Where the underlying is an interest rate, a description of the interest rate;
- Where the underlying is anything else, the note must contain equivalent information; and
- Where the underlying is a basket of underlyings, a description of the relevant weightings of each underlying.

Because the approach proposed by CESR requires more information than is required in 4.2.2 above, the Committee supports the proposed approach. However, the Committee continues to believe that all company-specific securities and derivative instruments should provide investors with the same level and depth of information as is required of issuers of equity securities.

Format of the Prospectus

Question 172: Which of the options set out above do you support?

CESR proposed a set of three options related to how to order the information contained in a prospectus. The proposals are:

- Issuers should follow the order of the disclosure requirements in different schedules to ensure a full and easy comparability of prospectuses;
- The summary, risk factors and terms and conditions were the most important parts and should be set out at the front, with other disclosures provided in any order chosen by the issuer; or
- Issuers should be able to choose the best way to present the information in a way that best describes the activities of the issuer and the nature of the securities.

The Committee prefers the second option of requiring summary, risk and terms and conditions information up front. The primary reason for this preference is that if issuers are not required to provide the most relevant information first, they may try to hide it elsewhere in the document, making it difficult for investors to find.

For example, a description of risk factors is important for investors, particularly retail investors. Yet it is a topic that few issuers wish to discuss. If not required to put such information at the front, where it is most likely to get read, investors may have difficulty finding it.

At the same time, the Committee believes that beyond these limited items, issuers should have the freedom to describe their businesses in the way they feel best describes their activities. Indeed, the manner in which a company describes its business can give investors important insights into how management operates the company.

As a result, the Committee prefers CESR's second option.

Question 176: Which of the options set out above do you support?

The options referenced in this question relate to the organization of a prospectus packaged as a single document, as distinguished from a prospectus packaged as several different documents as described in the preceding question. The Directive requires that such a packaged document include a summary, together with the securities note and registration document requirements.

The first option proposed by CESR would require the summary to be placed first, followed by the securities note and then the registration document. The second option would permit issuers to determine how best to organize the document, though with the summary near the beginning.

For the same reasons described in the preceding question (Question 172), the Committee believes that the single-document prospectus should have the structure provided by the first option. The organization proposed – summary, securities note, and registration document –puts the most salient information about the current offering near the beginning of the document where it is most likely to receive attention, while permitting issuers to organize the registration piece in whatever manner they feel provides the most accurate description.

Question 182: Which of the options for supplementing the summary do you support?

The Directive requires that issuers provide a summary in all cases, except when the offering seeks admission to trading on a regulated market for non-equity securities having a denomination of at least €50.000, unless requested by a Member State.

The Directive also stipulates that when a supplement to the summary is needed, that the "summary and any translation" should also be supplemented, as well, if needed to take into account the new information contained in the supplement. CESR proposed two options for supplementing the summary:

- Integrating the new information in the original summary to provide an up-to-date summary prior to closure of the offer or admission to trading; this requires a completely new summary which is approved together with the supplement; it also considers the possibility that the summary might be the only document published in investors' language.

- Producing, together with the supplement, a supplement to the summary limited to the new information; investors will have to read the original summary together with the supplement to obtain a full picture.

Based on these options, the Committee's preferred option is to incorporate the supplement into the existing summary. This method will make it easier for all investors, particularly those needing a translation, to understand the terms and conditions of the offering.

Annual Information

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

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

This question relates to Article 10 of the proposed Directive which deals with the publication of a document containing all information published by the issuer in any Member State and third countries during the preceding year. Issuers are to file these documents with the competent authorities in their home States after publication of their annual financial statements. The requirements of this article do not apply to issuers of large-denominated non-equity securities.

CESR proposes to permit issuers to choose among the methods for publication described above in Question 125. It stipulates that issuers should consider the objective of the document and that it should permit investors a fast and cost-efficient access to that information.

As stated in the response to Question 125 above, the Committee is most concerned with ensuring that the documentation is consistently available in pre-determined places like those described above, that the content is unchanged, and that the issuer and its agents remain bound by the regulations of this and other relevant Directives. The Committee also reiterates its belief that a Central Repository is the best long-term solution to publication and dissemination of such documentation because it will give investors a place where they know they can find any and all documents they need for their investment decisions.

Question 239: Do you consider that a deadline should be defined? If so, do you agree with the proposed deadline or would you suggest a different one?

CESR proposes that issuers fulfilling the obligation discussed in the preceding question should file the document within seven days after publication of its annual financial information.

Considering that the financial statements, which are usually the cause for any delay in publication of annual reports, are already available and published, there is little reason for issuers to delay filing these annual documents with the competent authority of their home Member

States. Indeed, it is hoped that issuers will file the annual documents at the same time that they publish their annual financial statements for the sake of ease and efficiency.

In some cases, though, it may take a few days to collect, organize and consolidate all the information given to investors over the prior year. Without the imposition of a short deadline it is likely that many issuers would delay publication until as late as possible. Therefore, the Committee believes that the seven-day deadline is the maximum the Commission should allow for issuers to file these annual documents.

Closing Remarks

The EAC appreciates the opportunity to comment on the CESR consultative paper on *Advice on Level 2 Implementing Measures for the Proposed Prospectus Directive* and its associated annexes. If you or your staff have questions or seek amplification of our views, please feel free to contact James C. Allen, CFA, by phone at 1.434.951.5558 or by e-mail at james.allen@aimr.org.

Sincerely,

/s/ Frederic P. Lebel

Frederic P. Lebel, CFA
Co-Chair
European Advocacy Committee

/s/ James C. Allen

James C. Allen, CFA
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