THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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DRAFT

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

Consultation Paper

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11-13 avenue de Friedland - 75008 PARIS - FRANCE - Tel.: 33.(0).1.53.36.43.21 - Fax: 33.(0).1.58.36.43.30
Web site: www.europefesco.org

EXECUTIVE SUMMARY

Background

The deadline set up by the European Council for the Prospectus Directive to be approved is end 2003. A Second Reading in the Parliament is now under way. If the targets for implementation of Level 1 and Level 2 measures are to be met, it is essential that the work on Level 2 measures starts while the final details of some components of the Level 1 measure are still under debate. This is why CESR is working on its advice to the European Commission on possible implementing measures of the future Directive.

Purpose

The purpose of this consultation document from CESR is to seek comments on the advice that CESR proposes to give to the European Commission on a number of these implementing measures. The measures covered are those that are set out in a provisional mandate received by CESR from the EU Commission.

Consultation Period

Consultation closes on 12th August 2003.

Areas Covered

- **Minimum information:** The directive provides that for the elaboration of the various models of prospectuses account shall be taken of the different types of securities, in particular non-equity securities issued under an offering programme, and also the various activities and size of the issuer. CESR proposes technical implementing measures related to schedules for derivative securities, offering programmes, securities issued by collective investment undertakings of the closed ended type, wholesale debt securities and a building block concerning the underlying for equity securities (when these securities are linked to some other product -the underlying instrument-).

- **Format of the prospectus:** The directive allows the prospectus to be composed of three separate documents (registration document, securities note and summary) or by a single document. It also offers the possibility to use a base prospectus. CESR proposes technical advice in relation to the prospectus drawn up as a single document and in relation to the format of a base prospectus and supplements. The consultation paper also provides a provisional roadmap the aim of which is to clarify what schedules and building blocks should be used for each type of security.

- **Annual information:** The directive requires issuers whose securities are admitted to trading on a regulated market to provide at least annually a document that contains or refers to previously published information in compliance with their obligations in relation to securities regulation. CESR proposes technical advice in relation to the method of publication of the said document.

Further Details

Full details of CESR's proposed advice, together with contact details can be found in the consultation paper.

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I INTRODUCTION

1. CESR invites responses to this consultation paper on its proposed advice to the European Commission regarding a second set of technical implementing measures for the Directive on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive).

2. Respondents to this consultation paper should address their input to Mr Fabrice Demarigny, Secretary General, CESR, by email at secretariat@europefesco.org.

Background

3. On 27 March 2002, the European Commission (EC) published its provisional request for CESR to provide technical advice on possible implementing measures on the Prospectus Directive. On 7 February 2003, the European Commission published an additional provisional mandate.

4. CESR has to deliver its technical advice under three different deadlines: 31 July 2003, 30 September 2003 and 31 December 2003.

5. The present consultation paper addresses the technical advice required by 30 September 2003.

6. CESR set up an Expert Group on Prospectus, responsible for developing the advice to the EC. It is chaired by Pr. Fernando Teixeira dos Santos, Chairman of the Portuguese Securities Commission and supported by the CESR Secretariat, first by Ms Silvia Ulissi until 8 April 2003 and since then by Mr Javier Ruiz. The Expert group has set up two drafting groups dealing respectively with the disclosure requirements for the Registration Document and the Securities Note. The two drafting groups have been coordinated by Mike Duignan of the UK Financial Services Authority and Philippe Lambrecht of the Belgian Commission Bancaire and Financière.

7. In addition, under the terms of CESR's Public Statement of Consultation Practices (Ref: CESR/01-007c), a Consultative Working Group (the "CWG") has been established to advise the Expert Group. A full list of members of the CWG can be found at Annex B. As part of the process for producing the technical advice required by 31 July 2003, CESR published a Consultation Paper on October 2002 (Ref: CESR/02-185b). Additionally, CESR published on December 2002 an Addendum to the Consultation Paper (Ref: CESR/02-286, *the Addendum*). Some of the issues covered by this consultation paper were already consulted in the Addendum. Almost sixty responses to the Addendum have been received. Those that are public can be viewed on CESR's website.

8. On 7 February 2003, CESR published a Second Call For Evidence (Ref: CESR/03-038) inviting all interested parties to submit views by 31 March 2003 on the issues which CESR should consider in its advice to the Commission. CESR received around 19 submissions by end of March and these can be viewed on the CESR's website.

9. On March 24, 2003 the Council has adopted its common position under written procedure and the EC has adopted its communication on the common position on March 26, 2003. CESR has taken into account this common position N° 25/2003 (ref. 2003/C 125 E/02) when preparing this consultation paper.

10. The timetable for handling the second part of the mandate (September 30 deadline) is set out below.

9 July afternoon	Open hearing on consultation paper in Paris.
10 July	Prospectus Experts Group meets with CWG.
12 August	Consultation period closes.
29 September	CESR plenary approves advice.
30 September	Deadline for submission of CESR's advice to European Commission.

In order to facilitate the consultation process, CESR will be holding an open hearing on 9 July 2003 in Paris at CESR's premises, *11-13 avenue de Friedland*. Please register your interest in participating with Mr Fabrice Demarigny at the following email address:secretariat@europefesco.org.

11. CESR regrets that it has been necessary to bring forward the consultation closing date by four weeks to ensure that consultation comments can be fully reflected in the final advice to be approved by the CESR Chairmen.

References

12. The additional mandate asks that CESR should have regard to a number of principles and a working approach agreed between DG Internal Market of the EC and the European Securities Committee in developing its advice. These are as follows:

- CESR should take account of the principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001.

- CESR should take full account of the key objectives of the Prospectus Directive: the need to encourage and build an efficient, cost-effective and competitive pan-European capital market on the one hand, and to provide the necessary levels of investor protection on the other.

- CESR should not seek to produce a legal text.

- CESR should take full account of developments in the Council and Parliament.

13. Papers already published by CESR which are relevant to this mandate are:

- *A European Passport for Issuers – A report for the European Commission – January 2001 (Ref. FESCO/00-138b)*

- *A European Passport for Issuers: an additional submission to the European Commission – August 2001 – (Ref. FESCO/01-045)*

- *Stabilisation and Allotment, a European Supervisory Approach – April 2002 (Ref. CESR/02-020b)*

II PRELIMINARY STATEMENT BY FERNANDO TEIXEIRA DOS SANTOS

14. The additional provisional mandate from the European Commission reflects the evolution of the text of the Directive during discussions in the European Parliament and the Council, including the addition of a number of areas requiring implementing measures. The consultation paper addresses the topics for which the mandate sets a deadline on 30 September 2003 at the latest.

15. Respondents to the consultation on CESR's first advice on prospectuses (documents CESR/02-185b and CESR/02-286) highlighted the difficulties created by the very tight timetable which CESR had to impose to meet the Commission's deadlines for receipt of the advice. CESR recognises this criticism and is striving to ensure the maximum amount of time possible for the consultation process. The overall timetable for the Lamfalussy procedure is, however, largely outside of CESR's control and, in responding to this new consultation paper, each of the parties involved will again be working to tight deadlines.

16. This consultation paper builds upon the experience of the two previous consultations undertaken by CESR on the Prospectus Directive: some of the comments made in response to the above mentioned CESR documents are applicable to the issues dealt with here. Comments received in response to CESR's second call for evidence have been taken on board as well.

17. Experience with said consultations suggests that many respondents may use the consultation exercise to highlight their points of more general concern with the level 1 text. These are not, however, within CESR's power to address, as CESR must remain firmly within the terms of its level 2 mandate.

18. The 30 September mandate focuses on three substantive areas:

- Prospectus as a single document including the summary; base prospectus and supplement. Although not specifically mentioned in the additional mandate, CESR also considered appropriate to propose at this stage a provisional roadmap explaining how to combine the different schedules and building blocks to produce the applicable prospectus.

- Minimum disclosure requirements: derivative securities and offering programmes. CESR also proposes disclosure requirements for securities issued by collective investment undertakings of the closed ended type, wholesale debt securities and an additional building block concerning the underlying of the equity securities that are linked to another product (the underlying).

- Annual information: method of publication of the document that contains or makes reference to all disclosure requirements published over the past 12 months with respect to information that would be required to be published under Community and national laws and rules dealing with the regulation of securities, issuers of securities and securities markets.

19. The additional mandate also requests by 30 September CESR's advice in relation to the notice that states how the prospectus has been made available and where it can be obtained. CESR has already published its views on this topic as part of the advice to be delivered by 31 July 2003 (document CESR/03-066B). Written comments to that document may still be sent to CESR until 16 June.

20. On **base prospectuses**, CESR has taken into account the responses to the Addendum to the October consultation paper (CESR/02-185b) and to the second call for evidence that conveyed a clear message for flexibility. The base prospectus plus the final terms should contain the same information as a stand-alone prospectus. Having this principle in mind, CESR has drafted the

proposed advice trying to respect the current market speed and ability to respond to market conditions.

