European Commission Consultation Document on the Transparency Directive
Response of the Law Society of England and Wales and the City of London Law Society
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Consultation document on the modernisation of 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 on the modernisation of the Transparency Directive

This response has been prepared on behalf of the Company Law Committee of the Law Society of England and Wales and the City of London Law Society Company Law Committee.

The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee. The committee is made up of senior and specialist corporate lawyers.

The City of London Law Society (CLLS) represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees and in this case the response has been prepared by the CLLS Company Law Committee.

I. Attractiveness of regulated capital markets for small listed companies

1. Impact of the Transparency Directive on the attractiveness of regulated markets for small listed companies. Do the Transparency Directive obligations for issuers (e.g. disclosure of annual and half-yearly financial reports, quarterly information etc.)¹ 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)? Please provide evidence supporting your answers.

In the joint committee’s view it is not the specific reporting regime of the Transparency Directive that makes small companies decide to list on or to exit regulated markets.

2. Costs for smaller listed companies. 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.)? Please support your answer with quantitative data.

¹ Note that this question refers to the obligations applying once the securities admitted to trading and therefore it is not addressing the prospectus.
3. Potential diminution of cost for small listed companies. What changes of the Transparency Directive will bring important reductions in costs for small listed companies? Please provide evidence in support of your answer (see also questions 7 and 8 if you are able to provide more detailed replies).

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4. The lower visibility of smaller listed companies. How does the visibility problem materialise (e.g. lower attention of analysts, lower investment levels, lower trading etc.) for (objectively) well performing small companies? Please provide evidence supporting your answer.

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

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Possible options to address in the Transparency Directive the problems related to small listed companies

6. Definition of a small listed company. 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? Please justify your replies

(i) for issuers of shares, those companies with a market capitalisation below a certain threshold such as €100 Million, €250 Million or other (please specify the threshold);

(ii) for issuers of shares, those companies with a market capitalisation below a certain percentage (e.g. 60%) of the average capitalisation of a company in the regulated market where the company is admitted to trading (please specify the percentage);

(iii) for issuers of shares, those companies with a market capitalisation below a certain percentage (e.g. 60%) of the average capitalisation of a company in the regulated market(s) of the home Member State of the company (please specify the percentage);

(iv) for issuers of debt securities only, those companies having outstanding debt securities below a certain threshold (please specify the threshold);

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3 See the External Study (section 1 of the executive summary) which refers to a threshold of between 250 Million and 1000 Million euro.
for issuers of debt securities only, those companies having a turnover below a certain threshold (please specify the threshold);

other.

If such a regime were to be introduced, we would note the need to have certainty of treatment for issuers. Market capitalisation is variable. It might be appropriate to have a regime providing for some fixed figure thresholds at the start of issuers' financial years. It might also be appropriate to have a band in-between small and large companies in which issuers may opt-in to the SMI regime.

If such a differential regime were to be introduced, there could be adverse consequences. In the first place, if companies are not clearly distinguished (as for example they now are with the premium and standard listing segments in the UK), that could cause confusion in the market. In addition investors may be more reluctant to invest in the segments with lower transparency requirements.

7. Potential diminution of cost for small listed companies if changes to the Transparency Directive were to be adopted

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/regulated markets from imposing in national law/listing rules more stringent or additional obligations on small listed companies?

No. It is for individual Member States/regulated markets to decide on super-equivalent regimes for their markets. The availability of different regimes is useful to issuers and investors.

Unlike in the case of the Prospectus Directive, there would not be any 'passporting' advantage in making the requirements of different States/markets conform with each other.

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? Please provide evidence supporting your answers (e.g. how much the cost would be reduced depending on the extension of the deadline)?

No. We do not think that the current publication deadline of itself results in legal costs.

7.3 Do the various rules requiring the disclosure by listed companies of reports of narrative nature bring significant costs/operation complexity

Those narrative reports (see Annex to this questionnaire for the legislative references) are:
- the annual management report (Article 4(5) TD), which refers to Article 46 of the Fourth Company Law Directive or to Article 36 of the Seventh Company Law Directive, and integrates disclosure obligations relating to environmental and social data;
for small listed companies (e.g. legal, account preparation, auditing, other type of costs)? Please provide evidence in support of your answer.

