Comments on

CESR's Advice on possible Level 2 Implementing Measures for the Proposed Prospectus Directive

Addendum to the Consultation Paper

6 February 2003

Introduction

Deutsches Aktieninstitut e.V. is the association of German exchange-listed stock corporations and other companies and institutions which are interested in the capital markets with a particular focus on equity. Its most important task is to promote the acceptance for equity among investors and companies.

The BDI is the umbrella organisation for a total of 35 industrial sector associations and groups of associations in Germany. It represents the interests of 107,000 enterprises employing 7.7 million people.The BDI calls for a rethink and reorientation of economic policy. Economics policy should once again gear itself more to the law of stability and growth.

We fully refer to our response to the Consultation Paper dated 31st December, 2002. In addition, we would like to comment on the Addendum to the Consultation Paper as follows:

Part I: General Comments

With respect to the Consultation Paper and the Addendum, at least three structural issues should be raised:

First, the ranking among the company disclosure requirements for the registration document and the correspondent disclosure to be included in the securities note urgently need to be harmonised as CESR confirmed and announced at the open hearing on 20 January, 2003 in Paris. Ideally, any new information about the company should be provided in a supplement to the registration document rather than in a securities note. Otherwise, the registration document would, as such, become outdated while, for each new issue, the same new disclosure about the company has to be included in each securities note. Obviously, this would result in a duplication of information, work and costs and decrease the transparency instead of improving it. Given however, that the current draft of Article 12 of the proposed Prospectus Directive actually provides for some information about the company even in the securities note, this has to be respected as long as this provision has not been amended. The scope of the disclosure to be included in a securities note is however very limited. Article 12 of the proposed Prospectus Directive refers to a “material change and recent development”. According to Annex III of the proposed Prospectus Directive, in terms of disclosure about the financial condition of the company, the disclosure to be provided for in the securities note seems to be limited to “capitalisation and indebtedness”. The disclosure described in the current drafts of the various annexes however goes far beyond these limited number of disclosure requirements to be dealt with in the securities note. Thus, it would be more time and cost effective if an issuer were in the position to update its data only once and to use it for a bigger number of issues. It would also be more transparent for investors if the registration document were limited to disclosure about the company while the securities note only deals with disclosure on the relevant securities.

Secondly, for the same reasons, the ranking among the various registration documents needs to be clarified. A more systematic approach would be preferable. Instead of creating a number of different building blocks which often require the same disclosure it would be better to produce one key document which applies to all issuers and securities. On the basis of such key requirements, one could add or remove, as the case may be, specific requirements which are (not) relevant for certain types of securities. In any case, even under the existing building blocks, it should be possible for issuers to base a bond issue, for instance, on a registration document for equity issues as long as this registration document is still valid. In other words, each ”higher ranking” registration document should cover the issue of other securities which, as such, would only require a less comprehensive registration document. An unnecessary duplication of registration documents would also lead to a lack of transparency and would therefore not give additional benefit to investors.

Thirdly, the reasons for the differentiation between the building blocks for wholesale debt, bank debt and derivative securities are not very clear. The derivative securities building block is designed to provide for lower disclosure requirements in respect of the issuer than other building blocks. It however contains some requirements which are not provided for in the bank debt building block. This contrasts to the fact, that the derivative building block is designed to apply only to banks or entities the obligations of which are guaranteed by a bank. That means that the disclosure requirements for derivative securities should not be higher (but lower) than disclosure requirements for other bank debt securities. In line with the nature of such products, the disclosure for such instruments should focus on the product specific risks rather than the issuer.

Additionally, we would like CESR to keep in mind that the European Parliament probably will not have the Second Reading until 31st March, 2003, the deadline for the CESR-advice on the Prospectus Directive. Therefore, possible changes in the wording as well as in the content of the directive can not be included in the advice and in the consultation process. We would like to point out that this procedure is not satisfactory neither for the industry nor for the legislation process itself. For future projects, more flexibility in the deadlines given by the European Commission to CESR should be implemented. The consultation process e.g. could be ended six weeks after the final adoption of a directive and the deadline of the CESR-advice should be another six weeks later.

Part II: Detailed Comments

Question 15:

No, as set out in our response to the Consultation Paper with respect to retail debt securities, we do not consider such disclosure generally to be material for the assessment of a debt investment. This certainly also applies to wholesale debt issues. If, under certain circumstances and with respect to the specific debt related risks such as failure to pay and insolvency, future investments may be material for the investor's assessment of such risks, then this risks should be described in the „Outlook“ section of the prospectus in accordance with the general disclosure requirement that all material facts and circumstances have to be disclosed.

