THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/02-286

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

Addendum to the Consultation Paper

(Ref. CESR/185-b)

December 2002

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INTRODUCTION

1. The present "*Addendum to the Consultation Paper*" (the "Addendum") deals with the outstanding disclosure requirements that, due to the tight deadline, were not covered by the Consultation Paper released by CESR in October (*CESR's Advice on possible Level 2 Measures for the Proposed Prospectus Directive* Ref.: CESR/02-185b; the "Consultation Paper"). The "*Provisional Request for Technical Advice on Possible Implementing Measures on the Future Directive on the prospectus to be published when securities are offered to the public or admitted to trading*" (the "Provisional Request") issued by the European Commission on 27 March 2002 requires CESR to deliver its technical advice by 31 March 2003.

2. CESR invites responses to this consultation paper on its advice to the European Commission on the requested implementing measures. The deadline for submitting responses to the paper is 6 February 2003. Responses should be addressed to Mr. Fabrice Demarigny, Secretary General, CESR, by email at secretariat@europefesco.org. Given the 31st March 2003 deadline set by the European Commission for receipt of CESR's advice, CESR cannot guarantee that due consideration will be given to responses received after 6th February 2003. In order to facilitate the consultation process, CESR is planning to hold an open meeting on 24 January 2003 in Paris at the CESR premises.

3. In undertaking its work, CESR is assisted by a Consultative Working Group (CWG) of experts drawn from a broad range of market participants. The group operates under the terms of CESR's Public Statement of Consultation Practices (Ref. CESR/01-007c). The members of the Group are the following: Ann Fitzgerald, Wolgang Gerhardt, Daniel Hurstel, Pierre Lebeau, Lars Milberg, Victor Pisante, Regis Ramseyer, Kaarina Stalberg, Torkild Varran, Stefano Vincenzi, Jaap Winter. Comments on the present Addendum were received from Mr. Wolfgang Gerhardt.

4. Consultees are invited to refer to the Consultation Paper for background information and references.

5. On 5 November 2002, the Ecofin Council has agreed on a text of the Proposed Prospectus Directive (the "Ecofin Text"). This text is available on the web site of the Council (ref. No. 13593/2/02 Rev 2). The references made in this paper to the Prospectus Directive should be considered as made to the Ecofin Text.

PRELIMINARY STATEMENT BY FERNANDO TEIXEIRA DOS SANTOS

6. As Chairman of the CESR's Experts Group on Prospectuses, I am pleased to present you an *addendum* to the consultation paper that was released by CESR in October 2002 (*CESR's Advice on possible Level 2 Measures for the Proposed Prospectus Directive* Ref.: CESR/02-185b; the "Consultation Paper"). This "*Addendum to the Consultation Paper*" is deemed to be a CESR's complementary proposal on some outstanding disclosure requirements that are relevant in the context of our effort to meet the European Commission's provisional request for technical advice on possible implementing measures on the future Directive on prospectuses. By presenting this additional consultative document, I am confident that, once again, CESR's contribution is of major importance for the debate on the definition of a single passport to issuers, which is a fundamental step forward in the completion of an integrated securities market.

7. The *Addendum* deals with several disclosure requirements specific to certain issuers (banks) or certain securities (wholesale debt, derivatives or asset backed securities) in relation to the presentation of information in the registration document or in the securities note. In particular, CESR expects your expert advice on several issues that are raised in this paper, namely the information to be provided in the summary and in the base prospectus, the specific disclosure requirements on the guarantee and the guarantor, the proposal of a blanket clause and the working capital statement.

8. This Consultation Paper does not express CESR's final position. To provide our technical advice on Level 2 implementing measures I would like to highlight the importance of a full consultation to users and market participants on our proposals. A productive consultation with the comments of users and participants showing the advantages and disadvantages of the proposal made, will result in a more supportive quality advice from CESR to the European Commission. Our main objective is to work together in order to achieve an effective and competitive European market. Bearing this in mind, I welcome all contributions on the impact of the proposals presented in this paper and any other suggestions.

PART ONE – REGISTRATION DOCUMENT

DEBT SECURITIES

Introduction

9. In the Consultation Paper CESR set out the disclosure obligations for issuers of corporate retail debt. As the Consultation Paper made clear, these disclosure obligations would be regarded as the "high-water" mark for disclosure requirements for debt issuers. This Addendum to the Consultation Paper sets out the proposed disclosure requirements for **debt securities aimed at those investors who purchase debt securities with a denomination per unit of at least EUR 50,000** (as set out in article 7.1(b) of the proposed Prospectus Directive). **Such investors are referred to throughout this consultation document as "wholesale investors**".

10. A differentiated disclosure regime for debt securities aimed at "wholesale investors" has been successfully operated in a number of Member States across the EU, without giving rise to significant complaints about a lack of information contained in the prospectus. CESR's approach in relation to a differentiated set of disclosure obligations has been to try and identify those disclosure obligations which require information that will be of little or no value to "wholesale investors" when making their investment decision. To require issuers to produce this information simply adds to their costs without giving rise to any investor protection benefits.

11. The detailed disclosure requirements for debt securities aimed at "wholesale investors" are set out in Annex [1]. CESR sets out below a discussion about some of the specific disclosure requirements.

Investments (Past, Present and Future) – CESR disclosure ref: IIIB (Wholesale Debt Building Block)

12. The proposed disclosure requirements for corporate retail debt issuers include a description of the principal past investments, investments being made and future investments. The previous consultation paper raised the question of whether such information would be of use to retail investors.

13. CESR discussed whether such information would be of value to "wholesale investors" and believes that disclosure of past and present investments does not provide "wholesale investors" with sufficient benefit to justify the costs imposed on these issuers in providing such disclosure. CESR considered whether disclosure of future investments provided useful information to investors. CESR decided to retain this particular disclosure, but would value the views of interested parties as to whether such information adds significant value to an investors' judgement of the issuer's ability to meet its obligations under the securities being issued.

14. Information about past investments would form part of the information contained in the accounts produced by the issuer. This could therefore perhaps be the most easily omitted disclosure requirement.

