Implementation of the EU Transparency Directive

The UK was required to implement the EU Transparency Directive by 20 January 2007. This was achieved via the Companies Act 2006, which includes provisions which amend the Financial Services and Markets Act 2000 and enabled the FSA to make the necessary Transparency Rules. The FSA published its new Transparency Rules (which were incorporated into its Disclosure Rules, re-named the Disclosure Rules and Transparency Rules or DTR) and these came into force, along with the relevant part of the Companies Act 2006, on 20 January 2007, although the financial reporting requirements will apply only to financial years starting on or after 20 January 2007.

What does the Transparency Directive cover?

The Directive is aimed at improving the quality and quantity of information available to the market about issuers who have securities admitted to trading on a regulated market, such as the Official List. The Directive requires:

- listed issuers to produce periodic financial reports; and
- listed issuers to release information useful to investors on a fast and pan-European basis. The Directive establishes a framework for the central storage of such information.

Most UK companies listed on the Official List already comply with many of these requirements.

The Directive also requires major shareholders of issuers with securities admitted to trading on a regulated market to disclose their holdings when these cross certain thresholds. The UK has decided that these latter provisions of the Directive (unlike those noted above) should also apply to companies listed on AIM and PLUS (formerly OFEX).

Key changes for companies admitted to the Official List

Periodic Financial Reporting

Annual Reports - Listed issuers must publish their annual financial report no later than four months after the end of each financial year. The annual financial report must include the audited financial statements, a management report (satisfied by meeting the Companies Act requirement to produce a Business Review) and statements from those taking responsibility for the information in the annual financial report. The management report must, as well as looking at the previous year's performance of the issuer's business, include an indication of future important events, any acquisitions by the issuer of its own shares and details of the issuer's risk management objectives and policies. Responsibility statements must be included from the persons responsible within the issuer (who will generally be the directors, including non-executive directors) accepting responsibility that, to the best of their knowledge, the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the management report includes a fair review of the development and performance of the business and the position of the issuer, together with a description of the principal risks and uncertainties faced. If consolidated accounts have been produced, the responsibility statement must extend to any undertakings included in the consolidation. Those persons taking responsibility for such statements will not necessarily be the same as those who might be liable for such statements - see "liability for financial reports" below - or who bear regulatory responsibility for them.

Half-yearly reports - Listed issuers continue to be required to produce half-yearly reports, and these must be published no later than two months after the end of the relevant period. The half-yearly report must include a condensed set of financial statements, an interim management report and, again, a responsibility statement.

Interim statements - Unless an issuer already publishes quarterly financial reports, its management must release interim statements during the first six months of any financial year and also during the second six-month period. The statements must be published no earlier than ten weeks after the start, and no later than six weeks before the end of, the relevant period. The statements must explain material events and transactions that have taken place since the start of the relevant period and any impact on the issuer's financial position and describe the financial position and performance of the issuer during that time. The FSA expects these disclosures to be less onerous than producing quarterly reports and gave non-exhaustive "negative" informal guidance on what it does not expect issuers to disclose in their statements in its List! newsletter, published in December 2006.

Preliminary statements - Issuers will no longer be required under the Listing Rules to produce preliminary statements of their annual results. However, the FSA has warned that issuers will, in effect, need to produce the same information in order to comply with obligations imposed by the Disclosure Rules so there is likely to be little substantive change for issuers in practice.

Dissemination of regulated information

Information which a fully-listed company is required to disclose under the Transparency Directive (e.g. information about shareholdings), Article 6 of the Market Abuse Directive (i.e. disclosure of inside information), the Listing Rules and the DTR is defined as "regulated information" by the FSA. The DTR require that such information must be published in a manner which ensures that it is disseminated as widely as possible and as simultaneously as possible in the issuer's home member state and any other relevant EEA state. Any announcement related to the publication of periodic financial reporting must include an indication of which website the relevant documents can be found on. There are detailed provisions relating to the way that regulated information is to be communicated, the disclosures it must contain and the media to be used. Regulated information must, at the same time, be filed with the FSA and companies can continue to use a Regulatory Information Service for this. In practice, we do not expect these requirements to have a material impact on issuers because most listed issuers are already accustomed to disseminating information via a RIS.

These new rules apply equally to companies whose home state is the UK as to those with securities admitted to trading on a regulated market in the UK (which is its host state) but whose home state is elsewhere in the EEA.