Question 16:

No, see our response to question 15.

Question 18:

Disclosure about the company's capital expenditure commitments are neither required for wholesale debt nor for retail debt.

Question 22:

Due to the hypothetical nature of profit forecasts, a report by the company's auditors would not give much additional comfort to the investors (and may even be misleading) while the issuer's costs will increase so that, in balance, any (voluntary) profit forecasts given by the issuers should not require to be reported on by the company's auditors. Also, auditors would probably be reluctant to report on such hypothetical scenarios and cannot, in any case, give sufficient comfort on profit forecasts.

Question 23:

A brief description of the current developments and the related prospects of the issuer would be of value even for debt investors. It should, however, be sufficient if such description is limited to a mere description of trends and a statement that, as of the issue date and to the extent it can be foreseen, there is or will be no material adverse change. In any case, profit forecasts or estimates must not be mandatory.

Question 25:

It does not seem to be necessary generally to require disclosure of Board practices for issuers of debt securities. Board practices such as the remuneration of members of the audit committee and the compliance with the corporate governance regime in general are more relevant for the assessment of the equity value rather than for the investor's assessment whether an issuer is likely to be in the position to pay its debt back. If any disclosure is to be included to this effect, one may consider whether the members of the audit committee should be mentioned in the prospectus (if different from the Supervisory Board).

Question 27:

For similar reasons, an issuer should not be required to disclose detailed information on all major shareholders since such disclosure would not enable any investor to assess the risk that the issuer will not be able to pay the borrowed money back.

Question 30:

This disclosure requirement should be removed as disclosure on certain transactions with third parties would not give much additional comfort for debt investors while they can be very burdensome for issuers.

Question 33:

One should distinguish between prospectus requirements and the requirement to produce and publish interim financial statements. These separate matters should not be commingled. Hence, the inclusion of interim financial statements in the prospectus can be useful for wholesale debt investors where such interim financial statements have to be produced under general corporate law or capital markets law. The proposed Prospectus Directive and the related rules should, however, not constitute such obligation where an issuer would, otherwise, not be obliged to prepare interim financial statements.

Question 35:

Our views and comments are not different from those given in our response to the Consultation Paper, i.e. we believe that, for the reasons set out in our response to the Consultation Paper (among others because of privacy law), only publicly available documents should be on display. In particular, there must not be any requirement to display contracts which may contain confidential information on the issuer or its counterparty.

Question 43:

As set out in Part I (General Comments), the scope of the building blocks for wholesale debt, bank debt and derivative securities should be differentiated much clearer. There should be a clear ranking among those building blocks or, if there is no such ranking in respect of the level of disclosure, a building block should be removed.

As banks are subject to a specific liquidity and solvency oversight, the building block for bank debt should contain less disclosure requirements than the corporate debt building block. Moreover, due to the nature of derivative instruments, the derivative securities building block is designed to contain less disclosure requirements regarding the issuer itself. Hence, as derivative securities are almost issued by banks and since the derivatives building block, as currently drafted, therefore only applies to securities issued by banks or guaranteed by banks, it should contain less disclosure requirements than the bank debt building block. As set out below (see our response to question 92), the same should also apply to derivatives securities issued by SPV's which are part of a banking group and which in general use the banking group's marketing name.

In respect of the issuance of debt and derivative securities, CESR should establish an acceptable lower level for all bank debt and derivatives issuers which are banks or which are part of the group of a bank. To such building block with a lower level of disclosure, a derivative annex relating to the relevant specific derivative products disclosure can easily be annexed.

Also, the differentiation between straight forward bank debt securities und bank derivative securities may often not be as clear as it seems to be. Investors who, for instance, buy a plain vanilla index linked certificate (i.e. without any leverage effect) and who pay the initial investment to the relevant bank which issues the certificate, make, as any debt investor, an initial deposit. The risk that, notwithstanding an increased or decreased market value due to the performance of the relevant index, such deposit is not repaid is similar to the credit risk under a straight forward bond. Also, a bank may use such deposit for general corporate purposes as long as the bank hedges itself against the future changes of the price of the relevant index.

