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DG Internal Market and Services/Company Law,
Corporate Governance and Financial Crime Unit
European Commission

Submitted by email to
markt-f2-transparency@ec.europa.eu

20 August 2010

Dear Sirs

ICSA response to the Consultation on Modernisation of the Directive 2004/109/EC (transparency requirements for listed companies)

The Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies chartered secretaries and we appreciate the opportunity to comment on this important issue. In our response we have some general comments followed by some responses to your specific questions.

1. General comments

As part of our consideration of the consultation on the Transparency Directive we have also considered the Commission Staff Working Document.

We note that point 14.6 of Annex 14 suggests that the provisions of the Commission's Remuneration Recommendations might be included in the Transparency Directive.

We are alarmed to note this suggestion to move provisions from a Recommendation, which is flexible and subject to comply or explain within the code of each member state, to a statutory framework.

We strongly support the 'comply or explain' model rather than prescription, as it is generally accepted that one size does not fit all. 'Comply or explain' gives scope for flexibility, allowing companies to be agile and proactive in their governance approach and permitting them to aspire to, and attain, higher governance standards than might be the case under a prescriptive regime.

The strength of 'comply or explain' is its flexibility. It allows companies to choose the most appropriate response to their national governance code which best meets the particular needs of the company and its stakeholders. We would be very concerned at steps to erode it by moving certain provisions into a statutory framework.

2. Specific points

Part I of the Consultation Document

On the question of lesser requirements for smaller companies, we are not able to give a considered view on this, since we represent a broad range of companies and do not have specific evidence for the smaller companies sector.

Preamble on Parts II and III of the Consultation Document

We welcome the discussion in the consultation document and in Annexes 11, 12 and 13 of the Commission Staff Working Document relating to the ability of issuers to obtain relevant information around the major holdings of voting rights and would wish to make the following general points first:

We recognise that in the UK and Ireland, issuers are able to exercise their rights under s793 of the Companies Act 2006 in the UK and s81 of the Companies Act 1990 in Ireland to obtain information concerning the identity of the beneficial holders of our shares. These enquiries can travel all the way up the chain of intermediaries from registered shareholder to ultimate beneficial holder and, importantly, disclosure is made at the expense of the shareholder or intermediary concerned, with criminal penalties for failure to respond, or for inaccurate response.

We understand however that issuers in other member states do not enjoy such extensive rights and that in some cases are only able to ascertain the identity of their shareholder base at limited times of the year (typically ahead of an AGM or corporate action), or only for holdings in excess of a certain percentage. In some member states, issuers may only know the identity of underlying shareholders holding over 5% of the shares who are required to disclose this holding under the provisions of the Transparency Directive. In the UK and Ireland, issuers have the right to make enquires down to the last share, should they so wish, from anyone whom they have grounds to believe may have an interest in shares in the company.

We believe that this divergence of practice across Europe is not conducive to good corporate governance for the following reasons:

1. Issuers are encouraged to engage with their shareholders and in the UK the Companies Act requires that the company be managed in the best interests of shareholders. Issuers are unable to do this effectively, if they are unable to identify who the ultimate holders of their shares are.

2. Constructive debate and engagement between issuers and their shareholders leads to better governance. Chairmen and Non Executive Directors of UK issuers routinely meet with institutional shareholders to debate matters of governance, remuneration or resolutions to be proposed at upcoming shareholder meetings. These conversations enable issuers to consider the views of their shareholders and take them into account when planning for an AGM or other activity. This engagement process is more constructive than waiting for a shareholder vote before an issuer can assess shareholder sentiment. This is something that should be encouraged across Europe and not available only in the few Member States where issuers have the ability to identify their underlying shareholders. The current divergence in practice is detrimental to the interests of issuers and their shareholders in jurisdictions, where there is less visibility.

3. The UK and Irish practice of being able to enquire at any time of any person whether they hold shares in the company, and if so whether those shares are held for themselves or on behalf of someone else is well established and investors view such

enquiries as routine. However, under a system whereby such enquiries can only be made ahead of a corporate action, the making of such an enquiry alerts some sections of the market prematurely to the possibility that a corporate action may be planned. This has the potential of distorting the market and providing some sections of the market with information not generally available to all shareholders.

