ABI Associazione Bancaria Italiana

ABI response to the CESR proposal to extend major shareholding notifications to instruments of similar economic effect to holding shares and entitlements to acquire shares

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Introduction

The Italian Banking Association (ABI) is grateful to CESR for the opportunity to participate in the consultation on the proposal to extend major shareholding notifications to financial instruments that can be used to create a similar economic effect to holding shares and entitlements to acquire the shares of companies admitted to trading on regulated markets.

ABI believes that this topic is extremely important and delicate to the system and more generally considers major shareholdings notification crucial to guarantee the integrity and correct functioning of the capital market.

Although, as will be illustrated in more detail below, we do not agree with the analysis presented by CESR that forms the basis of the proposal in question, we intend, in any event, to provide answers to the specific questions contained in the CESR document.

Questions and answers:

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?

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

The analysis that is conducted in the consultation document places particular emphasis on the idea that financial instruments of similar economic effect to holding shares and entitlements to acquire shares ("long economic exposure") can be used to acquire or exercise a potential influence on listed issuers.

ABI believes that such financial instruments physiologically respond to hedging and risk management or investment requirements rather than participation in the management of the company through the exercise of the voting rights associated to said instruments. Any use of said instruments for purposes other than their own (hedging and/or investment), indirectly avoiding Transparency regulations, is to be considered pathological and circumscribed.

However, this interpretation is substantiated by evidence, reported by CESR in the consultative document, that the use of derivative contracts for the purpose of avoiding regulations on ownership transparency has been encountered in a limited number of cases in Europe.

In this perspective, following the rule of proportionality of regulation, we do not believe that extending the legal scope of the Transparency Directive to financial instruments that are not included in the types identified by art. 11 of level two Directive 2007/14/EC is justified.

Instead, we believe, also given the exiguity of the phenomenon, it would be more efficient to adopt measures that aim to keep the phenomenon in check by strengthening supervisory activities, to identify and sanction the borderline cases in which the use of financial instruments of similar economic effect to holding shares and entitlements to acquire shares represents a form of evasion of shareholding disclosure obligations. As well as not pointlessly burdening the parties, the application of targeted sanctions has the advantage of being an effective deterrent against undesirable conduct.

Q3. Do you agree that disclosure should be based on a broad definition of 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 (paragraphs 50-52 above), 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.

Without prejudice to the above, the identification of the instruments potentially subject to the new regulation is without doubt a critical aspect. Basing oneself on a broad and general definition, rather than on an exhaustive list of instruments, although, as CESR states, avoiding the risk of the regulation being evaded through the creation of new instruments not included on the list, could give rise to interpretative uncertainties.

In line with the above explanation and to guarantee better interpretative certainty, it would be better if the definition of financial instruments for the purpose of the proposal in consultation was limited to the definition envisaged by MiFID.

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?

We believe that the entity of the share equivalence should be calculated based on the nominal value of the underlying security and not be calculated on a *delta-adjusted* basis. While the latter criteria is able to represent the real amount of the potential shareholding, on the other hand, it requires daily monitoring and adjustment to align the value of the option to the price of the underlying instrument. and therefore the preparation of calculation models and procedures to set in place said activities.

In fact, using a mechanism of this nature, the entity of the potential shareholding changes as the daily price of the underlying instrument changes, even in the absence of a real variation of the position, incurring, in any event, costs to implement the calculation mode and the procedures needed to perform monitoring and adjustment activities.

It should also be taken into account that the obligation of major ownership notification falls on any subject that holds a share equivalence. While financial brokers are equipped, for the investment activities that they perform as their primary business, with procedures and systems to evaluate the delta coefficient of the options held, the other categories of investors would presumably have to sustain costs to perform said activities.

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?

As regards the transparency regime to be implemented, on one hand,, we recognise the potential benefit of introducing a selective regime (so-called *safe harbour*) that permits the extension of disclosure obligations only to financial instruments that do not contractually preclude the possibility for the holder of the instrument to have access, more or less directly, to voting rights.

On the other hand, this provision - burdensome for the system insofar as it entails material checks of the clauses of the individual contracts – as also acknowledged by CESR, does not permit final certainties insofar as it is not possible to exclude *a priori* that the contractual provisions regarding the instrument are not then renegotiated by the parties.

Without prejudice to our opening remarks, if CESR intends to proceed with the regulatory initiative illustrated, we agree with the idea of also extending the exemptions envisaged by the Transparency Directive represented by the *market maker exemption* and the *trading book exemption* to financial instruments of similar economic effect to holding shares and entitlements to acquire shares; in this way at least parties that act as providers if liquidity to the market and all of those parties that hold trading assets that are not characterised by strategic worth would be dispensed from the disclosure obligations.

In order to extend the scope of application of the exemption envisaged for market makers, it is, however, possible to act on two fronts:

i) also include market making activities performed outside of the market and in the absence of an assignment;

ii) extend the exemption thresholds not only to positions relating to financial instruments for which market making activities are performed, but also to hedging positions undertaken both directly on the underlying instrument and on other derivative instruments.

We also propose to envisage an extension of the regime of exemptions for brokers that hold long positions in cash derivatives to hedge symmetrical short positions assumed towards customers, identical to the latter in terms of quantity, timing and reference prices.

Lastly, we believe that the possibility of exempting shares that are held indirectly through derivatives on baskets of shares from disclosure should be considered. Understanding the problems linked with their potential use as an instrument to evade transparency obligations - for example the creation of *ad hoc* particularly concentrated baskets - we suggest envisaging, as a condition to their exemption, the presence of a minimum level of diversification (measured by the number of securities) as well as a balanced level of concentration (measured by the proportion of the basket invested in the same security).

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.

The greatest criticism of the proposal is mainly related to the profile of the proportionality of the intervention, which translates into an increase in the costs of all market participants against limited benefits for the market itself, particularly given the exiguity of cases in which the financial instruments in question have actually been used for the purpose of evading ownership transparency regulations.

More specifically, with regard to the main cost components that should be considered in order to assess the impact of the CESR proposal - although the entity of the same varies considerably depending on the different regulatory options chosen – we retain that they regard:

1. Costs related to changing the IT procedures required to manage information (provision of software or its creation in-house, adjustment of databases). These are prevalently one-off costs, although naturally we should also consider the annual cost of running and managing the procedures in question.

2. Costs related to exploration of legal and compliance issues as regards the new regulation.

3. Costs related to fulfil disclosure requirements.

4. Costs related to monitoring the positions in order to check the exceeding of the threshold. This cost varies considerably with relation to the thresholds identified and to the consequent amount of disclosures to be made, and is also dependent on the clarity and simplicity of the rules introduced.