Market Watch #10

Substantial holdings and gross short positions

January 2024, edition 10

Continue reading

AFM

Table of contents

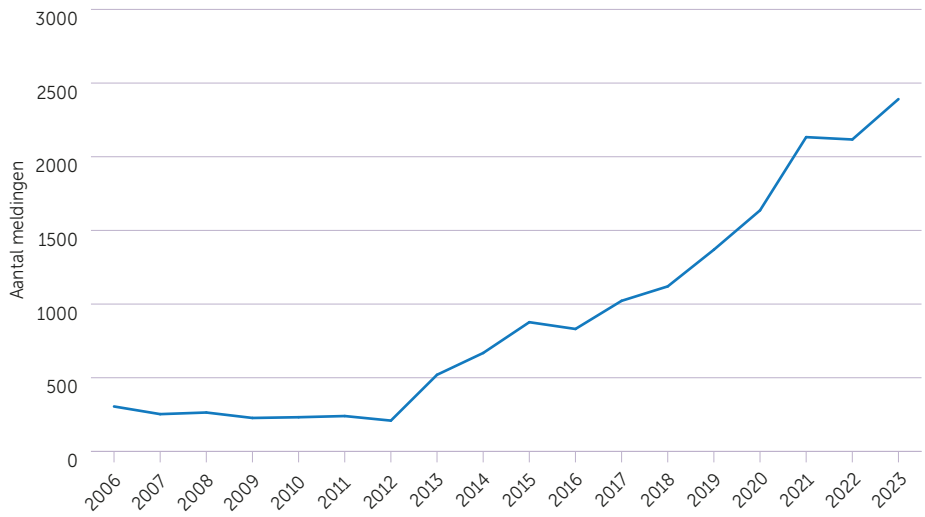
Introduction

In 1979, the Council of the European Communities introduced Council Directive 79/279/EEC. Schedule C, point 5(c), of this Directive included a reporting obligation for companies with an official stock exchange listing to inform the public of changes in their shareholder structure, amongst other things. The aim of this new Directive was to increase transparency in the European capital markets. However, even before it was implemented by the Member States it became apparent that this goal was not achievable, as companies could not inform the public about changes they themselves were not aware of. For this reason, the Council introduced a notification obligation for persons with substantial shareholdings in capital and voting rights in listed issuers (**the notification obligation**) by means of Council Directive 88/627/EEC in 1988. This notification obligation was ultimately implemented in the former *Wet melding zeggenschap en kapitaalbelang in ter beurze genoteerde vennootschappen* in the Netherlands. More than 27 years and a steady increase in received notifications later, the positions filed according to the notification obligation remain a primary source of information concerning ownership in issuers listed on the Dutch regulated market.

Recent cases, such as the acquisition by Exor NV of a 15% stake in Koninklijke Philips NV, Daniel Křetínský's stake-building in PostNL NV and the ownership structures of SPACs, have sparked a public discourse about the scope of the notification obligation. In this edition of the AFM Market Watch, the Dutch Authority for the Financial Markets (**AFM**) provides background information on the notification obligation and explains in more detail how the AFM has organised its supervision. Additionally, the AFM will discuss two examples..

The final part of this Market Watch contains a brief 'Facts & Figures' section on current developments in the Dutch capital markets. This is a regular feature of our Market Watch reports. In this edition, we provide some information on our findings regarding the specificity of the information supplied by issuers of green bonds.

Figure 1: Submitted Notifications of Substanial Shareholdings



01 The notification obligation

The notification obligation derives from the European Transparency Directive (**TD**)[1], which was last amended in 2013 with the addition of the notification obligation for gross short positions.[2] In the Netherlands, the rules from the TD regarding the notification obligation in capital and votes have been implemented in Section 5.3 of the Financial Supervision Act (in Dutch: *Wet op het financieel toezicht* (**Wft**)).[3]

1 Directive 2004/109/EC.
2 Directive 2013/50/EU.
3 Wetten.nl - Regeling - Wet op het financieel toezicht - BWBR0020368 (overheid.nl).

