Comments

CESR proposal to extend the Transparency Directive to instruments of similar economic effect to holding shares and entitlements to acquire shares

We support that instruments that can be used to create an economic long position should be inside the scope of the Transparency Directive. Transparency about voting rights including potential influence on voting rights of issued shares is key for listed companies, investors and regulators thus improving the efficiency of financial markets.

However, the introduction of thresholds should be considered to focus on significant voting rights. The calculation of share equivalence should be done on a nominal basis. In order to avoid single solutions in member states we favour a harmonized regulation on a European level.

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Proposal to extend the Transparency Directive to instruments of similar economic effect to holding shares and entitlements to acquire shares

Q 1: 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?

We agree with CESR's analysis of the issues raised by instruments of similar economic effect to shares and entitlements to acquire shares, in that these instruments may be used to acquire voting rights, de facto control over, or influence on, the exercise of voting rights, and, thus, allow for creeping control.

We also appreciate that CESR has not raised the issue that potential takeover bidders may use cash settled derivatives to limit their economic exposure with respect to the acquisition prior to share price increases following the takeover announcement. We think that making transparent such strategies should not be within the scope of the Transparency Directive which should remain limited to voting rights, including the potential influence on voting rights.

We would also like to point out that the recent cases described in CESR's analysis and in which derivative instruments have been used with the intention to influence or acquire control of a company have all operated with a very large number of such instruments. This shows that a high initial reporting threshold of at least 10% for such instruments is appropriate to filter out ordinary trading that does not represent a substantial shift in control and therefore need not be made transparent.

Q 2: Do you agree that the scope of the Transparency Directive needs to be broadened to address these issues?

Given that some member states have already introduced legislation to cover cash settled derivatives and others are in the process of doing so, we welcome CESR's initiative to broaden the scope of the Transparency Directive allowing a harmonized regulation which is desirable not only to improve information quality for investors but also for holders of instruments who need to monitor potential notification duties.

However, we would prefer an approach that does not broaden the purpose of the Transparency Directive, i.e. informing the public of changes to major holdings in voting shares of issuers traded on a regulated market and, thus, enabling investors to make decisions in full knowledge of the voting structure, enhance effective control of the issuers and ensure an overall market transparency of important capital movements.

Moreover, we believe that the broadening of the scope should not contravene the purpose of the Transparency Directive by diluting the information quality of the shareholding disclosure. We see a risk of such dilution if the disclosed holdings are no longer representative of a holder's actual or potential influence on voting rights of the issuer, but rather of his economic exposure to the share price of the issuer. Also, a considerable increase in the overall number of notifications to be digested by the public bears the risk of diluting the attention paid to them.

One solution to this problem should be a high initial threshold of at least 10% for capturing cash settled instruments. The exposure should be calculated on an aggregated basis taking into account all instruments giving access to voting rights and those instruments with similar economic effect. We believe that any investor that seeks to influence the issuer via instruments with similar economic effect is likely to be required to hold – either in physical or synthetic instruments – a significant interest.

Furthermore, instruments captured by the disclosure requirements should be limited to those which give potential access to, or influence on, voting rights, including those instruments which provide an economic effect similar to holding the share. It should not include instruments that just provide any economic benefit to the holder without being susceptible to exercising control.

Q 3: Do you agree that disclosure should be based on a broad definition of financial instruments of similar economic effect to holding shares and entitlements to acquire shares without giving direct access to voting rights?

We see benefit in including financial instruments of similar economic effect to holding shares and entitlements to acquire shares. However, we think that the definition should exclude financial instruments that – be it for their economic features or their diluted link with the actual voting share – are unlikely to be used for creeping up. We support CESR's view that the scope should only extend to instruments referenced to shares that have already been issued.
In particular, we propose to exclude:

- Writing of instruments, namely writing of put options, forwards and futures: Besides the fact that including the writing of instruments would deviate from the current logic of capturing only the "holding" of instruments, we do not believe that the writing of instruments conveys the writer a similar economic effect to the holding of shares. The holder of the respective instrument (i.e. the counterparty of the potential bidder) will not exercise any such instruments if they are out of the money. If they are in the money, any such exercise does not represent a price advantage for the potential bidder as opposed to the bid price or

the market price. However, we acknowledge that such instruments may be misused to ensure control over shares, but think that such abusive transactions should be captured separately (e.g. through existing provisions like the acting in concert provisions) and not lead to the general inclusion of the writing of instruments.

