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CESR's advice on possible level 2 implementing measures for the proposed Prospectus Directive

A response by the London Investment Banking Association

December 2002

1 Introduction

- 1.1 The London Investment Banking Association is the trade association for investment banks with operations in London. Its objective is to ensure that London continues to be an attractive location for the conduct of investment banking business. A list of our members is available on our website: www.liba.org.uk.
- 1.2 We welcome the opportunity to comment on CESR's advice on possible level 2 implementing measures for the proposed Prospectus Directive. We support the objective of the proposed Prospectus Directive to achieve a harmonised and efficient European capital market while providing an appropriate level of investor protection. We do have some concern that the CESR proposals are extremely detailed and the period allowed for consultation was extremely short given the level of detail of the proposals and the complexity of the issues. We hope that CESR will continue to take comments on its proposals and work closely with market participants as we view this as essential to achieving the aims of the Prospectus Directive.
- 1.3 We have had sight of the response sent separately by IPMA and entirely endorse all comments made in that submission. As a result, this response is more general and is aimed more specifically at issues affecting the equity issuance market.
- 1.4 As a general point, while we understand the choice of IOSCO as a basis for the CESR proposals we would point out that the IOSCO standards are rather dated and both the markets and standards of regulation have moved on in a number of areas. In addition they were aimed at equity issuers wishing to make a retail offer in all global jurisdictions and as such they contain a level of detail which is inappropriate in many circumstances. We believe therefore that they should be used as a comprehensive "menu" from which appropriate elements can be drawn out as appropriate. We would also point out that the IOSCO standards were compiled in isolation and were never subject to market consultation.
- 1.5 In many areas we find the CESR proposals to be overly detailed and, in many cases, to go beyond current market practice and regulation, and in some cases, beyond the requirements

of IOSCO. We do not believe that the existing regulatory burden should be increased without full explanation and consultation. We believe that the UK market in particular works extremely efficiently with effective investor protection at present and we would be wary of change without due cause.

- 1.6 We attach for your consideration extracts from our response to the FSA's Discussion Paper 14 which gives our views on a proposed review of the UK listing regime as many of the points raised in that response are also applicable to this consultation process.
- 1.7 The proposals as drafted make little distinction between types of investor or between equity and debt and we feel that it is essential that this is properly addressed.
- 1.8 We feel that the ability of the competent authority to interpret the requirements needs to be made much more explicit for efficient operation of fast moving markets and we feel that in some cases the rules as drafted may dissuade non EU issuers at significant cost to the efficiency and liquidity of the existing EU markets.

Issues and questions raised by CESR

This section considers those questions raised by CESR in the Consultation Paper of October 2002 which relate to equity (shares). The background to each question is, where necessary, briefly explained below.

2 Core Equity Registration Building Block

- 2.1 The core equity registration building block of disclosure items is contained in Annex A of the CESR proposals. In other words the disclosure items in Annex A set out the basic requirements that all equity issuers would have to satisfy in a registration document (updating information, and information specifically relating to the securities and their issuance, would be contained in the securities note, for which there is a separate building block).

2.2 CESR Question 44: Do you agree with the disclosure obligations set out in Annex A?

While we are broadly in agreement with the disclosure obligations in Annex A we believe that in a number of areas they are unnecessarily detailed and in some cases go beyond the existing requirements. In particular:

- We do not believe that CESR should set out requirements for selected financial data - full financial information is already required to be included and the form and content of any summary should be left to the discretion of the issuer and its advisers based on the individual circumstances.
- We do not believe the company's web site address should be included in the prospectus.
- The section on liquidity and capital resources seems unnecessarily detailed and would appear to duplicate a lot of information already disclosed in the issuer's accounts.
- The requirement to detail significant changes in major shareholdings, particularly for the period prior to the issuer becoming a listed company, is unduly onerous. It could

usefully be aligned with the major shareholdings directive, which mandates disclosure above 10 per cent.

- We oppose the reintroduction of an indebtedness statement or capitalisation table for equity issues. This is costly to companies, adds little in terms of investor protection and is effectively covered by the issuer's accounts and the "no material change" statement. The introduction of a working capital statement by issuers would achieve much more in terms of investor protection.
- The requirements for disclosure of related party transactions is adequately covered by the issuer's accounts and should not be included in Annex A where it risks getting out of step with the accounting requirements.

3 Risk factors

CESR's proposals will require disclosure of risk factors. CESR does not propose to list specific risk factors, as the risk factors should depend upon the circumstances of the issuer. CESR does propose to produce later guidance on the sort of risk factors that might be expected to be disclosed. This guidance will be amended in the light of experience and future developments in the market.

3.1 CESR Question 47: Do you agree with this approach?

We believe that disclosure of risk factors is covered under the general obligation requirement and that a specific requirement will lead to unhelpful "boiler plate" wording. We would prefer not to see formalisation of the risk factors requirement, as the risk factors will depend on the issuer.

4 Pro forma information

4.1 CESR Question 51: Do you agree that pro forma [information] should be mandatory in case of a significant gross change in the size of the company, due to a particular actual or planned transaction?

We believe that the inclusion of pro forma information should be permitted but not mandatory. If the resultant information provides significant information to investors it will be included under the general disclosure requirements.

4.2 CESR Question 52: Do you agree that pro forma information should also be required in all cases where there is or will be a significant gross change in the size of a company?

See response above. In addition it is difficult to envisage what additional situations would be caught here.

4.3 CESR Question 53: Do you agree that 25% is the correct threshold figure? Would a different figure, say 10%, be more appropriate?

If required, a level of 25% is not unreasonable. However, the comparators need to be defined. There should also be sufficient flexibility to allow the competent authority to

dispense with the requirement if the resultant percentage is anomalous. Given the requirement for an auditors report on pro forma financial information, mandatory inclusion of such information at a lower threshold would be unduly costly and onerous. The provision of pro forma financial information should only be required where it will be material to investors.

As CESR points out, the competent authority of the home countries should be able, pursuant to Articles 5 and 21 of the Prospectus Directive, to insist on pro forma financial information even in circumstances where the specified threshold criteria are not met. They suggest this should only be possible where there has been a transaction or a transaction is planned and the provision of pro forma financial information would be material to investors (i.e. in order to satisfy the general requirement that all material information is included in the prospectus).

4.4 CESR Question 55: Do you agree that the competent authority should be able to insist on pro forma information being included where this would be material to investors?

This should be adequately covered by the general disclosure requirement and the general ability of the competent authority to require any information necessary to investors.

4.5 CESR Question 64: Do you agree with the disclosure requirements in respect of pro forma financial information as set out in Annex B, in particular with the obligation of an independent auditor's report?

Mandatory pro forma information, combined with the obligation for an independent auditor's report will be an additional cost for issuers which are not currently subject to the listing rules. Mandatory pro forma information is not necessary; where it is provided, there should be an independent report by the auditor.

4.6 CESR Question 65: Would it be more appropriate to restrict the disclosure of pro forma information to the occasions where securities are being issued in connection with the transaction and hence require pro forma information in the securities note?

It is not clear in what circumstances pro forma financial information on significant transactions can be required in the absence of an offering of securities or application for admission to trading, since the Article 10 annual updating requirement does not appear to require it. We would suggest that any requirement is only applied to specific transactions and included in the securities note to be of any use. The trigger should be materiality, not the issue of securities per se.

5 Profit Forecasts

While prospectuses will be required to contain qualitative information about current year trends, uncertainties and prospects, quantitative projections (i.e. profit forecasts or estimates or other quantitative forward looking information) will be voluntary.

5.1 CESR Question 73: Do you have any comments at this stage about this preliminary definition of a profit forecast?

We urge CESR to adopt a definition of a profit forecast that enables issuers to make trading update statements without the need for costly reporting in order to encourage better communication with the market. We believe that reporting should be limited to clear and specific numerical profit forecasts. Trading statements are subject to verification and the general obligation not to mislead the market attaching to those making the statements.

5.2 CESR Question 85: Should issuers be required to repeat or update outstanding ad hoc profit forecasts in the prospectus?

We would refer back to the general duty to disclose material information under Article 5 of the proposed Directive. The directors' view of the prospects for the issuer is material; it will be a matter of judgement in each case whether changes since the last statement are material.

5.3 CESR Question 86: Do you agree with the disclosure requirements in respect of profit forecasts set out in disclosure requirement CESR reference IV.D.3(a) and (b) of Core equity building block (Annex A)?

We do not believe that CESR should be prescriptive on the format of any forecast and that this should be left to the issuer and its advisers based on the individual circumstances. However we do believe that any forecast should be capable of comparison with subsequently reported results.

5.4 CESR Question 87: Do you agree with the arguments set out regarding mandatory reporting by the company's financial adviser?

We support reporting by the issuer's accountants and agree that a report should not be required by the issuer's financial advisers.

6 Directors and Senior Management

6.1 CESR Question 89: Do you agree that [disclosure related to details of fraudulent offences, previous bankruptcies and/or public criticisms] may be material to an investor's decision to invest? Would the provision of such details breach privacy laws in your jurisdiction?

We agree that material information on directors should be disclosed. There should be sufficient flexibility allowed under the requirements to ensure that national privacy rules are not breached. For example, the equivalent UKLA listing rule requirements refer to "unspent convictions in relation to indictable offences" where the CESR requirements would refer to "convictions in relation to fraudulent offences". The wording in the UKLA rules ensures that information which individuals are entitled by law not to disclose is not required to be disclosed.

7 Controlling Shareholders

The UKLA makes it a condition for listing that the company can operate independently of its controlling shareholder and there are arrangements in place to ensure arms length dealings. In addition, disclosure of such arrangements is required. The UKLA listing rules

give a clear definition of what is meant by controlling shareholder in this context (namely a person is entitled to control 30% of the voting rights at general meetings or be able to control the appointment of directors who are able to exercise the majority of votes at board meetings). No definition of “control” is provided in the CESR proposals. We support the existing UK practise and believe that a clear definition should be provided.

7.1 CESR Question 91: Do you think that the additional disclosures of any limiting measures should be required?

Yes. It would also be helpful to have some definition in the rules or in Level 3 guidance of what is meant by “control” or “controlling shareholder” in this context.

8 Documents on display

8.1 CESR Question 93: Do you feel that issuers should be required to put on display all documents referred to in the prospectus? Would this cause problems due to privacy laws or practical problems as a result of having to review lots of documents for commercial information?

As a general principle, information which is material to investors should be adequately disclosed or summarised in the prospectus, so that it should not be necessary for investors to refer to documents on display. In our experience, documents made available for inspection are not frequently inspected, and where they are, it is more likely to be competitors or other parties who are not interested in the documents for investment purposes, rather than potential investors, who are inspecting the documents. As CESR points out in the Consultation Paper, it is not clear what is meant by “documents referred to in the prospectus”. At its widest, this could bring in a large number of documents which may not be material to investors, but where public disclosure could be difficult for reasons of commercial sensitivity. We would therefore support only requiring limited categories of documents to be on display, if any are required at all. One suggestion is that the category should be restricted to material contracts, with a carve-out for the full text of contracts which are commercially sensitive.

