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23 August 2010

ecoDa's response to the European Commission's consultation on the modernisation of the Transparency Directive (2004/109/EC)

Dear Sir / Madam,

Thank you for giving ecoDa the opportunity to comment on your consultation document, published on 27 May 2010. Issues surrounding corporate governance are of considerable interest to ecoDa and its national director associations. We are therefore pleased to present our views on your paper.

About ecoDa

ecoDa, the European Confederation of Directors' Associations, is a not-for-profit association acting as the European voice of board directors, active since March 2005 and based in Brussels. Through its 10 national institutes of directors, ecoDa represents around fifty-five thousand board members from across the EU, ensuring that their views on Corporate Governance are clearly communicated to policymakers in the EU institutions. ecoDa's member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted. ecoDa acts as a high-level forum for debate and for the exchange of experiences to promote high standards for directors. It acts as a standing body where national experiences are shared and discussed in detail.

Initial remarks

ecoDa believes that the Transparency Directive (2004/109/EC) has provided a **useful framework of disclosure** for the users of this information (the investors and related capital market parties, like analysts) as well as for the providers of disclosure (issuers of listed securities on regulated markets in the EU).

The disclosure requirements of the Directive are broadly sensible. **The costs of compliance for larger listed companies are acceptable** (although we would not be in favour of significant additional requirements).

However, the “one size fits all” nature of the Directive imposes a disproportionate cost on smaller listed companies. In particular, the need for issuers to publish half-yearly reports within two months of the end of the accounting period is an onerous requirement for SMEs which is not justified in terms of potential benefits.

ecoDa favours the introduction of a more flexible SME reporting regime which would limit the informational detail and spread the publication of periodic reports over an extended period of time. In addition, ecoDa believes that SMEs should be exempt from any requirements for quarterly reporting (including interim management reports). Such reforms would reduce compliance costs and assist market functioning.

A more flexible regime would be consistent with the recommendations of the International Organisation of Securities Commission (IOSCO), and reflect current practice in US securities markets. It would also reflect the views of the majority of issuers in the recent Mazars study on the functioning of the Transparency Directive¹.

ecoDa is not persuaded that changes to the Transparency Directive will significantly alter the lack of market visibility experienced by smaller listed companies. A change of this nature would require structural changes to the behaviour of institutional investors. However, we agree that it would be **very useful for the EU to develop a single EU portal** through which to access regulated information disclosed by smaller listed companies across the EU.

With respect to the **notification of major holdings** in a company's shares, **ecoDa does not believe that this should be subject to maximum rather than minimum harmonisation requirements (as at present).** The imposition of a maximum harmonisation regime could dilute standards in those markets that aspire to higher levels of market transparency. Conversely, it would impose a significant new burden on those countries that are currently only complying with the minimum requirements of the Directive. Neither of these outcomes would be justifiable in relation to the benefits that might accrue to issuers in terms of greater market visibility.

ecoDa is supportive of measures that would **increase the transparency of stock lending practices and discourage the use of “empty voting”.** Such

¹ Mazars. Transparency Directive Assessment Report. December 2009.

practices are not helpful to good corporate governance. Stock lending reduces the incentive of investors to engage with their investee companies. Empty voting lacks legitimacy as the investor no longer has an economic interest in the company and does not bear the consequences of their voting decisions.

ecoDa also believes that transparency should be increased with respect to position building “by stealth” through cash-settled derivatives. **Financial innovation should not be used to circumvent transparency requirements.** Disclosure requirements for cash-settled derivatives have already been introduced in the UK, France and Switzerland. It would be helpful if a common notification regime existed throughout the EU.

ecoDa response to specific questions

Responses are provided to some of the specific questions that are posed in the Consultation Paper. We reserve our comments for issues which are of particular concern to ecoDa and its member organisations.

I. Attractiveness of regulated capital markets for small listed companies.

1. Do the Transparency Directive obligations for issuers (e.g. disclosure of annual and half-yearly financial reports, quarterly information etc.) impact on the decisions of small listed companies to be listed in or to exit regulated markets (e.g. do they act as an entry barrier)?