21. CESR proposes further adjustments to the debt disclosure requirements in case of admissions of **non-equity securities having a denomination of at least EUR 50.000**. Document CESR/03-128 included a proposal on the Registration Document to be published in such cases. Now the Securities Note for such securities is released. The rationale is the same as explained in the above mentioned document: disclosure obligations which add to the costs of issuance of securities without providing any real investor protection benefits are removed from the retail debt schedule, bearing in mind the nature of the investors at which these securities are aimed.

22. On **derivative securities,** CESR proposes to adopt a new approach as a result of the previous consultations. Concerning the definition of these products, CESR consulted on two possible definitions. The views expressed were too divergent to allow a compromise. Therefore, CESR now proposes to set the scope of the proposed disclosures for derivatives by exclusion: every security that can not fit under the equity or debt securities definitions will be deemed to be a derivative (for the purpose of disclosure obligations). CESR also thinks this solution is more appropriate in dealing with market innovation.

23. Regarding disclosure obligations for these products, CESR also has changed its initial views. Consultation respondents had commented on the complexity of the initial proposals. When comparing the initial proposed Registration Documents for non-equity securities issued by banks with those proposed for derivatives it happens that the differences are minimal. The amended retail debt RD (see annex 5 of document CESR/03-128, published in May 2003) is also now closer to the said two RDs for banks and derivatives. As a result, CESR proposes to abandon the split between debt and derivatives for RD purposes. Banks will use the banks RD for any kind of non-equity securities. Non-bank issuers will use the retail debt RD for all non-equity securities except those having a denomination over EUR 50.000, in which case the wholesale debt RD will apply.

24. Finally, CESR considered that the specific nature of **closed ended investment funds** calls for an adapted RD. The proposed disclosure requirements contain detailed information in relation to the investment objective and policies, investment restrictions, service providers, investment managers and custodians and valuation and redemption.

The Consultative Working Group

25. CESR is grateful for the ongoing assistance of the Consultative Working Group (CWG), established in connection with the provisional mandate on the Prospectus Directive. There have been two meetings between the CWG and CESR's Expert Group on the issues covered by said mandate, during which the CWG provided comment and guidance on developing drafts of the papers the Group has produced. The CWG will continue to offer its views and advice to CESR as its work progresses. The next meeting between the CWG and the Experts Group will take place on July 10th.

III MINIMUM INFORMATION

Extract from the mandate

DG Internal Market requests CESR to provide technical advice on the different models of prospectuses following the latest drafting of Article 7 (1) – which were not covered or insufficiently detailed in the initial request.

CESR technical advice related to schedules for securities aimed at wholesale markets, for derivative securities and for securities issued by SMEs and credit institutions, should be completed.

Technical advice is required to CESR for following issues:

(1) Schedules adapted to the particular nature of derivative securities such as covered warrants, certificates or reverse convertibles should be defined; CESR should provide its technical advice by 30 September at the latest.

(2) Specific schedules or explicit reference in the schedules to certain types of issuers in particular SMEs; CESR should provide its technical advice by 31 July at the latest.

(3) Specific schedules or explicit reference in the schedules to certain types of entities authorised or regulated to operate in the financial markets, for example, credit institutions; CESR should provide its technical advice by 31 July at the latest.

(4) Schedules adapted to securities aimed at wholesale markets should also be examined; CESR should provide its technical advice by 31 July at the latest.

(5) The content of the prospectus to be used for offering programs (Article 7 par. 1 point c) has to be defined. Offering programs are supposed to cover frequent issuances of debt securities by an issuer or subsidiaries of an issuer, for example in the Eurobond market under the denomination "Euro medium term notes" or for derivative securities. Warrants in any form are covered by the definition of offering program (Art. 2 par. 1 point k); CESR should provide its technical advice by 30 September at the latest.

III.1 DERIVATIVE SECURITIES

Introduction

26. Derivatives is an area which CESR has consulted upon in both the October Consultation Paper issued in October 2002, and the Addendum to the paper issued in December 2002.

27. As pointed out in these papers, derivatives is a complex area that covers a broad variety of products, and as such CESR asked a large number of questions from high level fundamental questions about what a derivative security is, and whether or not it is possible to sub-divide these products into sub groups, to questions relating to particular disclosure requirements.

28. In relation to both consultations, overall there was no general consensus about any of the issues and in particular, what the definition of a derivative should be, and whether or not there

should be different disclosure requirements depending upon particular sub–groups of derivatives.

29. In addition to this, as CESR has made significant changes to its original proposals for other security types, therefore the responses to the questions asked about specific disclosure requirements for derivatives no longer reflect the revised proposals.

Issues for derivatives – highlight questions

30. In the absence of an agreed definition of derivative securities, CESR asked itself what disclosure requirements should apply to a basic derivative issued by a bank (as defined in paragraph 37 of CESR/02-286). The example chosen was a covered warrant where the investor's return is purely dependant upon the performance of the underlying over which the derivative is issued i.e. the investor may lose their premium and receive nothing.

31. CESR took the revised registration document for Banks (reference Annex 3 of CESR/03-128) as the starting point and identified the following areas where there was no consensus as to whether or not the disclosure requirements should apply for a bank issuing a basic derivative: principal activities (Annex D, ref 6.1.1& 6.1.2), principal markets (Annex D, ref 6.2), trend information (Annex D, ref 8.1 -wording as in banks column-), administrative, management and supervisory bodies conflicts of interests (Annex D, ref 10.2) and major shareholders (Annex D, ref 12.1 &12.2).

a) Principal activities – Annex D, ref 6.1.1& 6.1.2

In view of the nature of these products and the nature of the issuer's obligations to an investor, some CESR members do not consider the requirement that issuer's provide "a brief description the issuer's principal activities, stating the main categories of products sold and/or services performed … [together with] an indication of any significant new products and/or activities", to be necessary as such information is of no relevance for investors.

QUESTION

32. *Do you consider that this disclosure is relevant for these products? Please give your reasons.*

b) Principal markets – Annex D, ref 6.2

33. CESR members discussed the relevance of disclosure about the principal markets in which an issuer of derivatives competes. Some members consider that such information is of importance for investors, while others do not consider such disclosure to be of relevance to investors when deciding whether or not to invest in a derivative.

QUESTION

34. *Do you consider that disclosure about the principal markets in which the issuer operates is relevant for these products? Please give your reasons.*

c) Trend information – Annex D, ref 8.1 (wording as in banks column)

35. In relation to this disclosure requirement, there is no definitive view as to whether or not it is relevant for the issuer to identify its most significant business developments since the close of the financial year to which its last published annual statements relate. Some CESR members are of the opinion that such information is not a relevant disclosure for these products.

QUESTION

36. *Do you consider that disclosure about an issuer's significant business developments is relevant for these products? Please give your reasons.*

d) Administrative, management and supervisory bodies conflicts of interests – Annex D, ref 10.2

11

QUESTION

37. *Do you consider that this disclosure is relevant for these products? Please give your reasons.*

e) Major shareholders – Annex D, ref 12.1 &12.2

38. In view of the nature of these products, CESR discussed the relevance of requiring disclosure about the issuer's major shareholders. Some CESR members consider that this requirement is relevant disclosure for these products; others consider that this is not the case, as information about the issuer's major shareholders is of no relevance when making an investment decision about derivatives.

QUESTION

39. *Do you consider that disclosure about an issuer's major shareholders is relevant for these products? Please give your reasons.*

Changes in CESR's views in relation to the disclosure proposals for derivatives.

40. In addition to the issues discussed above, there are two areas of disclosure upon which CESR has changed its views from those stated in the Addendum:

a) Profit forecasts or estimates

41. It was proposed in the Addendum, that where a profit forecast or estimate is included in the Registration Document, the issuer would be required to include a statement ensuring that such forecast has been properly prepared on the basis stated, and that the basis of accounting is consistent with the accounting policies of the issuer.

42. Following further discussions about profit forecasts and estimates, and in accordance with changes made to the equity, retail debt and bank's registration documents, CESR believes that for retail investors, such a statement is not adequate, and as the issuer includes such a forecast or estimate because it wants to and not because it is required to do so, where it does include such information, an auditors report should also be included.

b) Interim and other financial information

43. In relation to interim and other financial information, CESR proposed in the Addendum, that interim financial information would only be required where the issuer had already published such interim financial information, and asked consultees if they agreed with this approach.

44. Although most of respondents agreed with this proposal, CESR has changed its views on this matter as it considers that retail investors should be provided with the most up to date financial information about the issuer at the time an offer is made irrespective of the type of security that is being issued.

45. As such, even when an issuer will not be required to produce interim financial information after the offer if it is not admitting its securities onto a regulated market, such information is considered to be of importance for investors.

