Alternative Investment Management Association

CESR,
11-13 avenue de Friedland
75008 Paris
France

Submitted via the CESR website

31 March 2010

Dear Sirs,

AIMA's response to CESR's Consultation Paper on major shareholding notification

The Alternative Investment Management Association Limited ("AIMA")[1] is pleased to have the opportunity to comment on CESR's Consultation Paper "CESR proposal to extend major shareholding notifications to instruments of similar economic effect to holding shares and entitlements to acquire shares" (the Consultation Paper).

The Appendix to this letter provides our detailed responses to the consultation questions posed but, in summary, we make the following comments:

- it is our understanding that the vast majority of investors holding synthetic interests in securities do so purely to obtain economic exposure to the underlying, rather than to obtain control of or influence the company. On this basis, CESR should only extend the shareholding notification regime to 'instruments of similar economic effect' if such a step is deemed justified following thorough research into the extent of the problems identified. Full consideration as to the cost of implementation and the ongoing costs for market participants should form a fundamental element of such research;

- nevertheless, to the extent that the proposed measures are found to be necessary, we accept that there are benefits to be achieved through CESR's proposals provided that these are sensible, proportionate and coordinated;

- it is important that any proposals in this area which are implemented should be done so on the basis of maximum harmonisation across all EU Member States with no scope for individual Member States to apply their own interpretation when implementing the new rules. This will both help minimise costs and provide clarity to market participants applying the regime; and

- the scope of the regime should be sufficiently clear to reduce the administrative burden of having to undertake difficult interpretation of the rules. AIMA believes a clear disclosure regime would take as a starting point the Markets in Financial Instruments Directive (MiFID) definition of "financial instruments" as instruments "in-scope", but provide explicit guidance and a non-exclusive shortlist of instruments which fall outside of the regime's scope.

AIMA would be happy to facilitate a meeting between CESR and a group of our members who trade in derivatives, if it is felt that this would be useful in discussing actual current sound market practices – in

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,100 corporate bodies in over 40 countries.

The Alternative Investment Management Association Limited
167 Fleet Street, London, EC4A 2EA
Tel: +44 (0)20 7822 8380 Fax: +44 (0)20 7822 8381 E-mail: info@aima.org Internet: http://www.aima.org

particular, in reassuring CESR that responsible market practitioners do not, in fact, use complex derivatives in order to avoid regulatory disclosure obligations.

We again thank CESR for the opportunity to respond to the Consultation Paper and would be happy to discuss any of our comments with you, if required, at your convenience.

Yours sincerely,

Matthew Jones
Associate Director
Regulatory & Tax Department

APPENDIX

AIMA'S RESPONSE TO CESR CONSULTATION PAPER CESR/09-1215b
"CESR PROPOSAL TO EXTEND MAJOR SHAREHOLDING NOTIFICATIONS TO INSTRUMENTS OF SIMILAR ECONOMIC EFFECT TO HOLDING SHARES AND ENTITLEMENTS TO ACQUIRE SHARES"
(the "CP")

	Question	Response
1.	Do you agree with CESR's analysis of the issues raised by the use of instruments of similar economic effect to shares and entitlements to acquire shares?	AIMA appreciates CESR's work in producing its consultation paper (the CP), which is both timely and helpful. We acknowledge the issues which CESR identifies in Part III of the CP and note the examples cited in Part IV. We accept that there have been instances in which Contracts for Differences (CfDs) or similar instruments have been used in a manner which resulted in some of the issues outlined in Part III of the CP becoming a reality, although our understanding is that these instances have been fairly isolated. We are not wholly convinced that, of themselves, the issues identified by CESR in fact reflect any significant market (or other) risk which requires regulatory intervention. Indeed, our view is that the vast majority of investors (many of whom are our members) who hold synthetic interests in securities do so purely to obtain economic exposure to the underlying and not to obtain *de facto* control/influence. In this respect, we would also urge CESR to consider the principles which lie behind the Transparency Directive itself - these lean very much towards the disclosure of voting rights, rather than pure economic interests. To the extent CESR considers that there is a significant market risk that requires regulatory intervention, our view is that a sensible, proportionate and coordinated regulatory response across all EU Member States would be appropriate. We also acknowledge the steps taken by other regulators across the world to address perceived issues in this area. Central to this position is the requirement that the regulatory response be proportionate. We do not believe that the examples given in Part IV of the CP are necessarily representative of a wider issue requiring extensive or heavy-handed regulatory intervention. In particular, we believe that the limited nature of the risk issues in this area justify only measures which can be implemented at reasonable cost and with as little disturbance as possible to the entirely legitimate commercial practices of the vast majority of investors. A key factor in ensuring that the cost of implementation and maintenance of the relevant measures are reasonable will be a requirement that they are implemented in a uniform manner across the whole of the European Economic Area (EEA) and contain a sufficient degree of clarity and granularity such that there is no scope for individual Member States to apply their own interpretation of the measures. This will allow investors to use a single calculation engine to monitor their positions in all European stocks and will reduce the cost of implementation and maintenance. In addition, the harmonised pan-European response which we seek will provide a better quality of information to both markets and issuers, since the information