A basic principle of capital markets regulation is the need to find a balance between the benefits to investors of greater disclosure and the costs to issuers of delivering this information.

In contrast to larger listed companies, the costs to smaller companies imposed by the disclosure requirements of the Transparency Directive are often not justified by the benefits that such companies experience in terms of greater access to capital.

The “one size fits all” nature of the transparency regime exerts a disproportionate cost impact on smaller listed companies. This perception is supported by the findings of the recent Mazars report on the impact of the Transparency Directive. This report found that 63% of large companies did not view compliance with the Transparency Directive as onerous, whereas the same opinion was shared by only 39% of small companies².

The cost of ongoing disclosure requirements creates an incentive for smaller companies to avoid listing on regulated markets unless this can be justified by significant benefits in terms of access to external (growth) capital.

² Mazars report, page 71.

2. Which are the most important costs for small listed companies associated to compliance with the Transparency Directive (e.g. cost of preparing the accounts, auditing costs, legal costs, cost of making public the information etc.)?

The most important ongoing costs are those incurred in preparing and auditing accounting information in order to fulfil the Directive's financial reporting deadlines. This is more challenging for SMEs, as they often have less in-house financial expertise and may have to seek external expertise (at extra cost). It also tends to exert a greater direct burden on the management time of the board and senior management.

A particularly onerous requirement imposed by the Directive is that of publishing half-yearly reports within a two month deadline. This is particularly problematic if accounts must be audited by an external auditor on a voluntary or obligatory basis. An obligatory audit is currently a legal requirement in five European countries: Austria, France, Italy, Poland and Spain.

3. What changes of the Transparency Directive will bring important reductions in costs for small listed companies?

In our view, it is important for any governance regime to take account of the size and/or level of complexity of an enterprise. This principle applies as much to transparency and reporting requirements as it does to other aspects of corporate governance.

ecoDa is supportive of the idea of a distinct transparency regime for SMEs. As argued in the Mazars report, "A specific regime for SMEs, limited to well-identified measures, would create a more favourable environment for listing and, if in relation to the timing of the publication of periodic information, it would contribute to the efficiency of the market. Without undermining investor protection, well identified measures could include more flexible deadlines and an exemption from certain disclosure obligations during an initial period of time"³.

We recognise that accounting rules rather than the Transparency Directive are the source of many disclosure obligations for smaller listed companies. However, there are several aspects of the Directive which could be reformed in order to create a more flexible transparency regime for smaller listed companies. These include the following:

➤ **More flexible deadlines for the disclosure of financial reports.**

As previously stated, the two-month deadline for the publication of the half-yearly financial report is particularly challenging for smaller listed companies. A longer reporting deadline for smaller companies in respect of both the annual and half-yearly reports (as currently practised in the US) would reduce the financial reporting burden.

³ Mazars report, page 35.

A further finding from the Mazars report is that a common reporting deadline for all listed companies contributes to a lack of visibility for smaller companies due to the focus of analysts and the media on large companies during the reporting season. This problem could also be alleviated by a different reporting schedule for small companies.

➤ **No obligation to produce quarterly financial information**

In our view, an obligatory requirement to produce interim management statements or financial information on a quarterly basis is unhelpful for both large and small listed companies. As well as giving rise to significant reporting costs, it may well contribute to a culture of short-termism in company decision-making and corporate performance measures.

We are particularly doubtful about whether any form of quarterly reporting at smaller listed companies can be justified. Consequently, we are in favour of removing any requirements for quarterly reporting in respect of SMEs from the Directive.

➤ **Measures to facilitate the cross border visibility of smaller listed companies.**

We are supportive of initiatives that could increase investor access to disclosed information on a cross-border basis. This would include access to annual reports, half yearly reports, and price sensitive press releases.

The development of a centralised EU access portal for regulated information could be a useful step, particularly in combination with a greater requirement for issuers to store regulated information on their websites⁴. Alternatively, greater linkage and coordination of existing national storage mechanisms should be explored.

