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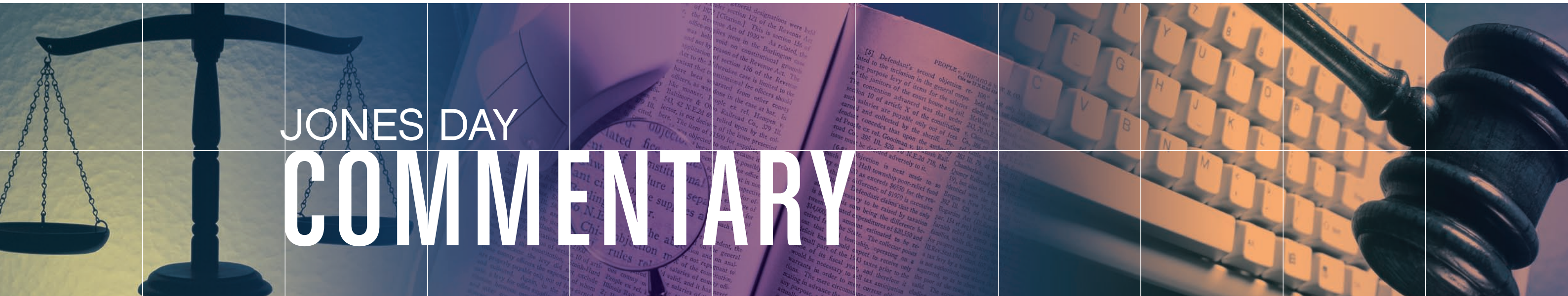

IMPLEMENTATION OF THE TRANSPARENCY DIRECTIVE IN THE UNITED KINGDOM

The Transparency Directive[1] ("TD") was implemented in the United Kingdom with effect from 20 January 2007 through the Financial Services Authority's ("FSA") Transparency Obligations Directive (Disclosure and Transparency Rules) Instrument 2006. This note is a brief guide to the main changes resulting from the implementation of the TD in the UK.

The main changes are:

- Amended content and timing requirements for financial reports.
- Annual and half-yearly reports will have to include responsibility statements.
- A requirement for interim management statements.
- A new statutory liability regime for financial reports.
- Companies will no longer have to issue a preliminary statement of their annual results under the Listing Rules. However, as this will usually be inside information for the purposes of the FSA's Disclosure Rules, a preliminary statement is likely to continue to be required in practice.
- A new regime for the notification of major shareholdings and related obligations on companies to release this information and other information relating to changes in their voting share and loan capital.
- More detailed obligations on communicating with shareholders (including electronic communications) and the market and additional rules on filing information with the FSA.

The above changes will primarily be reflected in the FSA's Transparency Rules, which will be included in the Disclosure Rules sourcebook to become the Disclosure and Transparency Rules sourcebook ("DTR"). The DTR will have new chapters on periodic financial reporting (Chapter 4), shareholder notifications (Chapter 5) and continuing obligations

1 Directive 2004/109/EC.

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and access to information (Chapter 6). In addition, there will be consequential changes to the FSA's Listing Rules ("Listing Rules" or "LR"). This paper focuses on the changes to the periodic financial reporting and shareholder notification requirements. Save in relation to shareholder notifications in Chapter 5, which will also apply to UK companies whose securities are admitted to AIM, these changes apply to companies whose securities are admitted to a regulated market in the UK (including the Official List).[2]

PERIODIC FINANCIAL REPORTING

Scope

Chapter 4 of the DTR sets out certain periodic financial reporting requirements and, in addition to the Listing Rules requirements which remain in force (see below), applies to companies whose transferable securities are admitted to trading on a regulated market and whose home member state is the UK. A company whose securities are admitted to trading on a regulated market whose home member state is not the UK will need to comply with the law of its home member state (which implements the TD). Partial exemptions from the full requirements apply to certain companies:[3]

- *Issuers of wholesale debt and issuers on the Professional Securities Market ("PSM")*: Required to prepare annual reports and may use accounting standards other than IFRS (i.e. no requirement to prepare half-yearly reports or interim management statements).[4]
- *Issuers of convertible securities or depository receipts:* Required to prepare annual financial reports (i.e. no requirement to prepare half-yearly reports or interim management statements).[5]
- *Non-EEA issuers:* Companies incorporated outside the European Economic Area ("EEA") whose laws are considered by the FSA to impose "equivalent" requirements are exempted from the periodic financial reporting requirements in the DTR. A list of such non-EEA states will be maintained by the FSA on its website.[6]

Timing

The new rules take effect for any accounting year beginning on or after 20 January 2007. Consequently, companies with reporting periods starting before this date (e.g. those whose reporting period equates to the calendar year) will not need to follow the new rules until 2008/9 for the 2008 reporting year. However, those companies with reporting periods starting after 20 January 2007 (e.g. April 2007) will have to comply with the rules from the beginning of that accounting period.