We understand that the corporate governance requirements in general generate significant costs, which may be proportionally greater for smaller listed companies.

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? Please explain you reply (e.g. rules would be more clear, the Home Member States rules would clearly apply, etc).

No. We consider this to be unnecessary and believe it would serve only to generate additional work for the legal profession.

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? Please provide evidence supporting your answers.

The answer to this would depend on the difference between the requirements which currently apply and those envisaged under a maximum harmonisation proposal. Where Member States have added requirements, they have presumably done that for a good reason and it would of course be open to them to remove these additional requirements if they are considered to be imposing too great a burden on small listed companies without there being any need for maximum harmonisation.

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? Please provide reasons on your reply.

(i) non-mandatory ready-to-use templates regarding these narrative disclosures (which could be prepared for instance by CESR/ESMA);

(ii) more detailed rules in European law, either in the Transparency Directive or in delegated acts adopted by the Commission;

(iii) a combination of both.

- the corporate governance statement as referred to in Article 46a of the Fourth Company Law Directive and Article 36(2) of the Seventh Company Law Directive, to be included in the annual management report;
- the information requested in Article 10 of the Takeover bids Directive, to be included in the annual management report;
- the disclosure on remuneration of directors (provided it is not integrated in the corporate governance statement)
- the interim management report (Article 5(5) TD); and
- the interim management statement (Article 6(1) TD);
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 Law⁵?

8. Diminution of cost for small listed companies vs. diminution of transparency to the market

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? Please provide evidence supporting your answer.

In our view it must necessarily follow that lighter transparency obligations will result in less information for the market in relation to the relevant companies. The significance of the reduction in transparency will depend on the nature of the relaxations which are envisaged. See for example our response in 8.2 below.

8.2 If the obligation to disclose quarterly financial information⁶ was waived for small listed companies, would this result in an unreasonable diminution of transparency? Please provide evidence supporting your answer.

We do not believe that there would be an unreasonable diminution of transparency for the following reasons:

- Interim financial reporting was relatively rare in the UK market before the implementation of the Transparency Directive and there was no perception that securities markets suffered from a lack of transparency.

- The Alternative Investment Market in the UK does not require interim financial reporting and is a well functioning market.

- The ongoing disclosure requirement provided by the Market Abuse Directive means that there should not be sensitive information, in terms of price movements, contained in the interim financial report since any material information should have been announced to the market in any event.

Whilst we do not believe that the waiver of the requirement for quarterly financial information would materially diminish transparency in the market, we also do not consider that it would provide significant cost savings for issuers and think that it might send an inappropriate message to the market that these issuers are not keeping the market fully informed when, by virtue of their obligations under the Market Abuse Directive, they must do so.

⁵ See Annex to the questionnaire for the text of Article 46(1)(b).
⁶ Either quarterly financial reports or interim management statements as referred to in Article 6 TD.
9. Addressing the lower visibility of smaller listed companies

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?

(i) Yes (see next question)

(ii) No, it is a structural problem or a market feature (e.g. size matters etc.) which EU measures will not be able to solve (please explain).

(ii) No. We think that such companies are less visible because generally investors are less interested in investing in them.

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

(i) The Transparency Directive should contain differentiated rules for small listed companies regarding timing and/or methods for the disclosure and dissemination of information (please explain);

(ii) there are rules in other EU directives (e.g. prudential requirements) and/or national law (e.g. tax law) which discourage financial analysts and intermediaries' interests in small listed companies which should be modified (please explain)

(iii) financial analysts and intermediaries should get incentives to interest themselves in small listed companies (please explain);

(iv) other (please explain).

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? Please explain.

No. Ability to access information does not appear to be a significant problem.

Other views regarding small listed companies

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

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II Information about holdings of voting rights

Disclosure of holdings of cash-settled derivatives

11. Would the disclosure of holdings of cash-settled derivatives be beneficial to the market? Please provide evidence supporting your answer (e.g. situations in which lack of disclosure of cash-settled derivatives produced negative results). Please report about your experience, if any, with the disclosure of cash-settled derivatives in the United Kingdom\(^8\) and/or in other jurisdictions where cash-settled derivatives are disclosed (such as in Switzerland).

