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Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.
The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

Response to CESR's Consultation Paper on the proposal to extend major shareholding notifications to instruments of similar economic effect to holding shares and entitlements to acquire shares

Key Points

- The EBF agrees with CESR that the secret building of voting rights in a company must not be tolerated; and that there is a need for an EU-harmonised approach to the Transparency Directive's disclosure requirements.

- Many EBF members are however concerned that the solution proposed by CESR would not be the most efficient way of addressing the identified concerns. The EBF therefore makes a number of proposals that could alleviate the burden of the proposed rules.

- In particular, it should be considered to require the notification of instruments of similar economic effect to holding shares ("SEE instruments") in separation from the notification of straight shareholdings, and to require such notifications only for significant holdings of SEE instruments. This solution was proposed by the European Securities Markets Expert Group in its report to the European Commission of November 2009.

- The EBF also suggests that in the case of breaches with the rules, sanctions take the form of the loss of voting rights, instead of fines.

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Related documents: CESR consultation document: http://www.cesr-eu.org/popup2.php?id=6481

General remarks

European banks share the objective that is underlying CESR's proposal of extending the Transparency Directive's notification requirements to instruments of similar economic effect to holding shares and entitlements to acquire shares ("SEE instruments"): the secret building of voting rights in a company must not be tolerated.

However, many EBF members are not convinced that CESR's proposal on how to address such concerns is the most efficient way of achieving the intended outcome. Instead, many EBF members are concerned that the costs implied by such an extension might not be proportionate.

The EBF would therefore urge CESR to consider possibilities to alleviate the difficulties implied by its proposal. This is especially with regard to the need for legal certainty and the instruments covered by the proposal; with regard to the disclosure thresholds; and with regard to the exemptions.

One such possibility could be to require the notification of holdings of SEE instruments in separation from direct holdings, as was proposed by the European Securities Markets Expert Group (ESME) in its November 2009 report on transparency of holdings of cash settled derivatives[1], and as implemented in France in November 2009. ESME's suggestion was limited to significant positions (meaning at least 5-10%) in cash settled derivatives. The EBF would strongly encourage its thorough consideration by CESR.

In addition, the EBF believes that helpful alleviation of the proposed requirements could be achieved through the sanctions that would be imposed on position-holders in case of breaches with the rules (notably in the case of "concerted action"). Specifically, such sanctions could take the form of the loss of the voting rights for the shares that have been acquired through the indirect building up of stakes. As an alternative to imposing fines, this approach would have the consequence of primarily punishing those investors that built up the stake with the intention of acquiring influence. Investors who did not intend to acquire influence over the company, on the other hand, would be little concerned by the loss of voting rights.

Finally, the EBF crucially agrees that the approach in applying the Transparency Directive's disclosure requirements to SEE instruments must be harmonised across the EU. The diversity of regimes that is currently in place throughout Europe is difficult and costly for firms to manage, and lacks clarity for investors and other concerned parties.

The Federation is however sceptical that full harmonisation could be achieved through CESR. Instead, it believes that hard legislative solutions at EU level should be considered. However, this should go along with additional research and the consideration of available alternatives in achieving the intended objectives.

[1] Cf. http://ec.europa.eu/internal_market/securities/docs/esme/tdcash_en.pdf

Responses to CESR's specific questions

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?

CESR is right to state that some SEE instruments have in a limited number of cases been used to quietly build up stakes in companies. Such use must not be tolerated, and the EBF supports CESR's efforts to thoroughly assess possible means to prevent the undermining of the Transparency Directive's disclosure obligations.

On the specific situations described by CESR, the EBF would nonetheless note that the shares which writers of SEE instruments acquire as a hedge are typically held in the trading book, meaning that the holders are normally not allowed to exercise the voting rights attached to these shares. On the other hand, it is true that the buyer of SEE instruments has an information advantage over the rest of the market concerning the free float, as he can assume the volume of the shares held by the writer of the instruments.

Nevertheless, the EBF would underline that the instruments under CESR's consideration normally serve entirely different purposes. They are acquired for risk management purposes, by investors wishing to hedge their existing exposures or having to comply with certain investment requirements. These investors do not have an interest to participate in the management of the company and do not intend to exercise the voting rights associated with these instruments.

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

Many EBF members are concerned that the costs which CESR's proposed solution would impose on the industry might not be proportionate to address the identified shortcomings.

If CESR comes to the conclusion that the scope of the Transparency Directive should be extended in the way proposed, this might be done by way of separate disclosure requirements, as recommended by ESME; meaning that holdings of SEE instruments should be notified in separation from straight-forward shareholdings, and only for significant positions in these instruments. Such an approach might in general be more meaningful, considering that – as noted above – SEE instruments are normally held with entirely different purposes than that of building up influence in companies.

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?

If the scope for the disclosure obligations is to be broadened, EBF members agree in principle that it makes sense to cover a wide range of different instruments, including instruments referenced to already issued shares. On the other hand, significant concerns would arise if the range of covered instruments was not spelt out in an exhaustive way. The resulting legal uncertainty could lead to very burdensome consequences for banks; in particular with regard to the sanctions that would be imposed further to failures to report instruments which supervisors would *a posteriori* consider to be within the scope of the requirement.

As a practical alleviating measure, the EBF would therefore propose that any possible legislative initiative foresee a combination of Level 1 and Level 2 measures, with the latter including an exhaustive list of covered instruments.