Questions

15.	*Do you consider that information about an issuer's principal future investments should be disclosed? Please give your reasons.*
16.	*Do you consider that a description of only some of these items should be made? If so, which ones?*

Liquidity and capital resources – CESR ref: IV.A. (Wholesale Debt Building Block)

17. Bearing in mind it is often the case that the issuers who issue debt securities aimed at "wholesale investors" are special purpose vehicles, most CESR members felt that information regarding the company's commitments for capital expenditure was not information that would be of particular value to "wholesale investors". CESR proposes not to require this disclosure for "wholesale investors", and seeks consultees views on this proposal.

Question

18.	*Do you consider that information about a company's capital expenditure commitments would be of value to "wholesale market investors"?*

Trend information –CESR ref: IV.B. (Wholesale Debt Building Block)

19. Consultees should note that the information regarding changes to the financial position or prospects of the company since the last published accounts has been amended to include a no material change statement possibility as set out in item IV.B.1 of the wholesale debt building block schedule.

20. In relation to profit forecasts, in the Consultation Paper CESR raised questions about whether or not these disclosures were appropriate. Clearly the responses to the consultation will influence CESR's opinion on those disclosure requirements. Perhaps the most costly aspect of those disclosure requirements is the requirement that where a profit forecast is included, it should be reported on by the company's auditor or reporting accountant. Since the securities concerned are aimed at "wholesale market investors", the need for such a report may be reduced.

21. As can be seen from the proposed wholesale debt building block schedule in item IV.B.2, it is currently proposed that issuers are required to give disclosure about their prospects for at least the current financial year. But such disclosure is not to be a profit forecast, but more of a statement about what the issuer deems its prospects to be. Most CESR members consider such disclosure to be of little value where such

statements do not amount to profit forecasts. Other CESR members believe that such statements are important for investors in assessing an issuer's ability to fulfil its obligations to them. CESR therefore seeks consultees views on this disclosure item.

Questions

22.	*Should any profit forecast that is included be reported on by the company's auditor or reporting accountant?*
23.	*Do you consider that the requirement to disclose an issuer's prospects should be retained, or should this requirement be deleted?*

Board Practices– CESR ref: V.C.1 and 2 (Wholesale Debt Building Block)

24. Details of Board practices are of much less significance for "wholesale investors" making an investment decision in relation to this type of securities. However, in the light of well publicised corporate governance failures, it would be an unusual time to decide that disclosure of such matters is of no consequence and can therefore be safely deleted. Consequently, CESR felt that it would be appropriate to ask interested parties their view as to whether such disclosures should be required of issuers of such securities.

Question

25.	*Do you consider it necessary to continue to require disclosure of Board practices for issuers of such securities?*

Major Shareholders – CESR ref: VI.A.1 and 2 (Wholesale Debt Building Block)

26. A number of disclosure requirements contained in the proposed disclosure requirements for corporate retail debt have been deleted. CESR had discussions about the disclosure requirements that remain. The majority of CESR members felt that this sort of information is unlikely to have a significant effect on the investor's assessment of the issuer's ability to meet its obligations. However, some CESR members felt that this was information that would be of value to investors for other reasons.

Questions

27.	*Do you consider that these disclosure obligations should be required?*
28.	*CESR's expectation is that either both would be deleted or both retained. Do you consider that only one of these disclosure obligations is necessary and if so, which?*

Related party transactions - CESR ref: VI.B (Wholesale Debt Building Block)

29. CESR discussed the disclosure obligations concerning related party transactions. CESR has doubts about whether such disclosures result in information of significant value to wholesale investors investing in this type of security. There are no doubt occasions when a related party abuses its position in some way to the detriment of investors. However, the cost of complying with this obligation for all issuers does run the risk of imposing an unreasonable cost compared to the potential benefits.

Questions

30. *Do you consider that this disclosure requirement should be retained in relation to this type of issuer?*

Interim financial statements - CESR ref: VII.H (Wholesale Debt Building Block)

31. There is a current obligation where admission to official listing is being sought to include own or consolidated interim financial statements, where the prospectus is dated more than nine months after the end of the last financial year. The question of interim accounts and how often these should be prepared (and to what standard) will be considered in relation to the future proposal for a Transparency Obligations Directive (or Regular Reporting Directive) for those securities that are admitted to trading on a regulated market.

32. CESR considers that it is sufficient in relation to debt securities aimed at ”wholesale investors” to require that interim accounts are included where they have been published and not impose an obligation to produce interims solely to form part of the prospectus. This contrasts with the approach set out in the Consultation Paper in relation to the retail corporate debt disclosure requirements which did require the production of interim accounts.

Question

33. *Do you consider this approach to be appropriate?*

Documents on display - CESR ref: VIII.C (Wholesale Debt Building Block)

34. This area was discussed in the Consultation Paper (paragraphs 92 and 93 and 147 to 150). Clearly the responses to the questions raised in that consultation will be considered when deciding what disclosure requirements should be included for issuers of these securities. However, if interested parties have a different view on whether there should be a different approach taken in relation to documents being on display for issuers of such securities CESR would be interested in their views.

Question

35.	*Are your views or comments different from those in response to the first consultation paper?*

SECURITIES ISSUED BY BANKS

Introduction

36. In the Provisional Request the Commission asked CESR to provide technical advice on possible disclosure requirements taking account of the different categories of issuers, investors and markets. In response to this, CESR has proposed specialist building blocks for the registration document of Start-up companies, SME's, Property Companies, Mineral Companies, Investment Companies and Scientific Research Based Companies (paragraphs 94 et sq. of the Consultation Paper – Ref: CESR/02.185b).

37. CESR has now considered whether a specialist building block for banks would be justified under Art. 7 paragraph 1 (e) of the amended version of the Commission Proposal. **Banks for the purposes of such a building block would include not only "credit institutions" as defined by the Prospectus Directive, but also regulated firms such as investment banks that have substantial experience of issuing securities.**

38. Members who were in favour of such a specialist building block argued that, due to Community legislation, banks were under close regulatory control and prudential supervision. Therefore, less information about the issuer is necessary as compared to corporate issuers. Others believed that investors who buy securities issued by credit institutions assume a similar risk and should therefore be informed similarly.

39. On the basis that a specialist building block for banks was justified, several CESR members considered that this approach should also be followed in relation to non-EU banks that were judged to be subject to the same level of prudential and regulatory supervision. To do otherwise would have the effect of preventing some existing issuers, such as US investment banks for example, from being treated as banks for these purposes.

