

J.S.D. Edita Čulinović-Herc, Assistant Professor
LL.M. Dionis Jurić, Research Assistant
Faculty of Law University of Rijeka

Disclosure of Beneficial Ownership – from EU Major Shareholdings Directive to EU New Transparency Directive – what needs to be changed in the Croatian Securities Markets Act?¹

Summary

Disclosure of beneficial ownership is a powerful mechanism for protection of the investors on capital markets. Through the duty to disclose beneficial ownership publicly traded companies (issuers) and other participants on capital market (individual investors, institutional investors, competent authorities) can obtain valuable informations for creation of their portfolios. The Admission and Information Directive 2001 and the Proposal for a Transparency Directive 2003 are focused in this point. In Croatian Law the disclosure of beneficial ownership is regulated by the Securities Market Act 2002. Its existent rules should be modernized and revised according to prior mentioned EU Directives.

Key words: *disclosure of beneficial ownership, The Admission and Information Directive 2001, The Proposal for a Transparency Directive 2003, Croatian Securities Market Act 2002*

1. Introduction

Although public companies are “anonymous companies” where the identity of individual shareholder is not important, modern legislators sought to create certain level of transparency of ownership structure in public companies. Transparency of financial and economic activities of publicly traded companies is essential for the functioning of capital

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markets, enhancing their overall efficiency and liquidity. Protection of potential investors, other shareholders, suppliers and creditors is secured in this way.

The identity of beneficial owner can be interesting in various situations as takeovers, notification of other shareholders on existing of major shareholder who controls company's policies and management and valuation of the company.

Recent financial scandals in USA and Europe also triggered debate over corporate governance and importance of adequate and timely information on financial activities of companies.² It is acknowledged in many guidelines on corporate governance published by international and national institutions and national acts.³ The importance of disclosure and transparency as a flexible and adaptable tool in company law is also emphasized in Winter Report 2002 of the High Level Group of Company law Experts.⁴ It enhances accountability for company's governance and makes company's activities transparent. Information and disclosure is an area where company law and securities regulation meet together. Securities regulation tends to ensure that market participants have sufficient information in order to participate in the market on an informed basis. In company law disclosure of relevant information creates an incentive to manage company's affairs in accordance with best practice and to avoid actions that are in breach of fiduciary duties or regulatory requirements. For different stakeholders who participate in companies or do business with companies, information is a necessary element to assess their position and respond to changes which are relevant to them.

² In USA four big financial scandals broke out in 2001 and 2002 («Big Four Frauds»): Enron, Global Crossing, WorldCom and Qwest. All these companies admitted their securities to stock exchange listings in late 1990s, they had bad accounting and supine corporate governance system and they used the same outside auditor Arthur / Andersen & Co. See Daniel Kadlec, Enron: Who's Accountable?, Time – Business & Technology, January 13, 2002., Jay M. Feinman, Liability Of Accountants For Negligent Auditing: Doctrine, Policy And Ideology, Florida State University Law Review, Fall 2003., pp. 17-19., Lawrence A. Cunningham, The Sarbanes - Oxley Yawn: Heavy Rethoric, Light Reform (And It Just Might Work), Connecticut Law Review, Spring 2003., pp. 923-936. In Europe there were financial scandals in various states: Marconi (UK), Elan (Ireland), EmTV, MobilCom (Germany), Vivendi, France Telecom (France), Swiss Life, Bz Group (Switzerland), Bipop, Cirio, Parmalat (Italy), ABB (Sweden), Royal Ahold, KpnWest (the Netherlands). See Luca Enriques, Bad Apples, Bad Oranges: A Comment From Old Europe On Post-Enron Corporate Governance Reforms, Wake Forest Law Review, Fall 2003., str. 912-916.

³ OECD Principles of Corporate Governance 2004, EASD Corporate Governance Principles and Recommendations 2000, Sarbanes-Oxley Act 2002 in USA.

⁴ Report of The High Level Group of Company law Experts on A Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002 (Winter Report 2002)), pp. 33-34..

2. EU Admission and Information Directive 2001

In attaining of this goals in area of financial services European Union brought Financial Services Action Plan (FSAP)⁵ in May 1999. This plan proposed policy objectives and specific measures for improving the single market in financial services. The action plan for a single financial market puts forward priorities and a timetable for specific measures to achieve three strategic objectives: 1) establishing a single market in wholesale financial services; 2) making retail markets open and secure, and 3) strengthening the rules on prudential supervision.

Establishing of the single market in financial services is steered in six areas: establishing a common legal framework for integrated securities and derivatives markets; removing the outstanding barriers to raising capital on an EU-wide basis; moving towards a single set of financial statements for listed companies; creating a coherent legal framework for supplementary pension funds; providing the necessary legal certainty to underpin cross-border securities trading, and creating a secure and transparent environment for cross-border restructuring.

