12 February 2008

Mr Simon Cottee
Policy – Primary Markets
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Mr Cottee

Joint SIFMA / ICMA Response to the FSA Consultation Paper on Disclosure of Contracts for Difference (CP07/20)

The International Capital Market Association (ICMA) and the Securities Industry and Financial Markets Association (SIFMA) are pleased to respond to the FSA Consultation Paper on the Disclosure of Contracts for Difference (the CP).

ICMA is the self-regulatory organisation and trade association representing investment banks and securities firms issuing and trading in the international capital markets worldwide. ICMA's members are located in some 50 countries across the globe, including all the world's main financial centres, and currently number over 400 firms.

SIFMA (the result of a merger between the Bond Market Association and the Securities Industry Association) brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA represents its members locally and globally. It has offices in London, New York, Washington DC, and its sister Association, the Asia Securities Industry and Financial Markets Association (ASIFMA), is based in Hong Kong.

Our response are based on extensive consultations with our member firms and their advisors. We attach them as Annex to this letter and would be pleased to discuss them with you at your convenience.

Yours faithfully,

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ANNEX

SIFMA/ICMA RESPONSE TO CP 07/20 'DISCLOSURE OF CONTRACTS FOR DIFFERENCE'

The Securities Industry and Financial Markets Association (SIFMA) and International Capital Market Association (ICMA) are pleased to respond to the FSA Consultation Paper (CP) on Disclosure of Contracts For Difference (CFD). The response has been developed by the SIFMA and ICMA Working Group (WG) on major shareholding notifications. The WG comprises representatives of financial institutions, legal and accounting experts and other market participants. Its objective is to monitor and work with public policy makers on the implementation of the major shareholding notification aspects of the Transparency Directive. The CP's proposal to extend the major shareholding regime to CFDs thus falls within the ambit of the WG.

Summary

We are not convinced that the market failure evidence presented in the CP support the FSA taking action to increase the disclosure of CFD positions. The FSA's analysis does not bring actual examples of market failure caused by non-disclosed stake building using CFDs. CFDs themselves do not normally have access to voting rights - to the extent that they do provide such access they are already disclosable under the existing Disclosure and Transparency Rules (DTR). Indeed, the CP acknowledges that CFDs are not used as substitutes for shares on a systematic basis and do not lead to inefficient price formation.

If the FSA nevertheless decides to take action we have a number of comments and concerns with the Options presented in the CP. These are outlined below and set out in greater detail in our responses to the CP questions.

Referring to Option 2, we are concerned that compliance with the safe-harbour conditions may lead to unduly burdensome re-documentation. We are aware of and fully support the ISDA proposal in this regard and would strongly resist any moves that lengthen confirmations or agreements (particularly in light of outstanding confirmations). We also believe that the proposed right of issuers to make additional requests for information is too broad as it undermines the safe-harbour provision and propose that it be restricted to holdings outside the safe-harbour.

We believe that the comprehensive disclosure regime of Option 3 would impose significant costs on market participants which are clearly disproportionate to the perceived market failings. We strongly suggest that these costs be minimized based on our suggestions regarding the definition of encompassed instruments and the scope of institutional exemptions from the regime.

For Both options 2 and 3, we believe there should be an exemption for regulated CFD writers similar to the Recognised Intermediary (RI) status under the Takeover Panel (TOP) Rules. The definition of instruments caught by the proposed rules should also be recast as it is currently far too wide: we would suggest a 'principle-based' definition covering delta one instruments and providing the FSA the ability to prevent avoidance measures. In addition, whilst comparisons may be made with the TOP regime, we note that the proposed rules would apply to a much wider spectrum of instruments (1500+ versus less than 100 under the TOP rules). The CP also gives insufficient consideration to the substantial costs involved in installing and upgrading IT systems to capture derivatives positions. This cost is difficult hard to quantify, as different participants have different infrastructures and systems at different stages of sophistication.

Given the scale of systems development potentially required, the ongoing implementation of the Transparency Directive (TD) and the pressure to control costs, we would urge the FSA to provide for a reasonable period of implementation if it does decide to implement a disclosure regime. We would suggest a transitional period of 18-24 months.

