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TOWARDS AN EU REGIME ON TRANSPARENCY OBLIGATIONS FOR ISSUERS WHOSE SECURITIES ARE ADMITED TO TRADING ON A REGULATED MARKET – SECOND CONSULTATION

We are appreciative of the fact that the Commission has conducted a full consultation and of the responsiveness it has demonstrated, evident in the latest draft. We are ready to take this dialogue further either by meeting the Commission or in any other convenient way. Some issues remain sufficiently uncertain (Article 15 of the proposal, for example), that further consultation is desirable before a draft directive is prepared.

Industry generally is a proponent of transparency, that is, the provision of relevant information in an accessible format and medium. Transparency is one of the key means of achieving the objectives of (1) retaining/enhancing the integrity and efficiency of Europe's markets and (2) protecting EU investors.

Executive Summary

Certain themes have emerged in our analysis of the two questions set out in the proposal.

- Objective should be efficient capital markets as in Lisbon conclusions
- Balance between market efficiency and investor protection must be reached
- Consistency within the Financial Services Action Plan is crucial
- Importance of third country issuers to the international securities market (two thirds of debt issuers) should be recognised more fully
- Mutual recognition should be a key pillar of the regime for third country issuers
- Requirements for reporting related to debt and equity should be considered separately
- Exemptions under the prospectus directive should be reflected in the proposal
- Specific market sectors, such as Global Depositary Receipts and structured financings, should be addressed
- A number of practical issues should be considered
- The proposal must recognise existing market structures, for instance, custody structures, in order to be capable of implementation
- Transitional provisions are necessary to avoid market disruption

Our answers to the two questions set by the consultation centre around the need to match the ongoing reporting obligations with the disclosure obligations established in the Prospectus Directive, where issues of proportionality have already been - and continue to be - discussed. There should be a logical development from the disclosure developed in connection with the public offer/admission to trading of securities in the EU and regular reporting obligations with respect to those securities. Accordingly, any proposal on regular reporting must differentiate as between (1) EU issuers/third country issuers, (2) issuers of debt/issuers of equity, (3) securities targeted at professional investors/retail investors, all of which concepts have been considered at length in the prospectus directive**.** The proposal should also recognise in its structure that the Market Abuse Directive is another crucial pillar of transparency under the Financial Services Action Plan.

Concept 1 – objectives and proportionality

The Lisbon conclusions recognise that "efficient and transparent financial markets foster growth and employment by better allocation of capital and reducing its cost". They also identify "the successful participation of all investors in an integrated market" as a "priority action area".

The Financial Services Action Plan (FSAP) itself states " Capital-raising does not stop at the Union's frontiers".

Read in the light of the well-established principle of proportionality in EU law, it is clear that the objective of the FSAP, and within it this proposal, is to balance the objectives of an efficient market and of investor protection in a global context. This principle of balance underlies the majority of our comments and we believe that so far as possible this and the other FSAP directives should seek to achieve their important objectives in a manner which preserves to the greatest extent possible the benefits of the existing international capital markets.

If the obligations of the directive are disproportionately burdensome, third country issuers in particular will be driven from the EU markets, and even take steps to delist their securities from regulated markets in the European Union, with consequent economic damage to EU exchanges (which would lose business) and EU investors (which would have to sell at short notice securities that no longer met their investment eligibility rules).

Concept 2 – consistency with other directives

The Financial Services Action Plan rightly states that " successfully to implement the regulatory blue-print set out in the annex…a piecemeal and reactive approach…is inadequate… A holistic, cross-sectoral view is required…in avoiding tensions between policy objectives…"

It is important for the efficient implementation of the FSAP that the transparency directive is consistent with other related existing or proposed directives and regulations (company law directive, prospectus directive, market abuse, investment services and the Regulation on IAS) and that the directives complement each other and do not introduce duplicative or potentially conflicting requirements. For instance, the latest draft of the prospectus directive envisages a mandatory shelf filing (annual update) but the relationship between the annual update and the annual report envisaged by this consultation is not clear. Ideally, the annual report should satisfy any annual update requirements.

