COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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CONSULTATION PAPER

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

Deadline for contributions: CESR invites responses to this consultation paper by **31 March 2010**. All contributions should be submitted online via CESR's website under the heading 'Consultations' at www.cesr.eu. All contributions received will be published following the close of the consultation, unless the respondent requests their submission to be confidential.

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I. Introduction and executive summary

1. In response to recent market developments, the CESR Transparency Group has started work on examining whether instruments that create a similar economic effect to holding shares and entitlements to acquire shares should be disclosed as part of major shareholding notifications. CESR recognises that these instruments may potentially be used to acquire or exercise influence in a company with shares admitted to trading on a regulated market, or allow for creeping control.

2. Instruments that create a similar economic effect to holding shares and entitlements to acquire shares effectively create a long economic exposure to the issuer. Currently these instruments are outside the legal scope of the Transparency Directive (TD). CESR intends to widen this scope to include all instruments referenced to shares that allow the holder to benefit from an upward movement of the price of these shares.

3. There is a range of instruments that can be used to create a similar economic effect, and a long economic exposure, to those financial instruments already captured under the TD without giving legal title to or the legal right to acquire the underlying shares, including certain options, equity swaps and Contracts for Difference (CfD's). Several member states have taken or are planning to take steps to broaden the scope of their national regime for the reporting of major holdings to include such instruments or to establish specific disclosure rules regarding them. The minimum harmonisation required by the Transparency Directive allows for these national initiatives.

4. This consultation offers a high-level issues paper proposing to extend major holdings notifications to include all instruments that give a similar economic effect to holding shares and entitlements to acquire shares in the broadest sense. CESR considers that a broad definition balances the need for legal certainty with the potential for avoidance. The intention is to cover all instruments that can be used to create an economic long position.

5. While seeking to broaden the scope of the TD's major shareholding disclosure regime, CESR does not seek to change the general principles underlying the current regime. The scope of the broadened disclosure regime is to remain limited to instruments referenced to shares to which voting rights are attached, already issued, of an issuer whose shares are admitted to trading on a regulated market.

6. The broad approach proposed by CESR seeks to coordinate national efforts in this area in order to achieve a more uniform approach for possible regulatory initiatives at national level. It will also be part of the feedback to the European Commission for its future review of the TD. The purpose of this consultation is limited to instruments that give a similar economic effect to holding shares and entitlements to acquire shares, and does not seek to harmonise other aspects of the TD's application across the membership. CESR recognises the need for further harmonisation, and will seek to promote convergence in its advice to the European Commission as part of the review of the Directive.

7. Where appropriate, this consultation proposes an approach that is consistent with the pan European short selling regime proposed by CESR's Task Force on Short Selling. It should be noted, however, that CESR considers these are two separate regimes that serve different purposes.

8. It should also be noted that instruments that create similar economic effect to holding shares and entitlements to acquire shares are generally entered into to give economic exposure without wishing to gain access to voting rights, and are an important source of liquidity to the market. CESR does not seek to discourage the use of such instruments, but only to make their resulting economic exposure transparent. Equally, the principles underlying CESR's proposed approach to disclosure aims for meaningful notification, avoiding disclosure of information which is either unnecessary or potentially misleading to the market.

9. This consultation paper has been prepared by CESR's Transparency Group chaired by Mr Hans Hoogervorst, Chairman of the Netherlands Authority for the Financial Markets. Following the reorganisation of CESR's working structure (ref. CESR/10-034) further work on the issue will be carried on by CESR's Corporate Finance Standing Committee.

II. Scope of the Transparency Directive

10. The purpose of the disclosure of major shareholdings is to enable investors to acquire or dispose of shares in full knowledge of changes in the voting structure. This information should also enhance effective control of share issuers and overall market transparency of important capital movements.

11. According to the TD, a major shareholding is composed of the voting rights attached to shares owned by the holder, and by the voting rights he is entitled to acquire, to dispose of or to exercise in a set of cases described in Article 10. The holding, directly or indirectly, of financial instruments that results in an entitlement to acquire, on the holder's own initiative alone, under a formal agreement, shares to which voting rights are attached, already issued, of an issuer whose shares are admitted to trading on a regulated market, triggers a notification requirement under Article 13.

12. Article 11 of Directive 2007/14/EC (L2D) determines the types of financial instruments covered by the notification requirement as follows: transferable securities; and options, futures, swaps, forward rate agreements and any other derivative contracts, as referred to in Section C of Annex I of Directive 2004/39/EC. A formal agreement means an agreement which is binding under the applicable law.

