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Corporate Legal Alert

FSA publishes revised disclosure rules for contracts for difference

Summary

Further to its announcement in July regarding the proposed adoption of a general disclosure regime for contracts for difference ("**CFDs**"), the UK's Financial Services Authority ("**FSA**") yesterday published a further consultation paper containing draft rules and additional guidance. Once finalised the new rules, which are intended to come into force on 1 September 2009, will require long CFD positions to be disclosed under the UK's Disclosure and Transparency Rules ("**DTRs**") at an initial threshold of 3 per cent. of total voting rights and every 1 per cent. after that.

Comment

The proposed change constitutes a significant tightening of the UK regime governing disclosure of substantial shareholdings and brings it closer into line with the position under the UK's Takeover Code which, as with interests in shares, already requires disclosure of CFDs and other purely economic interests in excess of 1 per cent. where the relevant issuer is in an "offer period". The new rules will make it more difficult to build up significant stakes in UK incorporated issuers who shares are traded on a regulated or prescribed market (such as the London Stock Exchange's main market or AIM).

24 October 2008

Background

CFDs currently fall outside the scope of the DTRs, unless the contracts explicitly give a right to acquire, or give access to the voting rights attached to, shares held as a hedge by the CFD writer. As a result, issuers have often been unaware of the identity of persons having significant economic exposure to their shares. In addition, the FSA has also concluded that CFDs are sometimes used to influence voting or to build up stakes in companies, in each case without disclosure.

The latest consultation paper issued by the FSA follows its November 2007 consultation in which the FSA stated that the current intention of the regulatory regime is to catch such activities and that therefore action should be taken to address these failings. Yesterday's consultation paper not only sets out the proposed new rules that are designed to address these problems but also responds to comments received in relation to the earlier consultation.

How will the changes be effected?

As expected, the rules will take the form of an amendment to the DTRs. The FSA proposes to extend the scope of the categories of shares and qualifying financial instruments that need to be disclosed under the existing DTRs to include any financial instruments having similar economic effect to a qualifying financial instrument. A financial instrument will have a "similar economic effect" if its terms are referenced to an issuer's shares and the holder of the financial instrument has, in effect, a long position in the economic performance of the shares, whether the instrument is settled physically in shares or in cash.

What financial instruments will need to be disclosed?

Although the FSA has focused on CFDs, the new rules will catch all similar economic interests. This effectively means interests, which may be hedged by shares, where there is the potential for the derivative holder to have access to the shares.

Specific issues

The consultation paper addressed the following issues.

Gross or net positions: Despite considering allowing disclosure on the basis of net positions only, the FSA has stated that this would provide too great an opportunity for investors to avoid disclosure and, as such, the new draft rules provide for disclosure of gross long positions.

Aggregation: The FSA has also confirmed that the new rules require the aggregation of holdings of shares and CFDs so that, for example, the 3 per cent. threshold will be crossed by an investor holding 1.5 per cent. in shares and 1.5 per cent. in CFDs. The existing TR1 disclosure form will be modified to allow notifications to indicate whether a notifiable holding is made up of shares or CFDs and, where applicable, what the breakdown of that holding is.

Exemption for client-serving transactions: As promised, the FSA has included within the new draft rules an exemption which will have a similar effect to the Takeover Panel exemption for recognised intermediaries. The principle being that firms holding a position purely to facilitate a client position, with no interest in the underlying equity, should not need to make a disclosure.

Delta adjusted hedging: In line with the short selling disclosure rules introduced in September 2008 which require the disclosure of short positions in certain UK finance sector companies, the new rules include the concept of disclosure on a "delta adjusted basis", namely that long financial instruments that do not have a "delta 1" profile will be considered to have an economic effect, in relation to the underlying shares represented, only in the proportion which is equal to the delta of the instrument at any particular point in time.

What next?

Following yesterday's consultation paper, the FSA has confirmed that it will not be seeking any further policy comment on the rules, but will accept technical comments on the effectiveness of the rules in meeting the intended outcomes for a period of three months. Once it has considered any further technical comments the FSA intends to publish the final rules in February 2009 to come into force on 1 September 2009.

If you have any questions or require specific advice on any matter discussed in this publication, please contact Stephanie Bates, William Charnley, Tim Knowland or your regular contact at Mayer Brown.

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