The main purpose of the notification obligation is to improve market transparency by providing insight into, amongst other things, the extent to which shares in a specific company are freely tradable, the existence of share or voting concentrations and conflicts of interest. It also reveals developments in control and capital interests in companies. Market participants can use this information to make a more informed and substantiated assessment of the securities in which they may wish to trade.[4]

The notification obligation is applicable to substantial shareholdings in roughly three types of companies, hereinafter referred to as 'issuers':

1. Public limited companies incorporated under Dutch law whose shares are admitted to trading on a regulated market;
2. Legal persons with a different Member State of origin whose shares are only admitted to trading on a regulated market in the Netherlands;
3. Legal persons incorporated under the law of a non-EU Member State whose shares are admitted to trading on a regulated market in the Netherlands.[5]

According to the notification obligation, anyone who acquires or disposes of a short position, a position in shares and/or voting rights in issuers that reaches, exceeds or falls below a threshold should make a notification to the AFM without delay. The AFM will then carry out a check before publishing the notification in its public registers.

The notification obligation differentiates between two ways in which a person can dispose of a position: actual disposal and potential disposal. The difference between these two types is that with potential disposal you have the right to acquire shares, whereas with actual disposal you already (directly or indirectly) hold the shares.

If the acquisition or disposal of shares is based on an agreement, the notification obligation arises when the agreement becomes effective; the time at which the shares are acquired or transferred (i.e. the time of transfer) from a property law perspective is not relevant. A threshold methodology is used to determine the time of notification.[6] When a person is or should be aware that a position has reached, exceeded or fallen below a threshold, the total position must be reported to the AFM without undue delay. For example, if a person's capital position reaches the 3% threshold, both the total capital holding and the holding in voting rights must be reported to the AFM, even if the latter has not reached or crossed a threshold.

As mentioned above, the notification obligation for gross short positions was introduced in 2013. This addition was prompted by a single notification of 10% of the issued capital of Koninklijke KPN NV made on behalf of Morgan Stanley on 4 May 2012. At the time, it was not clear whether Morgan Stanley had hedged its position. By expanding the notification obligation to include gross short positions, the markets would be better informed about the actual economic position of position holders. In addition, the legislator intended that this additional transparency would discourage large-scale *empty voting*, a practice in which shares and voting rights are decoupled, resulting in a situation where a person's voting interest in an issuer is larger than his economic interest.[7] The practice of decoupling is a deviation from the general corporate governance principle that one share equals one voting right.

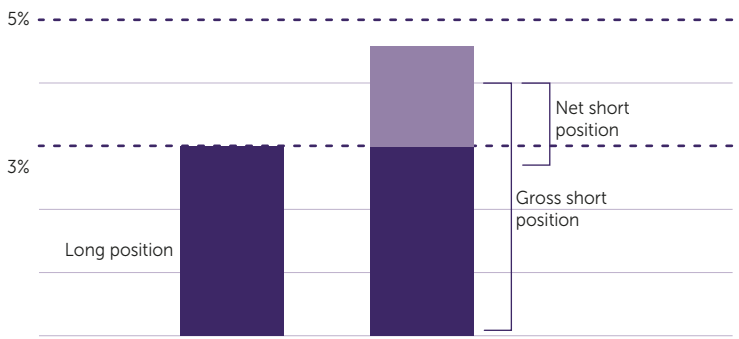
4 As considered in the Dutch legislative history and in the preamble to the Transparency Directive.
5 Article 5:33(1)(a) Wft.
6 The thresholds are 3%, 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50%, 60%, 75% and 95%.
7 *Kamerstukken II* 2010-2011, 32014, no. 12 (NNV I).

Difference between the notification obligation for net short positions and the notification obligation for gross short positions.

