

THE TAKEOVER PANEL

DERIVATIVES

In March 1995, following an appeal to the Panel during the Trafalgar House offer for Northern Electric, the Panel asked the Executive to review the use of derivative products in takeover situations. Having completed this exercise, the Executive reported back to the Panel which agreed that public disclosure should be required in respect of derivative transactions by the parties to an offer, their associates and large shareholders. For many years the Code has required details of holdings and dealings in relevant securities to be made public during offer periods. The Panel decided that this disclosure regime should be extended to cover derivatives.

Both during and after its own review the Executive has participated in discussions with other regulators about the regulation of derivative transactions. The Securities and Investments Board has today published a consultative paper on this subject and the Panel considers that this is the right moment to implement its new requirements in relation to derivatives.

In the course of the above review the Executive and the Panel considered whether a distinction should be drawn between securities held by market-makers as a hedge in respect of derivatives and securities held by them in connection with other business. It was concluded that such a distinction should not be drawn. The Executive is, however, in the process of reviewing the various Code rules which apply to market-makers generally, in the light of developments in market practice and the proposed changes in market structure. This may result in further amendments to the Code in due course.

The amendments to the Code which are set out in the appendix to this statement will come into effect immediately. Amended pages of the Code will be issued shortly.

13 June 1996

APPENDIX

DERIVATIVES - CODE AMENDMENTS

A DEFINITIONS

- (i) Insert new definition of derivative as follows:

“Derivative

Derivative includes any financial product whose value in whole or in part is determined directly or indirectly by reference to the price of an underlying security but which does not include the possibility of delivery of such underlying securities.”

- (ii) Insert new note as follows:

"NOTE ON DEFINITION OF DERIVATIVE

The term "derivative " is intentionally widely defined to encompass all types of derivative transactions. However, it is not the intention of the Code to restrict dealings in, or require disclosure of, derivatives which have no connection with an offer or anticipated offer. Offerors, offeree companies and their financial advisers should consult with the Panel at the earliest stage in order to determine whether a dealing in a derivative is to be regarded as having a connection with the offer or potential offer. "

- (iii) Changes to "Associate":

The first two lines of paragraph (6) will be replaced with the following: "a person who owns or controls 5% or more of any class of relevant securities (as defined in paragraphs (a) to (d) in Note 2 on Rule 8) issued by an offeror or an offeree company, ...".

In existing line 7 of paragraph (6) delete "Relevant" and replace with "Such".

B RULE 2.5(i) Rule 2.5(b)

Amend Rule 2.5(b) by inserting immediately after paragraph (iii) the following paragraph:

"(iv) details of any outstanding derivative referenced to securities in the offeree company entered into by the offeror or any person acting in concert with it (see Note 2);"

and by renumbering paragraphs (iv) and (v) as paragraphs (v) and (vi) respectively.

(ii) Note 2 on Rule 2.5

Amend Note 2 on Rule 2.5 by deleting the words "*offeree company shares held by*" currently in the third line and inserting in their place the following:

"any holdings of offeree company shares or options in respect of them held by or derivatives referenced to them entered into by".

C RULE 4(i) Rule 4.1(a)

Amend Rule 4.1(a) by deleting the words "(including option business)" in the first line and inserting after "offeree company" in the second line the following:

"(including options and derivatives in respect of or referenced to such securities)".

(ii) Notes on Rules 4.1 and 4.2

(a) Note 4

Amend Note 4 by inserting the following immediately after "securities" in line 4:

"(including options and derivatives in respect of or referenced to such securities)".

(b) Note 5

Amend Note 5 by inserting the following immediately after "securities" in line 2:

"(including options and derivatives in respect of or referenced to such securities)".

D **RULE 7.3**

(i) Rule 7.3

Amend Rule 7.3 by inserting after "offeror" in the third line the following:

"(which would include entering into options in respect of or derivatives referenced to securities of the offeror)".

(ii) Note on Rule 7.3

Amend Note on Rule 7.3 by deleting the words "*purchase of offeror securities*" in the first line and by inserting in their place the following:

"dealing of the kind".

