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Standardising the disclosure of significant shareholdings

The disclosure of significant shareholdings is an important tool for ensuring fair and orderly markets in public companies. Most IOSCO members therefore require a person having a significant interest in shares of quoted companies listed or incorporated in that jurisdiction to disclose their interest to the market. Despite this shared overarching objective, however, each jurisdiction applies different rules. There are important differences in disclosable thresholds, in timing, and in definitions of what is reportable as a significant interest.

To date there has been no international effort to promote consistency between different jurisdictions, although the Transparency Directive is a step towards further harmonisation in the EU. Given the increasing globalisation of financial markets, a standardised regulatory approach to the disclosure of shareholdings would, we believe, reduce costs and increase efficiency of reporting to the benefit of investors, regulators and financial institutions. The key areas where we would urge IOSCO to consider a standardised approach are highlighted below.

<u>Suggested priority areas for standardisation</u>

1 <u>IOSCO members should have a clear, consistent objective for disclosure rules</u>. One of the reasons for the divergent approaches in different jurisdictions may indeed be the lack of a recognised rationale for the imposition of disclosure regimes. Before considering how the regimes could converge, agreement on the underlying purpose of these requirements would be beneficial. We recommend that IOSCO set a common objective of ensuring fair and orderly markets by requiring that investors or potential investors in the shares of a public company are informed of significant changes in the holdings of voting rights .

2. <u>Disclosure should be limited to the control of voting rights.</u> in publicly traded shares. Requiring disclosure based on pure legal title, rather than on beneficial ownership or the disclosure of interests in shares without full voting rights can confuse investors. So too can the disclosure of convertibles, warrants and other rights which are exercisable into new shares which are not counted in the denominator of the calculation of the percentage holding. We also believe that requiring the disclosure of pure economic interests, including contracts for differences and other cash settled derivatives, increases the complexity of rules while potentially obscuring the information that is most material to investors, namely actual control over voting rights. The treatment of stock lending is similarly potentially confusing and often leads to significant number of disclosures of a chain of stock lending and borrowing which creates opacity rather than transparency. It is usual market practice that voting rights will be transferred to the borrower and the lender is therefore not entitled to exercise any such rights until the stock is redelivered to him.

3 <u>Disclosure should be based on end of day net positions.</u> No disclosure regime should result in a deluge of immaterial disclosures that distracts the attention of investors and regulators from disclosures that reveal significant changes in the structure of voting control. It should be clear that intra day positions are not reportable. It should also be clear that end of day netting is permitted, particularly of stock borrowing and lending and of derivatives. This would for example help avoid the numerous disclosures that can result from stock lending chains.

4. There should be clear and consistent rules on group aggregated reporting. Most jurisdictions require the aggregation of group holdings and financial institutions spend significant time and resources putting in place systems to gather the information necessary for them to determine their positions on a consolidated basis. Aggregation should only apply to easily identifiable consolidated groups and should exclude holdings held by entities in which only a minority interest is held, short term, trading book positions of banks and securities firms and the interests of investment managers which operate behind information barriers and independently of other areas within the group.

5. Data on outstanding number of shares issued should be published and disclosure statements based on these numbers should be accepted by regulators. We recommend that issuers be required to disclose shares in issue and that exchanges where the shares are listed should publish the information. Rules on any particular disclosure requirements should similarly be published. It would also be beneficial if the authority to which the disclosures were made were also the authority with whom a person may discuss and seek clarification of the rules.

6. IOSCO members should allow sufficient time to compile disclosure reports. In global markets, firms have to wait for the end of trading in all time zones order to begin to gather the necessary data. We recommend that firms be given five days to report.

7. IOSCO members should standardise the reporting thresholds. The thresholds at which basic disclosure obligations are required vary, without a clearly defined reason, across jurisdictions. For example, many start at either 3% or 5%, after which some jurisdictions require disclosure obligations on crossing every whole percentage above the threshold, where as others apply only in steps above the threshold (e.g. the EU Transparency Directive specifies a disclosure obligation at 5%, 10%, 20%, 25%, 30%, 50% and 75%). Complying with these varied regimes hinders market transparency, limits the degree to which regulators can compare data and adds to the compliance costs and the complexity of IT systems for global financial intuitions. IOSCO could facilitate the standardisation of these disclosure requirements. For example, we would recommend, as a start, requiring disclosure only when holdings cross a whole percentage threshold.