13. Instruments which do not give the right to acquire the voting rights are generally outside the scope of Article 13 of TD. For instance, writing a put option gives the writer potential access to voting rights when the buyer chooses to exercise his option to sell. Nevertheless, writing a put option is currently not in scope as it does not result in an entitlement to acquire, on the holders own initiative alone, shares to which voting rights are attached.

14. The basis of CESR's concern lies in the fact that these instruments grant the holder (and occasionally the writer) a special proximity to the physical share. This is because generally these instruments are a bilateral contract between holder and writer, and the writer will seek to hedge its contractual obligation in order to mitigate its exposure. The easiest way to minimise this exposure is to acquire the physical share as a hedge.

15. It should be borne in mind though that not all such instruments are used to acquire or influence the exercise of voting rights. Rather, the majority are used simply to gain an economic exposure to the issuer.

16. Some instruments that create a similar economic effect to holding shares and entitlements to acquire shares without giving direct access to voting rights can nevertheless indirectly fall under the scope of Article 10 of TD through the holding on behalf clause of paragraph g). The writer of an instrument who has hedged his position by acquiring and holding shares would not have an interest in the exercise of the voting rights attached to those shares. Therefore, the buyer of this instrument might be in a favored position to influence the exercise of the voting rights. If he is able to exercise such an influence, and bears the economic risk, such a contractual scheme can in certain cases be seen as holding on behalf. Nevertheless, CESR considers that such instruments should be reported in general.

III. Issues

17. Although outside the legal scope of Article 13 of the TD, CESR considers that instruments that create a long economic exposure without giving the right to acquire the voting rights may be used to acquire and/or exercise potential influence in a listed company or allow for creeping control. The writers of such instruments often hedge their economic risk by buying the shares to which the contract is referenced. Assuming positions are hedged in this way, this structure raises the following issues:

    (i) The writer of an instrument of similar economic effect to holding shares and entitlements to acquire shares has no economic exposure in respect of the transaction, and will naturally wish to obtain repeat business from the holder of the long instrument. As a result, the buyer has the ability to exercise a significant degree of de facto control (via the writer) over the voting rights attaching to the shares held as hedge;

    (ii) The buyer will have an information advantage over the rest of the market regarding the free float, since he can assume the volume of the writer´s shares held as hedge is not available to other market participants (as demonstrated by recent case 2 below);

    (iii) As the writer is unlikely to dispose of the shares held as hedge until the contract is closed out, at that moment, the (former) holder of the long contract may wish to acquire the shares held as hedge from the (former) writer and, if so, this is likely to suit the (former) writer. Alternatively, the buyer will know the shares held as hedge will be available in the market when the contract is closed out.

18. As a result, instruments that create a long economic exposure without giving the actual right to acquire the voting rights cut across the purpose of the TD's regime for the disclosure of significant holdings. CESR considers that the use of instruments of similar economic effect to holding shares and entitlements to acquire shares has resulted in the scope of the TD becoming too narrow.

19. The holder of a long position benefits from an increase in the share price. An economic position may be built up by buying shares, or by writing or buying instruments referenced to those shares. The use of other instruments allows for the possibility of unbundling economic and voting rights customarily associated with shares.

20. As a result of unbundling economic and voting rights, investors can have greater voting power than economic ownership, resulting in empty voting. Conversely, investors can have greater economic ownership than voting power, resulting in hidden ownership. Further, instruments that create economic exposure without giving potential access to voting rights may still be used to influence the exercise of voting rights, giving rise to further governance issues.

21. Hidden ownership raises the following forms of potential market failure. First, there may not be efficient pricing in capital markets due to insufficient information. Second, there is less transparency on large holdings, large transactions, possible conflicts of interest and free float of a share. Finally, it may enable avoidance of the launch of a mandatory bid at an equitable price, which would limit the take-over premium and harm the exit possibility for minority shareholders.

IV. Recent cases

22. In several countries around the world, there have recently been cases in which instruments of similar economic effect to holding shares and entitlements to acquire shares were used with the intention to influence or acquire control of a company, to build up a stake and to affect its governance. These cases have brought this issue into the public eye. The high profile cases include:

23. *CASE 1, Continental/Schaeffler*: In the summer of 2008, the privately owned Schaeffler Group launched a take-over bid for Continental AG, a listed company in Germany. Prior to the bid, the Schaeffler Group held below 3% of the voting rights in Continental, but concluded equity swap agreements with banks for around 28% of the capital. The agreements were never disclosed. BaFin investigated the case and found that such non-disclosure was not in breach of the current law.