Annual Financial Reports

Contents and timing. An annual financial report must include the company's audited financial statements prepared in accordance with the applicable accounting standards, a management report and appropriate responsibility statements from persons responsible in the company (usually the directors).[7]

In addition to the requirements of the Transparency Rules, the annual financial report of a company whose securities are admitted to the Official List must include those items specified in LR 9.8.4, and an official listed company incorporated in the UK must additionally include those items specified in LR 9.8.6. By retaining these Listing Rules requirements, officially listed companies will continue to be required to comply or explain governance arrangements against the Combined Code, make directors' remuneration disclosures and a statement by directors that the business is a going concern, set out details of arrangements under which a director has waived emoluments, make a statement of the beneficial and non-beneficial interests of directors, and give details of the company's purchases of its own shares.

The company must publish the annual financial report no later than four months after the end of each financial year.[8]

Management reports/Operating and financial reviews. The management report must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company. The full requirements for management reports are set out in DTR 4.1.8 to 4.1.11

2 AIM is not a regulated market but a prescribed market for the purposes of DTR 5.
3 See DTR 4.4.
4 DTR 4.4.2 for wholesale debt. DTR 4 does not apply to the PSM as it is not a regulated market for the purposes of the Prospectus Directive. PSM issuers must comply with the requirements of LR 17.3.4 and 17.3.5 as regards the periodic financial reporting.
5 DTR 4.4.4, 4.4.6.
6 DTR 4.4.7, 4.4.8.
7 DTR 4.1.5.
8 DTR 4.1.3.

inclusive, which restate the requirements for "business reviews" in Section 423 of the Companies Act 2006.

Operating and financial reviews ("OFR") were introduced as a legal requirement for all UK quoted companies (full list, NYSE, Nasdaq or officially listed in EEA) for annual financial reports on financial years beginning on or after 1 April 2005.[9] These regulations were, amongst other things, intended to implement parts of the EU Accounts Modernisation Directive. The OFR requirements were repealed with effect from 12 January 2006 on the basis that the OFR requirements were a "goldplating" of the EU Accounts Modernisation Directive.[10] The requirement to produce a business review (or "management report", as termed by the DTR) replaces the OFR requirements in their entirety.

Preliminary Statement of Annual Results

The need to issue a preliminary statement ("prelims") is now optional. However, if companies do choose to issue prelims, the current content requirements will continue to apply, including the requirement that they be disseminated in full text and need to be agreed by the auditors and, in circumstances where the audit report is likely to be modified, they comply with the rule requiring details of the modification.

Those companies who do not elect to issue prelims will still be required to publish inside information as soon as possible in line with their obligations under DTR 2. Consequently, in practice prelims are likely to continue to be issued.

Half-Yearly Financial Reports

Contents and timing. A half-yearly financial report (no longer referred to as an "interim statement") must include a condensed set of financial statements, an interim management report and a responsibility statement.[11] The report must indicate if it has been audited or reviewed by auditors, and if so, the audit report or review must be reproduced in full.[12] The report must be published no later than two months after the end of the period to which it relates.[13]

Publication. The FSA will no longer require listed companies to send half-yearly financial reports to shareholders or to publish them in newspapers.

Interim management report. This part of the half-yearly report must include an indication of the important events that have occurred during the first six months of the financial year and their impact on the condensed financial statements, and a description of the principal risks and uncertainties facing the company in the next six months, together with details of related party transactions.[14]

Interim Management Statements

Unless a company publishes quarterly financial reports, it must release a statement during the first six-month period of any financial year and also during the second six-month period.[15] The management must release the interim management statement between 10 weeks after the beginning and six weeks before the end of the relevant six-month period.[16] As this is a long period during which to comply, companies are likely to have to give the market some indication as to the actual timing of these statements.