46. CESR anticipates banks will be required to make public such interim financial information even where its securities are not admitted to trading on a regulated market.

47. In view of the likelihood that the majority of issuers of derivatives will continue to be banks, CESR does not believe that this requirement will prove problematic.

A new approach to derivatives

48. CESR consulted on two possible definitions of a derivative security, neither of which gained overwhelming support from respondents to the consultation, indeed some respondents provided their own definitions none of which solved all the possible problems. At this stage, there has been no success in achieving agreement on the definition of derivative securities. This process has not been made easier by the directive itself.

49. CESR compared the disclosure requirements in the various registration documents previously proposed and in particular the differences between them. It bore in mind the fact that derivatives are largely issued by banks (as defined in the previous CP).

50. Annex D sets out a comparison of the disclosure requirements for the registration documents for Retail debt, Wholesale debt, Banks, and derivatives issued by banks.

51. The purpose of this table is to highlight the similarities and differences between these registration documents. Those items shaded in grey indicate those disclosures which are not required for a particular type of registration document. Those items marked with a question mark in the derivatives column, highlight those items discussed above.

52. As one can see from this table, there are very few differences between the disclosure requirements in these registration documents, which reflect the change in approach that CESR has taken in relation to these registration documents following the consultations. On the assumption that the requirements set out in the table are unlikely to change substantially, it is likely that the differences between the disclosure requirements will remain relatively few.

53. Consultation respondents had commented on the complexity of CESR's initial proposals and complained that it was not clear how all of the different building blocks fitted together. Bearing in mind the relatively small number of differences between the disclosure requirements for derivatives and for non-equity securities issued by banks, CESR proposes a different approach.

54. Any differentiation between debt and derivative disclosure requirements will require some kind of definition of derivatives, which could potentially restrict market innovation. If CESR were to express an opinion, it would be that where the security provides for a 100% capital return, it

would be considered to be a debt security. Hence, all other securities, for which there is no specific disclosure regime, would be considered to be derivatives.

55. In the absence of an agreed definition for derivative securities, the minor differences between the disclosure requirements and the fact that most derivatives are currently issued by banks, CESR proposes that the disclosure requirements set out for debt (both retail and wholesale) are used for all non-equity securities, except those issued by banks.

56. This would mean that a non-bank issuing a retail derivative would have to provide the information required in the retail debt disclosures. A non-bank issuing wholesale debt would have to provide the information set out in the wholesale debt disclosure requirements. A bank issuing any non-equity security would have to provide the information set out in the bank disclosure requirements.

57. It should be noted that an SPV whose obligations in respect of retail non-equity securities are guaranteed by a bank would be required to provide the information set out in the retail debt disclosures. This is a change in approach to that set out in paragraph 62 of the Addendum (CESR/185-b). However CESR does not believe that this will significantly increase the cost of preparing documents for such entities as many of the disclosure requirements will not be relevant/applicable.

58. Clearly, this would be a simpler arrangement. However, it will impact on the desirability of changing the disclosure requirements set out above in paragraphs 31-40 above. Consultees should consider this aspect when providing their answers to the questions above.

QUESTION

59. *Do you agree with CESR's revised approach in relation to retail non-equity securities and wholesale non-equity securities? If not please give your reasons.*

60. One particular disclosure requirement needs careful consideration under this proposed approach. Currently, the disclosure requirements for wholesale debt require information about past, present and future investments. However, the disclosure requirements for banks do not require such information. So, if this approach were to be adopted, CESR considers that there should at least be a provision making it clear that where a bank issues wholesale debt it would not be required to provide such information about investments.

QUESTION

61. *Do you agree that information about investments should not be required for banks issuing wholesale debt securities? Please give your reasons.*

62. This disclosure requirement is the sole requirement that would be required in relation to an issuer of wholesale debt securities that is not required for a bank issuing a non-equity security. Consideration of this issue has led CESR to reconsider this requirement for issuers of wholesale debt. CESR now considers that an obligation to provide disclosure about investments made or to be made as a matter of course is not to be required for wholesale investors, because this information would be provided by the issuer when material.

63. Therefore, this disclosure requirement would be deleted from the wholesale debt requirements. This would mean that a bank seeking to issue wholesale debt could, if it so chose, produce either a bank registration document or a wholesale debt registration document to issue a wholesale debt security. However, it would only be able to use the bank registration document to issue a retail debt or derivative.

QUESTION

64. *Do you consider that information on investments is relevant for wholesale debt securities? Please give your reasons.*

Derivatives Securities Note schedule

65. CESR has consulted upon the Derivatives SN Schedule in both the Consultation Paper issued in October 2002 and the Addendum to the paper issued in December 2002.

66. The Derivatives SN Schedule now set out in Annex E takes the responses of both consultations into account. Further adaptations were necessary due to the amendments made in the equity and the debt Securities Notes ensuring therefore, that identical requirements in the schedules are worded in the same way.

67. While CESR developed the Derivatives SN Schedule with regard to a typical derivative security, such as a covered warrant, the schedule nevertheless applies to all securities which are neither covered by the equity SN Schedule nor by the Debt SN nor by any other specific disclosure regime. CESR deems the Derivatives SN as the most appropriate schedule to be used for such an "everything else box" as a starting point, because its disclosure requirements are drafted in the most high level way. For example, disclosure requirement 4.1.1: "A description of the type and the class of the securities being offered and/or admitted to trading" or requirement 4.1.6: "A description of the rights, including any limitations of these, attached to the securities and procedure for the exercise of said rights" should be able to apply to newly invented features of the security not known today. Of course, future market development might cause the need to further development of the corresponding disclosure rules. For more information on this topic and how to combine the schedules please refer to section V "Road Map" in this paper.

68. There are two items in the Derivatives SN Schedule as set out in Annex E that deserve further analysis: examples of the way the instrument works (ref 2.2.1) and past performance of the underlying and its volatility (ref 4.2.2).

Examples

69. In its Consultation Paper of October 2002 (CESR/02-185b) consulted on the inclusion of a worked example of the "worst case scenario"[1].

70. The result of the consultation showed a rejection by consultees of the compulsory inclusion of a worst case scenario. The most common arguments advanced were that the terms and conditions of the product were sufficient, that it was very difficult and potentially misleading to build such worst case scenarios, that risk warnings were sufficient and that only informed

1 The question was:
257.Section III.C.2.(d) – *Section III.C.2.(d) requires inclusion of a worked example of the "worst case scenario".*
1) Does this information provide material information for investors?
2) Are there circumstances in which an example of the worst case scenario is not appropriate?
3) Would the disclosures as set out below be an appropriate alternative:
a) a risk warning to the effect that investors may lose the value of their entire investment, and/or
b) if the investor's liability is not limited to the value of his investment, a statement of that fact, together with a description of the circumstances in which such additional liability arises and the likely financial effect.

investors should, according to the rules of conduct of the intermediaries, be offered such products.

71. Those in favour of the inclusion of an example of the worst case scenario wrote that the prospectus should allow an investor to be able to fully understand the product, that examples are didactical and much clearer than terms and conditions, that the examples were the most efficient way to inform the investors about the risk of the product.

72. Although not expressly consulted on, some consultees also gave their views about examples and their general usefulness for investors. Some consultees believe that examples are potentially misleading and do more harm than good, other consultees believe that examples are useful and necessary.

73. On the basis of the result of the consultation, CESR discussed in a more general manner the usefulness of examples in describing the working of the instrument in the prospectus. All members of CESR agreed that the overall principle should be that the prospectus must contain a clear and understandable explanation of how an investors return is calculated and how the instrument works. There was a debate about the best manner to attain this general principle. Some CESR members believe that examples are not necessary (or even dangerous) in order to fulfil this general principle. Other members consider that examples are the best way to attain it.

74. During this discussion the main arguments put forward by CESR members were the following ones.:

a) Against the inclusion:

- Examples can be misleading as, by their very nature, they can only present a limited number of scenarios. Investors may potentially place undue reliance on examples contained in a prospectus.
- The terms and conditions are sufficient to answer the requirement of Article 5(1) of the Proposed Directive and to provide any material information to investors and a clear and understandable explanation of how an investors return is calculated and the instrument works.
- Examples oversimplify the working of products.
- Examples raise too much expectation.
- People who buy sophisticated products are educated and do not need examples.
- The risk factors section of a prospectus should contain a risk that an investor may lose the value of his investment.
- Rules of conduct are sufficient to meet the concerns of investor protection without the need for examples in the prospectus.

b) In favour of the inclusion:

- The information included in the prospectus "shall be presented in an easily analyzable and comprehensible form"[2] and the terms and conditions for some complex products are not easily understandable and readable.
- Only examples make it possible to understand how sophisticated products work.
- In order not to be misleading, examples must be realistic and show the impact of a positive, negative or neutral evolution of the underlying.