IPMA considers that where a type of issuer or security merits a particular treatment in the prospectus directive, e.g. qualified investors or securities with a minimum denomination, that treatment should flow through into the regular reporting directive. Where this is not the case in the proposal, we would like to be given a clear rationale.

For instance, if an issuer has only debt outstanding that comes within the wholesale definition under the prospectus directive (and no equity), we consider that the ongoing

transparency requirements should benefit from a lighter approach corresponding to that applied by the prospectus requirements.
Article 6 of the market abuse directive will require that material information be promptly disclosed on an ongoing basis. The proposal should acknowledge that it is this provision which will give investors the most valuable information. Even quarterly information will be stale in comparison.

Concept 3 – third country issuers

The FSAP recognises that capital raising takes place in a global context. In the international debt market, two thirds of issuers are from third countries. In the international equity markets the majority of issuers are from third countries. These issuers provide diversification of risk for EU investors and economies of scale to the market, and benefit EU issuers by encouraging liquid and sophisticated markets with competitive pricing. It is essential that regular reporting obligations for these issuers are consistent as far as possible with their home country requirements in order to minimise the additional costs and to set standards which are practical for them to comply with.

We note that the proposal contains a number of provisions which are not appropriate for non-EU issuers because they are subject to their own home rules, and not, for instance, to the EU Company Law directives; for instance, the contents of the annual report in Article 9 and the requirement to submit drafts of amendments to corporate statutes to the "home state" competent authority in Article 14. Third country issuers come to the EU because of cost effective opportunities to raise capital; every additional cost is a deterrent and there are other financial centres, notably the US and Japan, which would be delighted to capture this business. It should be the objective of EU regulation not to impose an extra burden on third country issuers in addition to their home requirements unless there is compelling evidence that it would be in the interests of EU markets overall to do so.

Moreover, the extraterritorial impact and enforceability of any proposed obligations should be carefully considered.

Where third country issuers already file in the US, they will probably already have to prepare two different sets of accounts. If the EU were to impose requirements that made a third set of accounts necessary, many might decide not to access EU markets at all.

One reason that might be cited for imposing additional requirements on third country issuers is that of investor protection. A logical corollary would be to apply exemptions in line with those in the prospectus directive. If securities are targeted at professional investors or privately placed, the type of protection needed is different.

Concept 4 – distinction between debt and equity issuers

The existing directive distinguishes in a number of areas between the requirements for equity and debt securities and issuers of such securities. There are good reasons for this. We believe that continuing such a distinction, where appropriate, is a proper reflection of the differing risks and interests of the investors concerned, and is

necessary for the efficient functioning and continuing competitiveness of the EU markets.
In particular, the Report of the High Level Group of Company Experts on issues related to takeover bids is quoted in the proposal. This Report is explicitly written in the context of EU companies with listed shares, not third country companies or companies with only debt listed. It is not practicable to extend all the recommendations of the Report to these latter companies.

The proposal creates differing financial reporting obligations for issuers with equities (and/or debt securities) admitted to trading in the EU, on the one hand, and issuers with only debt securities admitted to trading in the EU, on the other hand. It is important that appropriate distinctions also be drawn in other areas. Debt securities and equity securities are quite different and regular reporting obligations should be tailored to reflect these differences and ensure that investors and the market receive relevant information. Equally, the proposal should address the situation where an issuer has both debt securities and equity securities admitted to trading in the EU. The requirements of the annual report and half-yearly/second quarter report will need to be modified to ensure that information relevant to both debt and equity is included.

Concepts - Conclusion

At the conceptual level, in order to achieve the optimum balance between investor protection and market efficiency, (1) this directive must correlate with the (proposed) Prospectus Directive and the Market Abuse Directive and (2) the positions of third country issuers, issuers of debt only and issuers of wholesale targeted debt should be analysed separately.

At the practical level, we suggest a number of considerations; that of the holding structure in particular will necessitate detailed reconsideration, perhaps at Level 2.

We are aware that in a number of the points made below we have queried items or made comments without being able to suggest constructive solutions, as we would normally like to do. We believe a further round of consultation, targeted to address these areas of concern, is desirable .We would welcome the opportunity to discuss the application of the proposal to the specifics of the international securities market with the Commission

We set out below detailed comments on the Articles of the proposal.