To sum up, there are good reasons to establish a uniform regime for bank debt and derivative securities with a lower level of disclosure on the issuer and some additional information on product specific risks to be annex in the case of securities annexes. If CESR decides not to adopt such uniform regime and to retain substantial disclosure requirements for bank debt then at least the requirements contained in the derivative building block should be reduced significantly.

We understand that the bank building block to which our responses refer primarily focusses on bank debt. With respect to bank equity, the disclosure requirements may be different. However, the suggestions we made for a reduction of disclosure requirements for equity issuers also hold true for equity securities issued by banks.

Question 47:

As set out in our response to the Consultation Paper with respect to other securities issuances (other than bank debt), there should not be a general requirement to disclose future investments. If such proposed investments may, under certain conditions, in fact increase the insolvency risk of the issuer, this should be stated under the general principle that all material facts need to be disclosed. Such material future investments should then be disclosed in the „Prospects“ or „Outlook“ section of the prospectus.

Question 49:

The solvency ratio does not help normal investors to assess the repayment risk of debt (bank debt and derivative securities) of the relevant issuer.

Question 51:

No, disclosure on Board practices should in principle not be required (see our response to question 25).

Question 53:

No, information on major shareholders is not of much value for debt investors (please see our response to question 27).

Question 55:

As set out in our response to question 30 above, this disclosure requirement should be removed as disclosure on certain transactions with third parties would not be much additional comfort to debt investors while they can be very burdensome for issuers. Moreover, related party transactions are also subject to banking supervision.

Question 57:

As long as it is clear that the prospectus requirements apply to existing interim financial statements and that it would not result in an issuer being obliged to produce separate interim financial statements only for the purposes of a prospectus, the approach set out in VII.H should be appropriate.

Question 59:

No, only publicly available documents should be displayed.

Question 66:

No, an issuer should not generally be required to disclose information about its principal future investments. This applies to both derivative securities and straight forward debt securities (see our response to question 15).

Question 69:

The information set out in V.A.1 should, in all cases (i.e. not only in the case of derivative securities), restricted to the highest level of the management and supervisory bodies, i.e. the CEO and CFO and the directors in a One-Tier System and the members of the management and the relevant supervisory body in a Two-Tier System.

Question 71:

The information on conflict of interest proposed in V.B is not relevant for derivative securities and should therefore be deleted.

Question 73:

As set out in our comments on the wholesale debt building block and the bank building block, disclosure on Board practices is in general not relevant for debt securities. The same reasoning also applies to derivative securities.

Question 74:

Please see our response to question 73 above.

Question 76:

No, for the reasons referred to in our response to question 30.

Question 78:

If interim reports are published there is no reason why they should not be included in the prospectus. The Prospectus Directive should, however, not impose such a requirement on issuers which do not publish interim financial statements.

Question 80:

No, for the reasons referred to in our response to question 35.

Question 87:

As set out in more detail in our comments on the Consultation Paper, no difference should be made between „guaranteed“ and „non-guaranteed“ derivative securities. Such differentiation is artificial. Also, the difference between those concepts may not be as clear as it seems to be. There are, for example, also products in the market which provide for a certain protection mechanism (e.g. protection of up to xx % of the nominal amount) without, however, granting a „guarantee“ in respect of full repayment of the nominal amount.

Question 88:

As set out in our response to question 87 above, no difference should be made between “guaranteed” and “non-guaranteed” derivative securities. Any percentage return applied to this effect would be arbitrary.

Question 89:

There is no reason why a derivative security (whether “guaranteed” or not) should require more disclosure on the issuer than straight forward bank debt securities. The creation of a separate derivative securities annex was based on the understanding that this kind of securities should be subject to lower disclosure requirements than other debt securities. Please see also Part I (General Comments), fourth paragraph above.

Question 92:

The (reduced) disclosure requirement for banks issuing derivative securities should, in principle, also apply to certain non-banks, so-called special purpose vehicles („SPV“) which issue derivative instruments and which, at least in the case of retail derivative securities, are part of a well-known banking group and which use the marketing name of the relevant banking group. Even if the derivative securities issued by such SPV are not guaranteed by the relevant parent company (but issued under the group’s marketing name) we believe that this should not impact on the basic scope of the disclosure requirements as the relevant bank would in general ensure the liquidity of the SPV. Next to any intra-group agreements which may exist and any backing statement which may be included in the annual report with respect to such SPV, this presumption is also based on the fact that a bank would loose its overall market reputation if it did not pay out its clients. Certainly, language should, in such cases, be included in the prospectus to the effect that the SPV has a very limited stated capital and that the securities are not guaranteed by the parent company. Also, the prospectus should disclose for which purposes and in which manner the SPV uses the proceeds from the relevant issuance, in particular in the cases of derivative certificates which require an initial deposit of the investor.