[2] Art. 5 (1), of the Common Position of 24 March 2003.

- It is not enough to know that a product is risky and that investors can lose their entire investment (see risk factors and warnings): for those who want to take that risk, it is important to be able to understand precisely in what circumstances they can obtain a positive return.
- The term "guaranteed products" and other such marketing terminology might be potentially misleading. In such cases, concrete examples demonstrating, for instance, that investors would earn more by investing on a risk-free investment, such as government bonds, than by investing in the product, even in the best-case scenario, can be particularly relevant.

QUESTIONS

On the basis of this discussion, CESR decided to consult on the need to include examples in order to provide a clear and understandable explanation of how an investor's return is calculated and how the instrument works.

75. *Do you consider that examples are necessary in order to fulfil 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? Please give your reasons.*

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? Please give your reasons.*

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? Please give your reasons.*

78. *Do you consider that the use of examples in the prospectus is dangerous and misleading and should not be mandatory? Please give your reasons.*

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?*

80. *If your answer to the previous question is yes do you think that examples should also fulfil other requirements (for example: the need to insert the break even point for the investor)? Please state these other conditions.*

81. *Do you consider that examples should be provided for derivatives? Please give your reasons.*

82. *If yes, for which types of derivatives should examples be provided? Please give your reasons.*

83. *Are there any other type of securities for which you consider examples should be provided, for example structured debt instruments that have a derivative component?*

Past performances and volatility

84. Last proposal of the SN Derivatives Schedule as set out in Annex E requires disclosure of past performance of the underlying and its volatility. This requirement states:

4.2.2.	*Information required in respect of the underlying, a statement setting out the type of the underlying and details of where information on the underlying can be obtained* – *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*

85. In its Consultation Paper of October 2002 (CESR/02-185b), CESR consulted on the inclusion of a statement concerning the past performance of the underlying and its volatility[3].There were different views about this question:

a) Main arguments against:

- Past performance does not give any reliable information regarding future performance.
- Information regarding past performance can be misleading and investors may place undue reliance on it.
- Expensive and difficult to produce this kind of information.

b) Main arguments in favour:

- Helps to understand the product and to assess its risk and its volatility.
- Helps to take an investment decision.
- Pricing made by the issuer is based on the past performance of the underlying.
- Not misleading if clearly mentioned that the past does not give any certainty for the future.

86. Without a clear answer to the question, CESR discussed the topic internally without fixing its opinion at this juncture. Three options were discussed:

1. No past performances and no volatility should be required.
2. Mandatory indication of where information about past performances and volatility can be found or, if not easily accessible, indication by the issuer of the past performances and the volatility.

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

3. Mandatory indication of past performances and volatility only where the issuer has composed the underlying of the derivative instrument.

87. If past performances were to be included or mentioned in the prospectus, CESR believes that there should be a clear warning to the investors stating that past performances and volatility do not give reliable guidance on the future performance of the security.

88. On the basis of this approach, CESR has decided to consult again.

QUESTION

89. *Which of the above options do you consider should be adopted by CESR (1, 2 or 3)? Please state your reasons.*

III.2 BASE PROSPECTUSES

Introduction

90. In the Addendum to the Consultation paper (CESR/185-b) published in December CESR set out a brief discussion about base prospectuses and what the disclosure requirements for these prospectuses should be.

91. Following the responses to that consultation and the additional mandate regarding base prospectuses published by the Commission on the 7th February 2003, which required CESR to give technical advice on:

a) the particular format of base prospectus and supplement,
b) the content of the prospectus to be used for offering programmes (Art. 7 par.1 point c) has to be defined) and
c) mortgage bond issues.

92. CESR has considered the base prospectuses in greater detail and sets out below a discussion about the issues relating to base prospectuses.

The particular format of base prospectus and supplement

a) General remarks

93. In view of the particular characteristics of base prospectuses and the method in which securities are offered under such prospectuses CESR thought it was necessary to consider how certain Articles of the Directive apply to such prospectuses.

94. Article 5 (4) of the Directive: format of a base prospectus. The wording "supplement" refers to the supplement pursuant to Art. 16 and is not to be mistaken for a reference to the final terms.

95. Article 7 (2) (c) and (d): content of disclosure rules on offering programmes. CESR has discussed Art.7(2)(d), although the Commission's request explicitly envisages Art.7(2)(c) only. CESR considers that the issues as described in Art.7(2)(d) should also be taken into account when establishing its technical advice on offering programmes as the above mentioned issues are usually issued in the form of such a programme.

96. Article 16 Supplement to the prospectus: For the purpose of base prospectuses, Article 16 applies to each separate issue of securities issued under the base prospectus, and therefore, if an event envisaged under Article 16(1) occurs between the time that the base prospectus has been approved and the final closing of the offer of each issue of securities under the prospectus or, as the case may be, the time that trading on a regulated market of those securities begins, the issuer must file a supplement in accordance with Article 16 (1) prior to the final closing of the offer or the admission of those securities to trading. If none of the facts stated in article 16 (1) take place before the final closing of the offer or the admission of those securities to trading, there is no need to publish a supplement.

b) Division between final terms and base prospectus

97. CESR discussed the content of the base prospectus and came to the conclusion, in line with most of responses to the Addendum, that only the format of the base prospectus differs from a single issue prospectus whereas the disclosure requirements of the base prospectus and the final terms will together be the same as the disclosure requirements included in a single issue prospectus.

98. Therefore CESR focused its discussion on determining which line items in the schedules can be announced in the final terms only and which ones always have to be contained in the base prospectus.

99. On consideration of this complex issue, taking into account the responses to the Addendum and bearing in mind that the purpose of base prospectuses is to give the market maximum flexibility, it was decided that an abstract generic rule should be used to determine which line items are to be classifiable as final terms and which line items have to go into the base prospectus. This generic rule is:

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.

100. CESR believes that this generic rule will accommodate current market practice whereby the issuer provides as much information as possible in the base prospectus leaving final issue specific terms to be provided as close to issue date as possible in order to facilitate quick access to the market. Maintaining this practice will also ensure that the necessary flexibility for innovation in the development of financial products in the future will continue.

QUESTION

101.	*Do you agree with this generic rule?*

c) Base prospectus as single document or tripartite prospectus

102. CESR considered the different ways in which an issuer can create a base prospectus and concluded that there was nothing in the Directive that explicitly prohibits the use of the Registration Document and Securities Note as separate documents being combined to create one single base prospectus. On that basis CESR concludes that the issuer has a choice between the following methods of creating a base prospectus:

a) *file one document as a base prospectus excluding final terms, or*

b) *file a registration document for a particular product group at one point in time, and then at a later date file another document which will be the security note less final terms.*

103. Although this gives issuers the flexibility to decide how they wish to create a base prospectus, it is important to note that a practical difference concerning the validity of the base prospectus exists.

104. If the base prospectus is filed as one document excluding final terms, then:

a) *in accordance with Article 9 (2) the base prospectus will be valid for a period of up to 12 months, so if the base prospectus is published on 20th Jan 2003 it will be valid up to and including the 19th Jan 2004; and*

b) *in accordance with Article 9(3) the base prospectus will be valid until no more of the securities concerned are issued in a continuous or repeated manner.*

105. If the base prospectus is filed as two separate documents, then the base prospectus is valid up to a year as long as the registration document on which it is based is also valid. For example, a debt RD is published in 20th January 2003, and the issuer files a security note excluding final terms in order to create a base prospectus for issuing debt which is published on 20th June 2003, then the base prospectus will be valid until 19th Jan 2004.

106. If in this case the issuer wishes to have the base prospectus published in June to be valid for a whole year, as the registration part of that prospectus expired on the 19th January 2004, if the issuer wants to use the base prospectus in order to issue debt securities between the 20th January 2004 and the 19th June 2004 the issuer will be required to get a new registration document approved and published.

d) Summary/Translation

107. CESR considers that a summary has to be drawn up for the base prospectus pursuant to Article 5 (2) and (4).

108. In relation to the summary and its applicability to base prospectuses, two issues arise: translation of the summary and summaries and multiple products in the same base prospectus.

Translation of summary

109. In relation to this, CESR discussed that in case of a summary for a base prospectus, some information (which would be included if the prospectus was a single issue prospectus) may not be available when the summary is prepared, filed and approved because it will be available later on as final terms. CESR member's have not yet fixed their final view on whether or not such final terms do or do not need to be translated.

110. Some CESR members consider that as the summary forms part of the base prospectus that gets approved by the competent authority, and the final terms do not, the final terms can not form part of the summary, and therefore do not have to be translated as the requirement to translate only relates to the summary;

111. Other CESR members consider that as the purpose of the summary is to convey the essential characteristics and risks associated with the issuer, any guarantor, and the securities, it is argued that there may be some items in the final terms that would if the issue was done as a single issue form part of the summary and therefore be translated. On this basis, there is a proposal that there may be items of the final terms that need also to be translated, even if they do not form part of the approved summary.