24. *CASE 2, Porsche/VW*: In October 2008, Porsche discreetly built a 31,5% position in Volkswagen through cash-settled instruments of similar economic effect to holding shares and entitlements to acquire shares. The sudden disclosure of this position by Porsche signalled to the market that the free float in Volkswagen was possibly reduced to less than 6%. This provoked a high increase in the share price, allegedly because of hedge funds rushing to cover their short positions.

25. *CASE 3, FIAT*: In April 2005, the Agnelli family entered into an equity swap agreement for around 7% of FIAT shares, which remained undisclosed until executed. While the originally equity swap agreement would be settled in cash, the agreement was eventually modified in September 2005 to physical settlement in shares. The equity swap allowed the Agnelli family to retain their pyramidal 30% controlling stake in FIAT, without having to launch a takeover bid for the remaining shares.

26. *CASE 4, CSX/TCI and 3G*: In 2008, the hedge funds TCI and 3G Capital Partners had a combined holding of 8.7% of CSX shares, and an undisclosed economic interest of almost 14% through total return equity swaps. A court hearing revealed that the hedge funds could convert their economic interest to a direct interest. The Court then ruled that TCI and 3G should be considered as beneficial owners with regards to the shares held by their counterparties, and had therefore failed to timely disclose their stake.

27. *CASE 5, Implenia/Laxey Partners*: Laxey Partners had signed five CfD contracts with five banks, each contract involving at least 5% of the capital of Swiss construction group Implenia. In April 2007, Laxey terminated the contracts for cash, but then acquired the corresponding shares which had been bought as a hedge. Laxey gave notice when passing the subsequent thresholds within the space of a few days. The Swiss supervisor found that Laxey should have notified its major holdings when the CfDs were signed.

V. National initiatives

28. Several CESR members have since announced national initiatives to address these issues. It should be noted that in many EU Member States, the CESR member does not have the legislative power to bring these instruments into scope of their national regime.

29. In the United Kingdom, the FSA introduced new rules which came into effect on the 1st of June 2009. This followed the consideration of a number of trading situations where CfDs appeared to have been a significant factor, and of research into the market practices of derivative writers and holders which established that those practices had allowed CfDs to be used on an undisclosed basis to build up stakes and/or exert influence over corporate governance. Under these rules, holdings of financial instruments *with similar economic effect to those financial instruments under Article 13*[1] are required to be aggregated with holdings in shares and financial instruments with entitlements to acquire shares for calculating the reportable gross long position.

30. An alternative approach, proposed and then rejected by the FSA was that all financial instruments with a similar economic effect to those under Article 13 were required to be disclosed unless they met certain provisions. These provisions included contractually excluding the possibility of giving access to influence or obtain the voting rights; that the holder of the instrument stated that no arrangements or understandings existed between the parties relating to the potential sale of the underlying shares; the holder made a written declaration that there was no intention to gain or acquire access to the underlying shares; and also that none of these provisions had subsequently been breached; and that there had been no change in the holder's intentions. This approach is sometimes referred to as the 'safe harbour' approach.

31. In France, new rules came into force on the 1st of November. These rules require that once a threshold has been crossed by holdings of shares and options, gross long positions held through financial instruments of similar economic effect to holding shares also need to be reported. There is no separate threshold for financial instruments of similar economic effect to holding shares.

32. In Portugal, the CMVM has published draft rules for public consultation requiring the disclosure of all instruments of similar economic effect to the holding of shares. According to the proposal, all instruments would need to be aggregated towards the existing thresholds. The introduction of additional thresholds is also under consideration.

33. In the Netherlands, the Ministry of Finance has published draft legislation for consultation. The draft law would create the presumption that the holder of an instrument which creates an economic long position but is not settled in shares, controls the underlying shares. Such instruments would have to be aggregated to shares and entitlements to acquire shares.

34. Outside the EU, Switzerland, Hong Kong and Australia have also taken action.

35. In Switzerland, Finma uses an approach based on three separate baskets: one for shares, one for long instruments, and a third for short instruments. Cash settled instruments need to be included in both the long and the short basket. Whenever the holdings in one of the baskets reach a threshold, the position in the other two baskets needs to be disclosed as well.

36. In Hong Kong, all types of equity instruments of similar economic effect are in scope of the significant holdings regime. A person holding, writing or issuing instruments of similar economic effect is taken to be interested in the underlying shares. These interests must be aggregated with physical holdings on a gross basis.