However, we are sceptical of the value of large scale European initiatives that might duplicate national data storage systems at EU level. Such projects could potentially absorb significant time and resources. We do not feel that the costs of such an initiative would be justified by the potential benefits.

4. How does the visibility problem materialise (e.g. lower attention of analysts, lower investment levels, lower trading etc.) for (objectively) well performing small companies?

Smaller listed companies face a number of difficulties in gaining the attention of investors and stockmarket analysts.

Firstly, small cap stocks (particularly those outside of domestic markets) are viewed as much riskier than large cap stocks due to their lower liquidity and (by consequence) greater volatility in share price. Investment in such stocks can only be justified on the basis of a proportionately greater investment in research and specialist know-how. However, in many instances, investors find it uneconomic to

⁴ It should be noted that the storage of Regulated Information on the website of the issuer is already compulsory in several Member States. Mazars report, page 169.

develop this know-how, and prefer to focus their attention on well-known large cap companies.

Secondly, for large funds, positions in even strongly outperforming small cap stocks are unlikely to make much of an impact on the fund's overall investment performance. Furthermore, it can be difficult for fund managers to take significant positions in small cap companies due to the impact that this will have on the share price. This further reduces the incentive of fund managers to devote attention to smaller cap stocks.

A low level of interest from the "buy side" has a knock on effect on the "sell side". A lack of turnover in small cap stocks from investors makes it difficult to generate brokerage commissions. As a result, relatively few brokerage research and trading resources are dedicated to smaller cap companies.

None of these underlying problems has been addressed or overcome by the Transparency Directive.

5. Are there, in your view, other cases reflecting low benefits for small listed companies resulting from disclosure obligations compared to larger listed companies?

No response.

6. What would be the optimal definition of a "small listed company" in the context of regular (i.e. after the admission to trading of the securities) transparency requirements?

In our view, a listed company with a market capitalisation of **less than €1 billion** should be subject to a less onerous transparency regime. This covers both small and many medium-sized listed companies.

7.1 If a differentiated regime for small listed companies is added to the Transparency Directive with a view to reduce the compliance costs of those companies, would it be desirable to prevent Member States/regulating markets from imposing in national law/listing rules more stringent or additional obligations on small listed companies?

No. We believe that the upper ceiling for transparency requirements is a matter for national regulators to determine. The imposition of a maximum harmonisation regime could undermine standards in those markets that are currently seeking to secure a high level of market transparency. Conversely, it might impose a significant new burden on those countries that are currently only complying with the minimum requirements of the Directive.

7.2 Do you think that an extension of the deadline for the publication of financial reports would imply a reduction in legal, auditing or other type of costs?

Yes. We believe that, in particular, accounting and auditing costs would be reduced. It would also relieve the burden on boards and senior management in the period after year end.

7.3 Do the various rules requiring the disclosure by listed companies of reports of narrative nature bring significant costs/operation complexity for small listed companies (e.g. legal, account preparation, auditing, other type of costs)?

Yes. The cost of such reporting is disproportionately higher than at larger companies. In addition, the reporting requirements impose a direct burden on board members and/or senior management. There is less scope to delegate the task to more junior support staff.

7.4 Would you see benefits from integrating in the Transparency Directive the disclosure obligations mentioned in question (8.3) which are currently in different directives?

No response

7.5. If the Transparency Directive provided for maximum harmonisation (no national add-ons) of the content of narrative reports referred to in question (7.3) for small listed companies, would this imply a reduction in legal, auditing or other type of costs?

It would depend on where the maximum harmonisation standard was set. If the standard was set at a high level, this could result in a significant increase in costs for companies in countries that are currently applying the minimum requirements of the Transparency Directive.

7.6. In case you think maximum harmonisation regarding the content of narrative reports referred to in question (7.5) is desirable, what do you think would be the best way?

Not applicable.

7.7. Concerning question (7.6), could you provide a specific reply regarding the disclosure of environmental and social data requested in Article 46(1)(b) of the Fourth Company Law?