9 Specialist Building Blocks

9.1 CESR Question 95: Do you believe that the building blocks in Annexes D, E, F, G and H (relating to property companies, mineral companies, investment companies and scientific research based companies) are appropriate as minimum disclosure standards?

We believe that the building blocks are appropriate. However we are very concerned that, in a number of areas, they extend the existing requirements. For example, it appears that property valuations and experts reports would be required whenever a property company or mineral company issues securities. At present these are required on IPO and on unlisted target assets in an acquisition. To require these reports on existing assets for a straight securities issue adds nothing to investor protection but adds significantly to costs.

9.2 CESR Question 96: What other specialist building blocks (if any) should CESR consider producing in the future?

This will depend on the future development of the market. It is essential that individual competent authorities have sufficient flexibility to allow the development of their markets in a timely fashion.

10 Start Up Companies

Annex C contains the start up company equity issuers building block. This includes requirements for information on the company's strategy and business plan, anticipated investment and advertising expenses and the method of financing them; a requirement to discuss liquidity and capital resources for a period of 24 months from the date of the prospectus; a requirement for an auditor's report on a profit forecast, with profit forecasts to be limited to the current and following financial year at most; a requirement for disclosure of lock-up arrangements or an explanation of the absence of lock-up arrangements with directors, senior managers or substantial shareholders; and an auditors report on the company's accounts if these have not been previously published and filed.

10.1 CESR Question 100: Do you agree with the specific disclosure requirements set out in the building block for start up companies?

The relationship between the requirements in IV.D. of Annex C on auditors' reports or profit forecasts and those in Annex A needs to be clarified. As indicated above, the scope of the report contemplated by IV.D.2 in Annex A is unclear, and hence it is not clear whether there is duplication between the provisions of that paragraph and those of IV.D. in Annex C.

The relationship between the start up companies building block and other building blocks should be made clear. For example, investment companies should only be regulated by the investment company building block and not also the start up company building block, even if they are new investment companies.

10.2 CESR Question 101: Do you feel that additional disclosure requirements should be included, for example - an independent expert opinion on the products and business plan?

Whether an independent expert opinion is necessary or appropriate will depend upon the company and the business sector in which the company is operating but should not be required in all, or even a majority of, cases. The UKLA currently requires such a report only where the company's market or technology is "unproven". A report is not required in most cases. A requirement for any such report should be left to the discretion of the individual competent authority if necessary for that specific issuer.

10.3 CESR Question 102: Do you feel that disclosure of restrictions regarding holdings by directors and senior management etc should be applied to all companies through the core building block? Or should this only be required for all companies where there are such restrictions?

Even in the absence of a specific disclosure requirement, contractual restrictions on dealings in shares by directors, senior management or shareholders are frequently disclosed in prospectuses on the basis that the information is material to investors.

We would therefore think it appropriate to have an obligation to disclose such arrangements where they exist, although not necessarily to have to justify why they are not in place, or to make a negative statement that there are no such arrangements, if that is the case.

11 SMEs

11.1 CESR Question 105: Do you believe that SMEs should only be required to provide details for 2 years under disclosure requirement II.A (the requirement to provide selected financial data?)

If financial information over a three-year period is available, it is hard to see why it should not be provided. From the point of view of investor protection, SMEs are no less risky than larger companies and hence it is difficult to see why less disclosure could be justified. In our view, the circumstance where a lower level of information disclosure may be justifiable is where there is an explicit distinction between different markets, for example, the distinction between admission to listing and to trading on an exchange's market for listed securities as opposed to listing on a second tier market such as the Alternative Investment Market in the UK.

11.2 CESR Question 106: If so, do you believe that all historical information should be restricted to this 2 year period?

See answer to Question 105.

11.3 CESR Question 107: Bearing in mind the materiality tests in the disclosure requirements contained in the core equity building block, if you believe that there should be some specific disclosure requirements for registration documents for SMEs, please list them.

We do not see any reason to require any specific additional disclosure requirements for SMEs.

12 Property Companies

12.1 CESR Question 111: Do you agree that valuation reports as set out in Annex D should be required for property companies?

Valuation reports would be appropriate for listed property companies on IPO, but may be onerous for companies applying to admission on the second tier markets or in the case of public offers of companies which are not to be admitted to trading. See also answer to question 95.

12.2 CESR Question 112: Do you consider it appropriate that the date of valuation must not be more than 42 days prior to the date of publication?

It is appropriate that valuations if provided should be at a reasonably recent date. However making this an absolute requirement rather than allowing the period to be extended in appropriate circumstances where the competent authority agrees could prove unduly onerous, for example where the timetable for an offering slips by a few days. In addition if there has been no material change from a valuation in the companies accounts or other documentation a new report would not add to investor protection. CESR could consider aligning this deadline with the period of 60 days allowed for the publication of financial results in the proposed transparency obligations Directive.

12.3 CESR Question 113: Do you agree that it would be more appropriate for such reports to be required when securities are being issued by a property company and hence should form part of the securities note?

Yes. Given the requirement for the valuation to be as at a date not more than 42 days prior to the date of the prospectus, it would make sense for it to be contained in the securities note, if this is published later, rather than in the registration document.

13 Mineral Companies

13.1 CESR Question 116: Do you agree that expert reports should be required for mineral companies? Do you agree that it would be more appropriate for such reports to be required when securities are being issued by a mineral company and hence should form part of the securities note?

See answer to question 95. We agree that such reports should only be required on IPO or on target assets on admission of securities for an acquisition and that it is appropriate for the report only to be included in the securities note. It would therefore seem appropriate that the dating requirement for the report should be not less than six months before the date of the securities note rather than the date of the registration document. Consideration should also be given as to whether it is unduly onerous to require such reports for companies which are not applying for admission to listing.

13.2 CESR Question 117: Do you agree with the disclosure requirements in registration documents for mineral companies set out in Annex E?

Yes.

14 Investment Companies

The proposed investment company building block is considerably less prescriptive than the UKLA listing rules on investment companies as they currently stand and as proposed to be amended. For example, there will be no ability to impose an undertaking on the company to adhere to its investment policy for a particular period or to undertake to comply with conditions necessary to qualify for a special tax status. There will also be no ability to introduce disclosure requirements on the charging of management fees to capital (as the UKLA listing rules on VCTs currently require). In addition, while “relevant details” must be disclosed of investments that have a value of a greater than 5 per cent. of gross assets,

no explanation is given as to what is meant by “relevant details”. Perhaps this is a matter on which Level 3 guidance could be given.

14.1 CCSR Question 120: Do you agree with the disclosure requirements in registration documents for investment companies set out in Annex G?

Some of the disclosure requirements are somewhat vague (e.g. the requirement to give “relevant details” of investments representing more than 5 per cent. of gross assets). It will be helpful if Level 3 guidance could be given on specific disclosure standards.

15 Scientific Research Based Companies

The requirements on scientific research based companies set out in Annex H are again less prescriptive than the UKLA listing rules on scientific research based companies. In particular, the CCSR proposals do not require commentary on funding requirements for the next two years, there is no requirement for an independent report on the company’s products and business and there is no requirement for details of past fund raisings.

15.1 CCSR Question 123: Do you agree with the disclosure requirements in registration documents for scientific research based companies set out in Annex H?

Again this is an area where further guidance under Level 3 might be helpful to enable companies to understand what is meant by “a full description” of each product. The requirement that the company should confirm that it is engaged in agreements with organisations of high standing and repute or that the absence of such agreements does not reduce the standing or quality of its research efforts may be excessive for companies which are not seeking listing or admission to trading on a regulated market.

16 Securities Note

Annex K sets out the required contents of securities notes relating to shares. Additional building blocks taking account of different categories of issuers, offers, markets and securities are to be developed for consultation in the coming months.

16.1 CCSR Question 249: Do you consider it an appropriate approach to obtain flexibility by creating specific building blocks on particular characteristics of some issuers, offers, markets and securities?

Yes. For example, in the response to Question 261 below, we highlight certain items of information that would be reasonable for a new issue of shares but may be impracticable to provide in the case of a sale of existing shares. The additional building blocks should not merely add to the disclosure items suggested in the existing Annexes, but should remove disclosure items that are not appropriate in particular cases. We also believe that this principle should extend to registration documents as well as to securities notes. In particular, we believe it is appropriate to distinguish between listed and other securities and between securities that will be admitted to trading and those that are to be offered to the public without being admitted to trading.

Under Article 8 of the Prospectus Directive, those responsible for the prospectus must be at least the issuer or its directors, the offeror or the person asking for admission to trading on a regulated market. The person responsible must give a responsibility statement. Annex A requires a responsibility statement to be given in relation to the registration document and Annex K requires a responsibility statement to be given in relation to the prospectus as a whole. These statements appear to be required from persons taking responsibility for parts only of the registration document or prospectus. If the current regime in the UK under which persons authorising part of the document are regarded as “persons responsible” were continued, this would mean that accountants or other experts, who are required to authorise the inclusion of their reports or statements in the document would have to give a responsibility statement which would look at the import of the whole prospectus. This is considerably more onerous than merely taking responsibility for the accuracy of their own statement or report.

16.2 CESR Question 254: Sections 1.6 and 1.7 both concern the responsibility attached to drawing up a prospectus. Although under the proposed directive it is possible to choose a format consisting of three documents (registration document, securities note and summary) these three documents are considered as making one prospectus. Is it therefore correct to assume that responsibility for each of these three parts must rest with the same person?

There may be practical difficulties in imposing requirements for the same persons to be responsible for both the securities note and registration document where these are published at different times, as permitted by the Directive. It is also not clear whether an offeror or person requesting admission of securities to listing may publish a securities note in connection with the particular offer or request, and be responsible for it, while relying on a registration document for which solely the issuer and its directors took responsibility.

16.3 CESR Question 261: For [Annex K] please identify those items that you deem unnecessary.

Set out below is a list of provisions in Annex K which, in general, appear likely to impose a burden of disclosure on issuers, offerors or persons asking for admission to trading, which outweigh any benefit potential investors may gain from the provision of such information (and see also the specific comments made in relation to each item):

- III.A** Capitalisation and indebtedness: The UKLA, after consultation, deleted the requirement for a similar statement of indebtedness in the case of listing particulars or prospectuses relating to shares, in January 2000.
- III.B.4.** Use of proceeds - details of indebtedness being repaid. This is far too detailed and of limited value to investors.
- V.A.6** Status of securities: The items mentioned appear more related to debt than shares.
- V.A.9** Authorisations: This is appropriate for new issues of shares but could be impossible to provide in the case of a sale of existing shares, which may have been previously traded or have been acquired over a period of time.

