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EU Consultation:
Harmonisation of the Transparency Requirements of Listed Issuers

This is the response by the Association for Financial Markets in Europe (AFME) to the EU Consultation document on the modernisation of the Directive 2004/109/EC on the harmonisation of transparency requirements. AFME promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76. Our website is located at www.afme.eu.

Introductory Comment

Our members consider that harmonisation and clarity in all key aspects of the Transparency Directive (in reporting thresholds, deadlines and affected instruments) is essential for legal certainty and thus for consistent interpretation and application in all Member States. Harmonisation is also required to minimise the costs and complexity of compliance with transparency requirements throughout the EU as a true single market.

The issue: attractiveness of regulated markets for small listed companies and the Transparency Directive

1. **Impact of the Transparency Directive on the attractiveness of regulated markets for small listed companies. Do the Transparency Directive obligations for issuers (e.g. disclosure of annual and half-yearly financial reports, quarterly information etc.) impact on the decisions of small listed companies to be listed in or to exit regulated markets (e.g. do they act as an entry barrier)? *Please provide evidence supporting your answers.***

   It is clear that the requirements of the Transparency Directive for issuers admitted to trading on the regulated markets do have an impact on the decisions of small listed companies whether to list or not to list. But there are more meaningful considerations which are part of the process e.g. increased investor visibility, potential for increased liquidity, perceived status as a traded company, increased credit standing.

2. **Costs for smaller listed companies. Which are the most important costs for small listed companies associated to compliance with the Transparency Directive (e.g. cost of preparing the accounts, auditing costs, legal costs, cost of making public the information etc.)? *Please support your answer with quantitative data.***

   This is best answered by the smaller companies.

3. **Potential diminution of cost for small listed companies. What changes of the Transparency Directive will bring important reductions in costs for small listed companies? *Please provide evidence in support of your answer (see also questions 7and 8 if you are able to provide more detailed replies).***

   This is best answered by the smaller companies.

4. **The lower visibility of smaller listed companies. How does the visibility problem materialise (e.g. lower attention of analysts, lower investment levels, lower trading etc.) for (objectively) well performing small companies? *Please provide evidence supporting your answer.***

   Objectively well performing small companies do have the basis for increased visibility which must be realised through a company's own outreach, part of which must be regular, reliable disclosure of comprehensive financial information to its shareholders and to the public. Listing aids visibility but its main function is to provide a venue for liquidity to be effected. The fact that any company is performing well is made visible to the market through required disclosure which is defined for all companies by the Transparency Directive in the EU framework.

5. **Other cases reflecting low benefits. Are there, in your view, other cases reflecting low benefits for small listed companies resulting from disclosure obligations compared to larger listed companies?**

   We are not aware of other cases.

Possible options to address in the Transparency Directive the problems related to small listed companies

6. **Definition of a small listed company. What would be the optimal definition of a "small listed company" in the context of regular (i.e. after the admission to trading of the securities) transparency requirements? *Please justify your replies***

   i) **for issuers of shares, those companies with a market capitalisation below a certain threshold such as €100 Million4, €250 Million5 or other *(please specify the threshold)*;**

ii) **for issuers of shares, those companies with a market capitalisation below a certain percentage (e.g. 60%) of the average capitalisation of a company in the regulated market where the company is admitted to trading (*please specify the percentage*);**

iii) **for issuers of shares, those companies with a market capitalisation below a certain percentage (e.g. 60%) of the average capitalisation of a company in the regulated market(s) of the home Member State of the company (*please specify the percentage*);**

iv) **for issuers of debt securities only, those companies having outstanding debt securities below a certain threshold (*please specify the threshold)*;**

v) **for issuers of debt securities only, those companies having a turnover below a certain threshold (*please specify the threshold*);**

vi) **other**

We have no comment.

7. Potential diminution of cost for small listed companies if changes to the Transparency Directive were to be adopted

7.1. If a differentiated regime for small listed companies is added to the Transparency Directive with a view to reduce the compliance costs of those companies, would it be desirable to prevent Member States/regulated markets from imposing in national law/listing rules more stringent or additional obligations on small listed companies?

No comment.

7.2. Do you think that an extension of the deadline for the publication of financial reports would imply a reduction in legal, auditing or other type of costs? Please provide evidence supporting your answers (e.g. how much the cost would be reduced depending on the extension of the deadline)?

