

FIRST REPORT OF ESME ON THE TRANSPARENCY DIRECTIVE ("TD")

5 DECEMBER 2007

The Transparency Directive (TD) seeks to provide a framework for the disclosure of accurate, comprehensive and timely information about security issuers in order to keep the public informed. Many countries are still in the process of implementing the directive: this report analyses some issues that have already been raised by market participants during the first months of application of the directive.

Appendix 1 attached to this paper sets out the issues, recommendations and priorities.

OBJECTIVES OF THE DIRECTIVE

The recitals to the TD include the following objectives:

- the disclosure of accurate, comprehensive and timely information about security issuers [to build] sustained investor confidence and [to allow] an informed assessment of their business performance and assets. This enhances both investor protection and market efficiency; and
- shareholders, or natural or legal entities persons or legal entities holding voting rights or financial instruments that result in an entitlement to acquire existing shares with voting rights should...inform issuers or the competent authority of the acquisition of or other changes in major holdings in companies so the latter are in a position to keep the public informed.

MAIN ISSUES ARISING

The main issues identified by ESME ("the group") at this time are:

- the rules relating to the notification of major shareholdings are complex and often difficult to adhere to in practice for reasons including the nature of the holdings that count towards the disclosure requirement, the thresholds at which holdings are required to be disclosed and the time period in which a shareholder has to make the disclosure and to whom; and
- the understanding and consequences of securities lending varies across the member states.

Looking forwards, the group intends to monitor the application and success of the interim reporting requirements, of the methods of dissemination and storage and of the definition of home member state, possibly in another report next year.

1. ONGOING INFORMATION

1.1 Shareholder notification

The TD requires a shareholder to notify the issuer of the proportion of voting rights held by the shareholder in the share capital of the issuer if, as a result of an acquisition or disposal, the proportion exceeds certain thresholds, starting with a threshold of 5%. The shareholder must report within a maximum of 4 trading days. The issuer, or the competent authority, has to report this information to the public within the following 3 trading days. Appendix 2 is a table showing various EU requirements.

The implementation of these requirements has given rise to a number of issues. The differences in thresholds, mechanics and timing requirements are readily apparent. However, there are also differences in the definition of a “major interest” and when that interest is disclosable.

The nature of the requirements means that they must be complied with exactly. It is not possible to determine the 'highest' standard and use that as a standard for all reporting. To make a disclosure when one is not required could mislead the market and breach regulatory requirements. Also, customer confidentiality obligations will often require firms to comply exactly with the requirements and, in particular, only make a disclosure when required.

One of the reasons for the divergent approaches in different Member States appears to be the lack of a clear recognised reason for the imposition of the disclosure regime. The Commission may wish to examine more closely the approaches of each Member State to the implementation of the TD. Such a review is likely to reveal the divergent approaches in the understanding of the Member States as to what the aim of the directive is.

However, in the group's firm view, the desire to ensure that companies, investors and potential investors are informed of significant changes in the voting structure of an issuer's share capital should be made very clear, and emphasised as the TD's exclusive reason for being.

It is clear that the TD has other acceptable effects, such as providing information to the market as a whole when major holdings are being acquired, preventing market abuse, or even acting as a warning to the management of listed companies when someone is building up a hostile position. However, these effects are secondary and must not condition the shape and scope of the disclosure requirements under the TD. Other directives and mechanisms such as shareholders rights directives / regulations and steps taken under the Corporate Governance Action Plan can assist in promoting these ancillary effects, but should not be considered to form part of the aim of the TD itself.

In order to best achieve of the aim of the TD, the group strongly recommends to the Commission and CESR that harmonisation of timeframes, mechanics and thresholds for notification be pursued. One approach would be to require more stringent requirements on investors in view of the TD being a minimum harmonisation directive. Whilst it is recognised that harmonisation outside the EU is likely to be difficult to achieve, we believe we should strive to harmonise within the EU as a priority.

Recommendations:

- That CESR seeks as a matter of priority to harmonise reporting requirements at the EU level; and
- That as a longer term project the Commission encourage global convergence of reporting requirements.

1.1.1 Timeframe for notification

Timing of reporting of holdings is different across the globe. The tables attached at Appendices 2 and 3 show the different approaches of certain Member States and more globally. A unified approach would be helpful and is greatly encouraged. Differences in reporting requirements lead to extra administration and monitoring costs for investors. This can be very significant for large financial institutions.

