# EUROPEAN PARLIAMENT

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*Committee on Economic and Monetary Affairs*

**2007/2239(INI)**

28.5.2008

# OPINION

of the Committee on Economic and Monetary Affairs

for the Committee on Legal Affairs

on transparency of institutional investors
(2007/2239(INI))

Draftswoman (*): Sharon Bowles

(*) Procedure with associated committees - Rule 47 of the Rules of Procedure

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## SUGGESTIONS

The Committee on Economic and Monetary Affairs calls on the Committee on Legal Affairs, as the committee responsible, to incorporate the following suggestions in its motion for a resolution:

1. Welcomes the findings of the studies on hedge funds, private equity and transparency, commissioned by its Committee on Economic and Monetary Affairs;

2. Recognises that improvements in transparency, in particular to promote greater comprehension and better visibility of risk, for example, of complex financial products, has a valuable role to play, including for ensuring the stability of financial markets - taking into account the current financial turbulence - but notes that transparency is an aid to, not a replacement for, due diligence;

3. Observes that a lack of due diligence by investors cannot be countered by more transparency alone; stresses that transparency contributes to a better understanding of complex financial products;

4. Recognises that hedge funds and private equity are distinct investment vehicles that differ as regards the nature of investment and investment strategy;

5. States that purposive transparency is a prime tool for managing risk for all stakeholders and makes available to market participants the information that they require as a basis for their decisions; stresses that progressive levels of transparency are needed: for the general public, openness about objectives is important, for investors, it is the detail of the nature, valuation and risk of investments and for supervisors, a full picture of positions, strategies, risk management, market abuse controls and other compliance procedures, subject to an appropriate level of confidentiality; suggests that negative effects of transparency, such as herding, as a result of which investment strategies are revealed to competitors, be avoided, and that positive effects, including preventing the assumption of worse-than-actual scenarios, promoted;

6. Notes the experience of the United States where freedom of information legislation has been used by competitors to obtain fund investment details at a level intended for investors, which has compromised both the investors and the fund;

7. Considers that some over-the-counter (OTC) products could use more open or visible trading systems in order to increase markt-to-market valuation where possible and to give an indication of potential ownership changes; considers that a more general OTC clearing system is attractive for purposes of supervisory oversight and risk assessment, but, in order to ensure that there is a level playing field in the global context, any new system needs to be introduced on an international basis;

8. Warns against the implementation of contractual terms to impose risk limitations, which would amount to product regulation and interfere with financial innovation as well as investor choice;

9. Underlines the necessity to overcome the fragmentation in the regulatory framework and hence the obstacles to cross-border distribution for alternative investments through the establishment of a European private placement regime;

10. Underlines that industry-wide monitoring and reporting has a role to play in addressing public concerns and in order to understand the economic impact of private equity, and that there is already a requirement on private and public companies to consult their employees about matters that affect their interests; emphasises that no imbalance should be created between commercial disclosure required of private equity portfolio companies and that required of other private companies;

11. Notes that public attention was drawn to hedge funds and private equity following high-profile cases and activity in the context of well-known companies; recognises that both hedge funds and private equity are responding to criticism by way of self-regulatory proposals incorporating a 'comply-or-explain' principle; considers that those codes (which exist as an autonomous complement to legislation) need to be taken up rapidly and spread globally, but that sufficient time should be allowed for their effects to be analysed;

12. Believes that tested voluntary guidelines offer a better basis for dealing with a wide range of complexities and circumstances, at least until they have been road-tested; suggests that a one-stop-shop website for codes of conduct be established for the European Union and promoted internationally; suggests that such a website include a register of companies that comply with the codes of conduct, their disclosures, and explanations of non-compliance; observes that reasons for non-compliance can also be a learning tool; is aware of the fact that adequate and effective monitoring of codes of conduct remains an open question that needs to be addressed;

13. Recognises that there is no uniform public disclosure of sovereign wealth funds (SWFs) and welcomes the initiative of the International Monetary Fund to establish a working group to draft an international code of conduct for SWFs; believes that such a code of conduct would go some way to demystifying SWF activities; calls on the Commission to take part in that process;

14. Recognises that EU onshore hedge funds, hedge fund managers and private equity firms are subject to existing legislation, notably concerning market abuse, and that regulation applies to them indirectly through counterparties and when related investments in regulated products are sold; recalls, in particular, that the banks that finance hedge funds and private equity are themselves regulated under Community law as regards, inter alia, capital adequacy, conflicts of interest and systems and controls; observes also that the business relationship of banks with hedge funds and private equity firms affords them considerable influence to demand and receive as much information from their clients as they deem necessary to fulfil their role;

