

# ARNOLD & PORTER (UK) LLP

## ADVISORY

OCTOBER 2009

## FSA PUBLISHES FEEDBACK STATEMENT ON SHORT SELLING DISCLOSURE

The UK Financial Services Authority (FSA) has recently published its Feedback Statement<sup>1</sup> in response to its February 2009 Discussion Paper<sup>2</sup> on the treatment of short selling. The FSA is not making any immediate changes to the disclosure regime covering net short positions in UK financial sector companies and companies undertaking a rights issue. However, the FSA intends to work towards agreement on future requirements at an international level rather than introducing a separate domestic regime.

### BACKGROUND

In September 2008, the FSA instituted a ban on the creation or increase of net short positions and the requirement to disclose to the market certain net short positions held in the stocks of UK financial sector companies<sup>3</sup> as the FSA perceived an urgent need to prevent the potential for market abuse resulting from short selling. Whilst the short selling ban expired in January 2009, the FSA extended the disclosure obligation in relation to shares in UK financial sector companies<sup>4</sup>.

The disclosure regime requires those holding a net short position in a covered UK financial sector company in excess of 0.25% of the ordinary share capital of such company at market close to make the disclosure by 3.30pm GMT on the business day following the day on which the net short position was held<sup>5</sup>. Once an initial disclosure has been made, additional disclosures are only required if a net short position changes “significantly”, meaning a change of 0.1% or more (higher or lower) in the net short position held (so disclosures will be required at 0.25%, 0.35%, 0.45% and so on). If a short position decreases below 0.25%, a final disclosure will need to be made.

In relation to rights issues, the FSA revised the Code of Market Conduct from 20 June 2008<sup>6</sup> so that a person who has reached, or exceeded, a short position which represents an economic interest of 0.25% of the issued capital

#### Brussels

+32 (0)2 290 7800

#### 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

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<sup>1</sup> FS09/4 Financial Services Authority—*Short selling: Feedback on DP09/1*.

<sup>2</sup> DP09/01 *Short Selling*.

<sup>3</sup> [http://www.fsa.gov.uk/pubs/other/Shortselling\\_list.pdf](http://www.fsa.gov.uk/pubs/other/Shortselling_list.pdf)

<sup>4</sup> CP09/15 *Extension of the short selling disclosure obligation* ([http://www.fsa.gov.uk/pubs/cp/cp09\\_15.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_15.pdf)) and *Extension of short selling disclosure obligations—feedback to CP09/15* ([http://www.fsa.gov.uk/pubs/policy/ps09\\_10.pdf](http://www.fsa.gov.uk/pubs/policy/ps09_10.pdf)).

<sup>5</sup> While disclosure of the net short position is required, there is no requirement to disclose any individual short or long positions underlying the net position.

<sup>6</sup> <http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/057.shtml>

of a company undertaking a rights issue (starting with the announcement of the issue) must, provided the short position relates to securities which are the subject of the rights issue, make an announcement disclosing such positions to the market. The disclosure must be made by 3.30pm GMT on the following business day.

## SUMMARY OF RESPONSES TO THE DISCUSSION PAPER

The FSA has acknowledged that there was strong support for the view that short selling should not be subject to any permanent ban and most respondents agreed that the FSA should not introduce other constraints, such as circuit breakers and up-tick rules. There was widespread support for enhanced transparency. The FSA says that no major aspects of their proposals for a disclosure regime should change, but they remain committed to proceeding on an international level through working with the International Organisation of Securities Commissions (IOSCO)<sup>7</sup> and the Committee for European Securities Regulators (CESR)<sup>8</sup> and therefore remain open to the possibility of confidential disclosures to the appropriate regulator from 0.1%, in addition to public disclosures from 0.5%; and for the disclosure regime to apply to all companies, not just those in the financial services sector, both of which have been suggested on an international level.

## SUMMARY OF THE FSA'S POLICY ON SHORT SELLING DISCLOSURE

- The FSA agrees that short selling plays an important and positive role in normal market conditions. It says that it is convinced that a blanket ban on short selling, other than in emergency situations, would have an undesirably negative impact on market efficiency.
- The FSA considers that the benefits of transparency around short selling outweigh the costs.
- The FSA has confirmed that the potential risks posed by short selling are not limited to any one sector

or set of companies and that, therefore, a future short selling disclosure regime should apply to all companies.

- Subject to the outcome of the CESR Consultation Process, the FSA now believes that a permanent short selling disclosure regime should apply to issuers admitted to trading on regulated or prescribed markets in the UK for whom the UK is the most relevant market in terms of liquidity in accordance with Article 23(5) of MiFID<sup>9</sup> (i.e., it should not be necessary for the company to be incorporated in the UK).
- The FSA continues to believe that using a net basis only is the right approach for an individual short position disclosure regime.
- Subject to the outcome of the CESR Consultation Process, the FSA continues to believe that 0.5% is the appropriate level at which net short positions in all stocks should be disclosed publicly.
- The FSA continues to believe that a banded approach should operate in conjunction with a minimum threshold. Although it has noted that respondents argued 0.1% is too low to reflect a meaningful change in position and is operationally burdensome, the FSA believes that, from a compliance perspective, it is important to have cross-border consistency when it comes to the disclosure obligations arising from a change of position and will follow the outcome of the CESR Consultation Process (which recommended 0.1%) closely in this regard.
- The FSA believes that there should be an absolute exemption from disclosure obligations for market makers.
- The FSA does not propose to depart from the current 0.25% net short disclosure threshold for companies undertaking a rights issue, but it does believe that, depending on the outcome of the CESR Consultation Process, there may be scope for re-considering whether a separate lower threshold for companies engaged in rights issues is necessary.

<sup>7</sup> Which published a Final Report (Principles for the Effective Regulation of Short Selling) in June 2009 outlining four principles for regulating short selling.

<sup>8</sup> Which published a Consultation Paper on a Proposal for a Pan-European Short Selling Disclosure Regime in July 2009 (CESR/09-581). A Final Report is expected from CESR before the end of 2009 (CESR Consultation closed on 30 September 2009).

<sup>9</sup> Markets in Financial Instruments Directive, The European Parliament and Council Directive on markets in financial instruments (No. 2004/39/EC)

- The FSA intends to keep ongoing disclosure obligations the same for rights issue situations as for the general regime—namely, disclosure should take place as subsequent of bands 0.1% above the initial disclosure are reached.
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*We hope that you have found this 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

**Charlotte Lindsten**

+44 (0)20 7786 6121

Charlotte.Lindsten@aporter.com