Not applicable.

8.1. Is it possible to apply lighter transparency obligations for small listed companies without a corresponding significant diminution of transparency provided to the market?

Yes. As argued above, the poor visibility of smaller listed companies in capital markets is not primarily a result of the impact (or lack of impact) of the Transparency Directive.

8.2. If the obligation to disclose quarterly financial information was waived for small listed companies, would this result in an unreasonable diminution of transparency?

No. The benefits in terms of reduced costs would exceed the negligible benefits of greater transparency arising from quarterly reporting.

9.1. Do you think that measures at EU level (including possible changes to the Transparency Directive) can help solving the lower visibility of smaller listed companies?

Only marginally. The primary obstacle to greater visibility of smaller listed companies is the structure and incentives of the institutional asset management industry (see answer to question 4).

9.2. What type of measures at EU level could help solving the visibility problem of small listed companies?

We do not believe that it will be easy to transform the perspective of institutional investors with respect to investments in small cap stocks.

However, the development of a more vibrant venture capital and private equity sector in Europe could, in many cases, represent a more viable source of external funding than public equity markets for smaller companies.

9.3. Do you think that the development of an EU database storing regulated information on all issuers of securities in the EU will facilitate research and create interest/result in greater attention in small listed companies by financial analysts, financial intermediaries and investors?

No. there is a significant risk that such a project would be excessively costly relative to the benefits that it would deliver to companies and investors. Furthermore, it could duplicate or undermine work that is being undertaken at national level. We would favour the exploration of a less ambitious solution to the problem of information dissemination, e.g. a central EU portal that facilitates access to issuers' websites or national databases. Such portal could form the link between all national information systems and give access to the relevant national and corporate websites.

10. Do you have any other views on regular transparency requirements which could make regulated markets more attractive to small listed companies?

No response.

II. Information about holdings of voting rights.

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

Yes. It should not be possible for market participants to use complex derivative securities for the purpose of avoiding disclosure requirements, e.g. to build a hidden ownership stake in a company. The UK and France have already implemented new disclosure requirements in order to take into account the use of this type of financial instrument. The Directive should follow this approach.

12. If the Transparency Directive was to require holders of cash-settled derivatives to disclose their positions,

12.1. should holdings of cash-settled derivatives be aggregated to holdings of voting rights and/or of financial instruments giving unconditional access to voting rights for the purposes of calculating whether the threshold triggering the disclosure obligation is reached or crossed?

Yes. There should be aggregation of all derivatives and shares for the purpose of computing the notification thresholds and notification in the event that the relevant thresholds are crossed.

The identification of shareholders is a precondition for effective company-shareholder engagement. As part of this process, boards need to know the identity of the holders of voting rights in their company, regardless of whether these voting rights arise through direct holdings of shares or more complex financial instruments.

12.2. and if such disclosure of cash-settled derivatives should be done independently of voting rights and of other financial instruments, which threshold should be applied?

Not applicable.

13. 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?

ecoDa is aware of the fact that liquidity of shares is essential for investors in listed companies. As such, the normal trading of shares should not be limited by additional barriers. However, ecoDa fully agrees with the observation that measures, such as specific disclosure mechanisms, need to be installed to cope with the problem of empty voting. Company law confers voting power on shareholders on the basis that they have an economic interest in the company. Empty voting allows market participants to exert influence on companies without any personal financial consequences. This undermines the accountability chain between companies and shareholders, and is therefore detrimental to good corporate governance.

A number of recent cases have shown the potential for abuse resulting from this type of conduct (for the instance the Laxey Partners case in the UK, the OMV / MOL case in Hungary, the Perry/Milan case in the US and the Henderson Land case in Hong Kong)⁵.