Yes we believe disclosure is helpful as evidenced by the decision to introduce a disclosure regime in the UK.

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\(^9\) and/or of financial instruments giving unconditional access to voting rights\(^10\) for the purposes of calculating whether the threshold triggering the disclosure obligation is reached or crossed?

Yes, aggregation should be required.

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? E.g. (i) the thresholds provided in Article 9(1) TD should be applied (5%, 10% etc); (ii) the lower/initial threshold for this kind of disclosure should be significant and higher than the 5% foreseen in Article 9(1) TD (e.g. at least 10% or higher); (iii) other).

- Transparency of holdings of voting rights after the record date in advance of the general meeting of shareholders (the question of empty voting)

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?

(i) yes (please explain);

(ii) no, only limiting/prohibiting empty voting practices would be effective.

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\(^8\) A disclosure regime on holdings of cash-settled derivatives was introduced in 2009 in the UK.
\(^9\) See Articles 9 and 10 TD.
\(^10\) See Article 13 TD.
A specific disclosure regime could not prevent empty voting. It is not clear what mischief would be prevented by such a disclosure regime. It seems illogical to have a general regime requiring disclosure of voting rights at 5% (or 3% in the UK) but a disclosure regime relating to this limited period at 1/2%. We do not imagine that it would change the voting patterns of the other shareholders if they were to be informed that there was empty voting over a percentage of the issued share capital.

In our view there are two underlying issues: sales of shares where the owner on the date of the relevant meeting is not on the register at the record date and stock-lending.

Sales / record date

In the UK there would not appear to be a significant empty voting problem largely because the record date for traded companies in the UK is limited to 48 hours (excluding any part of a non-working day) under UK law, by section 360B(2) and (3) of the Companies Act 2006. This is in contrast to some other EU jurisdictions where we understand the period can be much longer. Article 7(3) of the Shareholder Rights Directive requires Member States to ensure that companies do not impose record dates longer than 30 days before the general meeting. In the preceding EU Commission consultation it was concluded that systems of share blocking should be abolished and replaced with compulsory record dates. In the consultation document the EU Commission stated:

"The record date should be sufficiently close to the General Meeting, to limit as much as possible the number of persons 'recorded' as shareholders on the record date that would no longer be shareholders on the date of the General Meeting. At this stage, DG MARKT considers that the exact determination of the applicable record date should be better dealt with as part of possible implementing measures, should there be any Directive on shareholders rights" (EU Commission, Internal Market and Services DG, MARKT/ 13.05.2005 "Fostering an appropriate regime for shareholders' rights", paragraph 5)

The 30 day limit in the Shareholder Rights Directive does not appear to achieve the stated aim (of limiting empty voting as much as possible). It would be more appropriate to resolve this issue through the mechanic established by the Shareholder Rights Directive.

Stock lending

In the UK, stock lending best practice suggests that stock should not be lent purely to allow voting - see the Bank of England’s Securities Borrowing And Lending Code Of Guidance (http://www.bankofengland.co.uk/markets/gilts/stockborrowing.pdf at p.18), which states:

"There is a consensus, however, in the market that securities should not be borrowed solely for the purpose of exercising the voting rights
at, for example, an AGM or EGM. Lenders should also consider their corporate governance responsibilities before lending stock over a period in which an AGM or an EGM is expected to be held. Beneficial owners need to ensure that any agents they have made responsible for voting and for securities lending act in co-ordinated way."

Note also that in the UK voting interests in borrowed shares must be disclosed (DTR 5.1.3) unless the borrower has no intention to and does not exercise voting rights.

In our view the promulgation of an EU Stewardship code governing the behaviour of institutional investors with regard to stock lending might be an appropriate means for the EU Commission to give guidance on this point.

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.**

14.1 **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.**

**Intentions with holdings or voting policies disclosure**

15. **Which is the best way to make the investment process more transparent (please justify your answer):**

(i) requesting investors to disclose their future intentions with holdings;

(ii) requesting investors to disclose their actual voting policies;

(iii) both;

(iv) none;

(v) other.

