INTERNATIONAL PRIMARY MARKET ASSOCIATION

Response to CESR's Advice on Level 2 Implementing Measures for the Prospectus Directive Consultation Paper dated July 2003

Date: 30 October 2003

The International Primary Market Association is the organisation which represents the managers and lead managers of debt and equity securities in the international capital market. A list of IPMA members may be found on its website at www.ipma.org.uk

EXECUTIVE SUMMARY

IPMA is pleased to respond to CESR'S consultation on sovereign disclosure, financial information and advertising. This summary highlights the key points in our response, which are explained in more detail in our answers to CESR's specific questions.

We welcome CESR's decision to include non-EU States and their regional and local authorities in the scope of the sovereign schedule.

The question of the correct disclosure requirements for sovereign, sub-sovereign, state related entities and supranational organisations is extremely complex for numerous reasons. CESR should not be recommending a one size fits all approach but should advise that different disclosure requirements are appropriate for different kinds of public sector issuers.

One category of issuer, to which lower disclosure standards should apply, are members of the Organisation for Economic Co-operation and Development.

CESR has not been given sufficient resources to analyse the wide range of public sector issuers. Given the importance of this sector of the market and the increasing number of sub-sovereign issuers and other public sector issuers CESR should ask for more time and resources in order to produce tailored advice.

The proposed schedule is too detailed. Most sovereign issuers are highly rated, issue securities frequently, and at short notice, and there is a great deal of information about them already in the public domain. The schedule should be more generic.

The schedule is not sufficiently flexible to cater for differing funding structures used by sovereign issuers.

There are many quasi-governmental borrowers who currently access the European capital markets, who perform 'government-type functions', but which are not sovereigns as defined in CESR's 'strict' definition. They are nevertheless sovereign risk. They should not be subject to the wholesale/retail schedules, with which, in any event, they would not necessarily be able to comply. Many such borrowers prepare their accounts using government style accounting standards, not national or IAS accounting standards.

Public international bodies are subject to the treaties and/or statutes which create them. They are typically low risk issuers, whose members are sovereign states. The wholesale and retail building blocks are not at all suitable for such issuers.

In any case where CESR proposes issuer specific disclosure, there should be an exemption from any such requirements for securities issued in denominations of €50,000 (or approximate equivalent) or above. Any such disclosure requirements should not be mandatory for OECD issuers.

CESR should include specific provisions for incorporation of information by reference, and recognise specifically the possibility of mutual recognition/incorporation by reference of prospectuses prepared by sovereign and quasi-sovereign issuers for non-EU offerings.

The most important financial information question is the equivalence issue. CESR should recommend that, in the case of non-EU issuers, US GAAP, Canadian GAAP and Australian GAAP are equivalent to IAS for purposes of the Directive, as well as a non-Member State's local GAAP which is either (i) accepted by the Commission, customarily used in the field of international finance or comparable to financial information prepared according to IAS when taken together with a statement of differences.

CESR's advice should recognise the variety of systems/accounting standards used by sovereign, sub-sovereign and quasi-governmental issuers. IAS is seldom used by such issuers and is neither designed for nor appropriate for sovereign and sub-sovereign issuers. Many quasi-sovereign issuers are required by statute to report their financial results and positions in accordance with standards fixed by statute or regulation and not by local GAAP.

Transitional arrangements to accommodate the EU's adoption of international accounting standard will necessarily entail trade-offs between temporaral continuity and comparability between issuers and costs and benefits of restating previous years' accounts.

The Directive is clear that the home Member State competent authority for a particular issue of securities has exclusive power to control advertising activity. Control over advertising by a host Member State would defeat the passport for the prospectus.

The Directive does not contemplate harmonisation of compliance with advertising activity and we do not support any such harmonisation.

We do not support black out periods in the context of advertising activity.

MEMBER STATES, NON-EU STATES AND THEIR REGIONAL OR LOCAL AUTHORITIES

Definition of Member States and their regional or local authorities

Question 30: Do you agree with this approach? If not, please give your reasons.

We do not agree with the approach suggested in a number of respects.