The above more or less reflects the current market practice. If, however, it will, in future, happen that derivative securities are issued by entities which are not banks nor “bank-controlled” SPVs, then such entities should not benefit from a lower level of disclosure requirements. If derivative securities are issued by corporates there is no significant difference between a derivative issuer and a corporate retail debt issuer. In both cases, the investor would need to rely on the solvency and liquidity of such company. This would be obvious if a corporate issuer issued funded (ie. with an initial deposit) or „guaranteed“ certificates but should also apply to other derivative instruments.

Question 93:

As set out above, banks should be subject to the same lower level of disclosure requirements. The same should apply to “bank controlled” SPV’s regardless of whether the (re)payment claims of the investors are guaranteed by the parent company or not.

In the unlikely case that, in future, unregulated corporates, which trade in derivatives, start issuing derivative securities, such securities should be subject to the general corporate debt disclosure requirements which should, however, be reduced as set out in our response to the Consultation Paper and above in respect of the wholesale debt building block.

Disclosure on SPV’s which issue more sophisticated derivative securities for wholesale investors such as credit linked notes and collaterised debt obligations should be in line with the disclosure on SPV’s which issue asset backed securities.

Question 96:

With respect to asset backed securities (ABS), we would like to stress that there should either be a clear distinction between derivative securities, structured bonds and ABS. In particular, it should be taken into account that the market has developed instruments such as “true sale”-ABS, synthetic ABS (which clearly have credit derivative features) as well as credit derivative securities such as collaterised debt obligations and credit linked notes. This again shows that the building block concept is somehow problematic and therefore either requires further clarification or a more general concept of a reduced number of building blocks with less detailed requirements.

Question 102, 103:

A separate annex for depositary receipts is not necessary. Depositary receipts are mere technical securities which facilitate cross-border clearing and settlement. The underlying securities, however, constitute the actual investment and no further risks (other than the risks of the underlying securities and the risk of a breach of the depository's contractual obligations (see response to question 104 below)) will assumed by the investor. Disclosure on depositary receipts should therefore be limited to a description of this concept, the rights the investor has under this legal concept and the identity of the depository. This should be covered by paragraph IX.A and XI of Annex 5.

Apparently, the disclosure to be included in a prospectus should focus on the underlying. As depositary receipts only constitute a technical mean for cross-border clearing and settlement, the disclosure should be the same as the disclosure contained in a equity registration document of the relevant issuer and the securities note relating to the underlying.

Question 104:

The mere chance that, in the case of a breach of the obligations of the depository as a service provider, an investor may have recourse claims against the depository under the depository agreement, does not require a substantial amount of disclosure requirements as if the depository were the issuer of the underlying. It should be sufficient if the prospectus contains disclosure to the effect that the investor is informed on the duties and rights of the depository and the investor under the depository agreement and that the depository is sufficiently reliable in respect of its tasks and duties as depository. The latter could, for example, be proved by a description of its business experience or technical and personal facilities in this area.

Question 111:

As set out in our response to the Consultation Paper, the number of building blocks must not be too large. An extension of the building block approach to various sectors and branches of industry should be rejected. What information is deemed material in relation to a specific company in a given case and should thus be included in the prospectus, can only be determined for a specific issue and the respective macro-economic environment. In particular, it is entirely superfluous to create building blocks for specific industries (other than banks which as regulated entities are permanent issuers). Otherwise, we will end up with a variety of annexes each of which referring to very specific pecularities of each industry. One of the major items of the shipping companies building block, the valuation of ships, for instance, would apply accordingly to any other asset of any other industry.

Moreover, it will often be questionable whether the relevant issuer fulfills the criteria of an industry specific building block. It may be that only a part of the issuer's business falls within the relevant category or its business is only similar to the business of the relevant industry but has a couple of substantial features which deviate from the concept on which the relevant annex is based.

Question 122:

Yes, we agree with this approach.

Question 123:

The meaning of the expression "in the line items" is not entirely clear and should therefore be defined. Moreover, after the words "not applicable to" the following should be inserted: ", or not relevant for,". Otherwise, we are satisfied with the wording of the Blanket Clause.