- V.A.10** Issue date: See comment on V.A.9.
- V.A.13** Registered or bearer: There appears to be duplication with V.A.3.
- V.A.14** Legal Framework: Disclosure of general company law provisions seems unnecessary, at least where admission or an offering is not taking place outside the issuer's home state.
- V.C.4** Basis of allotment: It needs to be clear that the requirement for disclosure under this heading does not override the issuer's or seller's ability to retain flexibility in relation to these matters.
- V.E.3** Pricing factors: See comment on V.C.4.
- V.E.4** Offering price: This seems to duplicate V.E.3, as well as containing references to warrants and convertible securities which do not seem appropriate in the context of shares.
- V.E.6** Price history: These requirements could be unduly burdensome in the case of companies which have traded on several markets, or in the case of smaller companies which have been listed through a trading facility which is not a regulated market (which could arise without consent of the issuer).
- V.G** Disclosure of markets on which securities traded: In cases where an issuer's securities are traded on a number of markets, with or without consent of the issuer, disclosure of the principal markets might be more useful.
- V.H** Selling securities holders: Where a number of individuals (such as employee shareholders) are involved in a sale, each selling relatively small numbers of shares, disclosure of details of their addresses and the number of shares sold in the prospectus could be damaging to those individuals without it being material to investors to know these details.
- V.I.2** Expenses: The level of detail required seems excessive. What should be required is clear disclosure of what expenses are to be borne by the issuer.
- V.J.1** Dilution: The disclosure of past prices at which directors, management or affiliated persons have acquired shares in the past may be burdensome to compile and hardly seems material to investors, who need to assess the company on the basis of current information as to its business and prospects rather than on the basis of historic prices.
- VI.A** Articles of Association: The information on corporate objects etc. seems more appropriate to the registration statement than to the securities note.

16.4 CESR Question 262: For [Annex K], please list those items that are missing and that should be in the securities note.

The securities note must, under Article 12 of the proposed Directive, update the registration document if there has been a material change or recent development since the date of the registration statement. However, it would be more appropriate for the statement required by Annex A VII.L (Significant change in the company's financial trading

position) to be stated in the securities note, rather than in the registration statement with an obligation to update the statement in the securities note.

17 Incorporation by Reference

Documents incorporated by reference will form part of the prospectus and hence those taking responsibility for the prospectus will assume responsibility for the contents of the documents incorporated by reference. Incorporation by reference of previously published documents may cause practical difficulties, as the prospectus will need to update or amend aspects of such documents which are no longer current, with the potential consequence that the prospectus is more confusing than if it had been drafted as a standalone document. It should also be noted that the draft Directive has changed in relation to the annual updating of prospectuses since the draft of 9 August 2002 to which the CESR Consultation Paper refers. The explanation of the relationship between incorporation by reference and the updating requirement in the Consultation Paper is somewhat confusing and in any event needs to be modified to reflect the changes to the Directive.

CESR proposes that the following documents, published in the same language as the prospectus and filed with the competent authority either before or at the same time as the prospectus, may be incorporated by reference in a prospectus:

- annual and interim financial statements;
- merger and demerger documents;
- auditor's report;
- memorandum and articles of association;
- earlier approved and published prospectuses;
- press releases.

17.1 CESR Question 281: Do you think the above illustrative list is acceptable?

In relation to the possibility of inclusion of press releases, it would be helpful if it could be made clear whether this only applies to regulatory announcements required, for example, pursuant to the Listing Rules or to the Market Abuse Directive, or whether press releases of any kind could be included. We would suggest that certain other documents such as circulars to shareholders or other securities holders may also be appropriate for incorporation by reference. It would also be helpful to allow competent authorities the flexibility to permit other documents to be incorporated by reference in appropriate cases.

17.2 CESR Question 282: Should further technical advice be given on the documents that can be incorporated by reference in the prospectus? In the case of an affirmative answer, please indicate which technical advice should be given.

We do not find the explanation of incorporation by reference in paragraphs 267 to 269 of the CESR consultation paper very clear. In addition, the advice and explanation needs to be modified to reflect the current draft of the Directive as regards updating of registration documents.

CESR proposes that documents incorporated by reference should be published in the same way as the prospectus, with easy electronic links where the prospectus is published in electronic form.

17.3 CESR Question 289: Should other aspects concerning the accessibility of the documents incorporated by reference be considered?

We agree that it is appropriate that documents incorporated by reference should be accessible in the same way as the prospectus to which they relate.

17.4 CESR Question 290: Should CESR give other technical advice on further aspects of incorporation by reference? In the case of an affirmative answer, please indicate which technical advice should be given.

See the response to Question 282 above. In addition, it would be helpful if it could be made clear whether it is possible to incorporate parts of an earlier document by reference but not the whole document. For example, where an earlier published prospectus was to be incorporated by reference, parts of that prospectus might no longer be relevant. Would it be necessary to incorporate by reference the whole document and then provide an update in respect of the no longer relevant parts, or would it be possible to omit them from incorporation by reference?

It would also be helpful if guidance could be given as to whether documents filed to give pricing information as required by Article 8.1 of the proposed Directive are deemed to be part of the prospectus (to which liability and responsibility provisions apply). Finally, it would, as indicated above, be helpful to have clearer guidance as to whether documents referred to in the updating documents required by Article 10 of the proposed Directive are deemed to be documents incorporated by reference in a prospectus.

18 Availability of the Prospectus

CESR proposes that where a prospectus is published in electronic form, this should be done in such a way that the prospectus is easily accessed, the file format cannot be modified, the prospectus should not contain hyperlinks except to documents incorporated by reference, and investors should be able to download and print the prospectus.

18.1 CESR Question 337: Should there be technical implementing measures at Level 2 further defining what is deemed to be “easy access” and which specific file formats are accepted for this purpose?

No, such advice would risk rapidly becoming out of date as a result of technological changes.

CESR proposes that where a prospectus is published in a newspaper, the newspaper should be a national newspaper (but need not be a daily newspaper), it should be one of the eight newspapers with higher circulation in the member state and it should be a general or a financial information newspaper.

18.2 CESR Question 314: Are there any additional factors and/or requirements that should be taken into account at Level 2 concerning the availability via the press?

These requirements are too restrictive. The circulation requirements could (and certainly will if the Sunday papers are included) preclude the publication of a prospectus in the Financial Times in the UK. Meanwhile, several of the higher circulation newspapers in the UK, while falling within the definition of “general information” newspapers would probably not be regarded by issuers or offerors as suitable newspapers for the publication of a prospectus.

The directive does not make publication of a prospectus in the newspaper mandatory. However CESR believes that if the prospectus is posted on the issuer’s website, a notice should be published in a newspaper in a way that would fulfil the requirements for publication of prospectuses. Such a notice would need to identify the issuer, the securities to be offered or for which trading is sought, a timetable and a statement that a prospectus has been published and where it is available. We believe that there should be an alternative to publication of a notice in a national newspaper (for example release to a newswire or the competent authority). Particularly where there is no retail offer this requirement is costly and unnecessary.

18.3 CESR Question 325: Do you consider appropriate the requirement to publish the said notice in the absence of a specific provision in the Directive Proposal?

This question is no longer applicable, as the directive has been amended to include specific provision for such notices.

18.4 CESR Question 326: Should the minimum contents of the notice be determined at Level 2 legislation?

Yes but see comment on question 314

18.5 CESR Question 327: When the prospectus is made available by its insertion in one or more newspapers or in the form of a brochure, besides the publication of a specific notice, should the list available at the website of the competent authority mention where the prospectus is available?

This would be helpful.

18.6 CESR Question 326: In case of an affirmative answer to the previous question. Should the indication in the website of the competent authority be considered enough and, consequently, should it be considered as an alternative to the publication of a formal notice by the issuer/offeror?

Yes, since this would lessen the costs to be borne by issuers – see answer to question 314.

18.7 CESR Question 331: Which other issues regarding the availability of the prospectus in the form of a brochure should be covered by CESR’s technical advice?

We have nothing to add.

18.8 CESR Question 334: Do you consider that the issuer should not ask the investor for the payment of the delivery or mail costs?

Yes.

18.9 CESR Question 335: Should additional issues regarding the delivery of the paper copy of the prospectus be dealt with by Level 2 legislation?

We have nothing to add.

London, 20 December 2002

1. Introductory remarks

1.3 The success of the London financial markets as a [...] source of capital for UK and global companies is a testament to the legal and regulatory regime which has developed over many years. A system of checks and balances provides investor protection and a level of transparency of corporate behaviour, while maintaining a flexible and cost-effective regime for companies to raise capital. The UK Listing Rules are at the heart of this system for companies whose investors seek the standard or 'kite mark' that a London official listing provides.

1.4 The UK has established widely recognised standards of corporate governance and investor protection rules, while maintaining deep and liquid markets. The regime has been reasonably flexible and not unduly prescriptive, and has not over-burdened issuers with unnecessary costly compliance regulations to which investors might attribute little value. The very size of the UK market, and its continued status as a capital market of choice for many global companies, supports this view.

1.5 Our members generally consider the UK listing regime to be an appropriate and cost-effective framework supporting the UK financial markets. In our view, the UKLA generally meets its purpose as competent authority which is summarised as aiming to provide...

*'... a cost effective regime which facilitates access to capital markets by a broad range of business, and to operate that regime so as to maintain market confidence and to protect investors...'*¹

This is also consistent with the FSA's strategic aim set out in the Plan and Budget 2002/03 of ensuring:

*'....Consumers and other participants have confidence that markets are efficient, orderly and clean... and [inter alia]...
....continuing development of deep and liquid markets facilitating the capital raising process whilst maintaining investor protection...'*

1.6 We have some specific concerns with, and comments on, the details of the Listing Rules and DP14, which are set out in this paper. On balance, however, we consider the Listing Rules represent a fair and reasonable body of corporate regulation which help to determine how companies with an official listing, or those seeking admission to listing, should behave.

1.7 We note the FSA will be considering '... whether high level principles or more prescriptive rules' are the most appropriate framework for the Listing Rules and this will be considered in subsequent consultation papers under each theme. Our view is that, generally, the current approach is about right - somewhere between high level principles and detailed rules supporting them, coupled with interpretation guidance notes supporting the whole 'package'. The need to retain regulatory flexibility and a level of discretion is essential, as a 'one size fits all' approach rarely suits the dynamics of fast-moving capital markets, nor the huge variety of organisations wishing to access the UK capital markets. The application of the UKLA's principle of proportionality is particularly important in this context.

1.8 We believe it is a good time to be considering 'modernising' and reviewing the Listing Rules, some nine years after the last full review. This is particularly timely in the context of the changing economic and regulatory framework and global focus on corporate governance issues.

- 1.9 Given the volume of proposed changes to the EU regulatory environment, we hope that it will prove practical for the results of this consultation process to be used to inform the UK's input to the EU processes. We note, however, that this may be difficult for certain well - advanced proposed EU measures which could have a significant and ongoing impact on the Listing Rules, for example the Market Abuse and Prospectus directives.