40. On the basis that a specialist building block for banks was justified, CESR also considered whether further distinction between the type of issued securities and the way of offering was necessary. CESR proposes that no specific building block is justified where a bank issues equity securities. Therefore the scope of the building block should be limited to cases where the issuance of non-equity securities is planned.

41. This consultation does not deal with the disclosure obligations relating to a base prospectus as the contents of this document will depend so heavily on the final disclosure requirements dealt with in the Consultation Paper and this Addendum (see paragraphs no. [169-176]). However, it is anticipated that the specialist building block for banks would be capable of being incorporated into the base prospectus produced by a bank in relation to non-equity securities issued in a continuous or repeated manner.

42. The detailed disclosure obligations in relation to banks are set out in Annex [2]. Some specific issues are discussed below.

Questions

43. *Having reviewed the disclosure obligations set out in Annex [2], do you consider that a specialist building block for banks is justified?*

44. *If so, do you consider that this specialist building block should be applied to non-EU banks that are subject to an equivalent level of prudential and regulatory supervision, or should only EU banks be covered by this specialist building block?*

45. *Other than those disclosures considered separately below, do you agree with the disclosure obligations for banks as set out in Annex [2]?*

Investments (Past, Present and Future) – CESR disclosure ref: IIIB (Bank Building Block)

46. CESR believes that disclosure of past and present investments does not provide investors with sufficient benefit to justify the costs imposed on these issuers. CESR considered whether disclosure of future commitments provided useful information to investors. CESR decided to retain this particular disclosure, but would value the views of interested parties as to whether the regulatory oversight for such issuers means that such information no longer adds significant value to investors' judgement of the issuer's ability to meet its obligations under the securities being issued.

Question

47. *Do you consider that information about a bank's principal future investments should be disclosed?*

Profit forecasts and trend information – CESR disclosure ref: IV.A.1 (Bank Building Block)

48. This disclosure has been amended to make it more specific to the nature of the issuers concerned. There was substantial discussion about whether the solvency ratios for banks should be disclosed in the registration document. Clearly these

ratios would be of interest to investors as they give information about the health of the bank. Some banks provide these ratios as a matter of course anyway. But it could be considered as not appropriate to require the publication of these ratios to investors generally unless the significance of the ratios were fully explained and put in context. It should be noted that the solvency ratios that would have to be disclosed are the actual solvency ratios, not the regulatory solvency ratios.

Questions

49.	*Do you consider that a bank's actual solvency ratio should be disclosed?*

Board Practices – CESR ref: V.C.1 and 2 (Bank Building Block)

50. Details of Board practices have already been identified as being of less significance for certain issuer and investor classes. Since banks are subject to prudential and regulatory supervision, the significance of the Board practices for investors making an investment decision is reduced. However, as referred to before, with corporate governance being a topic of particular interest at present, it seemed appropriate to seek views from interested parties about whether such disclosures should be required for such issuers.

Question

51.	*Do you consider it necessary to continue to require disclosure of Board practices by banks?*

Major Shareholders – CESR ref: VI.A.1, VI.A.2 and 3 (Bank Building Block)

52. As previously mentioned, a number of disclosure requirements contained in the proposed disclosure requirements for corporate retail debt have been deleted for issuers of debt securities aimed at "wholesale investors". CESR had discussions about whether these disclosure requirements should also be deleted for banks. Clearly CESR's views will be influenced by respondents views on this disclosure requirement in relation to "wholesale debt". But respondents may have different views in connection with banks as issuers.

Question

53.	*Do you consider that the disclosure obligations [VI.A.1, VI.A.2 and VI.A.3] should be required for banks?*

Related party transactions - CESR ref: VI.B (Bank Building Block)

54. CESR discussed the disclosure obligations concerning related party transactions and their relevance for banks issuing non-equity securities. CESR has already raised doubts about whether such disclosures result in information of significant value in relation to "wholesale debt" products.

Question

55. *Do you consider that this disclosure requirement should be retained in relation to this type of issuer?*

Interim financial statements - CESR ref: VII.H (Bank Building Block)

56. Most CESR members believe that similar considerations apply in relation to these issuers as applied in relation to issuers of debt securities aimed at "wholesale investors". Therefore the same disclosure requirement has been included here. However, some CESR members felt that in this case there should be a requirement to produce interim accounts solely to form part of the prospectus.

Question

57. *Do you consider the approach set out in VII.H. of the Bank Building Block schedule to be appropriate?*

Documents on display - CESR ref: VIII.C (Bank Building Block)

58. As highlighted earlier, this area was discussed in the Consultation Paper (paragraphs 92 and 93 and 147 to 150). As before, the responses to the questions raised in that consultation will be considered when deciding what disclosure requirements should be included for these issuers. However, if interested parties have a different view on whether there should be a different approach taken in relation to documents being on display for such issuers CESR would be interested in their views.

Question

59. *Are your views or comments in relation to securities issued by Banks different from those in response to the Consultation Paper?*

DERIVATIVE SECURITIES

Introduction

60. In the Consultation Paper CESR set out a discussion about these products, and asked a number of high level questions. The questions included how these products should be defined; what if any sub-categorisation should be applied to these products; and what disclosure requirements should be applied to the issuers of these products.

61. As that consultation made clear, the responses will be used to inform future work on the possible content of the building block disclosure requirements for the registration document relating to issuers of these securities.

62. Pending the results of the consultation, CESR has considered the issues further. These products are currently issued by only one type of issuer; namely "Banks" as that term is defined above, or by special purpose vehicles whose obligations in respect of these products are guaranteed by such entities. Therefore, CESR has set out in this consultation the proposed disclosure requirements for derivative securities aimed at both "wholesale" and retail investors issued by such entities.

63. The detailed disclosure requirements for derivative securities aimed at retail and "wholesale investors" are set out in Annex [3]. CESR sets out below a discussion about some of the specific disclosure requirements.

Investments (Past, Present and Future) – CESR disclosure ref: III.B (Derivatives Building Block)

64. For similar reasons as discussed in the proposed disclosure requirements for Bank issuers set out above, CESR believes that disclosure of past and present investments does not provide investors with sufficient benefit to justify the costs imposed on issuers of derivative securities.

