

## **EuropeanIssuers' Comments on CESR's Consultation Paper: Proposal to Extend Major Shareholding Notifications to Instruments of Similar Economic Effect to Holding Shares and Entitlements to Acquire Shares of January 2010**

**Position  
15 April 2010**

### **General Remarks**

EuropeanIssuers welcomes CESR's Proposal to Extend Major Shareholding Notifications to Instruments of Similar Economic Effect to Holding Shares and Entitlement to Acquire Shares. In fact, the proposal is in line with our own position on the Transparency Directive in particular and shareholder disclosure in general. In the past we already called for a study on the merits of mandatory disclosure of the above financial instruments in order to expose hidden ownership.<sup>1</sup>

This issue is of core importance for the governance of companies in Europe: the recent cases which CESR mentions in paragraphs 22 to 27 of the Consultation Paper have shown us that by using such financial instruments and practices an investor can indirectly find a way to increase its stake in a company without having to disclose it to the market. This is not only detrimental to other shareholders but also leaves the issuer in the dark as to who owns the company and has an adverse impact on public confidence in general. This is contrary to the aim of ensuring transparency towards the issuer set forward by recitals 2 and 18 of the Transparency Directive.

### **Q1. Do you agree with CESR's analysis of the issues raised by the use of instruments of similar economic effect to shares and entitlements to acquire shares?**

**Answer:** Yes, we agree with the view that instruments which create a long economic exposure without giving the explicit right to acquire the voting rights may be used to acquire and/or exercise potential influence in a listed company. Therefore, we support CESR's proposal to include instruments of similar economic effect in the regime on major shareholding notifications. As CESR correctly analyses, this would enhance the

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<sup>1</sup> See [http://www.europeanissuers.eu/mdb/position/167\\_TD\\_disclosure\\_regime\\_-\\_EuropeanIssuers\\_letter\\_final\\_081212.pdf](http://www.europeanissuers.eu/mdb/position/167_TD_disclosure_regime_-_EuropeanIssuers_letter_final_081212.pdf)

reliability of major holding notifications, close information asymmetries among market participants and thus would improve the integrity and efficiency of the capital markets.

While improved transparency will be beneficial in general, it might however be difficult to distinguish the cases in which such instruments are used with this purpose from other cases where cash settled derivatives are entered into for purely financial or hedging purposes.

In order to avoid confusion, it should also be ensured that the future notification requirements allow market participants including the issuers to identify the exact composition of reported holdings (conventional long position in the underlying shares vs. other instruments and practices of similar economic effect).

Furthermore we suggest that the threshold for notification should be further harmonised across Europe.

**Q2. Do you agree that the scope of the Transparency Directive needs to be broadened to address these issues?**

**Answer:** Yes. In particular, article 13 of the Transparency Directive does not adequately cover the range of modern financial instruments and practices that do not give direct access to voting rights but have a similar economic effect and thus may be used to acquire voting rights, de facto control over, or influence on the exercise of voting rights.

**Q3. Do you agree that disclosure should be based on a broad definition of financial instruments of similar economic effect to holding shares and entitlements to acquire shares without giving direct access to voting rights?**

**Q4. With regard to the legal definition of the scope, what kind of issues you anticipate arising from either of the two options? Please give examples on transactions or agreements that should in your view be excluded from the first option and/or on instruments that in your view are not adequately caught by the MiFID definition of financial instrument.**

**Answer:** We agree that a broad definition going beyond the MiFID definition and based on the concept of similar economic effect to holding shares and entitlements to acquire shares, is the best solution because of the need to avoid creating potential loopholes. Such definition could usefully include a non-exhaustive list of instruments that are in scope.

