Linklaters

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UK Corporate Update.

Updated PIRC corporate governance policy for 2016

Pensions Investment Research Consultants, the shareholder advisory body, has published updated Shareholder Voting Guidelines for 2016. These now set out PIRC's corporate governance policies in a more concise way, with some changes from last year's guidance. The more significant of these updates, relevant to UK listed companies for the 2016 AGM season and M&A activity, are described below.

Authorities to allot shares for cash

PIRC remains sceptical about the 2015 revisions to the Pre-Emption Group guidelines which allow companies to disapply pre-emption rights for amounts equal to 10% of their issued share capital where half of this amount is used for specific acquisitions or capital investments. In PIRC's view no compelling case has been publicly made for shareholders to reduce their pre-emption rights to this extent. Nevertheless, PIRC will not oppose 10% authorities if the board has made a "clear, cogent and compelling case why the 10% level is appropriate for the company". Ideally PIRC would also like to see any such authorities split into two parts, with separate authority being sought for pre-emption disapplications for general corporate purposes and for acquisitions and specified capital investments.

Authority to purchase own shares

PIRC has for some time been critical of share buy-backs and as a result has been considering its position on the general authorities to buy-back shares which are routinely passed at listed company AGMs. PIRC has now concluded that it will only support future requests for such authorities if the board has made out a "clear, cogent and compelling" case to demonstrate how the authority will be used to benefit long-term shareholders and also that the directors are not conflicted in recommending the authority. PIRC's clients have been consulted on this matter and do not want a blanket ban on buy-back authorities, although they agree that there are concerns about the value for long-term shareholders of share buy-back programmes.

Significant votes not in favour of management proposals

PIRC believes that companies should be doing more to explain their position where a significant proportion of the shareholders fails to support resolutions put at a general meeting. Accordingly, the Guidelines now include the UK Corporate Governance Code recommendation that companies should comment on significant opposition in the RNS announcement issued after a company meeting. Separately, PIRC has also stated that it will expect a considered response on issues arising from significant adverse votes to be provided to shareholders before the next AGM.

In this issue

Auditor appointments and fees

The updated Guidelines give a clear statement of PIRC's policy in relation to auditor rotation and non-audit fees. They state that PIRC will normally recommend:

> opposing the re-election of an auditor with a tenure exceeding ten years and abstaining on re-elections where tenure exceeds five years; and

> abstaining where non-audit fees are between 25% and 50% of audit fees and opposing if non-audit fees exceed 50% of audit fees for either the year under review or the previous three years.

As a practical matter, to allow assessment of how long an auditor has been in office, PIRC this year is also asking companies to disclose when the auditor was appointed. If the information is not given, PIRC will draw a negative inference as to the length of the auditor's tenure and will assume that there is an impact on the auditor's independence.

UK investment companies

PIRC has clarified its position on two matters. Firstly, it has sought to add flexibility to its policy of not supporting the continuation of investment trusts where the year-end share price has been at a discount to net asset value of more than 10% at the past three fiscal year-ends. In this situation PIRC will accept explanations, within the context of the trust's overall investment strategy, in respect of the discount and the actions the trust is taking to address the situation.

Secondly, PIRC has sought to clarify how it would recommend voting where a company found it impracticable to put a dividend approval to the vote because it pays quarterly or monthly dividends. The Guidelines now state that PIRC considers that, where it has been demonstrated that an annual approval of a dividend could interfere to the detriment of shareholders with monthly or quarterly dividends the investment company should in any event put forward its dividend policy for annual shareholder approval. PIRC will not make adverse voting recommendations in these circumstances.

Remuneration

This section of the Guidelines is largely unchanged from last year. PIRC continues to oppose excessive remuneration and has added some new criticism of "absurd" retention awards made where there is no indication that a director wishes to move on or that there is outside demand for the director's services.

The new Guidelines are also now more prescriptive about who should be allowed to sit on the remuneration committee. PIRC states that remuneration committee members should not be executive directors of other UK listed companies and that, in 2016, PIRC will abstain on the election of any such directors who sit on the remuneration committee.

Board diversity

PIRC supports the efforts of Lord Davies to increase board diversity and, therefore, in line with the updated Davies target has updated the target in its Guidelines to 33% female board representation by 2020.

Charitable donations

PIRC continues to support these but has added wording to its Guidelines to clarify that company resources should be used in this way only where appropriate, proportionate and in the interests of the company as a whole.

Mergers and acquisitions

PIRC evaluates corporate transactions to assess the robustness of governance arrangements rather than seeking to opine on the commercial merits of such deals. PIRC's guidance on how it will analyse M&A has been updated to emphasize that PIRC's concern is the level of independent scrutiny which has been applied to the deal and whether shareholder rights will be impacted. The new Guidelines set out the factors which PIRC will review and any effect on voting recommendations.

