The Association of Corporate Treasurers

Comments in response to
Hedge Fund Standards: Consultation Paper Issued by the Hedge fund working group,
December 2007

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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.

General

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The ACT welcomes the opportunity to comment on your consultation. ACT members working in non-financial companies will tend to have little experience of investing in hedge funds although some treasurers can be involved in the activities of their pension schemes which may be investors. We therefore do not wish to comment in detail on the proposals around Disclosure, Valuation, Risk or Fund Governance other than to welcome your moves towards greater transparency and disclosure.

However, company treasurers do have a very strong interest in the capital markets for their securities operating efficiently and effectively. We therefore wish to respond in more detail to your section on market issues and activism.

Comments on market issues and activism

6.1. Prevention of market abuse

As your consultation points out that there already exist market abuse legislation and FSA requirements which hedge funds are subject to. Hedge funds can be active in several different markets so it is good that you have picked up the concept that there should be policies to restrict dissemination of material non-public information, albeit that knowledge of your own intentions is not inside information.

Hedge funds may have access to privileged information. We agree that it would be good management for hedge funds to have adequate policies and procedures in place to control against market abuse. To that end a best practice standard that hedge fund managers should disclose in offering documents whether there exist policies to prevent market abuse is helpful in flagging the importance of this matter. It is not a particularly forceful recommendation but since the provisions of law already apply it is probably a sufficient nudge to management to take market abuse prevention seriously. The guidance on compliance arrangements and illustrations do go into some detail and this must be welcome albeit that, from outside, one would have expected appropriate procedures, including monitoring and audit, to exist in any case.

Your side box gives examples of inside information. It would also be helpful in any guidance that accompanies your standards to reiterate that that (at the moment) in the UK it is illegal to deal in securities while in possession of 'relevant information not generally available' or RINGA (S118 Financial Services and Markets Act 2000), which is a class of information somewhat wider than inside information. (Your paper did, in passing, mention the two market abuse offences retained from the pre-MAD UK regime.) An example of information which is RINGA but not inside information may be helpful (for example knowledge of the how an important negotiation by the company is going).

Q 6.1.5
Are the governance and disclosure standards a useful addition towards market integrity?
Would other market participants equally value clarification or improved definition as to what constitutes a "concert party"?

For good markets to operate participants need confidence that market abuse will be prevented. Your proposed disclosure standards are a modest addition towards market integrity

6.2. Shareholder conduct: Proxy voting of stock owned

You are proposing that hedge fund managers should have a proxy voting policy and that this is widely disclosed. Your investors will have a degree of interest in this but more important for us is the fact that the companies in which the funds are invested have a very strong interest in understanding their shareholder and investor base, and what shape their relationship to the company is likely to take. Companies take investor relations seriously since commercially it is sensible to communicate well with these stakeholders and to get feedback. Reducing investor uncertainties about the company and its business (within the confines of the market abuse regulations)

should in principle reduce the company's cost of equity. Knowing that the hedge funds themselves have considered their polices and understanding the practices of hedge fund investors through disclosure will both be helpful.

Q6.2.5

To what extent would stakeholders value this new requirement?

The Companies in whom funds are invested and other stakeholders in those companies can be expected to find your new proposals helpful and welcome.

6.3. Shareholder conduct: Disclosure of derivative positions

In various consultations organised by the FSA and the European Commission in recent years the ACT has argued that material economic interests in the share of public companies should be disclosed to the company and the market.

Although not having voting rights the holders of CfDs, through their trading activity and the corresponding activity of the writers of the contracts, can influence the market. Large economic stakes may be indicative of the possibility of that investor wanting to build a large stake in the underlying shares, although there is no automatic right to convert a CfD holding into shares. Several instances have occurred of those interested in a company through CfDs asserting their control of the implied percentage holding in their communications with the company concerned.

The company the shares of which are the subject of the CfDs will want to be aware of any stakebuilding intentions and even if there are no ulteria motives will probably want to understand the aspirations of the CfD holder and communicate about the company to them in the same way as it devotes time and effort to investor relations more broadly.