Different national rules of Member States hinder the offering of securities in other Member States of EU and makes such operations extremely costly. To diminish this barriers on raising capital throughout the Union, Commission enacted directives on reporting requirements and on public-offer prospectuses.⁶ It is also necessary to advance cooperation between the Commission and the Forum of European Securities Commissions (FESCO). Further step to reduce this costs is giving to companies the option of using financial statements prepared on the basis of a single set of financial reporting requirements.⁷ Usage of International Accounting Standards (IAS) is appropriate tool for achieving this requirements. Regarding audit procedures, International Standards on Auditing are the minimum standards which should be satisfied in order to secure credibility to published financial statements.⁸

⁵ Commission Communication of 11 May 1999 entitled "Implementing the framework for financial markets: action plan" [COM(1999) 232 final - Not published in the Official Journal].

⁶ Directive 2001/34/EC of the European Parliament and of the Council on the admission of securities to official stock exchange listings and on information to be published on those securities and Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

⁷ This topics are harmonized by Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies and Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts.

⁸ Council adopted Regulation No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and Commission adopted Regulation No 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with formerly mentioned

First national rules on disclosure of beneficial ownership were enacted in United Kingdom in 1967. It was triggered by the American experience where there were already rules about the registration of shareholders owning more than 10 percent of a equity capital of a company.⁹ The development of these disclosure rules was connected with the regulation of takeovers. Rules Governing Substantial Acquisitions of Shares (SARs) and The City Code on Take-overs and Mergers were introduced together.

However, EU decided to harmonize national rules on disclosure and to coordinate the conditions for the admission of securities to official stock exchange listings and the information to be published on those securities in order to provide equivalent protection for investors at Community level with adoption of Admission and Information Directive 2001 and Prospectus Directive 2003.¹⁰ The Admission and Information Directive concerns all securities admitted to official listing, irrespective of the legal nature of their issuer. It thus applies also to securities issued by non-member countries or their regional or local authorities or by public international bodies. However, the rules must be flexible, minimal and partial in order to allow firms with increasing financial requirements to access liberalised capital markets. In order to protect investors, information on the financial status of the issuer and details of the securities for which admission to official listing is requested must be disclosed. This information is usually provided by publishing listing particulars. The content of this information varies between Member States and the Directive seek to eliminate the differences

Regulation of Council. Council Regulation of 2002 envisaged that all publicly traded companies shall prepare their consolidated accounts in conformity with the international accounting standards for each financial year starting on or after 1 January 2005 (Article 4). Member States may also permit or require that publicly traded companies shall prepare their annual accounts and that non publicly-traded companies shall prepare their consolidated accounts and/or their annual accounts in conformity with the international accounting standards (Article 5). Commission envisaged that all statutory audits prescribed by Community law should be carried out in accordance with International Standards on Auditing (Articles 26-28 of Proposal for a Directive of the European Parliament and of the Council on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC).

⁹ In 1967 USA enacted federal Williams Act which imposed the duty on any person, other than the issuer, who acquires beneficial ownership of more than 5 per cent of a class of securities to file appropriate disclosure with the SEC within 10 days after reaching the 5 per cent threshold. Williams Act amended Securities Exchange Act. See Nils Jul Clausen, Karsten Engsig Sørensen, Disclosure of Major Shareholdings: A comparative Analysis of Regulation in Europe, *International And Comparative Corporate Law Journal*, Vol. 4 Issue 3, 2002., pp. 202-203.

¹⁰ Predecessors to existing Admission and Information Directive 2001 and Prospectus Directive 2003 were Council Directive [79/279/EEC](#) coordinating the conditions for the admission of securities to official stock-exchange listing, Council Directive [80/390/EEC](#) coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock-exchange listing, Council Directive [82/121/EEC](#) on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing and Council Directive [88/627/EEC](#) on the information to be published when a major holding in a listed company is acquired or disposed of. Their content is consolidated by the Admission and Information Directive 2001.

in national rules and regulations in order to achieve a degree of equivalence in the safeguards currently required.

This coordination of information is ensured by the mutual recognition of listing particulars,¹¹ Nevertheless, the mutual recognition of a prospectus does not in itself confer a right to admission to official listing. The Directive also provides for the extension, by means of agreements to be concluded by the Community with non-member countries, of the recognition of listing particulars for admission to official listing from those countries on a reciprocal basis.

The information provided to investors must be sufficient and that means that investors may, in some cases, receive only simplified information rather than full listing particulars. It must be minimal since Member States may find it useful to establish non-discriminatory minimum quantitative criteria which issuers must fulfil to be eligible to benefit from the possibilities for exemption provided for in the Directive. Investors must regularly get appropriate information throughout the entire period during which the securities are listed. The present Directive also stipulates that companies must make available to investors an activity report covering the first six months of the financial year. This half-yearly report must, however, contain only the essential details on the financial position and general progress of the business of the company in question. The companies located in non-member countries must also comply with the rules on the provision of regular information to investors. The information must be relevant and it means that investors must be informed by shareholders in companies of «major» holdings and especially of changes in those holdings.

The rules on disclosure of beneficial ownership are situated in Chapter III, Arts 85-97 of Admission and Information Directive.¹²

The Admission and Information Directive in Article 88 indicates that it enacts minimum requirements and Member States may impose more stringent or additional requirements in their national rules. This obligations are conditioned by implementation to all who acquire or dispose of shares, as well as to all companies. All Member States harmonized their national rules with the Directive.