In short it is not clear to us that the benefits of increasing CFD disclosure would outweigh the considerable costs. For this reason, we would urge the FSA to carefully consider the definitions of the instruments encompassed by the disclosure regime and the entities exempt from it to ensure that the otherwise considerable costs do not outweigh the questionable benefits. If the FSA does take action we would prefer Option 2 where we see greater scope to address the imbalance between costs and benefits.

CHAPTER 3: VIEWS OF STAKEHOLDERS AND POTENTIAL MARKET FAILURES RAISED

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

While identifying most of the concerns of issuers and investors the CP does not fully cover those of CFD writers/holders and certain other stakeholders. Given that the potential market failures (and thus rationale for regulatory action) are held to stem from the non-disclosure of CFD positions taken to influence the issuers of underlying shares, the CP gives insufficient attention to the main motivations for buying CFDs which are all unrelated to any desire to exercise control over the issuer. The CP also completely overlooks the significant practical challenges faced by CFD holders in terms of monitoring and ensuring compliance with a CFD disclosure regime. Moreover, the CP does not address the issue of how the FSA intends to process the likely significant inflow of disclosures.

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

We agree that inefficient price formation, distorted market for corporate control, and diminished market confidence do comprise *potential* market failures. However we would question the degree of causality between those failures and the non-disclosure of CFDs. To a large extent the alleged market failures do not arise from a lack of disclosure of CFDs but instead from a lack of understanding of the product and/or appreciation that the prime motivation for CFD holders is not the exercise of influence over the issuers of the underlying shares.

CHAPTER 4: ANALYSIS OF EVIDENCE OF MARKET FAILURES AND CONSIDERATION OF OTHER CFD DISCLOSURE REGIMES

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?

The CP undertakes several strands of analysis to assess whether the potential market failures identified in Chapter 3 actually occur in practice. We note that the PWC analysis of the practices of the most active CFD writers and others to assess extent to which CFD are substitutes for the underlying shares is inconclusive. We also note that the study of pattern of CFD trading inside and outside takeover periods in certain stocks shows that there is not a particular increase in CFD trading in the run up to a takeover. Moreover, the consideration of other CFD disclosure regimes does not demonstrate that the disclosure of CFDs materially addresses the identified market failures. In this context, the much more limited scope of the Takeover Panel regime also makes this ill-suited as an indicator of whether expanded regime would work. Finally the findings of the Takeover Panel (in the context of its review of their regime) that most market participants were disinclined to changing the new rules is not necessarily indicative of satisfaction with them. The reluctance to change may be more a reflective of the fact that many market participants had already borne the expense of changing their systems to comply with the new rules and were therefore disinclined to change these again.

CHAPTER 5: OVERALL CONCLUSIONS FROM EVIDENCE AND POLICY OPTIONS

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

We do not believe that the evidence presented justifies the CP conclusion to take action to increase the disclosure of CFDs.

As the CP acknowledges, CFD are only used as substitutes for the underlying shares in a limited number of instances. And even for these cases, the FSA admits that they have 'been provided anecdotal evidence in support of stakeholder views but it has been more difficult to identify clear-cut empirical evidence which support the arguments cited. The assertion that CFD writers have on occasion been approached to vote the underlying hedged shares is not in itself, evidence of market failure, especially in light of the clear CFD writer policy of not voting.

Given the difficulties of targeting disclosure requirements (see below our response to Question 5 on instrument scope) any action to increase disclosure is likely to impact on the majority of cases where

CFDs are not used as a substitute for the underlying shares. Moreover, the necessarily less-than-instantaneous nature of disclosure will leave the regime unable to capture a change of intention of the CFD holder: e.g. an investor holding CFD position benefitting from the Option 2 safe-harbour may close out than position and simultaneously open a physically settled CFD position. This will be disclosable but given the time lag to do this, disclosure may not occur until after the exercise of voting rights.

Also, to extent that CFDs are not actually used as substitutes but merely perceived as such it may be perverse to exacerbate that misconception by requiring disclosure of CFDs. Increasing the disclosure of CFD positions where holders in the majority of cases have no interest in influencing the underlying share issuers is likely to cause other investors who incorrectly conclude the opposite to trade off the back of those CFD disclosures leading to market distortion. Increasing CFD disclosure will also confuse the issuers of underlying shares who mistakenly assume that CFD holders wish to exert influence on the issuing company.