- Index instruments: We do not believe that these instruments can be used to influence the exercise of voting rights, apart from abusive compositions of indices, designed to "hide" one value tracked by such index. Moreover, the information value of notifications of important shareholdings will suffer if derivatives with a much diluted exposure to the share price are included.

- Basket instruments: We do not believe that basket instruments can be used to influence the exercise of voting rights unless the weighting of one particular voting share is significant in the basket. Following the rules in Switzerland and Hong Kong, we regard that the equity security should have at least a weighting of 1/3 for the basket to have a similar economic effect with a direct holding of that equity, but believe that even a weighting of up to 50% would be innocuous.

- Instruments that cannot be settled in stock and where delivery in stock is unlikely: More generally, we propose to consider a slightly narrower approach to include instruments of similar economic effect. It would consist in including (a) financial instruments that – without giving the holder an entitlement to receive shares – may be settled by the counterparty fully or partly in shares as well as (b) other cash settled financial instruments, but only if the overall circumstances of the transaction render a delivery of shares likely. In contrast to the 'safe harbour' solution considered in No. 68 et seq. of CESR's proposal, this limiting approach would entail less administrative burden for the holders and seems therefore more workable.

Q 4: 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.

We would prefer to use the MiFID definition of financial instruments (but excepting certain instruments as set forth above) to avoid additional complexity arising from different definitions. We think that such definition is broad enough to adequately catch financial instruments that might be or become relevant in the context of the Transparency Directive.

Q 5: Do you think that the share equivalence should be calculated on a nominal or delta-adjusted basis?

We strongly favour a calculation of share equivalence on a nominal basis. A disclosure on delta-adjusted basis presents the following considerable disadvantages:

- It is difficult to handle by holders: Notification duties may arise from price changes of the underlying which requires holders to monitor such price on a constant basis. Most current systems are not designed for this kind of monitoring. Accordingly, substantial additional costs would have to be incurred by the investors in order to ensure compliance.

- Information conveyed by delta-adjusted calculation might be too complicated to be absorbed by the market. Notifications triggered not by a transaction (i.e. an acquisition or disposal by the holder or a corporate action of the issuer), but rather by the mere change of the share price might confuse the public about the information content.

- Only when calculating the share equivalence on a nominal basis, the full potential voting rights that a financial instrument might procure is disclosed from the beginning.

Q 6: How should the share equivalence be calculated in instruments where the exact number of reference shares is not determined?

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Q 7: 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)?

We prefer a limiting approach including only instruments that do not preclude the possibility of giving access to voting rights.

However, we agree with CESR's analysis in that a 'safe harbour' approach based on contractual arrangements precluding the holder from influencing voting rights or acquiring shares or on explicit statements to this purpose is unworkable. Introducing any such statements in transactions that are to the largest extent standardized as well as subsequently monitoring them would impose an excessive administrative burden.

Limiting from the outset the type of financial instruments that are considered to be of similar economic effect to holding shares or entitlements to shares, and thereby included in the scope of the Transparency Directive,

seems a more workable approach. We therefore propose to only include (a) financial instruments that – without giving the holder an entitlement to receive shares – may be settled by the counterparty fully or partly in shares as well as (b) other cash settled financial instruments, but only if the overall circumstances of the transaction render a delivery of shares likely (see also above our answer to Q3, 4th bullet).

Q 8: 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?

Yes. In particular the exception for holdings in the trading book of credit institution avoids unnecessary disclosures.

Q 9: Do you consider there is need for additional exemptions, such as those mentioned above or others?

We see a need for an exemption for accounting purposes as described in CESR's proposal. Such exemption would improve overall information quality if it allows neglecting intra group transactions at the aggregated group level.

Q 10: Which kinds of costs and benefits do you associate with CESR's proposed approach?

The benefit of the proposed approach is the detecting of creeping control and, ultimately, a more transparent and efficient securities market. However, transparency might suffer if the approach is too broad and thereby the information quality of the disclosure reduced.

Costs for investors for monitoring their positions and complying with potential notification duties will arise from the handling of additional data. We estimate these to be moderate unless the share equivalence is to be calculated on a delta-adjusted basis in which case they will be excessive.

Q 11: How high to you expect these costs and benefits to be?

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Q 12: If you have proposed any exemptions or have presented other options, kindly also provide an estimate of the associated costs and benefits.

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Berlin, March 2010