Comments on Annex 1

Article 1

The definition of "regulated market" currently in the Investment Services directive (ISD) will be extended in the new ISD to cover a wider range of markets. In some of these new markets (which include Jiway, Coredeal and EuroMTS), securities can be traded without the knowledge or consent of the issuer. This is likely to be of concern to issuers, may raise difficult questions of liability, and is likely to be particularly troublesome in the case of third country issuers. It should be made clear in the language of both this proposal and the Prospectus Directive that issuers are not liable in such circumstances.

There should be derogations for issuers whose securities are guaranteed by a third party which complies with the requirements and for structured issues such as asset-backed issues. The detailed application of the proposal to guaranteed issues, particularly where the guarantor comes from a third country, needs careful consideration on a point by point basis if it is to be effective and enforceable.

Article 2

Where terms are defined in existing EU directives or those to be completed in parallel with the proposal, then we believe it would introduce further potential for confusion by replicating definitions here. The better approach is to cross-refer to such definitions directly.

Bullet point 1
The definition of "securities" is yet to be finalised in the Prospectus Directive, as is the categorisation of hybrid securities such as convertibles; in principle the two directives should cover the same ground. See Concept 3.

Bullet point 2
As mentioned above, presumably the definition of "regulated market" will be amended to refer to the new ISD.

Bullet point 4
It is important that the definition of "home Member State" is aligned with the Prospectus Directive. Firstly, it is logical that the competent authority that approves the prospectus is the same one that approves the ongoing disclosure. If companies are subject to the rules of different competent authorities in respect of prospectus disclosure and other disclosure arising out of the issuance of the same securities, their costs of capital will be increased.

Article 3

See below for detailed comments.

Article 4

Is the purpose of the directive to harmonise compulsory disclosure requirements?

We would welcome clarification of this point; there are a number of associated points regarding the level of harmonisation this proposal seeks to achieve.

Article 5

Bullet points 1 and 2
We agree that it is clearly desirable that information should be made available to investors in all locations globally at the same time. We note the explanation that the first bullet point mandates "equal" treatment and the second bullet point "equivalent" disclosure because equal access is not possible with third countries. We agree; however, we also note that there are different time zones and national holidays within the EU, and the potential for systems failure, making identical access likewise impossible there. We therefore suggest that the two bullet points should be brought into line (using "equivalent") so that investors globally receive the best possible treatment.

We understand that the proposal is for the competent authority in an issuer's own home member state to act as a central repository. In this case, the issuer's obligations under Article 5 should be satisfied by filing with that authority.

We note that currently non-EU issuers are only required to provide information under articles 69 and 82, directive 2001/34/EC if it is relevant to shareholders (in the case of equity) or debtholders (in the case of debt). We do not understand why the proposal now seeks to impose upon third country issuers a requirement to disclose information which by definition is irrelevant to equivalent securityholders and which will increase the costs and administrative impact on investors, issuers and competent authorities. We suggest the existing situation is satisfactory. See Concept 3.

Bullet point 3
Information should remain available until it becomes incorrect or misleading. We cannot see any reason to remove it simply because the next annual report has appeared.

Article 6

We would like to see an arrangement whereby the disclosure requirements of particular third countries are recognised as achieving the objective of the directive so that the matter does not have to be considered on an item-by-item basis for each company.

Clear provision for mutual recognition of third country standards of regular reporting is essential. Mandatory IAS accounts, particularly on the timescales provided, will drive non-EU issuers away from the EU markets. We note that the proposed requirements set a significantly higher standard for foreign issuers than is required by the SEC. Foreign issuers registering with the SEC are not required to file US GAAP accounts, but instead may provide reconciliation to US GAAP. They also report according to their home country requirements. We recommend that EU requirements for non-EU equity issuers be based upon IAS reconciliation, with a strong commitment to mutual recognition of individual country's reporting standards, and for non-EU debt issuers, mutual recognition or a statement of significant differences where mutual recognition is not appropriate. We suggest that this would fulfil the goal of "equivalent" disclosure as set out in Article 6.

