The City of London Law Society

The Law Society

Response to the consultation paper on draft regulatory technical standards on major shareholdings and indicative list of financial instruments subject to notification requirements under the revised Transparency Directive

Introduction

The comments set out in this paper have been prepared jointly by the Listing Rules Joint Working Party of the Company Law Committees of the Law Society of England and Wales and the City of London Law Society.

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 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.

The Listing Rules Joint Working Party is made up of senior and specialist corporate lawyers from both the Law Society and the CLLS who have a particular focus on the Listing Rules and the UK Listing Regime.

We set out below our response to the consultation paper on draft regulatory technical standards on major shareholdings and indicative list of financial instruments subject to notification requirements under the revised Transparency Directive (the "**Consultation Paper**").

Draft Regulatory Technical Standards, Annex V – Indicative list of financial instruments

We have the following comments in relation to Question 21 in the Consultation Paper, and the draft indicative list of financial instruments that are subject to the notification requirements as set out in Annex V of the draft regulation.

Shareholders' agreements

We note that any financial instruments which are subject to conditions could be captured by paragraph 3 of Annex V of the draft regulation. For example, in paragraph 3 (j) of Annex V, ESMA considers that *'shareholders' agreements having any of the above mentioned financial instruments as an underlying'* would constitute financial instruments if they satisfy the conditions set out in points (a) or (b) of the first paragraph of Article 13(1) of the Transparency Directive and, consequently, would be subject to the notification requirements set out in the revised Directive. We do not think that it is clear what "having any of the above mentioned financial instruments as an underlying" means. Does this mean that the shareholders' agreement would have to give one of the parties to it the unconditional right to acquire one of these other financial instruments or is the reference to "an underlying" meant to convey some other meaning? It would be helpful if ESMA could clarify what is intended here.

Financial instruments with similar economic effects

Additionally, we should be grateful if ESMA would provide some guidance on the extent to which financial instruments which are subject to conditions (and therefore do not satisfy Article 13(1)(a)) can be caught by Article 13(1)(b).

In the UK, there is an accepted position that agreements and other financial instruments do not have 'similar economic effects' if they confer on the instrument holder or contracting party a conditional entitlement to acquire shares which is subject to conditions outside the control of the

parties. For example, an underwriter's or sub-underwriter's obligation to acquire shares under an underwriting agreement or a sub-underwriting commitment is subject to such conditions. The UK Disclosure and Transparency Rules provide in DTR 5.1.1(4) 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 of the transaction.'* The Financial Services Authority (FSA) (the predecessor to the Financial Conduct Authority, the UK's competent authority) has confirmed previously that this provision applies to financial instruments with similar economic effects. Accordingly, if such an instrument is subject to conditions outside the control of the parties, then the holder becomes subject to notification obligations when those conditions have been satisfied. For example, when entering into an underwriting agreement, the underwriter does not know how many shares will be taken up pursuant to the offer and its obligations to subscribe will be subject to certain conditions (including the level of subscription by shareholders and it not being practicable to place any shares not taken up in the market at above the issue price), which are beyond the control of any of the parties – but are subject to external market conditions.

The FSA has previously confirmed that it does not consider that 'conventional' underwriting or sub-underwriting contracts in relation to a primary markets rights issue would constitute a 'financial instrument' under MiFiD and that any long position in the economic performance of shares held by a lead or sub-underwriter pursuant to its obligations under the underwriting contracts would not be disclosable under the DTRs.

In our view, an instrument can only be said to have '*similar economic effects*' to an instrument covered by Article 13(1)(a) if it provides the holder with a similarly unconditional or discretionary right to acquire. The holder of an instrument which is subject to conditions beyond their control is not able to control whether they will benefit from upward price movements or suffer losses from downward price movements (as described in paragraph 178 of the Consultation Paper).

The Consultation Paper suggests that ESMA would share our view. Paragraph 195 notes that the requirement to notify '*conditional contracts or agreements*' will depend '*on whether the acquisition of shares can or cannot be prevented by the counterparty, a third person or an event, on which occurrence the holder of the financial instruments either has or does not have an influence*'. Paragraph 194 indicates that ESMA considers that holdings of 'conditional contracts and agreements' must only be notified where the condition '*is either a declaration of one of the parties or reaching a certain date*'.

Consequently, we would expect that the same approach would be taken by ESMA as in the UK in relation to agreements and other financial instruments containing conditional obligations which are beyond the control of the parties and we would expect that these agreements would not be caught by either Article 13(1)(a) or 13(1)(b). We would be grateful if ESMA would clarify its position on this point by either amending paragraph 3 of Annex V or providing further guidance on this point.

Existing shares

We agree with ESMA's statement in paragraph 177 of the Consultation Paper that '*the revised TD's major shareholding disclosure regime still remains limited to instruments referenced to shares… [which are] already issued*.' This is an important point and has been the subject of some debate in the UK. Paragraph 3 (a) of Annex V notes that ESMA considers that convertible and exchangeable bonds may only be subject to Article 13(1)(a) or (b) if they refer 'to already issued shares'. However, we suggest that similar wording be added to the other provisions in paragraph 3. For example, paragraph 3 should only include warrants relating to already issued shares (paragraph 3 (b)), conditional contracts or agreements relating to already issued shares

(paragraph 3 (g)), hybrid financial instruments relating to already issued shares (paragraph 3 (h)), and so on.

General

We have one other comment on the text of the draft regulation.

Chapter II, Articles 2 and 3

We note that in Chapter II (Articles 2 and 3) of the draft regulation, reference is made to the '*calculation of the 5% threshold*' provided for in Article 9(5) and (6) of the Transparency Directive. However, we consider that perhaps it would be more accurate to refer to the '*method of calculation of voting rights to ascertain whether the 5% threshold is met*', given that the calculation referred to relates to ascertaining whether the number of voting rights exceeds the 5% threshold, rather than calculating the 5% threshold.

We have no comments on the remaining proposals set out in the draft regulatory technical standards.

If you have any queries or would like to discuss any aspect of this response, please contact Richard Ufland.

30 May 2014