FSA Consultation Paper CP07/20 'Disclosure of Contracts for Difference'

A response by

The National Association of Pension Funds
February 2008

Introduction

1 The NAPF is the leading voice of workplace pension provision in the UK. Some 10 million working people are currently in NAPF member schemes, while around 5 million pensioners are receiving valuable retirement income from such schemes. NAPF member schemes hold assets of around £800 billion and account for approximately one fifth of investment in the UK stock market. We are grateful for the opportunity to respond to your Consultation Paper CP07/20 'Disclosure of Contracts for Difference'.

Options proposed by the FSA

2 The FSA has considered three options:

- Option 1 – leave the current disclosure regime as it stands;
- Option 2 – disclosure of economic interests equal to 3 per cent or more of a company's share capital, subject to safe harbours for holders who have precluded themselves from exercising influence over the underlying shares; and
- Option 3 – disclosure of all economic interests equal to 5 per cent or more of a company's share capital.

Both Options 2 and 3 would be combined with a clear statement of the existing regulatory regime, to make clear the extent to which certain behaviours that are causing concern are already caught by the FSA's Rules.

Consideration of the options proposed

3 We agree with the FSA's decision to exclude Option 1, but feel that neither of the two remaining options is satisfactory.

4 Our reasons for opposing Option 2 are as follows:

- Option 2 provides that the disclosure requirements do not apply to holders whose current intention is not to exercise voting rights. We agree with the FSA that instances where holders have used CfDs to exercise influence or to build undisclosed stakes are rare. However, a number of our members feel that they have been disadvantaged by this sort of behaviour. Option 2 effectively allows discretion to determine whether a position should be disclosed to the very people who are least likely to use it responsibly; for this reason alone it cannot be seen as a credible option.

- We also feel that, whatever the original intention, an investment bank that has hedged a client's CfD with the shares has an economic incentive to sell to the CfD holder rather than in the market. This also undermines the rationale for the safe harbours.

- We understand that some holders (or their agents) will prefer not to decide on a case by case basis whether a particular holding should be disclosed under Option 2. They will instead determine in advance whether any CfD that they are likely to hold lies outside the safe harbours, and – if it does – disclose all economic interests of 3 per cent or more. We believe that the resulting inconsistencies in disclosure policies will reduce the value of the disclosures and cause confusion in the market. Confusion will be aggravated by the FSA's current intention not to require that shareholder interests and CfDs be separately disclosed within the 3 per cent limit (we understand that the FSA is willing to reconsider this).

5 As far as Option 3 is concerned, we find it difficult to understand why the FSA is proposing that shareholder and other economic interests should be aggregated in determining the disclosure threshold for Option 2 but not for Option 3 – especially as the threshold for Option 2 is lower to start with. The effect of this is that Option 3 would allow a CfD holder to build a potential stake of just under 8 per cent without having to disclose it (a shareholder interest of just under 3 per cent plus a position in CfDs of just under 5 per cent). We do not believe that this is an acceptable result, and understand that the point has also been raised by a number of those who have already replied to your consultation.

Conclusion and recommendation

6 We oppose the safe harbours proposed for Option 2. We believe that they will provide opportunities for abuse, complicate the disclosure process and lead to inconsistencies in disclosure. At the same time, Option 3 as currently drafted

would allow the opportunity for unacceptably large economic interests potentially convertible into shares to be built up without being disclosed.

7 We believe that a higher disclosure threshold for economic interests (5 per cent, rather than the current 3 per cent threshold for shareholder interests) is an acceptable price to pay for improved disclosure of CfD holdings, provided it is combined with separate reporting of shareholder interests and other economic interests (CfDs) within the total. A 5 per cent threshold is in line with the Transparency Directive and, as a matter of principle, we oppose super-equivalent implementation of EU Directives unless there are extremely strong reasons for a stricter interpretation. We also note that a 5 per cent threshold is in line with the current reporting requirements for fund managers.

8 In conclusion, we believe that the disclosure regime should comprise:

- disclosure of aggregate economic interests at 5 per cent,
- separate disclosure of shareholder and other economic interests (CfDs) within this total, and
- maintenance of the current MSN requirement to disclose shareholder interests at 3 per cent.

9 We recognise that our proposal will result in more disclosures (essentially CfD holdings that would have benefited from the safe harbours in Option 2) but we believe that market participants are capable of drawing their own conclusions, provided shareholder interests and CfDs are separately disclosed. We doubt that the increased disclosures would disadvantage CfD holders whose interest is purely economic.