When determining what timeframe is most suitable, the fact that many investors are located outside the jurisdiction where the reporting obligation arises should be taken into account. In addition, group holdings are typically aggregated and financial institutions spend significant time and resources putting in place systems to gather the information necessary for them to determine their positions on a consolidated basis. For example it

may be quite difficult for an investor with branches in various jurisdictions globally to prepare its aggregate notification in time for its delivery by T+1 in Sweden, as is required.

The time at which the reporting obligation arises could be clarified. The TD requires the disclosure to be made as soon as possible (Article 12(2)). In practice, financial institutions report on the basis of the 'global' trading day – i.e. all trades recorded on that calendar day. To report during the day or at the end of the day in one jurisdiction whilst trading is continuing at another branch of an institution or investor would cause significant administration and complication. The use of reporting at the end of a trading day appears to the group to be the most relevant for determining when a disclosure obligation arises.

Recommendations:

- That there should be at least three days in which to notify the issuer to enable data to be gathered and verified, so that accurate disclosure can be made; and
- CESR to be asked to clarify that notifications can be made at the end of the global trading (calendar) day.

1.1.2 Mechanics of Notification

Reports of major shareholdings are required to be made to the issuer under Article 9 of the TD. The requirement to report to the public then either lies with the issuer, as in the UK, or is made the obligation of the competent authority under Article 12(7) of the TD, as occurs in Sweden and Italy.

Problems that have arisen in this respect are the identification of who to notify at the issuer, which can lead to lost notifications and delays the public notification, and also who to contact at the investor where notifications are incomplete. If the requirement for publication rested with the competent authority less delay would result. In addition, the use of unique codes for issuers' securities regardless of place of listing and security as well as unique identification for each class of security would assist in the making and tracking of announcements. This is a global as well as a European issue and work towards conforming codes globally is strongly encouraged.

In the longer term, if the notification requirement were to be to notify the competent authority only, which notifies the public and the issuer, there would be significantly less administration for investors and less delay for issuers. Investors would only be required to monitor the contact details for the competent authorities, rather than the many issuers and, as relevant, the competent authorities, and since competent authorities typically retain details of a focal point at an issuer, the correct person at the issuer will always be informed of a notification, avoiding lost and delayed notifications.

The standard reporting form is helpful and we support the work that CESR has done in this regard. We also note that Article 12 (8) requires the Commission to establish a standard form to be used throughout the Community and that the form prepared by CESR is currently subject to a trial period up to 30 June 2008. The group recommends that CESR monitors the use of this form with a view to encouraging its adoption by investors.

In addition, an electronic reporting system, whereby investors can submit reports electronically through an on-line tool based upon the CESR form would be an ideal reporting tool. This sort of approach has already been adopted in some jurisdictions.

In addition, it is often desirable to discuss with a competent authority what disclosures should be made in particular circumstances. In this respect, it would be beneficial if the competent authority to which the disclosure is to be made were also the authority with which a person may discuss and seek clarification of the

rules. CESR should recommend to its members, by a circular distributed as Level 3 guidance, that they do provide proper and prompt guidance to those seeking clarification on the implementation of the TD in this respect.

In the Netherlands and Germany proposals have recently been made by the governments to require holders of major stakes in companies to disclose their intention with regard to that holding. The intention of this proposal, the group understands, is to promote better dialogue with shareholders on long-term strategy to promote sustainable growth and returns. In France, Article 233-7 of the Code de Commerce requires that when equity participation thresholds of one tenth or one fifth of the capital or the voting rights in an issuer are exceeded, the person making the notification of interest is required to declare the objectives that he/she intends to pursue over the coming twelve months. That declaration shall state whether the acquirer is acting alone or in concert, whether he/she intends to make further purchases, whether he intends to acquire control of the company, and whether he / she intends to seek appointment to the board of directors, the executive board or the supervisory board for himself/herself or any other person(s). The declaration is sent to the issuer whose shares have been acquired and to the Financial Markets Authority and published as prescribed in the general regulations of the Financial Markets Authority. Should those intentions change, and this is permissible only in the event of substantial changes in the environment, the financial situation or the shareholder base of the persons concerned, a new declaration must be made and published in the same way.

