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News Bulletin

February 13, 2009

# UK's FSA Proposes a 'Permanent' Extension of the Disclosure Rules for all Short-Sellers

On 6th February 2009, the UK's Financial Services Authority (FSA) published a discussion paper inviting market participants to contribute to the development of a long-term short-selling regime in the UK.[1]

As we reported in our previous client alerts, in response to the global banking crisis and exceptional price volatility in UK bank shares, FSA has introduced, over the past eight months, two parallel sets of emergency rules to restrict short-selling in UK-listed companies:

1. On 13th June 2008, FSA introduced new rules requiring disclosures of short positions in UK-listed companies (financial sector or otherwise) undertaking rights issues where they reach or exceed 0.25% of the issued share capital of the relevant company;[2] and

2. On 18th September 2008, FSA introduced further rules relating to UK-listed financial sector companies, consisting of (i) a temporary ban on any short-selling of such stocks and (ii) obligations to disclose short positions reaching or exceeding 0.25% of the issued share capital of the relevant company as well as subsequent changes to such position.[3]

The latter rules (applicable to financial sector companies only) were modified in October 2008 and January 2009, such that the ban no longer applies after 16th January 2009, but until 30th June 2009, a disclosure obligation is triggered where the short position crosses a threshold (either by an increase or decrease in the size of the position) of 0.25% and increments of 0.1% above that.[4]

FSA has repeatedly stated that it may re-introduce the temporary ban against short-selling in the future if warranted by market conditions.[5]

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[1]. FSA DP 09/1: Short selling (6th February 2009), http://www.fsa.gov.uk/pubs/discussion/dp09_01.pdf.

[2]. *See* Morrison & Foerster News Bulletin entitled "Heightened Derivatives and Trading Disclosure for UK Equity Markets" (9th July 2008), http://www.mofo.com/news/updates/files/080709Heightened.pdf.

[3]. *See* Morrison & Foerster News Bulletin entitled "UK's New Short-Selling Prohibition" (19th September 2008).

[4]. *See* Morrison & Foerster News Bulletins entitled "Update on UK's Short-Selling Measures: FSA Proposes to End the Ban but to Extend the Disclosure Regime" (7th January 2009), http://www.mofo.com/news/updates/files/090107UKShortSelling.pdf and "Update Regarding UK's Short-Selling Prohibition" (1st October 2008), http://www.mofo.com/news/updates/files/081001UKUpdate.pdf.

[5]. *See* FSA DP 09/1: Short selling (6th February 2009), http://www.fsa.gov.uk/pubs/discussion/dp09_01.pdf; FSA CP09/01: Temporary short selling measures (5th January 2009), http://www.fsa.gov.uk/pubs/cp/cp09_01.pdf; and FSA Newsletter entitled "Temporary Short Selling Measures" (January 2009), http://www.fsa.gov.uk/pubs/cp/cp09_01_newsletter.pdf, which provides a summary of FSA CP09/1.



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In view of the controversy surrounding short-selling activities and FSA's emergency rules, FSA had promised to conduct a comprehensive review of these rules in January 2009.

In the recent Discussion Paper, FSA proposes to extend (with some amendments) the disclosure regime on a long-term basis to cover significant short positions in all publicly-quoted UK companies (financial sector or otherwise). The threshold for disclosure is proposed to be 0.5% of the relevant company's issued share capital with further disclosures being required at increments of 0.1%. Where the relevant company is undertaking a rights offering (and thus more vulnerable to potential market abuse), however, a lower threshold of 0.25%, and increments of 0.1% above that, would apply.

In the opinion of FSA, the advantages of short-selling (such as price efficiency and liquidity) tend to outweigh the potential risks (such as market abuse and disorderly markets), and therefore FSA does not propose any direct restrictions on short-selling which could result in reduced market efficiency.

In the Discussion Paper, FSA explains that as an alternative to the extension of the disclosure regime, it has considered, but rejected, the following regulatory options:

- Direct prohibitions on short-selling, whether targeted against all short-selling or limited to naked (as opposed to covered) short-selling, short-selling of financial sector stocks or during rights issues and the like;
- "Circuit breakers," whereby trading is suspended whenever there is an abnormal rise or fall in the share price (*e.g.*, more than 10% on a day); and
- "Tick" rules, whereby shares can only be shorted if the share price is rising.[6]

Based on its experience with the emergency measures, FSA admits that a "major side effect" of its temporary ban was reduced liquidity and a loss of profits for investment firms due to reduced trading volume. Therefore, it considers that direct prohibitions would not be a proportionate response to the problems.

"Circuit breakers" were rejected as the London Stock Exchange currently operates automatic execution suspension periods (AESPs), which provide a pause in trading (lasting five minutes and a random 0-30 seconds) when a transaction would otherwise be executed at a price exceeding a pre-set threshold.

"Tick" rules would be too costly to implement as its effectiveness depends on the market participants, exchanges, and clearing and settlement houses operating a consistent marking (or flagging) regime across the board and would involve requiring brokers to mark all share trades as a short or long sale and to aggregate them.

On the other hand, FSA believes that "enhanced transparency" would assist in improving the information available to the market and in curbing abusive short-selling practices. Hence its latest proposal to extend the disclosure obligations.

Market participants are invited to provide their comments on the FSA's proposal by 8th May 2009. Thereafter, FSA will publish a feedback statement setting out its conclusions on a longer term short-selling policy. This timing is designed to allow FSA time to bring in the new regulatory regime before the current disclosure rules relating to UK financial sector companies expire on 30th June 2009.

In many other jurisdictions the national regulators have similarly put in place a variety of rules to regulate short-selling. The different approaches adopted have highlighted the desirability of international convergence and regulatory coordination on the matter.

[6]. An "up-tick" (or "plus-tick") rule requires the last sale to have been at a higher price than the preceding sale before shorting is permitted. By comparison, a "zero-plus-tick" rule also permits shorting if the last sale price is unchanged but higher than the preceding sale.

In response, the International Organisation of Securities Commissions (IOSCO) Technical Committee launched a Task Force on Short Selling on 25 November 2008, to coordinate and harmonise the various regulatory approaches to 'naked' (or 'abusive') short-selling.[7] The Committee of European Securities Regulators (CESR) similarly launched its own task force on short-selling and on 19th December 2008, issued a call for evidence[8] on the regulation of short-selling by its members. CESR published the responses to its call for evidence on 27th January 2009.[9]

Accordingly, FSA will also use the feedback to its Discussion Paper partly "to inform the international debate," as it considers it important to "align [its] proposals with those being developed on an international basis," and has refrained from making any definitive policy proposals whilst international initiatives are still pending.[10]

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[7]. *See* IOSCO media release: "IOSCO Technical Committee launches Task Forces to support G-20 aims" (25th November 2008), http://www.iosco.org/news/pdf/IOSCONEWS134.pdf.

[8]. CESR's Call for evidence: Regulation on short-selling by CESR Members (19th December 2008), http://www.cesr-eu.org/popup2.php?id=5437.

[9]. http://www.cesr-eu.org/index.php?page=responses&id=129

[10]. FSA press release (FSA/PN/023/2009) entitled "FSA proposes enhanced transparency requirements on short selling for all stocks" (6th February 2009), http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/023.shtml.