No comment.

7.3. Do the various rules requiring the disclosure by listed companies of reports of narrative nature bring significant costs/operation complexity for small listed companies (e.g. legal, account preparation, auditing, other type of costs)? *Please provide evidence in support of your answer*.

We consider that the costs/complexity for small listed companies are proportionate to their size and appropriate.

7.4. **Would you see benefits from integrating in the Transparency Directive the disclosure obligations mentioned in question (8.3) which are currently in different directives?** ***Please explain you reply (e.g. rules would be more clear, the Home Member States rules would clearly apply, etc).***

No comment.

7.5. **If the Transparency Directive provided for maximum harmonisation (no national add-ons) of the content of narrative reports referred to in question (7.3) for small listed companies, would this imply a reduction in legal, auditing or other type of costs?** ***Please provide evidence supporting your answers.***

No comment.

7.6. **In case you think maximum harmonisation regarding the content of narrative reports referred to in question (7.5) is desirable, what do you think would be the best way?** ***Please provide reasons on your reply*****.**

i**)** **non-mandatory ready-to-use templates regarding these narrative disclosures (which could be prepared for instance by CESR/ESMA);**

ii) **more detailed rules in European law, either in the Transparency Directive or in delegated acts adopted by the Commission;**

iii) **a combination of both**

No comment.

7.7. **Concerning question (7.6), could you provide a specific reply regarding the disclosure of environmental and social data requested in Article 46(1)(b) of the Fourth Company Law?**

No comment.

8. Diminution of cost for small listed companies vs. diminution of transparency to the market

8.1. **Is it possible to apply lighter transparency obligations for small listed companies without a corresponding significant diminution of transparency provided to the market?** ***Please provide evidence supporting your answer.***

In general, our members do not favour a different transparency regime for small listed companies, however they may be defined. In our view, reduced transparency will adversely affect the ability of

such companies to attract investment because the investor will perceive greater risk arising from the unknown. Existing holders of these issuers may decide to unwind their investments because of the diminished transparency. There will be a perceived gap in investor protections with respect to the affected companies which will deter some investors.

8.2. If the obligation to disclose quarterly financial information8 was waived for small listed companies, would this result in an unreasonable diminution of transparency? *Please provide evidence supporting your answer.*

If our answer to 8.1 holds true, it follows that relieving the smaller listed issuers from a duty to report quarterly may well result in an unreasonable diminution of transparency.

9. Addressing the lower visibility of smaller listed companies

9.1. Do you think that measures at EU level (including possible changes to the Transparency Directive) can help solving the lower visibility of smaller listed companies?

i) Yes (see next question)

ii) No, it is a structural problem or a market feature (e.g. size matters etc.) which EU measures will not be able to solve (*please explain*).

No. We consider that it is a structural problem. However, the problem is reduced with transparency. To reduce or eliminate the ameliorating transparency factor would exacerbate the structural problem which is that investors perceive smaller companies as riskier.

9.2. What type of measures at EU level could help solving the visibility problem of small listed companies?

i) The Transparency Directive should contain differentiated rules for small listed companies regarding timing and/or methods for the disclosure and dissemination of information (*please explain*);

There may be some advantage to smaller companies in adjusting the time-limits for publicly reporting.

ii) there are rules in other EU directives (e.g. prudential requirements) and/or national law (e.g. tax law) which discourage financial analysts and intermediaries' interests in small listed companies which should be modified (*please explain*)

iii) financial analysts and intermediaries should get incentives to interest themselves in small listed companies (*please explain*);

iv) other (*please explain*).

We consider that smaller companies and their advisers should engage with the investor community and their agents. It is an issuer's responsibility to identify potential sources of investment, and it is the role of the investment community to search for suitable investments. However, we do agree that an EU database with access to all regulated information could facilitate research and create interest in due course. However, this is the subject of a CESR consultation which is ongoing.

9.3. Do you think that the development of an EU database, storing regulated information on all issuers of securities in the EU will facilitate research and create interest/result in greater attention in small listed companies by financial analysts, financial intermediaries and investors? *Please explain*.

Yes. Please see our answer to 9.2

10. Do you have any other views on regular transparency requirements which could make regulated markets more attractive to small listed companies?