'Super-equivalent rules' and 'maximum harmonisation'

- 1.10 There is much discussion in the DP about the possibility of some elements of the Listing Rules falling away or becoming ineffective in future due to the impact of various EU directives. In particular, we understand the latest draft of the Prospectus Directive is intended to be on a 'maximum harmonisation' basis, so that some provisions in the Listing Rules which are 'super-equivalent' to the Directive might not be compatible. It is also suggested that, if other directives in the securities areas were in future adopted as 'maximum harmonisation' directives, this could require revision of other areas of the Listing Rules. The DP suggests alternative means will be investigated for retaining those super-equivalent provisions which the FSA and respondents believe should be retained.
- 1.11 We have noted various recent comments suggesting that there is no intention that corporate governance or ongoing listing arrangements in member states should be subject to maximum harmonisation arrangements. We are not, however, aware of any clarification from the EU Commission on this point, which would be helpful.
- 1.12 The attractiveness of the London market as a place to raise capital is, we believe, in large part due to the flexibility of the existing regulatory regime and the system of checks and balances that have grown up over time. At the centre of these, the Listing Rules and the UK's governance codes remain amongst the 'strongest' in Europe and worldwide, while retaining flexibility and avoiding prescription. We believe the combination of clear rules, made in a transparent manner, with the exercise of regulatory judgement in an accountable way, is essential to an effective capital market.
- 1.13 Our members support the objective of creating a single European capital market, allowing companies to raise capital through cross-border multi-jurisdictional offers across the EU. We are not convinced that the gains for (relatively few) multi – jurisdictional offers would necessarily outweigh the losses in domestic investor protection terms, if a maximum harmonisation approach were to be adopted for the draft Prospectus Directive. There are certain positive elements of the UK listing regime affecting new issues which may become 'super-equivalent' to the draft Prospectus Directive. In particular, the working capital statement, the need for accountants' reports, profit forecast reporting and elements of the specialist company regimes. In such cases, we encourage the UK to take a lead in EU-wide consideration of such matters, for example to consider their inclusion at the level 2 and level 3 stages of finalisation of the draft directive.
- 1.14 Regarding the continuing obligations for listed companies (or those 'admitted to trading on a regulated market'), we note our strong support for EU member states, including the UK, to have the right not to have to diminish existing standards to meet any lower levels which might be mandatory in future directives. Such super-equivalent provisions might be in the Listing Rules, company law or other codes or frameworks. We recognise, however, that the aim of creating a single pan-European capital market is made more difficult if companies are subject to different standards in different jurisdictions. On balance, however, we would oppose the imposition of a maximum harmonisation approach in other EU directives in future, such as, for example, in any revision of the 'Consolidated Admissions and Reporting Directive' ('CARD') which underpins much of the Listing Rules, or the proposed Transparency Obligations Directive ('TOD').

2. Summary

- 2.1 The success of the London financial markets as a pre-eminent source of capital for UK and global companies is a testament to the legal and regulatory regime which has developed. A system of checks and balances provides investor protection, widely recognised standards of corporate governance and a level of transparency of corporate behaviour, while maintaining a flexible and cost-effective regime for companies to raise capital. The UK Listing Rules are at the heart of this system for companies whose investors seek the standard or 'kite mark' that a London official listing provides.
- 2.2 We believe the current approach to the listing regime—where the Listing Rules lie somewhere between high level principles and detailed rules supporting them- is about right. The need to retain regulatory flexibility and a level of discretion is essential, as a 'one size fits all' approach rarely suits the dynamics of fast-moving capital markets.
- 2.3 There is currently an extensive amount of regulatory change, particularly emanating from the EU, which may have a significant effect on the listing regime. Our starting point in considering changes is that, while there are some particular areas where we suggest and support change, in general we consider the Listing Rules are a positive feature in supporting deep and liquid capital markets in the UK.
- 2.4 Our members support the goal of creating a single financial market for the EU. A large number of initiatives are underway towards this goal, including preparation of the new draft Prospectus Directive and proposals to introduce other directives affecting the continuing obligations of companies whose securities are traded on regulated markets, such as the proposed Market Abuse Directive ('MAD') and TOD.
- 2.5 A single European capital market should allow companies to raise capital through cross-border multi-jurisdictional offers across the EU. We are not convinced that the gains for (relatively few) multi – jurisdictional offers would necessarily outweigh the losses in domestic investor protection terms, if a maximum harmonisation approach were to be adopted for the draft Prospectus Directive. There are certain positive elements of the UK listing regime affecting new issues which may become 'super-equivalent' to the draft Prospectus Directive. In particular, the working capital statement, the need for accountants' reports, profit forecast reporting and elements of the specialist company regimes. In such cases, we encourage the UK to take a lead in EU-wide consideration of such matters, for example to consider their inclusion at the level 2 and level 3 stages of finalisation of the draft directive.
- 2.6 As regards the ongoing or continuing obligations of companies, once their securities have been admitted to trading, our members strongly support the right of EU member states not to have to diminish existing standards to meet any lower levels which might become mandatory in future directives, such as TOD. We would therefore oppose the imposition of a maximum harmonisation approach in other EU directives affecting continuing obligations.
- 2.7 We note the FSA intends issuing a number of detailed consultation papers on the listing regime. Our initial responses to the issues raised in DP14 are summarised below, as a precursor to more detailed consideration of the topics in the future consultation papers.

Corporate Governance

- 2.8 We strongly support the Listing Rules requirement for companies to disclose compliance with the Combined Code in their annual report, and any reasons for non-compliance. We believe the Combined Code should continue to be non-statutory.
- 2.9 We also support continuance of the Model Code in its current form as an adjunct to the Listing Rules. We believe the rules concerning related party transactions are also a positive feature of the UK's corporate governance regime. Special rules relating to overseas companies with or seeking listings in London are also strongly supported and help to maintain London's position as an international market of choice.

Corporate Communications

- 2.10 We strongly support the UK's continuous disclosure regime, currently grounded in **Listing Rules 9.1 and 9.2**, and consider these essential to continuation of the present corporate communication regime and the integrity of UK markets. We comment on the key issues identified in the DP in this area, and have identified some additional areas for consideration. This has been an area where there has been increased focus, particularly since introduction of the UK market abuse regime, and where further significant regulatory change is currently in progress.
- 2.11 In particular, this paper considers alternatives for improving the somewhat unsatisfactory area of forward-looking information. These include reducing the need for some public formal reports on profit forecasts required in documents which do not involve share issues with listing particulars. It also includes suggestions regarding price-sensitive information and the issue of pre-briefings.
- 2.12 We seek clarification of the possible impact of current EU proposals in this area, particularly the draft MAD and proposed TOD, and ask that the FSA analyse differences between UK practices and draft proposals as they progress, and consult with the UK market accordingly.

Shareholders' Rights and Obligations

- 2.13 The Listing Rules reflect a body of market practice which has developed over many years, defining how listed companies will behave and what investors expect of them, beyond the company's formal constitution. We believe the shareholder rights provisions have been a major factor underpinning London's continued success as a pre-eminent financial centre for companies to raise capital on a cost-effective basis.
- 2.14 We comment on specific potentially 'super-equivalent' areas of the Listing Rules highlighted in the DP. In general, we see benefits in maintaining these provisions in the UK if practicable, because we believe shareholders continue to see them as supporting the 'kitemark' of a UK official listing. Some modifications are proposed in certain areas.
- 2.15 In particular, we support the continued need for class one circulars for significant transactions. However, we present a range of options for consideration for improving the cost-effectiveness of the current regime, such as considering dispensing with the need for UKLA reviews and shareholder approval of class one transactions (provided circulars are still issued), and amendments to the formal reporting regime for profit forecasts referred to above.
- 2.16 We support the existing regime for circulars and shareholder approval in respect of related party transactions.

Financial Information

2.17 We comment on the role of the FSA regarding financial information, where we see no reason to change the existing arrangements.

2.18 Detailed comments are provided on the following areas:

2.18.1 Quarterly reporting and the timing of quarterly and annual reports- our members have the following points to make:-

- We do not believe that ‘one size fits all’ in this area. We believe that the ‘adequate’ frequency for issuers of equity and equity-linked securities is an interim and final financial report, supplemented by trading statements where necessary. The ‘higher’ standard is quarterly reporting, which is mandatory for US-quoted European companies for practical purposes.
- We believe the current UK framework in the Listing Rules and company law for the timing of interim and preliminary results, and the annual report and AGM, works very well.
- We endorse the fundamental principle of regular release by listed companies of statements about material developments in their trading positions.

2.18.2 Working capital statements- the majority of our members strongly support continuation of the current requirements in this area.

2.18.3 The need to retain specialist regimes for different types of company, and specialist securities.

Sponsors

2.19 The majority of our members support continuation of the sponsor regime in the UK. Some suggestions are made to improve the cost-effectiveness of the current regime (particularly regarding eligible employees and the way the UKLA/FSA is organised to operate its sponsor regulation).

2.20 As at present, we do not believe a sponsor should be required to be retained by listed companies at all times, nor by issuers which only have listed debt securities.

3. Corporate Governance

Question 1:

Do you feel that the disclosure requirement imposed on issuers in the Listing Rules to state whether or not they have abided by the Combined Code is valuable? (**paragraphs 4.7 – 4.15**)

3.1 As stated in **section 1 above**, London’s attractiveness as a place to raise capital is in large part due to the system of checks and balances that have developed. At the centre of these, the Listing Rules and governance codes have been among the strongest in Europe and worldwide. Much change is now taking place in this area. In particular, we note the second report of the EU High Level Group of Company Law Experts (chaired by Professor Winter) is expected to consider the whole range of corporate governance issues and may lead to further action at the EU level.

3.2 We believe the Combined Code is a valuable element of the UK’s corporate governance regime, which underpins the continued attractiveness of the London capital markets, particularly in the current environment. We support the overall approach of the Combined Code and also its status as a non-statutory, principles-based Code for listed companies. We welcome the Government’s recently-stated intention to continue this non-statutory approach².

- 3.3 The Combined Code provides a strong framework for a high level of corporate governance, while retaining the flexibility needed. There may be companies for whom certain rules may not be appropriate, for example, the cost of a large board of directors for a small company may be thought to outweigh the benefits. The ability to ‘opt out’ of a particular requirement, provided this is disclosed to shareholders, with the reasons for doing so, is important. Shareholders can then make informed choices about their initial and continued investment.
- 3.4 **We therefore also strongly support the Listing Rules requirement (12.43A) for companies to disclose compliance with the Combined Code in their annual report, and any reasons for non-compliance.**
- 3.5 We note, however, that the Government intends to adopt the Steering Group of the Company Law Review’s recommendations³ to designate a new Standards Board to keep the Combined Code under review. The White Paper² also describes the Government’s intention to transfer from the UKLA to the new Standards Board the making of rules requiring companies to disclose compliance with the Code.
- 3.6 If the Standards Board does take over responsibility for the equivalent of **Rule 12.43A**, we would wish to see its content effectively unchanged, at least not ‘watered down’ to any extent. It is not clear whether this requirement to disclose compliance (and any reasons for non-compliance) would become a statutory requirement. Provided the Combined Code itself remained voluntary, however, compulsory disclosure would not give concerns to our members.
- 3.7 We question, however, the need for an additional regulatory body – the proposed Standards Board - to be set up for this (and other) purposes, given the existence of a number of other bodies which listed companies already have to deal with, and which could arguably undertake such roles, whether statutory or practitioner-based. As regards guardianship of the Combined Code in particular, we consider a non-statutory model to be preferable, in order to facilitate effective development of the Combined Code in the light of the rapid pace of change in market practice and expectations. For example, a body including representatives of company directors, shareholders, and advisers should be considered.

