

Linklaters

New UK reporting and disclosure obligations
under the FSA's Transparency Rules

November 2006

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This report does not purport to contain a comprehensive summary of the Transparency Directive, the FSA's "near-final" Transparency Rules or the Companies Act 2006, but merely to highlight issues of particular interest. This report is intended to give general information only and should not be relied on as legal advice.

Please refer to www.linklaters.com/regulation for important information on the regulatory position of the firm.

Executive summary

Financial reporting

- New FSA rules implementing the EU Transparency Directive will define periodic financial reporting requirements for companies admitted to trading on a regulated market (eg the London Stock Exchange's Main Market) if the UK is the company's "home state".
- The rules take effect for financial years commencing on or after 20 January 2007.
- The annual report content requirements are in line with existing UK statutory requirements, but the time for publication is reduced from six to four months, and there is a new requirement for a responsibility statement by directors.
- Half-yearly report requirements have been revised and, as for the annual report, there is a new requirement for a responsibility statement by directors.
- A new twice-yearly "interim management statement" is required in the middle of each half year.
- There is a new statutory compensation regime to protect investors who suffer loss due to errors or omissions in a company's financial reports.

This document explains new rules on periodic financial reporting, disclosure of major shareholdings and communications with investors

Disclosure of major shareholdings

- The Companies Act 1985 disclosure regime (Sections 198-211) is replaced by new FSA rules which "copy out" the Transparency Directive.
- The rules take effect from 20 January 2007, but the first monthly statement of voting share capital is required by 31 December 2006.
- The 3% disclosure threshold is retained, with further disclosures at each incremental 1%.
- The threshold for investment managers and collective investment schemes is reduced from 10% to 5%, with further disclosure at the 10% level (but not at any intermediate stage).
- The disclosure obligation is tied to shareholdings and voting rights, rather than the vague concept of "interest in shares" under existing regime.
- The aggregation of group interests is restricted to the holding company and its subsidiaries.
- The shareholder notification obligation is no longer knowledge-based – the obligation arises when the shareholder knew, or ought to have known, of his notifiable interest.
- The Section 212 company investigation regime (to force disclosure of shareholder information) remains in place.

Other changes

- Electronic communications are facilitated. Subject to shareholder approval, the accounts can be delivered to shareholders through the company's website as a default option.
- Issuers must disseminate "regulated information" (financial reporting disclosures, and information disclosed under Disclosure Rules and Listing Rules) fast and simultaneously throughout the EU – existing methods of disseminating information are adequate for this purpose.

The new regulatory framework

The EU Transparency Directive¹ deals with periodic financial reporting, major shareholding disclosures, and the provision of information to investors. It is the final major measure affecting listed issuers under the EU Financial Services Action Plan. Alongside the IAS Regulation,² the Prospectus Directive³ and the Market Abuse Directive,⁴ it is intended to ensure investor confidence in levels of disclosure by issuers of publicly-traded securities and to enhance the operation of efficient pan-European capital markets.

Implementation of the Directive will be effected by rules (the “**Transparency Rules**”) made by the Financial Services Authority (“**FSA**”) under new powers conferred by the Companies Act 2006.⁵ The Transparency Rules will form part of the FSA’s existing Disclosure Rules – which will be renamed the Disclosure and Transparency Rules (“**DTR**”).⁶ These rules will replace a number of the continuing obligations currently in the Listing Rules.

The new rules will in general take effect **from 20 January 2007** or for financial years beginning after that date. However, in order to achieve a smooth transition to the new shareholding disclosure regime, companies will be required to publish a statement of their total issued share capital **by 31 December 2006**.

The Transparency Rules are currently in “near-final” form.⁷ They are expected to be published in final form in December 2006, following publication of an implementing Directive by the EU Commission and once the provisions of the Companies Act 2006 giving the FSA power to make the rules have been brought into force.

The FSA’s approach (in which it was supported by the responses to its consultation on implementation of the Directive)⁸ is broadly to “copy out” the provisions of the Directive in the rules, so adopting the words of the Directive with minimal amendments. In particular, the FSA has been reluctant to add much guidance to the rules, but informal, non-statutory guidance is expected to be published by the FSA in a forthcoming edition of its newsletter *List!* (due in December 2006).

Concerns about the liability implications of the Transparency Directive under UK law, with respect to periodic reporting by issuers, have been addressed by a

The Transparency Directive seeks to improve the transparency and efficiency of EU securities markets

It is being implemented with effect from 20 January 2007

The FSA is adopting new “Transparency Rules”

¹ Directive 2004/109/EC, also known as the Transparency Obligations Directive.

² Regulation (EC) No. 1606/2002, which has effect for accounting periods commencing on or after 1 January 2005.

³ Directive 2003/71/EC, implemented in the UK on 1 July 2005.

⁴ Directive 2003/6/EC, implemented in the UK on 1 July 2005.

⁵ The Companies Act 2006 amends the Financial Services and Markets Act 2000 (“**FSMA**”) by the insertion of new Sections 89A-M, 90A-B and 100A.

⁶ References in this document to the “Transparency Rules” are to Sections 4, 5 and 6 of the Disclosure and Transparency Rules.

⁷ See FSA Policy Statement 06/11 “Implementation of the Transparency Directive”.

⁸ CP 06/4 published 30 March 2006.

package of measures in the Companies Act 2006, which defines and restricts the responsibility and liability of directors and issuers in respect of financial reports and their accompanying narratives.

This report describes the Transparency Rules and related legislation, and considers some of the practical implications for listed companies and investors.