4. Without a common policy across Europe, it is possible that the current development of the T2S platform for settlement services to Central Securities Depositaries could mean that the identification of shareholders becomes more difficult cross border. Already, UK issuers frequently experience some resistance from institutions based in countries unfamiliar with our practices, when asked to respond to a s793 request. We are in the fortunate position that the legal status of s793 means that it can be enforced effectively. T2S is intended to facilitate cross border settlement of securities. This could mean that institutions who wished to remain "invisible" might choose to settle in countries where shareholder visibility is lower. We understand that the T2S platform could be set up to facilitate the better identification of shareholders for all European issuers, but that this would not be part of the scope of the project without the legal framework to enable this.

5. Many of the questions raised in the consultation paper cannot be addressed without the ability first to identify who the underlying holder of the shares is. For example, question 15 asks how the investment process could be improved and immediately discusses disclosure of long term intentions and voting policies. Neither of these would be relevant without first knowing the identity of the shareholder.

We do not accept the arguments in Annex 11 of the Commission Staff Working Document against a rule of this type for the following reasons:

- The complexity of the modern securities market, with potentially many layers of investor, means that the introduction of a 'record date' system under the Shareholder Rights Directive is not sufficient to ensure adequate transparency;

- Communication via a website is a very imprecise means of communication when good corporate governance demands that a company seek feedback from major investors;

- The proposal for 'a uniform shareholder certificate as proof of entitlement' which it is suggested may form part of a future Directive seems to us to be unworkable in a registered share environment;

- The inclusion of disclosure requirements in issuer Articles of Association is ineffective where such requirements do not have the force of law. In the UK, failure to respond to a s793 notice is punishable by up to two years imprisonment, and so applies to all investors in that issuer, regardless of their place of domicile;

- We do not believe that a voluntary disclosure model would be effective in situations where investors were seeking to hide their interest – precisely the situation where the public interest is best served by their transparency;

- We do not accept the assertion (Annex 11.13) of technical difficulties. The definition of the 'ultimate investor' is irrelevant if a suitably wide interpretation of 'interest' is included in the legislation;

- Management entrenchment and the reinforcement of takeover defences are only an issue in markets where existing safeguards against such abuses are not sufficiently advanced;

- As outlined above, we do not accept the confidentiality / privacy argument – the loss of these rights is a reasonable and in our view necessary consideration in return for the benefits of limited liability; and

- The argument that "any new (mandatory) measure will entail costs" fails on the basis that there are already Member States where issuers have this statutory right. If the right already exists, how can its extension to issuers domiciled in other Member States entail additional costs? The bulk of any such costs that are created will, rightly, fall on those investors who have chosen to invest through complex chains, and not on shareholders as a whole.

Detailed comments on Part II of the Consultation Document

Question 11: Would the disclosure of holdings of cash-settled derivatives be beneficial to the market?

We note the arguments set out in the paper for the disclosure of cash-settled derivatives and the examples given of recent high profile cases, where investors have used cash settled derivatives to build a secret stake in a company, which is then converted into equity. We believe that such practices are detrimental to the fair operation of the market. The use of derivatives as position-building mechanisms is well documented, and the absence of disclosure obligations creates confusion in the market place, with prime brokers being seen as holding the economic – and voting - interest. We note that the UK has introduced a provision requiring the disclosure of such derivatives on the same basis as equity shareholdings, and many of the concerns expressed during the consultation process have proved unfounded. Investors have not found disclosure burdensome, and the market has not been overwhelmed with disclosures. This system has been working well.

Questions 12 and 17: Should share-holdings of cash-settled derivatives be aggregated to holdings of voting rights and at what level?

We believe that holdings of cash settled derivatives should be aggregated with holdings of voting rights, so that if the combined holding exceeds the threshold, disclosure is required. If there is no aggregation, investors will still be free to build up a sizeable secret stake in a company holding just below the threshold in each of voting rights and in cash settled derivatives. This would be detrimental to openness in the market.

The UK has operated with a lower initial threshold of 3%, reducing to 1% in takeover situations, for a number of years prior to the introduction of the Transparency Directive, when this threshold was maintained. This threshold does not lead to an excessive amount of disclosure and appears to work well for both issuers and investors. We are not convinced that there is a need to lower this threshold, as this could lead to excessive disclosure.

As we have noted in our preamble, issuers in UK and Ireland do have the right to make enquiries of the identity of underlying shareholders well below this level if we wish. We would however recognise that issuers in countries where there is no, or limited, rights to ascertain the identity of underlying shareholders may well seek a lowering of this limit as a means of identifying their underlying shareholders. In the absence of any other means of identification, we would support them in this.