Question 2:

Do the provisions of the Model Code still add value in the modern regulatory framework? (**paragraphs 4.14-4.15**)

3.8 The value of the Model Code is:

- 3.8.1 Standard-setting – it provides a greater level of detail and is easier to understand and apply than, for example, the Code of Market Conduct or the law on insider dealing.
- 3.8.2 It encourages Directors and employees to ‘stop and think’ about insider dealing, market abuse and reputational risk issues flowing from proposed actions.
- 3.8.3 It has clear lines of responsibility.
- 3.8.4 It is short, clear, readable and easy to access.
- 3.8.5 It contains discretionary provisions to deal with cases ‘in extremis’.

3.9 **We support the continued inclusion of the Model Code as an adjunct to the Listing Rules** and the Listing Rules requirement for Directors and certain employees to comply with a code of dealing no less exacting than the Model Code.

3.10 We do not consider any of the provisions of the Model Code to be redundant, despite introduction of the Code of Market Conduct and the proposed MAD. The Model Code provides an easy reference for Directors and can be updated as needed if regulatory or market requirements change.

Paragraph 4.9 of DP - Possible Code of Conduct or guidance concerning flotations and new issues

- 3.11 We do not consider introduction of some form of industry guidance or code of conduct in relation to flotations and other new issues to be necessary, given the welter of other regulation in the area, and the overarching principle that advisers value their reputation extremely highly. In addition, the approach taken by practitioners in the London market is reasonably formalised. Given also the recently introduced UK market abuse regime, we do not believe another code of conduct would add anything in the already highly regulated area of new issues.

Paragraph 4.12 Should the Listing Rules include guidance on issues such as conflict of interest of directors, limits on the number of directorships that a director can hold, and disclosure requirements for investment entities?

- 3.12 We do not have specific comments on these issues. We note the current review by Mr Derek Higgs may provide impetus for changes here and support the need for debate concerning non-executive Directors ('NEDs'), including the importance of independent NEDs. We would welcome clarification of the UKLA's views on conflicts of interest of directors, particularly in the light of responses to the Higgs review. However, we believe any additional prescriptive requirements on Board composition, numbers of Directorships and so on, should continue to be voluntary, by inclusion in the Combined Code. Guidelines can be useful, but the existing flexibility should be maintained for companies, and Directors, to opt out of specific requirements, with a mechanism to give reasons to shareholders for doing so.

Other Issues: Corporate Governance

- 3.13 It is also important that, as at present, any guidelines on corporate governance (such as are contained in the Combined Code) do not apply to overseas companies with listings in London, where differing and possibly incompatible regulations and practices might apply (**Listing Rules 12.43A and 17.12**).
- 3.14 We also support continuation of special Listing Rules concerning related party transactions, which we consider an important element of London's strong corporate governance regime.

4. Corporate Communication

Paragraphs 4.17 – 4.22 PSI :pre-briefings prior to disclosure

- 4.1 It has been common practice for companies and/or their brokers to seek consultative guidance from a limited number of key investors in order to ensure that they would be supportive of a given major corporate event (acquisitions, equity fund raising, merger etc.) prior to it being contracted for and announced. Of course, these consultations take place on a confidential basis and those involved are or become insiders. The benefits of such consultations are:
 - 4.1.1 Obtaining reassurance that key investors understand the reasons for the event
 - 4.1.2 Obtaining comfort that the event would receive their voting and financial support
 - 4.1.3 Providing an investor viewpoint so that all key potential investor concerns are identified and properly addressed in public announcements and documents
 - 4.1.4 Reducing the potential for damaging public disputes between management and the company's key shareholders
 - 4.1.5 Reducing the potential for unnecessary price volatility following the announcement of the event.
- 4.2 Since N2 we have seen an increased focus on 'briefings prior to disclosure'. There is a covert suggestion that such briefings facilitate insider dealing. We firmly believe that such consultations shortly prior to an announcement have not resulted in an investor 'insider dealing' following any such briefing. The overt regulatory concern is that such behaviour gives an advantage to the persons who have been pre-briefed to the detriment of those who have not been briefed. In particular, private individual investors' representative bodies have focussed on the lack of equal treatment for their 'members'.
- 4.3 The logistics of managing corporate finance operations require that individuals will be briefed in confidence shortly before the public announcement of the transaction. Such briefings recognise the confidential nature of the information and the need to ensure that the recipients cease to be insiders once the information is in the public domain. The PSI Guide already provides helpful guidance as to how these briefings can be managed.
- 4.4 We believe that the market price for securities in companies where a major corporate event has been announced changes for all practical purposes instantaneously. Everyone dealing after that moment, pre-briefed or otherwise, gets the same new market price, so there is no obvious benefit or disadvantage for any party. In addition, where a major corporate event is announced at 7.00 a.m there is a full hour before official dealings commence for market users to digest the information.
- 4.5 In like terms, a practice of early briefing of the corporate broker's analyst about major events and/or results has the benefit of assisting the company with advice as to likely market reaction to the announcement. Furthermore the practice can help to reduce some of the immediate intra-day share price volatility that such announcements can cause. The pre-briefing of the house broker's analyst facilitates accurate price formation. In a situation where the analyst is 'unsighted' of a development the market may lack price leadership which is detrimental to market participants, particularly private investors.
- 4.6 We would support retention of 'advisers' in **paragraph 9.5 of the Listing Rules**. In addition we would seek clear recognition of market practice in the PSI Guide. We would add rating agencies and index compilers to the permitted category in Rule 9.5. This is to cover the relatively rare situations in which they are made insiders before being consulted about prospective transactions.

- 4.7 An attempt to prescribe ‘certain defined situations’ where pre – announcement briefings are acceptable is likely to be less helpful, in our view, than giving examples of acceptable situations. The principle that companies should not be distributing information to too wide a circle prior to formal release should be retained, while allowing reasonable market practice to continue, including controlled pre-briefing of selected analysts where considered necessary to contribute to the operation of an orderly market.
- 4.8 A clear exposition by the FSA of its analysis of the differences between UK practices in this area based on the Listing Rules, PSI Guide and market abuse regime and the potential impact of the MAD (including setting appropriate standards at Level 3 as to who should receive inside information and in what circumstances) would be useful in furthering an informed debate in this area (**paragraphs 4.20 and 4.22 of DP**). Our comments above and developments here will need to be considered in the context particularly of the MAD and implementing measures currently under consultation.
- 4.9 We note that the Listing Rules may need to embrace some flexibility in this area for companies with multiple listings, where there will potentially be a number of regulators with jurisdiction in matters covered by the MAD. In particular, this may apply to companies for whom the FSA/UKLA is not the ‘home competent authority’.

Paragraph 4.23 Delays in announcing PSI

- 4.10 We are not sure in what area additional guidance or Rules are suggested here. It might be helpful for more Guidance to be available on the conflict between providing immediate or timely announcements of new matters, as opposed to the occasional need for delay to allow clarification of the full implications of a new matter. The tension between the over-riding need to keep the market informed, and the need to avoid misleading the market by releasing incomplete information is an area where advisers can play a valuable role. It continues to be important for companies and their advisers to be able to consult with appropriately experienced people at the UKLA on a case by case basis when they feel a delay would be beneficial for both the company and the market.

Paragraph 4.24 **Forward-looking information**

4.11 The area of forward-looking information, and profit forecasts⁴ in particular, is one where we believe changes are needed in the Listing Rules. This is closely related to the issue of quarterly reporting and continuous disclosure, explored further under **Section 6** below.

a) **Need for more PFI**

4.12 We believe the Listing Rules should be reviewed to encourage the release of more good quality prospective financial information ('PFI') by companies as a matter of course, particularly key trading information, rather than necessarily requiring more frequent full financial information releases (see also **Section 6** below re. quarterly reporting).

4.13 The integrity of markets can only be improved by the more frequent release of better quality forward – looking information to investors. There are, however, currently significant constraints on companies volunteering PFI due to the possible need for formal 'profit forecast' reporting if there is a subsequent transaction. UK companies are consequently wary of releasing PFI whether or not there is the possibility of a subsequent transaction. (This could include a share issue or class one circular or a takeover (although as this latter would be covered by The City Code on Take-overs and Mergers it is outside the brief of this DP)). These constraints reduce the likelihood of such forecasts being made, even where such a transaction is not reasonably in prospect.

4.14 The need for formal reporting on profit forecasts also adds cost, as well as time delays, to transactions.

b) **Quality of PFI**

4.15 Certainly the market needs to have confidence in the integrity of companies' internal financial systems, controls and procedures in producing PFI.

4.15.1 **Listing Rule 2.15** requires sponsor confirmation that such procedures for new applicants (or, exceptionally, as required by UKLA) have been put in place.

4.15.2 The **Combined Code** also requires a board to 'maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.'

4.15.3 **We endorse the combination of these requirements** to provide comfort on companies' internal financial systems etc., although, as set out further in **paragraph 7.13.1 below**, we suggest **Listing Rule 2.15** be amended to replace sponsor confirmation with confirmation from the most relevant adviser, i.e. the reporting accountant.

4.16 We also consider **Listing Rule 12.43(b)** an important provision, whereby listed companies must disclose and explain in their annual report significant (10%+) variations between the actual profit outcome compared with an earlier profit forecast. It might be helpful for additional Guidance to be provided encouraging companies to provide further information in their annual reports where appropriate, such as comments on actual results compared with earlier forecasts.

c) **Possible avenues for change**

4.17 The regulatory regime should enable companies to release clear guidance on prospects in plain English, and numbers, rather than the current practice of companies using somewhat euphemistic terminology in order to avoid the consequences of having an ‘official’ profit forecast on record. We would like the regulatory environment to facilitate companies giving forecasts/updates which are clear and realistic. There are a number of areas which we suggest are worthy of further consideration to improve the frequency and quality of PFI by listed companies. These are set out below.

4.18 Formal reporting on profit forecasts:

4.18.1 The provision of circulars to shareholders, in support of a transaction, involves a comprehensive due diligence process by Directors and their advisers. At such times, advisers/sponsors would ensure that Directors review forecasts or PFI previously released to the market and advise when updates or corrections of such information should be made to keep the market informed. We believe this would take place in almost all cases, even if there were no need for public formal reports by reporting accountants and sponsors in these documents, given the regulatory requirements for companies to keep the market informed (including the added emphasis following introduction of the UK market abuse regime). However, there is a balance to strike between facilitating the release of more PFI and affording protection for investors where PFI is provided in certain circumstances. Accordingly we recommend that formal reporting on profit forecasts by sponsors and reporting accountants is retained only in very specific situations.

4.18.2 A suggestion is that formal forecasts would only need to be reported on if made at the time of, and in conjunction with, transactions involving a significant fund raising i.e. involving the issue of listing particulars. This could include, for example, IPOs, some rights issues, class one circulars, placings for cash and fund-raising in connection with takeovers (the latter being subject to the City Code, requiring separate consideration, see **paragraph 4.24** below). Even in these cases, we recommend any earlier releases of PFI would not normally need to be formally reported on. We would, however, expect that both the regulatory regime and market forces would demand that they be considered and, if necessary, updated at the time of the fund-raising. We would still see the need for sponsors and reporting accountants to be fully involved in the formal reporting process.

