

INVESTMENT FUNDS ALERT



UK FINANCIAL STOCK SHORT SELLING REGIME – FSA RELEASES REVISED INSTRUMENT AND FAQs

SUMMARY

The United Kingdom Financial Services Authority (FSA) has released on 23 September 2008, a new Short Selling (No 3) Instrument 2008 and revised FAQs. The Instrument makes a few minor changes to the provisions as previously published. The revised FAQs include some new questions and answers and revise certain of the answers previously given.

KEY POINTS FROM THE REVISED FAQs

The revised FAQs clarify that the prohibition on short sales and the disclosure requirements apply to both covered and uncovered/naked short positions.

The prohibition and disclosure requirements do not apply to—

- the issuance of convertible bonds
- credit default swaps (CDSs)
- stock lending activities.

Hedging

It is acceptable to short/hedge a long position, if this does not create a new or increased net short position. Although the disclosure requirements only relate to the net short position (in excess of 0.25 percent) at the close of the day, the FSA have reiterated that a person must not increase their net short position intra-day.

Market Makers

Market makers are exempt from the new short selling measures. Note that a market maker is an entity that, ordinarily as part of their business, deals as principal in equities, options or derivatives (whether OTC or exchange-traded) (a) to fulfill orders received from clients in response to a client's request to trade or to hedge positions arising out of those dealings or (b) in a way that ordinarily has the effect of providing liquidity on a regular basis to the market on both bid and offer sides of the market in comparable size

Fund Managers

The short selling measures apply, on the one hand, to fund managers that manage funds on a discretionary basis and, on the other, to the client where they manage funds on a non-discretionary basis.

Where a fund manager manages funds on a discretionary basis, the disclosure obligation applies at the level of both the legal entity housing the individual fund and the fund manager. The fund manager is required to disclose its aggregate short position across all of the funds that it manages on a discretionary basis. Similarly, if trading desks within a firm are housed within the same legal entity, the aggregate position of the legal entity across all desks would be subject to the short selling measures.

Indexes

The FSA has stated that any economic interest held as part of an index, basket or exchange-traded fund (ETF), where the "predominance of the components" of that index, basket or ETF are UK financial sector companies, would be included in the aggregation of a person's economic interest in such company. Where an index, basket or ETF is exempt from the prohibition, but does contain one or more UK financial sector companies in it, it is not necessary to take into account any such holding when determining a disclosure obligation.

A short of an index, basket or ETF that does not contain a predominance of UK financial sector companies within it is permitted, but the FSA have warned that to short such an index, basket or ETF but to offset positions within that index, basket or ETF, leaving only one or more UK financial sector companies, would be considered a prohibited short position.

Delta Adjusted Basis

The revised FAQs state that, when calculating a net short position, financial instruments should be accounted for on a delta adjusted basis. Any derivative trades that are either delta neutral or delta positive at the time the orders are entered into are permitted. However, note that a net short position may arise or increase due to a change in delta as a result of changing market conditions. Such a change would not be caught by the prohibition, but may require disclosure.

LINKS

The new Instrument can be found here:

http://www.fsa.gov.uk/pubs/other/short_selling_instrument.pdf

The revised FAQs can be found here:

http://www.fsa.gov.uk/pubs/other/short_selling_faqs2.pdf

CONTACT INFORMATION

For specific advice in relation to your own disclosure obligations under this new regime or if you otherwise have questions regarding this alert, please contact:

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