We support CESR's proposal to provide a separate annex for Member States, non-Member States and their regional and local authorities but believe that different categories of sovereign, sub-sovereign and quasi-governmental issuers should have separate annexes. We have a number of comments on the annex itself.

The annex is too detailed and prescriptive. Many sovereign borrowers are highly rated, frequent issuers, who tap the market at short notice, and about whom there is extensive information already in the public domain. They are currently subject to minimal or no disclosure requirements (for example, the UK Listing Authority rules exempt sovereign issuers from the requirement to produce listing particulars). Investors rely on public credit ratings given to sovereign issuers and their instrumentalities. The cost and time required to compile the type of prospectus proposed would be disproportionate to any benefit to investors.

We agree that current practice on disclosure by sovereign issuers varies. This is often a function of the credit standing of the issuers concerned and the availability, or otherwise, of regular flows of information. Infrequent issuers in the European markets and emerging market issuers are more likely to prepare a detailed prospectus than regular, investment grade issuers. In other cases the additional disclosure is driven by issuer preference and practice. We see no merit to requiring all sovereign issuers to provide all of the information proposed in all circumstances. We suggest that the requirements should be more generic. For example, a brief description of the issuer's economy, a brief description of the issuer's current financial situation, including debt and income and expenditure figures. CESR's advice should specifically allow incorporation of relevant information by reference. We also suggest that there should be no specific disclosure requirements for OECD member states and in any event no specific disclosure requirements (other than the terms and conditions) for issues with denominations of €50,000 or approximate equivalent, or more. Issuers will still be subject to Article 5 requirements, and the relevant competent authority should decide in any particular case what is appropriate.

The proposed use of the schedule is also not sufficiently flexible to reflect differing funding structures used by sovereign borrowers. For example, the Province of Alberta raises finance through the Alberta Capital Finance Authority, which is an agent of the Province for all purposes, but which nonetheless has a statutory guarantee from the Province. Sovereign borrowers sometimes raise finance through their central banks. We suggest that the reference in paragraph 29 of the CP to 'strictly' is too rigid, and that CESR's advice should make it clear that a competent authority can apply the schedule flexibly in situations where investors' credit risk is clearly sovereign.

There are a number of quasi-government issuers who are currently major issuers of debt in the European capital markets who perform government – type functions. Such issuers sometimes issue with a government guarantee, sometimes they are set up by statutory instruments and/or are constituted and governed by special laws. Such issuers include, for example, Reseau Ferre de France, La Caisse d'amortissement de la dette sociale (CADES), U.S. government sponsored entities such as Fannie Mae, KfW, Oesterreichische Kontrolbank, Canadian Wheat Board, Societe de Transport de Montreal. The schedule should be extended to such issuers, with competent authority discretion to determine its applicability and the appropriate level of disclosure. We note, for example, the use of the concept of 'a related entity acting as a public authority' in the Savings Tax Directive (2003/48/EC), which also includes criteria for third country public entities, and which could provide a basis for defining which types of issuer should be able to use the schedule. Accounting treatment for such issuers varies. Some produce government type accounts. Some produce accounts according to statutory requirements. Sovereign and sub-sovereign issuers should not be required to provide IAS or equivalent accounts.

We also suggest that CESR's advice should include a specific acknowledgement of the possibility of mutual recognition/incorporation by reference of other prospectuses. For example, many sovereign, quasi-sovereign, and sovereign guaranteed issuers file prospectuses in the United States, which comply with the Schedule B requirements of the US Securities Act of 1933.

Public international bodies are supranational organisations which serve a governmental function, have sovereign nations as their members (including in many

cases EU Member States), and typically have the right to make capital calls on their member countries. The Directive provides that the public nature of the issuer should be taken into account by the Commission when adopting technical implementing measures (Article 7(2)(f)). These issuers are typically highly rated, low risk issuers for whom solvency risk is remote. By virtue of their statutes and/or the treaties which govern them, they are not subject to the same reporting and accounting regimes as corporate issuers, and the requirements of the retail/wholesale annexes would not be appropriate. Many of these organisations are sizeable issuers in the European international capital markets, where they currently issue with little or no disclosure. For example, a number of them are exempt from the prospectus requirements of the Luxembourg Stock Exchange, including EIB, EBRD, World Bank and the IADB. It is essential that supranational organisations can continue to access the European markets. We suggest that disclosure on such issuers should be general information about their structure, function and finances, and that there should be no specific disclosure requirements for issues of wholesale non-equity securities by such issuers. There should be no requirement to provide IAS or equivalent accounts. These disclosure requirements should apply also to the information that they provide about themselves as a guarantor of an issue.