Financial institutions which trade and invest, both for their own account and on behalf of clients, in securities of issuers from around the world, have to comply with the requirements of all these different disclosure regimes. These differences have a significant impact on the time and resources spent on compliance. It is important to recognise that these requirements must be complied with exactly; it is not possible to determine the 'highest' standard and use that as a standard for all reporting. We believe that standardisation would not only make compliance easier, but would also significantly increase the comparability of data for regulators and investors and improve the soundness and transparency of global capital markets. As practitioners we stand ready to assist IOSCO members in this work.

As a first step, we attach below a summary of certain key aspects of disclosure regimes currently in place in the major markets where we think standardisation is achievable as set out above. We appreciate that many of the requirements in this area are part of national legislation rather than rules issued by relevant securities regulators. We also attach, as annexes to this paper, a set of detailed country specific analyses that we hope IOSCO will find useful as a starting point for its own consideration of this important issue.

Issue	Examples of different approaches	Suggested approach
Scope of application of the significant shareholder reporting obligations		
An investor may have disclosure obligations under rules in the issuer's place of incorporation and in the place of listing. An obligation to disclose in more than one jurisdiction can also arise where an issuer has multiple listings.	A company listed on the Hong Kong Stock Exchange and the London Stock Exchange is subject to two separate regimes. If it is a UK company, significant shareholdings must be reported in accordance with the UK Companies Act 1985 and in accordance with the requirement of the HK Securities and Futures Ordinance. If a company has a dual listing in Australia and New Zealand then a report is only required to be made to the exchange in the country of incorporation (and the issuer).	Disclosure obligation should be determined by place of primary listing. Alternatively, standardisation of requirements such that the same information is relevant for all reporting obligations. Standard use of ISIN Codes for the same security, regardless of place of listing.
Determination of classes of shares in respect of which the disclosure obligation applies.	The obligation usually only arises in respect of voting shares. However, in some jurisdictions in Europe there can be issues about whether interests in shares with restricted voting rights are disclosable.	Only interests in shares with full voting rights should be disclosable.

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It can be difficult to obtain details of the outstanding number of shares to calculate percentage shareholdings and figures obtained are often unreliable.	Some countries do not impose specific requirements on issuers to publish on timely basis information on changes to the outstanding numbers of shares (e.g. due to issuances or buybacks), or to make this available to investors in an accessible manner, so as to enable investors to make accurate percentage calculations. The legislation also may not provide that investors can rely on a particular source of information. The EU Transparency Directive provides that the issuer must disclose the total number of voting rights and capital at the end of each calendar month during which there has been an increase or decrease, but does not state that investors can rely on this information. In the US, rules provide that in determining the number of shares outstanding, a filer may rely on information set forth in the issuer's most recent quarterly or annual report, and any current report on Form 8-K subsequent thereto, unless the filer has reason to believe the information is inaccurate. There are some differences in whether treasury stock is included in the denominator.	Issuers should be required to disclose the number of shares in issue and relevant for percentage calculations and to keep this number up to date. Numbers should be centrally published by stock exchanges on their website in a form that can be directly interfaced with the computer systems of financial institutions.
The different percentage thresholds triggering the basic reporting obligations.	The thresholds for disclosure obligations vary. Many start at 5% (although in Italy, for example, disclosure requirements arise at a 2% threshold). Some trigger a disclosure obligation on crossing every whole percentage above the threshold. Others apply steps, for example the Transparency Directive specifies a disclosure obligation at 5%, 10%, 20%, 25%, 30%, 50% and 75% (with Member States having a right to vary these thresholds to 33% and 66%). The disclosure obligation often arises only when the investor crosses the specified percentage threshold. However, in Australia, New Zealand, South Korea and Singapore, for example, a disclosure obligation arises when a holding is	Disclosure obligations should only arise when a holding crosses a whole percentage threshold. However, the main focus of attention should be on achieving greater standardisation in the method of calculation of percentage holdings (including aggregation and other rules), rather than in standardising the number or level of the thresholds for disclosure obligations.