Questions 13 and 14: Would the establishment of a specific disclosure mechanism for holders of voting rights who do not hold shares between the record date and the shareholders meeting be useful/ effective to prevent empty voting practices?

We do not believe that a specific disclosure mechanism is necessary to prevent the perceived problem of 'empty voting' unless the record date for a meeting is too far advanced. In the UK and Ireland where, by law, the record date can be no longer than 48 hours before the commencement of the meeting, empty voting is not a major issue – there will always be some shares that have been traded between the record date and the meeting, but if that window is sufficiently short the impact of this activity is much reduced. For us, this was one of the most compelling arguments against the extension of the record date to a period of several weeks before the meeting, as was proposed by some market participants during discussions around the Shareholder Rights Directive. We saw this as nothing more or less than an attempt by some intermediaries to build delays into the process in order that their underinvested and inefficient systems were not compromised.

The registration model in the UK and Ireland means that this is less of a problem for UK and Irish Issuers. In the UK, the record date is effectively 6pm the night before the meeting, when the register is closed. Proxies have to be submitted 48 hours prior to the meeting. If a proxy has been submitted for a shareholder who is no longer on the register, it is simply not counted. Typically investors are encouraged to vote "all" their shares rather than a specified number of shares, so that if there is a change in the number of shares held between submission of the proxy form and the date of the meeting (upwards or downwards) the full holding as at the meeting date is taken into account. If shareholders wish to vote some shares for and some against and the total number of votes cast exceeds the registered holding, the registrars usually liaise with the investors between proxy cut off and the date of the meeting to ensure that the correct number of shares are voted. We recognise that differing shareholding models in other member states mean that the process is not as straightforward elsewhere, and in those member states only, some disclosure or other mechanism may be helpful. However, we must emphasise that this is an area where a one-size fits all solution is particularly inappropriate, and that such a mechanism would quite simply be unworkable in the UK or Irish market.

Questions 15 and 16: Which is the best way to make the investment process more transparent?

The first step in improving the transparency of the investment process would be to enable issuers to identify the underlying holders of the shares more easily through a legal right to demand disclosure. For the reasons set out in our preamble, if issuers are able to identify their investors, they are then able to initiate discussion and engagement. We believe that this would be more effective than requiring disclosure of investment intentions.

We do not believe that there is any need to alter the current requirements on investors to disclose their investment intentions, recognising that these intentions may fluctuate and develop over time. Investors may also wish for legitimate reasons to develop their strategies confidentially and premature disclosure could distort the market.

We recognise that whilst some shareholders hold shares for the long term and wish to engage actively with the companies in which they invest, there are other shareholders who may hold shares on a short term basis and who may have less of an interest in engagement with issues. It would therefore be difficult to require all shareholders to disclose their voting policies. Nevertheless, we believe that it would be useful for issuers if investors who wished to do so were to disclose their voting policies. Investors who chose not to engage could also be required to disclose that they chose not to vote in the companies where they held investments.

It should be noted that our suggestions serve to improve disclosure between issuers and their investors and that there could be a further argument that this still does not improve transparency in the market. Were steps to be taken to enable issuers in other member states

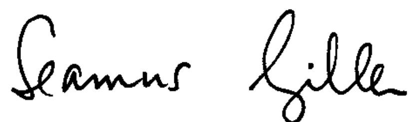
to identify their underlying shareholders more easily, a corresponding requirement could also be introduced to require issuers to make the results of such enquiries available on request. This would be similar to the UK Companies Act requirement under S808 to maintain a register of responses received to s793 requests.

Part III of the Consultation Document

Questions 19-24 Our preamble covers the response to the remaining questions but we would add the following specific comments in response to questions 19 and 20.

We can see the benefit from an investor perspective of there being a uniform EU regime. We very much support a disclosure threshold of 3% and note the statement in the Staff Working Document that there appears to be convergence towards this disclosure threshold as opposed to the current 5% threshold. We consider that those states that have adopted the 3% threshold should be permitted to retain it, even if the rest of Europe continues with a 5% threshold. We therefore do not think that Member States should be prevented from adopting more stringent requirements if the current threshold of 5% is retained. Similarly, we would support lower disclosure thresholds in special circumstances, such as takeovers, should that be a requirement in a particular member state.

Yours faithfully



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