The Association of Corporate Treasurers

Comments in response to
CP 07/20 Disclosure of Contracts for Differences
Financial Services Authority, November 2007

February 2008

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvassed the opinion of our members, in this case, through *The Treasurer magazine* and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter. In connection with earlier consultations by yourselves and the European Commission we have raised concerns around CfD disclosures so we particularly appreciate your detailed consideration of this subject now. We comment from the perspective of non financial companies where CfDs may be written on their shares and traded.

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Preamble

Publicly listed companies take a close interest in the performance of their equity shares and in the types of shareholders they have, the names of larger shareholders, the size of holdings, the trading activities and intentions of investors. As a prime objective the company directors will want to deliver shareholder value. Linked to this the Board will want to reduce their share price volatility and cost of equity. Clearly the underlying business characteristics, strategy and performance are crucial but if these are to influence the markets then the market needs to be well informed. As well as publishing information to the market generally a Company will try to ensure that the information is getting through to influential shareholders and analysts.

Analysts do not themselves own shares but yet companies' Investor Relations departments include them in their efforts at disseminating information. Likewise

companies are finding that holders of CfDs are becoming a far more significant constituent, so that they are interested in knowing the identity of holders of significant CfD stakes. CfD holders do not have a vote at company meetings but they are interested in the performance of the company, one way or another, and are influential in driving share prices up or down. An investor taking a large long position in CfDs will often trigger the CfD issuer to hedge themselves in the share market so that CfD positions do feed back into share price performance. We therefore question the conclusion you have reached in paragraph 3.16 - that pure economic CfDs ie with no voting rights do not create a significant problem of inefficient price formation. Even without voting rights, the identity of a significant CfD holder could well have an effect on market sentiment for the share in question. Why else would the Takeover Code require disclosure of transactions in such economic interests in bid situations? The market could still find the information influential before a bid situation formally begins.

Throughout your consultation you take the view that CfDs are not a substitute for shares since generally there are no voting rights attached and since CfDs are rarely closed out into the actual shares. Even so we believe that to all intents and purposes (other than voting) a CfD holder is equivalent to a shareholder.

Your evidence shows that the markets do react to Major Shareholding Notifications so the presumption must be that the lack of disclosures around significant CfD holdings does cause a market failure with regard to inefficient price formation.

With CfDs there exists the problem that the economic interest in the shares has become separated from the voting rights which prompts the question - for whose benefit are the directors running the company? We are clear here that from the point of view of the company they must have regard to the legal registered shareholders and that there should be no obligation to look beyond those registered shareholders, but even so the company should be able to gather information of significant CfD holdings, as any other interests in shares.[1]

[1] In other consultations we have supported the right of shareholders to separate out voting rights or rights to dividends or other benefits attached to shares and deal with then separately through contracts with third parties provided that the issuing company only has to deal with the registered shareholder and provided the information is disclosable at the usual thresholds and on company enquiry.

Response to FSA Questions

Q1 Do you agree that we have identified the concerns of issuers and market participants correctly?

Q2 Do you agree that we have identified the right market failures? If not, what other potential market failures do you think we should consider?

A1 and A2 We agree that you have correctly identified the concerns of issuers and market participants. From the issuer point of view we probably attach more weight to the importance of knowing about significant hidden owners and influential parties so that the issuer can know their motives and ensure they can be fully informed about the company.

Q3 Do you agree with our analysis of the evidence set out in this chapter? Is there further evidence that you think we should consider?

A3. Your analysis is helpful and appears to have been based on a thorough review of the evidence. We would repeat the point from our preamble that the concerns are very much linked to voting rights which of itself is absolutely right and proper. However we regard some of the behavioural issues arising from significant CfD holdings, albeit non voting, as equally important. Intuitively we would expect, for example, that news that Phillip Green had built up a large CfD stake in a retail group would be a significant factor in market price formation for the actual voting shares even though the CfDs carry no votes.

Q4 Do you agree with our conclusion that action should be taken to increase disclosure of CfDs?

A4 We agree that action should be taken to increase disclosure of CfDs. For a little while now, enhanced disclosure has been deemed a requirement during a Takeover period and this seems to have been working well. In general the ACT is strongly in favour of market led solutions and will tend to resist regulation except "where there is evidence of an actual or potential market failure or in quasi-monopoly areas where competition is insufficient, industry codes etc. have failed and where the public good from regulation manifestly exceeds the costs it engenders." [2] In this case you are not talking about any forms of regulatory prohibition but merely disclosure which we regard as a relatively light touch.

Q5 Do you agree that our proposed definition of comparable financial instrument, taken together with our guidance on 'similar economic effect', will effectively capture all instruments that could potentially otherwise be used to build stakes or exert influence on an undisclosed basis? If not, are there any instruments that a) should be caught but will not be, or b) will be caught but should not be?