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	increased by a whole percentage point above the original disclosable interest (which may have included a fraction of a whole percentage). In the US, thresholds also vary significantly both with respect to the federal securities laws and with respect to industry and other similar limitations.	
Additional disclosure obligations at other thresholds due to requirements other than significant shareholder notification legislation.	As well as the reporting obligations that are applied due to a company maintaining a listing, additional thresholds can apply. In particular, in some jurisdictions, companies may impose reporting obligations upon their shareholders through their articles of association or by-laws (for example, France and US). In many jurisdictions there are other thresholds at which disclosure or clearances may be required by virtue of the nature of the issuer or its business, for example, in respect of financial services companies, airlines or telecommunications companies. There can be foreign ownership limits (for example, in Australia, Government approval is required for a foreign holding of 15% or more). There can also be a different limit applied where the purchaser is another listed company.	Impose an obligation on issuers to disclose these additional disclosure obligations, when applicable. Information to be centrally published by stock exchanges on their website. Legislators should seek to standardise the method of calculation of percentage thresholds for these other purposes so that they more closely follow the rules for disclosure of interests (and, where they do not, the differences should be readily identifiable).

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Notification of a disclosable interest		
What type of interest constitutes a disclosable interest.	Generally the disclosure obligation applies to those having beneficial ownership of the shares, for example, in the UK, Hong Kong, most of the Asia Pacific region and the US. Beneficial ownership may be expressed in terms of controlling the votes attached to the shares. In some jurisdictions in Europe, the disclosure obligation is imposed upon the person with legal title. In some jurisdictions there is a reference to direct or indirect ownership, the meaning of which can vary. In the US, beneficial ownership tests generally look to (1) voting power and/or (2) dispositive power and the test also differs depending on the rule being applied.	Whether an interest is disclosable should be determined by whether the person has beneficial ownership entitling the owner to control the voting rights attached to the shares, whether or not the beneficial owner has legal title.
Whether the disclosable interests within a group should be aggregated to determine whether a threshold has been crossed.	In many jurisdictions there is a requirement for group holdings to be aggregated although this is not universal (for example, in Taiwan and South Korea there are restrictions on the extent of aggregation requirements). Difficulties can arise where the rules in a country require aggregation of interests held by entities in which the group only has a minority interest. This may mean that companies in which a significant interest is held for trading purposes or as a private equity investment become part of the group for disclosure purposes. In some jurisdictions, if the general partner of a limited partnership is in the group then the entire interest of the limited partnership is included as a group interest.	Group aggregation causes considerable workload and is time consuming. If continued, it should only apply to the 'consolidated accounting group' or other easily identifiable reference group. In particular, companies in which a bank has a significant interest through the trading book as part of the group should not be included in the group for disclosure purposes.
The treatment of intra-day positions.	In practice, in many countries in Europe and Asia Pacific, disclosure is made on the basis of the 'end of the day' positions, although in some cases the position is not entirely clear. In Hong Kong, the SFC has made clear that it only expects end of day reporting. In practice the disclosure is made on the basis of the 'global' trading day - all trades recorded on that calendar day.	Especially given the need to aggregate holdings within a group, it is only feasible to determine holdings on an end of day basis, looking at all trading on any calendar day within the group. Intra-day positions should therefore not be disclosable.

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In some jurisdictions part or all of a stock lending arrangement triggers a disclosure obligation.	The disclosure requirements in respect of stock lending are particularly varied and often unclear where the legislation does not specifically consider the position of stock lending or repurchase transactions. Stock lending often triggers multiple disclosures down the stock lending chain, with the lender retaining or having to disclose an interest due to the right to call for the securities lent and the borrower disclosing an interest because it acquires shares (this is the situation in the UK). In Hong Kong, there is an obligation to disclose any lending of shares that comprise part of a disclosed significant interest, regardless of the size of the loan. Also, in Hong Kong, the obligation of the borrower to return the stock is disclosable.	A simplified regime that reduces the number of disclosures being made to assist in clearly identifying the significant trading. For example, if a bank acts as an intermediary and borrows stock which is onlent, this should not be disclosable. Disclosure should be limited to the person who can exercise the voting rights, i.e. in most cases, the ultimate borrower. Lending of stock should generally be treated as a disposal.
Treatment of physically settled derivative positions and whether long and short derivative positions can be netted so that a fully hedged position would not be disclosable.	The treatment of physically settled derivative positions and the extent to which derivative positions can be netted against each other varies. For example, netting is currently allowed in some European countries but not in the US, where only long derivative positions are included in beneficial ownership calculations. Similarly, under the EU Transparency Directive only long call options over existing shares which are exercisable at the investor's own initiative are included in the calculation for disclosure purposes. Most derivative positions are hedged in some way and disclosure of only part of the arrangements can be confusing.	Disclosure should be driven by control of voting rights but with netting of physically settled positions permitted.
Whether cash settled derivatives are a disclosable interest.	In many cases, only derivatives with potential delivery of the underlying shares create a disclosable interest. There are exceptions, for example, in Hong Kong, in the UK (albeit only under the Takeover Code) and, in the US, where it depends on the rule being applied.	No disclosure obligations in respect of cash settled derivatives.
Whether convertibles and warrants (which give rights to shares that are	In Hong Kong and much of the Asia Pacific region holdings of convertibles and warrants are disclosable. In the UK	No disclosure obligations in respect of convertibles and warrants exercisable into new