All issuers still need to comply with the general disclosure requirement under Article 5 of the Directive in any particular case, which would ensure that other information which should appropriately be disclosed is disclosed to potential investors.

Minimum Information

Question 32: Do you agree with this list as more fully described in Annex D?

No. Please see our answer to Question 30. Disclosure should be tailored to reflect the fact that information on such issuers is already in the public domain, that the probability of default is low in most cases and issuers vary too much to make a single schedule appropriate. We refer you to our mark-up of Annex D in Appendix 1.

Question 33: Is there any other information which you consider relevant for Member States and their regional or local authorities and should be included in the Annex?

No. If additional or further disclosure is required in any particular case, it will be disclosed in compliance with the general disclosure requirement in Article 5 of the Directive.

Specific Requirements

Question 35. Do you consider that it is appropriate to have such a disclosure requirement? If so, do you believe that the selected indicators are those relevant to make an investment decision? Please give your reasons.

No. Please see our answer to Question 30. The disclosure of economic figures should not be mandated in all cases. Where it is appropriate and material to disclose such figures, disclosure will be made in compliance with the general disclosure requirement in Article 5. Such figures are also subject to frequent revision and should only be included where it is appropriate to do so. As a practical comment on the proposed schedule, to the extent that figures are included in a prospectus, there will

need to be a 'grace period' in relation to the age of figures included, as there is for corporate issuers, in order to avoid 'black out' periods during which issuers will otherwise not be able to issue.

Question 40: Do you deem that Investment and Development Plans should be included in the Annex for Member States and regional and local authorities? If so, please give your reasons.

No. As CESR acknowledges in paragraph 37, the solvency of a sovereign issuer is rarely affected by one or more investments and, if this were the case, disclosure would be made in accordance with Article 5. It should not however be mandated in every case as it will not usually be material to investors.

Question 42: Do you consider that potential conflicts of interest should be disclosed? If so, do you consider that the wording used will be sufficient to capture such conflicts?

It is most unlikely that any expert would have a material interest in the issuer in these circumstances. Where disclosure is relevant, the general disclosure requirement will drive such disclosure.

FINANCIAL INFORMATION REQUIREMENTS IN A PROSPECTUS

General comments

'Equivalent financial information'

This consultation paper promised to include proposals relating to the inclusion of financial information in a prospectus. This is an area of critical concern for the market and for all issuers especially non-EU issuers. Although further detail in some areas has emerged in this paper, we are disappointed that major questions remain and that the essential clarification on "equivalence" of financial information for non-EU issuers is still unresolved. Until CESR and/or the Commission addresses what equivalence means and gives some real guidance and confirmation to the effect, for example, that US GAAP will be treated as "equivalent", non-EU issuers are left in a complete state of confusion.

Issuers are currently making plans for future capital raising activities in 2005 and beyond. Many will plan on the assumption that a reconciliation or restatement to IAS will be required because of the uncertainty surrounding this question. Due to the substantial cost and practical difficulties involved, issuers may choose to look to other markets to raise capital. The question of what financial information will be considered equivalent needs to be addressed as a matter of priority to enable the EU capital market to continue to attract non-EU issuers. If CESR does not believe that it has an appropriate mandate from the Commission to advise on the question of "equivalence", it should request a formal mandate to enable it to deal with this question.

We have suggested in Appendix 2 to this response language which could be used to determine what financial information would be regarded as equivalent. We believe that a solution along these lines is required and that a public announcement of the Commission's decision should be made as soon as possible. Already leading law

firms are advising their issuer clients not to list their securities in the EU. It is worth pointing out that, in any particular case, issuers will also need to comply with the general disclosure standard in Article 5 and that the financial information included in a prospectus would benefit from the responsibility statement.