QUESTION

112. *Which of these two approaches do you think should be applied to base prospectuses? Please give your reasons.*

Summaries and multiple products in the same base prospectus

113. Following the conclusion as discussed in paragraphs 134-136 below that a base prospectus may cover more than one product, CESR considered whether or not it was necessary for an issuer of such a base prospectus to include a separate summary for each product included in the base prospectus.

114. There is no fixed view among CESR members on this issue at this junction, some CESR members considering that there is a need in such circumstances to stipulate that a separate summary is required for each product, while other CESR members consider that it should be left to the issuer to decide how to comply with the general requirement of summary content as set out in Articles 5 (1) and (2).

QUESTION

115. *Which of these views do you consider should apply to base prospectuses with multiple products? Please give your reasons.*

e) Final terms

116. In relation to the final terms, there are 2 issues that arise: form and publication of final terms, including the notice.

Form of the final terms

117. In the second call for evidence the respondents raised the question of the form in which the final terms have to be presented to the competent authority. There may be situations where in addition to the final terms the issuer produces a document that replicates some information already provided in the base prospectus. There is no fixed view on this issue at this juncture within CESR.

118. One view is that the issuer is free to replicate in the final terms some information already included in the base prospectus.

119. Other CESR Members consider that in such a case, the information replicated together with the final terms can only be information from the Securities Note.

120. A third view is that the issuer may be allowed to choose whether to file the full prospectus (base prospectus plus final terms) or only the final terms but the issuer should not be allowed to file a document which replicates only 'some' information already provided in the base

prospectus. These Members argue that the selection of only 'some' information may open a complex issue on how 'such information' will be selected and the risk of giving a misleading impression.

121. CESR considers that if the document presented includes information in addition to the final terms, such final terms should be easily identifiable. In any case, the final terms must make clear that the document is to be read in conjunction with the base prospectus.

QUESTION

122. *Which of these views do you consider should apply to the form of final terms? Please give your reasons.*

Publication of the base prospectus and final terms including the notice

123. In relation to the publication of the base prospectus although it is clear that Article 14 applies to the base prospectus, a question arises as to whether or not it also applies to the final terms.

124. CESR has not yet reach a final view on this issue, some CESR members believe that the method of publication of the final terms is limited to the methods set out under Article 14, other CESR members believe that there is no such restriction in the method of publication provided that the base prospectus sets out how the final terms will be published and that the final terms are easily accessible and free of charge for the investor.

QUESTION

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

126. Following on from the above, those members who believe that the methods of publication as set out in Article 14 applies to the final terms, also believe that on the basis of Article 14(5) the method of publication used for the base prospectus does not need to be same method used for the publication of the final terms provided that the methods used for publication is one of the methods used in Article 14.

QUESTION:

127. *Do you agree with this analysis?*

128. Under Article 14(3) each Member State has the discretion to require publication of a notice stating how the prospectus has been made available and where the public can obtain it.

129. In relation to this, CESR discussed whether or not there is a need to add to the advice in relation to the content of a notice for base prospectus. On review of the requirements of the content of the notice as set out on the advice, CESR considers that it may not be possible to publish some of those line items as they are not available at the time the notice of the base prospectus is published as they relate to items that can only be included in the final terms. As such, CESR considers that it is necessary to make it clear that Member States may require that an additional notice in relation to the final terms may also be required to be published.

The content of the prospectus to be used for offering programmes (Art. 7 par.1 letter c)

a) Additional information concerning the programme structure

130. In addition to the disclosure requirements as set out in the applicable registration document, or securities note, or other building blocks, CESR considers that the following additional disclosure requirements should apply to base prospectuses:

1. 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.

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

3. Include a general description of the programme.

QUESTIONS:

131. *Do you agree with the above additional disclosure requirements in relation to base prospectuses?*

132. *Are there any other disclosure requirements that are not specified above that you consider necessary for base prospectuses? If so, please specify what these are and give your reasons for why you think they are necessary.*

b) Types of securities that can be issued under the same base prospectus

133. In determining which types of securities can be issued off the same base prospectus, CESR took into consideration Article 2(1)(k) 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*".

134. On the basis of this definition CESR believes that multi-product base prospectus can be developed. If this is the case, CESR considers that the information given on different products should not be mixed up.

135. The following types of securities can be issued under the following types of base prospectus:

1. Debt securities base prospectus: for debt securities, which as set out in the original consultation are securities where the issuer has an obligation arising on the issue to pay the investor 100% of the investor's capital, in addition to which there may also be an interest payment;

2. Warrants to subscribe for new shares base prospectus: for warrants:

   a) issued for the purpose of capital raising that give the investor the right to receive newly created shares; and
   b) issued by the same issuer as the issuer of the underlying shares or by an entity belonging to the group of the said issuer.

3. Derivative securities base prospectus: for all types of derivatives,

4. Asset backed securities base prospectus: for asset backed securities, and

5. Mortgage bond securities base prospectus: for securities referred to under Article 5(4)(b)

QUESTIONS

136. *Do you agree with the above types of base prospectuses?*

137. *Are there any other types of base prospectuses that you consider are necessary? Please give your reasons.*

c) Number of issuers per base prospectus

138. Respondents to the 2nd call for evidence raised a question as to whether or not there would be a restriction on the number of issuers and/or guarantors that can issue securities under a base prospectus. On consideration of this issue, CESR concluded that no such restrictions would apply, thus maintaining current market practice.

Mortgage bonds issues

139. In view of concerns raised in the 2nd call for evidence regarding mortgage bonds, CESR has decided to provide for a separate base prospectus for mortgage bonds as set out above. CESR considers that no further advice on this matter at this stage is required.

III.3 WHOLESALE DEBT SN

Introduction

140. Current article 7 (2) (b) of the Proposed Directive on Prospectuses states that, in the elaboration of the various forms of prospectuses, account shall be taken on the appropriateness of information to investors in non-equity securities having a denomination per unit of at least EUR 50.000. Bearing this in mind, CESR has prepared a "Wholesale Securities Note" which is included as Annex F.

141. The scope of this Schedule is limited to admissions of these securities to trading on a regulated market. In fact, article 3.(2) (d) of the Directive exempts securities with a denomination of at least EUR 50.000 from the obligation to publish a prospectus in the case of a public offer.

142. The Wholesale SN is based on the Retail Debt SN with the exclusion of all the references made to offers, in order to accommodate the interests and views of the investors targeted and the relevant provisions of the Directive.

QUESTIONS

143. *Do you agree with this approach?*

144. *Do you consider that the information provided for in Annex F is adequate for wholesale investors? Please give your reasons.*

145. *Are there any other items included in the retail debt SN that should be included for wholesale investors? Please give your reasons.*

III.4 CLOSED ENDED INVESTMENT FUNDS

Introduction

146. Annex G sets out the disclosure requirements that CESR considers appropriate for the registration document of closed ended investment companies.

147. Given the particular nature and activities of closed ended investment companies, CESR considers that it is necessary to have separate RD disclosure requirements for such issuers. CESR does not consider it necessary to have separate SN disclosure requirements.

148. In order to distinguish between closed ended investment companies and trading/holding companies, CESR considers that the prospectus of a closed ended investment company should demonstrate that the company is a passive investor which does not take or seek to take legal or management control of any of the issuers of its underlying investments. The Minimum Disclosure Requirements for the Closed Ended Investment Fund Registration Document applies only to these issuers.

149. In the event that a closed ended investment company is not a passive investor, then the Minimum Disclosure Requirements for the Equity/Debt/Derivatives Registration Document shall apply as appropriate.

150. In addition to certain disclosures of the 'Minimum Disclosure Requirements for the Equity Registration Document', the registration document of a closed ended investment company must contain detailed information relating to the following matters:

- Investment objective and policies;
- Investment restrictions;
- Service providers; and
- Valuation and redemption.

QUESTION

151. *Do you agree with the disclosure obligations set out in Annex G as being appropriate for this type of issuer? Please give reasons for your answer.*

Property investment companies

152. Disclosure requirement 2.7 of the 'Minimum Disclosure Requirements for the Closed Ended Investment Fund Registration Document' sets out some information that must be disclosed in a prospectus where a fund invests directly in real property. Further disclosure requirements will be necessary for these types of funds, relating particularly to the nature of the investments being made. CESR has yet to conclude on what this additional information, may be.

153. In its deliberations to define the scope of this building block, CESR drew a distinction between two extremes: those entities which invest exclusively, on a passive basis, in real property assets for capital gain, and those which engage primarily in short term rental, development, refurbishment and other similar income generating activities relating to their property assets. CESR would categorise these latter companies as trading companies to which the normal RD disclosure requirements relating to equity and/or debt would apply. However, no conclusion was reached on the appropriate dividing line between the two types of activity.