Concerns about the liability of issuers and directors have been addressed in the Companies Act 2006

Periodic financial reporting

As explained in this section, the Transparency Rules will require listed companies to report formally on their financial position four times a year. They also involve a number of changes to the requirements for annual and half-yearly reports. The continuing obligations regarding production of annual and half-yearly reports under the Listing Rules are largely being replaced by new periodic reporting requirements under the Transparency Rules for financial years commencing on or after 20 January 2007. Some residual requirements of the Listing Rules will continue to apply to issuers with a primary listing in the UK and to issuers of wholesale debt. The liability implications of financial reporting in accordance with the Transparency Rules are addressed in the Companies Act 2006.

Scope

Subject to certain exemptions, the periodic reporting provisions (set out in DTR 4) apply to issuers whose securities are admitted to trading on an EEA-regulated market and whose home state is the UK. This will, broadly, encompass:

- UK-incorporated issuers of shares or debt with a denomination of less than €1,000 ("**low denomination debt**") admitted to trading on a regulated market (eg the London Stock Exchange's Main Market, but not the Alternative Investment Market),
- non-EU issuers of shares or low denomination debt if the UK is their "home state" for the purposes of the Prospectus Directive,
- other issuers, including other debt issuers, where the UK is their "home state" for the purposes of the Transparency Directive.⁹

Content

Annual reports

An issuer subject to DTR 4 is required to publish an annual report as soon as possible and in any event within four months of its year end. The annual report must include consolidated audited accounts, a management report and a responsibility statement.

The **consolidated audited accounts**¹⁰ must be drawn up in accordance with IFRS¹¹ and audited in accordance with international auditing standards. The

The Transparency Rules impose new periodic reporting requirements

These rules apply to issuers with securities admitted to trading if the UK is their "home state"

Annual reports must be published within four months of the year end

⁹ Issuers that only have debt securities with a denomination of €50,000 or more ("**wholesale debt**") admitted to trading on a regulated market, as well as certain institutions such as states or local authorities, are exempt from the periodic reporting requirements of the Transparency Directive. However, the FSA considers it important that listed issuers should continue to publish at least annual reports. Accordingly, listed issuers which are exempt under the Transparency Directive will have to produce annual reports in accordance with their national law requirements and within six months of the year end.

¹⁰ If the issuer is not required to prepare consolidated accounts, it must prepare accounts under national law in the EEA state in which it is incorporated.

¹¹ Non-EEA issuers will be required to prepare their accounts using IFRS or equivalent standards (as declared by the European Commission) for financial years beginning on or after 1 January 2009. Until that time, non-EEA issuers benefit from a derogation. This applies if they use U.S.,

audit report must be published with the annual report. The UK statutory requirements reflecting the EU's accounting directives are reflected in Part 7 of the Companies Act 1985 and will remain in effect until the new provisions in Part 16 of the Companies Act 2006 (which largely restate the existing law) are brought into effect. It is not clear when this will be but it could be as late as financial years commencing on or after 1 October 2008.

The **management report** must, as a minimum, comply with EU narrative reporting requirements,¹² reflected in Section 234ZZB of the Companies Act 1985 (the "business review" in UK parlance). This calls for a fair review of the business of the company/group and a description of the principal risks and uncertainties that it faces. There must also be a balanced and comprehensive analysis of the development and performance of the business during the financial year and its position at the end of that year, consistent with the size and complexity of the business. To the extent necessary for an understanding of the development, performance or position of the business, the analysis should include financial and non-financial key performance indicators, including information relating to environmental and employee matters.

The Transparency Rules prescribe a further list of requirements for the management report such as important post-balance sheet events and information regarding share buy backs. The list reflects existing disclosure requirements for the directors' report contained in Schedule 7 of the Companies Act 1985.

The Companies Act 2006 will in due course also require quoted companies to publish an expanded form of business review, with an additional level of detail on environmental, employee and social and community matters and more information on trends and factors likely to affect the company's business in the future. A controversial last-minute amendment will also require disclosure of essential contractual and other arrangements.

The Transparency Rules copy out the Directive's requirement for a **responsibility statement**, to be included in the annual accounts. This statement must be made by "those responsible within the issuer" who must confirm that, to the best of their knowledge:

- the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and its consolidated undertakings as a whole, and
- the management report gives a fair review of the development and performance of the business, the financial position of the issuer and the risks and uncertainties that it faces.

Canadian or Japanese GAAP or if the notes to the relevant financial statements include an explicit and unreserved statement that the accounts comply with IFRS or if the accounts are prepared under the GAAP of another country where that country has made a public commitment to converge those standards with IFRS with a view to achieving convergence by 31 December 2008.

¹² Directive 2003/51/EC, implemented in the UK by the Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005, in relation to companies' financial years beginning on or after 1 April 2005. These Regulations remain in force to the extent they relate to implementation of the Directive, although the provisions relating to the operating and financial review were repealed in January 2006.

The annual management report corresponds to the business review under Section 234ZZB of the Companies Act 1985

Annual reports will have to include a responsibility statement

It is clear what the responsibility statement has to say. However, it is not at all clear, under the “near-final” rules, who is supposed to give the responsibility statement, nor what the implications are for those who are named as giving it. The FSA’s Policy Statement proposes that the former is entirely a matter for the issuer and it seems likely that most issuers will conclude that it is the board of directors which is responsible for the accounts.¹³ What this means for directors is affected by the new liability provisions in the Companies Act 2006, which are discussed further below.

