



**Friends of
the Earth**

**CESR's advice on possible
Level 2 implementing Measures
for the
Proposed Prospectus Directive
October 2002**

Consultation Paper

**Friends of the Earth
England, Wales & Northern Ireland**

2003

Summary of general concerns

Overall: We believe that the European Commission and CESR have pursued a narrow and short sighted approach to the Prospectus and related listing directives. The Prospectus Directive consultation has ignored growing community and investor concern over the Social, Environmental and Ethical (SEE) risks associated with managing businesses in the 21st century. The implementing measures proposed will ensure the EU listing regime entrenches investor focus on the short term, sets minimum standards of disclosure that fall behind best practice at other exchanges and will be unable to respond quickly to investor and community expectations of business.

Poor consultation: We are very disappointed at the poor quality of consultation in preparing and seeking views on the Prospectus Directive. In particular we are disappointed at the narrow focus of participants who were invited to submit comments. We are aware that this is partly a result of the restrictive timetable developed by the European Commission. However it is clear that SEE issues have been largely ignored and that the views of a significant body of the investment sector such as asset managers, including those in socially responsible investment, have not been adequately sought or taken into account. The poor and narrowly focussed consultation is particularly worrying as the regulations implement a Maximum Harmonisation directive and so should require even more care. Instead we have been presented with a Directive which appears to be focussed toward satisfying a narrow group of institutions within the finance sector.

Lack of guidance on materiality: In many cases the regulations require disclosure if something is “material”, or similar. While the use of this concept is understandable to avoid irrelevant disclosure and unnecessary burdens, practice, particularly in the United States, shows that it can be abused, with the result that information is not disclosed that should be, and directors discretion is too strong. Clear guidance should be provided on materiality, including the general concept that the onus should be on the issuer to establish that something is not material. In addition, regulations and practice should establish mechanisms for enforcing a robust interpretation of materiality.

Inadequate enforcement: It is also worth noting, although slightly outside of the scope of this consultation, the need for adequate enforcement mechanisms. Firstly, the pre-approval checks need to be as thorough as possible. Secondly, if factors emerge after the event that should have been disclosed, regulators should not hesitate from using their enforcement powers, particularly on the directors and sponsors. This would also be the most effective way of encouraging good practice going forward. Existing practice appears to fall short of this.

Sustainability: Despite commitments made by the EU in previous Communications encouraging disclosure of social and environmental risks in Initial Public Offerings (COMM (2002) 347) and numerous other commitments from the EU to promote and encourage sustainability the opportunity to integrate these principles into how the financial markets are regulated has been ignored in the consultation process.

“Registration statements and prospectuses issued at the time of an IPO (initial public offering), can be another useful source of information on social and environmental risks allowing the prospective investor to assess the overall risks associated with a business”

[Communication concerning Corporate Social Responsibility, COM(2002) 347, July 2002]

Response to Consultation Paper

Risk factors & governance

Risk factors: While recognising the difficulty of making risk disclosure requirements too specific, the current wording appears vague and inadequate. In particular, the wording “make an offering speculative or high risk” should be deleted. As written, issuers appear to have the option of claiming their issue is not high risk or speculative, so they do not need to disclose risks. All investment involves some risk. The purpose of this statement is to enable investors to decide on the level of risk.

Guidance: While recognising that providing detailed guidance may best be provided elsewhere it is still very appropriate in the Level 2 Requirements to state more fully what is required. Firstly, risk factors should be identified, their impact summarised, and information provided on how they are managed. Secondly, broad categories of risk factors should be identified (on a non-exclusive basis) at this level, rather than in guidance, to ensure proper consideration and enable enforcement.

The Association of British Insurers has published guidance on socially responsible investment which could be applied to listing in regard to disclosure of environmental and social risks facing businesses (see Comments on Annex A). Similarly the updated Code of Corporate Practice and Conduct for companies listed on the Johannesburg Stock Exchange provides guidance on disclosure.

