EUROPEAN COMMISSION

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COMMISSION STAFF WORKING PAPER

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

Proposal for a

Directive of the European Parliament and ofthe Council amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC

{COM(2011) 683 final}
{SEC(2011) 1279 final}

1. INTRODUCTION

The Transparency Directive[1] ("the Directive") requires issuers of securities traded on regulated markets within the European Union ("EU") to ensure appropriate transparency for investors through the disclosure and dissemination of regulated information[2] to the public.

Five years after the entry into force of the Directive, the Commission published a Report[3] assessing the impact of the Directive. The Report recognised the Directive as useful for the proper and efficient functioning of the market, however it highlighted areas for improvement.

In 2010, the Commission launched a public consultation on the modernisation of the Directive. The main issues raised were: the attractiveness of the regulated markets for small and medium - sized issuers "SMIs" and ways to improve the regime for major holdings of voting rights.

The respondents to the public consultation varied in their views as to whether the situation of SMIs could be improved through changes to the Directive. Concerning holdings of voting rights, the public consultation demonstrated general agreement on the need to include a requirement to notify holdings of cash-settled derivatives[4] and to increase the level of harmonisation in this area. In addition, calls were made for greater clarity in certain technical areas.

Finally, in 2010, the Commission agreed with the European Parliament to evaluate the feasibility of requesting certain companies to disclose key financial information regarding their activities in third countries[5]. A separate impact assessment on this issue concluded that the Transparency Directive and the Accounting Directives[6] should be modified to include a new requirement in this respect.

2. PROBLEM DEFINITION

The problems identified with the existing regime can be grouped into two main categories: a) SMIs; and b) the requirements regarding the notification of major holdings of voting rights.

2.1. Problems identified in relation to SMIs

There is no legal definition of SMIs in the EU. Where reference is made to SMIs in this document, this should be understood in terms of the existing national concepts used in MS.

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1 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004.

2 The term regulated information includes, annual, half-yearly and quarterly financial information, on-going information on major holdings of voting rights and ad hoc information disclosed pursuant to the Market Abuse Directive (Directive 2003/6/EC).

3 COM (2010) 243 FINAL of 27 May 2010. The report was accompanied by a more detailed Commission staff working document (SEC(2010061)).

4 Cash-settled equity derivatives refer to equity linked transactions settled by the payment of cash only without any physical delivery of the underlying equity.

5 http://register.consilium.europa.eu/pdf/en/10/st15/st15650-ad01.en10.pdf

6 The Fourth Council Directive 78/660/EEC on annual accounts and the Seventh Council Directive 83/349/EEC on consolidated accounts.

Improving the regulatory environment for SMIs and facilitating their access to capital are high political priorities for the Commission[7]. Although transparency requirements are not considered to be the only source of problems faced by SMIs, they contribute to the high costs of compliance linked to listing on the regulated markets, their low visibility to analysts and investors, and the culture of short-termism.

2.1.1. High costs of compliance for SMIs

The objective of the Directive is to provide accurate, comprehensive and timely information to the market. Issuers are required to publish annual, half-yearly and quarterly financial information[8]. The Directive imposes a minimum requirement to publish Quarterly Interim Management Statements with limited content. However, many MS require additional items to be disclosed. For SMIs, the costs incurred through the publication of quarterly financial information are relatively high, while the utility of this obligation is not clear.

In addition, compliance with the strict deadline for the publication of half-yearly reports, as well as the complexity of the content and the types of information to be disclosed in the narrative parts of the reports, can also be costly and resource-intensive for issuers.

2.1.2. Focus on short-term results

The need to publish quarterly financial information could lead to pressure on management to demonstrate profits each and every quarter. Quarterly reporting could also be perceived as a regulatory incentive for investors to focus on the short-term performance of companies rather than taking a longer-term view.

2.1.3. Lower visibility of SMIs

The short deadline for the half-yearly reports, (two months after the end of the reporting period), creates a bottleneck at the end of the second month which disrupts the market, overloads investors and analysts with financial information and accentuates the tendency for them to restrict their attention to the largest market-leading companies, and to take little interest in SMIs. This is particularly the case for the majority of European issuers whose accounting year corresponds to the calendar year, and for whom this deadline therefore falls in late August. This contributes to the low visibility of SMIs in relation to investors and analysts.

The difficulties facing investors who wish to access published information, due to the insufficient interconnection of the various national storage mechanisms, is another issue limiting the visibility of SMIs.

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7 Communication from the Commission: "Towards a Single Market Act - For a highly competitive social market economy - 50 proposals for improving our work, business and exchanges with one another", COM(2010) 608 final and Communication from the Commission "Single Market Act - Twelve levers to boost growth and strengthen confidence- Working together to create new growth", COM(2011) 206 final.

8 Either quarterly financial reports or interim management statements: also referred generally as quarterly financial information.