65. CESR discussed whether information about the issuers principal future investments is relevant for derivative securities. Some CESR members considered that such information is relevant because this information relates to the investors assessment of the issuer's ability to fulfil its obligations to investors. Others considered a requirement for the disclosure of such information to be unnecessary in view of the issuer's on-going regulatory control and prudential supervision.

Question

66.	*Do you consider that issuers of derivative securities should be required to provide a description of their principal future investments? Please give your reasons.*

Directors - CESR ref: V.A.1 (Derivative Building Block)

67. In view of the nature of these products, CESR discussed the relevance of requiring disclosure about the names, addresses and functions of members of the administration, management or supervisory bodies, where the activities of these individuals outside the issuing undertaking is considered by the issuer to be significant in relation to the issuing undertaking.

68. Some CESR members considered that for these products such disclosure should be limited to the issuer's directors. Others considered that such disclosure should not be so limited and that disclosure about the members of the administration, management or supervisory bodies is relevant for an investor's assessment of whether or not to invest in a derivative security.

Question

69. *Do you consider that the information set out in V.A.1 of the Derivatives Building block should be restricted to the directors of the issuer? Please give your reasons.*

Management and directors conflict of interests – CESR ref: V.B (Derivatives Building Block)

70. In view of the nature of these products, CESR questions the relevance of disclosure about any potential conflicts between directors of the issuer and their private interests or other duties. Some CESR members consider such disclosure to be important and relevant information for an investor in order to make a decision about whether or not to invest in such products. Others do not consider such disclosure to be relevant in view of the nature of the issuers obligations to the investor, and the limited value that such disclosure gives investors in relation to the investment decision they are making about such products.

Question

71. *Do you consider that the information set out in V.B of the Derivatives Building block to be relevant and necessary disclosure for these products? Please give your reasons.*

Board Practices– CESR ref: V.C.1 and 2(Derivatives Building Block)

72. The question about the appropriateness of disclosure about the Board practices for these issuers has already been asked in relation to wholesale debt and Banks above. In addition to the question already asked, CESR feels it to be appropriate to ask interested parties for their views on this matter in relation to derivative securities

Questions

73.	*Do you consider it necessary to require disclosure of Board practices for issuers of derivative securities? Please give reasons for your answer.*
74.	*Do you consider it necessary to require disclosure of Board practices for issuers who are banks of derivative securities? Please give reasons for your answer.*

Related party transactions - CESR ref: VI.B (Wholesale Debt Building Block)

75. The issue of the disclosure obligations relating to related party transactions has already been discussed above and CESR has raised doubts about the value such disclosure gives to "wholesale investors" in debt securities.

Question

76.	*Do you consider that this disclosure requirement should be retained in relation to derivative securities? Please give your reasons.*

Interim financial statements – CESR ref: VII.H (Derivatives Building Block)

77. Most CESR members believe that similar considerations apply in relation to these issuers as applied in relation to issuers of debt securities aimed at "wholesale investors". Therefore the same disclosure requirement has been included here.

Question

78.	*Do you consider the approach set out in VII.H. of the Derivative Building Block schedule to be appropriate?*

Documents on display - CESR ref: VIII.C (Wholesale Debt Building Block)

79. As discussed, this area was dealt with in the Consultation Paper (paragraphs 92 and 93 and 147 to 150). Clearly the responses to the questions raised in that consultation will be considered when deciding what disclosure requirements should be included for issuers of these securities. However, if interested parties have a different view on whether there should be another approach taken in relation to documents being on display for issuers of derivative securities CESR would be interested in their views.

Question

80.	*Are your views or comments in relation to derivative securities different from those in response to the Consultation Paper?*

The disclosure requirements for guaranteed derivative securities.

81. In the Consultation Paper, CESR discussed the broad categorisation of derivative securities into "non guaranteed return derivatives" - where the investor's return is wholly dependant upon the performance of the underlying instrument to which the product is linked- , and "guaranteed return derivatives" products - where the investor will receive some form of return from the issuer irrespective of how the underlying instrument performs.

82. CESR pointed out that it considered that the disclosure requirements for "guaranteed return derivatives" should be drawn from the debt disclosure requirements to reflect the debt characteristics of these products and that these requirements should be tailored to reflect the nature of the product and the different investment decision about the issuer that an investor in a derivative security is making about the derivative issuer.

83. Although CESR pointed out that guaranteed derivative securities may be more akin to debt securities than derivative ones, in that the issuer has an obligation to give an investor some form of return on its investment, CESR explained that distinction between a guaranteed and non guaranteed derivative security became less clear, the lower the percentage of the guaranteed return was.

84. In view of this difficulty, CESR asked the question in paragraph 232 whether or not all guaranteed derivative securities should be classified as such, irrespective of the percentage of the guaranteed return, or whether or not there should be some form of benchmark percentage .

85. Following the publication of the Consultation Paper, CESR has further considered this issue and is unable at this stage to come to a consensual view on this matter. Some CESR members believed that any derivative security where the issuer is obliged to make a return to the investor - whether the return is 0.1% or 100% of the investor's initial capital - should for disclosure purposes be treated as a debt security. Others believe that unless the issuer of the derivative security is obliged to make a return to the investor of 100% of the investors capital, the instrument for disclosure purposes should be treated as a derivative .

86. As CESR has in this consultation set out the disclosure requirements for derivative securities issued by Banks or special purpose vehicles whose obligations are guaranteed by Banks as set out in Annex [3] and the disclosure requirements for other non equity securities issued by Banks as set out in Annex [2], CESR considers it appropriate at this stage to ask interested parties for their views on this issue.