		will be capable of consistent interpretation. This will bring the benefits of clarity and transparency, factors which we welcome.
2.	Do you agree that the scope of the Transparency Directive needs to be broadened to address these issues?	As above, we believe that a sensible, proportionate and coordinated regulatory response across EU Member States would be appropriate, and adjustments to the scope of the Transparency Directive would be an appropriate way of achieving this, provided care is taken to limit the extent of the changes to that Directive.
3.	Do you agree that disclosure should be based on a broad definition of financial instruments of similar economic effect to holding shares and entitlements to acquire shares without giving direct access to voting rights?	We would agree that it makes sense to have a general scope provision which refers to instruments having "similar economic effect", as proposed. In the interests of certainty, we would propose as follows: • explicit guidance be given as to the meaning of the phrase "similar economic effect", so that it is clear that this seeks to catch (and only to catch) instruments which create a day over day enduring interest in the positive price performance of the underlying security. It is this enduring interest in positive price performance which must underpin an argument that a synthetic interest can be equated to a physical holding. Consequently, financial instruments such as volatility, correlation and variance swaps should be excluded; • a non-exclusive shortlist of instruments which are not within scope should be included. This will allow parties to operate with certainty, whilst ensuring that instruments which arguably give rise to the mischief to be addressed by the revised rules remain caught. We would suggest that examples of instruments which would be expressly out of scope would include: i. instruments referenced to shares which are not in issue (and it would be useful to have guidance on how instruments referencing treasury shares or equivalent should be treated); ii. nil paid rights generally; iii. to the extent not covered by the above, underwriting obligations; iv. exchanged traded indices; v. derivatives referencing indices, including non-exchange traded broad-based indices; and vi. basket derivatives subject to meaningful concentration limits. Recognising that such a list would be non-exhaustive, and also with a view to guarding in any new regulation against market participants attempting to avoid disclosure, we do think it is important that the phrase 'similar economic effect' does convey an enduring interest in the positive price performance of the stock. We would point out that there appears to be an inconsistency between paragraph 45 of the CP (which states that the regime should extend only to "instruments referenced to shares that have already been issued") and paragraph 48 (which states that warrants and convertibles would be included) - unless the wording in paragraph 48 refers only to covered warrants and exchangeable bonds. CESR should clarify this point and also confirm that rights (e.g., under a rights issue/placing) are not included. To ensure consistency and reduce the costs of implementation and maintenance of these measures, individual EU Member States should be prohibited from including out-of-scope instruments within their own domestic rules.