The group considers however that proposals such as these are overly restrictive to the efficient functioning of the market. Although the group actively encourages transparency in the markets, there is a balance to be achieved between transparency and flexibility for market participants. Further the group does not think that a requirement that holders of shareholdings around the 3/5% level should disclose their intentions is realistic since it is unlikely to achieve meaningful disclosure.

Recommendations:

- That disclosure of major interests to the public to be made by competent authorities;
- In the longer term to require notification to be given to the competent authorities who notify the issuer and the public;
- That CESR monitors the use of the standard form for notification of holdings for the recommended trial period ending on 30 June 2008;
- That an electronic reporting system be favoured;
- CESR should ensure that its members provide proper and prompt guidance to investors on the application and the interpretation of the TD.

1.1.3 Thresholds

There is a variety of opinions of when a major shareholding arises and requires disclosure as is reflected in the implementation of the threshold at which disclosure becomes necessary under the TD in each of the Member States. Some Member States have a threshold of 2% or 3% but most have a threshold of 5%. There is a tendency to lowering the threshold to 3%.

Different thresholds bring additional administrative burdens for investors. These burdens can be significant since every different Member States' requirement needs to be catered for in the investor's reporting system and each Member State's requirements must be monitored for changes. International institutional investors may be discouraged from investing in countries with very low threshold (e.g. Italy which has a threshold of 2%) in the primary as well in the secondary market. Especially, raising capital for SMEs may become more

difficult as institutional investors buy a share in the company during IPOs just below the reporting threshold. Indeed, the threshold in the Netherlands may shortly be lowered. Issuers in Member States that do not have a statutory process for identifying shareholders, as appears in the UK, or that cannot otherwise easily ascertain the identity of their shareholdership in some other way, are supportive of a lowering of the 5% to a 3% threshold.

A uniform threshold would therefore be desirable to both investors and issuers. However a move towards the lowering of the thresholds must be viewed against the consequences that will flow from it. The desire to provide the markets with all potentially relevant information should not result in immaterial disclosures that distract the attention of the market from the disclosures that reveal significant changes in the structure of voting control. More transparency does not necessarily result in more efficient markets while a too low initial disclosure threshold can render the market for corporate control less mobile. Therefore, the group would not support a lowering of the thresholds below 3%.

Proof of ownership is also needed for different corporate purposes. For example, in the Netherlands a 1% interest suffices to put an item on the agenda of a company's Annual General Meeting ("AGM") whereas only shareholding interests above 5% are disclosed. In Germany a limit of 5% (500,000 euro, respectively) is used for disclosure and the right to put an item on the agenda. In Italy disclosure of an investor's interests in an issuer is required before he/she reaches the level of holding that entitles him/her to place an item on the AGM agenda, disclosure is required of an interest in 2% or above of voting capital and an interest of 2.5% or above is required for an item to be accepted for an AGM.

In the group's view, where other mechanisms are available to demonstrate ownership and foster good corporate governance they should also be considered alongside the TD. In the UK, there is a statutory process whereby a company may require a person whom the company knows or has reasonable cause to believe to be interested in its shares and require confirmation of that fact and where he holds his shares. This obligation to disclose extends to past holdings and also interests under agreements to acquire shares. This mechanism therefore assists the company in ascertaining not just who holds the voting rights, but who holds the economic benefit of those shares. We recommend that the Commission considers adopting such a right on an EU-wide basis.

Recommendations:

- A uniform threshold is desirable. The directive sets 5%. Important financial markets are converging to 3%. It is important that the others, with lower or higher threshold, follow as soon as possible.
- That the Commission adopt a right for companies to ask for shareholder identification.

1.1.4 Operational problems associated with reporting of major holdings

Member States that have already implemented this part of the directive experienced a surge in reporting of holdings. However, a major complaint among investors is the cost to investigate and report according to 27 systems cross Europe (and around 60 systems internationally) with differing approaches to what holdings are required to be reported, as well as when.

In general, the calculation method of the threshold itself (proportion of rights) and what should be calculated is overly complex. Some parties (especially management of investment funds) take the view that it is better to double report than not report at all, even with the consequence that at AGMs in some Member States more than 100% of shareholders could be represented. Above that, uncertainty about the calculation provides for interpretation that could be abused by market parties.