Questions

87. *After review of the proposed disclosure requirements for banks set out in Annex [2], do you consider it necessary to set out separate disclosure requirements for guaranteed derivative securities issued by banks (including for these purposes special purpose vehicles whose obligations are guaranteed by banks), or should all such derivative securities irrespective of their percentage return be treated as all other non-equity securities issued by banks (or special purpose vehicles whose obligations are guaranteed by banks)? Please give your reasons.*

88. *If you consider that there should be a difference between the disclosure requirements for a bank (or a special purpose vehicle whose obligations are guaranteed by a bank) issuing a guaranteed derivative security, and the disclosure requirements for a bank issuing all other types of non-equity securities, please indicate what percentage return should be applied to differentiate between these different disclosure requirements. Please give your reasons.*

89. *Having reviewed the disclosure obligations set out in Annex [3] for derivative securities issued by banks or special purpose vehicles whose obligations are guaranteed by banks, and the disclosure obligations set out in Annex [2] for all other non equity securities issued by banks, what, if any, additional disclosures do you consider a bank issuer or special purpose vehicle issuer whose obligations are guaranteed by a bank of a guaranteed derivative security should provide? Please give reasons for your answers.*

The disclosure requirements for derivative securities issued by entities other than banks or special purpose vehicles whose obligations are guaranteed by banks

90. It has not been possible without the results of the first consultation and in the time available to come to any conclusions about what the disclosure requirements for derivative securities issued by non-bank issuers should be.

91. Although at present CESR recognises that only banks as defined above issue derivative securities, CESR deems it important for interested parties to consider the following questions in relation to non-bank issuers of these products.

Questions

92. *Do you consider that the disclosure requirements for Banks issuing derivative products should also be applied to non- bank issuers of non-guaranteed derivative securities? Please give your reasons.*

93. *If you consider that there should be different disclosure requirements for non-bank issuers of derivative securities, on review of the derivatives disclosure requirements set out in Annex [3], and the "wholesale debt" disclosure requirements set out in Annex [1] please advise:*

(a)	*what, if any, different disclosure requirements to those set out in Annex [3] should be applied to non-bank issuers of derivative securities. Please give your reasons; and*
(b)	*what, if any, additional disclosure requirements set out in the "wholesale debt" disclosure requirements at Annex [1] should be applied to non-bank issuers of derivative securities. Please give your reasons.*

ASSET BACKED SECURITIES

Introduction

94. Where securities are issued that are asset backed (as defined in Annex [10]), the most important information is arguably about the nature of the assets rather than the issuer itself. It is also the case that many of the issuers of this type of securities are special purpose vehicle or entity. Often they are also backed by a separate guarantor. In such circumstances it does not seem reasonable to require the same sort of disclosure about the issuer as would normally be required for an issuer of equities, for example.

95. Annex [4] sets out the disclosure requirements that CESR considers appropriate for the registration document for issuers of asset backed securities. It should be noted that where the issuer does not have any legal identity itself, the obligation will apply to the financial institution that set up the special purpose vehicle or entity.

Questions

96. *Do you agree with the disclosure obligations set out in Annex [4] as being appropriate for this type of securities?*

DEPOSITORY RECEIPTS

97. It will not be possible to have fully developed disclosure regimes for all securities that will be developed in the financial markets. That is one reason for an approach based on features – the "building block" approach – being used. This approach will allow competent authorities and issuers alike to identify the most appropriate disclosures that should be made in a prospectus.

98. However, it should be possible for CESR to develop detailed disclosure regimes for securities that currently exist and are admitted to trading on a regulated market. One type of security that was not addressed in the previous consultation was Depository Receipts (DRs), which would include Global Depository Receipts. These are not widely listed across the EU, but there are sufficient numbers of these securities admitted to trading on regulated markets to justify a differentiated approach as they raise their own particular aspects.

99. CESR's proposed disclosure regime for DRs is shown in Annex [5]. The proposal does not distinguish between the information that is to be set out in the registration document, and the information that is to be set out in the securities note because CESR believes that an issuer of DR's would produce the prospectus in the form of one complete document.

100. In establishing what the disclosure requirements regarding the issuer of the DR's should be, CESR considers the issuer for disclosure purposes to be the issuer of the underlying shares to which the DR's relate, although from a legal perspective the issuer of the DR is in fact the depository.

101. On the basis that the investor rarely has a right of recourse against the depository under the terms of the DR, the information concerning the depository itself is probably of less importance. This has led those CESR members with significant numbers of such securities being issued to conclude that the disclosures regarding the depository itself should be minimal. In the event that the investor has a right of recourse against the depository under the terms of the DR issued, the general obligation to include all material information in the prospectus would probably mean that the sort of information that investors would need in relation to the depository would be the same information as that regarding the issuer of the underlying.

Questions

102.	*Do you agree with the disclosure obligations set out in Annex [5] as being appropriate for this type of security?*
103.	*In particular, do you consider that any information regarding the depository is required in addition to that set out in IX.A?*
104.	*If there is recourse to the depository under the terms of the DR issued, what disclosure requirements do you consider would be appropriate in relation to the depository?*

SPECIALIST BUILDING BLOCK FOR SHIPPING COMPANIES

105. In the Provisional Request the Commission asked CESR to provide technical advice on possible disclosure requirements thereby taking account of the different categories of issuers, investors and markets. CESR has therefore considered specialist building blocks for the registration document of Start-up companies, SME's, Property Companies, Mineral Companies, Investment Companies and Scientific Research Based Companies (paragraphs 94 et sq. of the Consultation Paper – Ref: CESR/02.185b).

106. Additionally, as mentioned in paragraph 94 of the Consultation Paper, CESR has considered a specialist building block on Shipping Companies which is now set out in Annexes [6] and [6a].

107. Some CESR members believe that shipping companies can give rise to specific issues that would not be sufficiently explained in the disclosures required in the Core Equity building block. Other CESR members feel that the Core Equity building block can be adapted sufficiently easily that the appropriate information can be captured by those disclosure requirements. CESR has nevertheless produced a draft specialist building block for these companies. For the purposes of this building block, a shipping company is:

" a company that activates in ocean-going shipping and manages, leases or owns cargo and/or passenger vessels either directly or indirectly, as a main activity."

108. On the basis that a specialist building block was required, some CESR members considered that the prospectus for a shipping company would not provide all the information necessary for investors to make an informed investment decision if the prospectus did not include a valuation report. CESR has therefore prepared two specialist building blocks in relation to shipping companies; one for the registration document (Annex [6]) and one for the securities note (Annex [6a]). The requirements in respect of the valuation report are set out in Annex [6a]. Other CESR members felt that routes operated by shipping companies could have a more important effect on the value of the company than the valuation of the ships themselves.

109. However, CESR also considered when such a valuation report would be of most use to investors. CESR concluded that it would be of most use to investors when securities were being issued. On the assumption that companies will generally prepare their registration documents at the same time as their annual accounts, there seemed no compelling reason to provide valuation reports in addition to the annual accounts. Therefore CESR considers it appropriate for such valuation reports to form part of the securities note for shipping companies.