We also recommend a provision similar to that in Rule 144A in the US which permits issuers whose securities are sold and traded only between professionals to satisfy continuing disclosure obligations by providing their home country information to investors without the need to comply with additional US requirements (Exchange Act Rule 12g3-2(b)). This recommendation ties in with Concept 2; the prospectus directive has an exemption under discussion for sales to professional investors which has already been recognised by the Commission as essential to the eurobond (international debt) market.

Article 7

This language appears to refer to all "States", including third countries. We note that many countries provide for a reduced disclosure regime for foreign sovereign issuers. For example, the Schedule B under the United States Securities Act of 1933 provides for very limited disclosure of the financial condition of foreign sovereign issuers.

Article 8

This is the first question set by the consultation document.

We are aware that other organisations are preparing detailed submissions on the timing of the annual report.

The proposed timing of 3 months for preparation of a final, printed annual report is not realistic. 4 months (perhaps combined with an earlier preliminary announcement at 3 months) is more realistic, although we would need to consult further with the market to decide if even this is practical. Timing is likely to be particularly difficult for non-EU issuers which will be preparing accounts according to their own GAAP and according to their own legal framework (and often in a language different from that of the relevant home member state). Allowance also needs to be made for the practical time required for typesetting, printing and distribution. It is a balance between quality and timing. Any significant developments which will be in the annual report will already have been disclosed to the market in accordance with the requirements of the Market Abuse Directive, so the benefit of the annual report to recipients is mainly one of having information all in one place.

Many (most) issuers now have the same financial year-end (the calendar year-end) and the trend to use the calendar year as the financial year is accelerating. Pressure on resources, both within a company and more broadly, including accountants, printers and others, may be unacceptable. There is a risk that analysts and investors could be overloaded with too many results in a short period, so that benefits to investors are undermined. Moreover, as we have noted already, the "real time" reporting obligations of material developments imposed by the Market Abuse Directive will ensure that investors/the market will already be aware of material information affecting the issuer.

Bullet point 2
As noted above, information should be removed once it becomes inaccurate or misleading for current purposes. Outdated information should be moved to an "archive " section for so long as it may give rise to legal liabilities.

Article 9

The contents of the proposal appear to differ in a number of respects from the recommendations of the High Level Working Group, for reasons which are not clear.

Further, not all of the provisions of this article are applicable to non-EU issuers; for instance, the provisions of the Company Law directives are not relevant to such issuers.

It is proposed that the report drawn up by management to accompany the annual financial statements and quarterly financial reports (see Article 10) must be "drawn up… in accordance with Article 46 of the 4th Company Law Directive… or Article 36 of the 7th Company Law Directive".

Article 46 provides:

> "1. The annual report must include at least a fair review of the development of the company's business and of its position.
> 2. The report shall also give an indication of:
>   a) any important events that have occurred since the end of the financial year;
>   b) the company's likely future development;
>   c) activities in the field of research and development;
>   d) the information concerning acquisitions of own shares prescribed by Article 22 (2) of Directive 77/91/EEC. (4th Company Law Directive 78/660/EEC)"

Article 36 of the 7th Company Law Directive requires similar disclosure for consolidated reports.

In other words, issuers will be required to produce and publish what is in effect a mini-prospectus and not just financial statements, whether or not the issuer intends to offer additional securities to the public or seek to have securities admitted to trading on a regulated market in the EU. Presumably prospectus type civil liability will attach to the annual and quarterly reports.

It is unacceptable to propose such a requirement by means of an obscure cross-reference.

Article 10

Bullet points 1 and 4
The period of two months after each quarter will be very difficult to comply with in August and February (when pressure will be increased by the need to prepare half-yearly and annual reports, respectively). As noted above, material information will already have been provided to the market, as required by the Market Abuse Directive, so this period should be lengthened.

It will not be in the interests of issuers, the markets or investors to require issuers to publish fourth quarter results which will be superseded very shortly by fully audited annual results, particularly if, because of timing requirements, the audited annual report were to be inconsistent with the fourth quarter report. The practical effect of the proposal in these two bullet points is to mandate a 60-day limit for producing the annual report which, for the reasons set out above, is not practicable.

Bullet point 5
The definition of SMEs should be conformed with that in the prospectus directive. See Concept 2.