Transitional provisions

The requirement to include "at least two years audited historical financial information in a form consistent with that which will be adopted in the issuer's next annual financial statements" means that issuers will be required to present information in accordance with the IAS Regulation. Because two years comparative data will need to be included, this means that in practice three years financial information must be prepared in accordance with IAS.

On this basis, an issuer who has prepared its 2005 financial statements in accordance with IAS would also be required to prepare IAS financial statements for 2003 and 2004 to enable the disclosure of comparative information for two years. Similarly, an issuer who comes to the market for the first time in, say, 2010 would be required at that time to publish IAS financial statements. The requirement for comparative data for two years under the Prospectus Directive would require that IAS financial statements would also be required for 2008 and 2009. In both cases, this has the effect of retrospectively requiring IAS financial statements and is not consistent with the timing requirements in the IAS Regulation.

In addition, issuers will be faced with the problem of complying with the international auditing standards on a retroactive basis.

This will be the case for all issuers if IAS statements are required for 2003 and for first time issuers thereafter who have been preparing their accounts in accordance with non-IAS standards and international auditing standards.

There is an irreconcilable conflict between assuring easy comparison of results and financial position and added costs.

A possible comparison would be to require a narrative description of the differences between an issuer's 2003 accounts and what they would have shown if they had been restated or reconciled. Alternatively, a lighter form of reconciliation is possible.

We believe historical financial information is of more value to equity investors than to fixed income investors. Therefore, CESR should consider recommending less restatement/reconciliation for issuers of debt only.

Appropriate transitional measures will be required to ensure that the timing for IAS financial statements is consistent with the timing under the IAS Regulation. We believe that the requirement for comparative financial information should be limited to one year when IAS accounts are first prepared. In our examples above, this would mean that existing issuers would be required to prepare IAS accounts for 2005 and 2004 and issuers first coming to the market in 2010 would be required to prepare IAS accounts for 2010 and 2009). This would accommodate issuers who have previously prepared their financial statements in accordance with local GAAP and would be more consistent with the timing requirements in the IAS Regulation.

Question 56: What are your views on the costs of providing reconciliation as compared with a full restatement?

IPMA is not in a position to express any independent views on the costs of providing reconciliation as compared to full restatement. We understand, however, that there are various kinds of reconciliation, requiring significantly different amounts of work and therefore different costs.

A narrative description of differences between national accounting standards and IAS is, obviously, the least expensive and is accepted by securities regulators in some countries. It is frequently used in the United States Rule 144A market.

IPMA was surprised that this option was not included in the Consultation Paper.

Question 58: What are your views on the importance of comparability both within the audited historical track record and with the reporting standards that are to be adopted?

Comparability can take two forms: comparability between issuers and comparability of a given issuer's financial statements over time. Unless issuers are required to restate all their financial statements from the year they began operations, the European Union's decision to require all issuers whose securities are admitted to trading in the EU to publish accounts prepared in accordance with IAS will result in losing temporal comparability. In addition, the IAS Regulation only applies to issuers which prepare consolidated accounts and the Transparency Directive (Article 4.3) will require issuers who prepare company only accounts to prepare these accounts in accordance with the national law of its home Member State[1].

Therefore IPMA believes that choices as to the nature and quantity of comparability which are achievable will have to be made. The cost of reconciliation or restatement should be one of the factors that should be taken into account.

These are difficult judgements and CESR should only make its recommendations after it has completed its consultation and reflection on its Consultation Paper on Draft Recommendation for Additional Guidance regarding the transition to IFRS (Ref: CESR/03-3236).

IPMA believes a distinction should be made between issuers to whom any restatement/reconciliation requirements apply that are first subject to the requirements through 2007 and issuers that are subject to the requirements thereafter.