4.18.3 If these proposals were adopted we believe it would go some way to encouraging Directors to release voluntary PFI more frequently and on an ongoing basis.

4.18.4 It may also be helpful to review existing rules as to what constitutes a profit forecast for the purposes of formal reporting under the Listing Rules, for example, consider limiting this to releases of clear, specific forecast numbers (**Listing Rules 12.21 – 12.23A**)

4.19 Our suggested approach might need to be supported by having additional guidance and monitoring to ensure that the PFI information released from time to time is of good quality, for instance to require statement of any unusual bases or assumptions. We note the formal consultation taking place by the Institute of Chartered Accountants in England and Wales (‘ICAEW’) on PFI⁵, with the aim of providing guidelines to assist companies releasing PFI. We hope this will lead to a useful framework allowing an improvement in the quality, materiality, reliability and relevance of PFI released by companies, including mechanisms for judging PFI and allowing subsequent validation.

- 4.20 Possible new guidance might be considered encouraging companies to include additional information in annual reports, comparing actual results achieved with earlier profit forecasts (and continuation of the existing **Listing Rule 12.43(b)** requirement).
- 4.21 It is possible that the proposed Operating and Financial Review to be required in companies' annual reports in future ^{2,3} could be a useful tool against which subsequent PFI released during the following year could be measured and judged.
- 4.22 Other possibilities include considering whether the FSA/UKLA should establish a 'good faith safe harbour' scheme. This could, for example, allow companies to make forward – looking statements (subject to inclusion of appropriate risk warnings, assumptions etc.) with a recognition that the company should avoid liability provided it was shown to have acted in good faith.
- 4.23 The implications for PFI of the future development of the regular reporting regime, including the proposed TOD, also need to be considered. For example, whether regular updating of PFI might be required and how this would sit with the existing continuous disclosure regime and the desire to encourage companies to release more PFI.
- 4.24 Any changes considered in this area – particularly as regards formal reporting on profit forecasts - would need to be carefully considered in consultation with the Panel on Takeovers and Mergers given the implications for the City Code.

Question 3:

Have we identified the key issues we should review within the area of corporate communication or are there other areas which you feel merit our attention?

(paragraphs 4.16-4.25)

Information released in conjunction with major transactions

4.25 We would welcome further Guidance and flexibility on the type of basic summary information which can be produced in addition to listing particulars and other circulars. Short ‘aide memoire’-type documents, or ‘flyers’, particularly aimed at retail investors, can be a valuable tool for investor understanding. They, of course, need to be accompanied by full listing particulars documentation, where relevant, and be clearly labelled as intended to be read in conjunction with the formal documentation. Mini-prospectuses or supplementary listing particulars are generally too cumbersome to achieve the aim of easily-digestible short-form information. The current regulatory approach by UKLA has meant that in practice, such ‘flyers’ are effectively banned or rendered ineffective.

Electronic dissemination of information and the new regime

4.26 Information available to retail investors has much improved with recent technological advances in areas such as web-based news services.

4.27 We support the increased use of company websites to allow investors access to information widely and efficiently, provided the existing UK regime continues whereby all such information must also be released via the official structure.

4.28 We are concerned, however, that developments in the EU may lead to some difficulties in this area. There is a possibility of web-based information being able to be provided without the same need for simultaneous ‘official’ release of information through RNS-equivalent services. This would be a problem given not all shareholders have access to the internet. It would also make it very difficult for those trying to monitor the release of such information to do so. We would like to see the UK taking a lead in the EU context, to encourage development of a similar model to that developed in the UK. We are also concerned about the current difficulties encountered by UK companies with dual listings, particularly those in the US, where different regulatory requirements and legal restrictions on electronic dissemination apply. This can lead to anomalous and different electronic solutions in different countries, including the need for password – protected and restricted access sites and potential sanctions in other countries.

4.29 We note the FSA’s intention to review information systems, including the present unsatisfactory electronic submission of documents and the possible introduction of a single repository of information for UK listed companies **(paragraphs 5.15 – 5.17 of DP)**. This is also referred to under **paragraphs 8.10-8.11** below.

Question 4:

Do the current corporate communication rules deliver all the necessary disclosures to maintain market confidence and protect investors? (**paragraphs 4.16-4.25**)

- 4.30 The UK's continuous disclosure regime, currently grounded in **Listing Rules 9.1 and 9.2**, is the lynchpin for company disclosure and the requirement to keep the market informed. The regulatory framework supporting this and its effective policing are essential to the integrity of the UK markets. We believe this model has worked well in the UK and that markets have benefited from the wide application and effective policing of continuous disclosure.
- 4.31 We note **Listing Rules 9.1 and 9.2** are consistent with CARD⁹, the relevant EU directive (**Articles 68 and 81**). Also that the proposed MAD (including associated Level 2 'implementing measures' currently under development) will provide – at least – additional requirements for disclosure of price sensitive information.
- 4.32 The proposed TOD is also likely to impact in this area. For example, there is a suggestion in the latest consultation on the proposed TOD¹¹ that...

'...As a consequence [of the proposed MAD, particularly Article 6] the current ad-hoc disclosure requirements provided in [CARD] ..would disappear..'

- 4.33 As stated under **paragraph 4.8** above, we seek further clarification from the FSA of the impact of current proposals in this area. In particular any developments affecting **Listing Rules 9.1 and 9.2** could be fundamental to continuation of the present corporate communication regime embodied within the listing regime.

5. Shareholders' Rights and Obligations

Question 5:

What are your views on the contribution that the shareholder rights provisions make to market confidence and investor protection? **(paragraphs 4.26-4.30)**

- 5.1 The Listing Rules reflect a body of market practice which has developed over many years, defining how companies will behave and what investors expect of them, once their securities are admitted to the Official List. These rules are beyond the company's formal constitution, primarily in the Memorandum and Articles of Association.
- 5.2 In general terms, we believe the Listing Rules provide a good balance between flexibility and investor protection, ensuring market confidence is maintained. We believe the shareholder rights provisions have been a major factor underpinning London's continued success as a pre-eminent financial centre for companies to raise capital on a cost-effective basis.
- 5.3 We comment below on specific potentially 'super-equivalent' areas of the Listing Rules highlighted in the DP.

Major transactions- 'Class tests' (paragraphs 4.25 -4.29 of the DP)

- 5.4 Class tests are a good example of a specific, prescriptive way of giving effect to a principle that shareholders should be consulted on major deals in advance. However, to avoid over-regulation without associated investor benefit, it remains essential that the UKLA exercises discretion over the application of the class tests in a pragmatic accountable way.
- 5.5 Our members expressed the following views on the continuation of the Class tests in **Chapter 10 and elsewhere in the Listing Rules:-**
 - 5.5.1 On the one hand, the need for major transactions (or those involving related parties) to be specifically announced to prescribed standards ensures a minimum level of information is provided to shareholders. The added need for shareholder approval for class one and related party transactions also provides a forum for shareholders to influence management, and, in the ultimate analysis, to reject transactions which have not been properly justified. The publication of a class one circular also ensures a certain level of due diligence takes place and provides the market with important information about the implications of the transaction.
 - 5.5.2 On the other hand, such circulars are costly to prepare, and can add significant administration and delay to transactions. The additional need for shareholder approval can lead to UK listed companies being in an uncompetitive bidding position when competing with overseas or unlisted competing bidders for assets and businesses. However, this may be mitigated by mechanisms such as the taking of irrevocable undertakings from a majority of shareholders to vote in favour.
 - 5.5.3 In practice, few if any transactions by listed companies requiring shareholder approval are ever voted down by shareholders. Ultimately, the likely effect of a transaction on the share price is a key determining factor for management. It is unlikely a Board would put forward transactions which would not have shareholder support and an expected positive effect on the share price (at least in the long term). This is at least as important as the requirement for a vote – in our view underscoring the need for a positive reception from shareholders.

- 5.5.4 Furthermore, the actual tests used are necessarily somewhat arbitrary and can lead to anomalies unless flexibility is maintained by the UKLA in their interpretation on a ‘case by case’ basis. For example, application of tests for loss-making companies, or those with significant exceptional or intangible items where the use of ‘normalised’ results might be meaningful.
- 5.5.5 Shareholders who are dissatisfied with the level of communication and consultation from company management have a variety of options, ranging from active dialogue demanding change (in practice, only likely for major institutional shareholders) to ‘voting with their feet’ and selling their shares. This would continue to apply if, for example, the need for shareholder approval for certain transactions or the need for class one circulars were abolished or changed.
- 5.5.6 We consider that, in practice, the UK has a better flow of information between listed companies and their shareholders about major transactions than in many other jurisdictions. We would not like to see any diminution of effective communications. We support the continued need for class one circulars to be issued for significant transactions.
- 5.6 In summary we see a range of options for class one transactions to maintain investor protection in this area while avoiding unnecessary cost and administrative burdens for company development:
- 5.6.1 Maintain the regime ‘as is’
- 5.6.2 Provide more flexibility in the application of the various class tests.
- 5.6.3 Explore means of reducing the cost of preparing circulars while maintaining investor protection, such as:-
- Eliminate the need for formal reporting on profit forecasts in some class one circulars (and other transactions) **(see paragraph 4.18 above)**
 - Provide greater flexibility relating to the inclusion of financial information, and, in particular, remove or significantly limit the requirement for an accountants’ report in the case of financial information that has not been subject to an audit **(Listing Rule 12.9)**. Issues frequently arise in the case of an asset purchase or the purchase of a division as opposed to a separately audited entity. In cases where purchases are made from companies that themselves have been subject to audit to international standards, relaxation would be welcomed. It is time consuming and costly to commission a true and fair view on such financial information. Where, in particular, such purchases are from another company, quoted on an appropriately regulated market or recognised exchange, we do not believe this additional cost is warranted. In such cases, the UKLA can rely on the sponsor’s letter (under **Rule 2.20**) which will confirm that information outside any comparative table/accountants’ report has been properly extracted. In any event, additional guidance as to when the UKLA is willing to exercise its discretion in this area would be welcomed.
 - Encourage companies to provide circulars in electronic form or on websites for shareholders electing to ‘receive’ them as such, provided this is permitted under company law.
 - Eliminate the requirement for FSA approval of class one circulars, which can add significant delays to a conditional transaction. If this were to be adopted, it would be important for guidance/clarification as to how this might work in practice, to avoid possible uncertainties arising later if documents were subsequently reviewed and considered to be problematic. We would be happy to work with FSA to consider this in more detail.
- 5.6.4 Consider dispensing with the need for shareholder approval for class one transactions.

- We would only recommend this be considered if the key information were still required to be made available to shareholders for such transactions.
- In practice, the additional cost of holding a shareholder meeting is probably not significant. The main benefit would be to avoid undue delays or uncompetitive positions in competitive bid situations (**see paragraph 5.5.2 above**).
- On the other hand, shareholder meetings provide a forum (both before and at the meeting) for shareholders to discuss/question management on significant proposals. Indeed, the voting requirement ensures that shareholders can veto a board from substantially altering the company by one, or a series of, major transactions.
- On balance, members do not consider there are major benefits in dropping the need for shareholder approval if the rest of the current structure remains unchanged but this may be worthy of further consideration by the investing community.