In that process, it should furthermore be ensured that the industry be given the opportunity to comment on possible instruments to be included at Level 2. For example, the EBF does not believe that put options would rightly be included in the scope of an extended reporting requirement under the Transparency Directive: put options do not constitute a right for the writer, but rather an obligation to acquire the underlying share. Further difficulties would arise in terms of accounting, were CESR to require the reporting of long positions for holdings that are in effect short positions.

Similarly, in the view of the EBF baskets are not suitable to build up stakes in a company and should therefore not be covered by extended disclosure requirements. If CESR nevertheless comes to the conclusion that baskets ought to be included in the scope of the Directive, the Committee should consider the possibility to establish an exemption for baskets with a minimum level of diversification (measured by the number of securities) and/ or with a maximum level of concentration (measured by the proportion of the basket invested in the same security).

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.

In order to provide the greatest possible degree of legal certainty, the EBF would have a preference for the second option, i.e. to limit the legal definition of financial instruments to those instruments covered by MiFID.

Q5. Do you think that the share equivalence should be calculated on a nominal or delta-adjusted basis?

Both possibilities have advantages and disadvantages.

Calculation on a delta-adjusted basis is better suited to represent the real amount of the potential shareholding. On the other hand, it is much more difficult to measure and to administer, as it requires daily monitoring and adjustment to align the value of the option to the price of the underlying instrument. In fact, the amount of the potential shareholding changes with price changes in the underlying instrument. Therefore, even when an investor maintains the same position, under the delta-adjusted method he would have to undertake daily calculations to re-establish his holdings,.

Another consequence from requiring delta-adjusted calculations would therefore be a higher number of notifications, which could possibly mean to over-burden the market with such information.

Delta-adjusted calculations would also be more costly to implement and to maintain; all the more so as it would not be possible to base the notifications on existing reporting systems. Furthermore, while many financial institutions might already have basic IT and other infrastructure on which they could build, costs would likely be yet more significant for non-financial institutions.

Even if less accurate, the nominal calculation might nevertheless be sufficient for the need of the Directive and provide sufficient information to the markets. When prices are "in the money", it is in effect equivalent to the delta-adjusted method.

Q6. How should the share equivalence be calculated in instruments where the exact number of reference shares is not determined?

The EBF is unsure about the type of situation CESR has in mind and would welcome clarification.

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)?

The EBF believes that a safe-harbour regime could be beneficial; i.e. a selective regime 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 obtain access to voting rights.

On the other hand, depending on its structure the safe-harbour approach could be burdensome in its application. A safe-harbour approach would also have to be defined in a way that provides legal certainty.

A viable alternative could therefore be that of a "White List", which would spell out all those types of instruments that do not have to be disclosed.

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?

If CESR intends to proceed with the proposed regulatory initiative, the EBF believes that the existing exemptions under the Transparency Directive for disclosure of straight shareholdings should at a minimum be extended to holdings of SEE instruments; including in particular the market maker exemption and the trading book exemption. This would ensure that liquidity providers and parties that hold assets for trading purposes and do not have the intention to influence a company's strategic decisions are exempted from the disclosure obligations.

When extending the exemptions for market makers to possible disclosure requirements for SEE holdings, it should also be considered to include market making activities performed over the counter and in the absence of an assignment. In addition, the EBF suggests that it should be considered to extend the exemptions to brokers who hold long positions in cash settled derivatives with the purpose of hedging symmetrical short positions taken by these brokers as a service towards their clients, where these long positions are identical to the short positions in terms of quantity, timing, and reference prices.

Lastly, as noted above the EBF believes that it should be considered to exempt shares that are held indirectly through derivatives on baskets of shares. The EBF understands the risk around such exemptions, in that they could be used as a way of avoiding transparency obligations; for example by way of *ad hoc* creating baskets with particular concentrations. This risk could however be addressed through particular conditions in terms of the minimum diversification and/ or maximum level of concentration of these baskets.

Finally, the EBF recalls ESME's proposal which would only require disclosure of SEE instrument holdings when these exceed a certain threshold of significance.

Q9. Do you consider there is need for additional exemptions, such as those mentioned above or others?

As noted above, there are a number of cases which the EBF believes should be considered for exemptions. Such exemptions will however have to be defined with great clarity to provide legal certainty, and with a view to achieving full harmonisation across the EU.

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.

Most EBF members expect that the costs from an extended reporting requirement would indeed be considerable. Before taking any final decisions or making any firm legislative proposals, it should therefore be carefully considered whether the expected benefits from the proposed requirements would outweigh these costs.

In doing so, the main cost components that would have to be taken into account include the following (with varying significance for different regulatory options):

- Costs related to adapting the IT procedures required to manage information (such as purchase of software or its creation in-house, and adjustment of databases). In addition to these one-off costs, there would be recurrent costs for the running and management of the necessary procedures and for staff training.
- Legal and compliance costs related to the implementation of the new rules and related to the consideration of questions that come up in that process.
- Costs related to the identification of necessary disclosures. This cost depends highly on the level of the thresholds and on the clarity and simplicity of the rules.
- Cost related to making the disclosures.

Banks expect that the disclosure of SEE instruments by way of separate notifications would be less costly than aggregate disclosures, in particular due to the lower number of notifications.

Indirect costs, which would result from any legal uncertainty around the new rules, should be kept as limited as possible.

On the other hand, the EBF would note that the current diversity of regimes also creates considerable costs, which – especially for firms that are active cross-border – could be significantly reduced through the harmonisation of the regimes.