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?

A variety of derivative scenarios can be imagined to achieve 'a similar economic effect' increasing the danger of a significant volume of confusing disclosures. We believe that the definition must be made clearer and more focused and would suggest a 'principle based' definition limited to delta one instruments while giving the FSA the ability to prevent avoidance measures. The significance of the definition issue is of course inversely dependent on the extent of exemptions available - the broader the exemptions the less the negative impact of having an unclear definition.

UNDER OPTION 2 – STRENGTHENING THE EXISTING REGIME

Our answers to questions 6 – 16 assume that the FSA decides to take action as proposed under Option 2 or 3.

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

We agree that CFDs falling outside the safe harbour of Option 2 should be disclosed. However, as mentioned (above in our response to question 4) the safe harbour regime would not prevent a (perfectly legitimate) last-minute change of intention leading to irrelevantly late disclosure.

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?

Subject to our comments on exemption (in response to Question 10 below) we agree with the specific conditions that have been proposed for the safe harbour and believe that these could be incorporated into the agreements between the parties to a CFD contract. We believe that this should be achievable without unduly burdensome re-documentation. We are aware of and fully support ISDA's proposal in that regard and would strongly resist any proposal that effectively lengthens confirms or agreements (particularly in light of outstanding confirmations). However we emphasize the practical difficulties and costs of implementing and maintaining a monitoring system capable of determining whether a given CFD falls in or outside the safe harbour. Additionally, it should be made clear that the regime does not apply to CFDs entered into prior to its enactment i.e. there is no requirement to re-document existing CFDs.

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

We do not agree that a disclosure regime should include a 'notification to issuer on reasonable request' provision. Assuming that the purpose of the safe harbour regime is exactly that, we see no justification for an additional (double-jeopardy-type) notification requirement. Moreover, we believe that such a provision will despite FSA guidelines be abused, leading to a significant number of spurious requests from issuers or (more likely) their agents. Our experience with section 793

disclosures indicates that agents (who often market themselves as being able to provide up-to-date data on company ownership structures) systematically send out frequent and often unsolicited requests. Building and maintaining a process for evaluating the 'reasonableness' of such requests would be extremely labour intensive and costly. If the FSA nevertheless decides to impose a new right for issuers, we strongly suggest that this be limited to CFD holdings falling outside the safe harbour allowing the holders within the safe harbour to decline an issuer's request for notification.

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?

As indicated in our response to Question 8, we believe rules and guidelines on the content of 'reasonable grounds' will be ignored by agents and many issuers, particularly as the rules and guidelines are not supported by sanctions for non-compliance. We therefore suggest that if a on-reasonable-request-notification is implemented then this should include a reasonable charge to the requestor for receipt of this information. In addition, the requester should be required to provide evidence of what it perceives to 'reasonable grounds' e.g. a copy of a media article, speculating about a specific hedge fund holding.

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

We believe that aggregation will make the distinction between CFD and underlying shares less clear adding credence to the misperception that cash settled derivatives give access to the voting rights of the shares to which the CFDs are referenced. The 3% starting threshold is low and will lead to a very significant number of disclosures. We therefore suggest that if Option 2 is implemented, the starting threshold should be raised to 5%.

If Option 2 is implemented - and even more so if Option 3 is chosen - we would further suggest that the disclosure regime incorporate a trading-book type exemption for credit institutions (as referred to in the DTRs). In this context we would propose a broad exemption, similar to an Recognised Intermediary exemption but including principal activities. The activities of credit institutions in the CFD and related areas are generally to support customer business or hedge proprietary positions. We suggest that the exemption would fall away in the event of any intention or action to use CFDs etc to gain access to votes or intervene in the company.

In this context, we reiterate the importance of an appropriate definition of encompassed CFDs as set out above in our response to Question 5. We would suggest that the definition of instruments caught by the proposed rules should be limited to delta one instruments while giving the FSA the ability to prevent avoidance measures.