Consideration should be given to whether the desire to “prominently disclose risks factors” might conflict with the desire also for a proper discussion of risk impact and management. The risk factors section could be split into a summary of risks and a more detailed discussion.

Governance: Clear guidance on the disclosure of risks, particularly social and environmental, is critical in being able to establish suitable governance mechanisms for ensuring these risks are properly taken into account. The absence of clearly agreed guidance will reduce the capacity to establish suitable corporate governance mechanisms to ensure that such risks are being properly assessed and managed.

Business ethics

The importance of business ethics have taken on a much higher profile since the recent US corporate scandals including Enron and Arthur Anderson. Clearly the background of directors is highly relevant to the decision to invest and should certainly be seen as more important than the right of privacy in this context. The right of privacy of directors in this context should be seen as applying to their personal life not their business life.

We also note moves in other exchanges to address business ethics. In particular the recent amendments to the New York Stock Exchange listing rules regarding corporate governance and business ethics and the inclusion of an updated Code of Corporate Practice and Conduct for companies listed on the Johannesburg Stock Exchange.

Comments on Annex A

Note: Comments in *italics* are where additions have been made to the proposed text otherwise additional comments indicated by NEW prefix.

	Text	Comments
II.B Risk Factors.	<p>The document shall prominently disclose risk factors that are specific to the company or its industry and make an offering speculative or one of high risk, in a section headed "Risk Factors".</p> <p>NEW: The document shall prominently disclose risk factors that are specific to the company or its industry and may significantly affect the company's short or long term value in a section headed "Risk Factors". Such risks may include, but are not limited to, market, reputation, operational, financial, political, social, environmental and ethical risks.</p> <p>The document should describe how the risk factors might impact on the business and the company's policies and procedures for managing risks. If the company has no such policies and procedures, the document should provide reasons for their absence.</p> <p>The document should include information about the extent to which the company has complied with its policies and procedures for managing the risks identified.</p>	<p>The wording suggested is based on the wording of the Association of British Insurers Guidelines for disclosure of social and environmental issues.</p>
III.C.7	<p>Summary information regarding the extent to which the company is dependent, if at all, on patents or licenses, industrial, commercial or financial contracts (including contracts with customers or suppliers) or new manufacturing processes, where such factors are material to the company's business or profitability.</p> <p>NEW: In particular, the document should disclose the nature and extent of any long term contracts, which, in aggregate, are material in extent and expose the company to pricing, cost or delivery risks.</p>	<p>Exposure to fixed long term contracts has been a major factor in a number corporate collapses including power utilities, life insurance companies, and computing leasing. While accounting standards are being enhanced to address this, it should be an item for specific disclosure in the prospectus.</p>
III.C.9	<p>NEW: A statement outlining the significant social and environmental impacts of the company's operations and products as appropriate, and any material impact these may have on the capital expenditures, earnings and competitive position of the company and its subsidiaries.</p>	<p>Loosely based on the SEC regulation S-K Reg. §229.101. Item 101. (c) (1) (xii), and also reflecting the French disclosure requirements in Decree N° 2002-221 of February 20th, 2002</p>