¹¹ This principle is already enshrined in Council Directive 89/298/EEC coordinating the requirements for the drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public.

¹² There were no substantial changes to the original rules of Council Directive 88/627/EEC on the information to be published when a major holding in a listed company is acquired or disposed of (Major Shareholdings Directive 1988).

2.1. Scope of Application

Article 85(1) states that provisions on disclosure of beneficial ownership will be implemented to all natural persons and legal entities in public or private law who acquire or dispose of, directly or through intermediaries, holdings in companies. Person's nationality is not important and all forms of incorporation are covered, regardless of their domicile.

The duty to disclose applies on acquisition or disposal of shares which involve changes in the holdings of voting rights in all companies which are incorporated under the laws of the Member States and whose shares are officially listed on a stock exchange or exchanges situated or operating within one or more Member States.¹³ It means that Member State shall regulate companies which are incorporated by them or if they are the subject to the Member State's law.¹⁴ Companies must either be listed on a stock exchange situated in one of the EU Member States, or on a stock exchange which, although it is situated outside the EU, carries on business within the EU.¹⁵

The Directive doesn't apply to companies which are subject to the jurisdiction of third countries (countries outside the EU or the EEA), even if they are listed on a stock exchange in the EU. It doesn't apply to the acquisition or disposal of major holdings in collective investment undertakings (Art. 85(3)). Article 94(1) provides possibility to exempt from the obligation to disclose the acquisition or disposal of a major holding by a professional dealer in securities.¹⁶

The Directive doesn't apply if the person or entity acquiring or disposing of a major holding is a member of a group of undertakings required under Seventh Council Directive 83/349/EEC to draw up consolidated accounts, if it is made by the parent undertaking or,

¹³ In practice this provisions are applying on public companies limited by shares whose shares can be listed on a stock exchange. Where the acquisition or disposal of a major holding is effected by means of certificates representing shares, rules on disclosure of major shareholding will apply to the bearers of those certificates and not to the issuer (Art. 85(2)).

¹⁴ In some Member States (Germany, France, Belgium) companies with their real seat in particular Member State will be the subject of national law, even if these companies are incorporated and registered in another Member State.

¹⁵ Germany, the Netherlands, Finland and Sweden have extended the obligation to apply to companies listed in European Economic Area (EEA) countries. In Iceland the obligation has been extended to all companies listed on the stock exchange without reference to the location of stock exchange. However, Norway and Austria have limited the obligation to companies listed on the domestic stock exchange. See N.J. Clausen, K.E. Sørensen, *op. cit.*, pp. 218-219.

¹⁶ This exemption shall be applied if that acquisition or disposal is effected in his capacity as a professional dealer in securities and if the acquisition is not used by the dealer to intervene in the management of the company concerned. National authorities shall require the professional dealers in securities to be members of a stock exchange situated or operating within a Member State or to be approved or supervised by a competent authority of the Member State. Germany, Finland, Austria, Denmark and Luxembourg reproduced the exemption from the Directive.

where the parent undertaking is itself a subsidiary undertaking, by its own parent undertaking (Art. 93).

2.2. Thresholds for Disclosure

According to Article 89(1) of the Directive all natural and legal persons must notify the company if their acquisition or disposal of shares of that company means that their proportion of voting rights reaches, exceeds or falls below one of the thresholds of 10 %, 20 %, 1/3, 50 % and 2/3, and must notify at the same time the competent authority. The Directive allows Member States to set a single threshold of 25 % instead of 20 % and 1/3 and a threshold at 75 % instead of 2/3.¹⁷

These thresholds are commonly used in other company directives.¹⁸ Member States can decide that disclosure shall also include the proportion of the capital of the company which is held by a natural or legal person.¹⁹ In these Member States there will be a duty to disclose both when the voting threshold is passed and when the nominal capital threshold is passed.²⁰

Many Member States have introduced additional thresholds for triggering the duty to disclose. Most of them introduced the threshold of 5 % of the voting rights to trigger the duty to disclose the beneficial ownership.²¹ This lower threshold is also recognized in the Commission's Proposal for a Directive on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC in 2003. In some countries it is assumed and partially regulated that a company may set further disclosure thresholds in its statutes.

The Directive missed to solve some cases when there is difficult to assess whether the threshold for disclosure has been passed. Sometimes the number of voting rights in a company can vary because of existing of shares with multiple voting rights or reduction of voting rights in case when the company acquires its own shares. Article 89(2) therefore

¹⁷ Germany has applied both options and the Netherlands has applied the first of them.

¹⁸ These thresholds are shaped in a way reflecting differences in national company law on issues such as the thresholds necessary to represent blocking minorities on annual shareholder meetings, to achieve changes to the company's statutes or exercising special rights, such as nomination of special auditors, etc.

¹⁹ Such possibility is provided in Iceland, Norway, Denmark, the Netherlands, Finland and Sweden.

²⁰ N.J. Clausen, K.E. Sørensen, *op. cit.*, p. 221.