[1] A financial instrument has a similar economic effect to a qualifying financial instrument (in Article 13), if its terms are referenced, in whole or in part, to an issuer's shares and, generally, the holder of the financial instrument has, in effect, a long position in the economic performance of the shares, whether the instrument is settled physically in shares or in cash.; see DTR 5.3.3 G (2) in FSA Handbook (http://fsahandbook.info/FSA/html/handbook/)

37. The Australian Treasury has started a consultation to determine whether equity instruments of similar economic effect should be included in the definition of substantial holding, and, if so, on what basis they should be included. It considers that while equity instruments of similar economic effect give economic interests but not voting rights, they may give a degree of effective control over the referenced shares.

VI. Reporting instruments of similar economic effect to holding shares and entitlements to acquire shares

38. CESR considers that the scope of major shareholding disclosure should include all instruments that give similar economic effect to holding shares or entitlements to acquire shares, irrespective of whether such an instrument is settled in cash or physically. Examples include CfD's, equity swaps, cash-settled call options and the writing of put options.

39. CESR is aware that the TD does not aim to produce information about the free float in the market. Nevertheless, CESR acknowledges that major shareholding disclosure can provide useful additional information in this respect. CESR considers that market developments with regards to the use of instruments of similar economic effect to holding shares and entitlements to acquire shares challenge the scope of the TD. The current scope may be too narrow to meet the purpose of major shareholding disclosure, which is to clarify who actually can exercise influence over an issuer.

40. It should be noted that instruments of similar economic effect to holding shares and entitlements to acquire shares are already partly in scope in some Member States, notably those Member States discussed above. Including instruments of similar economic effect to holding shares and entitlements to acquire shares is considered to be a logical next step after including entitlements to acquire.

41. CESR considers that the current thresholds set under the TD should apply to instruments of similar economic effect to holding shares and entitlements to acquire shares because it is likely that an investor with a significant economic long interest will seek to influence the issuer.

42. CESR considers that netting of long and short positions does not prevent access to voting rights and therefore gives the possibility of hiding stakes. Netting should therefore not be allowed.

43. It should be noted that CESR does not propose a symmetrical regime for gross long and gross short holdings.

44. The issue of net short positions is currently under consideration by CESR's Task Force on Short Selling. The task force has presented a consultation paper proposing a pan-European short selling disclosure regime. This disclosure regime seeks to address issues of market abuse and disorderly markets. The scope of the short selling disclosure regime includes all holders of net short positions, and is not limited to shareholders who hold a gross long position. CESR recognises that the regime proposed by its Task Force on Short Selling would have the unintended consequence of making empty voting more transparent.

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?

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

VII. Broad definition

45. CESR considers that all instruments of similar economic effect to holding shares and entitlements to acquire shares should be in scope of major shareholding disclosure. This scope should only extend to instruments referenced to shares that have already been issued.

46. While market participants need as much certainty as possible as to what instruments should be disclosed, CESR notes that there are significant risks in trying to deliver an exhaustive list as this would increase the risk of avoidance through the creation of new instruments that are not on the list. This has been the experience of a number of other jurisdictions outside the EU.

47. For this reason, CESR considers that a broad definition, based on the concept of similar economic effect to holding shares and entitlements to acquire shares is the only practicable way forward.

48. A non-exhaustive list of instruments that are in scope may serve as guidance to the market. Such a list might include convertibles (bonds exchangeable for shares), writing of put options (European and American, in and out of the money), futures and forward contracts, Contracts for Difference (CfD), equity swaps, warrants, baskets and share indices.

49. A basket or index would need to be included depending on the weight of the individual shares to which the basket or index is referenced. Also, share equivalence depends on the weight of the aggregate holdings in an individual share through a basket or index.

50. In terms of legal definition of the scope (instruments of similar economic effect) CESR has discussed whether reference to financial instruments as defined in MiFID should be made. There are basically two options: (i) to extend the legal definition beyond the definition of financial instrument in MiFID and possibly to exclude certain types of transactions/agreements, or (ii) to limit the legal definition to the definition of financial instrument in MiFID. CESR notes that the discussion is – at least partly – linked to different national transpositions of the TD and the MiFID definition of financial instrument.

51. Through the first option possible loopholes in the definition could certainly be avoided. On the other hand, the definition might catch some transactions or agreements which the new regime may not be intended to catch. Therefore, some types of transactions or agreements might need to be excluded from the scope. There might also be some legal uncertainty as to what instruments are in the scope of the definition.