Requiring the disclosure of pure economic interests in the capital of the company, including contracts for differences and other cash settled products, is likely to lead to significantly larger number of disclosures, and an increase in complexity of the rules, while potentially obscuring the information that is most material to investors, namely actual control over voting rights. Even extending the disclosure obligation to include options or other rights which, if exercised, could result in the acquisition of voting rights significantly increases the volume of disclosures and leads to reporting of multiple interests in the same shareholding. A netting regime across all Member States so that only those truly holding the voting rights are required to make a disclosure would add to market clarity through the avoidance of excessive disclosures being made and, in particular, avoid the numerous disclosures that can result from stock lending chains, see below.

Even if it is concluded that the disclosure obligations should extend beyond persons holding voting rights, or agreement cannot be reached on the underlying purpose of the requirements, standardisation of disclosure requirements in this area would be of significant benefit.

Guidance or regulatory measures have been published by various regulatory authorities, including the Dutch¹, the United Kingdom² and the Italian³. These sets of guidance or measures have been produced to address the concerns of investors surrounding which holdings they are required to report and when that obligation arises. The issues can be quite technical, and apart from issues of determination it would be advantageous to have a uniform EU approach. The group therefore recommends that CESR considers the guidance published by the regulatory authorities of Member States and publishes one set of EU guidance on such matters. This approach will also assist the EU in dealing with technical developments in the financial markets and ensuring consistency of disclosure.

Recommendation: That CESR produces specific EU recommendations on reporting requirements.

1.2 Securities Lending

Securities lending provides for liquidity in equities, bond and money-markets. Long-short strategies of asset managers increasingly make use of the lending market. It is also used to maximise tax efficiency of dividends in the AGM season (“dividend stripping”). Stock lending also provides for an additional return on the existing investment portfolios at investment firms, insurance companies and pension funds. It is a highly sophisticated business. The premium varies from a couple of basis points to as much as 60 basis points for scarce securities.

Securities lending takes place under many legal contracts such as lending contracts, repurchase agreements, portfolio-lending auctions, etc. When lending a share, an absolute transfer of ownership takes place in most jurisdictions even where the lending party retains the right to withdraw the position when needed, e.g. for the purpose of voting at a shareholders’ meeting. Since securities lending takes place in many different forms, the legal treatment may differ across Member States. In addition, jurisdictions have differing tax treatment of such transactions.

Although the group recommends that the general regulatory environment should continue to support stock lending as a concept for the benefit to the market and the investors that it brings, there are some concerns. In the season of shareholders’ meetings, specific parties may borrow specific securities for the primary purpose of participating and voting at an AGM. In some cases lenders and borrowers may both report major holdings over the same shares and there are occasions when the total number of shareholders that consider that they are eligible to vote at a general meeting would exceed 100% of the total outstanding capital of the issuer. However, in some jurisdictions such exceedings are excluded by law. For example, in Germany, according to national law for owners of bearer shares, the participation in a general meeting is subject to proof by the

¹ http://www.afm.nl/marktpartijen/upl_documents/WFT_voorlichtingsbrochure_aandeelhouders.pdf

² http://www.fsa.gov.uk/pubs/ukla/list_dec06.pdf

³ <http://www.consob.it/mainen/documenti/english/laws/reg11971e.htm>

custodian banks which have to confirm the holding of the shareholder. The record date, as determined by law, is the beginning of the 21st day prior to the general meeting.

1.2.1 Corporate governance issues

Different countries have different time frames for the submission of a resolution to an AGM, which can result in little notice being given to management to collect the data required for a complete and accurate response. Further, a short notice period for an AGM may not allow shareholders who have lent their shares to recall them in time to vote if there is a controversial or sensitive item on the AGM agenda.

A corporate governance requirement that the agenda for an AGM must be circulated to all shareholders within a maximum and minimum time frame prior to the meeting, and a requirement that notice of an item to be placed upon the agenda must be given prior to the meeting or the circulation of the agenda would assist not only in good corporate but in enabling securities lenders to recall their shares to vote. In fact, the TD at Articles 17 & 18 and the shareholders' rights directive already addresses these issues and the group's view is that Member States implement these provisions in the way intended, which is to allow shareholders to fully exercise their corporate rights.