Therefore, disclosure by investors of stock lending and empty voting activities is required. ecoDa wants to stress that it is bad practice to borrow shares for the purpose of shareholder voting. ecoDa is indeed supportive of the principles of stock lending that have been defined by the International Corporate Governance Network's Securities Lending Code of Best Practice (2007). The principles emphasize the importance of transparency, consistency and responsibility in securities lending practices. The key points are as follows:

- Institutional shareholders should have a clear and disclosed policy with respect to the lending of shareholdings;
- Lending policy should be mandated by the ultimate beneficial owners of the shares;
- Where lending activity may alter the risk characteristics of a portfolio, the investor's investment policy should state the extent to which this is permitted;
- The returns from lending should be disclosed separately from other investment returns when reporting to clients or beneficiaries;
- It should be regarded as bad practice to borrow shares for the purpose of shareholder voting.

14. If a specific disclosure obligation is imposed regarding the transfer of voting rights independently of the shares between the record date and the general meeting,

14.1. which threshold of voting rights should be applied in order to trigger the obligation? E.g. 0,5%, 1%, 2%, other.

The specific figure is a matter for debate. However, any transfer of voting rights that could exert a material impact on the outcome of the vote should be disclosed.

⁵ Mazars report, page 96.

14.2. which time-limit for the disclosure should be applied for this disclosure to be useful? E.g. immediate disclosure; no later than 1 day, other.

The disclosure should be made immediately.

15. Which is the best way to make the investment process more transparent (with respect to the disclosure requirements for significant holdings of voting rights)?

We believe that investors should disclose their voting and engagement policies. This would allow fund managers to be held accountable for their approach to company ownership. Disclosure of actual voting records by institutional investors would also be helpful.

We are not convinced that the publication of a “statement of intentions” by investors above a certain ownership threshold (e.g. in respect of their control intentions for the company, or their plans for its strategy or board composition) would be helpful to corporate governance. It would not be feasible to hold investors to their stated intentions, and their plans could rapidly change. As a result, a formal requirement for such a statement could give rise to unhelpful boilerplate disclosures.

It is more important for companies to be able to identify their major shareholders on a timely basis. This would offer the possibility of an engagement process that would allow the board and shareholders to become fully informed regarding mutual intentions and preferences.

16. If investors were required to disclose to the market which their intentions are with regard to their investment,

16.1. Would such disclosure be useful?

No. See answer to question 15.

16.2. Which should be the minimum threshold triggering such disclosure?

No. See answer to question 15.

16.3. What should such disclosure consist of?

No. See answer to question 15.

17. Should holdings of shares and voting rights be aggregated with holdings of financial instruments giving unconditional access to voting

rights for the purposes of calculating the relevant thresholds that trigger the notification obligation?

Yes.

18. Are there other cases of potentially insufficient transparency regarding corporate ownership?

No response.

III. Ineffective application of the Directive because of diverging national measures and/or unclear obligations in the Directive

19. Would it be desirable to set up a uniform EU regime (e.g. by a directly applicable EU Regulation) for the notification of major holdings of voting rights?

No. The current minimum harmonisation regime is preferred. This allows national regulators to tailor disclosure requirements to national circumstances (above a minimum level defined by the Directive). Individual countries should not be prevented from establishing an environment for transparency that goes beyond the regime of other EU states.

20. If a fully uniform EU regime is not possible because of insurmountable legal barriers, should Member States be prevented from adopting more stringent requirements than those of the Transparency Directive regarding the notification of major holdings of voting rights?

No. See answer to question 19.

21. Would it be desirable to set up a uniform EU regime (e.g. by a directly applicable EU Regulation) regarding issuers' disclosures?

No. See answer to question 19.

22. Could you please explain in what way national rules implementing the Directive result in different methods for aggregating holdings of voting rights (and where applicable financial instruments) for the purposes of calculating whether the relevant thresholds triggering the notification obligation are reached or crossed by investors?

No response.

23. Could you provide evidence of cases where unclear rules in the Directive ought to be clarified?

No response.

IV. Any other comments

24. Do you have any other comments regarding the Transparency Directive?

We do not believe that the Transparency Directive is the appropriate vehicle through which to address issues of Environmental, Social and Governance (ESG) disclosure.

ecoDa's Policy Committee

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