COMMENT LETTER

July 8, 2002

Comment Letter on Proposed EU Reporting Rules for Institutional Investors, July 2002

July 3, 2002

Juergen Tiedje
DG Internal Market,
Unit F.2—Securities and Organized Markets
European Commission
200, rue de la Loi
B—1047 Brussels
Belgium

Dear Mr. Tiedje:

The Investment Company Institute appreciates the opportunity to comment on the Second Consultation by the Services of the Internal Market Directorate–General of the European Commission "Towards an EU Regime on Transparency Obligations for Issuers Whose Securities are Admitted to Trading on a Regulated Market." The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,928 open-end investment companies ("mutual funds"), 499 closed-end investment companies, and six sponsors of unit investment trusts. Its mutual fund members have assets of about $6.898 trillion, accounting for approximately 95 percent of total industry assets, and over 88.6 million individual shareholders. Many of our members also manage investment companies and pension funds outside the United States, including mutual funds domiciled in the European Union that are sold under the EU UCITS Directive.

We are writing to comment on two specific items in the Consultation Document: Section 4.2, which proposes to give equal effect to votes cast in person or in absentia and Section 4.3, which would revise EU rules for the reporting of major holdings in companies. Text for the proposed changes is set forth in Sections D-1 and D-2 of Annex 1 of the Consultation Document.

Rights and Treatment of Shareholders

We support the notion expressed in Section 4.2 of the Consultation Document that the existing EU principle of equal treatment for shareholders should include giving equal effect to votes cast either in person or in absentia and, thus, that all member states should be required to permit proxy voting. The inability to cast votes by proxy can be one of the most significant procedural impediments to exercising voting rights.[1] We also agree that equal treatment for security holders should not be limited to securities listed on official markets but also extended to securities admitted for trading on regulated markets. We also would support the concept of permitting voting by electronic means.

Reporting of Major Holdings

Section 4.3 of the Consultation Document proposes revisions to the rules for reporting significant holdings in securities that would lower the threshold for reporting securities ownership positions from 10 percent to 5 percent and shorten the time for reporting. Under the proposal, investors would be required to file ownership notifications with the issuer and competent regulator within five calendar days. Issuers would be required to disclose this information to the public as soon as possible, but not more than five calendar days after receiving notification. Currently, the applicable time periods are seven calendar days and nine calendar days, respectively.

As discretionary investment managers of securities portfolios for investment companies, pension funds and other clients, members of the asset management industry have had extensive experience complying with securities ownership reporting requirements in the many countries in which they invest. Worldwide mutual fund assets have grown significantly from €2 trillion in 1990 to over €13 trillion at the end of 2001. Worldwide pension assets also have grown to stand at over €12 trillion. An increasing amount of assets are invested in equity securities subject to ownership reporting rules. For example, worldwide, assets of equity and balanced mutual funds comprised over €6.7 trillion, or more than half of total worldwide mutual fund assets at the end of 2001. In the European Union, assets of equity UCITS funds have grown from less than €600 billion in 1997 to over €1.4 trillion (or 40 percent of total industry assets) at the end of the first quarter of 2002. Assets in balanced funds grew during the same period from approximately €200 billion to €521 billion (or 15 percent of total industry assets).[2] Given the growth of institutional assets under management and of equity investing, it is not uncommon for institutional managers to make investments for their clients that cross securities ownership reporting thresholds.

The Institute and its members support the policies that underlie requirements to disclose significant ownership of issuers. Obligations to report such ownership provide both issuers and the market with information about the accumulation of interest by investors in a particular issuer. As the Consultation Document states, this disclosure allows investors to see movements of shares by an investor prior to the investor obtaining possible influence on the company. Securities ownership reporting rules, however, should be drafted to balance the need for the market to learn promptly of the accumulation of securities by those who may seek to influence control over an issuer with the goal of not imposing unnecessary burdens on institutional investors, such as mutual funds and pension funds and their managers, that have no such change of control purpose.

It is especially important with respect to the threshold level for reporting to weigh the benefits of any changes against the burdens imposed on investors subject to the reporting obligations. Accordingly, the Institute believes that the proposal to lower the threshold from 10 percent to 5 percent[3] should include provisions to tailor the reporting rules to avoid imposing undue burdens on institutional investors not investing for a change of control purpose. There are a number of ways in which the European Union could tailor the reporting rules for institutional investors without compromising the important policy goals of the reporting rules. Below, we present three suggestions for the Commission's consideration.