QUESTION

154. *Do you consider there is a distinction to be drawn between these two types of activities, as set out above? Please give reasons for your answer.*

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

III.5 SN BUILDING BLOCK ON UNDERLYING FOR EQUITY SECURITIES

Introduction

156. In the Addendum to the Consultation Paper (CESR/02-286) CESR introduced an additional building block for subscription rights. This building block applied to equity securities within the meaning of Article 2 (1)(b) of the Prospectus Directive. The purpose of this building block was to provide disclosure rules concerning the manner in which the investor can exercise the right to convert or exchange the security into shares or other transferable securities equivalent to shares of the issuer or an entity belonging to the group of the issuer. Therefore, references made in this building block to "shares" should be understood as made also to "other transferable securities equivalent to shares".

157. Although most of respondents agreed in general with the approach taken by CESR and with the content of the building block they also expressed a need for simplification.

158. CESR reconsidered the subject and rearranged the building block. Items 1 to 9 and 11 of Annex 12 of the Addendum, which described the right to convert or exchange are now covered by the Debt SN or the Derivative SN schedules respectively. However, CESR considers it necessary to keep the remaining requirements to describe the underlying in a modified additional building block set out in Annex H. This building block concerning the underlying for equity securities applies to securities which are – at the issuer's or at the investor's discretion or by predetermination – to be converted or exchanged into or which give in any other way the possibility to acquire shares or other transferable securities equivalent to shares issued by the issuer of the security or by an entity belonging to the group of the said issuer by way of physical delivery.

159. Concerning the information on the offered security, CESR deems appropriate to apply the SN schedule corresponding to the main characteristics of this security. This means, for example, that in cases where the issuer offers convertible or exchangeable bonds, the requirements set out in the Debt SN schedule will apply and when the issuer offers warrants or reverse convertible bonds, the Derivatives SN schedule has to be used.

160. Concerning the information on the underlying securities, for underlyings that are "own shares or shares of an entity belonging to the same group", CESR deems it appropriate to require more information on the underlying share than the Derivative SN schedule would provide.

Therefore, the information on the underlying share will be provided for by adding the building block concerning the underlying to the Debt SN schedule or by replacing item 4.2.2. of the Derivative SN schedule by this building block, as the case may be.

161. Concerning the information on the issuer of the underlying security, CESR deems it necessary to distinguish two situations: firstly, cases in which the shares to be acquired are the shares of the issuer itself and secondly, cases in which the shares to be acquired are the shares of an entity belonging to the group of the issuer. For own shares, CESR deems it appropriate to require more information on the issuer of the underlying. This more extensive information will be provided for by the Equity RD schedule. On the contrary, when the shares to be acquired are the shares of an entity belonging to the same group, CESR deems it sufficient that the issuer of the security discloses where further information on the issuer of the underlying shares can be found (additional information on the issuer of the underlying shares has to be given as set out in item 2 of the building block).

QUESTIONS

162. *Do you agree with this approach?*

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

164. In cases where the security gives the right to acquire newly created shares some CESR members feel that additional information taken from the Equity SN schedule has to be disclosed as the investor might be an equity holder after the transaction. This additional information would be the Working Capital Statement (item 3.1 of the Equity SN, Annex C to the Technical Advice, CESR/03-066b Annexes) and information on Capitalization and Indebtedness (item 3.2 of the said Equity SN). Other CESR members believe that this additional information will add no value because it will be outdated at the time when the investor finally receives the shares.

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? Please give your reasons.*

166. In cases where the issuer of the underlying shares is not the issuer of the security or an entity belonging to the group of the issuer but a third party, this building block concerning the underlying does not apply. In these cases the underlying is normally described by item 4.2.2. of the Derivatives SN schedule. But there are cases where the Derivative SN schedule is not applicable (for example in cases of a convertible bond, convertible by the investor in into shares of another issuer): in these cases CESR suggests to apply item 4.2.2. of the Derivative SN schedule, additionally to the relevant SN schedule (which is the Debt SN schedule in the above mentioned case).

QUESTION

167. *Do you agree with this approach?*

The most common cases of convertible or exchangeable equity securities can be found in the table included as Annex I.

QUESTION

168. *Do you agree with the combinations set out in the table?*

IV. FORMAT OF THE PROSPECTUS

Extract from the mandate

DG Internal Market requests CESR to provide technical advice on the format of the prospectus or base prospectus and its possible supplements by 30 September 2003. The present additional request should be partly covered by work already realised on the basis of the initial provisional mandate as far as the format of the prospectus composed by three separate documents is concerned. More particularly CESR is invited to:

(1) Complete its work with respect to the format of prospectus as a single document, including the summary as part of the prospectus.

(2) Specifically consider the particular format of base prospectus and supplement.

(3) To grant particular attention to offering programs and mortgage bond issues.

The prospectus: single document or separate documents

169. Article 5 (3), of the draft Directive states that "the offeror or person asking for the admission to trading on a regulated market may draw up the prospectus as a single or separate documents".

170. The prospectus drawn up as separate documents shall divide the required information into three different documents: the summary, the securities note and the registration document.

171. CESR has presented in last published documents (CESR/03-066b of April and CESR/03-128 of May), schedules and additional building blocks referring to the registration document and the securities note. In each schedule, the information is divided into chapters, each one referring to a different kind of information, and the line items are numbered. CESR did not specifically consider the question of how the information in prospectuses should be ordered. In response to the mandate from the Commission requiring advice on the format of prospectuses, CESR has now focused on this issue. Three different views have been expressed:

- Some CESR members are of the opinion that issuers, when drafting their prospectus, should follow the order of the disclosure requirements in the different schedules in order to ensure a full and easy comparability of prospectuses in the European market.

- Other CESR members felt that the summary, the risk factors and the terms and conditions of the security were the most important parts of the prospectus and so should be set out at the front of the prospectus. The other disclosure requirements could then be met in an order chosen by the issuer.

- Others consider that issuers should be able to choose the best way to present the information which meets the disclosure obligations. This would allow issuers to choose the order of the information to best describe to investors the activities of the issuer and the nature of the securities. This could change from one issuer to another.

QUESTION

172. *Which of the options set out above do you support? Please give your reasons for your choice.*

173. CESR has also considered the question of how a single document prospectus should be prepared. The Directive requires that a single document prospectus must include a summary. However, the information that would otherwise be included in the securities note and the registration document must also be included in the single document prospectus. This gives rise to the question of whether the SN and RD information should be kept separate from each other even in a single document prospectus.

174. Some CESR members believe that in a single document prospectus, the prospectus shall start with the summary, followed by the securities note requirements and then the registration document requirements.

175. Others consider that no specific order should be set although they would anticipate that the summary would probably be towards the beginning of the prospectus.

QUESTION

176. *Which of the options set out above do you support? Please give your reasons for your choice.*

177. Finally, even if the prospectus is drawn up as a single document, the summary may circulate separately.

The summary

Cases in which a summary is required

178. Article 5 (2), of the draft Directive states that the prospectus shall include a summary. A summary is needed whether the prospectus is composed of separate documents or not.

179. However, according to article 5 (2), the requirement to produce a summary does not apply "where the prospectus relates to the admission to trading on a regulated market of

non-equity securities having a denomination of at least EUR 50.000 (…) except when requested by a Member State as provided for in Article 19(4)". This is the only exception provided for by the draft Directive.

Cases in which the summary has to be supplemented

180. Article. 16 (1), of the draft Directive provides that when a supplement to the prospectus must be published "the summary and any translation thereof shall also be supplemented, if necessary to take into account the new information included in the supplement". Accordingly, issuers should consider if it is necessary to take the new information into account for the purpose of the summary, either when it has an impact on information already included in the original summary, or when it concerns the essential characteristics and risks associated with the issuer, any guarantor or the securities (see principles for the drafting of a summary at level 1).

181. Concerning the way to supplement the summary, if necessary, CESR considers two different approaches:

- The first one consists of integrating the new information in the original summary, in order to have an up-to-date summary prior to the closure of the offer or admission to trading on a regulated market. This means that a new complete summary will be approved together with the supplement to the prospectus. This approach takes into account the fact that the summary might be the only document published in investors' language according to Art. 19 of the draft Directive.
- The second one consists in producing, together with the supplement to the prospectus, a supplement to the summary which is limited to the new information. In this case, investors will have to read the original summary together with the supplement to the summary in order to have a full picture.

QUESTION

182. *Which of the options set out above do you support? Please give your reasons for your choice.*

General principles for the drafting of a summary at level 1

183. The draft Directive states the following aspects related to the summary:

- its scope: convey the essential characteristics and risks associated with the issuer, any guarantor and the securities;
- its language, which should be non technical;
- its length: the summary should be "brief" and –according to the preamble - should "normally not be more than 2.500 words";
- its contents: "the summary shall also contain a warning that: (a) it should be read as an introduction to the prospectus, and (b) any decision to invest in the securities should be based on consideration of the prospectus as a whole by the investor, and (c) where a claim relating to the information contained in a prospectus is brought before a court, the plaintiff investor might, under the national legislation of the Member States, have to

bear the costs of translating the prospectus before the legal proceedings are initiated, and (d) no civil liability attaches to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus."