Article 11

The same issues apply here as to article 10. Where third country issuers do not already produce interim figures, this will be a deterrent to them. In addition, if an issuer has only securities targeted at professional investors, this requirement is disproportionately expensive. See Concepts 2 and 3.

Article 12

Bullet point 1
We find this language difficult to understand, although we are aware it is the same as in the current directive. It is not clear to us what "equal treatment" or "in the same position" means in this context. We would appreciate clarification of the Commission's understanding of this provision.

Bullet point 2
We believe that account should be taken of the effect of the law of the place of incorporation in the case of third country issuers. This law may permit or dictate a certain treatment of shareholders.

Under c), it is not clear to us why the proposal suggests that the definition of "investment firm" is broader than that of "financial institution" which is the current definition.

Article 13

First sentence: The meaning of this sentence is not clear to us. We recognise that it is in the existing directive 2001/34/EC, but its interpretation has always been difficult and we would like to see it clarified. In legal language, the term *pari passu* refers to priority of payment as between classes of debt in the event of insolvency. Each class of debt may contain numerous (perhaps hundreds) of different debt obligations, each of which has different terms and conditions. Exactly equal treatment can only apply within issues of debt, not within classes, and by definition not between classes.

The second sentence appears to refer to methods of early repayment of an issue. We would be happy to discuss in more detail how this can be achieved, but do not understand the reference to “social priorities”, although we realise it is in the current directive. We would appreciate further discussion on this point.

A crucial practical point is that the proposal will be ineffective unless it is adapted to recognise the characteristics of custody and holding in the international debt market. Probably about 90% of international debt issues are held in clearing systems, such as Euroclear and Clearstream. The depositaries for the clearing systems are technically the holders of the debt and their customers receive payment in the clearing systems, and then pass on payment to their own customers. Likewise, the clearing systems pass on voting papers to their own participants but cannot check whether the ultimate beneficial owner is ever contacted.

We suggest that this area should be discussed separately, perhaps at Level 2, in order to produce a system that utilises current market structures to produce the desired outcome.

The European Union should take into account efforts in other arenas as it develops its transparency standards. For example, the G-10 is preparing a set of “collective action clauses” which are intended to be included in the terms and conditions of bond issues by emerging market sovereign issuers. These will include an undertaking by the issuer regularly to provide the bondholders with information about the financial condition of the issuer. It is possible that the members of the G-10, which include several Member States of the EU, will require as a condition of admission to trading on a regulated market that issuers accept such clauses. IPMA, and other trade associations, are actively collaborating with the G-10 Working Group on the drafting of the clauses.

Article 14

We note that this article applies to all issuers including SMEs. It also applies to issuers with only debt securities and to third country issuers. See Concepts 2 and 3 above – it should not apply to issuers with only debt.

The Report of the High Level Working Group recommends that “important” changes in the areas covered in this paragraph should be disclosed. Therefore, there should be a materiality test for information to be disclosed.

Under subparagraph a), we believe it is impracticable to communicate a plan to the competent authority until it becomes a definite proposal. We therefore suggest that the competent authority should be copied with the first communication to shareholders, whether a notice of meeting or the other earliest document required by local law.

With respect to b) and d), we are unclear as to their intended scope. What matters are intended to be covered by these paragraphs which are not covered by a)? It would not be appropriate for decisions by a board of directors (e.g. to appoint a committee to consider the possibility of taking over another company or issuing securities) to have to be disclosed.

With regard to j), such disclosure should only be required where the information is material to the holders of securities admitted to trading on a regulated market, otherwise very large companies would be making announcements in such numbers that investors would be overwhelmed by immaterial information and be unable to focus on material information. Moreover, the existing law contains a right to derogate which should be retained.

Article 15

We welcome the rationalisation of this difficult area. There are still, however, some outstanding questions as recognised in the second main question on the cover of the consultation document.

This language applies to all issuers who have EU listed securities, including third country issuers and issuers who have only debt (not equity) listed in the EU. The explanatory reference, however, is to an article currently applying only to companies incorporated in the EU, with shares listed in the EU. Is this change intentional? Where an issuer has only debt listed in the EU, we suggest that the benefit to debtholders is disproportionately small.