Key changes for companies admitted to the Official List or other prescribed markets

Voteholder and issuer notification rules

The Companies Act 1985 regime relating to the disclosure by major shareholders of interests in shares of public companies, was repealed on 20 January 2007. Shareholders in companies listed on the Official List and whose Home State is the UK or listed on AIM and other prescribed markets such as PLUS (as long as they are incorporated in and have their principal place of business in Great Britain) are now required to disclose information about the percentage of voting rights held as a result of the acquisition or disposal of shares to which voting rights are attached. This includes shares such as preference shares which have become fully enfranchised. Disclosures under the DTR are necessary when a person acquires or disposes of shares carrying voting rights rather than, under the old regime, where a person acquires or disposes of an "interest in shares." An acquisition or disposal will be treated as taking place when the relevant transaction is executed - i.e. upon a contract being entered into (unless the contract is subject to conditions beyond the control of the parties, in which case the acquisition or disposal will arise on settlement of the transaction). Notification might also be required where the percentage of voting rights changes because of a change in the issuer's total voting rights (e.g. as a result of share buy-backs) or changes to financial instruments which give the holder a right to acquire voting shares.

For UK issuers, the FSA retained the previous 3% and subsequent 1% thresholds for disclosure. Some non-material interests only need to be disclosed at 5% and 10% thresholds (such as voting rights attaching to shares held by investment managers on behalf of others). If a person holds both material and non-material interests which together reach the 5% or 10% thresholds, then all his holdings must be disclosed.

For non-UK issuers, the obligation to disclose starts at 5% and is then triggered again at 10%, 15%, 20%, 30%, 50% and 75%. "Non-UK issuers" are companies listed on the Official List whose Home State is the UK but who are not public companies under the Companies Act 1985 and not incorporated in, or with a principal place of business in, the UK. To judge whether a threshold has been crossed the shareholder must calculate his holding against all the shares in the same class to which voting rights are attached, even if the exercise of such rights is suspended. Aggregation of holdings may be necessary and the aggregation may result in the thresholds being reached earlier than expected.

Certain acquisitions or disposals of voting rights are to be disregarded, but these are not identical to the previous exemptions under the 1985 Act. For example, shares acquired for the sole purpose of clearing and settlement within a settlement cycle will be disregarded, as will shares held by a custodian (or nominee) in its custodian (or nominee) capacity, provided such a person can only exercise the voting rights attached to such shares under instructions given in writing or by electronic means. Shares held by a market maker are, subject to meeting certain conditions, exempt below the 10% threshold. Stock lending transactions will also not be caught by the new rules.

The obligation to disclose also applies to a person who is an indirect holder of shares and who is entitled to acquire, to dispose of, or to exercise voting rights in specified cases. A disclosure obligation will also arise where a person holds specified financial instruments which result in an entitlement to acquire on such holder's sole initiative, under a binding agreement, issued shares to which voting rights are attached. This will not apply to instruments that only give an economic exposure to the underlying shares. It is possible this obligation could catch contracts to purchase shares, the right to call for delivery of the shares, or a physically settled call option.

A person is treated as an indirect holder of shares, and liable to disclose the holding, if he is entitled to exercise voting rights in certain cases. For example, a disclosure obligation will arise where the voting rights are held by a third party with whom that person has concluded an agreement which:

- authorises the parties to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the listed company in question; or

- provides for the temporary transfer (for consideration) of the voting rights in question.

An indirect holder is also under an obligation to disclose voting rights which he can exercise at his discretion in the absence of specific instructions from the shareholder(s). Under the DTR, it may be necessary for both a shareholder and proxy holder to make notifications. The previous exemption where a proxy or corporate representative is appointed to vote at a specified meeting will no longer be available. Where a proxy has been appointed for a specific shareholder meeting, a single notification, which explains what will happen to the voting rights when the proxy appointment ceases to apply, will be sufficient.

The issuer must disclose any acquisition of its own shares where the percentage of voting rights held reaches, exceeds or falls below the 5% or 10% thresholds. It must, at the end of each calendar month during which an increase or decrease has occurred, disclose to the market the total number of voting rights in respect of each of its issued classes of shares and the total number of voting rights attaching to its shares held in treasury.

A person making a notification of his combined holdings must disclose:

- the aggregate of all voting rights which he holds as a shareholder and as the direct or indirect holder of financial instruments;

- the aggregate of all voting rights held as a direct or indirect shareholder;

- the aggregate of all direct and indirect holdings of financial instruments.

The effect of this is that a notification may be needed if the percentage level of one or more of the above categories changes, even if the overall level of voting rights remains the same.

