EUMEDION
CORPORATE GOVERNANCE FORUM

Call for evidence EU regulatory framework for financial services

Eumedion's draft online response

General remarks

Eumedion welcomes the opportunity to respond on the call for evidence EU regulatory framework for financial services. Eumedion is the Dutch corporate governance and sustainability forum for institutional investors. Our 70 Dutch and non-Dutch participants represent more than EUR 4 trillion assets under management. They invest for their clients and their beneficiaries in listed companies worldwide, and also in listed banks. Our response is limited to those topics which are most relevant for Eumedion and its participants i.e. gaps and reporting and disclosure obligations. Eumedion believes that a fully functioning Capital Markets Union can only be created if the following topics are addressed in the financial services directives.

Cross-border investment is hampered by 'gold plating' and numerous Member State options. Therefore, institutional investors with a pan-European focus have to take into account 28 separate regulatory regimes when investing in listed companies which have their statutory seat in one of the 28 Member States. Detailed regulations – instead of directives – without Member State options in the areas of financial services would represent an important step towards the creation of a Capital Markets Union. The regulations should be complemented by European supervision and enforcement.

Before the proposal for a regulation is published, the European Commission should assess whether there are overlapping, duplicating or inconsistent requirements. For example both EMIR and MiFIR contain transaction reporting requirements. Although the subject is the same, the requirements itself are not aligned. As a consequence parties who have to comply with both reporting requirements, for example asset managers, have to spend significant amounts of effort to meet both transaction reporting requirements.[1]

[1] Reference is made to paragraphs 11-18 of the Final Report Review of the Regulatory and Implementing Technical Standards on reporting under Article 9 of EMIR (ESMA/2015/1645).

Numerous directives and regulations in the area of financial services contain provisions for so-called 'Level 2' measures to be adopted by the European Commission. As a consequence detailed implementing measures (Level 2) will be adopted following the adoption of the framework legislation (Level 1). Currently the transposition deadlines are linked to the adoption of the framework legislation (Level 1). Nevertheless, for a proper implementation the specifics of the detailed implementing measures (Level 2) are needed as well. Those measures are often adopted much later and as a consequence the transposition deadlines for many legislative packages are too short. To resolve this, the transposition deadline for the whole legislative package could be linked to the adoption of the last detailed implementing measures (Level 2).

Furthermore, regulations are subject to review, generally three years after coming into effect. However, quite often parts of the obligations in such regulation have not taken effect yet, or just recently as a result of the phasing-in or transitional provisions in such regulations. As an example, the EMIR reporting obligation did not enter into force until 12 February 2014, while EMIR itself took effect 16 August 2012. Due to the review obligation in EMIR (article 85 stipulated a review by 17 August 2015), the European Commission was obliged to review the effects of that regulation very shortly after it came into effect (or even before its main obligations, in case of EMIR for example the clearing obligations, have taken effect). Such a review usually leads to changes in requirements again. For EMIR reporting for example, market parties have to adjust their reports several times in a row to comply with the Level 2 measures subsequently with the (frequently updated) ESMA Q&A (Level 3), followed by so-called L1 and L2 ESMA validations and lastly by changes proposed as a result of the EMIR review. MiFIR requirements will come on top of this in 2018. We do not see the need for such a high frequency of changes to requirements as these lead to substantial additional efforts for the industry and ultimately investors. We therefore advise the European Commission not to start with the review of a regulation until all its obligations have effectively came into effect and a certain period of experience with such obligations has been gained (e.g. market parties have applied the obligations for a minimum period of two to three years).