2.1.4. Problems identified in relation to the notification of major holdings of voting rights

The Directive requires issuers to notify the market whenever they acquire or dispose of shares admitted to trading on a regulated market to which voting rights are attached (that is, to notify the proportion of voting rights held whenever that proportion reaches, exceeds or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%). Two problems have been identified with the current regime: hidden ownership as a result of gaps in the rules for notification; and divergent notification rules across MS.

2.1.5. The possibility of hidden ownership

Since the adoption of the Directive, the use of cash-settled derivatives in the market has increased substantially. Cash-settled derivatives can be used to acquire and exercise influence over a listed company or to build a hidden stake in a company (there are several reported examples of such behaviour[9]). However, they are not currently covered by the Directive's rules for disclosure. This omission can lead to possible market abuse, inefficiency in the price formation mechanism, and empty voting, resulting in low levels of investor confidence and misalignment of the interests of investors with the long-term interests of the companies themselves.

2.1.6. Divergent notification rules across MS leading to increased liability and regulatory risk and high compliance costs for cross-border investors

Divergent notification rules across MS, in particular regarding aggregation of holdings of shares with those of the financial instruments, raise costs and create legal uncertainty for investors who participate in cross-border activity. Lack of aggregation of holdings of shares with those of the financial instruments also leads to lower level of transparency within some MS.

3. SUBSIDIARITY

The EU has the right to act in this area according to Articles 50 and 114 of the TFEU. All the problems identified concern the EU capital market in its entirety, and so, for changes to be effective, they should be made at EU level.

In addition, the problems identified concerning SMIs derive from EU and MS legislation and can only be addressed through changes in the EU legislation. Finally, only an instrument adopted at the EU level would ensure that all MS apply the same regulatory framework based on the same principles, thereby ending the current fragmentation of the regulatory response with regard to the notification of major holdings.

[9] Exemples: LVMH/Hermes, Porsche/VW, Schaeffler/Continental.

4. OBJECTIVES

The measures envisaged should simplify certain obligations so as to help ensure that regulated markets are attractive to SMIs, and should improve the legal clarity and effectiveness of the transparency regime with respect to the disclosure of corporate ownership.

5. POLICY OPTIONS: ANALYSIS OF IMPACTS AND COMPARISON

To realise the objectives set out above, the Commission has designed, analysed and compared different policy options to determine which options satisfactorily address the problems identified. These options are set out below.

5.1. Policy options to allow for more flexibility regarding the frequency and timing of publication of periodical financial information for SMIs

(1) *No action* – this option would not achieve the objective. This option is therefore discarded.

(2) *Abolish the obligation to present quarterly financial information for SMIs* – This option would reduce both costs for SMIs and regulatory incentives which can encourage short-termism. However, introducing differentiated regimes for companies listed on regulated markets according to their size could be confusing for the investors, and could also lead to lower visibility for SMIs. This option is therefore discarded.

(3) *Abolish the obligation to present quarterly financial reports for SMIs during an initial period of 3 years after admission to trading* – Although alleviating the immediate pressures faced by SMIs, this option would only delay the costs. Introducing differentiated regimes for companies listed on regulated market according to their size and their age could be confusing for the investors. This option is therefore discarded.

(4) *Abolish the obligation to present quarterly financial reports for all listed companies* – This option would reduce companies' compliance costs. The average estimated cost reduction, excluding costs linked to preparation of the quarterly information, ranges from 2 k€ to 60 k€ per year/per issuer for SMIs and from 35 k€ to 250 k€ per year/per issuer for large issuers. The reduction in costs concerning the staff employed to prepare this information could not be estimated in monetary terms for SMIs: this reduction varies widely from one issuer to another; from 8 man-days per year to 30 man-days per year. For large issuers, the maximum total cost reduction (including costs linked to the staff involved in preparation of these reports) could be estimated as being a maximum of 2 M€ per year per issuer. It should enable the SMIs to redirect their resources to publish the kind of information that best suits their investors. This option should reduce short-term pressure on issuers and incentivise investors to adopt a longer-term vision. It should not have a negative impact on investor protection. Investor protection is already sufficiently guaranteed through the mandatory disclosure of half-yearly and yearly results, as well as through the

disclosures required by the Market Abuse and Prospectus Directives[10]. Therefore, investors should be duly informed about important events and facts that could potentially influence the price of the underlying shares, independently of the quarterly information as foreseen in the Directive. Thus, it does not seem necessary to mandate disclosure of interim management statements in legislation. To be effective, this option should also prevent MS from imposing in national legislation the publication of quarterly information. Companies would have discretion to publish quarterly information if they so desire.

(5) *Extending the deadline for the publication of half-yearly information to 3 months after the end of the relevant reporting period for all listed companies* – For SMIs, there would be some cost savings, however the most important benefits would be non-monetary. Issuers would have extra time to draft their reports, thus improving the quality of their output. This option would also have a positive impact on the visibility of SMIs as they would be able to time the publication of their reports more easily so as not to fall at the same time as that of the reports by large listed companies. This would mean analysts and investors would have more time available to look at the half-yearly results of SMIs.

