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10 September 2015

UK Corporate Update.

FCA proposes changes to rules on audit committees and on cancellation of listing

In its latest quarterly consultation, the FCA has proposed a number of amendments to the Listing Rules and Disclosure and Transparency Rules to implement new EU rules on accounting and audit. It is also proposing to increase protection for minority shareholders by making it more difficult for a controlling shareholder to cancel an issuer's listing.

Audit committees

The FCA seeks views on proposed amendments to DTR 1B and DTR 7.1 in relation to audit committees. These changes implement parts of the Statutory Audit Amending Directive (Directive 2014/56/EU) of public interest entities. In particular, the FCA proposes to:

– extend the independence requirement for audit committee membership from at least one member to a majority of the members (DTR 7.1.1AR) and require the members of the body as a whole to have competence relevant to the sector in which the issuer is operating;

– insert a new rule, DTR 7.1.2AR, to require the chairman of the audit committee to be independent and to be appointed by the members of the audit committee or by the administrative or supervisory body of the issuer. The FCA is not, however, adopting the option in SAAD to require the annual election by shareholders of the audit committee chairman;

– amend the responsibilities of the audit committee, set out in DTR 7.1.3, to reflect the changes made by the SAAD. The audit committee must inform the administrative or supervisory body of the audited entity of the outcome of the statutory audit and (i) explain how it contributed to the integrity of financial reporting and the committee's role in the process; (ii) submit recommendations or proposals to ensure the integrity of the financial reporting process; and (iii) while monitoring the audit, take into account any findings and conclusions by the competent authority resulting from inspections of previous audits; and

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– amend DTR 1B.1.3R to exempt Alternative Investment Funds and UCITS from the requirement to appoint an audit committee.

The new rules will take effect for financial periods commencing on or after 17 June 2016.

The Prudential Regulation Authority will be consulting later this month on audit committee requirements for credit institutions and insurance undertakings. If those bodies have transferable securities issued for trading on a regulated market, they will be subject to requirements under both the DTRs and the PRA's rules.

The Financial Reporting Council will be consulting later this year on possible changes to the UK Corporate Governance Code and its Guidance on Audit Committees in relation to implementation of SAAD.

Cancellation of listing

The FCA is also consulting on the rules on the cancellation of an issuer's listing following a takeover offer.

Under the amendments made to the Listing Rules in May 2014, as part of the FCA's "Enhancing the effectiveness of the Listing Regime" project, the FCA built in protection for investors where an issuer has a controlling shareholder. In LR 5.2.5R(2)(a) the FCA included a requirement for a majority of votes of independent shareholders to support an application for a cancellation of listing, where the issuer has a controlling shareholder.

However, the FCA disapplied this provision where a controlling shareholder has made a takeover offer for the issuer and holds 80% of the voting share capital of the issuer (by virtue of its pre-offer shareholding or acceptances of its offer) (LR 5.2.11DR). This step was taken because, following a takeover offer, the FCA did not want a company to remain listed on the Official List with a low level of free float.

Since the amendments were introduced, the FCA states that it has become conscious of "potentially significant consequential and unintended implications for investor protection" in relation to the operation of LR 5.2.11DR. For example if a controlling shareholder of an issuer (which already holds 80% of the issuer's voting share capital) makes a takeover offer for the issuer, it has the ability, under LR 5.2.11DR, to cancel the issuer's listing without either independent shareholder approval or its offer being accepted by any independent shareholders. This would leave the independent shareholders holding shares in an unlisted issuer, which is generally unattractive for investors. As a result, they may feel compelled to accept the controlling shareholder's offer.

The FCA have considered a number of ways to deal with this risk and are proposing to delete LR 5.2.11DR. However, the FCA emphasises that this should not be seen to imply a more general tolerance of low free floats. It also highlights that it retains the ability to initiate delisting where a remaining free float is too small to support adequate liquidity.

Accounting Directive

The FRC is consulting on its proposal to retain one rule that goes beyond the requirements of the Accounting Directive (2013/34/EU). The requirement for issuers to disclose important post-balance sheet events in the management report has been deleted from both the Accounting Directive and the Transparency Directive although the Accounting Directive still requires issuers to include details of important post-balance sheet events in the notes to the accounts. To prevent mismatch of disclosures between issuers subject to the Accounting Directive and non-EU issuers not subject to the Directive, the FCA is proposing to retain the disclosure in the management report in DTR 4.1.11R(1).

Other

The consultation also proposes changes to the Prospectus Rules which reflect regulatory technical standards produced by ESMA. These relate to the procedures for approval and publication of prospectuses and the information that may be provided to investors about an offer.

The FCA is also proposing to replace references to the former operating subsidiaries of the Financial Reporting Council (e.g. Auditing Practices Board), so as to refer only to the FRC itself, and to make some other minor changes to the Listing Rules, Disclosure and Transparency Rules and other areas of the FCA Handbook to update references to UK GAAP.

Responses to the proposed amendments to the Prospectus Rules are required by 5 October 2015. Otherwise, the consultation on the changes to the Listing Rules and Disclosure and Transparency Rules closes on 5 November 2015.

Click here for CP15/28: Quarterly Consultation Paper No.10.

Click here for the FCA Press Release.

True and fair view and distributions: international accounting standards said to be flawed

The Local Authority Pension Fund Forum has published a further opinion from George Bompas QC. This questions the extent to which international accounting standards allow for a departure from their requirements in order for accounts to give a true and fair view (the “true and fair override”) and suggests that accounts which fail to distinguish between distributable and undistributable amounts do not give a true and fair view.

George Bompas gave a more extensive opinion to LAPFF in April 2013. His conclusions were rejected by Martin Moore QC in October 2013 whereupon the Department for Business, Innovation and Skills and the FRC issued statements confirming that a true and fair view remained the overriding objective when preparing financial statements.

In his latest opinion, George Bompas argues that:

– International accounting standards do not contain an overriding obligation to give a true and fair view, merely information that is "useful". George Bompas disagrees with Martin Moore that this can be equated with a true and fair view; and

– company law requires amounts for distribution to be determined by reference to amounts stated in the accounts, not by reference to other records. George Bompas disagrees with Martin Moore that there is no legal requirement for a company to distinguish between distributable and non-distributable profits in its accounts and expresses doubt that accounts which fail to enable a determination of what is or not available for distribution by reference to amounts stated in them can give a true and fair view as they will fail to meet one of the central purposes for which accounts are required.

LAPFF has sent the opinion to key members of the European Parliament with a view to stopping the endorsement of the proposed standard applicable to banks, IFRS 9 on financial instruments.

Further information

George Bompas' QC's opinion can be found here. A press release from LAPFF can be found here. LAPFF's letter to members of the European Parliament can be found here.

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