

Review

Corporate Finance



Capital Markets Practice

News round-up

INTRODUCTION

Welcome to the latest in our series of regular alerts containing a round-up of news from our capital markets practice. The European Commission has recently published a number of high-level proposals with the aim of improving the transparency and stability of the financial markets and also announced proposals for the reform of the audit market. We consider these, and other recent developments, below.

Audit market: European Commission proposals for reform

On 30 November 2011, the European Commission announced proposals for the reform of the statutory audit regime for listed companies and other public-interest entities, such as banks and insurance companies, with the aim of enhancing auditor independence and making the statutory audit market more dynamic.

For details, [click here](#)

Audit market: the OFT refers the audit market for large companies to the Competition Commission

Following a recent consultation, the Office of Fair Trading ('OFT') has referred the market for the supply of statutory audit services to large companies in the UK to the Competition Commission for further investigation, amid concerns that the audit market is very concentrated, has low levels of switching and substantial barriers to entry.¹ The Competition Commission is required to report by 20 October 2013 although it is likely to do so before then.

OFT Press Release 115-11 available at:

<http://www.of.gov.uk/news-and-updates/press/2011/115-11>

Competition Commission News Release 56/11 available at:

http://www.competition-commission.org.uk/press_rel/2011/october/pdf/56-11_audit_ref_news_release.pdf

Corporate governance: EU Green Paper on the EU Corporate Governance Framework: the Commission publishes feedback

On 24 November 2011, the European Commission published a feedback statement with a summary of the responses to its Green Paper on the EU Corporate Governance Framework.

¹ In 2010 the four largest firms (PwC, KPMG, Deloitte and Ernst & Young) earned 99 per cent of the audit fees paid by FTSE 100 companies. Between the years 2002 and 2010, the average annual switching rate among FTSE 100 companies was 2.3 per cent.

The Green Paper, which was launched in April 2011, had focused on listed companies and, in particular, on boards of directors, shareholders and corporate governance statements. The Commission will now consider whether any legislative proposals are needed.

Feedback Statement: Summary of Responses to the Commission Green Paper on the EU Corporate Governance Framework available at:

http://ec.europa.eu/internal_market/company/docs/modern/20111115-feedback-statement_en.pdf

Corporate governance: executive pay: the High Pay Commission publishes its final report

On 22 November 2011, the High Pay Commission ('the Commission')² published its final report on executive pay in the private sector. The report, which deals mainly with executive pay in listed and other publicly quoted companies, contains twelve recommendations for reform.

For details, click here

Corporate Governance: 2012 AGM season: NAPF publishes revised Corporate Governance Policy and Voting Guidelines 2011

On 25 November 2011, the National Association of Pension Funds ('NAPF') published its revised Corporate Governance Policy and Voting Guidelines. The new Guidelines, which are intended for use during the 2012 AGM season, are broadly the same as those published in 2010 although they contain some amendments arising from NAPF's support for the Stewardship Code as well as for increased gender diversity in the boardroom and the annual election of directors.

NAPF Corporate Governance Policy and Voting Guidelines: November 2011 available at:

http://www.napf.co.uk/PolicyandResearch/DocumentLibrary~/media/Policy/Documents/0201_Corporate_Governance_Policy_Voting_Guidelines_Nov_2011_COMPLETE.ashx

Financial reporting: FRC Panel consultation on going concern and liquidity risks

The Sharman Panel, set up by the Financial Reporting Council ('FRC') in March this year, has now published for consultation a preliminary report and recommendations on improvements to the reporting of going concern and liquidity risks. The Panel's recommendations include:

- greater harmonisation between the going concern assessment and disclosure process in accounting standards and the UK Corporate Governance Code;
- a focus on solvency risks as well as liquidity risk, together with the inclusion of stress tests of liquidity and solvency; and
- a change to a system that integrates the directors' going concern reporting with their discussion of strategy and principal risks - in place of one where the company raises going concern risks only when there are significant doubts about its survival.

Comments are requested by 31 December 2011. The Panel intends to issue a final version of its recommendations in February 2012.

The Sharman Inquiry: Going concern and liquidity risks: Lessons for companies and auditors: Preliminary report and recommendations: November 2011 available at:

<http://www.frc.org.uk/images/uploaded/documents/The%20Sharman%20Report%20-%20final%20031111.pdf>

² The Commission is an independent non-governmental enquiry established by Compass and supported by the Joseph Rowntree Charitable Trust.

Financial reporting: the Government consults on audit exemptions (including exemptions for subsidiary companies) and change of accounting framework

In October this year, the Department for Business Innovation and Skills ('BIS') launched a consultation on audit exemptions and change of accounting framework. BIS proposes, among other things, that a subsidiary company that is not quoted and is outside the banking or finance sector should be exempt from mandatory audit subject to certain conditions, including the requirement that its parent company guarantees the subsidiary's debt. The consultation also seeks comments on the proposal that would allow companies that prepare individual accounts under IFRS to change their accounting framework to UK GAAP.

Comments are requested by 29 December 2011. BIS proposes that any changes to the audit and accounting regime would apply for accounting years ending on or after 1 October 2012.

BIS: Consultation on audit exemptions and change of accounting framework available at: <http://www.bis.gov.uk/assets/biscore/business-law/docs/c/11-1193-consultation-audit-exemptions-and-accounting-framework.pdf>

Market abuse regime: the European Commission publishes proposals for reform

On 20 October 2011, the European Commission published a package of proposals, consisting of a draft regulation and directive, which would replace the current market abuse regime.