110. CESR also considers that there will be risk factors that will need to be disclosed which are specific to this type of issuer. For example, the market value of the vessels may fluctuate significantly and losses may incur when the vessels are sold which may adversely affect the company's earnings.

Questions

111.	*Do you believe that a specialist building block for shipping companies is appropriate?*
112.	*Do you agree with the disclosure requirements in registration documents for shipping companies set out in Annex [6]?*
113.	*Do you agree that valuation reports as set out in Annex [6a] should be required for shipping companies?*
114.	*Do you consider it appropriate that the date of valuation must not be more than 90 days prior to the date of publication?*
115.	*Do you agree that it would be more appropriate for such valuation reports to be required when securities are being issued by a shipping company and hence should form part of the securities note*?

PART TWO - SECURITIES NOTE

INTRODUCTION

116. As stated in the Consultation Paper of October 2002, the three draft schedules for securities notes that are submitted to consultation are core schedules, or minimum schedules. They contain the minimum items that a securities note should, in CESR's opinion, contain for all types of offers or admissions to trading of any type of securities.

117. CESR is aware of the fact that not all securities can easily be defined as strictly belonging to one of the three types of securities for which a schedule has been drafted. For instance, a convertible obligation is a debt security which, under specific circumstances and at certain conditions, can be converted into a share. In such a case, the issuer should be able, under guidance of the competent authority, to add some specific items of the equity schedule to the debt schedule in order to reflect all characteristics of the convertible obligation.

118. CESR also considered to include additional items in the draft SN schedules in order to encompass other securities which would not otherwise fit in the basic schedules (such as preference shares, structured bonds, reverse convertibles). Three additional sets of information are presented below:

- Additional information to be included in the SN Equity Schedule (Annex [7])
- Additional information to be included in the SN Debt Schedule (Annex [8])
- Additional information in the SN Derivatives Schedule (Annex [9])

119. CESR believes that additional building blocks are necessary in order to add specific information regarding the type of issuer, offer, market and security concerned. In this paper, we present different building blocks that address specific type of securities or peculiar rights or obligations concerning specific securities. These building blocks are the following ones:

- Asset Backed Securities SN Building Block (annex [10])
- Guarantees SN Building Block (Annex [11])
- Subscription, Conversion or Exchange rights SN Building Block (Annex [12])

In the following paragraphs, each building block is presented and discussed.

PROPOSAL OF A BLANKET CLAUSE

120. Before discussing the various attachments, CESR wishes to address a general concern. In some cases, items listed in one of the three draft schedules might be inappropriate or inapplicable for a specific issue or admission to trading. This concern has been partially dealt with under Article 8 (3) of the amended proposal for a Directive on the prospectus to be published when securities are offered to the public or admitted to trading[1] and amending Directive 2001/34/EC.

> According to Article 8 (3), "Without prejudice to the adequate information of investors, where, exceptionally, certain information required in implementing measures referred to in Article 7 (1) to be include 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".

121. In order to make sure that clearly inapplicable items must not be taken into account when drafting a securities note, CESR proposes to introduce the following *blanket clause* in its draft schedules:

> *"If certain information required in the line items or equivalent information is not applicable to the issuer or to the securities to which the prospectus relates this information can be omitted".*

Questions

122.	*Do you agree with this approach?*
123.	*Are you satisfied with the wording of the Blanket Clause?*

[1] See art. 8 (3) of the Ecofin Text ref. 13593/2/02 REV 2.

WORKING CAPITAL

124. In creating the separate disclosure requirements for registration documents and securities notes, it was sometimes necessary to allocate different parts of IOSCO disclosure requirements between the Registration Document and the Securities Note. One example of such a possible allocation split was IOSCO disclosure V.B.1.a which deals with working capital statements. Unfortunately, the last sentence of this requirement was mistakenly omitted from both documents. CESR now proposes that this requirement is included in the securities note disclosure requirements for equities. This requirement forms part of the discussion concerning liquidity and capital resources. These disclosure requirements are currently part of the registration document. It might be more appropriate to make these disclosures part of the securities note rather than the registration document so that the wider discussion is more closely linked to the working capital statement.

Questions

125. *Do you consider that this disclosure is more appropriate to the securities note or the registration document?*

126. *If you consider that this disclosure is more appropriate to the securities note, do you believe that the other disclosures regarding liquidity and capital resources currently in the registration document should be included in the securities note instead?*

ADDITIONAL INFORMATION IN THE SN EQUITY SCHEDULE

127. When considering the various classes of **shares** and the specific information needed in relation to each one, the need for specific building blocks has been lengthily evaluated. Following such analysis, CESR had come to the conclusion that rather than drafting a building block for shares in general, or for any specific class of shares, it would be more adequate to add to the Equity Securities Schedule (Annex K of the CP) a few items of information (Annex [7]) and, thus, make it suitable to be used as a SN for any class of shares.

128. In accordance with this approach, CESR is now proposing to add information regarding (i) the description of the rights attached to the securities and procedure for the exercise of any right attached to the securities (V.A.7.) and (ii) lock-up agreements.

129. Under the description of the rights attached to the securities, CESR has listed the most common rights attached to shares of different classes and the main features of such rights. For instance, for dividend rights, besides general features (such as time of entitlement and procedures for non-resident holders), it is also asked to provide the rate of dividend and the cumulative or non-cumulative nature of payments as such information is deemed to be essential in the case of **preference shares**.

130. Also with regard to **preference shares**, whose main characteristics make them both similar to shares and debentures, CESR recognizes that there are items from the Equity Securities Schedule that are not suitable for such shares. Nevertheless, CESR is not providing a list of the non-applicable items due to the fact that it has been assumed that when the information required is inappropriate to the securities, the prospectus shall contain information equivalent or if no equivalent information exists, the requirement shall not apply (see §§ 106 and 107 about the proposed Blanket Clause).

131. In certain jurisdictions, it is legally possible to issue redeemable shares, i.e. shares that may be redeemed either at the option of the issuer or at the option of the holder. For this reason, under the description of the rights attached to the securities, CESR is proposing to include an explicit indication to "redemption provisions". Obviously for those shares that are not redeemable, such item will not be applicable.