Additional contents required by the Listing Rules

The FSA’s Listing Rules contain a number of provisions not deriving from EU legislation in relation to information required in the annual report. The FSA consulted on the removal of certain of these “super-equivalent” requirements and the retention of others; however, the consultation feedback persuaded the FSA to retain all of them. For listed issuers (both UK and non-UK), therefore, the Listing Rules will require a number of additional matters to be disclosed in the annual report. These will be familiar to existing listed issuers and include information on directors’ remuneration and shareholding interests, the corporate governance compliance statement and a statement by the directors that the business is a going concern.

Half-yearly reports

Issuers of **shares and debt securities**¹⁴ must publish a half-yearly report as soon as possible and in any event within two months of the period end. This must contain “condensed” financial statements, a management report and a responsibility statement. This replaces the current Listing Rule requirements on half-yearly reports for listed companies.

The **condensed financial statements** must be drawn up in accordance with IAS 34 (the accounting standard that deals with the form and content of half-yearly information). There is no requirement for an auditors’ report or review, but any such report or review must be reproduced in full, or a statement made that the financial statements have not been audited or reviewed.

The interim **management report** must include at least an indication of the important events that have occurred during the first six months of the year, and their impact on the half-year results, together with a description of the principal risks and uncertainties for the remaining six months of the year. Disclosure must also include major related party transactions by an issuer of shares.

As with the annual report, the **responsibility statement** must be made by the persons responsible within the issuer. It must confirm that, to the best of those persons’ knowledge:

¹³ The Policy Statement proposes that the responsibility statement can be “signed” by a single director only, when acting on behalf of other responsible persons, although neither the Directive, nor the Transparency Rules, require a signature, merely an indication as to who the responsible persons are.

¹⁴ “Debt securities” are defined for the purposes of the Transparency Directive as “bonds or other forms of transferable securitised debts, with the exception of securities which are equivalent to shares in companies or which, if converted or if the rights conferred by them are exercised, give rise to a right to acquire shares or securities equivalent to shares”. Convertible debt securities and GDRs fall outside this definition.

Additional contents requirements under the Listing Rules are being retained

Half-yearly reports must be published within two months of the period end

Half-yearly reports must look forward as well as back

- the financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and its consolidated undertakings as a whole, and
- the management report includes a fair review of the matters it is required to cover (see above).

Since “true and fair” arguably has a different meaning when used in the context of a half-yearly report, DTR 4.2.10G(4) helpfully confirms that the requirement to state that the financial statements in the half-yearly report give a true and fair view will be satisfied by a statement that the condensed accounts have been prepared in accordance with IAS 34.¹⁵

The existing Listing Rules requirement (LR 9.9.5) to publish the half-yearly report in a national newspaper, or circulate it to all shareholders, is being deleted.

The requirement to publish a half-yearly report does not apply to issuers who only have wholesale debt securities, convertible debt securities or global depositary receipts (GDRs) admitted to trading.

Interim management statement

Probably the most significant change imposed by the Transparency Rules is a new requirement for issuers with **shares** admitted to a regulated market to publish an interim management statement. This statement must be published not earlier than week 11 nor later than week 20 in each six-month financial period. It must cover the period from the beginning of the relevant six-month period to the date of publication and provide:

- an explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer and its subsidiaries, and
- a general description of the financial position and performance of the issuer and its subsidiaries during the relevant period.

However, there is no requirement to publish an interim management statement on issuers who already publish a quarterly financial report in accordance with national legislation, the rules of a regulated market or on their own initiative.

The interim management statement represents a compromise position – the Transparency Directive in its original draft form would have made quarterly reports mandatory. The UK Government expressed the view that an interim management statement under the Transparency Directive would be only marginally more onerous than current disclosure practices by UK companies:

Half-yearly reports will also have to include a responsibility statement

Interim management statements must give a general description of the issuer's financial position and performance

¹⁵ Or, for UK issuers not required to report using IFRS, in accordance with pronouncements on interim reporting issued by the ASB (ASB Bulletin on Interim Reporting, issued in September 1997) or, for other issuers, in accordance with the issuer's applicable national accounting standards.

“Importantly, the [interim management statement] allows the UK ... largely to continue to rely on its tried-and-tested forms of *ad hoc* disclosure, commonly referred to as trading statements.”¹⁶

Many companies, however, do not currently make regular trading statements, or if they do, they publish a trading update within a few weeks of the financial half-year or year end (ie after week 20) to update the market on their expectations as to performance as the financial period nears completion. The Transparency Rules will bring forward the timing of such interim announcements.

Moreover, where companies issue trading updates, the announcement may be linked to meetings with analysts, and intended to ensure the public has access to the same information as the analysts. The information given may consist of no more than a few key performance indicators, such as relevant commodity prices, numbers of passengers carried (for an airline), or like-for-like retail sales. These statistics may enable analysts to confirm or revise their expectations as to a company's performance, but would not necessarily satisfy the Transparency Rules' requirement to give the public a general description of the **financial position and performance** of the issuer during the relevant period. Compliance with this requirement may involve a fuller description of capital, as well as revenue, items.

The provisions should not be a concern for those companies that already produce quarterly reports (for example, those subject to SEC reporting requirements). Such companies can continue to do so. Other companies will, however, now be required to draw up this new twice-yearly financial report, albeit without necessarily having to publish financial line items. This will be an undoubted increase in their compliance burden.

The FSA has resisted calls to publish formal guidance on the contents of the interim management statement, stating that it would prefer to see market practice develop without a box-ticking approach which might have resulted from formal guidance. However, the FSA proposes to publish a special edition of *List!* in December 2006 to provide informal “negative” guidance about what is **not** required in the interim management statement and will review the situation 18-24 months after implementation of the Directive.