For details, click here

Transparency Directive: the European Commission publishes proposed amendments

On 25 October 2011, the European Commission published the provisional text of a proposal for a directive to amend the Transparency Directive (2004/109/EC) ('TD')⁴. The amendments aim to increase the transparency of economic holdings in companies, as well as to reduce certain administrative burdens.

For details, click here

We would be pleased to discuss with you in more detail any of the matters raised in this article.

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⁴ The TD requires major investors to disclose their interests in shares to issuers and the market and also deals with the periodic financial reporting obligations of listed companies.



The proposals include:

- mandatory rotation of audit firms: audit firms will, with some exceptions, be required to rotate after a maximum period of engagement of six years. A cooling off period of four years will apply before the audit firm can be re-engaged by the same company, although the four year period may be extended to nine years in cases of joint audit;
- mandatory tendering: listed companies will be obliged to have an open and transparent tender procedure when selecting a new auditor;
- non-audit services: audit firms will be barred from providing non-audit services to their audit clients;
- EU supervision of the audit sector: coordination of auditor supervision activities will be dealt with within the framework of the European Markets and Securities Authority; and
- creation of a Single Market for statutory audits: a European passport will be introduced for the audit profession thereby allowing audit firms to provide services across the EU. All auditors will be required to comply with international auditing standards when carrying out statutory audits.

Commission proposals available at:

http://ec.europa.eu/internal_market/auditing/reform/index_en.htm

BACK



The proposals include the following:

- the simplification of executive pay structure: executive pay to comprise a basic salary and, 'where absolutely necessary', one performance-related element. The Commission's preference is for a performance share plan award, or a similar system, that would vest in six to ten years after its grant;
- reform of shareholder vote on executive pay: the vote, which the Commission believes should remain non-binding, should be forward-looking and relate to pay over the three subsequent years; and
- the simplification and extension of disclosure, including:
 - the presentation of directors' remuneration reports in a standardised form showing a single total remuneration figure for each director;
 - the publication by listed companies of 'fair pay reports' showing the ratio of highest to median pay within the company; and
 - the disclosure of the top ten executive remuneration packages below board level.

The Commission envisages that its recommendations would be implemented by way of amendments to the UK Corporate Governance Code, or other voluntary means, with the introduction of legislation only if necessary.

High Pay Commission report: Cheques with Balances: why tackling high pay is in the national interest: November 2011 available at:

http://highpaycommission.co.uk/wp-content/uploads/2011/11/HPC_final_report_WEB.pdf

BACK



Among the changes proposed by the draft regulation are those that relate to the following:

- scope of regime: the regime, which currently applies to financial instruments admitted to trading on a regulated market (such as the Main Market of the London Stock Exchange), would be extended to include a broader range of financial instruments (including those admitted to trading on a multilateral trading facility or on organised trading facilities);
- definition of 'inside information': the current regime uses the same definition of 'inside information' for all purposes. In a move which could lead to uncertainty, the proposals make a distinction between the type of information that restricts trading and that which issuers have to disclose: they expand the definition of 'inside information' for the purposes of the offences of insider dealing and improper disclosure, but not for the purposes of the issuer's obligation to disclose inside information to the market;
- public disclosure of inside information: delay in disclosure:
 - where an issuer delays disclosure (as it would still be allowed to do in certain limited circumstances) it would, under the proposals, be required to notify the competent authority³ following announcement of the information that disclosure had been delayed; and
 - competent authorities will be given a new power to allow delayed disclosure where the information is of 'systemic importance' provided that delayed publication is in the public interest and that the confidentiality of the information can be ensured; and
- whistleblowers: member states must introduce systems to encourage the reporting of breaches of the regime to the competent authority.

The draft directive requires member states to introduce criminal sanctions for serious cases of insider dealing and market manipulation, as well as for cases of inciting, aiding and abetting, and attempting insider dealing and market manipulation.

It is currently anticipated that the proposed amendments will complete the EU legislative process by the end of 2012, with a dead-line for the implementation of the provisions into national law two years later.

Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) available at:

http://ec.europa.eu/internal_market/securities/docs/abuse/COM_2011_651_en.pdf

Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation available at:

http://ec.europa.eu/internal_market/securities/docs/abuse/COM_2011_654_en.pdf

³ In the United Kingdom, the Financial Services Authority.



Key proposals include the following:

- information about major holdings: the notification requirements in the TD would be extended to include interests in financial instruments that have economic effects similar to holdings of shares (and entitlements to acquire shares). Investors would have to aggregate their holdings of voting rights with holdings of such financial instruments when disclosing their notifiable interests. The proposals align the EU regime more closely with the existing UK regime, which requires a higher standard of disclosure than the TD;
- sanctions: the proposals would give competent authorities in the member states⁵ more effective sanctions and include details of the minimum powers that should be available to them; and
- quarterly reporting/interim management statements: the requirement for listed companies to publish quarterly reports or interim management statements would be abolished.

It is currently anticipated that the proposed amendments will complete the EU legislative process by the end of 2012, with a dead-line for the implementation of the provisions into national law two years later.

Proposal for a Directive of the European Parliament and of the Council amending the Transparency Directive available at:

http://ec.europa.eu/internal_market/securities/docs/transparency/modifying-proposal/20111025-provisional-proposal_en.pdf

⁵ In the United Kingdom, the Financial Services Authority.