4.	With regard to the legal definition of the scope (paragraphs 50-52 above), what kind of issues you anticipate arising from either of the two options? Please give examples on transactions or agreements that should in your view be excluded from the first option and/or on instruments that in your view are not adequately caught by the MiFID definition of financial instrument.	We believe that the most logical approach here would be to adopt the Markets in Financial Instruments Directive (MiFID) definition of "financial instruments". This avoids the over-extension of the regulatory regime and allows market participants to operate with a concept with which they are already familiar.
5.	Do you think that the share equivalence should be calculated on a nominal or delta-adjusted basis?	Share equivalence should be calculated on a delta-adjusted basis. If the principal concern is that a non-delta 1 financial instrument gives the holder influence over those shares held as a hedge, then logically it should be the delta adjusted value that is used for the purposes of the calculation. We would be concerned that disclosure on a notional basis would lead to over-disclosure, which could potentially hamper CESR's objectives.
6.	How should the share equivalence be calculated in instruments where the exact number of reference shares is not determined?	To avoid anomalies in the calculation of the net position, CESR should make it clear that the valuation methodology for non-delta 1 positions should be applied to all instruments that currently constitute qualifying financial instruments under the Directive (e.g., physically settled, manually-exercised call options, some exchangeable bonds and some covered warrants). Regarding calculation on a delta-adjusted basis, our members' experience of long and short position disclosure regimes which contemplate or require delta adjustment is that delta-adjusted disclosure is effective, subject to our comments below regarding passive changes, without the need for a standardised or prescribed calculation of delta.
7.	Should there be a general disclosure of these instruments when referenced to shares, or should disclosure be limited to instruments that contractually do not preclude the possibility of giving access to voting rights (the 'safe harbour' approach)?	We submit that the categories of instrument to be caught within an additional disclosure regime (if any) should be as narrow as possible, catching only those interests which carry rights similar to those of shares. Thus, we agree that this should be limited to equities or traded equity derivatives. We additionally submit that the use of the 'safe harbour' approach would create an additional administrative burden for market participants applying the disclosure regime. Instead, we are in favour of simplicity - if all positions are disclosable (above the relevant threshold) then this gives a clear compliance requirement and removes the need for legal or compliance input on the terms of a particular instrument to determine whether or not it is disclosable.
8.	Do you consider there is a need to apply existing TD exemptions to instruments of similar	We believe that all current Transparency Directive exemptions should continue to apply.

	economic effect to holding shares and entitlements to acquire shares?	
9.	Do you consider there is need for additional exemptions, such as those mentioned above or others?	No.
10	Which kinds of costs and benefits do you associate with CESR's proposed approach?	Costs associated with CESR's proposals will largely be limited to those necessary to introduce new systems and to ensure full and on going compliance with the rules. We believe that the greatest benefits will be achieved only if CESR's approach is adopted on a maximum harmonisation basis across the European Member States. The proposals, if implemented in this way, may be expected to: • reduce the need to take legal advice on instruments/regulations; • create a coordinated pan-European system; and • create a predictable and consistent system for market participants.
11	How high do you expect these costs and benefits to be?	We are unable to quantify the costs of implementation at this early stage. We would suggest that, once more detail is available as to the proposed regime, a full impact assessment be carried out to determine whether the cost of implementation justifies the benefit achieved. AIMA would be happy to provide input into such an assessment if this was thought to be helpful.
12	If you have proposed any exemptions or have presented other options, kindly also provide an estimate of the associated costs and benefits.	We have the following additional comments: • any revisions to the regulatory regime should provide sufficient detail so that the calculation is identical in every Member State, particularly surrounding the scope of instruments within the regime and how their value is calculated (see, for example, the UK FSA's FAQs - www.fsa.gov.uk/pubs/ukla/disclosure.pdf - together with the content of the LIST! 14 newsletter - www.fsa.gov.uk/pubs/ukla/list14_apr07.pdf). If this can be achieved, then there will be a significant benefit to market participants in terms of the cost of implementation. On this basis, any resultant Directive should be a maximum harmonisation directive. In addition, we would suggest that: i. it be made unlawful for EEA-issuers to include in their articles requirements that require greater disclosure than those set out in the Transparency Directive, as amended; and ii. the new legislation should introduce (maximum) harmonisation of the disclosure thresholds, the timing of disclosures, the form of disclosure, and the calculation of the position for physical shares as well (so that there is consistency across Europe and, therefore, best information to the market and greater transparency); • to avoid discrepancies arising as a result of changes to the numerator in any relevant calculation that are not reflected in changes to the denominator, issuers should be required to make a new total voting rights announcement to the market promptly on increasing their capital and the current number of outstanding shares clearly displayed on the issuer's website and/or the website of the competent authority; and

		• the new measures should provide that purely "passive" changes resulting in an investor going through a threshold should not be disclosable. So, where, for example, non-delta 1 instruments are held by an investor and changes in market price of the underlying shares result in an adjustment to the delta valuation which takes the investor through a disclosure threshold, this should not lead to a disclosure obligation. The disclosure obligation should only be triggered on the next occasion when the investor trades (assuming that the investor remains above the relevant disclosure threshold following that trade).