In our view regulated markets provide transparency, visibility, and liquidity beyond what is possible for unlisted issuers. However, there may be opportunities for a private provider or for a trade association to establish a facility funded jointly by small companies and users to showcase issuers by sector or by other metrics.

Disclosure of holdings of cash-settled derivatives

11. Would the disclosure of holdings of cash-settled derivatives be beneficial to the market? Please provide evidence supporting your answer (e.g. situations in which lack of disclosure of cash-settled derivatives produced negative results). Please report about your experience, if any, with the disclosure of cash-settled derivatives in the United Kingdom*11* and/or in other jurisdictions where cash-settled derivatives are disclosed (such as in Switzerland).

We believe that any disclosure model should avoid undue complexity to prevent uncertainty in calculations of holdings and thresholds.

As regards our members' experience of the UK model, we note that it has been operational since June 1, 2009. The FSA regime requires aggregation of three categories (along with a break-down by category) i) cash shares, including depository receipts (reported on a nominal basis) ii) physically settled derivatives (also reported on a nominal basis); and iii) cash settled

derivatives (reported on a delta-adjusted basis). The regime includes a full exemption for regulated broker dealers for client-serving transactions in cash-settled derivatives.

-As regards our members' experience with the Swiss requirements, we note that the regime requires reporting of cash settled derivatives but not on a delta-adjusted basis. In our view the resulting disclosures may be materially less meaningful than those made under the equivalent UK regime. This is because options (for example), which are significantly out of the money and which are reported without delta-adjustment, are likely to materially overstate the holders' real interest.

In this context we note that some of our members have expressed the concern with the UK regime that disclosure of cash–settled derivatives and similar instruments has been very costly with few identifiable beneficial results. These members propose that the EU Commission consider undertaking a comprehensive and robust cost benefit survey to objectively measure the real costs of disclosure against identifiable and measurable benefits.

12. If the Transparency Directive was to require holders of cash-settled derivatives to disclose their positions,

12.1. should holdings of cash-settled derivatives be aggregated to holdings of voting rights and/or of financial instruments giving unconditional access to voting rights for the purposes of calculating whether the threshold triggering the disclosure obligation is reached or crossed?

Yes. In the interests of creating a harmonised Pan-European approach, we would agree that the proposed aggregation method would be optimal because it would provide all required information directly to the user. That is, issuers would receive information in a format which facilitates analysis of potential voting power of the disclosing party. This approach is used in the UK.

12.2. and if such disclosure of cash-settled derivatives should be done independently of voting rights and of other financial instruments, which threshold should be applied? E.g.

(i) the thresholds provided in Article 9(1) TD should be applied (5%, 10% etc);

(ii) the lower/initial threshold for this kind of disclosure should be significant and higher than the 5% foreseen in Article 9(1) TD (e.g. at least 10% or higher);

(iii) other).

We note that the initial threshold used in the UK and Germany is 3%, and our members would propose pegging the initial threshold at 3% with subsequent disclosures at 5%, 10% etc. However, we note again that harmonisation of a proportionate transparency regime across the EU is the most important aim to be achieved.

In this context and as noted previously, the UK regime includes a full exemption for regulated broker dealers for client-serving transactions in cash-settled derivatives. We propose that this exemption be included in the pan-EU regime, and we also seek an appropriate transition period for any changes, to enable system enhancements to be made.

Transparency of holdings of voting rights after the record date in advance of the general meeting of shareholders (the question of empty voting)

13. Would the establishment of a specific disclosure mechanism for holders of voting rights who do not hold shares between the record date and the shareholders meeting be useful/effective to prevent empty voting practices?

No. Such a regulation would not be practical or effective. The potential for "empty voting" exists in those Member States where there is a lengthy interval between the record date and the date of the general meeting. Where such interval is brief (for example, as is the effect of the UK Companies Act provisions in this area) the circumstances in which 'empty voting' are possible, are removed. In addition, it is our view that a disclosure model to combat 'empty voting' which is based on economic interests would be ineffective and our members have difficulty identifying which benefits (if any) would flow from such a proposal. Hence, we propose that the Commission consider taking steps to reduce the interval between record date and the date of a meeting. This appears to be a more simple, proven and effective means to prevent "empty voting".