There is often confusion about the differences and overlap between the notification obligation for net short positions (Article 6 of Regulation (EU) No 236/2012 (**SSR**)) and the notification obligation for gross short positions (Article 5:48(3) Wft).

We illustrate the difference with an example:
Investment firm X has borrowed and sold 4.5% of the issued share capital of issuer Y. Subsequently, X has bought call options which give X the right to acquire shares representing 3% of the issued capital of Y. The following notifications must be filed by X:

- As the sale and the acquisition concern different financial instruments, it is not possible for X to net them against each other. This means that X has a long position of 3% and a gross short position of 4.5%. Both the long and gross short positions must be reported according to Article 5:38(1) and (3) Wft;
- The net short position equals the long position minus the gross short position. In the case of X, this results in a net short position of 1.5%. This net short position must be reported according to Article 6 SSR.



02 Supervision

In 1996, notifications had to be filed with the AFM by fax or regular mail. At the end of the day, the AFM would send all received notifications to the Dutch newspaper *Het Financieele Dagblad* so that they could be published in the newspaper the following day. A full printed version of the register could be requested. This was then sent by regular mail or made available for collection at the AFM reception desk. The 'supervision' of this obligation tended to be more an administrative process than a substantive supervisory task.

A lot has changed since then. Currently, all received notifications are reviewed (marginally) by the AFM before they are published in its public register. The AFM checks whether a notification has been filed on time – notifications must be filed "without delay" (In Dutch: *onverwijld*) – and reviews marginally whether the notifications are complete and accurate.[8] Amongst the supervisory instruments used to conduct its supervision, the AFM has access to various data sources to check whether a notification is complete and accurate. Examples of these data sources are annual reports, transaction reporting from MiFIR, securities financing information from SFTR and derivative transactions from EMIR. In the coming years, the AFM intends to use this data also to automatically detect unreported positions that need to be filed with the AFM..

The AFM wishes to emphasise that persons with an obligation to notify are themselves fully responsible for proper compliance. This requires systems and controls to actively monitor the holdings in issuers and an understanding of the relevant statutory requirements. The AFM considers compliance with the notification obligation very important because it contributes to market transparency. Notifications that have not been filed in accordance with the statutory requirements therefore often lead to appropriate enforcement actions according to our enforcement policy.[9] The AFM imposes both informal sanctions and administrative fines for violations of the notification obligation. Last year, the AFM imposed two fines for violations of the notification obligation.[10]

8 Although the AFM pursues data quality in its supervision, the publication of a notification in the public register is not a confirmation of its correctness.
9 Het handhavingsbeleid van de AFM en DNB.
10 For a full overview of all sanctions imposed by the AFM, please see our website.

03 Perfect vs optimal: when is the market transparent enough?

In the legislative process, there is a constant balance of interests between the effectiveness of legislation and the resulting administrative burden. In a world with perfect market transparency, all capital market transactions would be fully transparent for every market participant.

As perfect transparency is not an attainable goal for our current markets, the legislator has chosen the threshold methodology referred to above. The thresholds used are far from arbitrary: most thresholds correspond to a shareholder right. For example, shareholders with 3% or more of the total voting rights have the right to request the inclusion of certain items on the agenda of the general meeting of shareholders. Furthermore, shareholders with 10% or more of the total voting rights are entitled to send a request to convene a shareholder meeting. We will discuss two examples.

3.1. Exor-Philips case

The AFM recently found in the Exor-Philips case that Goldman Sachs, the investment firm involved in the transaction, used the securities lending market to acquire a substantial shareholding in Philips on behalf of its client Exor. As both the securities lending agreements and the sale to Exor were effected on the same day, no notification obligation arose for Goldman Sachs for this part of the transaction (i.e. no thresholds were crossed). As we explained in the previous paragraphs, the selling of borrowed shares can result in a reportable substantial gross and/or net short position. However, in this specific case the market maker exemption of Article 5:46a Wft appeared to be applicable, in which case Goldman Sachs would not have a notification obligation for its gross short positions.