Preliminary statements of annual results

The Listing Rules currently require listed issuers to prepare and publish a preliminary statement of annual results. This requirement is not in the Transparency Directive, and so does not appear in the Transparency Rules. Following its consultation, the FSA has decided to remove the Listing Rules obligation, on the basis that the period of time for the production of the annual report is being reduced from six months to four months by the Transparency Rules. However, the existing content requirements are being retained for issuers who choose to publish a preliminary statement (or who need to do so, on the basis that the results constitute inside information for the purposes of the existing Disclosure Rules (DR2)).

Companies may find that interim management statements will require increased disclosure

Preliminary statements of annual results may not be necessary

¹⁶ Government Response dated 13 January 2004 from the Financial Secretary of the Treasury to the Report of the European Union Committee of the House of Lords (Sub-Committee B) on the Financial Services Action Plan (45th Report, Session 2002-03, HL Paper 192) published in the Committee's Supplementary Report (15th Report, Session 2003-04, HL Paper 89).

Publication requirements

There is no requirement under the Transparency Rules to post annual or half-yearly reports or interim management statements to shareholders.¹⁷ Instead, these must be published by means of an RIS announcement.

As a general matter, the Transparency Rules require all information that has to be announced to be published via an RIS in “full unedited text”. This applies to half-yearly reports and interim management statements. However, an exception is made for the annual report and accounts. For these, as well as announcing the availability of the report on the company’s website, issuers must announce summary information, including the financial items that are required in the half-yearly report.

The annual report and half-yearly report must remain available to the public for at least five years.

Transitional period

Inconveniently, the Transparency Directive’s implementation date of 20 January 2007 does not correspond with corporate financial reporting periods. The new reporting regime will apply to issuers in respect of their financial years commencing on or after 20 January 2007. For the large number of issuers whose reporting year is the calendar year, therefore, the new half-yearly reports and interim management statements will not be required until 2008 with the annual report for that year under the new rules being published in 2009. The FSA considers that this approach will be helpful in maximising the time available to adapt to the new regime, although, during the transitional period, different issuers will be complying with different reporting rules.

*Periodic reports
must be published
via an RIS*

*The new requirements
will apply to financial
reporting periods
beginning on or after
20 January 2007*

¹⁷ UK companies will continue to be under an obligation to send annual reports and accounts to shareholders, subject to the e-communications provisions of the Transparency Rules and the Companies Act 2006 (see “Information for shareholders” below).

Liability for reports and statements

Current law and impact of the Transparency Directive

There is currently no statutory regime conferring a right to compensation on shareholders and investors for errors in, and omissions from, a company's financial statements. It is generally understood, using the principles laid down by the House of Lords in *Caparo Industries plc v Dickman*¹⁸ (which concerned the liability of auditors), that directors have a duty of care to shareholders as a whole to enable them to exercise their governance rights but not, in the absence of circumstances creating proximity or a special relationship, to individual shareholders in relation to their investment or to potential investors or other third parties.

In recent years, serious concerns have been expressed that the liability of directors would be affected by implementation of periodic financial reporting requirements of the Transparency Directive. The objective of these requirements, as stated in the recitals of the Directive, is to allow investors to make an "informed assessment" of an issuer's position and to increase investor protection within the EU. As explained above, periodic financial information must be made generally available throughout the EU and, for annual and half-yearly reports, a statement of responsibility must be given by the "persons responsible".

In the absence of legislative intervention, it is likely that the effect of the Transparency Directive would be to extend the scope of liability under English law for annual accounts and other financial reporting to investors and the public in general across the EU. Fortunately, while member states must impose liability for information published under the Directive on "at least the issuer or its directors", the Directive allows member states to determine the **extent** of that liability.

The Government has therefore taken the opportunity to include two provisions in the Companies Act 2006 to clarify the liability of directors for narrative reports and the liability of issuers for periodic financial information (which also includes narrative reports). Both provisions operate so as to define the limited circumstances in which liability will arise, and to exclude liability in all other circumstances.

Liability of directors to their company for narrative reports

The first provision is designed to meet concerns about directors' liability for forward-looking statements in narrative reports, in particular the enhanced business review that quoted companies will be required to produce once the relevant provisions of the Companies Act 2006 come into force. However, the provision also relates to the whole of the directors' report (not just the business review), the directors' remuneration report, and information in summary financial statements derived from either of these reports. It provides that:

¹⁸ [1990] 2 AC 605.

Currently, the common law governs potential liability on periodic reports

The Transparency Directive could have increased directors' liability

The Companies Act 2006 defines and limits the liability of directors and issuers for reports and periodic financial information

- a director will be liable to compensate the company for any loss it suffers as a result of any untrue or misleading statement in, or omission from, such a report, but only if he knew (or was reckless as to whether) the statement was untrue or misleading, or knew the omission to be dishonest concealment of a material fact, and
- no director, auditor or other person will have any liability to anyone other than the company resulting from reliance on these reports.

Directors will be liable to their company if reckless or knowing as to misleading information or omissions, but not otherwise

The provision thus limits the liability of directors in relation to directors' reports (including the business review) to the company only. Directors will not be liable to shareholders or other third parties for such reports – unless they take some action beyond publishing their reports in accordance with company law. For example, if a director were to send a copy of the company's annual report and accounts to a bank in connection with the negotiation of an overdraft facility, he might still, as now, be liable to the bank as a result of an express or implied representation to the bank as to the accuracy of the contents of the report.

