The City of London Law Society

The Law Society

Commission proposal for a directive amending the Transparency Directive

Comments of the Law Society of England and Wales
and of the City of London Law Society Company Law Committee

EU Interest Representative Register ID (LSEW): 38020227042-38

Commission proposal for a directive amending the Transparency Directive

Comments of the Law Society of England and Wales and the City of London Law Society Company Law Committee

Introduction

1. This response has been prepared on behalf of the Company Law Committee of the Law Society of England and Wales and the City of London Law Society Company Law Committee.

2. The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee. The committee is made up of senior and specialist corporate lawyers.

3. The City of London Law Society (CLLS) represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees and in this case the response has been prepared by the CLLS Company Law Committee.

4. This response comprises the views of the Joint Committee on the European Commission's proposal for a Directive (the "proposed Directive") to amend the Transparency Directive (EC 2004/109/EC).

5. This response refers to detailed provisions of the FSA's Disclosure and Transparency Rules (DTR), which implement the Transparency Directive and can be accessed from the following link:

   http://fsahandbook.info/FSA/html/handbook/DTR/5

Article 3(1): Integration of securities markets

6. New paragraph 2 of Article 3(1) of the proposed Directive provides that the home Member State may not make a holder of shares, or a natural person or legal entity referred to in Articles 10 or 13 subject to requirements more stringent than those laid down in the proposed Directive, except setting lower notification thresholds than those laid down in Article 9(1).

7. The UK has a well-developed regime for the disclosure of interests in shares and voting rights attached to shares. There are several areas where new paragraph 2 will have an impact on the UK's current transparency regime:

    (a) the UK Takeover Code contains a separate disclosure regime in relation to positions or dealings in relevant securities of the parties to a public offer during an offer period;

    (b) Part 22 of the Companies Act 2006 gives a public company the ability to issue notices to persons to give details of any past or present interests held by them or by any other parties while their interest subsisted during a prior three year period. This section is designed to allow companies to determine the identity of the beneficial owners of its shares; and

    (c) Part 22 also covers rights to subscribe, as does DTR 5. This is not covered by the Transparency Directive, which only deals with interests in issued shares.

8. If Article 3(1) comes into force in its present form, it could be construed to mean that it will no longer be possible for the provisions referred to above to remain in force, as they are more stringent than those in the proposed Directive. The Joint Committee's view is that the provisions referred to above are valued by issuers and market users and we believe that it would important to have confirmation that these provisions could remain in force following the implementation of the proposed Directive.

9. It also follows from new paragraph 2 of Article 3(1) that over-implementation of the Directive in national legislation may no longer be possible. Currently in the UK, over-implementation is not limited to imposing stricter percentage limits (see, for example, paragraph 7(c) above). Furthermore:

    a. in DTR5.2.1R(e), a person is considered to be an indirect holder of shares (for the purposes of the applicable definition of shareholder to the extent that he is entitled to acquire, to dispose of, or to exercise voting rights) where the voting rights are held, or may be exercised, by a person undertaking investment management or by a management company or an undertaking controlled by that person. This is an extension of existing Article 10(e), following the UK's interpretation of existing Article 10's application to this kind of interest (see DTR5.2.2G(2) and (4)); and

    b. a second example relates to the time limits for notifying a major holding to the issuer under DTR 5.8.3 (two trading days for a UK issuer) and for the issuer to make public the notification under DTR 5.8.12 (the next trading day for a UK issuer). These are stricter than the corresponding time limits applying to non-UK issuers (four trading days and three trading days, respectively) which are laid down by the Transparency Directive and incorporated into the DTRs in relation to non-UK issuers.

The Joint Committee considers that it will be important to have confirmation that provisions which over-implement the Directive will be permitted following implementation of the proposed Directive.