Further information

To order a copy of the PIRC UK Shareholder Voting Guidelines 2016 and PIRC's explanation of its corporate governance policy changes for 2016 click here.

EU referendum: new client briefings

The UK's referendum on membership of the EU will be held on 23 June 2016. Whilst businesses are paying increasing attention to the possibility of a UK exit from the EU (Brexit), many have not yet done any detailed assessment or planning in the event of a UK exit from the EU. This short briefing provides an overview of the referendum's implications for businesses and what might happen if the UK were to vote to leave the EU, including:

> Simple overview and timeline of key events over coming months

> What companies should do before the referendum

> What a vote to stay in means in light of the new 'settlement' for the UK' membership of the EU

> If the UK votes to leave the UK, what happens next?

> What Brexit means and who would be affected

> What are the commercial and economic implications of a UK exit and what impact it would have on UK laws?

View the EU referendum overview here.

Please see our additional briefings:

EU referendum - risk assessment overview which identifies some of the questions businesses could consider in their assessments or scenario planning for the impact of the UK voting to leave the EU (Brexit) in the referendum to be held on 23 June 2016.

EU referendum – controls on campaign funding and spending – businesses which are considering making their voice heard in the campaign leading up to the UK's referendum on membership of the EU should be aware of the rules on campaigning expenditure and funding as set out in this short note.

FRC flags topical reporting issues, including Brexit

A brief Financial Reporting Council letter to investors highlights recent changes in reporting with a view to encouraging investors to engage with the companies in which they invest.

The letter addresses Brexit, among other issues, and suggests that companies may be considering the risk and uncertainties associated with the UK's renegotiation of its EU position and potential exit. If the board considers this to be a principal risk, it should be disclosed to shareholders.

Other topics covered by the letter include the overall aim of the annual report, enhanced reporting on risk and internal control (including the new viability statement), alternative performance measures, audit reporting, dividend

disclosures, explanations of non-compliance with the UK Corporate Governance Code, the impact of new accounting standards and the FRC's commitment to transparency.

The letter can be found here.

FRC guidance on how to deal with volatility in annual reports

The Financial Reporting Council has published a letter to audit committee chairs on possible ways to address uncertainty and volatility in annual reports and accounts. It suggests that:

> the strategic report provides an opportunity to provide the most current view of prospects. The FRC notes that the first draft of the strategic report may have been written some time earlier and recommends that the board review it before it is issued to ensure all the statements in it remain pertinent;

> directors' judgments as to principal risks and their potential impact are key to an understanding of a company's prospects. In some cases, the range of potential outcomes may be wider than previously reported and more disclosure as to sensitivities may be required;

> the accounts should be drawn up on the basis of the conditions existing at the balance sheet date but events or information that come to light at a later date that affect valuations may need to be disclosed;

> accounting standards require companies to disclose material post balance sheet events, including the nature of each event and its estimated financial impact or a statement that such an estimate cannot be made;

> in some cases, it may be necessary to consider whether events have a material effect on the preparation of the accounts on a going concern basis of accounting and whether there are material uncertainties relating to that assessment requiring disclosure.

The FRC's letter can be found here.

ICAEW guidance on realised and distributable profits – amendments proposed

The Institute of Chartered Accountants in England and Wales and the Institute of Chartered Accountants of Scotland has published an update to Tech 02/10, their guidance on realised and distributable profits under the Companies Act 2006.

The update is in the form of a mark up to Tech 02/10. The deadline for comments is 9 June 2016 but the following aspects, being matters of interpretation, are stated to have immediate effect.

> Additional guidance is given on the definition of a distribution as set out in Section 829 CA 2006. The guidance emphasises that the purpose and substance of a transaction is key rather than the label that is given a particular transaction. In particular, an undervalue transaction with a shareholder or sister company is capable of being a distribution, because it involves, in substance, an element of gift to the transferee. The state of mind of the Parties may be relevant.

> There is a new section on intra-group loans on off market terms. This has been added to take account of the change in accounting treatment of interest free intra-group loans and other intra-group loans not at a market rate of interest (unless they are repayable on demand) following the adoption of FRS 102. In accordance with FRS 102 (and IFRS) these loans

are recognised initially at fair value rather than face value. The guidance sets out the accounting treatment for an interest free loan from parent to subsidiary, subsidiary to parent and subsidiary to fellow subsidiary.

> Although the definition of a distribution refers to distributions of assets, a distribution can arise from an assumption of a liability if the company does not receive consideration of the same amount. This is because the liability commits the company to transfer assets at a future date and its assets are therefore reduced when entering into the commitment.

> The guidance now confirms that a distribution that arises from the discharge of a liability for a liquidated sum (such as a waiver of an amount due from a parent) is not a distribution in kind and so not within the scope of Sections 845 and 846 CA 2006. This is because the discharge of a liability for a liquidated sum falls outside the definition of "non-cash" asset in Section 1163(2) CA 2006.