We are not in favour of limiting the definition to the MIFID definition of financial instruments because some practices might not be covered: from a purely legal point of view it is uncertain whether repurchase agreements and stock lending would qualify as

a financial instrument in the current regime. Nonetheless, both practices could easily be used to hide the accumulation of voting rights: an investor only has to buy shares without reaching the lowest notification threshold, arrange to lend stock shortly after and repeat this technique several times with different partners. The main purpose of the new regime should be to uncover attempts at building up hidden ownership. For this reason it will be sufficient to include cash-settled positions and other practices (such as securities lending and borrowing, repurchase agreements) that may be or are de facto used to secretly accumulate voting rights in Article 13 of the Transparency Directive.

**Q5. Do you think that the share equivalence should be calculated on a nominal or delta-adjusted basis?**

**Q6. How should the share equivalence be calculated in instruments where the exact number of reference shares is not determined?**

**Answer:** We strongly believe that instruments of similar economic effect to holding shares and entitlements to acquire shares should be aggregated with shares or entitlements to acquire for the calculation of the notification threshold. Additionally, there should be a specific mention of the type of instruments that are used by the holder to build his position.

Thus, we also support CESR's proposal to notify financial instruments on a nominal basis since this is the method already in place in article 13 of the Transparency Directive: by aggregating there would only be one threshold and therefore there should be only one method of calculation in place.

Additionally, the nominal basis would better serve the purposes to uncover hidden ownership and informing the market. Take for example the building up of a cash-settled-call position to prepare for a takeover bid. When the parties enter into the call agreement the delta of the call will regularly be lower than at the expiration date (it might be even zero if the call is out of the money). If such a call were to be notified on a delta-adjusted basis the real economic interest would only be uncovered by the time when the takeover bid is close. Thus, the delta-adjustment would facilitate hidden ownership compared to a nominal notification requirement. Only when calculating the share equivalence on a nominal basis would the full potential voting rights that a financial instrument might procure be disclosed from the beginning.

Finally, a delta-adjusted system is likely to be difficult to handle by investors and issuers: notification duties may arise from price changes of the underlying shares which require holders to constantly monitor such price changes. Most current systems are not designed for this kind of monitoring. Accordingly, substantial additional costs would presumably have to be incurred by the investors in order to ensure compliance.

**Q7. Should there be a general disclosure of these instruments when referenced to shares, or should disclosure be limited to instruments that contractually do not preclude the possibility of giving access to voting rights (the ‘safe harbour’ approach)?**

**Q8. Do you consider there is a need to apply existing TD exemptions to instruments of similar economic effect to holding shares and entitlements to acquire shares?**

**Q9. Do you consider there is need for additional exemptions, such as those mentioned above or others?**

**Answer:** We share the view that a ‘safe harbour’ approach would be unworkable due to the concerns pointed out in the Consultation Paper.

In our opinion, existing Transparency Directive exemptions should apply also to instruments of similar economic effect to holding shares and entitlements to acquire shares. Indeed, although we are aware that some long positions are not built up in order to influence the company’s governance (see our comment under Q1) and could be eligible for an exemption, we think it is very difficult to define specific exemptions for the above mentioned instruments. An alternative to an exemption would be to require the reporting party to disclose any characteristics of the financial instruments and the transaction. This would allow investors to understand the real nature and potential effects of such transaction over the holdings and the governance of the company.

**Q10. Which kinds of costs and benefits do you associate with CESR’s proposed approach?**

**Q11. How high do you expect these costs and benefits to be?**

**Q12. If you have proposed any exemptions or have presented other options, kindly also provide an estimate of the associated costs and benefits.**

**Answer:** Transparency might initially generate costs but that must never be a reason to waive it. The market has given ample evidence that the current scope of disclosure of major shareholdings doesn’t live up to the expectations. The costs that will arise from enlarging the scope of the notification and disclosure regime are already caused by the transparency obligation as such.

For issuers and investors the benefits derived from the efficiency and integrity of the capital markets largely outweigh possible additional compliance costs, which we estimate to be moderate (unless the share equivalence is to be calculated on a delta adjusted basis). Eventually the markets will find it is more costly to operate in non transparent markets.

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