Article 4: Annual Financial Reports

10. Pursuant to Articles 4(7) and 5(7) of the proposed Directive, ESMA is to issue guidelines, including standard forms or templates, to specify information to be included in the management report and in the interim management report. It is worth noting that the UK Department for Business Innovation & Skills ("BIS") conducted a consultation in September 2011 (which closed on 25 November 2011) on the future of narrative reporting, with a view to simplifying narrative reporting for quoted companies and removing duplication in the required disclosures. BIS is also working with the FSA to determine whether disclosures required under company law, the International Financial Reporting Standards, the Listing Rules and the Disclosure and Transparency Rules are consistent. It is proposed that new rules will come into force for financial years beginning on or after 1 October 2012.

Article 9 and 13: Information about major holdings

11. As regards the proposed underwriting amendment to Article 9, giving ESMA the power to develop Level 2 measures could give rise to a danger of divergence between the Transparency Directive and the Acquisitions Directive 2007/44/EC, which amends various sectoral directives. The relevant exemptions need to be consistent. The Law Society intends to comment in more detail on the underwriting exemption in its response to the Commission on its proposal for a directive to amend the Acquisitions Directive.

12. Article 13(1) of the proposed Directive sets out new notification requirements in relation to financial instruments (as defined in paragraph (1)(a) and (1)(b) of Article 13(1)). It is, however, not clear from the proposed Directive when the new obligations to report will arise. Transitional provisions should set out whether notifications should be made either on the date on which the proposed Directive comes into force for interests which fall within the disclosable thresholds *on* that date or only once the relevant thresholds are reached *after* the Directive comes into force. The Joint Committee's view is that a requirement to notify should only arise once a holder's proportion of voting rights exceeds or falls below the relevant thresholds in Article 9(1) at any time after the Directive comes into force.

13. Article 13(1)(b) represents a major change in the philosophy of these provisions, which are concerned with control over voting rights. It moves away from any concept of a right to physical possession and therefore from any rights over voting rights. If a purely economic interest is coupled with some level of control over the voting rights, it is surely likely that one of the paragraphs in existing Article 10 will be engaged.

14. If this philosophical change is accepted and a provision along the lines of Article 13(1)(b) is to be included, it needs to avoid the vagueness of the current proposal, which is likely to result in different interpretations among Member States and difficult interpretational points. DTR5 sets out the provisions regarding notification of voting rights arising from the holding of certain financial instruments which apply in the UK. Whilst Article 13 appears to be based on DTR5.3, Article 13 omits a number of important exclusions and some formal FSA guidance, which market participants regard as helpful in practice.

Therefore, further clarification is needed in the drafting of Article 13 (rather than being left to Level 2 measures that cannot limit the scope of Article 13 unless it envisages this), as otherwise there is a risk that these uncertainties may not be resolved.

15. A possible alternative is to use an approach more like that in the UK Takeover Code, but drafted to fit in with proposed Article 13. For example, this might say:

> *"(b) a financial instrument whose value in whole or in part is determined directly or indirectly by reference to the price of shares to which voting rights are attached, already issued, of an issuer whose shares are admitted to trading on a regulated market and which results, or may result, in the holder of the relevant financial instrument having a long position in them.*"

Index transactions should also be excluded from this definition to avoid broker-dealers having to follow a *reductio ad absurdum* approach to calculating their interests.

16. The Takeover Panel and DTR 5.8.11R also allow certain types of netting (for example, intra-day netting) and it would be helpful to have greater harmonisation between Member States' regimes as regards netting. There would also need to be a provision specifying when interests may be netted (for example, at any point in a day up to midnight (see the wording in Article 9(2) of the European Parliament's proposal for a regulation on Short Selling)).

17. Further, both DTR5.3 and the UK Takeover Code include exemptions from public disclosure for (broadly) client-serving intermediaries. Provisions of this kind will also be needed in, or under, the Transparency Directive.

18. Clarification is sought as to whether notifications should be required to distinguish between interests which fall within Article 13(1)(a) and Article 13(1)(b), as this could result in additional administrative burdens for persons who are required to make notifications.

19. Article 13(4) should be amended to include a reference to article 23(6), which applies the aggregation exemptions to third country undertakings.

