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UK Rules for Disclosure of Derivatives

Posted by Adam O. Emmerich, Wachtell Lipton Rosen & Katz, on Saturday March 28, 2009 at 1:27 pm

(Editor's Note: This post is based on a client memo by Theodore N. Mirvis, Adam O. Emmerich, William Savitt, David E. Shapiro, and Adam M. Gogolak of Wachtell, Lipton, Rosen & Katz.)

Forthrightly addressing the continued proliferation of swaps, options and other equity derivatives, the UK's Financial Services Authority ("FSA") has now adopted final rules requiring the disclosure under the UK's Disclosure and Transparency Rules of swaps, options and other derivative contracts, including those providing for cash settlement. *See* Policy Statement 09/3. The new rules require disclosure of aggregate equity positions (including derivatives) beginning at the 3% level (with an exemption for the writers of equity derivatives acting as intermediaries).

The FSA noted two important changes from its prior thinking in adopting the final rules.

First, while the FSA's prior intention was to make the new rules effective in September 2009, it determined, "in light of the changes in market conditions since last summer and the need for increased transparency driven by these changes," to accelerate the effectiveness of the new rules to June 1, 2009.

Second, the FSA decided that disclosures should be made on a delta-adjusted (rather than nominal) basis, which the FSA believes is a more accurate reflection of the actual extent of economic interest held at any one time. As a transition matter, the FSA will allow reporting on either a nominal or a delta-adjusted basis for a period of seven months following effectiveness of the new rules, provided that firms choosing to report on a nominal basis during the transition period will be required to provide sufficient information – including the strike or exercise price of each financial instrument reported and the total number of voting rights relating to shares referenced by each financial instrument reported – to allow market participants to calculate the underlying adjusted economic interest.

The FSA's decisive action to require disclosure of accumulations of significant stakes in publicly traded companies through derivative instruments – and its corresponding approach toward disclosure of short positions (*see* Discussion Paper 09/1) – only further highlights the inadequacy of the current U.S. disclosure and regulatory regime. While there has been piecemeal reform and adjustment in the U.S. – through judicial decisions such as that in CSX, through private and contractual ordering in by-laws, rights plans and other contracts, and through a variety of other mechanisms – the need for comprehensive reform and market transparency has not been met. There continues to be an overwhelming global consensus towards full and fair disclosure of equity derivatives and other synthetic and non-standard ownership and control techniques. We remain strongly of the view that U.S. regulation should be comprehensively reformed to address

derivative arrangements in a clear and uniform manner, generally treating all such arrangements that are coupled with direct or indirect ownership of actual shares by counterparties as in all respects equivalent to actual ownership, and requiring appropriate disclosure of all such arrangements involving more than 5% economic equivalent ownership, whether long or short, and whether accompanied by underlying ownership positions or otherwise.