The summary schedule provided in annex IV to the draft Directive, is only indicative, i.e. not all of the items set out in this list have to be included in the summary.

184. Finally, in accordance with Article.11 (1), of the draft Directive, the summary shall not incorporate information by reference.

Guidelines for the drafting of a summary at level 2

185. Some respondents to the consultation on the Addendum specifically asked for guidelines on the drafting of the summary. CESR considers that it is not possible to produce detailed requirements or schedules, which are meaningful in every single case. However, CESR has produced some additional guidelines in order to help these issuers.

186. The number of guidelines is limited as the level 1 provisions are already very developed. They are:

- The issuer should generally avoid duplicating in the summary the text of whole paragraphs of the prospectus;
- The summary should be a meaningful synthesis of key points chosen by the issuer;
- The summary should highlight potential risk/return considerations;
- When drafting the summary, the issuer should keep in mind the fact that the summary might be the only document published in investors' language.

V. ROAD MAP

Introduction

187. The present section has been drafted taking into account the documents published by CESR up to now. Nevertheless, it must be noted that these papers are still under consultation and, since this is a work in progress, the documents could be amended at a later stage. These possible amendments would have an impact on the present road map that would have to be changed accordingly.

Building block approach

188. CESR has developed a "building block approach" for the prospectus schedules. This means that the issuers must combine several "blocks" in order to draft their prospectus. The combination will depend on the type of issuer and security concerned. This system has been favoured because of the flexibility it offers, especially in the perspective of the creation of new products in the future. It has to be noticed that the definitions of different types of security given in this roadmap are without prejudice to the legal definitions that might exist at national level, notably for taxation purpose.

189. The blocks have been developed following the subdivision provided for by Article 5(3), of the draft Directive between the securities note (SN), which contains the information concerning the securities offered or to be admitted to trading on a regulated market, and the registration document (RD), which contains the information related to the issuer.

Securities Note: main schedules and additional building blocks

190. For the SN there are four main schedules encompassing the following main types of security: equity securities, debt securities and derivative securities. These schedules are: the Equity SN schedule, the Retail Debt SN schedule, the Wholesale Debt SN schedule and the Derivative SN schedule.

191. The **Equity SN schedule** is applicable to "shares and other securities equivalent to shares". Therefore, this schedule is applicable to any class of shares[4] since it considers information regarding a description of the right attached to the securities and the procedure for the exercise of any rights attached to the securities. For example, the reference to "redemption provisions" is included because in certain jurisdictions it is legally possible to issue redeemable shares, i.e. shares that may be redeemed either on initiative of the issuer or on initiative of the holder.

192. The **Wholesale** and **Retail Debt SN schedules** are applicable to "bonds and other forms of securitized debt"[5]. For the purpose of the use of the schedules proposed by CESR, debt security has been defined as *"any security where the issuer has an obligation arising on issue to repay the investor 100% of the investor's capital "the capital return element", in addition to which there may also be an interest payment".* This scope comprises structured bonds, i.e. debt securities where the investors will be reimbursed 100% of the invested capital at the maturity date and which incorporate elements of derivative securities, in particular concerning the return investors might receive. Therefore certain disclosure requirements from the derivative SN have been introduced in the debt SN (retail and wholesale), such as those relating to the interest rate.

193. The distinction between wholesale and retail debt securities has been made following Art. 7 (2) (b) of the draft Directive. Accordingly, the Wholesale Debt SN disclosure requirements are set for admission to a regulated market of *"debt securities with denomination per unit of at least EUR 50.000".* These securities are usually aimed at qualified investors.

194. The **Derivatives SN schedule** is an "everything else box". In the absence of an agreed definition of these products, the scope of this schedule is determined by reference to the other two broad categories of securities. Hence, all securities different from equity and debt securities for which there is no specific disclosure regime, would be considered to be derivatives.

195. Additional SN building blocks have also been developed. They must be combined with one of the four main schedules. These building blocks, that address specific types of security or peculiar rights or obligations concerning specific securities, are the following: the SN building block for Guarantees, the SN building block for Asset Backed Securities and the SN building block concerning the Underlying for Equity Securities.

196. The additional **SN building block for Guarantees** is applicable to any arrangement intended to ensure that any obligation material to the issue will be duly serviced, whether in the form of guarantee, surety, Keepwell Agreement, Mono-line Insurance policy or other equivalent

[4] Ordinary shares, non-voting shares, preference shares, redeemable shares, income shares, deferred shares, priority shares, etc…

[5] Ordinary bonds, income bonds, capitalization bonds, zero coupon bonds, perpetual bonds, structured bonds, etc…

commitment and requires information on the guarantee and the guarantor. This building block may be added to any of the proposed RD and SN schedules.

197. The additional **SN building block for Asset Backed Securities** applies to securities of a type which either represent an interest in assets (including any rights designed to assure servicing, or the receipt or timeliness of receipts by holders of assets of amounts payable hereunder); or are secured by assets and the securities by their terms provide for payments which relate to payments or reasonable projections of payments calculated by reference to identified or identifiable assets. This additional SN building block for Asset Backed Securities has to be combined with one of the main schedules, and will normally be used together with either the wholesale or the retail debt SN schedule.

198. The additional **SN building block concerning the Underlying for Equity Securities** applies to securities which are – at the issuer's or at the investor's discretion or by predetermination – to be converted or exchanged into or which give in any other way the possibility to acquire shares or other transferable securities equivalent to shares issued by the issuer of the security or by an entity belonging to the group of the said issuer by way of physical delivery. The information concerning the underlying share will be provided for by adding this building block to the Debt SN schedule or by replacing item 4.2.2. of the Derivative SN schedule by this building block, as the case may be.

Registration Document: main schedules and additional building blocks

199. For the RD, there are six main schedules which encompass the main types of securities or which are specific to some types of investor or issuer. These main schedules are the Equity RD schedule, the Retail Non-Equity RD schedule, the Wholesale Non-Equity RD schedule, the RD schedule for Asset Backed Securities, the RD schedule for Banks issuing non-equity securities and the RD for closed-ended investment funds.

200. The scope of the **Equity RD schedule** is not the same as the one stated for the Equity SN Schedule. Instead, it follows the definition of Equity provided by the future Prospectus Directive: "shares and other transferable securities equivalent to shares in companies, as well as any other type of transferable securities giving the right to acquire any of the aforementioned securities as a consequence of their being converted or the rights conferred by them being exercised, provided that securities of the later type are issued by the issuer of the underlying shares or by an entity belonging to the group of the said issuer".

201. The **Retail Non-Equity RD schedule** will be used for those securities that do not fall under the scope of the Equity RD schedule and that have a denomination per unit of less that EUR 50.000.

202. **Wholesale Non-Equity RD schedule applies** to those securities that do not fall under the scope of the Equity RD schedule and that have a denomination per unit of at least EUR 50.000.

203. The **Asset Backed Securities RD schedule** shall apply to the issuers of asset backed securities. An issuer of asset backed securities is only required to comply with these disclosure requirements for the purpose of its Registration Document.

204. The **Banks Non-Equity RD schedule** can be used by banks issuing any type of non-equity securities (with the exception of asset backed securities issued by SPVs). Banks, for the purposes of the use of this schedules would include not only "credit institutions" as defined by the Prospectus Directive, but also regulated firms such as investment backs that have substantial experience of issuing securities. It should be noted that an SPV whose obligations in respect of retail non-equity securities are guaranteed by a bank would be required to provide the information set out in the Retail Non-Equity schedule.

205. The **RD for Closed Ended Investment Funds** has been developed taking into consideration the particular nature and activities of closed ended investment companies. CESR has not developed separate SN disclosure requirements for securities issued by these issuers.

206. In order to distinguish between closed ended investment companies and trading/holding companies, the prospectus of a closed ended investment company should demonstrate that the company is a passive investor which does not take or seek to take legal or management control of any of the issuers of its underlying investments. The Minimum Disclosure Requirements for the Closed Ended Fund Registration Document applies only to these issuers.

207. In the event that a closed ended investment company is not a passive investor, then the Minimum Disclosure Requirements for the Equity/Debt/Derivatives Registration Document shall apply.

208. Depending on the securities being issued by a closed ended investment company, an issuer may apply the Equity Securities Note, the Debt Securities Note or the Derivatives Securities Note, as appropriate.