E RULE 8**(i) Note 2 on Rule 8**

- (a) Amend Note 2 on Rule 8 by inserting immediately after paragraph (d) the following paragraph:

"(e) options in respect of any of the foregoing and derivatives referenced to any of the foregoing."

- (b) Amend the second paragraph of Note 2 by deleting the words *"In addition"* in the first line and replacing the words after *"in respect of any of the foregoing"* in the second line with the following:

"or the exercise or conversion of any security under (d) above whether in respect of new or existing securities and the acquisition of, entering into, closing out, exercise (by either party) of any rights under, or variation of, a derivative will be regarded as a dealing in relevant securities (see also Notes 5 and 7 below)."

(ii) Note 5(a) on Rule 8

Amend Note 5(a) on Rule 8 by inserting a new penultimate paragraph as follows:

"In the case of option business or dealings in derivatives full details should be given so that the nature of the dealings can be fully understood. For options this should include the number of securities under option, the exercise period (or in the case of exercise, the exercise date), the exercise price and any option money paid or received. For derivatives this should include, at least, the number of reference securities to which they relate (if relevant), the maturity date (or if applicable the closing out date) and the reference price."

(iii) Note 5(b) on Rule 8

- (a) Amend Note 5(b) on Rule 8 by inserting at the end of the second paragraph the following new sentence:

"In (the case of dealings in options or derivatives the same information as specified in Note 5 (a) is required "

(iv) Note 7 on Rule 8

- (a) Amend Note 7 on Rule 8 by inserting the words *"and derivatives"* in the heading.

- (b) Delete the existing note and insert the following:

"Under Rule 8.3, a disclosure of dealings in options or derivatives is only required if the person dealing in such options or derivatives owns or controls 1% or more of the class of securities which is the subject of the option or to whose price the derivative is referenced".

F RULE 24.3

(i) Note 1 on Rule 24.3

- (a) Amend Note 1 on Rule 24.3 by deleting the word *"and"* at the end of the first line of paragraph (a)(ii), inserting a comma in its place and by inserting after the words *"in respect of(i)"* in the second line of that same paragraph the following:

"and derivatives referenced to (i)".

- (b) Further, paragraph (b)(iii) is amended by deleting the word *"and"* in the second line and inserting a comma in its place and by inserting at the end of that same paragraph the following:

"and derivatives referenced to (i) or (ii)".

(ii) Note 2 on Rule 24.3

- (a) Amend Note 2 on Rule 24.3 by inserting the words "*and derivatives*" in the heading.
- (b) Amend Note 2 on Rule 24.3 by inserting after the comma in the first line and after the second comma in the third line the following:

"the number of securities under option."

- (c) Amend Note 2 on Rule 24.3 by inserting as a new second paragraph the following:

"Where holdings of derivatives are disclosed, the number of reference securities to which they relate (if relevant), the maturity date and the reference price must be given. Where dealings involving derivatives are disclosed, the number of reference securities to which they relate, the date of entering into or closing out of the derivative, the maturity date and the reference price must be stated. In each case full details should be given so that the nature of the holding or dealing can be fully understood."

G RULE 26

Amend Rule 26 by inserting a new paragraph (1) as follows:

"(1) all derivative contracts which in whole or in part have been disclosed under Rules 24.3(a) and (c) and 25.3(a) and (c) or in accordance with Rule 8.1. Documents in respect of the last mentioned must be made available for inspection from the time the offer document or the offeree board circular is published or from the time of disclosure, whichever is the later."

H RULE 38**(i) Rule 38.2**

Amend Rule 38.2 by inserting after "relevant securities" in the third line the following:

"(as defined in Rule 8)".

(ii) Rule 38.5

Amend Rule 38.5 by inserting at the end the following sentence:

"In the case of dealings in options or derivatives, full details should be given so that the nature of the dealings can be fully understood (see Note 5 on Rule 8)."

I DISCLOSURE FORM

Amend Disclosure Form 8.1/8.3 by inserting as a new Note 5 the following:

"Note 5. It may be necessary, particularly when disclosing derivative transactions, to append a sheet to this disclosure form so that all relevant information can be given."