The exemption would only be applicable to the gross short position of a position holder. This means that a notification must still be filed if the position holder disposes of a position in capital and/or voting rights. This 'partial' exemption resulted in a notification by Goldman Sachs which, in the AFM's view, did not originally reflect the actual capital position. Goldman Sachs therefore also reported its short position.

There are arguments for and against the use of the OTC market to acquire substantial shareholdings (even to the extent permitted by law). From the buyer's perspective, it is impossible to acquire a substantial shareholding in the open market without significantly impacting the price. This makes the OTC route an obvious choice. However, from the perspective of other market participants not involved in the OTC transaction, it represents an opaque market practice where transparency measures are deliberately avoided. Especially in the case of an activist shareholder or hostile takeover, this lack of transparency could be harmful to the market. Irrespective of one's viewpoint, the ability to acquire substantial shareholdings in the OTC market is a sign of an efficient capital market.

According to Article 5:46a Wft, transactions do not have to be disclosed if they can be regarded as 'market-making activities'. According to the EU Short Selling Regulation, there are three types of market-making activities when an investment firm that is a member of a trading venue deals as a principal in a financial instrument:

I. By posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
II. As part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;
III. By hedging positions arising from the fulfilment of tasks under points (I) and (II).

3.2. Greater than 100%

Contrary to what one might expect, it is possible for the total position in voting rights or capital holding to be greater than 100% of the issued capital of an issuer. Examples of situations where this can happen include securities lending transactions with a right to recall[11] (in which the already reported position from the lender changes from actual to potential and the borrower gains an actual holding) and agreements concerning sustained joint voting policy where every participant is required to notify the total amount of shares held by all the participants.[12]

11 Paragraph 4.5.9. of the Guideline for Shareholders.
12 Paragraph 4.5.4. of the Guideline for Shareholders.

04 Looking ahead

After the introduction of the notification obligation, it soon became apparent that publication in the newspaper did not sufficiently contribute to market transparency. The Dutch legislator therefore introduced an online register in 2003 in which anyone with internet access could view all filed notifications. At the time, particularly compared to the ways in which other European supervisors published the notifications they received, this register was revolutionary in that it included a search function and automatically calculated the interest of a position compared to the total issued capital of an issuer. Furthermore, the portal used to file notifications would automatically prefill notification forms with information from previous filed notifications and issuer information (e.g. the total issued shares and the total voting rights). Furthermore, the ability to export the entire register enables operators such as financial data vendors to integrate register data in their services, thereby contributing to overall market transparency.

On the European level, a forthcoming evolution will be the incorporation of the substantial shareholding data in the European Single Access Point, or ESAP for short. ESAP will offer a single access point for public financial and sustainability-related information on EU companies and EU investment products. Something similar can be seen with net short selling data, where aggregate totals will be shared with ESMA by the national authorities on a daily basis from next year.