5.7 We have also explored and rejected as inappropriate various other options regarding class one transactions. These include:

- 5.7.1 Dispense with the need for working capital statements. We consider these to be an important element of the due diligence underlying such transactions, whether financed by shares, cash or both (see further under **paragraphs 6.25 to 6.29 and Section 7 below**).
- 5.7.2 Dispense with the need for class one circulars altogether, or provide exemptions for less significant transactions e.g. those not involving significant share issues. We consider such circulars an important shareholder right.
- 5.7.3 Whether special rules should be introduced for smaller companies ('SMEs') for class tests, circulars etc. We do not consider this to be appropriate. All companies with an official UK listing should have similar shareholder rights provisions, although we recognise the cost burden this can represent for smaller companies. Differing obligations arise under AIM (or OFEX) which may be more appropriate market alternatives for some companies and their shareholders.
- 5.7.4 We do, however, endorse continuation of the special application of class tests provided for certain types of companies, in the specialist regimes chapters of the Listing Rules (**e.g. Chapters 18, Property Companies; 19 Mineral Companies; 20 Scientific Research Based Companies etc.**) where the rules are tailored to the specialist activities and characteristics of these industries. (see further under **paragraphs 6.31 to 6.50 below**)

Class 2 transactions

5.8 We see no reason to change the current requirements for announcements of Class 2 transactions.

Reverse takeovers –paragraph 4.25

5.9 These provisions should be continued.

Related party transaction disclosures –paragraph 4.25

- 5.10 In general terms we believe the related party requirements serve a useful purpose in guarding against Directors and substantial shareholders taking advantage of their position. However, whilst we accept there is a need for the related party requirements to apply to Directors and substantial shareholders of the listed company, we do not believe it is the case that subsidiary Directors and substantial shareholders of subsidiaries frequently influence the outcome of a transaction in the same way. There is a case for considering amendment of the definition of related party to exclude subsidiary Directors and substantial shareholders of subsidiaries so that the test focuses more on where influence is actually exerted.
- 5.11 We would suggest clarification of the application of significant influence provisions on joint ventures (**Listing Rule 11.1(a)(iii)**)

Directors' dealings –paragraph 4.25

- 5.12 We support the current disclosure regime for significant dealings by Directors which we believe the market finds extremely valuable.
- 5.13 We do not, however, see the need for continuation of the almost real-time required disclosure of a wide range of minor dealings by Directors. Amendments to company law requirements have previously been suggested to eliminate unnecessary statutory burdens in this area, which we consider add little to the protection of investors. We would like to see the introduction of such amendments to Companies Act 1985.

Major shareholdings disclosures –paragraph 4.25

- 5.14 We support the current UK disclosure regime. We note EU proposals for change in the forthcoming TOD, where a 5% minimum disclosure level for major shareholdings is proposed. We would encourage the adoption EU-wide of the lower UK 3% disclosure level to improve transparency and minimise differing regulatory disclosures for companies with multiple listings.

Purchase of own shares

- 5.15 We believe these rules are satisfactory. In the event of these provisions being at risk under a future maximum harmonisation directive, we would wish to see them enshrined elsewhere in the UK regulatory framework.
- 5.16 The possible impact of the proposed MAD also needs to be considered.

Other Issues –shareholder rights

- 5.17 There are a large number of areas in the Listing Rules dealing with shareholder rights, many of which are potentially super-equivalent to current EU directives. In general, we support continuation of these provisions.
- 5.18 For example, we believe that those Listing Rules relating to controlling shareholders (**Rules 3.12, 3.13 and 9.34**) are of continuing value and importance. They contribute strongly to the principles of investor protection and corporate governance and help ensure the reputation of the markets by regulating certain conflicts of interest.
- 5.19 Other areas include those matters referred to in **Annex B of the DP**, as well as areas in Chapter 9 of the Listing Rules, such as ‘shares in public hands’ (**Listing Rule 9.37**) and sub-underwriting disclosures (**Listing Rules 9.41 - 9.42**). Furthermore there are several specialist regimes where the application of shareholder rights, such as class tests, are modified (**see paragraph 5.7. 4 above**) and we believe the special shareholder rights provisions of these specialist regimes should be continued (**see also paragraphs 6.31 – 6.50 below**)

Pre-emption rights and related issues

- 5.20 The bases of pre-emption rights are set out in UK company law and allow disapplication of these rights by a shareholder vote. The Listing Rules include provisions providing a 10% maximum price discount on certain further share issues (**Rules 4.8 (placings), 4.26 (open offers) and 4.30(b) (vendor placings)**). These Listing Rules, which place greater constraints than company law, are not waivable by shareholders (but in the case of financial difficulties may be waived by the UKLA).
- 5.21 The ABI guidelines place even greater constraints on issuers. They stipulate that: cash placings should be limited to 5% of the issued share capital per annum (subject to certain further rolling limits) at no more than a 5% discount; and that vendor placings should give a claw back right for issues greater than 10% of the issued share capital or a discount greater than 5%.
- 5.22 We consider the combination of company law (with its possibilities for shareholder disapplication) and the ABI guidelines (which issuers can waive upon consultation with ABI and/or directly with major shareholders) give a sufficient balance between flexibility for issuers and dilution protection for shareholders. We consider that this is a matter for shareholders and not the UKLA and that the Listing Rules discount limits are therefore inappropriate and unnecessarily restrictive.

6. Financial Information

Question 6:

What role should the FSA as competent authority play in ensuring that financial information is of sufficiently high quality for investors? (**paragraphs 4.31-4.40**)

- 6.1 We consider the role of the FSA, as the UK competent authority for listing, regarding financial information should be limited to:
 - 6.1.1 Implementing EU and UK requirements, so far as is within its remit
 - 6.1.2 Making known its views, on behalf of users of accounts, to preparers of accounts
 - 6.1.3 Setting specific requirements as to content of financial information disclosures in various areas –e.g. working capital statements, profit forecasts
- 6.2 In addition, the FSA itself (rather than as competent authority) has a role of monitoring the standard-setters (e.g. professional bodies) for evidence of falling standards.
- 6.3 We agree the FSA/UKLA should have a clear policy on the frequency and timeliness of financial reporting for listed companies, in addition to the requirements of company law, where relevant(**paragraph 4.34 of DP**).
- 6.4 As regards quality of financial information we consider that the content and quality of financial information is best left under the aegis of the various accounting professional bodies and statutory bodies overseeing the industry.
- 6.5 We note the proposal for a new body – the proposed Standards Board – to have responsibilities in the area, such as the form and content of financial statements and disclosure requirements for the Operating and Financial Review. (**See also paragraphs 3.5 - 3.7 above**)

Quarterly reporting and timing of quarterly and annual reports (**paragraphs 4.35-4.36 of DP**)

- 6.6 Our members have the following points to make regarding the introduction of mandatory quarterly reporting for equity issuers under the proposed TOD.
- 6.7 We have previously commented ⁸ as follows:

‘...We do not believe that ‘one size fits all’ in this area. LIBA believes that the ‘adequate’ frequency for issuers of equity and equity-linked securities is an interim and final financial report, supplemented by trading statements where necessary. The ‘higher’ standard is quarterly reporting, which is mandatory for US-quoted European companies [for practical purposes]...’
- 6.8 We believe the current UK framework in the Listing Rules and company law for the timing of interim and preliminary results, and the annual report and AGM, works very well. This is due in large part to the additional over-riding requirement for continuous disclosure (**Listing Rules 9.1 and 9.2**), and also where companies supplement information, as is increasingly the case, by the release of more qualitative trading statements before each close period and at AGMs. We believe there are now more company announcements of this type, particularly following introduction of the UK market abuse regime.

- 6.9 We endorse the fundamental principle of regular release by listed companies of statements about material developments in their trading positions. We consider that the combination of existing requirements (including **Listing Rules 9.1, 9.2** and the provisions relating to annual and half-yearly reports) adequately underpin this fundamental principle. However, if further regulation is to be introduced in this area, we would strongly prefer a codification of the current market practice adopted by the majority of the FTSE 350 companies, namely qualitative trading statements being released 5 times per year (being prior to the commencement of the half year and final results close periods, as part of the announcement of half year and final results, and in the Chairman's AGM statement) to any requirement for quarterly financial statements for equity issuers.
- 6.10 In the event that quarterly reporting under TOD does come into effect in the UK, we support the reduced deadlines for reporting for quarterly reports for equity issuers to 2 months as a matter of necessity, for more frequent reports to be meaningful and useful. We note, however, the substantial administrative and cost burden this will place on UK companies, and that significant lead times must be allowed for companies to adjust to tighter deadlines
- 6.11 We are also concerned that the content of quarterly reports envisaged by the proposed TOD is unreasonably onerous and will add unnecessary cost and administration with little, if any, benefit to investors. In particular, its proposal to include a management report, by reference to the 4th and 7th Company Law Directive requirements, would appear to require prospectus-type information on a quarterly basis in addition to financial statements. This will also make the deadlines even harder to achieve than if reports were limited to financial information, and explanatory statements, similar, say, to the UK interim results announcements required under **Listing Rules 12.52 – 12.59** (much of which is based on the existing CARD requirements).
- 6.12 While we support the reduction in time limits proposed for the release of annual report and accounts for public quoted companies in UK company law ²(reduced from 6 months to 4 months, including website publication), we are not convinced that mandatory additional changes as envisaged under TOD are necessary to provide investor protection. They may also impose significant additional cost and administrative burdens on UK companies.
- 6.13 The proposed TOD deadline for annual reports of 3 months may not be practical. Reduced deadlines, together with quarterly reporting, would create an unnecessary and unhelpful increase in both the administrative burden on companies and the number of corrected statements. In our view, the more important deadline is the release of the preliminary final results, currently required within 120 days under the Listing Rules (**Rule 12.40**). This might reasonably be reduced to 3 months, given the proposed minimum 4 month UK deadline for the release of the annual report ². There would also need to be a corresponding waiver of the 2 month requirement for the final quarter if quarterly reporting were introduced. Again, there will be significant burdens for many companies, and a transitional period will need to be reasonable to allow for adjustment to new deadlines.
- 6.14 Furthermore, international co-ordination, and co-ordination with other relevant UK regulators, will be necessary to avoid undue market disruption.
- 6.15 We oppose the need for any compulsory review of quarterly statements by external accountants. As we commented in our earlier response to the 1st TOD pre-consultation:
- '..It is likely that the directors and auditors of quoted companies will perform a limited review of interim figures [whether issued once or three times a year]. Such a review will enable them to satisfy themselves for example that the figures have been properly extracted from the books and records of the company and that the figures have been compiled in accordance with the stated accounting policies of the company...'*
- The latest TOD consultation ¹¹ has dropped the proposal for compulsory audit review, and appears to propose allowing member states to determine whether to require such audit reviews. Any such reviews undertaken must be disclosed in full.