The provision is expected to apply to directors' reports for financial years commencing on or after 20 January 2007, the date for implementation of the Transparency Directive. This is because it is closely related to the second liability provision dealing with periodic reporting disclosures under the Transparency Rules. This is discussed below.

Liability of issuers for reports and statements published under the Transparency Rules

The second provision will insert new Sections 90A and 90B into FSMA and deals with liability in relation to annual and half-yearly reports and interim management statements published under the Transparency Rules by issuers with securities traded on a regulated market in the UK (or outside the UK where the UK is the home state).¹⁹ It will also extend to preliminary announcements of results, where issuers choose to publish them under the new voluntary regime, but only to the extent that the information contained in the preliminary announcement is of a kind appearing in the subsequent annual report.

The provision imposes on an **issuer** of securities liability to pay compensation to an investor who acquired securities of the issuer and suffered loss:

- as a result of an untrue or misleading statement in, or omission from, a report,
- but only if a "person discharging managerial responsibilities"²⁰ within the issuer knew or was reckless as to whether the report was untrue or misleading, or knew the omission to be dishonest concealment of a material fact.

Investors will be entitled to compensation from issuers if reports contain errors as to which directors were knowing or reckless

The provision exempts the issuer and any other person from any other liability, subject to limited exceptions described below.

¹⁹ This will include issuers admitted to the FSA's Official List, whether incorporated in the UK or elsewhere, but will not include Alternative Investment Market issuers.

²⁰ "Persons discharging managerial responsibilities" will generally mean directors (or the members of the issuer, where the issuer's affairs are managed by its members). It will only catch senior executives of non-corporate issuers.

The existing power under FSMA for a court or the FSA to require restitution to be paid to investors or others who have suffered loss resulting from a breach of FSA rules is not affected by the new provision. Although never yet used in the context of a breach by an issuer or director of the Listing, Disclosure or Prospectus Rules, this power does leave open at least a possibility of personal liability to investors on the part of directors. Similarly, the provision does not exclude civil or criminal liabilities such as under the market abuse regime, penalties for Listing Rule breaches or criminal acts under Section 397 of FSMA.

Existing regulatory powers and sanctions will be unaffected

New Section 90A of FSMA is expected to apply to periodic financial information and preliminary announcements of results for financial years commencing on or after 20 January 2007.

Effect of the new liability regime

The combined effect of these two provisions is that investors should not have a direct right of action against directors but they could claim against the company, if they can show that they have suffered loss, and that there was knowledge or recklessness, or dishonest concealment, on the part of one or more directors regarding the defect in the report. The company could then claim its own loss (compensation paid to an investor) against an individual director whose knowledge, recklessness or dishonest concealment gave rise to that loss.

The new provisions have been generally welcomed by issuers as creating a reasonable balance between responsibility and the ability to report in an open and forward-looking manner without undue fear of litigation. However, the new regime does give rise to a number of issues:

The provisions will provide a measure of comfort to directors regarding liability

- **Quarterly reports:** On a strict reading of Section 90A, quarterly financial reports by (for example) SEC-registered companies fall outside its scope, and accordingly do not benefit from the exclusion of liability. This is because the Section only relates to reports and statements published in response to a requirement imposed by a provision implementing Article 4, 5 or 6 of the Transparency Directive. This does not catch quarterly financial statements as DTR 4.3.6R (which implements Article 6.2 of the Directive) provides that issuers who publish quarterly financial statements are not subject to the Directive's requirements to publish interim management statements.
- **Timing:** On the same basis, an issuer with a December year end will not be able to benefit from the Section 90A regime when it publishes its half-yearly report as at 30 June 2007 and its annual report and accounts for the year ended 31 December 2007. Although it will be publishing those reports and accounts after the Transparency Directive takes effect on 20 January 2007, they will not be published in response to a Transparency Directive requirement, because they will relate to a financial year that commenced before 20 January 2007.
- **Existing shareholders:** An issuer is potentially only liable to persons who acquire securities and suffer loss as a result of an untrue or misleading statement or omission. It is not subject to any other liability, including liability to its existing shareholders (who may, for example, decide not to sell their securities on the basis of a misleadingly positive statement). Existing shareholders therefore lose whatever common law rights they may have

The scope of the new liability regime is limited to information published under the periodic reporting provisions of the Transparency Rules and to preliminary results

had²¹, although, in the light of *Caparo*, these may be limited to exercising governance rights.

- **Other disclosures:** There is a somewhat arbitrary division between disclosures that are within the regime and those that are not. The liability regime, as originally proposed, covered periodic financial reporting under measures implementing the Transparency Directive, namely annual and half-yearly reports and interim management statements, but not preliminary announcements of results, price-sensitive announcements such as profit warnings, or announcements of significant transactions under the Listing Rules. Following a consultation in Summer 2006, the Government extended the regime to cover preliminary announcements of results²² but concluded that any further extension was inappropriate as the issues were too complex to be resolved quickly.

Due to the controversy caused by the new statutory liability regime for issuers, the Government has been prompted to initiate a further review of whether a statutory liability regime for other financial disclosures is necessary, and has appointed Professor Paul Davies of the London School of Economics to conduct the review. The review is unlikely to be completed before the middle of 2007. The Government has taken a reserve power to amend the Companies Act 2006 by secondary legislation if changes are recommended by the review and supported by subsequent consultation.

Jurisdictional scope of liability

Neither of the new liability provisions protects issuers or directors from being sued in other EU jurisdictions under laws implementing the Transparency Directive. During negotiations on the Directive, the Government attempted to introduce a provision that would have required cross-border civil liability disputes to be resolved within the civil liability regime of the issuer's home state, but this was not accepted. Certainty and a relatively benign regime in the UK has, therefore, to be balanced by the risks of legal action taken elsewhere where liability regimes may be more onerous and far-reaching.