The proposal can be expected to create complications for third country issuers that have a secondary EU listing and which are already subject to similar rules in its jurisdiction of incorporation. A third country recognition process would be preferable here. The US has similar rules and we note that there are a number of US companies with such secondary listings in the EU which would be affected by this proposal.

The proposal does not cover a number of disclosures, for instance, disclosure of directors' dealings and of major transactions (currently required by the UK competent authority), nor does it state whether additional requirements would continue to be possible.

We must point out that the obligations of the first bullet point are imposed on the holder of securities. As explained above, in the case of international debt securities the holder is the clearing system where the securities are held and not the beneficial owner, who is several steps down the custody chain. In the case of shares the technical holder may be any one of a number of parties depending on the interaction between the law of the jurisdiction of incorporation and that of the place of custody. It will be necessary to take this into account so as to impose obligations on the appropriate party and ensure the obligations are within its capacity. For instance, clearing systems may not know of other holdings in a company which its customer has with other custodians.

The wording of the third bullet point would not be of assistance to companies which are part of a non-EU group as they will not be subject to the directive 83/349/EEC.

Finally, the article seeks to impose obligations on investors in third countries which may be unenforceable and/or may create a deterrent for those investors to buy EU securities, even GDRs where the underlying securities are in their own home country.

Article 16

Further work is needed in general on the definition of debt versus equity and on the position of hybrid securities which may affect voting rights, such as convertibles and warrants. The prospectus directive should also be matched.

The same points made under Article 15 as to custodianship, etc, apply here.

Article 18

See 24; a great deal of education will be needed globally.

Article 19

We are aware that the use of newspapers for publications is starting to seem old-fashioned and we sympathise with the wish to use electronic means of information distribution wherever possible. However, the proposed language creates difficulties for investors by creating the possibility of fragmented and/or differing approaches to dissemination. The result is that investors will have to search all three locations and so will find it much more difficult to find what they are looking for, particularly small or retail investors. Issuers might use the most accessible source for good news and the least accessible source for bad news or simply vary the method from time to time.

The use of issuers' websites is a further example of fragmentation. Investors will have to scan the separate websites of each of the companies whose securities they hold and the enormous volume of information they will have to read will in fact leave them less protected, again particularly small or retail investors.

We therefore suggest that a more centralised system, perhaps using the websites of the competent authorities and/or the services of commercial information providers, would be more investor/market friendly and, in fact, more transparent.

Moreover we should point out that the Internet is not 100% reliable and issuers should be protected if it breaks down after they have posted their information.

We have given some thought to the requirements of an appropriate information silo and would be glad to make more specific IT based suggestions separately.

Article 20

The reference here should be to a language customary in the sphere of "international" finance.

Article 21

Subparagraphs a) and b) are impracticably wide.

Subparagraph e) removes the current requirement for the competent authority to be satisfied that there is a problem and substitutes for it a mere suspicion. This is draconian, and in fact it might expose the authority to liability if it turns out that the authority acted without a proper foundation for its suspicion. Also, a distinction should be drawn between the suspension of trading (which is temporary) and delisting (which is permanent).

Finally, the extraterritorial exercise of the powers to be granted to the competent authorities should be considered. Many of the requirements purport to be applicable to persons outside the EU (persons controlling issuers, auditors, and managers in third countries). While it is feasible to design certain sanctions to be applied to such persons and/or their property, we suggest once more that this should be very carefully considered and the benefits of each option weighed up against the difficulty of enforcement and the inevitable negative reaction of non-EU persons to extraterritorial legislation.

Article 24

It is essential that transitional provisions be made. The final language of the directive and its implementation in national law may not be complete until a time closely approaching 31 December 2004. A major educational effort will be needed, particularly in third countries, to ensure that issuers are aware of their responsibilities and can adapt their financial reporting and information systems within the necessary timeframe.

It will be important to avoid market disruption that the directive provides "grandfathering" provisions for issuers of outstanding debt securities who do not issue further securities and do not have equity securities admitted to trading on a regulated market. Such issuers should not be required to comply with the directive unless and until they issue new securities which are admitted to trading on a regulated market. Unless there is such an exemption, such issuers may de-list their outstanding securities, causing problems for EU investors.

5 July 2002