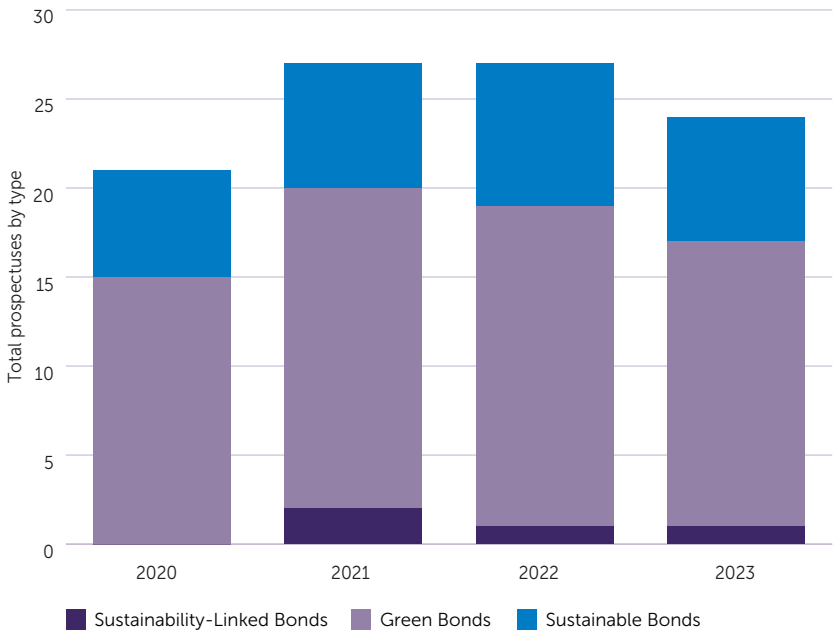
Following the introduction of the public register in 2003, there are ample opportunities from 2023 onwards to enhance both the registers and the portal used for filing notifications. The AFM is currently in the process of upgrading both systems, with the goals of improving the legibility of the registers and simplifying the process of filing notifications. Suggestions for data visualisations in the public register can be sent to melden@afm.nl. This upgrade aims not only to enhance the administrative filing process for supervised persons but also to improve data quality. In the coming years, the AFM will continue the dialogue with stakeholders to improve the notification obligation and associated guidance where necessary.

FACTS & FIGURES

This section of the AFM Market Watch provides facts and figures concerning developments in the Dutch financial markets. In this edition, we provide information on the total of AFM-approved prospectuses that allow for issuance of sustainable bonds.

1. Surge in approvals

Figure 2: Total prospectuses approved by AFM and types of sustainable bonds



In the absence of a formal definition of sustainable bonds, in this publication the term sustainable bond refers to green, social, sustainability, impact, ESG and similarly labelled bonds[13]. The graph above shows the total number of approved[14] prospectuses[15] per year and the names of the sustainable bonds that could be issued in respect of these prospectuses. In the graph above, sustainable bonds that could be issued under AFM-approved prospectuses are split into green bonds and sustainable bonds (a mix). The graph also includes sustainability-linked bonds[16]. This publication accounts for all prospectuses approved by the AFM up to the date of publication of this MarketWatch.

In 2019, the AFM approved 17 prospectuses allowing for the issuance of sustainable bonds, as outlined in the Report on Sustainable Bonds in the Netherlands from April 2020. Whereas this number increased to 27 in 2022, the total amounted to 24 in 2023. However, the cause of this decrease does not necessarily lie in the Dutch market for sustainable bonds, as the AFM in total received fewer requests for approval of prospectuses (in respect of both equity securities and non-equity securities) in 2023 than in 2022.

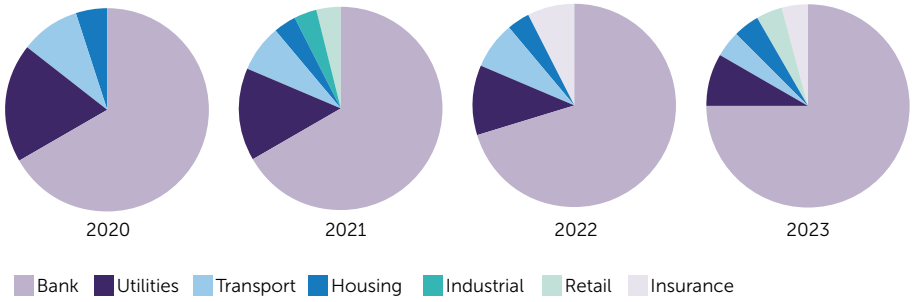
In 2020, three approved prospectuses enabled the issuance of sustainable bonds in the form of covered bonds, compared to four in 2021 and 2022 (2023: 3). In 2023, two prospectuses in respect of which sustainable bonds could be issued were approved for asset-backed securities (2021 and 2022: 1; 2020: 0).