(6) *Extending the deadline for the publication of half-yearly information to 3 months after the end of the respective reporting period for SMIs* – This option would have positive impact on visibility of SMIs. However, introducing differentiated regimes for companies listed on regulated markets according to their size could be confusing for investors. This option is therefore discarded.

5.2. Policy options to simplify the narrative parts of financial reports for SMIs

(1) *No action* – this option would not achieve the objective. This option is therefore discarded.

(2) *Harmonising the maximum narrative content of financial reporting at the EU level for SMIs* – Standardising the content of reporting may lead to increased compliance costs for SMIs located in those MS where the requirements are currently low. This option would, however, facilitate comparability of financial information across the EU. But if the threshold for content at the EU level was set too low in the hope of saving costs, this might in turn have negative implications for investors. This option is therefore discarded.

(3) *Requiring ESMA[11] to prepare non-binding guidance (templates) on narrative content of financial reports for all listed companies* – This option would enable ESMA to target the template so as to ensure cost savings. It would also facilitate comparability of information for investors and could increase the cross-border visibility of SMIs. It would entail some one-off costs for ESMA.

(4) *Requiring MS to prepare non-binding templates or guidance on the content of the narrative aspects of reporting* – This option would allow MS to adapt the content of

[10] Directive 2003/6/EC and Directive 2003/71/EC.

[11] European Securities and Markets Authority.

the reports to their internal market. It would not, however, facilitate the cross-border comparability of information. This option is therefore discarded.

5.3. Policy options to eliminate the gaps in requirements for notification concerning major holdings of voting rights

(1) *No action* – this option would not achieve the objective. This option is therefore discarded.

(2) *Broad regime: disclosure regime extended to all instruments with similar economic effect to holding shares and to entitlements to acquire shares* – This option would capture cash-settled derivatives, as well as any similar financial instruments that may emerge in the future. It was supported by the majority of respondents to the consultation as a solution to the problems described above. It would have a strong positive impact on investor protection and confidence. The new disclosure regime covering all types of financial instruments equivalent to share ownership might cause an increase in the organizational and compliance costs for holders of cash-settled derivatives (the maximum estimated one-off costs are from 100 k€ to 600 k€ per holder of cash-settled derivatives, but they would concern only investors who hold a significant quantity of these instruments). The ongoing costs could not be estimated as they would vary depending on the increase in practice in the number of disclosures per holder. However, following the experience in the UK which has already introduced such a regime in 2009, the increase in notifications is estimated to be limited.

(3) *Limitative approach: disclosure not required in case "safe harbor" criteria are met*– This option would require all instruments giving access to the underlying voting rights to be disclosed unless some specified criteria are met. It would still enable investors to circumvent the purpose of the disclosure requirement. This option is therefore discarded.

5.4. Policy options to eliminate divergences in notification requirements for major holdings

(1) *No action* – this option would not achieve the objective. This option is therefore discarded.

(2) *Harmonise the regime for the disclosure of major holdings of voting rights by requiring the aggregation of holdings of shares with those of financial instruments giving access to shares (including cash-settled derivatives)* – This option would harmonise the method used to calculate the thresholds, but not the thresholds themselves, thus creating a uniform approach that would reduce legal uncertainty, enhance transparency, simplify cross-border investments and increase the attractiveness of EU capital markets. The estimated reduction in on-going costs for cross-border investors is 77 k€/year/operator. This option could, however, create some additional costs linked to additional disclosures in those MS where there is currently no aggregation requirement.

(3) *Harmonise the regime for the disclosure of major holdings of voting rights by requiring 3 separate regimes of disclosure: one for holdings or shares, one for financial instruments giving access to shares, and one for cash-settled derivatives –*

This option would create a uniform regime, but may have a negative impact on investor protection and confidence. This option is therefore discarded.

(4) *Harmonise the regime of disclosure of major holdings of voting rights by harmonising the thresholds for disclosure* – The thresholds of voting rights were not considered a major issue by the majority of respondents. In addition, thresholds for notification seem to be difficult to harmonise because of the differences in shareholding population from one MS to another. This option is therefore discarded.

6. THE INSTRUMENT TO BE USED AND TRANSPOSITION AND COMPLIANCE ASPECTS

Only a binding legal instrument would ensure that all MS apply the same regulatory framework based on the same principles. A directive would allow for maximum harmonisation in some areas, but would still leave MS flexibility to allow their specific situation to be taken into account in other areas.

To ensure a better implementation of the Directive, and following the Commission's Communication "Reinforcing sanctioning regimes in the financial sector"[12], the existing framework for sanctions should also be improved.

7. MONITORING AND EVALUATION

The Commission will monitor how the MS implement the Directive. Where needed, the Commission services will offer assistance to the MS. The evaluation of the impact of the application of the legislative measures should take place six years after the entry into force of the legislative measures. The Commission will monitor the application of the Directive, as amended, through ESMA and through extensive dialogue with major stakeholders.

[12] Communication of 9 December 2010: COM(2010)716 final.