15. Notes that the linkage between hedge funds and their counterparties has been exhibited in enforced de-leveraging during the recent financial turmoil; notes that share holdings are subject to the usual disclosure requirements; recognises that investment managers have a fiduciary responsibility to investors and should exercise voting rights in the interest of such investors and in consideration of the investment mandate of the investment vehicle; observes that institutions lending shares should have due regard to whether and how the

shares might be used, including for voting;

16. Is of the opinion that any investigation into the possibility of a system of EU-wide shareholder identification should include a cost-benefit analysis of additional reporting requirements with the aim of avoiding an overflow of information;

17. In the interests of ensuring that there is a level playing field, considers it inappropriate to discriminate between different investors;

18. Asserts that, in the context of private equity funds, the costs of any additional reporting requirements, in particular where these are frequent, should be justified and proportionate to the benefits from them; in all contexts, believes that better linkage is needed between remuneration packages and long-term performance;

19. Welcomes the proposal of the International Organization of Securities Commissions (IOSCO) for the valuation of hedge fund portfolios and looks forward to its widespread introduction; notes that the valuation of illiquid assets is currently work in progress;

20. Recognises that neither hedge funds nor private equity are the cause of the current financial turmoil; supports the international consensus expressed by the Commission, Member States, the European Central Bank, the Financial Stability Forum, the (IOSCO) and others that it will take time to understand the full causes and effects of the sub-prime turmoil and that a hasty legislative response would be a mistake; notes, however, that a lack of comprehension of complex products and ratings has been exposed and that measures to ensure better understanding, visibility of processes and notation for different types of risk, such as liquidity and complexity, as well as credit worthiness, should be developed as soon as possible;

21. Considers that, regarding new products, innovation is important and must not be unduly hampered; states that ‘prudent person’ principles, supervisory and investor diligence and risk visibility are more important than a registration system;

22. Notes that Member States have or can put in place measures to counter asset stripping, as regards the obligations of directors, and that there is no evidence that a Community measure in these terms would be more effective;

23. Does not support the development of stand-alone legislation targeting hedge funds and private equity but believes that the Commission should investigate appropriate adjustments to existing regulation; believes any changes must be universal and should not be unfairly discriminatory; is a strong supporter of better regulation and believes that harmonisation should occur only when there is evidence of market failure;

24. Considers it impractical and counterproductive in terms of encouraging investment to make an artificial differentiation between categories of private investors in equities;

25. Recommends that hedge funds which seek investment by retail investors should be required to commit themselves to a defined sector and to a formulaic risk profile and should be sold only through sales people who are specifically authorised as regards their technical qualifications, counselling ability and ethical probity;

26. Notes that securities lending with the sole purpose of voting on borrowed shares or options is a bad practice in the absence of procedures for disclosure of voting rights acquired through borrowed shares or options; urges the Commission to look again at forming a recommendation enabling those lending share to exercise their vote, through recall or otherwise; and to ensure that voting policies of institutional investors are disclosed.

## RESULT OF FINAL VOTE IN COMMITTEE

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| **Date adopted** | 19.5.2008 |
| **Result of final vote** | +: 29<br>–: 2<br>0: 10 |
| **Members present for the final vote** | Mariela Velichkova Baeva, Zsolt László Becsey, Pervenche Berès, Sharon Bowles, Udo Bullmann, David Casa, Jonathan Evans, Elisa Ferreira, José Manuel García-Margallo y Marfil, Jean-Paul Gauzès, Donata Gottardi, Benoît Hamon, Gunnar Hökmark, Karsten Friedrich Hoppenstedt, Sophia in 't Veld, Othmar Karas, Wolf Klinz, Christoph Konrad, Kurt Joachim Lauk, Andrea Losco, Astrid Lulling, Florencio Luque Aguilar, Hans-Peter Martin, John Purvis, Bernhard Rapkay, Dariusz Rosati, Antolín Sánchez Presedo, Olle Schmidt, Peter Skinner, Margarita Starkevičiūtė, Ieke van den Burg, Cornelis Visser, Sahra Wagenknecht |
| **Substitute(s) present for the final vote** | Dragoş Florin David, Harald Ettl, Alain Lipietz, Vladimír Maňka, Thomas Mann, Poul Nyrup Rasmussen, Margaritis Schinas, Theodor Dumitru Stolojan |