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UK Corporate Update.

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BIS addresses concerns about the operation of the new share buyback rules

The Department for Business, Innovation and Skills has published a guide to the changes to share buyback rules that came into force in April 2013. It includes further detail on how the Government intended the "de minimis" exemption (which allows private companies to repurchase shares out of capital, up to a certain limit, without following creditor protection procedures) to operate in practice. BIS also proposes to consult on further legislative changes to make the rules work better.

Background

The Companies Act 2006 (Amendment of Part 18) Regulations 2013 came into force in April 2013. They made the following changes to simplify the provisions of the Companies Act 2006 relating to share buybacks, with the aim of making it easier for private companies to buy back shares from leaving employees.

> Only an ordinary resolution is required to approve an off-market share buyback (rather than a special resolution).

> Private companies may pay in instalments for shares bought back in connection with an employees' share scheme (all other buybacks have to be paid for on repurchase).

> A more relaxed procedure is provided for share buybacks out of capital in connection with an employees' share scheme (directors' solvency statement rather than an auditors' report and directors' report).

> Private companies can pay for small share buybacks out of share capital without having to follow the detailed procedures set out in Chapter 5 of Part 18 CA 2006 (the so called de minimis exemption).

> All companies can hold shares bought back out of distributable profits, or using the de minimis exemption, as treasury shares (previously only listed public companies could hold treasury shares).

The de minimis exemption

Since April the Government has received feedback and concerns about the operation of the de minimis exemption.

The new Section 692(1)(b) CA 2006 allows a private company to purchase its own shares with cash without having to identify distributable reserves (i.e. the payment is made out of capital) if it has authority in its Articles. The maximum amount that can be paid using this exemption in each financial year is the lower of (i) £15,000 and (ii) the value of 5% of the company's share capital.

BIS acknowledges that the Regulations are unclear how the 5% of share capital is calculated if there are several buybacks over the course of the year (each buyback will reduce the level of share capital and so the 5% level will get lower after each buyback). It suggests that companies could calculate the 5% at the start of the financial year and use this as the reference point.

BIS states that shares bought back using the de minimis exemption must be repurchased at nominal value. This is not explicit in the Regulations. BIS's reasoning is that there are no rules on how you account for a buyback using this exemption if the purchase is at a premium or a discount and therefore it cannot be done.

Section 734 CA 2006 sets out the accounting consequences of a payment out of capital for a share buyback when the shares are repurchased at a premium (a reduction can be applied to various undistributable reserve accounts) or below nominal value (the difference is applied to capital redemption reserve), but it does not currently apply to buybacks using the de minimis exemption (only to buybacks out of capital made in accordance with Chapter 5 of Part 18 CA 2006).

Next steps

BIS proposes to consult on further changes:

- to clarify the accounting treatment of shares bought back using the de minimis exemption where the shares are bought back at a premium or a discount;
- to consider whether allowing shares bought back using the de minimis exemption to be held in treasury is consistent with normal accounting practices and the treatment of other buybacks out of capital (where the shares must be cancelled); and
- to consider how the timing of the surrender and payment of shares could be simplified under the relaxed procedure available for buybacks out of capital for an employees' share scheme (currently payment can only be made five to seven weeks after the shares are "surrendered" to the company).

BIS will also conduct a general review of the Regulations in 2016.

Comment

The BIS guide is helpful in clarifying the Government's intention behind certain areas of the Regulations which are otherwise ambiguous.

The guidance is available here.

NAPF Corporate Governance Policy and Voting Guidelines 2014 and Remuneration Principles

The National Association of Pension Funds has issued updated Corporate Governance Policy and Voting Guidelines. These aim to help investors assess a company's compliance with the UK Corporate Governance Code. From a company's perspective, the Guidelines give an indication of issues pension fund investors are likely to be concerned about, and how these may be reflected in voting patterns.

The latest version of the Guidelines emphasizes the importance of long term investment and stewardship by shareholders. As a result, there are changes of nuance in a number of existing provisions. In addition, certain new sections have been added to reflect recent developments. Specific recommendations of interest are described below.

A new set of "Remuneration principles for building and reinforcing long term business success" are incorporated into the updated Policy and Voting Guidelines.

