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FSA Q&As on Disclosure of Contracts for Differences and Similar Instruments

July 1, 2009

The new rules of the Financial Services Authority ("FSA") for enhanced disclosure requirements in respect of interests in shares held through derivatives such as contracts for differences ("CFDs") came into force on 1 June 2009, with transitional provisions applying until 31 December 2009. The rules, effected by way of amendments to Chapter 5 of the Disclosure and Transparency Rules, implement a general disclosure regime requiring aggregated disclosure of all economic interests in 3 per cent or more of an issuer's shares, including interests held through CFDs and other derivatives. An exemption applies to CFD writers acting only as intermediaries.

The FSA has published a helpful set of Q&As summarising key aspects of the new regime to assist market participants with application and compliance.

Key points to note regarding the new regime include the following:

- the new regime applies to UK-incorporated issuers with shares admitted to trading on a regulated market (and whose Home Member State is the UK) or on a prescribed market (*i.e.*, the regime extends to issuers whose shares are admitted to trading on AIM). The new regime does not extend to non-UK issuers;
- there is no list of financial products that fall within the scope of the new rules. The rules are drafted using a principles-based approach, intended to ensure that all financial products referenced to the shares of an issuer and capable of having a similar economic effect to qualifying financial instruments¹ are caught;
- the FSA does not expect a holding acquired during a day and disposed of prior to the end of the same day to be disclosed (as is already the case for qualifying instruments);

¹ Transferable securities (*i.e.*, securities which are negotiable on a capital market, such as shares, bonds, depositary receipts) and options, futures, swaps, forward rate agreements and any other derivative contracts are qualifying financial instruments, provided that they result in an entitlement to acquire, on the holder's own initiative alone, under a formal agreement, issued shares (to which voting rights are attached) of an issuer whose shares are admitted to trading on a regulated market or UK prescribed market.

- all financial instruments giving access to voting rights or that are referenced to an issuer's shares and, in effect, give a long position in the economic performance of the shares, must be aggregated across the categories of instruments held. Holders must also provide a detailed breakdown of the composition of their holding;
- all long positions must be disclosed on a gross basis, irrespective of any offsetting short position; and
- the scope of disclosure is extended to require disclosure of any financial instruments having similar economic effect to qualifying instruments. All such types of shares in, and instruments relating to, the same issuer must be aggregated to determine if a disclosure threshold has been crossed and a notification requirement triggered. The FSA confirmed that if, on 1 June 2009, a person held any financial instruments which, when aggregated with their holdings in shares and/or qualifying financial instruments, would lead them to reach or exceed a disclosure threshold, they would need to disclose their aggregated position, even in the absence of any new dealing after the rules came into force. A person would be considered to have reached or crossed a relevant threshold on 1 June 2009, regardless of when the instruments were acquired.

In its second version of the Q&As, the FSA addresses two new questions on the application of the new rules in the context of transactions such as rights issues.

Underwriting Obligations

There have been concerns that underwriting commitments would trigger disclosure obligations under DTR 5, which requires disclosure of an instrument granting a right to acquire shares which have not yet been issued. However, the FSA has helpfully confirmed that a conventional underwriting agreement and related sub-underwriting arrangements in relation to a primary market rights issue would be unlikely to constitute a "financial instrument" as defined in MiFID². Consequently, any long position in the economic performance of shares held by a lead underwriter or sub-underwriter by virtue of its underwriting or sub-underwriting obligations would not trigger disclosure obligations under DTR 5.

² Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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Rights Issued to Shareholders under a Rights Issue

The FSA considers that a right issued to a shareholder in connection with a rights issue constitutes a financial instrument having similar economic effect to a qualifying instrument and, therefore, falls within the scope of DTR 5. However, it acknowledges that a shareholder who passively receives rights solely as a consequence of being an existing shareholder will be maintaining its proportionate holding in the issuer and will not be changing its long position in the economic performance of the issuer's shares. Consequently, it does not expect shareholders granted rights under a right issue to include those rights in the calculation of their position for disclosure purposes.

A shareholder who actively acquires or disposes of rights during a rights issue with the effect that its proportionate holding following the issue of new shares will change relative to its holding before the issue, must, however, include all rights, whether acquired actively or passively, in their calculation of its position for the purposes of DTR 5. When calculating a change in position resulting from an active acquisition or disposal of rights, the most recent denominator published by the issuer pursuant to DTR 5.6 should be used.

The same analysis would apply to a pro-rata entitlement to acquire shares under an open offer, with the effect that a shareholder who maintains its proportionate holding would not need to disclose its entitlement.

The FSA will be consulting on a specific exemption to be included in DTR 5.

The FSA's Q&As on Disclosure of Contracts for Differences: Version 2 are available at <http://www.fsa.gov.uk/pubs/ukla/disclosure.pdf>

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