- 6.16 We welcome the latest TOD proposal to drop the requirement for mandatory quarterly reporting for issuers of (only) listed debt securities.
- 6.17 If quarterly reporting were to be introduced along the lines of the current TOD proposals, the majority of our members would welcome proposals to provide exemptions for SMEs. However, in our view the EU definitions for SMEs are unacceptably low in this context, exempting only the smallest companies from some information requirements (criteria are 2 of the following : Turnover- € 25m, balance sheet - € 12.5m, average employees -250) . To be of significant benefit any SME exemptions would need to:
- 6.17.1 substantially increase the SME size thresholds (for example to cover companies of size equivalent to those outside the FTSE 350)
 - 6.17.2 exempt SMEs entirely from quarterly reporting, not just limiting the contents of such reports, albeit the proposed contents are minimal.
- We also note that the proposed TOD would apply to all companies whose securities are admitted to trading on a regulated market, thus apparently including, inter alia, companies traded on AIM as well as the UK Official List.
- 6.18 A minority of our members would not oppose quarterly reporting. They also consider that, if introduced, it should apply equally to all listed companies, with no exemptions for SMEs, for example. However, if so, the content requirements would need to ensure that it is practicable for all companies – i.e. substantially less than is currently proposed under TOD (although companies should, of course, be free to include additional information if desired).
- 6.19 We have concerns that, for non-EU companies, the TOD proposals could result in them having to produce accounts on more than one basis, unless exemptions are provided. It is also noted in this context that EU companies will also be required to report to IAS standards by 2005 (unless particular extensions to 2007 apply).
- 6.20 Our views on PFI set out under **paragraphs 4.11 – 4.24 above** are also relevant here.

Auditor independence and role of auditors (paragraphs 4.37 -4.39 of DP)

- 6.21 We note the substantial amount of work taking place on these issues in the UK and elsewhere, particularly as noted and reviewed by the Co-ordinating Group on Audit and Accounting Issues set up by the DTI/HMT, whose interim report was released in July 2002¹⁰.
- 6.22 We believe the FSA should work closely on these issues with the various bodies concerned, including for example the Accounting Standards Board and the Accounting Foundation, as well as with the EU Commission. The latter body is particularly important, given references in various EU proposals for the competent authority to have a role in ‘approving’ financial information.
- 6.23 We support moves to promote high standards of care in the preparation and auditing of financial statements, and financial disclosures required under the Listing Rules (**paragraph 4.38 of DP**).
- 6.24 In order to minimise duplication of activity, we do not propose to comment significantly on these matters here save as follows.
- 6.24.1 **Auditor rotation and regular re-tendering of contracts (paragraph 4.37)** - We note divergent views emerging on this issue. We are not convinced of the need for auditor rotation, and most members believe this would be likely to lead to increased cost. We strongly urge, however, that any new UK regulatory requirements in this area should not be in conflict with overseas requirements, given the difficulties this could impose for many UK companies with one or more overseas listings.

- 6.24.2 **Role of reporting accountant and auditor in undertaking various formal reports for Listing Rules** (e.g. accountants' reports; reports on profit forecasts) - We would oppose any new regulatory requirement prohibiting reporting accountants being the company's auditors. On balance, we consider the current regime, which permits this role to be performed by the company's auditor, to be an acceptable and cost-effective approach. While we recognise the potential for a conflict of interest where the same firm undertakes both roles, in practice we consider such conflicts can generally be identified and managed satisfactorily by the accounting industry's own practices and professional standards.

Question 7:

How significant is the contribution that the current requirement for a working capital statement makes to maintaining market confidence and protecting investors?
(paragraphs 4.31-4.40)

- 6.25 The need for a working capital statement is an important element of the due diligence process in IPOs, major transactions and secondary share issues. Indeed one of our members has described the due diligence process underlying the working capital requirement as ... 'one of the most valuable elements of the entire listing process...'
- 6.26 The need for Directors to assure themselves as to the sufficiency of working capital for at least the next 12 months is, in our view, a vital element of most transaction-related due diligence. We also consider this to be an important element in maintaining market confidence in the UK, which is almost alone in requiring such statements.
- 6.27 **The majority of our members strongly support the continued need for formal reporting on working capital to the UKLA by sponsors, as a means of preserving the existing effective framework for working capital review in the UK.**
- 6.28 Given the need for directors to satisfy themselves on such an important area in any event (for example, by virtue of directors' duties generally), we do not believe the formal reporting requirements in the Listing Rules add significantly to the level and cost of due diligence that ought otherwise to be taking place. The formal requirement, albeit at least partly in the form of a private letter from the sponsor to the UKLA, also provides comfort to investors that such work be undertaken as a matter of course.
- 6.29 In the current environment, particularly, the majority of members would question the benefit of changing the existing regime in such a fundamental area. This is further commented on under **Section 7** below.
- 6.30 Some members, however, consider the requirement for a private letter from the sponsor to the UKLA on working capital does not add greatly to the due diligence that would otherwise take place, and does not add much, if anything, to investor protection.

Question 8:

Should the rules recognise the particular needs of SMEs and provide a framework for a wider range of size and type of company? (**paragraphs 4.31-4.40**)

Start-Ups, SMEs and wider range of companies : Specialist Regimes of the Listing Rules– paragraphs 4.32 and 4.34 and 4.39

- 6.31 Our comments in response to Question 8 are in a wider context than just financial information aspects, under which this question is framed. They are therefore also referred to under **Section 9 below**.
- 6.32 There are a number of areas in which the Listing Rules provide special rules which are tailored to the needs of particular types of issuers, or particular types of securities. These include:-

<i>Chapter</i>	<i>Type</i>
Issuers	
18	Property companies
19	Mineral companies
20	Scientific research based companies
21	Investment entities
22	Public sector entities
25	Innovative high growth companies
26	Venture capital trusts
27	Strategic investment companies
Securities	
23	Specialist securities (including eurobonds)
24	Miscellaneous securities

- 6.33 There are references in DP14 to some of these specialist regimes, for example under “Financial Information” in **paragraphs 4.32** (three year trading records); **4.33** (start-ups and SMEs) and **4.39** (facilitating access for a wider range of size and type of company).
- 6.34 Question 8 deals with the particular needs of SMEs and whether the rules should provide a framework for a wider range of size and type of company.
- 6.35 We support the flexibility of the Listing Rules in allowing different rules for different types of company/organisations. We believe that adaptation of the rules to recognise the particular characteristics of certain types of organisation or industry is justified, provided investor protection is maintained at an appropriate level.

a) 3 Year Trading Records

- 6.36 One of the major areas where specialist Chapters provide a relaxation of existing rules is in relation to 3 year trading records. In particular, **Chapters 19, 20, 21, 25, 26 and 27**, where additional disclosures and information are required for investors/potential investors. In other words, the usual requirement for a 3 year trading record can be relaxed provided other additional information is provided relevant to the type of companies.
- 6.37 If investors are provided with information allowing an informed assessment of the organisation's assets and liabilities, financial position and prospects, we do not see good reason for excluding certain types of company from eligibility for listing purely by virtue of the absence of 3 years' trading history.
- 6.38 The 3-year trading record requirement is currently a provision of CARD (Article 44), which is a 'minimum harmonisation' directive. It also specifically provides for a competent authority to vary (i.e increase or decrease) this required trading history period in certain circumstances, thus supporting the UKLA's ability to create such special rules.
- 6.39 We would not wish to see any variation in this current right for the UKLA to vary the trading record and to set additional disclosure requirements as it sees fit.
- 6.40 It is possible that similar specific requirements for prospectuses for certain types of issuer could be included as "level 2 implementing" measures under the proposed Prospectus Directive (such process to commence imminently). We would encourage UK representatives, including the FSA, to seek the inclusion at EU level of some of the UK developments in this regard – such as elements of **Chapters 19-21 and 25-27**.

b) Small/Medium - Sized Companies (Question 8, paragraph 4.32/4.33)

- 6.41 We are sympathetic to the issues concerning cost of compliance with ongoing obligations for smaller companies, particularly given that some of the costs often do not vary significantly with the size of transaction. **On balance, however, we do not consider lesser disclosure requirements should apply for SMEs (however defined) as this could diminish the "quality kitemark" of an official listing.**
- 6.42 There is, of course, the option for companies to join AIM, or OFEX, with their somewhat less onerous obligations, if this is more appropriate for the company and its shareholders (present and/or likely future).

- 6.43 Our views generally apply both to financial information requirements as well as to other continuing obligations for SMEs.
- 6.44 Quarterly reporting – in the event that proposals along the lines of the current TOD are introduced, the majority of members would welcome special rules for SMEs, given the particularly onerous requirements proposed (**see paragraph 6.17 above**).

**c) Facilitating access to a wider range of size and type of company
(paragraph 4.39 of DP)**

- 6.45 As stated above, we consider the competent authority should be able to consider creating special rules for types of issuer (or type of security -**see paragraph 6.47 below**), including, inter alia, variation of the required trading record. We see this as a means of encouraging innovation in the markets and supporting development of deep and liquid markets.
- 6.46 However, consistent with the approach adopted in the Listing Rules to date, any changes or relaxation of specific requirements need to be carefully considered in order to preserve the quality and integrity of official listing, and maintain an appropriate level of investor protection.

d) Rules for Different Types of Security

- 6.47 We strongly support continuation of the specialist debt regime contained particularly in **Chapter 23** and other specialist securities such as warrants (**Chapter 24**). Issuers of debt securities are a significant part of London's market.
- 6.48 We particularly support continuation of different requirements for non-UK debt issuers. It is inappropriate to apply the same corporate governance rules and continuing obligations such as those relating to shareholder rights, particularly as these may conflict with rules applying in the home country of such issuers.

e) Overseas Companies

- 6.49 An important and valuable area of the Listing Rules is in providing an appropriate regime for secondary listings of foreign companies. This has supported the success of the UK market in attracting overseas companies. We believe the power of the UKLA to make its own judgements on the adequacy of third country (non –EU) prospectuses and arrangements should be retained.

f) Summary –SMEs, different types of issuer, and different securities

- 6.50 In order to maintain the attractiveness and depth of London's capital markets, we would support continuation of the UKLA's ability to create and maintain specialist regimes. The existing special chapters of the Listing Rules are the result of extensive market practice and consultation and should be retained. Thus any future EU developments which could result in loss of such ability should, in our view, be robustly resisted.

Other Issues – Financial Information

- 6.51 We would encourage the FSA to have dialogue with the SEC with the aim of avoiding unnecessary/unintended conflicts between UK Listing Rules and SEC accounting and financial requirements –e.g. financial information requirements which have diverged from US requirements (such as the rules relating to pro-forma financial statements). Companies listed in both UK and US currently have to deal with 2 sets of requirements for financial information, which can be costly and time-consuming to prepare. For example, in the context of a securities offering, having to have different press releases where there is no US exemption to send the full UK press release into the US. While the issue of differences in disclosures between US and UK GAAP is outside the scope of this paper, it should be recognised that this can lead to significant and costly problems. We also note the substantial transitional and jurisdictional difficulties which will need to be addressed with the proposed introduction of international accounting standards within the EU by 2005 (for most UK companies).
- 6.52 Reporting Accountants - We have commented **in paragraph 4.18 above** on the possibility of dropping the need for formal reports by reporting accountants (and sponsors) on profit forecasts in some circumstances.

London, 17 October 2002