



CESR Proposals to Extend the Major Shareholding Notification Regime to Instruments of Similar Economic Effect

In recent years, there has been increasing acceptance across the EU, that existing notification rules in relation to major shareholdings have become outdated and in need of amendment. Of particular concern, has been their inability to prevent parties from building up significant economic exposures in companies, primarily through derivative instruments, without having to disclose their interests. This was highlighted in October 2008, when Volkswagen AG (“Volkswagen”) temporarily became the highest valued company in the world as a result of Porsche SE (“Porsche,” which already held 42.6% of Volkswagen directly), discreetly building an additional 31.5% position in the company through options agreements. When Porsche finally disclosed its position to the market, the price of Volkswagen soared, making the German group worth more than the entire European motor industry combined.¹

Major shareholding notification rules in the EU are primarily governed by the Transparency Directive² (the “Directive”). This is a minimum harmonisation directive, thereby ensuring that Member States are free to impose any additional requirements they believe to be appropriate. We published a client alert outlining one such amendment in the UK, in March 2009, which made substantive changes to Chapter 5 of the UK’s Disclosure and Transparency Rules.³ The primary aim was to ensure increased transparency in respect of the holding of derivatives positions. Accordingly, in the UK, existing disclosure obligations relating to financial instruments were extended to cover instruments with a similar economic effect to holding shares. This took effect on 1 June 2009.

Following on from these changes (and others like them in a number of Member States⁴), the Committee of European Securities Regulators (“CESR”) published a consultation paper (the “Consultation”) on 9 February 2010.⁵ This makes clear that CESR now believe there is merit in imposing minimum requirements in this area. Accordingly, it proposes amendment to the Directive, such that national efforts are coordinated to achieve a harmonised approach to disclosure of derivative positions across the EU. The Consultation’s main focus is to extend major shareholding notifications to instruments of similar economic effect to holding shares.

¹ This was primarily as a result of hedge funds rushing to cover their short positions upon discovery that there were very few shares available on the market (approximately 6%).

² Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

³ <http://www.mofo.com/files/Publication/2b61d138-1d60-4979-b3d1-6a8394657e25/Presentation/PublicationAttachment/721548da-cfd3-43dc-ac5a-9044a1b5a114/090327UKContracts.pdf>

⁴ New rules have been implemented in France and Portugal, and draft legislation has been published in the Netherlands.

⁵ <http://www.cesr-eu.org/popup2.php?id=6481>

Current position under the Transparency Directive

The Directive currently requires disclosure of major shareholdings by both issuers and investors in respect of any securities that are admitted to trading on a regulated market in the EU and to which voting rights are attached. A major shareholding disclosure requirement is triggered by a party holding shares that result in the meeting or exceeding of certain thresholds in respect of voting rights or entitlements thereto, as set out in the Directive. Typically, the investor is required to inform the issuer. The issuer is then required to inform the market. Parent undertakings are required to combine their holdings with those of their controlled undertakings for notification purposes. The purpose of these rules is to enable investors to acquire or dispose of shares with full knowledge of any changes in the voting structure.

Suggested amendments

CESR would like to extend the Directive to require disclosure, not only of voting rights in shares or entitlements thereto, but also of instruments that create a similar economic effect to holding shares (but which do not provide a right to acquire voting rights), irrespective of whether they are settled in cash or physically. Examples might include convertible securities, warrants, contracts for difference (“CFDs”), equity swaps, cash settled call options or put options.

CESR is proposing to create a broad definition (as opposed to an exhaustive list⁶) of the type of instrument which may qualify, based on the definition of “financial instrument” as set out in the Markets in Financial Instruments Directive (“MiFID”).⁷ To this end, there are two proposals: 1) to extend the legal definition beyond the definition of “financial instrument” in MiFID (making various exclusions for certain types of transactions/agreements); or 2) limiting the legal definition to that of “financial instrument” in MiFID.

Calculation of thresholds

As referred to above, the requirement to make a major shareholding notification is triggered by thresholds being met in respect of voting rights or entitlement to acquire voting rights. If instruments of similar economic effect to shares are brought within the scope of this requirement, their equivalence as regards potential voting rights needs to be determined. This can be done on either a nominal or delta-adjusted basis.

Using the nominal approach, it is possible to take into account the number of shares that are referenced to the particular instrument of economic effect. So, for example, a CFD which references 50,000 shares, may result in the holder having access to 50,000 shares. The number of voting rights attached to those shares follows automatically. However, under a delta-adjusted approach, a holder must consider the “delta” value of the instrument in question. Delta in this context is a ratio representing the movement in an instrument’s value as the value of its underlying reference asset (shares in this case) moves. For example, if the instrument’s value is predicated on the value of an underlying share, such that a £1 increase in the share results in a £1 increase in the instrument, then this would be a “Delta 1” security (an instrument with a delta value equal to 1). This is because every 1 tick increase in the value of the underlying share, results in a 1 tick increase in the value of the instrument. CFDs are a typical example of Delta 1 securities. Since the delta value will tell the holder how many underlying shares they will need to hold in order to perfectly hedge their exposure, it can be seen as a more accurate determinant for the purpose of calculating the relevant disclosure thresholds. As can be seen from our March 2009 update,⁸ disclosure in the UK for the purposes of DTR 5.3.2R is determined on a delta-adjusted basis. CESR has invited comments as regards whether the Transparency Rules should do the same.

⁶ Although it accepts that a non-exhaustive list of instruments may serve as useful guidance to the market.

⁷ Directive 2004/39/EC.

⁸ <http://www.mofu.com/files/Publication/2b61d138-1d60-4979-b3d1-6a8394657e25/Presentation/PublicationAttachment/721548da-cfd3-43dc-ac5a-9044a1b5a114/090327UKContracts.pdf>

Further questions for consideration

In addition to the above, CESR has also invited responses in respect of the scope of required disclosure. For example, it may be necessary to disclose only details of instruments that do not contractually preclude access to voting rights (the “safe harbour” approach). Alternatively, holders could be required to disclose details of all instruments with a similar economic effect to holding shares or entitlements to acquire shares. This general disclosure regime would then be subject to a list of possible exemptions. CESR has additionally invited further comments as regards which exemptions might be appropriate.

Finally, please note that the deadline for contributions to the Consultation is 31 March 2010. Contributions are to be submitted via CESR’s website⁹ under the heading “Consultations.” Responses will be published on the website.

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⁹ www.cesr.eu