(v) Pursuit of a code similar to the UK Stewardship Code in the other EU Member States.

The key principles of the UK Stewardship Code are that institutional investors should:

- publicly disclose their policy on how they will discharge their stewardship responsibilities.

- have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
• monitor their investee companies.
• establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
• be willing to act collectively with other investors where appropriate.
• have a clear policy on voting and disclosure of voting activity.
• report periodically on their stewardship and voting activities.

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?

(i) this would be useful for issuers and other investors (e.g. more transparency) – please provide examples/justify your reply;

(ii) this would be negative to issuers and other investors (e.g. facilitate anti-takeover defences) – please justify your reply.

We believe that such a requirement would make the EU a very unattractive market and in addition would raise serious market abuse issues. For example, would holders have to notify every change in intention?

We think these issues are better tackled though the publication of a Stewardship Code as outlined above.

16.2 which should be the minimum threshold triggering such disclosure? Please justify your reply.

(i) the thresholds provided in Article 9(1) TD should be applied (5%, 10% etc);

(ii) the lower/initial threshold should be significant and higher than the 5% foreseen in Article 9(1) TD (e.g. at least 10% or higher);

(iii) the information should only be requested only if certain threshold are crossed and provided that the investor is among the largest 3 investors in the issuer;

(iv) other.

16.3 should such disclosure consist in (please justify your reply):

(i) simple information on intentions (e.g. box ticking in a form: I intend to change/influence control of the issuer/I do not intend to change/influence control of the issuer);

(ii) more substantial information on intentions (e.g. narrative explanations on purpose of the acquisition including any plans or
proposals of the investor for future purchases or sales of issuer’s stock or for any changes in the issuer’s management or board of directors etc.);

(iii) information on source and amount of funds used to acquire the securities;

(iv) arrangements to which the investor is a party relating to issuer's securities;

(v) other.

Aggregation of holdings and voting rights

17. Should holdings of shares and voting rights\(^{11}\) be aggregated with holdings of financial instruments giving unconditional access to voting rights\(^{12}\) for the purposes of calculating the relevant thresholds that trigger the notification obligation? Please justify your reply.

Yes. We believe that the thresholds are currently appropriate, but would be too high if they were considered as separate thresholds for each of shares and financial instruments.

In the UK, holdings of shares and financial instruments are aggregated for the purpose of meeting the threshold requirement (as are instruments having a similar economic effect e.g. CFDs), but the individual interests are also shown in the relevant form.

Other cases of insufficient transparency regarding corporate ownership

18. Are there other cases of potentially insufficient transparency regarding corporate ownership? Please justify your reply.

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

Uniform EU Regime or maximum harmonisation: major holdings of voting rights

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? Please justify your reply by describing any legal obstacles (e.g. related to civil or company law) to such uniform EU regime.

\(^{11}\) Articles 9 and 10 TD.

\(^{12}\) Article 13 TD.
It would be helpful for all the Member States to have coherent regimes. We do not believe that a directly applicable EU Regulation would be helpful. Some differences in national regimes are due to regulators interpreting the Transparency Directive differently (see the Commission's commentary on question 22). In addition, the UK market's super-equivalent regime is working well. An approach which encourages greater discussion between Member States with a view to their producing a harmonised (as opposed to uniform) approach, taking in to account the differences between markets, would be more likely to produce a satisfactory result. Any attempt to provide a maximum harmonisation approach should exclude takeover rules which are subject to separate regimes and appear to be functioning well.

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**?\(^{13}\)

We do not believe that UK market users would be receptive to maximum harmonisation, if that would lead to a watered down regime or to changes from the current UK regime which works well. The ability for issuers to ask for information about the true owners of their shares (which may be important for corporate governance purposes) (such as the ability to issue notices under section 793 of the Companies Act 2006 to require information about interest in shares in the UK) is valued and we would be concerned if that were removed in the name of harmonisation.

In addition, there are further disclosure rules in the UK under the Takeover Panel's disclosure regime relating to public offers and these should not be affected by the Transparency Directive.