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not currently in issue) are a disclosable interest.	and under the Transparency Directive, such interests are not disclosable. In the US, the general rule is that securities which are convertible within 60 days are disclosable.	shares.
Exemptions and exceptions		
In some jurisdictions the trading book receives a different treatment from other interests.	The EU Transparency Directive provides an exclusion from the reporting requirement at 5% for trading book holdings where the voting rights are not exercised. In Hong Kong and generally in the Asia Pacific region there is no exemption for proprietary positions.	There should be an exemption for positions held in the trading book (as determined for regulatory capital purposes).
In some jurisdictions the interests of funds managed by investment managers within a group do not need to be aggregated with the rest of the group or a different threshold applies.	The EU Transparency Directive provides that a group does not need to aggregate, for disclosure purposes, an interest held by a subsidiary that is a management company or investment firm that manages portfolios where voting rights are exercised independently of the parent company. In many other jurisdiction interests have to be aggregated (although the U.S., Taiwan and Korea provide exemptions).	There should be an exemption from the aggregation requirement for investment managers that operate behind information barriers and independently of other areas within the group.
In some jurisdictions there is an obligation on custodians to report their interests.	In general custody positions do not need to be reported although a requirement to report custody positions is imposed in some jurisdictions (for example, Turkey).	Exemption from the disclosure obligation for custodians.
In some jurisdictions an interest in shares as a result of a bank taking a security interest over the shares is exempt.	There is an exemption from the disclosure requirement for an interest held by way of security in, for example, the UK and Hong Kong. However, if a right of rehypothecation is exercised (in other words, the security holder has exercised a right to treat the collateral as its own) the exemption is no longer available.	The security interests of a lender or other creditor should be exempt where the lender/ creditor does not exercise or control the exercise of voting rights in respect of the shares concerned.
In some jurisdictions there is an obligation on proxies to report their interests.	In Hong Kong, for example, there is an exemption for proxies. In other jurisdictions proxies are specifically included in the disclosure requirements, for example, the Transparency Directive.	Exemption from the disclosure obligation for proxies.

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Reporting procedures		
The report can be required to be submitted to the issuer, the exchange or a regulatory body.	The report can be required to be made to the issuer (as in the UK), the relevant stock exchange or regulator (e.g. in the US, where they are reported to the SEC) or both (as in Hong Kong).	Reporting to the stock exchange or a regulator would avoid issues that can arise in identifying who to notify at the issuer and avoids unnecessary delays in disclosure.
The information to be included in reports varies significantly.	There is an inconsistent requirement for information, some disclosure obligations being more onerous than others. In particular, the requirements in Australia requiring the disclosure of four months of historic trading data are onerous to prepare and would appear to be of limited value. In the People's Republic of China there is a simplified disclosure form at the lower threshold.	Use of a simplified form, particularly at the lower threshold, containing the basic information. Greater consistency on data required to be disclosed would be preferable. In particular, it is difficult to appreciate the clear benefit of requiring disclosure of historical trading information.
What action triggers a reporting obligation.	In some jurisdictions the reporting obligation arises when there is a 'knowing' crossing of the threshold. In practice, disclosure obligation are usually determined by reference to the trade date. In some instances the settlement date is relevant, for example, in Hong Kong when determining when there has been a disposal.	The use of trade dates is easier to monitor and would appear more relevant for disclosure. However, for reporting obligations to reference the trade date, it is important that the time for compliance is sufficient for data to be obtained globally.
The time limit in which the reporting obligation must be met once the obligation has arisen.	Timing for reporting obligations varies. For example, it is by 9:00am the next day in the Nordic countries, two days after trade date in Singapore and Australia and five days in Spain and Italy (and five days after settlement in Korea). In the context of an international group, it is necessary to wait until the end of the trading day around the world before calculating the holding. Therefore, obtaining data from New York to meet reporting obligations in the Far East and Europe can be challenging when the deadline is short.	There should be at least five days in which to file the report to enable data to be gathered and verified, so that accurate disclosure can be made.