Remuneration

NAPF welcomes the Government's pay reforms but expects remuneration committees to make appropriate pay decisions as investors do not "wish to micro-manage businesses". NAPF also confirms that, in line with other investor guidance, it expects votes on the new policy report to take place every three years and not annually. The Guidelines strongly encourage companies to take account of the GC100 and Investor Group Guidance on remuneration disclosures published in September 2013.

The five "Remuneration principles for building and reinforcing long term business success" were prepared by NAPF together with Hermes, Railpen and others involved in pension fund management. These principles seek to provide high level guidance, rather than prescribing specific structures, and state that:

> remuneration committees should expect executives to make a material long term investment in the company's shares;

> pay should be aligned to long term strategy and the company's desired culture;

> pay schemes should be clear, understandable and reflect shareholder returns;

> remuneration committees should use their discretion to reflect business performance; and

> companies and investors should regularly discuss strategy and long term performance.

Audit

Audit committees are generally encouraged to take ownership of the audit relationship and to be more open to investors. Audit committee reports should avoid boilerplate and disclose significant issues considered by the committee and how they were addressed. Committees should also consider reporting on the findings of any review by the Financial Reporting Council's Audit Quality Review team.

According to NAPF, the Code's recommendation that FTSE 350 companies should put the external audit contract out to tender every ten years should be seen as a minimum requirement. An intention to tender should be notified in advance, the tender process should be rigorous and assessments of external auditors should be "robust".

NAPF welcomes a downward trend in recent years for non-audit fees relative to audit fees and now states that companies should aim to spend not more than 50% of the audit fee on non-audit services. Revisions to the Guidelines allow the NAPF's non-audit fee cap to be either 100% of audit fees (as before) or a material monetary sum (£500,000).

Risk management

The Guidelines remind directors of their statutory duty to promote the interests of the company with regard, amongst other things, to reputation. Companies are warned that shareholders may form judgments on their management of reputational risks, including in relation to tax issues and material environmental and social factors. The report on the accounts should also communicate how the company is responding to materialised risks over the preceding year.

Related party transactions

Boards should not only have procedures for identifying and managing conflicts of interest but also a robust, independent process for dealing with related party transactions. These transactions should be reviewed by a committee of independent directors to determine if they are necessary, appropriate and in the best interests of the company and all its shareholders.

Rule 9 waiver

The Guidelines now state that investors do not “for the most part” support resolutions to waive the application of Rule 9 of the Takeover Code (where a share buyback might otherwise trigger a requirement for a major investor to make a mandatory takeover bid for the company by taking its holding over the 30% threshold) and recommend voting against such proposals.

Controlling shareholders

A new section notes the imminent reforms to the Listing Rules in this respect (see below) and states that details of the relationship with a controlling shareholder should be disclosed to investors and a relationship agreement should be put in place.

Shareholder action

Shareholders should make systematic use of all the powers at their disposal in order to support the highest standards of governance. Apart from voting and tabling shareholder resolutions, in this version of the Guidelines shareholders are also encouraged to attend and speak at AGMs and to make public statements.

Diversity

Companies are warned that investors may vote against the report and accounts if diversity statements made are not considered satisfactory or there is no clear evidence that diversity is being sufficiently considered by the board.

Other issues

Companies may wish to take note of the following miscellaneous revisions and renewed emphasis in the Guidelines, supplementing the provisions of the UK Corporate Governance Code.

- The need for succession planning is emphasized. Boards are requested to endeavour to consult long term investors over sensitive board appointments.
- Explanations of non-compliance with the Code should not only be thoughtful, but also justifiable. Investors will seek evidence that the Code is being applied, not only in letter but also in spirit.
- NAPF now expects the Chairman’s statement in the annual report to give a clear picture of governance and steps taken by the board.
- As a minimum, the company should disclose when a board evaluation took place and when a subsequent review is planned.
- Voting outcomes should be disclosed promptly and include details of votes withheld.

More information

For a copy of the NAPF Corporate Governance Policy and Voting Guidelines 2014 click here and for a stand-alone copy of the “Remuneration principles for building and reinforcing long term business success” click here.