Retain a higher reporting threshold for filings by investment managers

One way to tailor the rules to avoid imposing unnecessary burdens on institutional investors would be to use a higher reporting threshold for investment managers or other institutional investors not investing for change of control purposes. This is the approach currently used in the United Kingdom for filings by certain investment managers based in the UK or EU. These managers currently file under a 10 percent threshold instead of the 3 percent threshold applicable to other filers.[4] Under this approach, the EU could lower the filing threshold for other filers to 5 percent but retain the 10 percent threshold for investment managers.

Reduce the frequency of filings by investment managers

Another way to tailor the reporting rules to avoid undue burdens on institutional investment managers would be to reduce the frequency with which these investors must report holdings over the threshold amount. This is the approach used in the United States, where Qualified Institutional Investors and Passive Investors may file on an abbreviated filing schedule using a short form (Schedule 13G, rather than Schedule 13D, the form applicable to all other filers.) Qualified Institutional Investors[5] file within 45 days after the calendar year in which the investor held more than five percent at the end of the year and thereafter make additional filings within 45 days after the calendar year to report any changes in the information reported in the previous filing. However, if the ownership of the investor exceeds ten percent at the end of any month, the investor must file within ten days after the end of the month. Passive Investors[6] file within ten calendar days of crossing the five percent threshold and make additional filings within 45 days after the end of the calendar year to report any changes in information. Passive Investors must file promptly during the year if they acquire more than ten percent of the subject securities.

Similarly, to reduce the filing burden on investment managers or other institutional investors not investing for a change of control purpose, the European Union could permit these filers to disclose securities holdings on a streamlined basis. We would recommend that these investors be permitted to disclose securities holdings over the threshold amount annually.[7] We emphasize that any streamlined filing rules generally should be available to investment managers based outside the EU as well as to EU-based managers.[8]

Include a reasonable aggregation policy in the rules

In order to avoid imposing unnecessary costs on institutional investors the Commission in any case should develop a reasonable rule on when holdings of affiliated entities must be aggregated for purposes of reporting securities ownership. Requiring aggregation in all cases can be extremely burdensome for global investment management organizations.

Member states of the European Union take different approaches regarding positions held by related asset managers for purposes of determining whether an asset manager has crossed the relevant threshold for reporting securities ownership. For example, in the United Kingdom, we understand that positions held by asset managers that are under common control must be aggregated for purposes of determining whether an asset manager has crossed the reporting threshold. The requirement to aggregate is irrespective of whether the affiliated asset managers are structured and operated so that voting and investment powers over the securities positions are exercised independently.[9]

We would submit that, in situations in which voting and investment decisions about particular securities are not made pursuant to any explicit or implicit agreement, but rather are made independently, there appears to be no reason why the holdings of affiliated asset managers should be aggregated for purposes of reporting. Aggregation in these circumstances does not provide the market or the issuer with useful information about buying activities or patterns of a particular investor. It does, however, impose significant burdens on certain institutional investors.

For example, with the globalization of financial institutions, two completely separate affiliates from different parts of the world purchasing securities for their investment funds or other clients without consultation with each other would be required to aggregate their holdings for reporting purposes. Institutional investors, therefore, must establish global compliance programs to monitor constantly holdings by their affiliates around the world.

Given that asset managers typically are passive investors and do not invest for control purposes, the excessive burden imposed by such an aggregation policy does not appear to be justified. Moreover, with the increasing trend towards greater consolidation of financial institutions, more fund managers likely will be under a holding company structure and the burdens imposed by this type of aggregation policy will become more commonplace.[10]

The burdens imposed by policies that require aggregation in all cases necessarily will be compounded by the proposal to lower the filing threshold. Accordingly, the Commission should not adopt the lower threshold without including in the revisions a rule on aggregation that would not require affiliates of institutional investment managers to aggregate holdings if the affiliates exercise voting rights and investment decisions separately.[11]

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We appreciate the opportunity to comment on the Consultation Document. If you have any questions or would like additional information on any of these matters, please contact me at 202 326-5826 or at podesta@ici.org.