A further revision of the Transparency Directive

Currently the initial thresholds for the notification of major holdings not only differ from Member State to Member State but can also differ from one listed company to another. The Transparency Directive does not prohibit issuers to require notification of holdings by means of a provision in their articles of association. In 15 Member States investors have to check the articles of association of a company to find out what the first notification threshold is.[2] This is burdensome for large institutional investors who – for

[2] Report of ESMA Mapping of the Transparency Directive –Options, Discretions and “Gold-plating”, 7 July 2011/194, page 86 states that *“14 Member States (AT BE, CY, DK, EE, EL, FI, FR, HU, IS, IT, LU, LV, MT, PT) indicated that this possibility is provided for their issuers, while 14 Member States (BG, CZ, DE, ES, IE, LT, NL, NO, PL, RO, SE, SI, SK, UK) indicated that they do not allow issuers to set in their statutes additional thresholds for major shareholding notifications.”* Also in The Netherlands there are examples of companies, like Altice and Esperite, with lower thresholds in their articles of association.

reasons of diversification – invest in many listed companies seated in various countries. Consequently investors have to make substantial costs to a) monitor the notifications that follow from legislation and, if at all possible, from the articles of association and b) to maintain an adequate and up to date notification system. It is estimated that the costs of the introduction of extra thresholds in the articles of association for shareholders of Dutch listed companies amounts to additional administrative burden of at least € 7.2 million. Eumedion takes the view that lower initial thresholds at Member State level or in the articles of association of issuers should be avoided and calls for full harmonisation of the thresholds for the notification on major holdings in listed companies, including a ban on the introduction of additional thresholds in the articles of association.

A revision of the Take Over Bids Directive

The Takeover Bids Directive leaves it to Member States to define the threshold for a mandatory bid. This is the reason why that threshold differs from Member State to Member State: in a range from 30% to 50%.[3] The underlying objective of the Takeover Bids Directive is the protection of the holders of securities, in particular those with minority holdings, when control of their companies has been acquired. The protection consists of the obligation for the party who has acquired control of a company to make an offer to all the holders of that company's securities at an equitable price. There is no logic why the protection of minority shareholders should differ from Member State to Member State. Therefore Eumedion calls for full harmonisation of the mandatory bid threshold. Also the calculation of that threshold should be fully harmonised. Most Member States calculate the threshold on the basis of voting rights alone and do not include derivatives like cash settled equity swaps and cash settled options in the calculation of the threshold.[4] The use of those derivatives may make it possible to bypass the rationale of the mandatory bid rules, which is to offer a realistic exit to shareholders in the event a party acquires control over the company and to provide shareholders with a part of the control premium. Therefore Eumedion believes that consideration should be given to include these derivatives in the calculation of the threshold for a mandatory bid. In addition Eumedion would welcome harmonisation of the treatment of anti-takeover devices in order to achieve clearness on the protection of minority shareholders in public bid situations.

According to the Take Over Bids Directive a party is exempted from the mandatory bid rule if it acquires control as the consequence of a voluntary bid (art. 5 (2)). Shareholders may be confronted with a voluntary bid launched at a low price which allows the offeror to increase its stake just above the mandatory bid threshold without triggering a real exit. The use of a voluntary offer would pose the risk that

[3] The Take Over Bids Directive Assessment Report, p. 291 (http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf).
[4] The Take Over Bids Directive Assessment Report, p. 156 (http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf).

the rationale of the mandatory bid rule is circumvented. Therefore some Member States apply the equitable price rule not only to mandatory but also to voluntary bids.[5] Eumedion believes that the additional condition of issuing a voluntary bid for an equitable price should be introduced at European level. Another way to protect minority shareholders would be to introduce a minimum acceptance threshold for voluntary offers.

A further revision of the Accounting Directive

Corporate reporting is of the utmost importance for investors. Long-term investors look beyond the financial facts and figures. The increased relevance of all material information for institutional investors requires a reporting framework that results in concise communication how a business' governance, performance, strategy and prospects lead to value creation over the short, medium and long term. In December 2013, the International Integrated Reporting Council (IIRC) presented a reporting framework that enables companies to combine all information that is relevant for analysing the long term development of a company in a single, integrated report. Eumedion believes that integrated reporting is a logical and essential next step in corporate reporting, as environmental, social and governance information is critical for assessing the overall performance and prospects of companies, and for the stewardship role that investors both want and must exercise. Currently, finding all the relevant information is very time consuming and makes good research very expensive for each investor. The IIRC's integrated reporting framework draws an accurate picture of what long-term investors need for their investment analysis and their engagement activities. We expect integrated reporting to be very helpful for both investors and preparers. Therefore, we would encourage the European Commission to consider requiring listed companies to draft its annual report in accordance with the IIRC reporting framework.