Question

132. *Do you agree with this approach?*

ADDITIONAL INFORMATION IN THE SN DEBT SCHEDULE

133. As CESR acknowledged in its first Consultation Paper, not all securities can easily be defined as strictly belonging to one of the three main types of securities for which a core schedule has been drafted (equity, debt and derivative securities). For instance, a structured bond could be construed as a debt security which incorporates also certain elements of a derivative security, in particular concerning the return investors might receive.

134. CESR has decided not to produce an additional building block for structured bonds. Instead, CESR's approach has been to select a number of disclosure items aimed at catering for the particular features of these securities. CESR proposes to add these items to the Debt SN Schedule in order to cover cases where the security in question is deemed to be a structured bond. (Annex [8])

135. In accordance with this approach, CESR proposes to

(i) include in the risk factors section of the SN Debt schedule (III.C) the disclosures required under this heading in the SN Derivatives schedule.

(ii) Add in the Interest rate section of the SN Debt schedule three items taken from the section V.B of the SN Derivatives schedule: in particular, items 13 (description of any market disruption or settlement disruption events that affect the index or variable), 14 (adjustment rules with relation to events concerning the index or variable) and 17 (nomination of a calculation agent).

Question

136. *Do you agree with this approach?*

ADDITIONAL INFORMATION IN THE SN DERIVATIVES SCHEDULE

137. CESR suggests three minor modifications to the SN Derivatives Schedule in order to clarify some of the requirements, especially those concerning certain characteristics (existence of a rate of interest and/or a redemption amount) of a number of existing derivative products such as reverse convertible notes (Annex [9]- SN Derivatives Schedule).

138. These three minor modifications would be introduced in *V.A Description of the securities to be offered/ admitted to trading*, under numbers 9, 14 and 15. Additions are highlighted (in light blue).

Question

139. *Do you agree with this approach?*

ADDITIONAL SN BUILDING BLOCK FOR ASSET BACKED SECURITIES

140. Asset backed securities are debt securities, normally issued by special purpose vehicles or entities, which are backed by assets intended to produce funds to be applied towards interest payments due on those debt securities and repayment of principal on maturity.

141. In order to assess the ability of an issuer to meet its obligations under an asset backed debt security, it is essential that investors are provided with detailed information on the assets that actually back the debt, as well as information on the debt itself.

142. Annex [10] sets out an additional building block for asset backed securities, which must be combined with the SN Debt schedule to compose the Securities Note for asset backed securities. In particular, Annex [10] requires detailed disclosures on the assets backing the debt securities and the cash flows arising on those assets.

Questions

143. *Do you consider the disclosure requirements set out in Annex [10] to be appropriate for asset backed securities?*
144. *On review of the debt security note disclosure requirements set out in annex [L] to the Consultation Paper, please advise what if any of these items of disclosure should not be required for these types of securities? Please give your reasons"*

ADDITIONAL SN BUILDING BLOCK FOR GUARANTEES

145. CESR has determined that the disclosure requirements for guarantees should form a separate building block (Annex [11]) rather than remain a fixed part of the Securities Note Debt Schedule. This is considered to be the best approach because a guarantee can, in theory, be applied to any obligation in relation to any type of security. Having the disclosure requirements for guarantees in a separate building block means that there is the flexibility to add the Guarantees Block to any of the Securities Note Schedules, Debt, Equity or Derivative, and in combination with any other building block.

146. The Guarantees Building Block is also drafted so that it is not restricted to simple guarantees, but can encompass existing equivalent arrangements such as Keepwell Agreements and Mono-line Insurance Policies and any other arrangements that may be developed in the future.

147. For example, a Keepwell Agreement is the economic equivalent of a guarantee but, instead of providing a legal undertaking to the holder of the security to fulfil the issuer's obligations should it default, the Keepwell provider commits to keep the issuer solvent so that it can meet its obligations.

148. In the case of Mono-line Insurance, the insurance is typically provided in relation to a Special Purpose Vehicle (SPV) created to manage a specific project. While the insurer has an obligation to the security holder to meet the SPV issuer's obligations in the event of default, the insurer enters into a further agreement with the issuer relating to the management of the project. Under this further agreement the insurer will assess the issuer's conduct of the project and, if it appears that the issuer's conduct will result in it becoming unable to meet its obligations to security holders, the insurer can exercise certain powers in relation to the project such as the right to replace contractors. The exercise of these powers is intended to prevent the issuer defaulting in the first place.

Questions

149. *Do you agree with the proposal to have the disclosure obligations in relation to guarantees in a separate building block so as to allow greater flexibility in structuring the issue of securities?*

150. *Do you believe that the level of disclosure required by the proposed building block is appropriate? Please give reasons for your answer.*

151. *If, in answer to the previous question, you said the requirements were inappropriate please indicate which of the proposed disclosure requirements you believe to be excessive and/or which additional disclosures should be required of guarantors.*

ADDITIONAL SN BUILDING BLOCK FOR SUBSCRIPTION RIGHTS

152. The additional building block for subscriptions rights (Annex [12]) applies to equity securities within the meaning of Art. 2 (1)(b) of the current text of proposal of the Prospectus Directive[2]. According to this provision, equity securities means "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 them being converted or the rights conferred by them being exercised, provided that the latter type of securities are issued by the issuer of the underlying shares or by an entity belonging to the group of the said issuer."

153. The purpose of this building block is 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.

154. However, this type of product generally gives a right to convert the security into a share. Accordingly therefore, CESR members have decided to adapt the scope of application of this building block.

Questions

155. *Do you agree with this approach ?*

156. Due to the specificity of these securities, CESR decided not to use the derivative schedule but to prepare a specific building block that shall be combined with the SN Equity Schedule or the SN Debt Schedule depending on the type of security to which the right is attached or with which it is combined (e.g.: shares with warrants, bonds with warrants, convertible bonds). Amongst other things, this building block requires information regarding the description of the "underlying" share, potential dilution effect and issuer's commitments. CESR members agree that the "technical" description of the "underlying" share should refer to para. V. A. of the equity securities note and additionally to information on the listing place of the shares.

157. CESR has discussed the extent of information which must be given on the issuer of the underlying share. In cases where the issuer is that of both the security and the underlying share, the information is already disclosed in the prospectus.