20. The Joint Committee notes that ESMA will draft regulatory technical standards only in relation to Articles 9(4), 9(6) and 13(1)(a) and 13(4) of the Directive. There are still large discrepancies as to how the Transparency Directive is implemented in each EU Member State (for example in relation to aggregation by group companies and stock lending (see paragraph (c) below)). If a maximum harmonisation regime is to apply to the rules relating to information about major holdings, certain other provisions in the Transparency Directive will need to be clarified. For example:

    (a) It is not clear what circumstances may trigger a disclosure pursuant to Article 9(2) of the Transparency Directive "as a result of events changing the breakdown of voting rights". The FSA in the UK has clarified that where there is a notifiable switch (for example, 1% for UK issuers) from a soft shareholding to an absolute shareholding by the exercise of entitlements to acquire shares, without affecting the overall percentage of the holding, a new disclosure would be required (see DTR 5.1.2(R)(2)).

    It could also be clarified that this particular provision does not necessitate a disclosure where a person has disclosed its holding of voting rights but then it subsequently changes the capacity in which it holds them. For example,

where a person has disclosed its indirect holding of shares as a beneficiary (and these shares are held by a non-discretionary nominee), the person would not be required to disclose a change if it then takes those shares out of the nominee account and holds the shares directly itself.

(b) There is divergence across Member States as to whether (i) it is mandatory for a parent company to make an aggregated disclosure of both its own shareholding and those of its controlled undertakings, and (ii) if the parent does so, the controlled undertakings are exempt from making their own individual applicable disclosures. Article 12(3) of the Transparency Directive appears to state that parent aggregation is permissive as opposed to mandatory, which may explain the divergence in approaches.

(c) There is divergence across Member States on the application of the provisions in Articles 12(4) and 12(5), which are applied to third country entities by article 23(6). For example, one Member State takes the view that unless the immediate parent undertaking of the manager is able to disaggregate, no parent undertaking above that immediate parent in the ownership will be able to disaggregate either. Members of the Joint Committee have also come across other regulators which either do not allow disaggregation in relation to third country investment managers or impose additional requirements.

(d) There is a wide divergence as to how regulators of Member States apply Article 10(b) of the Transparency Directive on the disclosure obligations of each of the stock lender and stock borrower in a stock lending transaction which involves an outright transfer of ownership of the loaned shares with the stock lender having a right of recall. In the UK, the stock lender, because it has a right of recall, is exempt from disclosing a disposal (see DTR 5.1.1R(5)).

(e) The denominator to be used for calculating the thresholds can give rise to anomalies in the context of a large issue of shares (see Article 15 of the Transparency Directive and DTR5.6, which sets out when issuers should make disclosures). This needs to be harmonised across Member States and requires an amendment to Article 15 (which is cross-referred to in Article 9(2)).

(f) There may also need to be a uniform approach in relation to:

(i) rounding up or rounding down (in the UK the latter applies);

(ii) disclosures by investment managers. Where a client has an investment manager, the FSA takes the view that only the investment manager needs to disclose because it currently controls the voting rights. In some Member States, the investment manager and its client need to disclose; and

(iii) when acquisitions or disposals of shares are regarded as effective. DTR5.1.1R(4) provides that "*an acquisition or disposal of shares is to be regarded as effective when the relevant transaction is executed unless the transaction provides for settlement to be subject to*

conditions which are beyond the control of the parties in which case the acquisition or disposal is to be regarded as effective on the settlement or the transaction."

Guidance

21. When the DTR5 came into force in the UK, the FSA issued detailed guidance for market participants, which can be accessed here:

    http://www.fsa.gov.uk/pubs/ukla/list14_apr07.pdf

22. If a maximum harmonisation regime is to operate effectively, guidance of this type will be helpful in assisting the Commission to ensure that there is no ambiguity in any of the matters the Directive covers.

For further information, please contact:

Catherine Howdle

Internal Market EU Policy Advisor
The Joint Brussels Office of the Law Societies
85 Avenue des Nerviens, Box 10
B-1040 Brussels, Belgium
Tel (+32-2) 743 85 85
Fax (+32-2) 743 85 86
http://www.lawsociety.org.uk