CESR may decide that the first category should be given some relief on the grounds of relative costs and benefits and the difficulty of restating accounts on a retroactive basis. If an issuer is required to include two prior years of restated IAS accounts in a prospectus which it publishes in September 2005 (assuming the Prospectus Directive is fully transposed into national law by May 2005), it will have to have financial reports for the years ending 31 December 2003 and 31 December 2004. In order to

[1] Or, where the issuer is incorporated in another Member State, in accordance with the national law of that Member State (working text of the Transparency Directive dated 13 October 2003)

have a revenue statement for the year ending 31 December 2003 prepared in accordance with IAS, the issuer will have to prepare an IAS balance sheet for the year ended 31 December 2002.

This will be exceedingly difficult and expensive. Moreover, the Commission has not adopted all of the International Financial Reporting Standards proposed by the IASB and issuers cannot know what information they should be collecting now nor what auditing standards should apply before 2005.

For issuers who first publish a prospectus which is subject to the Prospectus Directive after 2007, the situation is different and IPMA does not believe any special relief is required. Issuers will be on notice of the new requirements and the Commission will have determined which IFRS it will require and the auditing standards to be used.

Question 59: What are your views on how this should be achieved?

We agree that comparability is important for investors. We believe that this can be achieved by requiring issuers to provide two or three years comparable figures to investors (but please see our views above on appropriate transitional arrangements). If, in any particular case, additional years for comparable data are required to be included, this will be done under the general duty of disclosure set out in Article 5 of the Directive.

Question 60: Do you agree with the approach taken in relation to issuers of debt securities? If not, please state your reasons.

IPMA agrees that the approach taken in relation to issuers of debt only securities is correct. Fixed income investors are less concerned with the past results than equity investors. A higher percentage of non-EU issuers only issue debt in the EU capital markets than EU issuers and if the cost of restatement/reconciliation deters issuers from making public offers, applying for admission to trading or maintaining a listing in Europe, the effect will be diluted if debt only issuers have a lighter restatement/reconciliation burden.

Auditing standards

Paragraph 63

Until the rules on audit standards are finalised, it will be impossible to determine that financial information of a non-EU issuer has been reported on under 'equivalent' audit standards. This leaves non-EU issuers in an uncertain position and needs to be addressed by CESR and the Commission at this point. We refer you to our suggested wording in Appendix 2.

Non-EU Issuers

Question 69: What are your views on extending this treatment to EU issuers for the types of securities identified?

We believe that such treatment should be extended to EU issuers if "this treatment" refers to accounting standards. However, we do not believe it is appropriate to exempt EU issuers from the requirement to have an independent audit, conducted in accordance with either EU or a Member State's auditing standards. Where different accounting standards and/or auditing standards are used, a warning and narrative description of the differences should suffice for EU issuers as well as non-EU issuers. It is not logical to differentiate issuers in this way. Furthermore, the requirements should extend to all wholesale non-equity securities and not simply to the limited non-equity securities presently covered.

Question 70: Are there any other types of issuer where you believe that different requirements should apply?

We believe that non-EU issuers of convertible securities should also be subject to different requirements, i.e., they should be treated in a similar way to non-EU issuers issuing non-equity securities. The Directive would permit such treatment as the reference to IAS is indicative and could be disapplied in relation to certain categories of equity securities such as convertible securities where they have a minimum denomination of €50,000. It is not necessary to extend this treatment to EU issuers of convertible securities because such issuers will be preparing financial information to the IAS Regulation and the EU's auditing standards in respect of the underlying shares.

Issues of securities by a non EU-issuer to existing or former directors or employees (whether in respect of their own employees or employees of group companies), when the issuer does not have such securities admitted to trading on a regulated market, should also be subject to different requirements. In these cases the issuer is remunerating its employees and directors with securities. Employees and directors are not making an investment decision. They have a far greater degree of understanding and information about their employer through their employment and should be considered sophisticated investors in relation to that particular issuer for this purpose, with no requirement for IAS accounts or EU or international auditing standards.