In this context, we draw the Commission's attention to a number of related points:

- The International Securities Lending Association has publicly stated that it is opposed to the borrowing of shares specifically to vote (one form of 'empty voting') and this position is reflected in the Securities Lending and Repo Code of Guidance[1]
- We also understand members have polices against lending for such purposes.
- We note here that the proposal that lenders should be required before a shareholders' vote to recall borrowed shares in order to vote them and to prevent empty voting would be extremely disruptive to orderly markets and settlements. If this suggestion were put into practice, it could cause a flurry of otherwise unnecessary buy-backs and price volatility (effectively

[1] http://www.isla.co.uk/uploadedFiles/Publications/Corporate%20Gov.pdf

a short squeeze of the market) and over time would impact trading strategies and liquidity.

We note that under the UK regime, a loan of securities does not affect the disclosed holdings, which recognizes the lender's right to recall the securities (including for the purpose of voting).

14. If a specific disclosure obligation is imposed regarding the transfer of voting rights independently of the shares between the record date and the general meeting,

14.1. No comment.

14.2. No comment.

Please see our response to Question 13 above. Our members are not supportive of this proposal which they deem to be unnecessary and impractical. Our members are very concerned regarding the material market disruption that is likely to result from such a measure. Aside from adversely impacting market liquidity over time , such a measure would entail complex and costly systems changes by financial entities in order to meet its requirements. Alternatively, they believe the simplest and most effective solution is to amend the laws in those Member States where the law would otherwise allow a long interval between record date, and meeting date.

Intentions with holdings or voting policies disclosure.

15. Which is the best way to make the investment process more transparent (*please justify your answer*):

We do not consider that there is any need to disclose voting policies or other additional information concerning significant holdings. Significant holders may be contacted by issuers for the purpose of exploring common interests during which questions concerning intent may be discussed. The discussion of intent of the holder should be voluntary, and regulated under the takeover directive which would permit a full exploration of the related issues and interests of all involved stakeholders, and particularly ensuring that information relating to a holder's intent isn't inappropriately disclosed/misused for the purposes of market abuse.

16. If investors were required to disclose to the market which their *intentions* are with regard to their investment,

16.1 Would such disclosure be useful?

We believe that a requirement upon investors to disclose their intentions with regard to their investment would not make the investment process more usefully transparent, nor lead to improved performance by companies vis a vis investors. Indeed, we believe it may have the inadvertent effect of making companies less efficient because a board would, if this proposal were to be effected, be on notice of a potential take-over and could act defensively, rather than addressing the inefficiencies which have attracted the investor. As we reference above, we also see potential for such information to be misused in the context of market abuse. In addition, as intentions change, the value of such information would be likely to be questionable.

If such additional disclosure is contemplated, it should be made privately to the issuer alone, and it should not be considered binding to avoid hampering the investors' ability to act immediately, if he deems it necessary.

16.2. which should be the minimum threshold triggering such disclosure? *Please justify your reply*.

In our view, there is no reason for expanded disclosure. We consider that the proposal to require a potential bidder to disclose would be more appropriately considered in a consultation on the takeover regime.

16.3. should such disclosure consist in (*please justify your reply*):

This is a matter for takeover regulations and should be addressed in that context.

Aggregation of holdings and voting rights.

17. Should holdings of shares and voting rights be aggregated with holdings of financial instruments giving unconditional access to voting rights for the purposes of calculating the relevant thresholds that trigger the notification obligation? *Please justify your reply*.

Yes. This is broadly the method of aggregation used in the UK. The method highlights the net aggregated interest held by an investor thereby closely approximating his *potential voting power. In any case, it is most important that the transparency disclosure regime be harmonised in the EU.*

Other cases of insufficient transparency regarding corporate ownership.

18. Are there other cases of potentially insufficient transparency regarding corporate ownership? *Please justify your reply*.

We are not aware of any substantial need for additional transparency in the context of the transparency directive.

Uniform EU Regime or maximum harmonisation: major holdings of voting rights.