Practical implications

Issuers may wish to consider whether any additional verification procedures on narrative and periodic reporting are required to limit the risk of their liability to investors. However, the existing statutory obligations and sanctions, coupled with the high standard of care required for information released to the market by both the Disclosure Rules (DR 1.3.4) and Listing Rules (LR 1.3.3), should mean that existing procedures do not need to be adjusted to take account of the new regime. The level of verification should take into account the fact that the trigger for liability is high, requiring knowledge, recklessness or dishonest concealment rather than mere negligence.

Issuers may also wish to meet their auditors to discuss whether additional processes are required in relation to forward-looking statements in the business review or interim management report.

The new regime does not apply to ad hoc statements of inside information or announcements required by the Listing Rules

Issuers and directors will still be at risk of litigation in other member states

²¹ Section 90A(5) FSMA.

²² The definition of preliminary announcements is restricted to information in the annual report which the preliminary announcement presages. It does not catch other disclosures made under the Transparency Rules.

Issuers should also consider who will give the responsibility statement in relation to annual and half-yearly reports. As stated above, this is most likely to be the board of directors. Whilst directors may not have any liability to investors under the new statutory liability regime as a matter of English law, they may be liable to the issuer. Furthermore, there may be additional consequences for directors as a result of being named in the responsibility statement, for example, under local securities laws if the issuer's shares are traded on exchanges outside the UK. Such issuers and their directors may wish to investigate with their legal advisers whether it is possible to include a disclaimer in the responsibility statement such that neither are liable except to the extent that they would be under English law.

Companies should also discuss with their insurance brokers whether the insurance cover for directors and officers needs to be adjusted to reflect the new liability and responsibility regime.

Issuers should consider whether additional procedures or protections are needed as a result of the new rules

Disclosure of major shareholdings

The Transparency Directive amends the provisions previously contained in the Major Shareholdings Directive²³ regarding the disclosure by shareholders of the level of voting rights held by them in listed companies.

The changes seek to increase market transparency, but, given the minimum harmonisation nature of the Directive, will not – to the regret of many institutional investors – create a single regime with identical disclosure thresholds and exemptions across the EU.

Implementation of these provisions in the UK involves the FSA making rules on shareholding disclosures (DTR 5) pursuant to new powers under FSMA. The Companies Act 2006 will repeal the current disclosure provisions in Sections 198-211 of the Companies Act 1985.

The major shareholding disclosure provisions of the Transparency Directive are not radically different from the previous rules at EU level. However, the provisions on disclosure of interests in the Companies Act 1985 have previously imposed a super-equivalent regime in the UK. The Transparency Rules seek to make as few changes as possible to the shareholding disclosure regime for UK companies, within the confines permitted by the Transparency Directive. This includes retaining elements of super-equivalence, but a number of changes are inevitable.

Scope

The provisions of the Transparency Rules on disclosure of major shareholdings are both wider and narrower in scope than the provisions of the Companies Act 1985 which they replace. They are wider in that they apply to non-UK companies (if their home state is the UK) as well as to UK companies. However, they are narrower in that they only apply to companies whose voting shares are admitted to trading on a regulated market or on a “prescribed market”, which in this context means the Alternative Investment Market or PLUS (the market formerly known as Ofex).

Disclosure thresholds

The UK’s current basic disclosure thresholds of 3% (or 10% for “non-material” interests)²⁴ and 1% increments above those levels are as far as possible retained for UK companies. By contrast, the Transparency Directive itself only requires disclosure at levels of 5%, 10%, 15%, 20%, 25%, 30% (or one-third), 50% and 75% (or two-thirds). The FSA consulted on whether to retain the existing thresholds or adopt the Transparency Directive thresholds. Given the loss of market transparency that would result from higher, and fewer, disclosure thresholds, the favoured option was the retention of the existing thresholds for

The FSA assumes responsibility for shareholding disclosure rules

These rules will apply to listed companies and UK-incorporated, AIM quoted companies

The current thresholds for disclosure will continue to apply to UK companies

²³ These provisions are now incorporated into the Consolidated Admission and Reporting Directive (Directive 2001/34/EC), and are implemented in the UK by Sections 198-211 of the Companies Act 1985 and the Listing Rules.

²⁴ “Non-material” interests include, broadly, interests held by virtue of managing investments or operating collective investment schemes.

UK companies. For non-UK companies, however, the Transparency Directive thresholds will apply.

The requirement to disclose 5% holdings contrasts with the provisions of the Major Shareholdings Directive, under which the lowest disclosure threshold was 10%. This change means that interests of investment managers, unit trusts, open-ended investment companies and similar, which are “non-material” for the purposes of Section 198 of the Companies Act 1985 and do not have to be disclosed below 10%, will now have to be disclosed at both 5% and 10% (but not when they cross the intermediate whole percentage thresholds).

Other partial exemptions, permitted by the Transparency Directive, mean that holdings of regulated market makers up to 10% or of shares held on a financial institution’s trading book up to 5% may be exempt. In both cases, these exemptions depend upon the holder of the shares not in fact exercising voting rights or seeking to influence the management of the issuer. The market maker exemption also requires the market maker to make a notification to its home regulator of its intention to act as a market maker for the particular issuer’s shares. However, “market maker” is less narrowly defined than under the Companies Act 1985, so that more financial institutions which trade in shares will be able to take advantage of the exemption.