The interim management statement must explain material events and transactions that have taken place since the start of the relevant period and their impact on the company's financial position and describe the financial position and performance of the company during that time.[17]

The FSA expects these disclosures to be less onerous than producing quarterly financial reports, and companies may be able to use trading statements as an alternative. In the Transparency Directive edition of *List!* (edition No 14, December 2006), the FSA stated that companies may be able to meet the interim management statement requirements based on the content of performance reports, trading statements and other similar reporting formats with no additional information, provided those statements or reports include the information set out in DTR 4.3.5. This means that it must explain the material events and transactions that have taken place during the relevant period and the impact on

9 See the Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005.
10 See the Companies Act 1985 (Operating and Financial Review) (Repeal) Regulations 2005.
11 DTR 4.2.3.
12 DTR 4.2.9.
13 DTR 4.2.2.
14 DTR 4.2.7, 4.2.8.
15 DTR 4.3.2.
16 DTR 4.3.3.
17 DTR 4.3.5.

the financial position of the company and provide a general description of the financial position of the company (not just the financial performance of the company).

Close Periods Under the Model Code

The definition of a "close period" in the Model Code (which forms part of LR 9) has been amended as follows:

- The period of 60 days immediately preceding a preliminary announcement of the listed company's annual results;
- The period of 60 days immediately preceding the publication of its annual financial report or, if shorter, the period from the end of the relevant financial year up to and including the time of such publication;
- If the listed company reports on a half-yearly basis, the period from the end of the relevant financial period up to and including the time of such publication; and
- If the listed company reports on a quarterly basis, the period of 30 days immediately preceding the announcement of the quarterly results.

In the Transparency Directive edition of List! (edition No 14, December 2006), the FSA stated that there would not be a close period prior to the publication of interim management statements, although the FSA would keep this under review. This is inconsistent with the rules, which state that there is a close period prior to the publication of interim management statements. The FSA has since informally confirmed that the rules erroneously refer to interim management statements and that the close periods are as stated in the bullet points above.

Liability for Financial Statements

The TD requires home member states to ensure that responsibility for the financial statements prepared in accordance with the TD lies at least with the company *or* its administrative, management or supervisory bodies and shall ensure that their laws, regulations and administrative provisions on liability apply to the companies, those bodies or the persons responsible within the companies.[18]

Section 463 of the Companies Act 2006 (which came into force on 20 January 2007) imposes personal liability on a director of a UK company for any loss suffered by the company as a result of any untrue or misleading statement in, or omission from, the directors' report, directors' remuneration report or a summary financial statement. However, a director is only liable 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. The director is not liable to any other person (e.g. a shareholder or a potential investor in the company) regarding the contents of those reports or summaries. The safe harbour of actual knowledge or recklessness in relation to the directors' report, directors' remuneration report or a summary financial statement does not apply to statements made in related documents, such as a chairman's letter sent to shareholders with the report and AGM notice. It remains to be seen whether this will lead to more information being included in the directors' report and less in the chairman's statement. Part 11 of the Companies Act 2006 will set out a new derivative right of action which may be brought by a shareholder on behalf of the company. The action may be brought for acts or omissions involving negligence, default, breach of duty or breach of trust.

Under Section 501 of the Companies Act 2006, a person commits an offence if he or she knowingly or recklessly makes to an auditor of a company a statement (oral or written) that conveys or purports to convey any information or explanations which the auditor requires, or is entitled to require, and is misleading, false or deceptive in a material particular. A person committing such a criminal offence is liable for up to two years' imprisonment or a fine or both.

The new Section 90A of the Financial Services and Markets Act 2000 ("FSMA") imposes a statutory liability regime for periodic financial information published under the provisions made implementing the TD, by companies with securities traded on a UK regulated market or on an overseas regulated market but where the UK is the home member state for such company. Under this section, a company will be liable to pay compensation to a person who has acquired securities and suffered loss as a result of any untrue or misleading statement in, or omission from, the annual financial report, the half-yearly report, the interim management statement or any preliminary statement published in advance of the annual financial report. A company will be liable if a person discharging managerial responsibilities for the publication knew that the statement was wrong or misleading, was

18 Article 7 of the TD.

reckless as to whether it was or knew any omission was a dishonest concealment of a material fact. In practice, a company is only likely to be liable where a director knew the statement was wrong etc. because of the way "persons discharging managerial responsibilities" is defined (the definition includes any director of the company, any member where a company's affairs are managed by its members and any senior executive where a company does not have directors or members managing it (Section 90A(8) of the FSMA). Only the company will be liable to third parties, although the directors concerned may be liable to the company (Section 90A(5) of the FSMA). Note that this definition of "persons discharging managerial responsibilities" is different from that used in Chapter 3 of the DTR.