²¹ Belgium, Denmark, Austria, the Netherlands, Iceland, Sweden (NBK Recommendation), Germany, Spain, Finland, France, Greece, Ireland. The UK provides even the lower threshold of 3 % of voting rights and in Italy it is 2 % of voting rights.

provides that Member States shall, if necessary, determine in their national law the manner of notification of shareholders about the voting rights that shall be taken into account for the assessing whether a threshold for disclosure has been passed.²² However, only a few Member States enacted such rules.²³

2.3. The Concept of Acquisition

The Directive states that the duty to disclose emanates for all natural and legal persons who acquire or dispose of shares in a company. This points out the question of the manner and time of the acquisition. According to Article 86 “acquiring a holding” shall mean not only purchasing a holding, but also acquisition by any other means, regardless of the capacity in which the acquisition is made or by what method. It means that involuntary acquisitions²⁴ and all active acquisitions²⁵ trigger the duty to disclose. There are different opinions on passive acquisitions and their impact on the duty to disclose.²⁶ The same situation is regarding the partial acquisitions and acquisitions without a real change of control.

The time of acquisition of shares is also doubtful. The suggested solution of this question would be to trigger duty to disclose when the acquisition first occurs to be final. In the case of the increasing of equity capital it is doubtful whether the acquisition is effective when an irrevocable rights issue is decided on or when the equity capital increase has been carried through and the shares are issued.²⁷ The Directive shall be applied to the temporary or involuntary exceeding of threshold. It is not relevant whether the acquired shares are listed or whether they belong to a class of shares that isn't listed on the stock exchange.²⁸

²² Usually in counting of voting rights there shall not be counted the voting rights of shares acquired by the company itself (own shares) and convertible debentures and other securities that can be converted into shares with voting rights. See N.J. Clausen, K.E. Sørensen, *op. cit.*, pp. 224-225.

²³ France, the UK, Luxembourg, Denmark, Italy, Sweden, Belgium.

²⁴ For example forced sale under administration.

²⁵ For example acquisitions by inheritance, by gift, by merger and similar transfers. In Norway the loan of a share is equivalent to its acquisition.

²⁶ Passive acquisition of shares could occur by exceeding the threshold because of suspension of voting rights (voting ceiling, company's acquisition of its own shares) or increasing of voting rights because of changes in equity capital.

²⁷ In the UK the former moment is decisive.

²⁸ See N.J. Clausen, K.E. Sørensen, *op. cit.*, pp. 225-229.

2.4. The Calculation of Share Holdings

The calculation of a shareholding is based on the voting rights which belong to the specific shareholder. Detailed rules on calculation of shareholdings are laid down in Article 92. In calculating of holdings of the specific person it must be included every voting right which he can himself exercise, has the possibility of exercising or the exercise of which he can influence in concert with others.

Article 92 lays down eight situations which require the voting rights to be regarded as being held by a person:

(a) voting rights held by other persons in their own names but on behalf of that person. It means that even if the voting right is held by a nominee, the beneficial owner is always obliged to make his identity and his holding public. Major shareholders cannot hide behind nominees;

(b) voting rights held by an undertaking controlled by that person. A controlled undertaking is any undertaking in which a natural or legal person: a) has a majority of the shareholders' or members' voting rights, or b) has the right to appoint or remove a majority of the members of the administrative, management or supervisory body and is at the same time a shareholder in, or member of the undertaking in question, or (c) is a shareholder or member and alone controls a majority of the shareholders' or members' voting rights pursuant to an agreement entered into with other shareholders or members of the undertaking (Art. 87(1)). A parent undertaking's rights as regards voting, appointment and removal shall include the rights of any other controlled undertaking and those of any person acting in his own name but on behalf of the parent undertaking or of any other controlled undertaking (Art. 87(2)). Both direct and indirect control are included, and insertion of nominee cannot alter the picture;

(c) voting rights held by a third party with whom that person has concluded a written agreement which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the company in question. This provision covers all shareholders which act in concert. It is limited only to written agreements which are concluded to a long term;

(d) voting rights held by a third party under a written agreement concluded with that person or with an undertaking controlled by that person providing for the temporary transfer for consideration of the voting rights in question;

(e) voting rights attaching to shares owned by that person which are lodged as security, except where the person holding the security controls the voting rights and declares

his intention of exercising them, in which case they shall be regarded as the latter's voting rights;

(f) voting rights attaching to shares of which that person has the life interest (ususfructus);

(g) voting rights which that person or one of the other persons mentioned in previous points is entitled to acquire, on his own initiative alone, under a formal agreement. In such cases the notification of beneficial ownership shall be effected on the date when the agreement is entered into force;

(h) voting rights attaching to shares deposited with that person which that person can exercise at its discretion in the absence of specific instructions from the holders. This provision covers situations when the shares are deposited with banks which then exercise the voting rights. In such cases Member States may lay down that the person who is obliged to disclose of its major shareholding is only obliged to inform the company concerned 21 days before the general meeting of that company. The timing of disclosure in such situations is prolonged from 7 to 21 days.