Sincerely,

Mary S. Podesta
Senior Counsel

ENDNOTES

1 See "Global Corporate Governance Issues for Mutual Funds," a survey of corporate governance policies and procedures in selected countries in Asia, Europe, Latin America and Africa, published by the Institute in 2000. Nine of the eleven countries covered in the survey did not permit proxy voting or had practices that placed significant restrictions on the ability of investors to vote by proxy.

2 See Trends in the European Investment Fund Industry in the First Quarter of 2002, FEFSI Quarterly Statistical Release, June 2002, No. 9. It is expected that equity investing in Europe through mutual funds and occupational pension schemes will continue to grow as member states implement or strengthen programs to foster long-term retirement saving.

3 A majority of jurisdictions use a five percent threshold for securities ownership reporting purposes. The Institute's annual survey of securities ownership reporting requirements in 52 jurisdictions outside the United States indicates that 29 countries currently use a 5 percent threshold. See "Foreign Investing Guide", Investment Company Institute. The U.S. also uses a 5 percent threshold.

4 Under the UK Companies Law, the 10 percent threshold is available to persons authorized under UK law to manage other persons' investments, operators of authorized unit trust schemes, recognized schemes, or UCITS, and investment companies with variable capital. See Companies Act Part VI, section 199(2)(b) and 199 (2A).

5 Qualified Institutional Investors include U.S. asset managers, foreign institutional investors permitted by SEC interpretive positions to file in this category, and investors permitted by SEC exceptive orders to file in this category.

6 Passive Investors include investors that certify that they did not acquire or hold the subject securities to change or influence the control of the issuer and own less than 20 percent of the securities.

7 The Commission also might want to consider the feasibility of developing a uniform form that could be used throughout the European Union for filing securities ownership reports. The use of a standard form would be of significant benefit to institutional investors in administering their securities ownership reporting compliance programs.

8 There are various ways to make the rules developed for institutional investors available to both domestic and foreign investment managers. Korea recently enacted an amendment to its beneficial ownership reporting rules to exempt institutional investment managers from a burdensome documentation requirement. The exemption is available not only to specified types of institutional investors under Korea's Securities Exchange Act and Securities Investment Company Act but also to corporations whose main business is banking, securities, insurance, asset management or discretionary asset management outside of Korea under foreign laws and regulations; securities investment companies governed under foreign law; and other similar corporations as determined by the Financial Supervisory Service. See Amendment to Article 135 under the Regulation on Issuance and Public Notice of Securities enacted on April 4, 2002. In the U.S., the status of Qualified Institutional Investor under Regulation 13D-G under the Exchange Act is available to specified types of financial institutions subject to U.S. regulation as well as to foreign investment managers who qualify under SEC staff interpretations or obtain designation as Qualified Institutional Investors by SEC exemptive order. Both foreign and domestic institutions also can qualify as Passive Investors under Regulation 13D-G.

9 In most European countries, the issue of aggregation by investment managers is not addressed directly but rather is addressed indirectly through definitions of control. In Finland, a person who has control over an entity that is a shareholder is considered a shareholder for purposes of the reporting requirements. Germany and Spain also appear to require aggregation of shares held by controlled affiliates. In Italy, however, a company controlling several management companies does not aggregate the shares for which the

controlled companies hold or have the authority to direct voting rights to determine its disclosure obligation. Italian law does, however, require a mutual fund manager to aggregate the shareholdings of all the funds over which it exercises discretionary control.

10 For example, financial services reform legislation enacted in 1999 in the U.S. removed impediments to the creation of financial services holding companies that combine banking, securities, insurance and other financial services activities. In addition, the burdens associated with a requirement to aggregate all securities positions also can be expected to have a significant impact on European asset management institutions, which are increasingly operating on a global basis. Foreign firms, and in particular European firms, have made significant acquisitions of U.S. money management companies in recent years. We estimate that, as of March 26, 2002, $981 billion, or 14.2 percent, of total U.S. mutual fund assets were managed by foreign investment management companies or their affiliates.

11 In the U.S., the federal securities laws contain exceptions with respect to aggregation that reduce unnecessary burdens on professional managers that are subject to securities ownership filing requirements. Regulation 13D-G provides that when related money managers independently exercise voting and investment powers, the positions of the individual managers need not be reported together for purposes of disclosure under Regulation 13D-G.