The annual financial and half-yearly reports must include responsibility statements by those persons responsible within the company. The statements must name the persons responsible and state:

- *For annual financial reports:* That the financial statements give a true and fair view and the management report includes a fair review of the development and performance of the business, together with a description of the principal risks and uncertainties;[19]
- *For half-yearly reports:* That the condensed statements give a true and fair view which can be satisfied by a statement that the condensed accounts have been prepared in accordance with International Accounting Standard 34.[20]

Following its consultation on the proposed extension of responsibility for periodic financial information published by UK incorporated listed companies to their directors, the FSA has decided not to extend responsibility for financial information published pursuant to the requirements of the Listing Rules or DTR beyond the company. Responsibility statements can therefore be signed by one director on behalf of the company without incurring personal liability.

19 DTR 4.1.12.
20 DTR 4.2.10.

SHAREHOLDER NOTIFICATION REQUIREMENTS

Scope

DTR 5 and Sections 89A to 89L of the FSMA implement the TD provisions on the disclosure of major shareholdings. They replace the disclosure of interests in shares provisions in Sections 198 to 220 of the Companies Act 1985 with responsibility for monitoring and enforcement passing from the Department of Trade and Industry to the FSA. DTR 5 applies to companies whose shares are admitted to trading on a regulated market for whom the UK is the home member state and to other UK incorporated companies with shares admitted to trading on a prescribed market, including AIM and PLUS Markets. The provisions relating to the notification of major interests in shares in Sections 198 to 220 of the Companies Act 1985 were repealed with effect from 20 January 2007. Thereafter, shareholders in UK incorporated companies that are not subject to the new requirements will not have an obligation to notify such major interests, though they will be able to investigate interests in shares (see "Investigation of holdings" below).

Announcement of Share Capital and Voting Rights

In order to ensure that the notification regime provides investors with the information they need to make the appropriate disclosures in a timely manner, each company will be required to make a public announcement of the total number of voting rights and capital which are admitted to trading (distinguishing the voting rights attaching to shares held in treasury) at the end of each calendar month during which there is an increase or decrease in its share capital. The transitional provisions required each company to make public (i.e. through an announcement through a RIS) (i) by no later than 31 December 2006 the total number of voting rights in respect of each class of share in issue and which is admitted to trading on a regulated market or UK prescribed market, i.e. AIM and PLUS Markets, and distinguishing the number of voting rights attaching to any shares held by the company in treasury; (ii) any subsequent alteration of that total number of voting rights and of voting rights attaching to treasury shares occurring between the date on which the disclosure in (i) is made and 20 January 2007.

The Disclosure Obligation

Disclosure thresholds. DTR 5.1.2 sets out the basic obligation of disclosure relating to the acquisition or disposal of shares of a company to which voting rights attach. Subject to the exemptions described below, a disclosure obligation will arise when an interest reaches the following thresholds:

- *For UK companies:* 3% of its voting rights and each whole percentage point after that.
- *For non-UK companies:* 5%, 10%, 15%, 20%, 30%, 50% and 75%.

The requirement under Section 324 of the Companies Act 1985 for directors of companies to disclose their shareholdings will be repealed with effect from 6 April 2007, although they will be required to disclose holdings to the extent they fall within the thresholds above.

Investigation of holdings. The provisions in the Companies Act 1985 allowing public companies incorporated in the UK to investigate interests in their shares have been preserved without material amendment in Part 22 of the Companies Act 2006. The provisions in Part 22 came into force on 20 January 2007.

Time limits for notification and manner of notification. Disclosure to the relevant company must be made within two trading days for UK companies and four trading days for non-UK companies. The timing runs from when the shareholder became aware or should have become aware of the relevant acquisition or disposal. Where a person has instructed a third party to effect the transaction, he will be deemed to have knowledge of the transaction no later than two trading days thereafter.

A notification in relation to shares admitted to a regulated market must be made using the form TR-1 available in electronic format at the FSA's website at www.fsa.gov.uk (DTR 5.8.10).