Key differences in the basis for disclosure

The Companies Act 1985 disclosure obligations are based on the existence of “interests” in shares. This – very widely defined – term creates a broader obligation in some respects than the Transparency Rules. The latter are based on:

- shareholdings (including holdings of depositary receipts, which are deemed to be holdings of the underlying shares),²⁵ or
- the ability to exercise voting rights in certain circumstances.

The obligation to disclose will fall on the shareholder (defined as a person holding shares in his own name, whether directly or indirectly, and whether for his own account or that of another) and also, in some circumstances, on any other person who is entitled to exercise the voting rights attaching to those shares. These circumstances include:

- where there is an agreement which obliges holders of voting rights to vote in concert,
- where someone holding securities as collateral intends to exercise the voting rights,
- where a person has discretion on how to vote under an appointment as proxy. This will include a proxy granted to the chairman of a company if no direction as to voting is given, so that instead he has discretion how to vote. A residual discretion to vote on procedural matters will not, however, trigger a disclosure requirement under this rule. In addition, a notification need only be made after the deadline for return of proxy forms has passed.

²⁵ DTR 5 does not, however, apply to issuers which only have depositary receipts traded on a regulated market.

“Non-material” interests are subject to a new disclosure obligation at 5%

The Transparency Rules focus on control of voting rights, rather than the wider “interests” that must be disclosed under the Companies Act 1985

Holders of discretionary proxies may have a disclosure obligation

Parent companies must aggregate their holdings with those of their subsidiary undertakings. The Companies Act 1985 is more stringent, requiring aggregation of holdings in entities in which a person has one-third ownership of the voting rights.

The Transparency Rules, unlike Section 198, do not deem an individual to be interested in shares that belong to his spouse and infant children.

Holdings of “financial instruments” relating to shares must be disclosed, but this term is narrowly defined compared with the Companies Act 1985 obligations, which apply to any right **or obligation** to acquire shares, “whether contingent or otherwise”. To be caught under the Transparency Rules, a financial instrument must confer a right to acquire shares – so that someone who is obliged under a put option, but has no right, to acquire shares, does not have a disclosable holding. Moreover, financial instruments will only be counted if they do, or will on maturity, give the holder an unconditional right to acquire shares at his (the holder’s) own discretion. For example, an option which gave the grantor the right to cash settle would not be caught.

Where an investment manager holds shares as part of its investment management activities, and the other members of the group also hold shares, it is not necessary to aggregate the holdings of the investment manager with other holdings, provided that the manager exercises its voting rights independently of others in the group.

Notifications by issuers

In order to facilitate the accurate calculation of holdings, the Transparency Rules require issuers to publish a monthly statement of the total number of voting shares in issue, and of the number of treasury shares held (since the latter are excluded from the denominator in calculating percentage holdings). This must be made at the end of each calendar month, unless there has been no change in the month.

Under transitional provisions, the first such monthly announcement by issuers must be made no later than **31 December 2006**, with a further announcement to be made by 20 January 2007 of any changes up to that date.

As under the current regime, it is the obligation of issuers to announce to the market via an RIS the notifications they receive from shareholders. This must be done as soon as possible, and in any event by the end of the trading day following the day of notification.

Issuers are also under a new obligation (to the extent not already covered by the Listing Rules) to disclose acquisitions or disposals of treasury shares if these cause them to cross the 5% or 10% threshold in terms of the number of treasury shares they hold as a percentage of total shares in issue.

Notifications by shareholders

Where a shareholder has a notification obligation, the notification must be made both to the FSA (electronically) and to the issuer. The Transparency Rules introduce a new standard form (TR-1) for this purpose. The deadline for

An obligation to buy shares is not disclosable under the Transparency Rules, by contrast with the existing regime

Issuers will have to publish new monthly statements of their total issued share capital

notification is two trading days (four in the case of a non-UK issuer) after the date on which the holder knows or **should have known** of the acquisition, disposal or other event giving rise to the notification obligation.

For the purposes of determining whether a shareholder “should have known” of a transaction, he is **deemed** to know of it no later than two days following the transaction. This imposes an increased compliance burden on investors, particularly in groups of companies, to ensure that they keep track of acquisitions and disposals in order to comply with the disclosure obligation.

The form of notification requires disclosure, in particular: of the total voting rights held; the chain of controlled undertakings through which voting rights are effectively held, if applicable; the date on which the threshold was reached or crossed; and the identity of the shareholder and, if different, of the person entitled to exercise voting rights.

Under transitional provisions, shareholders who have a holding above the notifiable thresholds on 20 January 2007 must disclose the holding by 20 March 2007 if they have not otherwise had cause to make a notification because of a change in their holdings. Issuers who receive a notification under this provision will have until 20 April 2007 to disclose it to the market.

Contracts for difference and stock lending

The FSA has undertaken to consider further whether to impose disclosure obligations in relation to contracts for difference (“**CFDs**”) which give a holder a purely economic interest in an issuer’s shares. Such disclosure is not required under the Transparency Directive but is felt by many to be increasingly important for true market transparency.

In relation to stock lending, however, the FSA has included guidance in the Transparency Rules which limits the need to disclose stock lending transactions:

- a lender is treated as having no change in his holding level, by virtue of netting off the disposal of shares (the loan) against the right to recall the shares, and
- a borrower of shares under a stock lending agreement will not have a disclosure obligation if he has on-lent or otherwise disposed of the shares (for example, where using them to settle a short sale) by not later than the close of business on the next trading day.