Notification of the relevant acquisition or disposal must be made, in the case of UK companies, by the holder to the issuer by no later than two trading days from when he learns about, or is informed about, the notifiable event and four trading days in the case of a non-UK issuer. Notification must be made on a prescribed form that is available on the FSA's website. Shareholders in Official List companies must also, at the same time, file a copy electronically with the FSA. UK issuers must disclose via a RIS, no later than the end of the following trading day, notifications they have received. For non-UK issuers the deadline will be by the end of the third trading day. There is no longer a requirement for companies to maintain a register of interests in shares which have been disclosed to it under these rules.

Non-EEA companies - equivalent notification rules

Companies which are registered in a non-EEA state, whose shares are admitted to the Official List, and whose Home State is the UK will, if the laws of their jurisdiction are considered equivalent by the FSA not be caught by the notification requirements summarised above. If the laws of the jurisdiction are not considered equivalent they will have to comply with these rules as a non-UK issuer.

Penalties for breach of the transparency obligations

Breach of the voteholder notification rules is no longer a criminal offence. Instead the FSA may issue a public statement of censure or impose financial penalties for a breach of the rules. In addition, the FSA can order the publication of information which should be disclosed or, failing that, publish the information itself.

Changes to the Listing Rules

A number of continuing obligations were moved from the Listing Rules to the DTR in January 2007. For UK issuers with a primary listing of their equity securities on the Official List, these relate to:

- use of electronic communications;

- the requirement for companies to have a registrar;

- amendments to the constitution - which must now be published in draft form to the FSA and the market no later than the date the general meeting to approve such amendments is called;

- the importance of treating all shareholders equally and ensuring equal information is sent to shareholders; and

- notifications relating to capital.

The Companies Act 2006 facilitates the more efficient use of electronic communications, including the introduction of a process whereby shareholders may be deemed to agree to receive information and notices of meetings via the company's website. The DTR also contain provisions permitting electronic communications with shareholders. The FSA has said that it is not ideal to have two sets of rules governing this area and has indicated that the DTR provisions should be "applied in a way which is consistent" with the Act. Companies listed on the Official List should not need to do any more, in terms of obtaining prior approvals, than any other companies, although if such companies could not "lawfully use electronic means" to convey information to shareholders before 20 January 2007 they will need to pass a shareholders' resolution to use such means after that date. The December 2006 edition of List! reminds companies that Chapter 6 of the DTR "stipulates that the use of electronic means must not depend on the location of the shareholder and other persons". However, the February 2007 ICSA Guidance on Electronic Communications with Shareholders states that this rule should be interpreted to mean that within the EEA, companies cannot discriminate between shareholders who hold shares of the same class in relation to the use of electronic communications.

Timing

As mentioned above, the relevant provisions of the Companies Act 2006, including the provisions on electronic communications, came into force in January 2007.

Issuers (including those listed on AIM and PLUS) had to publish, prior to the new regime coming into force, a statement of the total number of voting rights and capital in respect of each class of their shares which were admitted to trading on a market covered by the shareholder notification regime.

Major shareholders were required to notify their holdings by 20 March 2007, if they had not already done so in consequence of a notifiable change. Any such notifications must be published by the issuer by 20 April 2007.

The requirements relating to periodic financial reporting (which only apply to companies admitted to a regulated market such as the Official List) will apply for financial years beginning on or after 20 January 2007. This means that, for many companies, the requirements to prepare reports in accordance with the Transparency Directive will not have an impact until 2008.

Liability for financial reports

The Companies Act 2006 has introduced a new statutory regime governing liability to investors in respect of information in the periodic financial reports required by the Transparency Directive. Under the new section 90A of the Financial Services and Markets Act 2000 (introduced by the 2006 Act), an issuer may be liable to pay compensation to a person who has acquired securities in the issuer and suffered loss in respect of them as a result of any untrue or misleading statement in such financial statements (including any preliminary statements) or because of the omission from any such statement of any matter required to be included in it. The issuer is only liable if its directors (or, in limited cases, other senior executives) knew that the statement was untrue or misleading, were reckless as to whether it was untrue or misleading or knew the omission to be the dishonest concealment of a material fact. The individuals themselves will not be liable to third parties other than the issuer itself. Similar provisions in the 2006 Act, relating to directors' liability to issuers in respect of certain narrative reports (including remuneration reports and summary financial statements), have also come into effect.

The statutory liability regime will not address the issue of liability to existing shareholders. In March the Government announced the terms of reference of a formal review of whether issuers should also be liable in respect of damage or loss suffered as a consequence of the disclosure of inaccurate, false or misleading information by them or their management to financial markets (including their own shareholders or bondholders) or for a failure to disclose relevant information. This extension of liability could apply, for example, to statements required to be published under the DTR.

If you would like more information on any the topics discussed in this Note, please contact your usual contact at the firm.

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