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Christian Krohn,
Policy – Primary Markets,
Financial Services Authority,
25 North Colonnade,
London E14 5HS / cp06_04@fsa.gov.uk

Dear Mr Krohn,

CP06/4 – Implementation of the Transparency Directive

The International Swaps and Derivatives Association (ISDA¹) is glad to have the opportunity to comment on this subject. We focus exclusively on chapter 6, relating to contracts for difference.

We support the FSA's policy of not extending disclosure requirements to purely economic interests. Our reasons for reaching this conclusion, however, seem to be different. As argued in our submissions to the Code Committee of the Panel on Takeovers and Mergers², we consider disclosure of such interests to be fundamentally misguided and, as such, an unnecessary and unjustified burden. Believing as we do that this is true even in the relatively 'high-stakes' environment of a takeover bid, we cannot see any reasonable policy motivation for applying such disclosure to market operations more generally.

Over and above this issue of principle, we agree that it is practically difficult to achieve such a disclosure regime. This is true, even before one takes into account any cost-benefit analysis. There are a number of situations (particularly related to the use of options) where the role the (cash-settled) derivative is far from that of a simple proxy for the shares. It is, for instance,

¹ ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association by number of member firms. ISDA was chartered in 1985, and today has over 700 member institutions from 50 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

² Attached. We have reproduced these in their entirety, as the issues discussed are relevant to those raised in CP06/4 and explain more fully the reasoning behind our position. Copies of these submission are also available at <http://www.isda.org/speeches/pdf/ISDA-PCP-2005-1-Response2-28-05.pdf> and <http://www.isda.org/speeches/pdf/PCPcommentletter062405.pdf>

widely understood that market participants may well pursue trading strategies relating to volatility, which do not depend on the absolute level of the underlying shares. Such transactions extend the range of views that may be expressed in financial markets and accordingly allow those financial markets to more fully accommodate investor preferences.

Other derivatives-based strategies are designed to achieve the same effect as limit orders. This is a more subtle distinction (versus pure economic exposure to continuous change in the price of the shares), but a valid one all the same.

In any case, even when a derivative is used as a proxy for direct economic exposure the relevant shares, it does not follow that a participant will be willing or able to vote indirectly through its counterparty. As we have argued in our submissions to the Takeover Panel, to the extent that market participants are using side arrangements combined with cash-settled derivatives to disguise a voting interest, it is right that this should be addressed. But it should be addressed through an effective and targeted policy – not indiscriminate and disproportionate action.

To be absolutely clear, if properly analysed, it is *not* the ownership of a cash-settled derivative that conveys disguised voting rights – it is side-arrangements attaching to those positions. This point has in effect been discarded by the Takeover Panel – hence its policy with regards to disclosure of cash-settled derivatives in a bid. But the point remains true for all that.

This has an important consequence in policy terms. Before discriminating against such economically valuable instruments, the FSA should consider very carefully whether the disguising of voting interests could be achieved by means other than side-arrangements associated with derivatives. It should also bear in mind that there are many possible reasons why investors may turn to CFDs – not least the tax burden associated with transactions in shares.

On a slightly different note, we observe that any measure to extend disclosures more widely would constitute a clear instance of super-equivalence. In paragraph 6.2, FSA refers to changes to its powers being introduced in the Company Law Reform Bill. That effectively means that the Directive is being extended. We view this as unwelcome, in that our membership believes in cross-border business and super-equivalence works against that.

Thank you, again, for the opportunity to comment; and please do not hesitate to get in touch if you wish to discuss any of the above points.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R. Metcalfe', with a stylized flourish at the end.

Richard Metcalfe, Senior Policy Director