Member States have largely chosen to import the provisions of the Directive on the calculation of shareholdings into their national rules without changes or with slight changes.²⁹

The listing of provisions in Article 92 is exhaustive. This can result in easy evasion of these rules.³⁰

2.4. The Procedure for Declarations and Their Content

In most countries beneficial owner or holder of voting rights is obliged to disclose major shareholdings. The beneficial owner is a person who enjoys the benefits of ownership even though title is in another name.³¹ However, in many countries the rules enact that a subsidiary has no obligation to disclose if its parent company or another undertaking which is higher in the group hierarchy discloses the major shareholdings.³²

Article 95 of the Directive provides the possibility of exemption from the duty to disclose. The competent authorities may exempt certain companies from the obligation to

²⁹ For example in Austria, Belgium, Denmark, Germany, Greece, Iceland and Luxembourg.

³⁰ It is acknowledged in Sweden and Germany. Norway and Iceland extended the concept of holding shares in relation to the Directive. See N.J. Clausen, K.E. Sørensen, op. cit., pp. 231-232.

³¹ For example, when shares of a mutual fund are held by a custodian bank or when securities are held by a broker in street name, the true owner is the beneficial owner, even though, for safety and convenience, the bank or broker holds title.

³² There are special rules on disclosure of beneficial ownership in group of companies in Germany, Belgium and the UK.

notify the public on the beneficial ownership (major shareholding) because they consider that the disclosure of such information would be contrary to the public interest or seriously detrimental to the companies concerned, provided that, in the latter case, such omission would not be likely to mislead the public with regard to the facts and circumstances knowledge of which is essential for the assessment of the transferable securities in question. It should be noted that only disclosure to the public may be exempted. Beneficial owners are always obliged to disclose themselves to the company and to the competent authorities.

The Directive prescribes two stage procedure for the disclosure of beneficial ownership. According to Article 89(1) major shareholder must notify the company and at the same time the competent authority within seven days. The period shall start from the time when the person in question learns of the acquisition or disposal, or from the time when he should have learned of it. If the shares are deposited with banks which then exercise the voting rights (Art. 92(h)), the period for notifying the company can be prolonged in national rules to 21 days before a general meeting of the company (Art. 92(2)).

In second stage the company which has received a notification from the mayor shareholder must as soon as possible but not more than nine days disclose it to the public. The disclosure shall be made in each of the Member States in which company's shares are officially listed on a stock exchange. A Member State may provide that the public disclosure shall not be made by the company but by the competent authority in cooperation with that company (Art. 91)). The lack of such regulation of the disclosure of beneficial ownership is that the public gets first notion about changes of beneficial ownership too late regarding the actual change of beneficial ownership.³³ Articles 102 and 103 lay down more detailed rules for the disclosure procedure.

The Directive doesn't prescribe the content of the disclosure. National rules are more detailed on this issue. The beneficial owner shall be clearly identified, the number of shares, the class of shares and the date of the acquisition shall be given and in some countries the acquisition price and nominal value of the shares should be also given. Where the holdings of other parties are included in the calculation, the basis for the calculation and apportion of the

³³ This can be postponed for more than two weeks after the actual change of beneficial ownership. Austria, Germany and Luxemburg adopted in their national rules the provisions of the Directive. Belgium, the UK, France, Italy and Greece prescribed shorter periods for the disclosure of beneficial ownership. In the Netherlands, Norway, Sweden, Finland, Denmark and Iceland the notification to the company should be made immediately with immediate disclosure to the market.

total holding between the different parties shall be given. In the case of a concerted practice, some countries require revealing of the identities of all involved parties.³⁴

2.5. Enforcing the Duty to Disclose

Article 97 of the Directive provides that Member States shall provide for appropriate sanctions when the beneficial owners and the companies do not comply with the provisions on disclosure of beneficial ownership. Different countries have adopted different sanctions and consequences in cases of omission to disclose the beneficial ownership. Some countries enacted fines and imprisonment sanctions.³⁵ Another sanction for the breach of rules on disclosure of beneficial ownership is suspension of voting rights of shares which ought to have been but have not been disclosed.³⁶ If a shareholder exercised his voting rights of shares which have been suspended, it is possible to annul the decisions of a general meeting if the decisions have been taken on the basis of improper voting.³⁷ Some countries allow that the authorities or the courts could impose different sanctions on undisclosed shares.³⁸

3. The Commission's Proposal for a Transparency Directive 2003

The EU Commission proposed a new Directive on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC in 2003. This proposal for a directive should markedly improve the information made available to all investors about publicly traded companies on regulated securities markets within the European Union. It will further integrate European securities markets by reducing or eliminating information asymmetries, which may endanger comparability and market liquidity. Its aim is to enhance investor's confidence in the financial position of issuers and to reduce the cost of accessing capital.³⁹ The proposal is part of a strategy for harmonization of securities markets legislation,

³⁴ N.J. Clausen, K.E. Sørensen, op. cit., pp. 236-239.

³⁵ For example in the UK, the Netherlands, Norway, Sweden, Iceland, Italy, Greece, Belgium, Germany, Denmark and France.

³⁶ For example in France, Belgium, Germany, Luxembourg, Italy.

³⁷ For example in Belgium, Luxembourg and Italy.

³⁸ For example in France, Greece, the Netherlands, the UK, Germany. See N.J. Clausen, K.E. Sørensen, op. cit., pp. 239-243.