Rights of companies

The somewhat narrower scope of the Transparency Directive disclosure requirements, compared with the existing disclosure regime for interests in UK companies, means that some interests that currently have to be disclosed may not be disclosable in future. Companies concerned about the loss of visibility of their investor base will still, however, be able to make inquiries under the provisions of the current Section 212 of the Companies Act 1985, which are to be retained under the Companies Act 2006. These provisions enable a company to serve a notice on anyone whom it reasonably considers may have an interest in its shares, requiring them to provide details of their interests.

Shareholders have an increased compliance burden because the obligation arises from deemed, rather than actual, knowledge

The FSA has clarified the treatment of stock lending arrangements and will consider whether to require disclosure of CFDs in the future

The issue of concern to investors is that there will in effect be two different bases on which they have to disclose holdings in UK companies. They will need to adjust their information and record-keeping systems to enable them to disclose under the new FSA rules, but will still also need systems to track the more widely defined “interests” under the Companies Act, to enable them to respond to company inquiries.

*Company
investigation rights
under Section 212
will be unaffected*

Information for shareholders

Another objective of the Transparency Directive is to ensure that investors, including cross-border investors, are enabled to exercise their rights, for example by appointing proxies for general meetings. To this end, the Transparency Rules contain a number of provisions aimed at ensuring that shareholders, or the holders of debt securities, receive adequate information about meetings, and how to exercise their rights, together with a proxy form (on paper or using electronic means).

The Transparency Rules provide that issuers may use electronic means of communication for these purposes, subject to a number of conditions:

- the use of electronic communications must be approved by the shareholders (or the holders of debt securities, in the case of communications to them) in general meeting,
- security holders of each class must be treated equally. In particular, electronic communications must be available to all security holders, no matter where they are located,
- shareholders must be contacted in writing to request their consent to the use of electronic means of communication. However, they can be deemed to have consented if they do not object within a reasonable period of time. They may always thereafter request a return to communication by conventional means, and
- identification arrangements must be put in place to ensure that not only shareholders but, where relevant, others entitled to direct the exercise of voting rights are effectively informed. Unfortunately the FSA offers no guidance on what this will require in practice.

These provisions are complemented by the company communications provisions under the Companies Act 2006. These amend the existing rules on e-communications by UK companies and are some of the few provisions that are being brought into force early, to coincide with the adoption of the Transparency Rules. These provisions, like the Transparency Rules, allow silence to constitute assent to use of website communication or, alternatively, allow communication by e-mail. The Companies Act 2006 additionally requires a hard copy notification to be sent to shareholders to inform them that communications that would otherwise be sent to them have been published on the website.

Practical implications

Companies wishing to take advantage of these provisions will need to pass an appropriate shareholder resolution approving the use of e-communications. They may also need to amend their Articles to make them consistent with the new Companies Act and Transparency Rule provisions.

The ability to cease sending annual reports and accounts to shareholders who do not opt for hard copies is expected to save many companies substantial amounts of money. The need to specifically opt in to hard copy communications is likely to result in fewer shareholders receiving hard copies than under the

All shareholders must be enabled to exercise their rights

Companies can use electronic means to communicate with shareholders

The Companies Act 2006 contains complementary provisions to allow website publication as a default option

current arrangements, where shareholders must positively opt in to receiving electronic communications. Posting documents on a website is treated as sufficient communication, provided that, as required by the Companies Act 2006, shareholders are sent a hard copy notification of the publication of the relevant document. Companies following this route will have to carry the postage costs for the notification, but these will obviously be significantly less than the costs of printing and posting a full annual report and accounts.

The use of electronic communications for other documents, such as rights issue documents or other shareholder circulars may need to be considered on a case by case basis. The requirement under the Transparency Rules for the use of e-communications not to depend upon the location of the shareholder may make it impossible to use e-communications for any document which the company does not wish to send to a particular jurisdiction because doing so could breach securities laws, or lead to onerous obligations, in that jurisdiction. It is to be hoped that the FSA will offer some guidance on its interpretation of this matter.

Companies should benefit from reduced postage costs on annual reports

Effective dissemination of information

The Transparency Directive is concerned with ensuring that company information is made accessible to the general public throughout the EU rapidly and without discrimination. This principle applies to all regulated information – which includes information published not only under the Transparency Directive, but also under the Listing Rules and the current Disclosure Rules.

Under the Transparency Rules, the current system for announcing information to the market by means of a Regulatory Information Service (“**RIS**”) is maintained, but issuers are obliged to ensure that the RIS meets the minimum standards laid down by the Directive.

These standards include obligations to:

- disseminate regulated information to as wide a public as possible and as close to simultaneously as possible throughout the EU,
- communicate information to the media in unedited full text, and
- communicate information in a manner which is secure, minimises the risk of data corruption and unauthorised access, and provides certainty as to its source.

In practice, the FSA maintains a list of approved RISs, and the FSA’s approval criteria are designed to ensure that an RIS will satisfy each of these requirements. Accordingly, issuers should be able to rely upon the fact that the RIS is approved by the FSA rather than needing to perform onerous due diligence on RISs.

Finally, the Transparency Rules require issuers to provide to the FSA upon request information such as the name of the person who communicated a particular piece of regulated information to the RIS, the time at which it was communicated and details of security and embargo measures. While companies may keep records of such information as a matter of best practice, this is now an explicit obligation.

Issuers using an RIS must ensure it meets appropriate standards

Issuers must be prepared to give details to the FSA of how information has been released to an RIS

Further information

If you require further information on the matters discussed in this report, please contact Steven Turnbull on 020 7456 3534, Lucy Fergusson on 020 7456 3386, Judy Pink on 020 7456 3532, or your usual contact at Linklaters.

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