Financial Services Authority

Policy Update on Disclosure of Contracts for Difference (CfDs)

Our consultation on the disclosure of Contracts for Difference (CP07/20) closed on 12th February. The CP set out the evidence to support our conclusion that enhanced disclosure is needed to address some market failures around access to voting rights, and proposed changes to our regime designed to deliver that. We have received a large number of responses from a broad spectrum of interested parties - including banks, investors, industry and other representative bodies, listed companies and law firms - for which we are extremely grateful. We plan to publish our detailed Feedback Statement (FS) in September, along with draft rules. Because of the importance of the issue, and the significant market interest in it, we are setting out in this note our planned policy direction ahead of that Feedback statement.

The consultation paper contained two different options for increased disclosure, having rejected the do nothing option (Option 1). The first was a targeted disclosure regime, with a safe harbour from disclosure for CfDs meeting certain criteria, and issuer powers to request disclosure of certain interests (This was labelled Option 2 in the CP), and the second was a general disclosure regime requiring disclosure of all CfDs over 5% (Option 3). The responses to the CP revealed many different opinions, both on the market failures identified, and the appropriate policy response. There is no clear market consensus. However, overall there was little support for Option 2.

Our focus in the CP was on access to voting rights, and corporate control and influence. Some respondents urged us to require further disclosure on the basis that general transparency of CfD positions, irrespective of any link to voting rights, would bring its own benefits. However we do not share this view. We have no compelling evidence of market failure in respect of inefficient price formation caused by a lack of transparency. We also note that there is evidence that excessive disclosure can cause market inefficiencies.

In the light of the CP responses, we have decided that Option 2 is not the most appropriate means of achieving the objective of addressing the identified market failures in relation to voting rights. There was little support for Option 2, with many respondents questioning whether it would be enforceable. As a result of this feedback we do not believe that Option 2 would be as effective as the CP suggested in bringing about the behavioural changes needed to deliver the expected benefits. If this option will not deliver the intended benefits, then the cost-benefit case supporting it is no longer valid.

We have concluded that our objective of addressing the market failures the CP identified in relation to voting rights and corporate control can best be addressed through a general disclosure regime. Therefore we have decided to implement a general disclosure regime of long CfD positions, based on Option 3 in the consultation paper, but with two significant modifications:

- firstly in relation to aggregation and disclosure thresholds; and
- secondly in relation to an exemption for CfD intermediaries.

We originally proposed that there should be no aggregation of CfD holdings with share holdings, with CfD holdings becoming disclosable at a threshold of 5%. This was on the basis that the risks of non-disclosure were not the same for CfDs as for shares, and therefore there was a less strong argument for super-equivalence to the Transparency Directive.

There was significant support from respondents for aggregation, principally because otherwise it would allow a potential interest of nearly 8% to be built up without disclosure (i.e. up to 3% in shares and 5% in CfDs). The lack of aggregation would also lead to a parallel disclosure regime, which some respondents thought would be more costly. We propose moving to aggregation, and - once the view is taken that CfDs should be aggregated with shares - it is both logical and pragmatic to maintain the initial disclosure threshold at the existing DTR level of 3%.

Some respondents pointed out that the rules, as drafted, would require disclosures where CfD writers were effectively simply acting as intermediaries and providing liquidity, which would not provide useful information to the market about corporate control (e.g. where a CfD writer writes a short CfD for a client, it effectively takes a long CfD position itself.) An exemption for CfD writers, similar to the Takeover Panel's Recognised Intermediary (RI) exemption, would reduce unnecessary disclosures, and significantly reduce the cost of implementing this Option, both in terms of the number of disclosures required and the cost of implementing the systems. Therefore we are developing an exemption which will have similar effect to the Takeover Panel RI exemption.

We plan to publish a Policy Statement in September, with a Feedback Statement on the consultation responses, along with draft rules to implement the position described above. Whilst the Policy position has now been finalised, we will accept technical comments on the rules over the consultation period, to ensure we have the most effective, workable rules. We will then publish final rules in February 2009.

Stakeholders will then have up to a further six months to implement the necessary process and systems changes, with the new rules coming into force at the latest in September 2009. However, given the importance of these rules, subject to discussions with stakeholders, if they are able to comply at an earlier date, we will seek to bring the implementation date forward. We will confirm the final date in our September Policy Statement.