Review of the engagement of pension funds with investee companies

The National Association of Pension Funds has published its ninth annual survey of pension funds’ engagement with the companies in which they invest. The report indicates that almost all (96%) of the pension funds surveyed agree that they are responsible for the effective stewardship of their investments, which includes engaging with companies and voting shares at company meetings. NAPF also notes that there has been a 30% increase in pension funds signing up to the Stewardship Code since the beginning of 2013 and that most pension funds consider stewardship policies and activities when selecting asset managers.

ESG factors

A second key finding is that 82% of the funds surveyed think that environmental, social and governance factors can have a material impact on investments in the long term. This indicates that pension funds are likely to be interested in how companies respond to the new reporting regime, introduced in autumn 2013. Listed companies must include details of social factors affecting the business, including, for the first time, diversity statistics and human rights issues in the new, separate, strategic report. The new reporting requirements will also affect remuneration and audit and are welcomed by NAPF in the report as an opportunity for companies to build on the relationships with their shareholders.

Shareholder engagement

Other findings of interest to companies are that, although pension funds believe it to be important, many are not seeing evidence that the engagement activities they undertake are influencing changes in company strategy, remuneration and social or environmental policies. In addition, just under half thought that more can be done to make sure investors play an active role as stewards of investee companies. In terms of voting on company business, the report finds that funds are exercising their votes in the UK more (96%, up from 93% in 2011).

Overall, the report concludes that pension funds are getting to grips with their stewardship responsibilities. Advisers to the pension fund community, on the other hand, are found to have done little to call attention to the importance of stewardship and are asked to reflect and re-commit to the spirit of the Stewardship Code.

For a copy of the NAPF Engagement Survey 2013 click here.

HM Treasury publishes draft regulations implementing Country-by-Country Reporting

HM Treasury has published draft regulations and guidance to implement the country-by-country reporting requirements set out in the Capital Requirements Directive 4 into national law. CRD 4 looks to increase transparency in the financial sector as a means of regaining the public's trust.

Disclosure obligations

CRD 4 requires "institutions" (banks and financial institutions) to publicly disclose the following information annually on a country-by-country basis:

> name, nature of activities and geographical location;

> turnover; and

> number of employees.

This information must first be published by 1 July 2014 and on an annual basis from 2015.

"Global systemically important institutions" are also required to disclose to the European Commission and to HM Revenue and Customs by 1 July 2014:

> their profit or loss before tax;

> tax on profit or loss; and

> any public subsidies received.

Subject to a European Commission impact assessment, all institutions will be required to make public disclosure of the above three items on an annual basis from 2015.

Meaning of "institutions" and "global systemically important institutions"

The Government confirms that all institutions within the scope of CRD 4 (broadly banks and financial institutions) will need to comply with the regulations and there will be no carve-out for smaller institutions. However, branches of institutions established in a third country are excluded.

"Globally systemically important institutions" mean those identified as a "global systemically important bank" by the Financial Stability Board in its update of 11 November 2013, as amended from time to time. Only global systemically important institutions authorised in the UK are subject to the regulations.

Disclosure of information on a consolidated basis

An institution within the scope of the regulations will be required to report on a consolidated basis in accordance with international accounting standards for each country in which the institution has a subsidiary or branch or both.

Institutions which are part of a wider group may either report information on a consolidated basis for all institutions and their subsidiaries and branches within the group on a country by country basis or may report on a consolidated basis for a subset of the group so long as all institutions in scope of the regulations are covered within the consolidation.

Tax and public subsidy disclosures

The draft guidance contains some helpful pointers in relation to the information that must be disclosed. For example:

> profit or loss before tax should be consistent with that used in an institution’s financial statements;

> disclosure of “tax on profit and loss” is limited to corporation tax payments (or similar charges in other jurisdictions) and will need to be made on a cash tax paid basis. Institutions will, however, have the option of separately and voluntarily reporting additional information such as current and deferred tax, as well as other taxes paid beyond corporation tax, in order to help clarify their tax position;

> public subsidies should be interpreted as direct support by the Government. They do not include central bank operations that are designed for financial stability purposes or operations that aim to facilitate the functioning of the monetary policy transmission mechanism, schemes in line with the European Commission’s guidance on state aid or general tax deductions that apply across the board.

Publication and audit requirements

The regulations require the information to be audited in accordance with the EU Statutory Audit Directive. Where an institution decides that including the country-by-country reporting requirements in statutory audit is not appropriate, the Government expects the assurance engagement to provide the same assurance as a statutory audit.