A person must at the same time file a notification with the competent authority of the home member state of the company as well as with the company (DTR 5.9.1).

The company must release details to a RIS as soon as possible on receipt of a notification and by no later than the end of the following trading day for UK companies with shares admitted to trading on a regulated market and by no later than the end of the third trading day for other companies. A company must now comply with DTR 6.3, which sets out more detailed rules as to the dissemination of information than currently in force, when releasing the information to a RIS.

Types of Holding Which Are Subject to the Notification Regime

DTR 5.2 sets out the types of shareholding which will potentially lead to a notification obligation. Both "direct" and "indirect" holdings of shares are covered by the disclosure regime. For example, a parent company of a subsidiary which holds shares will generally be an indirect shareholder, and the shares held by the parent will generally have to be aggregated with those held by its subsidiary when determining if a notification obligation arises. In contrast to the requirements of the Companies Act 1985, interests held by family members are not generally aggregated when determining if a notification obligation has arisen, although the rules in relation to direct and indirect holdings should be examined in each event to ascertain if interests need to be aggregated.

In addition to shareholdings, notification obligations can also arise from the holding of certain financial instruments, provided that they result in an entitlement to acquire, on the holder's own initiative, under a formal agreement, shares (already in issue) to which the voting rights are attached. These financial instruments include options, futures, swaps, forward rate agreements and any other derivative contracts.

The disclosure obligations relate to interests in shares and do not cover contracts for differences ("CFDs"). Consequently, there is currently no disclosure obligation in relation to CFDs under the DTR. Under Rule 8 of the City Code on Takeovers and Mergers, there are different and more stringent disclosure requirements when a company is in an offer period. Essentially, dealings in shares and CFDs in relation to 1% or more of the issued share capital of the company require disclosure by 3:30 p.m. on the business day following the dealing. The FSA has stated that it will undertake further analysis of the effect of disclosure of CFDs on the market and the differing CFD disclosure regimes and models, and proposes to publish the results of this analysis in summer 2007.

Principal Exemptions from Disclosure

The notification requirements of DTR 5.2.1 do not apply in the following cases:[21]

- Shares acquired for the sole purpose of clearing and settlement within a settlement cycle not exceeding three days.
- Persons holding shares in their capacity as custodian or nominee, provided that they can only exercise voting rights under written or electronic instructions.
- A market maker holding less than 10% in that capacity, provided that it does not intervene in the management of the company or exert influence on the company to buy back shares or back the share price. As soon as the 10% threshold is reached, the entire holding is disclosable.
- Shares representing less than 5% of the voting rights of a company held within a trading book of a credit institution or investment firm, provided that the institution or firm ensures that the voting rights in respect of those shares are not exercised or otherwise used to intervene in the management of the company.
- Shares held by a collateral taker under a collateral transaction involving an outright transfer of securities, provided that the collateral taker does not exercise the voting rights.
- Shares held by a borrower under a stock lending agreement, provided that the borrower on-lends or disposes of the shares by the end of the next trading day.

In addition to the above, the following voting rights are to be disregarded for the purposes of determining whether a person has a notification obligation, save where the holdings reach the 5% and 10% thresholds (and above):[22]

- Shares held by persons in their capacity as investment managers.
- Shares held by operators of unit trusts and certain other collective investment schemes.
- Shares held by investment companies with variable share capital.

21 DTR 5.1.3.
22 DTR 5.1.5.

When the relevant 5%, 10% and higher thresholds are reached, the entire holding becomes disclosable.

Sanctions for Non-Compliance by Shareholders

Non-compliance is no longer a criminal offence. The FSA can impose a penalty if it considers that a person has contravened the DTR. The FSA also has certain powers to ensure that the information is disclosed to the market, including the power to prohibit trading in the securities of a company and the power to require certain information to be disclosed to it.

LAWYER CONTACTS

This *Commentary* provides a brief guide to the principal changes in the United Kingdom regulatory regime from the implementation of the Transparency Directive. It does not seek to be a complete summary of the amended regime but rather only highlights certain specific changes which are considered material to companies whose securities are admitted to trading on a regulated market in the UK and for whom the UK is the home member state. This *Commentary* does not reflect the laws or practice of any jurisdictions outside the United Kingdom, nor should it be taken as UK legal advice. Specific legal advice should be taken in relation to particular issues.

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