Rights issues: new disclosure regime for significant short positions

On 13 June 2008, the Financial Services Authority (the “FSA”) announced a new disclosure regime for significant short positions in quoted companies undertaking rights issues. The new disclosure regime takes effect from Friday 20 June 2008 and applies in relation to any position held on or after that date.

FSA’s rationale for the new disclosure regime

Whilst the FSA does not consider short selling in itself to constitute market abuse, it is concerned that the rights issue process provides greater scope for what may amount to market abuse, particularly in current market conditions.

The FSA considers that improving transparency of significant short selling in the context of a rights issue is a good way of preventing the potential for market abuse, and that non-disclosure of significant short positions in that context gives the market a false and misleading impression of supply of and demand for the securities concerned.

The new disclosure regime

The FSA is effecting the change through an amendment to its Code of Market Conduct sourcebook. With effect from 20 June 2008, any person holding a short position must disclose that short position if:

- the short position represents any form of economic interest of 0.25% of the company’s issued share capital;
- the short position relates (directly or indirectly) to securities admitted to trading on a prescribed market (including the London Stock Exchange’s main market and AIM) which are the subject of a rights issue; and
- the short position is reached or exceeded during a rights issue period (being the period from announcement of the rights issue until admission to trading of the rights issue shares).

In addition, any existing short positions held on 20 June 2008 which meet or exceed the threshold will have to be disclosed. In a set of Frequently Asked Questions issued by the FSA on 17 June 2008, the FSA has confirmed that once a short position of 0.25% or above has been disclosed, there is no obligation to make further disclosures should the size of that position change (although the FSA has said it will keep this approach under review and may consider the introduction of an incremental disclosure requirement should experience suggest that this would add value to the regime).
In calculating whether a holder has a short position which needs to be disclosed, the holder should take into account any form of "economic interest" which it has in the shares of the company concerned, excluding any interest held as a market maker in that capacity. Short positions resulting from derivatives will therefore count towards the 0.25% disclosure threshold.

Disclosure needs to be made on a Regulatory Information Service by 3.30p.m. on the business day after the date on which the short position is reached or exceeded. The disclosure must include the name of the person who has the short position, the short position and the name of the company in which the short position is held.

Failure to disclose a short position as required is behaviour that, in the FSA’s opinion, is market abuse (misleading behaviour). This is a new example of behaviour amounting to market abuse. The FSA has the power to impose unlimited fines on individuals and firms that commit market abuse.

Comment

The announcement of the new disclosure regime came as a surprise to the market and has provoked a mixed reaction. As ever with disclosure requirements, there are issues about interpretation and the practicality of complying in a timely way.

The move has been welcomed by the British Bankers Association. However, hedge funds have been highly critical. The Alternative Investment Management Association (“AIMA”), which represents the global hedge fund industry, has expressed its disappointment with the new disclosure regime: whilst it supports appropriate measures to prevent market abuse, it comments in particular on the lack of consultation, lack of time for the industry to prepare before the new disclosure regime comes into effect, and the fact that the new disclosure regime seems to be a rushed measure to assist a single sector and sets an awkward precedent for the future. AIMA also argues that there is no clear evidence of market abuse of this kind.

The FSA has noted that the new provisions, and in particular the threshold for triggering a disclosure of a short position, will be kept under review, and that the overall effectiveness of the measure will be considered as part of a wider review into how capital raising by listed companies can be made more orderly and efficient. Separately, it has been reported that the Chancellor will say this week that the new disclosure regime is temporary, and that he is seeking dialogue to find a lasting solution.

It is worth repeating that the FSA is not prohibiting or even restricting short selling during rights issues, but is merely requiring disclosure at a lower threshold than the disclosure of voting rights under the FSAs Disclosure and Transparency Rules. In effect, however, the FSA is trying to discourage short selling of shares in companies whilst they are conducting rights issues.

In addition to the new disclosure regime, the FSA has also stated that it is considering whether it might be necessary to take further measures in this area. Options under consideration include restrictions on the lending of securities in rights issues for the purposes of enabling short selling and restrictions on short sellers covering their positions by acquiring rights to the newly issued shares.

If you have any questions or require specific advice on any matter discussed in this publication, please contact Stephanie Bates, Drew Salvest, Justine Usher or your regular contact at Mayer Brown.

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