A5 We support your proposed definition of comparable financial instrument.

Q6 Do you agree that CfDs not complying with a safe harbour should be disclosed?

[2] From the ACT Policy and Technical Manifesto
http://www.treasurers.org/technical/resources/manifestoMay2007.pdf

A6 No. Our view is that the identity of holders of significant economic interests is an important indicator to the market irrespective of the presence of links into voting rights. We therefore do not support your option 2 and the safe harbour concept but prefer the more extensive requirements of Option 3.

Q7 Do you agree with the specific conditions we have proposed for the safe harbour, and that, as necessary, they can practicably be incorporated into the agreements between the parties to a CfD contract?

A7 As mentioned in A6 we do not support the concept of a safe harbour but were that principle to be agreed, no doubt your definitions would meet the needs.

Q8 Do you agree that there should be a 'notification to issuer on reasonable request' provision?

A8 You are proposing that there be a process for companies to seek information on CfD holdings similar to the 'notification to issuer on reasonable request' provisions in the Companies Act (Sect 793, previously Sect 212) for those that the company believes may be interested in its shares. We support this idea and in particular agree that the notification obligation should even include CfDs that met the safe harbour provisions you have proposed in Option 2 (with which we disagree – see above).

Q9 Do you agree with the proposed guidance on what constitutes reasonable grounds, and that issuers should be required to include these in the notification request?

A9 We support your principle of trying to avoid indiscriminate use of this provision but cannot support the sort of guidance you are considering. On the premise that CfDs should be treated as akin to owning the shares themselves we would wish to see exactly the same provision for CfDs as for shares, as in CA 2006 Sect 793(1) where there is a requirement for a "reasonable cause to believe". Conditions as in your para 5.38 or limits on repeated requests could well mean that the company discovers the critical information on economic ownership too late. As it is the standard Sect 212 requests can often be slow in generating responses and issuers would not want to aggravate the situation.

Q10 Do you agree with our proposed approach to aggregation and thresholds for Option 2?

Q11 Do you agree with our proposed approach to aggregation and thresholds for Option 3?

A10 and 11 The premise for disclosure of significant CfD holdings is that if a party is building up a significant stake or interest (in the widest sense) in a company, by whatever means, the sheer size of that holding means that they could be influential in affecting the market for that company's shares. We therefore do not agree with your approach which fails to aggregate across all the categories. We believe that the category of CfD holdings should be aggregated with the category of interests in shares. We have in previous consultations around the transparency directive supported the continuation of the UK's tighter threshold of 3% rather than 5% for disclosure by the holder. If you are now introducing a notification to issuer on request requirement covering CfDs then for consistency (and on the same grounds as led to the choice of 3% elsewhere) we would prefer a 3% threshold.

Q12 Do you agree with our analysis of the relative costs and benefits of Option 2 and Option 3?

A12 We broadly agree that for issuers, who are already dealing with notifications of share holdings the incremental costs are unlikely to be that material. On the benefits side the improved transparency will be important to the reputation of the London markets and will contribute to lowering of the cost of capital for issuers.

Q13 Which option do you think would best address the identified market failures?

A13 For the reasons already explained we prefer Option 3 since this does not offer the safe harbour for CfDs that include an exclusion from influencing any votes. All CfD holders will be within its ambit. However as a variation from your proposal we believe the two categories (shares and CfDs) should be aggregated.

Q14 Do you agree with our view on what information should be disclosed to the issuer, and how that information should be disseminated?

A14 Your proposals appear reasonable.

Q15 Do you agree with our proposal that we should seek to avoid as far as possible duplication of disclosure?

Q16: Do you agree with our approach that disclosures pursuant to the Code would negate the need for additional disclosures under the proposed CfD disclosure regime?

A15 and A16 We agree that during a Takeover period it would be reasonable to avoid duplication so that your proposal to turn off the Disclosure and Transparency Rules would be a pragmatic solution given that the objective of the exercise is to ensure that adequate information is properly disclosed to the market and the Takeover Panel rules certainly cover this. For the avoidance of doubt we presume that the Section 793 'notification to issuer on reasonable request' will continue to operate, since it is of particular importance to issuers during a Takeover Period.

Conclusion

Your consultation paper referred to a recent survey of 70 UK quoted companies which found overwhelming (96%) support for a disclosure regime based on the Takeover Code approach. In summary the ACT supports the Takeover Code principle that economic interests in shares such as CfDs should be treated as shares so that CfDs and interests in voting rights be aggregated and subject to the 3% threshold be disclosable in line with the existing DTR regime.

TREASURY, RISK AND FINANCE PROFESSIONALS ACT

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at http://www.treasurers.org/technical/resources/manifestoMay2007.pdf .

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