

## **FSA Proposes Extension of UK Major Shareholder Notification Requirements to Equity Contracts for Differences (Including Equity Swaps and Other Equity Derivatives)**

**July 8, 2008**

### **What This Means**

In the light of responses to its 2007 consultation paper on the disclosure of Contracts for Differences (CP07/20), the United Kingdom's Financial Services Authority (FSA) has decided to implement a general disclosure regime for long equity Contract for Differences (CFD) positions, which will include long equity swap positions and other equity derivatives (FSA Policy Update 2 July 2008). The proposed rules contemplate that reporting will be required regardless of whether the holder has control over voting of the underlying shares or the right to receive or elect to receive physical settlement.

As a result, the proposed rules should significantly increase the circumstances in which reporting by an investor or derivatives counterparty is required. This FSA policy update announcement comes shortly after the recent introduction of new provisions in the FSA Code of Market Conduct, which have been effective since June 20, 2008, and which require the disclosure of short positions of 0.25% or more in stocks of companies that are undertaking rights issues. It also follows on the heels of a closely watched litigation in the United States involving two activist hedge funds (The Children's Investment Fund and 3G Fund) and CSX Corporation, in which a federal judge found that the hedge fund defendants had violated Section 13(d) of the U.S. Securities Exchange Act of 1934 by using total return swaps with the purpose and intent of preventing the vesting of beneficial ownership in the hedge funds as part of a plan or scheme to evade the reporting requirements of Section 13(d). See *CSX Corporation v. The Children's Investment Fund (UK) LLP, et al.*, Case No. 08 Civ. 2764 (S.D.N.Y. June 11, 2008).

### **Discussion and Analysis**

#### ***Current FSA Disclosure Requirements: Acquisition and Disposal of Voting Rights***

- Under current FSA Handbook Disclosure and Transparency Rules (DTR), which apply to equities admitted to trading on a U.K.-regulated market, disclosure is required of the acquisition or disposal of voting rights attached to shares that exceed 3% (and every 1% after that) of issued share capital, or disposals falling below those thresholds. The DTR major shareholder notification regime concerns voting rights only and not any wider economic interest in shares.
- There is an exemption for market makers and a higher disclosure threshold for fund managers (5% and 10%, respectively). In addition, under current UK Takeover Panel rules, during an offer period, a person holding 1% or more of any class of relevant shares of either the offeror or the offeree must disclose any transactions in shares or financial instruments (including CFDs and other equity derivatives) relating to those companies.

### **Proposed Expansion of Disclosure Regime to Economic Interests**

- The FSA now intends to introduce a comprehensive regime, similar to the major shareholder notification regime, which would require disclosure by all holders of substantial “economic interests in shares” as is required by the Takeover Panel in relation to shares subject to a takeover offer. The regime will require the disclosure of all economic interests above a 3% threshold held through CFDs and other equity derivatives, regardless of the holder’s control over the voting rights attached to the referenced shares. The 3% threshold will apply to the aggregate long position in CFDs and swaps referencing shares and to other equity derivatives. Holders will be required to aggregate direct holdings in shares with those held indirectly through CFDs and other equity derivatives in calculating whether they have exceeded the 3% threshold.
- The FSA will also introduce an exemption from these disclosure requirements where CFD writers are effectively simply acting as intermediaries and providing liquidity. The exemption for CFD writers is expected to have similar effect to the Takeover Panel’s Recognised Intermediary exemption.

### **Final Rules Due in Early 2009**

- The FSA indicated that it plans to publish a Policy Statement in September 2008, with a Feedback Statement on the consultation responses, along with draft rules to implement the position described above. While the Policy position has now been finalized, the FSA will accept technical comments on the rules over the consultation period, to ensure it has the most effective, workable rules.
- The FSA indicated that it will publish final rules in February 2009. Stakeholders will then have up to a further six months to implement the necessary process and systems changes to come into compliance with the rules, with the new rules coming into force at the latest in September 2009. The FSA may, however, seek to bring the implementation date forward if it considers that stakeholders are able to comply with the proposed rules at an earlier date. The FSA will confirm the final date in their Policy Statement, expected to be published in September 2008.

If you have any questions concerning these important legal developments, please contact one of the following Morgan Lewis attorneys:

#### **London**

Robert Falkner +44 (0)20.3201.5537 [rfalkner@morganlewis.com](mailto:rfalkner@morganlewis.com)

#### **New York**

Georgia Bullitt 212.309.6683 [gbullitt@morganlewis.com](mailto:gbullitt@morganlewis.com)  
Robert C. Mendelson 212.309.6683 [rmendelson@morganlewis.com](mailto:rmendelson@morganlewis.com)

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