52. The second option would allow more legal certainty as to what instruments are in the scope of the definition. However, CESR has discussed whether certain instruments, such as private contracts, repurchase agreements or right to recall lent securities would be adequately caught by the definition of financial instrument or by Articles 9, 10 or 13 of the TD, and CESR would welcome views on this.

Questions:

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.

VIII. Calculation of thresholds

53. In September of 2008, the CESR Transparency Group published a mapping of the implementation of the directive across the membership (CESR 08-514b[2]). This mapping revealed divergence on the transposition of the directive with regards to aggregation across asset classes.

54. In the current regime, it is up to the member states to decide if and how instruments of similar economic effect to holding shares and entitlements to acquire shares should be aggregated. They may be included as a separate category with a separate notification threshold, or may be aggregated with shares or entitlements to acquire under a single threshold. CESR considers aggregation should be considered within the wider context of options and exemptions allowed under the TD. It is beyond the scope of this consultation to seek to harmonise the broader TD framework.

55. The disclosure of instruments of similar economic effect to holding shares and entitlements to acquire shares also raises the question of how to calculate the respective notification thresholds. Thresholds are set in terms of shares and voting rights. Bringing instruments of similar economic effect into scope requires calculating their equivalence in terms of potential voting rights. There are two general approaches for doing this: a nominal basis and a delta adjusted basis.

56. Under a nominal approach, an instrument is counted as the number of shares it is referenced to. Voting rights are calculated based on the number of shares. For instance, a CfD based on 100,000 shares would result in the holder potentially having access to 100,000 shares. This allows a straightforward calculation to be undertaken by the holder, results in relatively lower costs, and the holder will only need to recalculate if the position is altered or the denominator changes.

57. CESR notes that the current Article 13 instrument disclosure works on a nominal basis.

58. Under a delta adjusted approach, share equivalence is based on the delta. The delta of an equity derivative represents how the pay off from that instrument changes in relation to a change in the price of the underlying equity. A CfD for example would normally have a delta of 1 as it perfectly mirrors the change in the underlying share price. Options on the other hand have a delta that fluctuates. Furthermore, the delta of a cash-settled option will change as the time to expiry shortens.

59. Delta can be seen as a useful and relevant measure as it is representative of the number of shares the person writing the instrument would need to hold in order to perfectly hedge its exposure. However, the instrument holder may need to recalculate on a daily basis the delta-adjusted holding as the delta will generally change over time and may result in thresholds being crossed passively.

60. CESR notes that instruments will be required to be calculated on a delta-adjusted basis under the suggested short-selling rules currently being consulted on under the CESR Task Force.

Example

Company A has 1 Million shares or voting rights

A CfD for 100,000 shares in Company A has a delta of 1. Therefore the appropriate calculation would be (100,000 x 1) / 1,000,000 which gives a position of 10% of Company A's shares. This would trigger a disclosure obligation on the CfD holder.

A cash-settled call option for a nominal 100,000 shares in Company A has (at transaction date) a delta of 0.2. Therefore the calculation (100,000 x 0.2) / 1,000,000 results in a delta-adjusted position of 2% of the company's shares, and therefore no disclosure is required.

[2] http://www.cesr.eu/index.php?page=groups&mac=0&id=41

The person writing the CfD would need to hold 10% of the company in order to be perfectly hedged. This is the number of shares likely to be under the potential influence of the CfD holder.

Typically, the person writing the option would (at this point) only be holding 2% of the shares as a hedge, and therefore this would be below the disclosure threshold.

Questions:

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?

IX. Scope of disclosure

61. The scope of the disclosure could be extended to all instruments of similar economic effect to holding shares and entitlements to acquire shares, or it may be limited to only include instruments that do not contractually preclude access to voting rights. An extension to all instruments would mean a holder needs to include all instruments that give him, in effect, a long economic exposure to an issuer subject to some exemptions.

Potential exemptions

62. A general approach raises the issue of exemptions as it is likely to yield a large number of disclosures. Exemptions would seek to limit that number.

63. Some of the current exemptions allowed by the TD are optional and are not implemented in all Member States. Because of the different implementation across the membership, under the current regime it will not be possible to harmonise exemptions for instruments of similar economic effect to holding shares and entitlements to acquire shares. The TD currently allows member states not to require investment firms and credit institutions to count part of the holdings in their trading book for the purposes of the Directive. The voting rights held in the trading book under this exemption are not to exceed five percent and the holder needs to ensure that the voting rights are neither exercised nor used to intervene in the management of the issuer.