III.E Property, Plants and Equipment.	The company shall provide information regarding any material tangible fixed assets, including leased properties, and any major encumbrances thereon, including a description of the size and uses of the property; productive capacity and extent of utilisation of the company's facilities; how the assets are held; the products produced; and the location. Also describe any environmental or social issues that may affect the company's utilization of the assets. With regard to any material plans to construct, expand or improve facilities, describe the nature of and reason for the plan, an estimate of the amount of expenditures including the amount of expenditures already paid, a description of the method of financing the activity, the estimated dates of start and completion of the activity, and the increase of production capacity anticipated after completion	Wording based on the SEC 20-F for foreign issuers. Social added for completeness
IV.A.5	Provide information regarding any governmental economic, environmental, social , fiscal, monetary or political policies, proposed policies or factors that have materially affected, or could materially affect, directly or indirectly, the company's operations.	Wording strengthened for completeness. Proposed policies would include green / white papers, international commitments not yet translated into law etc.
IV.D.1	Comment: Develop a guidance note indicating that the trends, uncertainties etc, should include consideration of social and environmental factors.	Phrasing as is potentially adequate, especially if the changes above are adopted, but enforcement is the key. Thus a guidance note appears appropriate.
V.C.3.a	NEW: Details regarding the company's procedures for making appointments to the board, including membership of the appointment committee and summary terms of reference. Any policies regarding the balance of non-executives on the board, their independence and the role of the chairman and chief executive unless covered under V.C.4	Strengthening corporate governance disclosure and making it less reliant on national corporate governance codes.
V.D Employees.	Provide either the number of employees at the end of the period or the average for the period for each of the past three financial years (and changes in such numbers, if material) and, if possible and material, a breakdown of persons employed by main category of activity and geographic location. Also, where material, disclose any significant change in the number of employees, and information regarding the relationship between management and labour unions. If the company employs a significant number of temporary employees, include disclosure of the number of temporary employees on an average	Improvements in this section have been loosely based on the King Report on Corporate Governance in South Africa, and also on the French Disclosure standards in Decree N° 2002-221 of February 20th, 2002. At present the discussion of employees seems a little lopsided – disclosure of numbers but not of their value or other aspects. The additions are intended to

	<p>during the most recent financial year.</p> <p>NEW: Include disclosure of policies and practice in human capital development. Include information on employee training and development including financial investment committed. If appropriate discuss how such policies contribute to the business or create competitive advantage through attracting and retaining staff and improving motivation and productivity.</p> <p>Include disclosure of policies, procedures and outcomes, including any legal action, regarding equal opportunities among the workforce. If appropriate, identify any contribution from this diversity.</p> <p>Disclose policies, practices and significant outcomes regarding occupational health and safety, including any occupational fatalities, major work related incidents or prosecutions in the last three years.</p>	rectify this.
V.D.1 V.D.2.	<p>Reference to section V.B wrong (should be section V.A?). These sections should be V.E.1 and V.E.2?</p> <p>NEW (in V.D/E.2): Disclose no of shares held by employees (other than directors) if available.</p>	Inclusion of employee share ownership important and relevant.
VII.K	<p>Legal and arbitration Proceedings</p> <p>Provide information on any legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the company is aware), including those relating to bankruptcy, receivership or similar proceedings and those involving any third party, which may have, or have had in the recent past (covering at least the previous 12 months), significant effects on the company and/or group's financial position or profitability. This <i>should</i> include <i>all</i> governmental (<i>including government agencies and local governments</i>) proceedings <i>including those</i> pending or known to be contemplated, <i>regardless of extent</i>.</p>	Make clear that with government proceedings, financial significance is not an issue. Government cases in areas such as environment or equal opportunities can open the door to far greater liabilities, as well as being an indicator of management quality and risk.

Comments on Other Annexes

Annex D: Property Company Building Block.

<i>Additional Disclosure</i>	NEW: The Company should disclose risks associated with rent control programs, fuel or energy requirements or regulations, and other social or environmental factors, including regulations actual or pending, that could affect development, construction, letting or sale.	Loosely based on SEC Securities Act Industry Guides: Real Estate Partnerships.
------------------------------	--	--

Annex E: Mineral Company Building Block

<i>Additional Disclosure</i>	NEW [for all mineral companies]: Describe the company's policy and procedures for addressing: indigenous people's rights, including land ownership; human rights, including security aspects; corruption; environmental impact, including biodiversity. Disclose any areas of specific dispute or contention. Disclose total payments in each of the last three years to the government and public authorities (taxes, royalties, license fees etc.) of each country in which the company has operations.	For mineral companies these are important areas and full disclosure is justified on financial grounds alone. The last item reflects the "publish what you pay" campaign
------------------------------	--	---

Annex H: Scientific Research Based Company Building Block

<i>Additional Disclosure</i>	NEW: Any information that might be relevant regarding the social or environmental acceptability of the company's research or products.	The history of GM foods shows that consideration of the broader acceptability of GM would have been highly relevant.
------------------------------	---	--