However, any positive obligation to redeem stocks ahead of each general meeting would potentially be disruptive to the market because it may result in the loss of liquidity in a certain stock during the AGM season and breach the freedom of contract among shareholders.

1.2.2 Stock recall for voting

In the group's view, investors should take their own responsibility to recall the stock each time they want to participate in the general meetings of the issuer. In market practice, this situation will not occur for every stock invested in. Many investments are part of non-fundamental, i.e. quantitative, investment strategies and there may be no need to recall those stocks ahead of a general meeting.

Some large investors have started to maintain full voting lists for specified companies as part of their corporate governance policy and socially responsible investment strategies as well as to enhance the equity value of the company involved. More investors wish to explicate their long-term interest in a companies' welfare.

We would advocate the investment industry to take its own responsibility, but at the same time introducing clear monitoring and enforcement of their policies.

1.2.3 Disclosure of lent positions

The lenders are the starting point when considering what, if any, steps need to be taken to clarify the position of who holds the voting rights and the economic benefit where shares are lent. A number of points arise in this context:

- It is not clear at present that the lending of shares is in fact causing a market failure in relation to transparency of who is the economic holder versus the voter;
- There is concern that too much disclosure can be equally misleading making material information less easy to identify;
- There is a risk that placing a disclosure obligation on all stock lenders may affect liquidity in the lending arena;

- Where important strategic choices are at stake, shareholder activists have tried to increase their influence by borrowed positions. In most of these cases however, confusion could be avoided by promoting a continuous strategic dialogue between a company and the parties that have equity capital at risk, which can be dealt with under good corporate governance arrangements, and is also facilitated by providing companies with a mechanism whereby they can call for information from persons that they suspect have an interest in their shares (see 1.1.3 above);
- Some jurisdictions have a concept of disclosure of actual holdings and potential holdings where an investor has recall facilities over shares. This approach could be more fully investigated as a potential for clarification of positions. The ability for investors to net lent/borrowed positions may also be helpful in this respect;
- In respect of the general status of stock lending, the group considers that any exercise in the harmonisation of the status of a lent share will be highly complex and would not necessarily achieve the objectives of the TD. If it is accepted that the aim of the TD is to ascertain voting rights, the requirement should follow whoever holds the right to vote at any given point;
- The group would consider the following to be elements of good practice in the lending market:
 - Exercising the right to vote is an integral and important aspect of good corporate governance;
 - Securities lending agreements should contain provisions informing the relevant parties of the effect of the agreement with regard to the voting rights relating to the lent shares;
 - Where there is a breach of the lending agreement regarding voting lent shares, any conflict between the parties to the lending agreement should not affect the issuer but be contested solely between those parties;
 - The lending agreement should contain provisions informing the relevant parties of the effect of the agreement with regard to the rules of return of the borrowed shares;
 - Lenders should have a transparent policy of when they will recall shares to vote;
 - Lenders should report how they have applied their voting policy in their annual report or by way of some other mechanism during the course of a year;
 - Institutional investors and custodians and other intermediaries should have a transparent policy on stock lending towards the beneficial owners, the issuers and the market;
 - Any potential conflict of interest of both the lender and/or the borrower relating to securities lending practices should be disclosed to the market;
 - Arrangements need to be made by beneficial owners to ensure they receive corporate documents in time to call the shares and exercise their voting rights;
 - Beneficial owners must control whether and when their securities can be lent;
 - Issuers should ensure that, where legally and logistically possible, where a record date is used for the purposes of ascertaining voting rights, dividend record dates are set at a different time to allow the lender to recall the shares for purposes of the AGM but without disturbing any right of the borrower to the dividend; and

- Issuers should ensure that the necessary documentation regarding shareholders meetings are distributed prior to the record date for the meeting to allow recall for voting.

Recommendations:

- The Commission to consider other corporate requirements promoting the ancillary effects of the TD under the Corporate Governance Action Plan;
- CESR/the Commission to monitor whether a more detailed disclosure becomes appropriate depending upon how market practice develops in view of the increase in lending policies and guidance;
- CESR/ the Commission to consider permitting netting of borrowed and lent positions by investors in reporting and consider the disclosure of actual/potential rights.