³⁹ This initiative is one of the priority actions in the Financial Services Action Plan (FSAP), endorsed by Heads of State and Government at the Lisbon European Council in March 2000. The aim is for Member States to have successfully implemented the agreed directive by 2005 at the latest - a commitment affirmed by Heads of State and Government at Stockholm in March 2001 and at Barcelona in March 2002.

in particular for achieving a greater level of transparency and information in respect of issuers whose securities are traded on regulated markets.⁴⁰

The proposed Transparency Directive envisages to impose a level of transparency and information which will obtain sound investor protection and market efficiency. In order to achieve these aims, the current initiative should be consistent with the Regulation on the application of IAS, the Directive on Market Abuse and the Prospectus Directive. Its scope should be extended from official to regulated markets, thus bringing second tier markets within its scope, it should ensure greater openness to the international financing in terms of use of languages and also in the use of modern information technologies. Finally, the Proposal should appropriately respond to developments in the US, including the Sarbanes-Oxley Act, for promoting European capital markets.

The Proposal reforms requirements in the form of standardized information at a certain point (periodic information) or information on an ongoing basis. Its objectives are: a) to improve annual financial reporting by security issuers through disclosure of an annual financial report within three months (Art. 4); b) to improve periodic disclosure of share issuers over a financial year, by introducing a pragmatic policy mix of more detailed half-yearly financial report (Art. 5) and less demanding quarterly financial information for the first and third quarter of a financial year (Art. 6);⁴¹ c) to introduce half-yearly financial reporting to issuers of only debt securities who are currently not subject to any interim reporting requirement at all (Articles 5 and 8); d) to base on-going disclosure of changes to important shareholdings in issuers on proper capital market directed thinking (Articles 9-12);⁴² e) to

⁴⁰ The Proposal for a Transparency Directive is part of a “disclosure and transparency agenda” on which the EU institutions adopted: Regulation 1606/2002 of 19 July 2002 on the application of international accounting standards (OJ No L 243 of 11.9.2002), Directive 2003/6/EC of 3 December 2002 on insider dealing and market manipulation (market abuse) and Directive 2003/71/EC of 4 November 2003 on the prospectus. The Directive 2004/39/EC of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC is designed to strengthen the Community legislative framework for investment services and regulated markets and aims to protect investors and safeguard market integrity by establishing harmonised requirements governing the activities of authorised intermediaries and to promote fair, transparent, efficient and integrated financial markets. This Investment Services Directive 2004 will be efficient only if a new set of regulatory transparency requirements are enacted.

⁴¹ This solution is balanced between American and prior European standards on corporate transparency. American standards would be to require three fully-fledged quarterly financial reports based on highest international standards. Prior European standards (prior to the Internal Market) ignored that capital markets became more competitive and that they now act much faster. Investors investing in several Member States should benefit from more reliable and standardized financial information cycles. See Explanatory Memorandum on Proposal for a Directive of the European Parliament and of the Council on the harmonization of transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, Commission of the European Communities, COM(2003) 138 final, 2003/0045 (COD), Brussels, 26.3.2003, p. 3.

⁴² This should lead to more frequent information within stricter disclosure deadlines.

update existing Community law on the information provided to security holders (holders of shares or debt securities) in general meetings through proxies and electronic means (Articles 13 and 14).⁴³

3.1. Reform of existing rules on disclosure of beneficial ownership

Revision of current rules on disclosure of beneficial ownership is envisaged in Chapter III Section I of the Proposal for a Transparency Directive 2003. The Proposal provides more frequent and stringent disclosure regime, shortening of deadlines for notification and disclosure of beneficial ownership and transparency about holdings in securities giving access to shares.

The Admission and Information Directive 2001 provided in Article 89(1) thresholds which trigger the duty to disclose beneficial ownership. Meanwhile, twelve Member States have introduced further thresholds.⁴⁴ The Committee of European Securities Regulators (CESR) also launched a discussion for reconsidering current thresholds.⁴⁵ The Commission in Article 9 now proposes the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75% of the voting rights or the capital or both.⁴⁶ Member States can provide further thresholds, especially lower ones. The Member State can provide obligation to disclose proportion of capital only when the home Member State⁴⁷ allows multiple voting rights to attach to shares and the issuer provides this in its statutes or instruments of incorporation. The home Member State can decide that the 5% threshold shall not be applied where a security holder holds only derivative securities⁴⁸ or where voting rights are attached to shares in which person has the life interest or to shares deposited with person which can exercise voting rights at his discretion in the absence of specific instructions from the security holders (custodian banks,

⁴³ This aspect is particularly important for investors resident abroad.

⁴⁴ Only Luxembourg, Portugal and Sweden abide solutions of The Admission and Information Directive 2001.

⁴⁵ CESR paper on "Measures to promote market integrity – a follow-up to CESR paper on market abuse of 31 January 2002 (FESCO/01-052h of 31 January 2002).

⁴⁶ Already seven Member States apply such directed transparency regime at national level. Austria, Denmark, Spain, Finland, Greece, Italy and the UK introduced this by law or regulations. Sweden introduced this through recommendations by the stock exchange. The Netherlands is about to follow the same route.