2. Industries of issuing entities

Depicted in the graph below are the industries of issuing entities with regard to prospectuses for sustainable bonds as approved by the AFM from 2020. The first institution issuing a sustainable bond in the Dutch market was a bank (FMO/Dutch Development Bank in 2013). In the past four years, banks have been the dominant institutions publishing AFM-approved prospectuses for sustainable bonds.

13 In line with the ESMA Public Statement on sustainability disclosure in prospectuses, these non-equity securities could be described as 'use of proceeds' bonds, whose proceeds are used to finance or refinance green and/or social projects or activities.
14 We refer to Article 3(3) of the Prospectus Regulation (Regulation (EU) 2017/1129).
15 To clarify, in our use of the term 'prospectuses' we also refer to base prospectuses.
16 In line with the ESMA Public Statement on sustainability disclosure in prospectuses, these non-equity securities could be described as bonds for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability/ESG objectives.

Figure 3: Prospectuses by industry

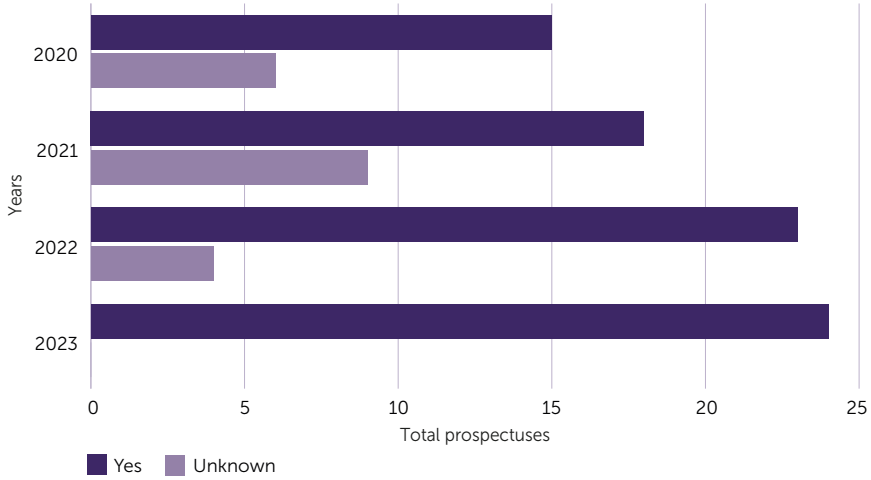


3. Disclosure of information in prospectuses

In the past four years, the disclosure of information on sustainable bonds in prospectuses approved by the AFM has become more extensive. This disclosure encompasses, inter alia, a specific description of the use of proceeds of the sustainable bonds and of the intended and actual impact/reduction (for instance, in terms of greenhouse emissions) prior to issuance, insofar as this information is available to the issuer. At the beginning of 2023, the AFM stated on its website what information it expects in prospectuses on sustainable bonds, amongst other things.

To illustrate the trend towards more extensive disclosure in prospectuses on sustainable bonds, the graph below shows the intention of issuing entities to provide post-issuance information on the use of proceeds in AFM-approved prospectuses. In July 2023, ESMA published its Public Statement on sustainability disclosure in prospectuses. ESMA recommends that issuers disclose in their prospectuses whether they intend to provide post-issuance information, and what information will be reported and where it could be obtained. A URL of the website where investors will be able to access this post-issuance information could be included. As illustrated below, more issuers are stating their intention to provide post-issuance information.

Figure 4: Described intention to publish post-issuance information



Any questions or comments about this publication?

Send an email to: redactie@afm.nl

The Dutch Authority for the Financial Markets
PO Box 11723 | 1001 GS Amsterdam

Telephone
+31 20 797 2000

www.afm.nl

Data classification
AFM - Publiek

Follow us: →

The AFM is committed to promoting fair and transparent financial markets.

As an independent market conduct authority, we contribute to a sustainable financial system and prosperity in the Netherlands.