> Additional guidance on the determination of the amount of a distribution in kind. In determining whether a company has profits available for distribution after any adjustment in accordance with Section 845(3) CA 2006, it is concluded that there must always be a positive balance of profits available for distribution, however small, immediately before the transfer of the asset and the balance cannot be nil. The guidance now notes that the balance may be nil after the transfer of the asset when the asset is transferred at below book value such as to eliminate the whole of the positive balance.

Other changes to the guidance:

> In a situation where an asset is sold partly for qualifying consideration and partly for other consideration (for example a mixture of cash and real property) any liabilities should first be deducted from the amount of qualifying consideration received.

> The guidance on retirement benefit schemes has been rewritten as the previous material was mainly concerned with transition from SSAP 24 to FRS 17.

> New paragraphs draw attention to the considerable doubt concerning the operation of the special rule in Section 843 CA 2006 for long term insurance business in light of the new Solvency II regulatory regime. This will affect accounts for years ending on or after 1 January 2016. The ICAEW understands that the Government is actively considering changing the law to address this issue.

> Further guidance on deferred tax. A deferred tax credit which results in the recognition of a deferred tax asset (rather than a reversal of a realised loss) will generally be an unrealised profit because a deferred tax asset does not usually meet the definition of qualifying consideration.

The exposure draft can be found here.

Foreign companies active in the UK to disclose their beneficial owners

The Department for Business, Innovation and Skills has published a discussion paper setting out various proposals for requiring foreign companies to provide information on their beneficial ownership before they are able to buy land or property in England or Wales or enter into public procurement contracts in England.

This is the latest in a series of measures by the UK Government aimed at increasing transparency. From 6 April 2016 UK companies and LLPs will have to keep registers of persons having significant control, which will mean

information on the beneficial ownership of UK entities will be publicly accessible (click here for more details of how this affects UK corporates). The discussion paper seeks to extend this requirement in effect to non-UK companies buying land or bidding for public contracts here.

The discussion paper is available here and comments are invited by 1 April 2016.

Substance beats form when identifying reverse takeovers

As part of its quarterly consultation No.12, the Financial Conduct Authority is consulting on a change to Listing Rule 5 which would prevent a transaction being artificially broken up to avoid being classified as a reverse takeover.

The consultation also contains proposals to set a reporting format for reports on payments to governments under the Transparency Directive and to update the Prospectus Rules to reflect recent publications by ESMA.

Changes to LR 5 - reverse takeovers

In January 2012, the definition of reverse takeover was moved from LR 10 to LR 5. An unintended result of this move was to lose the connection between the rules on reverse takeovers and the aggregation provisions in LR 10.2.10R. These provisions state that transactions completed during the 12 months before the date of the latest transaction must be aggregated with that transaction if:

> they are entered into by the company with the same person or with persons connected with one another;

> they involve the acquisition or disposal of securities or an interest in one particular company; or

> together they lead to substantial involvement in a business activity which did not previously form a significant part of the company's principal activities.

The FCA is proposing to amend LR 5.6.4R to make explicit reference to the aggregation provisions. This ensures that it is clear that a transaction cannot be broken up to avoid the reverse takeover requirements.

Format for the reports on payments to governments

The FCA is proposing an electronic format for reports on payments to governments made, under the Transparency Directive, by UK listed issuers in the extractive and logging industries. If approved the measures will be set out in a new DTR 4.3A.10R. The format is the same as that currently prescribed in the UK for the reports on payments to governments made under the Accounting Directive. This will ensure that issuers who are required to report under both the Accounting and Transparency Directives can prepare a report which meets the requirements of both Directives. However, it should be noted that these issuers must also continue to disclose, disseminate and file a human readable version of the report (the electronic format is only machine readable). The FCA proposes that this reporting requirement will apply in relation to financial years beginning on or after 1 August 2016.

Changes to the Prospectus Rules

PR 1.1.6G sets out a list of documents that need to be considered together when determining the effect of the Prospectus Directive. The FCA proposes that this rule will be amended to add three opinions from the European Securities and Markets Authority on third country prospectuses.

Click here for the FCA's Quarterly Consultation No.12.

Invitation to Tweet? #TakeoverCode - the communication and distribution of information during a Code offer

The Takeover Panel has published a new consultation paper relating to the communication and distribution of information during an offer.

The proposals in the consultation focus on the means by which information is communicated and distributed to target shareholders and other relevant persons taking into account the requirement in General Principle 1 that all holders of target securities from the same class must be afforded equivalent treatment.

In large part, the consultation seeks to codify existing Takeover Panel practice and, where appropriate, seeks to update the rules to reflect advances in the use of the internet, social media and other forms of electronic communication.

However, the Takeover Panel is proposing to relax certain requirements relating to the chaperoning of meetings with target and bidder shareholders which market participants are likely to welcome.

A full briefing is available on the Linklaters Knowledge Portal. Click here for the consultation paper.

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