64. The TD currently exempts the acquisition or disposal of a major holding reaching or crossing the 5% threshold by a market maker acting in its capacity of a market maker. In addition, the shareholder needs to be recognised as a market maker for the purpose of the Directive, and may neither intervene in the management of the issuer concerned nor exert any influence on the issuer to buy such shares or back the share price.

65. Member states that have already taken action have included or are planning to include additional exemptions. Examples include client serving positions, and transfers for accounting purposes, which are set out below.

66. Exemption for client-serving transactions: In order to reduce the amount of disclosures, positions where CfD writers are effectively acting as intermediaries and providing liquidity may be exempt. This would only be available for transactions done in a client-serving capacity (for instance fulfilling a client order, or in order to facilitate filling a client order), and not for proprietary business. Those CfD positions taken out to hedge a client order would also not need to be disclosed. For instance, when writing a short CfD position for a client the writer will effectively take out a long CfD position itself. The principle underlying this exemption is that firms holding a position purely to facilitate a client position, with no interest in the performance of the underlying equity, should not be required to disclose their position.

67. Exemptions for accounting purposes: Positions created by intra-group movements may also be exempt from the notification process as they may not be deemed to have similar economic effect to holding shares and entitlements to acquire shares providing such movement occurs purely for tax or accounting purposes. This would only be the case if the original transaction had either been disclosed if required (or included in the calculation for disclosure) or continues to benefit from an exemption notwithstanding this intra-group movement.

Limiting approach

68. An alternative to a general approach combined with exemptions, is to prescribe a limiting approach. Such an approach would be based on contractual terms that preclude the possibility of the holder obtaining the voting rights or influencing their exercise. This would mean that all instruments that potentially give access to the underlying voting rights would require disclosure unless stringent 'safe harbour' requirements are met, such as, for instance:

(a) The agreement with the writer of the financial instrument explicitly precludes the holder from exercising or seeking to exercise the underlying voting rights;

(b) The agreement excludes any arrangements or understandings in relation to the potential sale of the underlying shares;

(c) An explicit statement is made by the holder that there is no intention to use the financial instrument to seek access to the voting rights

69. There are, however, a number of concerns with this approach:

70. Even if robust contractual agreements were created regarding explicit influence over voting rights and disposal of shares, it would be possible to circumvent the purposes of the disclosure obligation simply by changing the contract terms of the instrument immediately prior to the contract being closed.

71. The 'safe harbour' is partly based on the intention of the holder of the instrument. This means that even if holders might comply strictly with the terms of the safe harbour it would not with certainty prevent the building up of stakes on an undisclosed basis. For example, if the holder knows that the writer holds the underlying shares as a hedge then, as a matter of fact, the holder knows that when the contract is closed the stock is likely to be sold in the course of normal business. They can therefore be confident of purchasing the stock without the need for any 'understanding' whether formal or informal.

72. There would also be difficulties about how to evidence that a person did not have a legitimate change of intention, at which point the safe harbour would cease to be effective if there was a change of intention, and whether a change of intention could be reversed. Conversely, a safe harbour approach may make it unreasonably difficult for holders to evidence a legitimate change of mind.

73. Further, a safe harbour approach might also impose legal expenses on market participants to include the necessary provisions to come under the safe harbour.

74. Based on these concerns, CESR considers an approach that creates such a 'safe harbour' for certain types of contractual agreements to be unworkable.

Questions:

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?

X. Costs and benefits

Costs

75. CESR considers that extending the scope of major shareholding notifications would lead to additional costs as market participants need to change their systems in order to capture more instruments.

76. CESR also considers that investors, issuers and regulators would incur ongoing costs in order to make and process additional notifications.

Benefits

77. CESR considers disclosure of such instruments enhances transparency, reduces the possibility of hidden ownership and empty voting, and limits the possibilities for creeping control.

78. CESR considers that this proposal will help address the practice of writers of these instruments voting in line with the interests of the holders of these instruments to the extent that this occurs.

79. At the same time, a pan-European approach would limit the required systems changes and thereby reduce the associated costs compared to diverging national approaches. A pan-European approach would also improve legal certainty as to which instruments need to be included across the EU.

80. CESR also considers disclosure may provide useful information on free float.

Questions:

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.

Annex: List of consultation questions

In answering the questions below, kindly state your reasons for the answer given.

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?

Q3. 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?

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.

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?

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?

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.