UNDER OPTION 3 – GENERAL DISCLOSURE REGIME

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

For the reasons set out above (in our response to Question 10) we support the non-aggregation and higher threshold aspects of Option 3.

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

On the cost side, we are not convinced that Option 2 would necessarily be less expensive than Option 3. As currently proposed, Option 2 would cause most wholesale CFD holders to change to two disclosure systems (so as to incorporate CFDs into both major shareholding and Section 793 request systems) rather one.

The substantial costs and systems impact that such disclosure regime would impose is clearly disproportionate to the perceived market failings. Whilst comparisons have been made with the TOP regime, it should be noted that the FSA's proposed regime would cover a significantly increased universe of stocks (1500+ versus less than 100 under the TOP regime) with consequent impact upon the system requirements and build time. Both options would also entail ongoing costs with respect to the making of disclosures to FSA.

For both Options, the costs will also be linked to the extent of any (trading book type) exemptions and the definition of the encompassed instrument. The narrower the exemption and the vaguer the definition, the more complex, labour-intensive and costly will be the necessary monitoring and disclosure system. The CP gives insufficient consideration to the substantial cost involved in installing, maintaining and upgrading IT systems to capture derivatives positions. While difficult to quantify because of uncertainties as to the requirements themselves and differences between market participants in the systems used and their level of sophistication, participants have estimated at least 12-18 months in development time alone. As an additional potential cost, we see a real danger that a CFD disclosure regime may drive business offshore.

We believe that the benefits of both Options are questionable. Far from providing greater transparency to issuers and the market, or reducing the price volatility that is alleged to arise from real or perceived information asymmetries, we believe that a general CFD disclosure regime may lead to market confusion and distortion.

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

We are not convinced that the market failure evidence presented in the CP supports either Option 2 or 3. If action is nevertheless taken, we would on balance prefer Option 2 where we see the greatest scope to address the imbalance between the costs and benefits of CFD disclosure by amending the instrument scope, restricting the issuer's right to request notification and implementing a broad exemption for credit institutions. In addition, we would encourage the FSA to explore alternatives to the Options 2 and 3.

An alternative to the CP Options may be presented by the Substantial Acquisition of Shares (SAR) regime of the Takeover Panel. With a view to addressing the minority scenarios where CFDs may have been used to quickly build up undisclosed influence on the underlying share issuers, we would invite the FSA to explore the feasibility of introducing SAR1 type rules to restrict the speed with which an entity can increase its CFD holding. Another alternative may be the introduction of rules on the way CFDs and their hedges are used, in effect codifying the existing market practice of using CFDs to obtain economic exposure rather than corporate influence.

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

Providing the FSA can evidence the market failure, then disclosures should be transmitted to the issuer and/or the wider market where the market failure is located.

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

Yes. Duplicative disclosure should as far as possible be avoided. However, the FSA should recognize that the staggered implementation of the TOP and FSA disclosure regimes and consequent development of multiple monitoring and disclosure systems will likely make it difficult and costly for market participants to eliminate 'unnecessary' duplicative disclosures. The FSA should make clear that it will take no action in the event of such disclosures.

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?

Yes. Duplication of disclosure of the Takeover Panel would only confuse the market. During offer periods, the rules should clearly avoid the need for disclosures under both the Panel and FSA regimes. Although Rule 8 disclosures are only triggered by trades, rather than the position itself, any position above, say 5% (under Option 3), would need to have been disclosed before the offer period, regardless of whether any trades occur afterwards, to trigger a rule 8 disclosure.

OTHER COMMENTS

Geographic Scope:

We invite the FSA to consider and set out clearly the position of CFD holders located in third country jurisdictions. We would suggest that if the FSA decided to impose a CFD disclosure regime then

CFD holders in third country jurisdictions should be exempt from such a regime to the extent that they are subject to equivalent disclosure requirements in their home country jurisdiction.

Entry Into Force:

Given the scale of systems development potentially required, the ongoing implementation of the Transparency Directive and the pressure to control costs, we would urge the FSA to provide for a reasonable period of implementation if it does decide to implement a disclosure regime. We would suggest a transitional period of 18-24 months.