⁴⁷ The home Member State means: a) in the case of an issuer of debt securities the denomination of which does not exceed EUR 5 000 or an issuer of shares: where the issuer is incorporated in the Community, the Member State in which it has its registered office, or where the issuer is incorporated in a third country, the Member State in which it is required to file the annual information with the competent authority in accordance with Article 10 of the Prospectus Directive; b) for any issuer not covered by a), the Member State chosen by the issuer from among those Member States which have admitted its securities to trading on a regulated market on their territory, provided that those securities continue to be admitted to trading on that regulated market for three financial years, that being the period of validity of the issuer's choice (Art. 2(1)(i)).

⁴⁸ The Commission limits the notification requirements to derivative securities. As a result, warrants or convertible bonds are included whereas options remain outside.

investment funds, proxies). The Member State can decide to not apply the 30% threshold where it applies a threshold of one-third and the 75% threshold where it applies a threshold of two-thirds. This system guarantees more frequent information on changes of the beneficial ownership and promote better protection of investors in public companies traded on securities markets.⁴⁹

Article 10 specifies persons who may, legally or actually, exercise voting rights on behalf of securities holders (custodian banks, investment funds, proxies and others). This provision is important for publicly traded companies who are informed not only about security holders, but also about proxies. This provision also facilitate information between companies and security holders in the context of general meetings through the use of proxies and electronic means (Articles 13 and 14). This provision is essentially the same as Article 92 of the Admission and Information Directive 2001. Although, limiting the definitions to those persons entitled to vote on behalf of shareholders requires deleting the current Article 92 (a), which is now incorporated into the definition of security holders under Article 2 (e) second indent.⁵⁰ The determination of situations in which voting rights which may be exercised on behalf of controlled undertakings is much wider in Article 10 (e) compared to the current Article 92 (b). This is possible due to a wider definition laid down in the proposed Article 2 (f).⁵¹ The only new provision relates to proxies (Article 10(h)). Since proxy participation across Member States is generally allowed in general meetings, a company should be duly informed about major shareholdings for which a proxy received common instructions by a number of shareholders.⁵²

Article 11 provides procedures on the notification and disclosure of beneficial ownership. It clarifies the minimum contents of a notification to be made to a company.⁵³ There is no corresponding provision in the Admission and Information Directive 2001. The

⁴⁹ Explanatory Memorandum, p. 18. and 24.

⁵⁰ The security holder means any natural or legal person governed by private or public law, who, directly or through intermediaries, acquires or disposes of securities of the issuer in its own name, but on behalf of another natural or legal person, except where such securities are acquired for the sole purpose of clearing and settling transactions within a short period.

⁵¹ The controlled undertaking means any undertaking: a) in which a security holder has a majority of the voting rights; b) of which a security holder is both the parent undertaking, with the right to appoint or remove a majority of the members of the administrative, management or supervisory body, and a shareholder or member; c) of which the security holder is a shareholder or member and alone controls a majority of the shareholders' or members' voting rights, respectively, pursuant to an agreement entered into with other shareholders or members; d) over which the security holder actually exercises, directly or indirectly, a dominant influence.

⁵² Explanatory Memorandum, p. 25.

⁵³ The notification of beneficial ownership shall include following information: a) on the resulting situation, in terms of voting rights and capital; b) the date on which the acquisition or disposal was effected; c) the identity of the security holder, and the natural or legal person entitled to exercise voting rights on behalf of the security holder; and d) in the cases referred to in Article 10(a), (b) and (g), the remuneration or any other form of consideration given in return for the voting rights.

Commission's initial suggestions to inform an issuer about the entire agreement between shareholders are no longer upheld because of opponent reactions. However, issuers and the public have legitimate interests to be informed at least about the consideration given in return for those arrangements about voting rights. The period for notification of the issuer (company) is reduced from seven calendar days to five business days.⁵⁴ Longer notification periods, which in particular banks with which securities are deposited may have under national law, should be abandoned.⁵⁵ Exemptions which are currently provided for in Articles 94 (professional dealers) and 95 (disclosure contrary to the public interest or detrimental to the company) are outdated. Finally, the period for notification of public is reduced from nine calendar days to three business days.⁵⁶

Control of companies may be directly exercised on companies through shares or indirectly through financial instruments which confer the right to acquire or sell shares (warrants or convertible bonds). There is a question if the holding of such financial instruments which reach valid thresholds triggers the duty to disclose beneficial ownership. The Commission accepted arguments of different participants on capital market and adopted appropriate solution of this question. There were particular concerns on the inclusion of options and a minority of investment companies requested higher thresholds compared to other investors. The Commission took the stand to include investment companies because the public companies have a strong interest to know which investment companies invest in them and what their position is in shareholder meetings. The notification requirement would be easier for investment companies (Art. 9(3)(a)).⁵⁷

⁵⁴ Referring to business days instead of calendar days is more adapted to the market reality and follows the view put forward by many interested parties.

⁵⁵ Art. 92(2) Admission and Information Directive.

⁵⁶ Explanatory Memorandum, pp. 19. and 25-26.