Question 125, 126:

As set out in Part I, all disclosure on the issuer should be included in the registration document which may be updated from time to time in the case of material changes to the issuer's financial condition. Hence, the IOSCO disclosure V.B.1 on working capital is more appropriate to the registration document rather than to the securities note.

Question 132:

Yes, we welcome CESR's decision not to draft a further building block for separate types of shares and to allow the application of the Blanket Clause if certain requirements are not applicable, or not appropriate, to a specific class of shares. However, it should be sufficient to require a detailed description of the relevant shares and all rights attached to the shares. As the legal concept of the relevant class of shares and the rights attached thereto are clearly defined in each jurisdiction, it is not necessary for a EU-wide disclosure harmonisation to enumerate the most common rights and main features of specific classes of shares.

Question 136:

It is very difficult or sometimes even impossible to distinguish between derivative securities, structured bonds and certain types of asset backed securities. Thus, we welcome that CESR does not provide for a further building block to this effect. For the same reasons, we believe that the securities note for derivative instruments sufficiently covers structured bonds which, as certain types of certificates, either often contain a proper derivative instrument or qualify otherwise as derivative securities. If CESR however concludes that the derivative securities building block shall only apply to securities issued or guaranteed by banks, then annex 8 should remain.

Question 139:

Yes, in principle we agree with this approach. However, as set out in our response to the Consultation Paper, disclosure on historical values and data of the relevant instruments or underlying can be misleading and should therefore not be required.

Question 143, 144:

CESR should reconsider the definition of ABS which could be more precise since there are a number of products which may qualify for both derivative securities and ABS. Please also see our response to question 96.

Question 149:

Yes, we agree with this approach.

Question 150, 151:

The proposed level of disclosure should be appropriate. In addition, CESR should clarify that the entire wording of the guarantee is set out in the prospectus since this is the key document which is legally binding for the guarantor and the investors.

Question 155:

The definition of equity securities within the meaning of Art. 2(1)(b) of the proposed Prospectus Directive would also cover equity derivative securities. We however understand that Annex 12 is designed to apply to convertibles, exchangeables and similar instruments and not to derivative securities with physical settlement. If not, this should be amended. In any case, it should be clarified that Annex 12 shall not apply to derivative securities.

Question 159:

In the case of separate legal entities, each entity is responsible for its own disclosure even if the relevant entities belong to the same goup. Hence, the latter approach is more appropriate.

Question 168:

Given the level of detail of the Ecofin text and annex IV, there is no need for detailed requirements established on level 2. It would not be possible to reflect in a summary annex or schedule all types of securities dealt with in the Consultation Paper and the Addendum. By its very nature, the content of the summary has to a certain extent to be left to the issuer. If CESR members feel that some advice may be appropriate to this effect CESR should provide for some general guidelines (rather than detailed requirements) as to how the summary should be dealt with and for which purpose it shall serve.

Question 175:

In principle, a base prospectus together with the relevant supplement should contain the same amount of information as a normal prospectus. However, the pecularities of a base prospectus should be taken into account. Hence, it should be possible to supplement the blanks contained in the incomplete base prospectus by the final terms, i.e. the specific terms of the relevant transaction (i.e. primarily economic data such as issue price, interest rate etc.), on or immediately before the date of public offer. Moreover, in accordance with Article 5(4) of the proposed Prospectus Directive which does not explicitly provide for a summary, a summary should not be required.

Question 176:

As already indicated in our response to question 175 above, a definition of "final terms" should include all terms and conditions which are specified with respect to the relevant transaction and which are, and can be, determined only on or shortly before the date of public offer of the relevant securities. This includes the election of the specific type of securities provided for in the base prospectus (e.g. bearer bonds or registered bonds; index linked or share linked warrants etc.), the determination of due dates, expiry dates, interest rates, nominal amount, denomination, currency and, for derivatives, the initial purchase prise, the strike price, the subscription ratio, the exercise period, and similar terms. This is current practice in Germany which has proved to be appropriate and practicable for many years without any lack of investor protection.

Due to the variety of derivative instruments, we would not recommend to classify certain terms as "final terms" in a base prospectus annex. A definition of "final terms" based on the description above should be sufficient, e.g. the following: "Final terms are those terms and conditions of a security issued pursuant to a base prospectus which can only be determined shortly before or on the date of public offer."