Where possible, information should be made available with the institution’s annual financial statement. However, institutions will be permitted to report on a website if the information is easily and freely accessible but should provide a link to that website within the annual report.

The Government acknowledges that the deadline of 1 July 2014 may make compliance impracticable for some institutions. However, after that date, institutions may align the disclosure to their year ends.

Next steps

The draft regulations were subject to a one-week final consultation that ended on 26 November. The Government intends to publish final regulations in December 2013. These will take effect on 1 January 2014.

The draft regulations and guidance can be found here.

The regulations are accompanied by a summary of responses to the consultation on the same topic that was launched on 20 September 2013 and a tax information and impact note which can be found here.

Shorter settlement window for securities transactions

Euroclear UK & Ireland, which operates the CREST system in the UK, has announced that the standard settlement cycle for the UK capital markets will be shortened from T+3 to T+2 from 6 October 2014.

This means that, from 6 October 2014, the cash and securities will need to change hands two business days after a securities transaction conducted on a stock exchange or multilateral trading facility, rather than the current cycle of three business days after the trade. Over-the-counter transactions are not subject to the T+2 settlement cycle.

The move to T+2 settlement will in time be required by a draft EU regulation currently progressing through the EU legislative process. The regulation, known as the CSD (central securities depositories) regulation, aims to improve securities settlement and to regulate settlement system operators such as Euroclear. It is expected that the regulation will come into effect in early 2015, but Euroclear is voluntarily shortening the settlement cycle ahead of the regulation taking effect.

The London Stock Exchange published a market notice giving information on the impact of the move to T+2 settlement on the LSE’s markets and trading services. This includes changes to the ex dividend regime. The LSE will be publishing an updated Dividend Procedure Timetable for 2014 soon.

The Euroclear announcement is available here. The LSE Notice is available here.

Boards encouraged to do more to tackle cyber threats

HM Government has published the results of a Cyber Governance Health Check survey, which was responded to by 62% of FTSE 350 companies’ chairs or audit committee chairs. The largest number of respondents came

from the financial services sector and the lowest from the pharmaceuticals, biotechnology and healthcare sectors.

Findings indicate that 25% of the companies surveyed considered cyber threats a top risk, because of the need to protect intellectual property or deliver vital or safety-critical services or because of high exposure to online transactions and theft or fraud. 62% think board members are taking the risk very seriously. However, the report concludes that:

> there is still a great deal of concern and uncertainty about cyber security in board rooms;

> many companies admit that they do not actively manage the risk at board level; and

> nearly half of the companies surveyed stated that they need to do more to protect themselves.

The survey considers a number of topics, including the extent to which the threat is understood, who takes ultimate responsibility for cyber security, how risks are managed and to what extent boards are aware of cyber incidents which have already affected their company and of available help and support.

The survey was sent out by company auditors last summer (BDO, Deloitte, EY, Grant Thornton, KPMG and PwC) as part of the Government's on-going Cyber Security Strategy. It is to be followed up in the next six months by the roll out of a tool to assess cyber vulnerabilities and good practice, as well as suggested actions for management.

An Annex to the report also contains information about further advice and guidance for companies in relation to various areas, including cyber crime and fraud, responses to cyber incidents, information sharing opportunities and systems testing.

For a copy of the FTSE 350 Cyber Governance Health Check Tracker Report, dated November 2013, click here.

Latest FCA Proposals: Enhancing the Effectiveness of the Listing Regime

The UK Listing Authority has published feedback, a consultation and proposed rules with the aim of bolstering existing corporate governance provisions and improving the effectiveness of the listing regime.

This follows the highly public debate around the corporate governance of certain premium listed companies and a previous consultation (CP12/25) launched in October 2012. The proposals in the new consultation paper (CP13/15) are primarily aimed at companies with controlling shareholders and will provide more transparency and give more rights to non-controlling shareholders. There are also some proposals which will affect premium listed

companies with no controlling shareholder and standard listed issuers.

In our briefing paper, available on the Linklaters Knowledge Portal or from your usual Linklaters contact, we set out a summary of the main points arising from both the feedback statement and also the new consultation.

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