Consistent application of IFRS

From the perspective of an institutional investor it is important to have consistent and comparable reporting by all listed entities, irrespective of their size and the location of their listing. Therefore Eumedion believes that new and/or amendments to existing international financial reporting standards (IFRS) should be fully endorsed –without carve-outs – at European Union level. In line with the Maystadt report[6] Eumedion is of the view that full endorsement is the only way to achieve the full benefits of IFRS.

Currently we see diverged enforcement of IFRS among Member States. We prefer more harmonisation of the IFRS enforcement regime, so investors can rely on a pan-European enforcement regime. Therefore

[5] The Take Over Bids Directive Assessment Report, p. 96 (http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf),

[6] Should IFRS standards be more "European"? Mission to reinforce the EU's contribution to the development of international accounting standards, report by Philippe Maystadt, October 2013 (http://ec.europa.eu/finance/accounting/docs/governance/reform/131112_report_en.pdf).

Eumedion would take the view that the supervision by national supervisory authorities should be transferred to a pan-European authority, e.g. ESMA.

Harmonisation of cluster munitions disinvestment legislation

An increasing number of Member States are developing their own legislation to ban investments in cluster munition producers. The 2008 Convention on Cluster Munitions (CCM) prohibits the use, production, transfer and stockpiling of cluster munitions and is ratified by the fast majority of Member States. Following the CCM, various Member States started implementing legislation that prohibits investments in companies that are involved in cluster munitions. To date, Belgium, Ireland, Italy, Luxembourg, The Netherlands and Spain implemented legislation that prohibits financing of companies involved in cluster munition production. In addition, the governments of Croatia, the Czech Republic, France, Hungary, Slovenia and The United Kingdom released an interpretive statement suggesting that investments in cluster munition manufacturers are considered as prohibited based on the CCM.

The legal requirements for banning investments in and financing of cluster munitions differ between EU-member states, which in turn leads to confusion among investors operating in different EU markets. Eumedion believes that harmonisation of cluster munitions disinvestment legislation would set clear minimum standards for financial institutions operating in several jurisdictions. In addition, clear harmonised standards will provide room for one single compliance framework that will also be beneficial for financial institutions from non-EU countries. Eumedion would encourage the European Commission to implement legislation banning investments in cluster munitions at a European level, based on the criteria set in the CCM.

Financial Transaction Tax is counterproductive

The original proposal of the European Commission for a financial transaction tax (FTT)[7] was broadly based and related to transactions in all kinds of financial instruments and derivatives. No consensus could be reached on this proposal between the Member States. Nonetheless, 11 Member States expressed a strong willingness to go ahead with the FTT. Against that background the European Commission tabled a proposal for ‘enhanced cooperation’. That new proposal has to be adopted by the aforementioned participating Member States.[8]

Although the scope and objectives of the original FTT proposal have been limited further in this new proposal, we believe that the introduction of the FTT could discourage institutional investors (pension funds, asset managers and insurance companies) from investing in companies located in the participating

[7] Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC (COM (2011) 594 final).
[8] Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (COM(2013) 71 final).

Member States.[9] Furthermore, the FTT would have negative effects on the results of institutional investors. This will have negative financial consequences for the beneficiaries and clients of those investors. After all, institutional investors by their nature invest either directly or indirectly at the expense and risk of their clients (the final beneficiaries). For that reason we take the view that the introduction of the FTT (in the participating Member States) is counterproductive to the underlying objectives of a Capital Markets Union.

[9] The harmful effects of a FTT can be demonstrated by the so called speculation tax that is introduced in Belgium as of 1 January 2016. In Belgium a tax of 33 percent is due on the capital gains on financial instruments which have been acquired for less than six months. According to an article in the Belgium business newspaper "De Tijd" dated 20 January 2016 the average retail trading volume among in warrants has been declined since 1 January 2016 from almost €900.000 per day to less than €400.000 (http://www.tijd.be/markten_live/nieuws_aandelen/Speculatietaks_doodt_derivatenmarkt.9722698-3453.art).