ADVERTISING

General comments

Our understanding of Article 15 is that this provision gives the competent authority of the home Member State the power to regulate advertising activity in relation to a specific public offering of securities or admission to trading on a regulated market. We also understand that, as the home Member State has the exclusive power to regulate advertisements (as defined) for such issues, a host Member State has no ability to regulate such advertising. Control over such advertising by a host Member State would defeat the purpose of the passport for a prospectus, and would render Article 15 (6) meaningless. It would also create additional costs and lead to procedural and timing difficulties for offerings. Our answers below are given on this basis.

Question 84: Do you agree with the scope of the present consultation paper on advertising? Please give reasons for your answer.

On the assumption that the features listed in paragraph 80 are cumulative, we broadly agree with the scope of your advice. As it is unclear that the listed features are in fact cumulative, we would suggest that it should be clarified in the drafting.

The first feature listed is drafted in broad terms and could capture many types of general advertisements. To ensure that only advertisements which relate to a specific public offer or admission to trading are covered, we would suggest that the second sentence be amended to read: "Accordingly, advertisements that consist of merely general promotion of the issuer, which do not promote a specific public offer or an admission to listing are outside the scope of this paper." This makes it clearer that the advice only relates to advertisements which refer to a specific issue and would not capture general advertising.

Question 85: Do you believe that blackout periods should be imposed for the dissemination of any advertisements when a prospectus has not been made available? Please give reasons for your answer.

No. We do not believe that blackout periods should be imposed as they are not necessary for the protection of investors. Advertising activity should be permitted to continue in those markets where blackout periods do not currently apply (please see our comments below on harmonisation in response to question 85). In any event, imposing a black-out period has no meaning in particular cases including, for example, in the case of institutional offerings and private placements, which are exempt from the requirement to produce a prospectus unless they are admitted to trading on a regulated market.

Question 87: Do you consider that control over compliance of advertising activity with the principles referred to in paragraphs 2 to 5 of Article 15 of the Directive should be harmonized? If so, do you think that competent authorities should exercise the above mentioned control? Please give reasons for your answer.

No. The Directive itself does not contemplate harmonisation of this area and we do not consider that control over compliance of advertising activity should be harmonized. Member States should be given discretion to determine how to control compliance of advertising activity in the most effective and appropriate way. There is one exception to this which we suggest CESR should consider in its advice. It should be clear that advertisements that are to be used in a host Member State do not have to be in a language accepted by the Home Member State for the purposes of Home Member State control of advertising activity. Furthermore we consider that CESR should make clear that a host Member State cannot require that advertising in a newspaper, other publication or document which is distributed in more than one member state must contain such advertisement in its domestic language[s] or that a translation into such language[s] be included.

APPENDIX 1

PLEASE SEE SEPARATE DOCUMENT

ANNEX D

REFERENCE 301003 IPMA ANNEX D RESPONSE TO CESR CONSULTATION

APPENDIX 2

'EQUIVALENT' FINANCIAL INFORMATION

Accounting standards

Financial information must have been prepared according to:

(a) IAS or, if not applicable;

(b) a Member's State local GAAP; or

(c) in the case of non-EU issuers, US GAAP, Canadian GAAP or Australian GAAP; or

(d) in the case of non-EU issuers, a non-Member State's local GAAP which is either: (i) accepted by the Commission from time to time in accordance with the procedure referred to in Article 24 of the Directive; or (ii) customarily used in the field of international finance and/or in connection with securities offered internationally of the type being offered; or (iii) comparable to financial information prepared according to IAS when taken together with a statement of differences between such standard of GAAP and IAS.

Auditing standards

The historical financial information must have been independently audited in accordance with:

(a) International Standards on Auditing (ISAs) or, if not applicable;

(b) auditing standards applicable in a Member State; or

(c) in the case of non-EU issuers, auditing standards applicable in the US, Canada or Australia; or

(d) in the case of non-EU issuers, auditing standards: (i) accepted by the Commission from time to time in accordance with the procedure referred to in Article 24 of the Directive; or (ii) customarily used in the field of international finance and/or in connection with securities offered internationally of the type being offered; or (iii) that if the audit had had to meet ISA or a Member State's auditing standards, the audit standard actually applied would not have led to a reservation or such reservations are fully disclosed.