209. In addition to these main RD schedules, CESR has prepared a building block on **Pro Forma Financial Information** that will be combined with the Equity RD schedule in those cases when pro forma financial information is required to illustrate the impact of a significant gross change in the size of the issuer, due to a particular actual or planned transaction (with the exception of those few situations where merger accounting is required).

Single schedule for depositary receipts issued over shares

210. Concerning the disclosure requirement relating to depositary receipts issued over shares, there is a single schedule which is not divided between SN and RD: the **Depositary Receipt prospectus schedule**. However, issuers of depositary receipts will have the option of producing a prospectus in three parts (summary, SN and RD), with an RD limited to the information on the depository.

Ranking between the various main RD schedules

211. As a general principle, the most comprehensive RD schedule can always be used to issue securities for which a less comprehensive RD schedule is provided for. This principle is intended to limit the costs to issuers and increase the flexibility in the building block system. For example, an issuer who has already prepared an Equity RD will not be required to prepare a new RD to issue debt or derivative securities, as long as the Equity RD is valid. In the same way, an issuer who has already prepared a Retail Non-Equity RD will not be required to prepare a new RD to issue wholesale debt securities or to issue wholesale derivative securities, as long as the Retail Non-Equity RD is valid. On the other hand, if an issuer who has issued retail debt securities with the Retail Non-Equity RD wants to launch an offer of equity securities, it will have to prepare a new RD that satisfies all the disclosure requirements of the Equity RD schedule.

212. Regarding the use of the Banks Non-Equity RD schedule CESR points out that these entities have the choice of using their specific schedule or the general Retail or Wholesale Non-Equity RD schedules when issuing debt or derivative securities. This would mean that a bank seeking to issue wholesale debt could produce either a Banks Non-Equity RD or a Wholesale Non-Equity RD. Additionally, banks issuing retail debt or retail derivative securities would have the option to choose between the Banks Non-Equity RD and or the Retail Non-Equity RD.

Complex or new financial instruments

213. It is a fact that not all existing securities can easily be defined as strictly belonging to one of the types of security for which a schedule has been produced. The RD applicable disclosures should be easily determined according to the principles set out above. However, concerning the information of the SN, the scope as defined in the previous paragraphs will determine the SN that should be used as a starting point. Since all relevant information concerning the security must be contained in the prospectus, the issuer might need to add some specific items from another schedule to the main schedule chosen in accordance with the main characteristics of the securities being offered.

214. The situation is different when an issuer applies for approval of a prospectus concerning a new type of security, with features completely different from those of the securities for which schedules exist. If the characteristics of those new securities are such that a combination of the existing schedules and building blocks is not suitable, the Competent Authority will decide what information should be included in the prospectus in order to comply with Article 5 of the proposed Prospectus Directive. Such prospectus should benefit from the European passport.

215. If the new type of security becomes a mainstream product, further harmonization would be necessary. CESR Members would assess the convenience of informing the European Commission about the possible need of additional level two measures. Of course that would not prejudice the power of the Commission to take the initiative in such cases.

Blanket Clause

216. There are only a limited number of main schedules applicable for all types of offers or admission to trading. Therefore some disclosure requirements may be inapplicable in some specific cases. These are cases in which the issuer cannot provide the required information.

217. For instance, in the case of an offer of equity securities without right of pre-emption for the existing shareholders, the requirements concerning pre-emption rights are not applicable.

218. As a general principle, if certain information required in the schedules or equivalent information is not applicable to the issuer, to the offer or to the securities to which the prospectus relates, this information can be omitted. In other words, the issuer must only provide the required information, "if any".

219. A different matter is the case where disclosure requirements are applicable but might be inappropriate to the issuer's sphere of activity or to the legal form of the issuer or to the securities to which the prospectus relates. This concern has been dealt with under Article 8 (3) of the future Prospectus Directive: "Without prejudice to the adequate information of investors, where, exceptionally, certain information required in implementing measures referred to in Article 7 (1) to be included in a prospectus are inappropriate to the issuer's sphere of activity or to the legal form of the issuer or to the securities to which the prospectus relates, the prospectus shall contain information equivalent to the required information. If there is no such information, the requirement shall not apply".

How to combine the schedules and the building blocks

220. In drafting a prospectus, issuers will have to combine the main schedules and the additional building blocks.

221. In a number of cases, this combination will be obvious. For example, for an issue of shares by a corporate issuer the Equity SN schedule will have to be combined with the Equity RD schedule. Another obvious example: for an issue of retail (structured) bonds, with a guarantee, the Retail Debt SN schedule will have to be combined with the building block for Guarantees and the Retail Non-Equity RD schedule, or the RD schedule for banks, if the issuer is credit institution.

222. For asset backed securities, the issuer will combine the Wholesale or Retail Debt SN schedule, following the case, the additional SN block for Asset Backed Securities and the RD schedule for Asset Backed Securities.

223. In some other cases, the combination might be less straightforward. In order to clarify which are the schedules that should be used when drawing up a prospectus, a general view for different types of security is given in the table attached to this document (Annex I). This table does not cover all existing securities, but reflects the combinations for the most common types of securities in order to show how the system works.

VI. ANNUAL INFORMATION

Extract from the mandate

DG Internal Market requests CESR to provide technical advice by 30 September 2003 at the latest on possible implementing measures relating exclusively to the method of publication of the document that contains or makes reference to all disclosure requirements published over the past 12 months with respect to information that would be required to be published under Community and national laws and rules dealing with the regulation of securities, issuers of securities and securities markets and more specifically, pursuant to Company Law Directives, Directive 2001/34/EC and Regulation (E) No. 1606/2002 on the application of International Accounting Standards.

Introduction

224. This matter is dealt with in article 10 of the Proposed Directive of the European Parliament and of the Council on prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

225. This provision imposes that issuers whose securities are admitted to trading on a regulated market shall at least annually provide a document that contains or refers to all information published or made available to the public over the preceding 12 months in one or more Member States and in third countries in compliance with their obligations under Community and national laws and rules dealing with the regulations of securities, issuers of securities, and securities markets. According to this text, issuers shall refer at least to the information required pursuant to Company Law Directives, Directive 2001/34/EC and Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of International Accounting Standards.

226. In addition, the provision also states that the document shall be filed with the competent authority of the home Member State after the publication of the financial statements.

227. Finally, the Proposed Directive imposes that where the document refers to information available elsewhere, it shall be stated where the information can be obtained.

228. This duty is not imposed on issuers of non-equity securities whose denomination per unit amounts to at least EUR 50.000.

229. It should be pointed out that this document aims exclusively at compiling and disclosing, once a year, in a single document, references to all disclosures made by an issuer pursuant to all its disclosure obligations, in spite of the law under which those disclosures were made or the markets it occurred. This list of indications will enable investors to be aware of all the disclosures made by the said issuer over the period of time and where those can be obtained.

230. In giving its technical advice, CESR is aware that the Proposed Directive restricts level 2 measures to only the method of publication of the disclosure requirements and will not involve new disclosure requirements.

231. This document can be disclosed through a variety of means. It should be reminded that Article 14 of the Proposed Directive deems a prospectus published when it is made available through insertion in one or more papers circulated throughout, in a printed form or by insertion, in an electronic form, on the issuer's website or on the website of the Competent Authority. This task could be delegated, namely to the regulated markets, according to article 21 of the Prospectus Directive. Additionally, Member States are allowed to request that the prospectus made available through insertion in a newspaper or in a brochure is also made available electronically and may require publication of a notice informing the public where the prospectus is available and where it can be obtained.

232. Two possible approaches could be followed in this matter: CESR could, in the lines of the Proposed Directive, provide as technical advice an indication that this document should be disclosed using the same methods allowed for the prospectus, at issuer's choice. On the other way, CESR could alternatively choose to select some of those means of publication, e.g. the issuer's website or the website of the Competent Authority.

233. Bearing in mind the relevance and purpose of this document and the views expressed by some respondents on the Call for Evidence on the Second Provisional Mandate provided by the Commission, CESR considers that issuers should be allowed to choose, among those means referred to in Article 14 of the Proposed Directive, the method of publication they consider adequate. In selecting the method of publication, issuers shall consider the objective of the document and that it should permit investors a fast and cost-efficient access to that information.

234. CESR considers that it is also included in its mandate to provide technical advice on the timings for publication of the document. The Proposed Directive only mentions that the document must be filed after the publication of the financial statements. CESR considers adequate to suggest, as a level 2 advice, that a deadline of seven business days after publication of the financial statements should be indicated as a deadline to file this document and to disclose it to the public.

Level 2 Advice

235. The document referred to in Article 10 of the Proposed Directive of the European Parliament and of the Council on prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC should be made available, at the issuer's choice, through one of the means allowed in Article 14 of that Directive.

236. This document shall be filed and made available at the latest seven business days after publication of the annual financial information.

QUESTIONS

237. *Do you agree with the method of publication proposed?*

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

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? Please give reasons for your answer.*