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ARNOLD & PORTER (UK) LLP

CLIENT ADVISORY

BAN ON SHORT SELLING OF UK FINANCIAL SECTOR COMPANIES TO BE LIFTED

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Brussels
+32 (0)2 517 6600

Denver
+1 303.863.1000

London
+44 (0)20 7786 6100

Los Angeles
+1 213.243.4000

New York
+1 212.715.1000

Northern Virginia
+1 703.720.7000

San Francisco
+1 415.356.3000

Washington, DC
+1 202.942.5000

The UK Financial Services Authority (FSA) introduced a ban on the creation or increase of net short positions in the stocks of UK financial sector companies on 18 September 2008. The FSA has now confirmed that the ban will expire on 16 January 2009.

BACKGROUND

The ban on short selling of UK financial sector companies was introduced on an emergency basis without consultation as the FSA considered there was an urgent need to prevent the potential for market abuse resulting from short selling.

The FSA states that, since the introduction of the ban, it has continued to monitor the market and short selling very carefully. It considers that the ban is no longer necessary but that it will not hesitate to reinstate the ban if necessary in order to maintain orderly markets. It has said it could do this again without consultation with market participants.

The FSA's concerns with short selling remain as follows:

Market abuse: the FSA believes that short selling can be used abusively to create misleading signals about the real supply or the correct valuation of a stock and/or scaremongering to push down the price of a stock being shorted.

Disorderly markets: the FSA believes that short selling can send a signal to the market that a stock is overvalued, and if investors respond irrationally to that signal, the price decline may be excessive and so misleading about the value of the stock.

Transparency deficiencies: the FSA has said that information about the aggregate short position in a single stock could help the market judge the extent to which short selling is driving the price of that stock. The FSA has also said that information about who is holding the significant short positions could be helpful for the market to determine which entities are driving the trading. Complete transparency would obviously be of commercial concern to short sellers trying to keep their investment decisions and strategy confidential. The FSA has at least recognised that from an economic viewpoint, complete transparency is not necessarily the optimum level of transparency.

CHANGES TO THE DISCLOSURE OF NET SHORT POSITIONS

Whilst the ban will be removed, the FSA is proposing to extend the obligation to disclose interests in short positions until 30 June 2009. It is also proposing to make one change to the disclosure rules so that once a disclosure has been made, additional disclosures will only be required if a short position changes "significantly". The FSA intends to do this by introducing disclosure bands every 0.1% above the 0.25% threshold (so disclosures will be required at 0.25%, 0.35%, 0.45% and so on).

The FSA will publish proposals on the long term options for the short selling regime in a separate consultation paper in February 2009.

The FSA's changes in this area are in line with the FSA's desire to require more disclosure and transparency in the market. Another example of this strategy is its intention to require the disclosure of Contracts for Difference (CfDs)[1]. Comments can still be made on the FSA's proposals on the disclosure of CfDs until 23 January 2009, with final rules proposed to come into force on 1 September 2009. The changes will require investors who hold 3% or more of a company's voting equity through either shares, CfDs or an aggregation of shares and CfDs, to disclose their stakes. Please refer to our November 2008 client advisory for more details.

1 A CfD is a derivative instrument that gives the holder an economic exposure, which can be long (that is, where the holder gains from a rise in the underlying share price) or short (that, is where the holder gains from a fall in the underlying share price) to the change in price of a specific share over the life of the contract. The contract is normally open-ended and can be closed out by the holder on demand. Usually the contract will be cash settled and will not confer the right to take delivery of the underlying shares. In addition, it does not usually give ownership rights, such as voting rights.

We hope that you have found this client advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

Jeremy Willcocks
+44 (0)20 7786 6181
Jeremy.Willcocks@aporter.com

Fiona Ellett
+44 (0)20 7786 6120
Fiona.Ellett@aporter.com