19. **Would it be desirable to set up a uniform EU regime (e.g. by a directly applicable EU Regulation) for the notification of major holdings of voting rights?** ***Please justify your reply by describing any legal obstacles (e.g. related to civil or company law) to such uniform EU regime.***

    We are in favor of establishing a common EU scheme with maximum harmonization so that consistent disclosure rules are applied across all Member States, Our members support conduct of the usual comprehensive consultation beforehand to ensure the regime struck is proportionate, reasonable and appropriately calibrated to reflect detailed cost/benefit analysis.. We also are concerned that the EU transparency regime should exempt the takeover context from its structures. As we note above, there are some matters (e.g. disclosure of intent of holders and funding) which are important considerations in the takeover context. In our view, matters which are integral to takeovers should be consulted upon in the context of the takeover directive.

20. **If a fully uniform EU regime is not possible because of insurmountable legal barriers, should Member States be prevented from adopting more stringent requirements than those of the Transparency Directive regarding the notification of major holdings of voting rights?**

    We do not believe such an approach is consistent with the purpose or spirit of the Financial Services Action Plan to establish a single market for financial services. We urge the Commission to continue to work towards full harmonization of implementation of this important Directive.

Uniform EU Regime or maximum harmonisation: disclosure by issuers.

21. **Would it be desirable to set up a uniform EU regime (e.g. by a directly applicable EU Regulation) regarding issuers' disclosures21?** ***Please justify your reply by describing legal/other obstacles to such uniform EU regime***

    We favor a proportionate Pan-European regime for issuers’ disclosures. In our view a new directive with maximum harmonization would permit each competent authority more flexibility to fit the new regime within its own legal context. An EU regulation would perhaps increase the need for primary legislation within individual member sates.

Divergent rules: calculation of holdings.

22. **Could you please explain in what way national rules implementing the Directive result in different methods for aggregating holdings of voting rights (and where applicable financial instruments) for the purposes of calculating whether the relevant thresholds triggering the notification obligation are reached or crossed by investors? *Please justify your reply*.**

Our members have encountered differences among Member States, which results in diverging methods and complicates the use of unique disclosure of interest systems. Some of these differences include:

- Disclosure threshold differences (for example at 2%, 3% and 5% in different Member States);
- Differences in disclosure reporting deadlines;
- Differences in the legal entity level to which disclosure duties apply; some Member States require thresholds to be monitored and disclosed at group and/or entity level. In our view monitoring and disclosure should take place on an aggregated basis on group level in first instance and asset management holdings should be considered independently. Complex regulation or local specific interpretations concerning the attribution of holdings within a group or the disclosure of chain of controlled entities should be avoided because such disclosure notification may "mislead" the issuer/market – a simple disclosure method would be preferable.
- Differences in aggregation requirements: some Member States require aggregation of shares with physically settled derivative instruments; others do not; some require reporting of these products by bucket; others do not.
- Treatment of stock lending;
- Definition of market making and in the method of claiming the exemption;
- Treatment of hedging by a market-maker;
- Treatment of client-facing writers of derivatives, specifically to permit inclusion in the exemption; and
- Treatment of financial instruments e.g. convertibles, securities lending schemes
- Treatment of re-hypothecation of securities by agents, custodians and lenders.

Unclear rules

23. **Could you provide evidence of cases where unclear rules in the Directive ought to be clarified23? *Please explain*.**

The rules treating the appropriate treatment of baskets, ETFs, and hybrids would benefit from clarification.

Any other comments

Do you have any other comments regarding the Transparency Directive?

Our members request that the Commission consider the following changes, desirable for improved transparency as well as for issuer and market participant efficiency:

- An online CESR listing of non-EEA issuers who have chosen an EEA jurisdiction as their Home state would be extremely valuable to our members, would help improve timeliness of compliance with the Directive;
- Harmonized disclosure forms and wording, would overcome the existing divergent approaches among Member States and address inconsistencies in percentage disclosure requirements on percentage of voting rights and/or share capital;
- A consistent interpretation and application of definitions as some EEA Member States apply a wide definition of "market maker," whereas a broad and workable "market maker" definition is preferable.
- A separate use of the market maker and trading book exemptions should be applied.
- A harmonised approach on key issues is essential as regards to whom disclosure must be made; the relevant deadline (T+3, for example); and the method (form of media, language of disclosure etc.)

We thank you for the opportunity of responding to this consultation. If it would be helpful to your efforts we would be available to discuss the issues and our views with you at your convenience.

Very truly yours

William J. Ferrari

Managing Director
The Association for Financial Markets in Europe