2. PERIODIC REPORTING

2.1 Financial reporting

Many issuers are not yet subject to the reporting requirements under the TD. The group intends to adopt a watching brief to monitor the quality of reporting over the next 18 months and will report back to the Commission. In particular the group will review:

- Consistency of reporting across Member States; and
- Quality of the information contained in interim statements.

2.2 Dissemination and storage of reports

There is currently no central method of delivery for dissemination of reporting information. Certainly the most efficient approach for issuers and investors alike is to have one pan-EU system for delivery and storage, without the requirement for issuers to deliver reports to more than one information service. The group fully supports CESR working towards the establishment of pan-EU system on this basis. However, in the meantime, if a pan-EU approach is not likely to be available in the short term, the group would encourage CESR to look at a unified reporting approach in each Member State, since the amalgamation of all reporting systems into one-EU wide system is more likely to be achieved if the Member States each have created a national approach along similar principles.

**ESME
5 December 2007**

APPENDIX 1 - ISSUES, RECOMMENDATIONS AND PRIORITIES

Issue	Recommendation	Priority
Reporting generally	➤ That CESR aim to harmonise reporting timeframes, mechanics and thresholds within the EU	High
	➤ That the Commission seek to harmonise timeframes, mechanics and thresholds globally on a longer term basis	High
Timeframe for reporting	➤ That there should be at least three days in which to file with the issuer/competent authority	High
	➤ Notification to be made at the end of the global trading day	High
Mechanics of notification	➤ Competent authorities to notify public rather than the issuer	High
	➤ In the longer term, alter the notification from the issuer to the competent authority, so that investors notify the competent authority who is to inform the issuer and the public	Medium
	➤ That CESR monitors the use of the standard form for notification of holdings for the recommended trial period	Low
	➤ Electronic reporting to be favoured	High
	➤ CESR to ensure that its members provide proper and prompt guidance to on the TD.	High
	➤ Develop unique international issuer and security codes	Low
Thresholds	➤ A uniform threshold set at or above 3%.	High
	➤ That the Commission adopt a right for companies to ask for shareholder identification.	High
Operational problems associated with reporting of major holdings	➤ That CESR produces specific EU recommendations on reporting requirements.	High – and should be achievable in the short term
Securities lending	<ul style="list-style-type: none"> ➤ The Commission to consider other corporate requirements promoting the ancillary effects of the TD under the Corporate Governance Action Plan; ➤ CESR/the Commission to monitor whether a more detailed disclosure becomes appropriate depending upon how market practice develops in view of the increase in lending policies and guidance; ➤ CESR/the Commission to consider permitting netting of borrowed and lent positions by investors in reporting and to consider the disclosure of actual/potential rights. 	Low

Issue	Recommendation	Priority
Corporate Governance	➤ The Commission to consider actions that can be adopted under the Corporate Governance Action Plan to underline better issuer/shareholder relations	

APPENDIX 2 - SELECTED TIMING OF REPORTING OF HOLDINGS

Member State	Holder to notify within	Holder notifies to Company/competent authority	Notification to the public & by whom	Total days
United Kingdom	2 business days for UK issuer/ 4 for non-UK issuer	FSA/company	1 / 3 business days (company)	Up to 7 days
Italy	5 days	Consob /company	3 trading days (CONSOB)	8 days
Sweden	1 trading day	FSA/company	1 trading day; not later than 12.00 CET (competent authority)	2 trading days
France	5 days	AMF/company	3 days	8 days
Germany	4 trading days	BaFin/company	3 trading days (company)	7 days
Finland ⁴	ASAP, but not later than 4 trading days	RATA (FSA) /company	ASAP, but not later than 3 trading days	7 trading days
Denmark ⁵	4 trading days	FSA/company	3 trading days	7 days
Netherlands	Immediately	Financial Market Authority, who notifies the company	1 working day (Financial Market Authority)	2 days
Spain	4 business days	CNMV/company	3 business days (CNMV)	7 days

⁴ No time lines are mentioned in the legislation, except that notification/publication shall be made without undue delay. It may, however, be assumed that the maximum timelines in TOD apply.

⁵ Prior to TOD, the obligation to publish was put on the investor. Thus, the transposition of TOD in Denmark has resulted in an extended maximum time to market in terms of publication.