⁵⁷ The Commission allowed to each Member State to decide whether it sets 10% as the first threshold where investment companies (but also other investors) only acquire covered warrants or convertible bonds. The same rule would apply to life interests linked to shares. In addition, the notification and disclosure regime would be limited to derivative securities, but not all kind of derivatives, such as options. See Explanatory Memorandum, p. 19. and 24. American Investment Company Institute (ICI) also suggested to ease the disclosure regime for institutional investors, either by retaining a higher disclosure threshold for institutional investors (e.g. the UK), or by reducing the frequency of duty to disclose beneficial ownership (e.g. the USA), or providing a reasonable rule on when holdings of affiliated entities must be aggregated for purposes of reporting beneficial ownership. See Comment Letter on Proposed EU Reporting Rules for Institutional Investors, Investment Company Institute, July 2002, http://www.ici.org/statements/cmltr/02_eu_rpt_com2.html#TopOfPage, 25 February 2005, pp. 2-5.

4. Disclosure of Beneficial Ownership in Croatian Law

In Croatian Law the duty to disclose of beneficial ownership is governed by the Securities Market Act (SMA).⁵⁸ According to Article 115 when a natural or legal person (beneficial owner) directly or indirectly acquires or disposes shares of public joint stock companies(issuer)⁵⁹ which confer voting rights at the general meeting of the issuer, the beneficial owner must notify in writing the issuer and the competent authority (Securities Exchange Commission) of the proportion of voting rights conferring to this shares held by the beneficial owner as a result of the acquisition or disposal where that proportion reaches, exceeds or falls below the thresholds of 10%, 25%, 50% and 75%. If we confer this solutions with the solutions in EU Law we can state that there is less frequent and stringent disclosure regime in Croatian Law. It must be enacted lower threshold for triggering the duty to disclose (5 %) and must be introduced further thresholds. The duty to disclose is now imposed only on acquisition or disposal of shares in public joint stock companies.

The notification to the issuer and the competent authority shall be effected within fifteen calendar days, the first of which shall be the day on which the business transaction for acquisition or disposal of shares is concluded⁶⁰ or from the moment of originating the fact on which the transfer of shares is based, regardless of the entry into the share book or the depository of the central depository agency (Art. 115 and 116). Unlike the European Law, the Croatian Law fixes the starting moment of the deadline for notification. The period for notification of the issuer must be reduced according to the EU Law (five business days).

Article 117 prescribes the minimum contents of a notification to the issuer.⁶¹ This provision is detailed and it must be further harmonised according to proposed Transparency Directive 2003.

⁵⁸ Official Journal, No. 84/2002.

⁵⁹ Public joint stock companies are those that fulfil one of the following criteria: a) they issue shares in a public offering, or b) they have more than 100 shareholders, and their equity capital is at least HRK 30.000.000,00 (cca. 4.000.000,00 Euros)(Art. 114(1) SMA).

⁶⁰ The business transaction shall be deemed concluded in spite of an agreed condition for deferral.

⁶¹ The notification of beneficial ownership shall contain information on: a) name and surname, personal identification number (JMBG) and residence of the natural person who has acquired or disposed the shares, or the firm, head office and the registration number (MBS) of that legal person, and the name and surname, personal identification number (JMBG) and residence of the responsible person in the legal person which has acquired or disposed the shares; b) the document on the basis of which the shares were transferred; c) the number of acquired or disposed shares, the proportion in the equity capital of the issuer on the basis of acquired or disposed shares, the proportion of voting rights conferring the acquired or disposed shares of the issuer; d) the total number of shares, i.e. the proportion in the equity capital of the issuer after the acquisition or disposal.

The second stage of the disclosure of beneficial ownership is regulated in Article 118. The issuer (public joint stock company) who receives the notification on beneficial ownership shall publish the notification in the daily press within seven calendar days from the date of its delivery. This deadline for disclosure must be shortened according to the EU Law (three business days).

According to Article 119 the competent authority (the Security Exchange Commission) can render a decision to temporarily exempt the issuer from the obligation of publication for a period of time that may not be longer than three months. The issuer must submit a written proposal within three days from the date of receipt of the notification on beneficial ownership and if he feels that this publication of the notification might cause him serious harm and that the public, even without the publication of the notification, will be able to assess the value of shares to which the notification relates. If within eight days from submitting of the written proposal the Security Exchange Commission does not render a decision, the proposal shall be considered rejected, and the issuer shall perform his obligation to publish within seven days. This exemption from the obligation to inform the public on the beneficial ownership must be abolished as outdated.

The breach of the duty to disclose the beneficial ownership is sanctioned by fine or imprisonment (Art. 153).

In Croatian Law should be introduced the rules on determination of the voting rights, especially because of greater role of institutional investors and proxies on financial markets and publicly traded companies. Finally, there is a need to regulate the transparency about holdings in securities giving access to shares (convertible bonds, warrants, etc.).

6. Conclusion

Transparency of the financial activities and beneficial ownership of publicly traded companies is highlighted as a powerful mechanism for protection of investors. Through financial reports, reports of auditors, disclosure of beneficial ownership and mandatory content of prospectus investors obtain informations on which they can bring right decisions on their investments. It is acknowledged in various directives of the European Union with which are harmonized the national rules of Member States. The Republic of Croatia must harmonize its own rules on financial reports, auditing, disclosure of beneficial ownership and the prospectus for better protection of investors and as a candidate for membership in the EU.