158. However, some CESR members question the extent of information where the issuer of the security is not the same as the issuer of the underlying share, but belongs to the group of the issuer. Two possibilities have been discussed:

- The majority of CESR members consider that the information should be based on the information publicly available with for instance the possibility to incorporate by reference the Registration Document of the issuer of the underlying share (if

[2] See Ecofin Text ref. 13593/2/02 REV 2

any), (without prejudice to voluntary additional information which could be given by the issuer of the security on the issuer of the underlying share).

- When the securities give the right to only acquire existing shares, a minority of CESR members have suggested revealing the information as required in para. V.B.12 of the derivatives securities schedule (refer to Annex [M] of the Consultation Paper); as they feel that the issuer should not be responsible for the information disclosed by an entity of the group.

159. *Which approach do you deem to be more appropriate?*

PART THREE -SUMMARY

INTRODUCTION

Extract from Provisional Request

160. According to paragraph 2.1 of the Provisional Request, it is stated that "*the draft schedules should be structured respecting the new format of the prospectus (registration document, securities note and summary note)*". Even if according to the Commission's Proposal and the text agreed upon at the Ecofin Council of November 5, 2002 (Ecofin Text), the shelf registration system is no longer envisaged as mandatory, the request put forward by the Commission is still valid: those issuers who wish to do so, may structure the prospectus in three different documents and the summary is nevertheless always a part of the prospectus drafted as a single document.

The Summary according to the "Ecofin text"

161. According to Article 5(2) of the Ecofin text, the prospectus "*shall also include a summary. The summary shall in a brief manner and in non-technical language convey the essential characteristics and risks associated with the issuer, any guarantor and the securities in the language in which the prospectus was first drawn up. 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 related to the information contained in a prospectus is brought to a court, the plaintiff investor might according to the national legislation in the Member States have to bear the translation costs of the prospectus before the beginning of the legal proceedings, and (d) no civil liability is attached 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 other parts of the prospectus."*

162. According to no. 16a of the Preamble to the Directive "*to ensure easy access to this information the summary shall be written in non-technical language and normally not be more than 2.500 words in its original language*."

163. Annex IV of the Ecofin text indicates the items containing the most important information that should be included in the summary.

NEED FOR LEVEL 2 ADVICE

164. The Ecofin text of the directive therefore already states, with a high degree of detail, the following aspects related to the summary: the scope: convey the essential characteristics and risks associated with the issuer, any guarantor and the securities; the language, that should be non technical; the length: the summary should be "brief" and –according to the preamble - should "normally not be more than 2.500 words"; the content: the items indicated in annex IV and warnings mentioned in article 5.2.

165. Bearing this in mind several CESR members have questioned whether there is a need for level 2 advice on this topic since the Ecofin text of the Directive already contains sufficient indication for the issuers as to how the summary should be prepared. These CESR members believe Level 3 guidance might be more appropriate.

166. Other members instead are of the opinion that the content of the summary provided for in the Directive is only indicative and therefore believe there is a need for level 2 implementing rules. In particular they stress the need for those core disclosure requirements that should always be included in the summary in order to assure legal certainty for both the issuer (responsible for the content of the summary and its capability of pursuing the said aim) and the competent authorities that have to decide on the approval of the prospectus. It has also been noted that the summary might be the only document drafted in the language of the investor.

167. In line with the requirement set out in article 7 of the Ecofin Text, CESR stresses that the issuer should avoid duplicating in the summary the content of whole paragraphs of the prospectus.

Question

168. *Given the level of detail provided for by the Ecofin Text on the scope, language, length and content of the summary; taking in consideration that the summary is based on the content of the prospectus and that it is up to the issuer to evaluate which elements are essential, do you believe that there is need for level 2 advice on the content and characteristics of the summary and that, in particular, there is need to prepare specific summary schedules? If yes, please indicate what level 2 implementing measures should deal with. CESR also welcomes views on the way in which the need to standardise the content of the summary may be compatible with the maximum length the summary should normally have.*

PART FOUR – BASE PROSPECTUS/PROGRAMMES

169. According to Art. 7(1)(c) of the Ecofin Text, while developing the different models of prospectuses, account shall be taken of "*the format used and the information required in prospectuses relating to non-equity securities, including warrants in any form, issued under an offering programme*".

170. Furthermore, according to Art. 7(1)(d) of the Ecofin Text, while developing the different models of prospectuses, account shall be taken of "*the format used and the information required in prospectuses relating to non-equity securities, insofar as these securities are not subordinated, convertible, exchangeable, subject to subscription or acquisition rights or linked to derivatives products, issued on a continuous or repeated manner by entities authorised or regulated to operate in the financial markets within the European Economic Area.*"

171. Article 5 (4) provides for the possibility to use a base prospectus in two specific circumstances.

172. Due to the tight timetable, CESR has not been able to develop a specific regime for base prospectuses. The concept was developed in the Proposed Directive only after the provisional mandate of the Commission had been issued. However, as the mandate asks CESR to fully take account of developments in Parliament and Council, CESR would like to seek the views of market participants at an early stage.

173. It is evident that the contents of the base prospectus will heavily depend on the final disclosure documents dealt with in the Consultation Paper and this Addendum. However as anticipated in paragraph [41], the specialist RD building block for banks would be capable of being incorporated into

a) the base prospectus produced in relation to non-equity securities, including warrants in any form, issued under an offering programme (Article 5(4)(a)), or

b) the base prospectus produced by a credit institution in relation to non-equity securities issued in a continuous or repeated manner (Article 5(4)(b)).

174. Furthermore, most CESR members believe at this stage that the information that must be disclosed should not be different whether the issuer uses the "normal prospectus procedure" or the "programme or base prospectus procedure". In other words, after the final terms have been filed, the information concerning the issue or the admission to trading of a specific security should not be different if such a security is issued or admitted to trading under a programme or a base prospectus or if it is issued or admitted to trading under a normal prospectus.

Questions

175. *Do you have any comments on the preliminary views expressed in paragraph [174]?.*

176.	*Bearing in mind that the final terms will not be approved, what information disclosures from the securities note do you consider it would be appropriate to reclassify as being the final terms [for issues off a base prospectus]?*