**Uniform EU Regime or maximum harmonisation: disclosure by issuers**

21. **Would it be desirable to set up a uniform EU regime (e.g. by a directly applicable EU Regulation) regarding issuers' disclosures**?\(^{14}\) **Please justify your reply by describing legal/other obstacles to such uniform EU regime**?\(^{15}\)

There would be merit in regulators in Member States engaging in discussion with each other to agree a common position. However, there does not appear to be any need for a directly applicable EU Regulation, which would be bound to result in increased costs for issuers and make changes to current national regimes which currently operate satisfactorily.

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\(^{13}\) For instance, if the Transparency Directive was to reduce its initial disclosure threshold from 5% to 3%, should the Member States that have set a 2% threshold be required to raise it to 3%?

\(^{14}\) Articles 4 to 8 TD.

\(^{15}\) Please see questions 8.5 and 8.6.
Divergent rules: calculation of holdings

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? Please justify your reply.

Unclear rules

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

a) EU clarification of the circumstances which may trigger a disclosure pursuant to Article 9(2) of the Transparency Directive, "as a result of events changing the breakdown of voting rights", would be desirable. For example, it could be clarified, as the FSA has done in the UK (see DTR5.1.2R(2)), that where there is a notifiable switch (e.g. 1% for UK issuers) from a soft shareholding to an absolute shareholding by the exercise of entitlements to acquire shares, without affecting the overall percentage of the holding, a new disclosure would be required.

It could also be clarified that this particular provision does not necessitate a disclosure where a person has disclosed its holding of voting rights, but then it subsequently changes the capacity in which it holds them. For example, where a person has disclosed its indirect holding of shares as a beneficiary (and these shares are held by a non-discretionary nominee), the person would not be required to disclose a change if it then takes those shares out of the nominee account and holds the shares directly itself.

b) CESR guidance regarding corporate group disclosures would be desirable as there is divergence across Member States as to whether (i) it is mandatory for a parent company to make an aggregated disclosure of both its own shareholding and those of its controlled undertakings, and (ii) if the parent does so, that the controlled undertakings are exempt from making their own individual applicable disclosures. The divergence of approaches may be due, in part, to Article 12(3) of the Transparency Directive appearing to state that parent aggregation is permissive as opposed to mandatory.

c) CESR guidance regarding the approach on netting of holdings of voting rights would be desirable, as the Transparency Directive is silent on this issue, e.g. netting intra-group and at the parent level (where the parent is making a group disclosure). In the UK, pursuant to DTR 5.8.11R, the FSA has introduced a practical solution to the general position that no netting is permitted under the Transparency Directive, whereby a person is

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16 See section 2.8 and Annex 6 to the Staff Working Document.
permitted to disclose its net holding up to midnight of a relevant day, but has clarified that this intra day exemption does not, however, permit the netting of long and short positions in financial instruments.

d) EU clarification of the application of Article 10(b) of the Transparency Directive as to the disclosure obligations of each of the stock lender and the stock borrower on a stock lending transaction which involves an outright transfer of ownership of the lent shares with the stock lender having a right of recall would be desirable. Our experience has shown that there is a wide divergence as to how regulators of Member States approach this issue, as is highlighted in Annex 10 of the Staff Working document. For example, in the UK, pursuant to DTR 5.1.1R(5), the stock lender, because it has a right of recall, is exempt from disclosing a disposal.

IV Any other comments

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

Our experience has shown that two practical issues regarding lack of easily accessible information cause shareholders problems when considering their disclosure obligations, particularly in light of the divergence of disclosure regimes across EU Member States. EU consideration of a need for issuers/regulators to regularly publish such information would assist in alleviating these operational difficulties.

The issues are: (a) where an issuer has multiple listings, it is paramount for the shareholder to establish which country is the issuer's home Member State to ascertain which disclosure regime applies. However, few regulators publish such lists or ensure that they are regularly updated; and (b) ascertaining the issuer's total number of issued voting rights for the denominator of the disclosure calculation is not straightforward because Article 15 of the Transparency Directive only requires an issuer to publish such information where there has been a change in its total number of voting rights. This information may be difficult to obtain if there are infrequent changes to an issuer's share capital.