Other conventional investors have an interest in understanding the dynamics of any buying and selling activity in the market and of any significant stakeholdings. This sort of market openness has been deemed sufficiently important for it to be enshrined in Company Law. We would contend that with the advent of new instruments that are in many ways proxies for shares the same sorts of disclosure requirements should apply and this would extend to CfDs.

While doubting that a CfD confers fractional ownership, the ACT welcomes the acknowledgement from the hedge fund working group that companies have a right to know who owns them and that you would be in favour of greater disclosure. We, of course, fully accept the point that if greater transparency is required then this should apply to all stakeholders and not just 'hedge funds'.

The FSA is currently consulting on this very subject and we will again be supporting greater disclosure of significant CfD holdings and believe that your intervention in the same direction could be very important in helping the FSA reach a decision.

Q6.3.4
Would consultees be prepared to enter debate about improved disclosure (eg of contracts for difference)?

As discussed above we believe that the current debate led by the FSA is timely and that all market groupings should be encouraged to contribute their views so that a co-ordinated market-led response to this problem can be initiated.

6.4. Shareholder conduct: Voting of borrowed stock

Your paper says it is best practice for hedge funds not to vote on borrowed stock while not being economically exposed. Again on this point you propose a wider consultation with market participants and regulators to develop a new regime

In other public discussions around this subject the ACT has held that a shareholder in a company has the full property rights to dispose of those shares howsoever the holder wishes – even disposing of the voting right separately from other rights in the share. The holder is at liberty to 'lend' those shares through what is actually a sale and repurchase agreement. If the original holder wishes to retain the right to direct how those shares are voted or wishes to have the ability to "recall" the shares (i.e. have delivered a similar number of shares) in order to vote that is for him to build into his contractual arrangements.

Managements of companies almost certainly would like to feel that, conveniently, if they act in the interests of shareholders who hold the main economic interest in the shares those who vote would recognise that. It is not a policy aim of regulation to be convenient for company managements in this sense. However, the holder of the main economic interest must, of course, recognise the risk that a person to whom he has transferred only the voting right might not vote in the main economic interest holder's interests.

In our response to the European Commission's third consultation on 'Fostering an Appropriate Regime for Shareholders' Rights (April 2007)' we said:

"Share lending is a way of enhancing the return on the investment in the shares. It is a right of the property in the shares and should not be fettered. Investors should expect to inform themselves about their decisions, and to make appropriate contractual arrangements as regards share lending – none, unrestricted, or with right of recall. It should be open to the parties to enter into whatever agreement they wish."

We still hold by this comment.

The stock borrower, while holding the shares has the legal voting rights and may either vote as he chooses or agree to be constrained as he feels fit. Disposing of "borrowed" shares subject to contractual constraints on voting may present problems. There would be practical problems in formally declaring those shares in some official way as 'non-voting'. Borrowed shares are often used to settle an existing short position, being put back into general circulation in the market and, to all intents, not traceable. Shares identified as "non voting unless the lender instructs" would not be suitable for this purpose. There is the further practical point that the issuer should only have to concern itself with instructions received from the registered shareholder and not be required to keep multiple parallel registers of lent shares with special voting restrictions at the whim of particular shareholders.

Q6.4.3
Would other consultees value a wider debate aiming at voting being restricted to those holding economic interest?

This question was recently consulted on by the Commission (see above) and we responded that it was, in principle, a right of the owner to split up his property into voting rights and other rights and to dispose of them separately, as mentioned above. We agree that the separation of voting rights and other economic interests can throw up some anomalies. With more and more market practices and instruments that do create this split the subject is worthy of continued public attention.

Any regulatory changes should clearly be market wide and not restricted to one segment of the market like hedge funds, but if hedge funds want to issue their own code of standards in this area they should proceed, and if that contributes to development of market wide practice you would, presumably, not mind.

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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