

08/6

Financial Services Authority

Implementation of the 8th Company Law Directive

Feedback on CP07/24 and final rules

June 2008



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Annex 1: List of respondents

Appendix 1: Final Handbook Text

This Policy Statement reports on the main issues arising from Consultation Paper 07/24 on proposals to implement certain parts of the Statutory Audit Directive and the Company Reporting Directive. This Policy Statement also publishes final Handbook text.

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Copies of this Policy Statement are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

1 Overview

- 1.1 In December 2007 we published a Consultation Paper (CP07/24) on proposals to implement certain parts of Directive 2006/43/EC (Statutory Audit Directive) and Directive 2006/46/EC (Company Reporting Directive). This followed a consultation process undertaken by the government, under which it concluded that certain aspects of the Directives should be implemented in the UK by way of FSA rules adopting a minimum implementation approach.

Statutory Audit Directive

- 1.2 The Statutory Audit Directive¹ introduces, among other things, a requirement that UK companies with transferable securities admitted to trading on a regulated market in any Member State have an audit committee that meets certain requirements set out in the directive, or that they have a body performing equivalent functions. Accordingly, CP07/24 proposed that issuers have a body responsible for carrying out the audit functions set out in Article 41(2) of the Statutory Audit Directive. CP07/24 also proposed that such body have at least one independent member and a member who has competence in accounting and/or auditing. The independence requirement and the financial expertise requirement may, but need not, be fulfilled by the same person. We also proposed to introduce a new rule requiring companies to issue a statement which identifies the body which carries out the audit functions and describes how that body is composed.
- 1.3 The Statutory Audit Directive also requires that every third-country auditor and audit entity providing an audit report on the annual or consolidated accounts of a company incorporated outside the EEA whose transferable securities are admitted to trading on a regulated market within the EEA, must be registered. Accordingly, CP07/24 proposed that a new rule be introduced into the Disclosure Rules and Transparency Rules Sourcebook (DTR) to the effect that a company incorporated outside the EEA whose transferable securities are admitted to trading must use:

¹ A copy of the Statutory Audit Directive can be found at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:01:EN:HTML>

- an auditor on the register of third-country auditors kept for the purposes of Regulation 34 of the Statutory Auditors and Third Country Audit Regulations 2007 (i.e. the register of third-country auditors maintained by the Professional Oversight Board);
- an auditor eligible for appointment as a statutory auditor under section 1212 of the Companies Act 2006; or
- an EEA Auditor (as that term is defined in s. 1261 of the Companies Act 2006) from another EU Member State.

Company Reporting Directive

- 1.4 The Company Reporting Directive² introduces, among other things, a new provision requiring companies whose securities are admitted to trading on a regulated market to produce a corporate governance statement in their annual reports. The statement will have to refer to the corporate governance code applied by the company and explain whether, and to what extent, the company complies with that code. It will also have to include a description of the main features of the company's internal control and risk-management systems in relation to the financial reporting process. The Company Reporting Directive also requires the statement to refer to certain matters related to the company's share and control structures (already required by the Takeovers Directive (Directive 2004/25/EC)) and the composition and operation of the board and its committees. Accordingly, CP07/24 proposed to insert a new rule into DTR which will 'copy out' the relevant paragraphs of the new Article 46a(1) of the Fourth Company Law Directive.
- 1.5 LR 9.8.6R (6) requires a UK company with shares admitted to primary listing to include a statement on whether it has complied with all relevant provisions set out in Section 1 of the Combined Code on Corporate Governance³ (Combined Code) and, if not, give the reasons for not doing so (the 'comply or explain' rule). CP07/24 set out our intention to retain the 'comply or explain' rule and add guidance to DTR to the effect that a company that complies with the 'comply or explain' rule will satisfy the comparable requirements of the new DTR rule.
- 1.6 CP07/24 also sought views on the proposed deletion of LR 9.8.6R (5) which requires a UK company with shares admitted to primary listing to include a statement of how it has applied the principles set out in Section 1 of the Combined Code in its annual financial report.

² A copy of the Company Reporting Directive can be found at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:224:0001:01:EN:HTML>

³ The Combined Code is published by the Financial Reporting Council and a copy of it can be found on the Financial Reporting Council's website at: www.frc.org/uk/corporate/combinedcode.cfm

Responses received

- 1.7 We received 24 written responses. Annex 1 sets out a list of respondents.
- 1.8 Chapter 2 summarises the responses and sets out our views on the issues that were raised. Respondents were largely supportive of the approach set out in CP07/24. The only area where responses were mixed related to our proposal to delete LR 9.8.6R(5) which requires a company to set out how it has applied the principles of the Combined Code. Most respondents asked us to keep the rule. As far as possible we have taken respondents' comments into account and revised our proposed draft rules accordingly.
- 1.9 We are extremely grateful to all the respondents for their time and effort in providing comments.

Timing

- 1.10 The rules will come into effect on 29 June 2008 for financial reporting periods beginning on or after that date.

Who should read this Policy Statement?

- 1.11 This Policy Statement will be of interest to:
- Companies, including issuers from non-EEA countries, whose securities are admitted to trading on a regulated market, their directors and advisers;
 - investors; and
 - accountants and statutory auditors, including auditors from non-EEA countries of issuers admitted to trading on a regulated market.

2 Consultation Responses

- 2.1 This chapter sets out our feedback to the responses to the proposed rules.

Statutory Audit Directive

- 2.2 We asked:

Q1: Do you agree with, or have any comments on, our proposed approach to the implementation of the Statutory Audit Directive?

- 2.3 Responses were broadly supportive of our proposals for implementing the Statutory Audit Directive. In particular, respondents supported the proposal to effect UK implementation of Article 41 on the basis permitted by Article 41(5).
- 2.4 Given the broad nature of our question, we received comments on a range of issues, summarised below.

Independence and financial expertise

- 2.5 There was strong support for our proposal that independence and financial expertise can be fulfilled either by one and the same person or by more than one person. However, one respondent expressed concern that it might be possible for a company, where the board takes on the role of the ‘body performing equivalent functions’, to achieve form over substance and not satisfy the *raison d’être* for an audit committee. There was also strong support for our proposal that, in the context of implementing Article 41(5) of the Statutory Audit Directive, FSA rules should not prescribe what would constitute independence or expertise.

Our response: We will proceed on the basis that independence and financial expertise can be fulfilled either by one and the same person or by more than one person. However, we are also of the view that shareholders should play an important role in the corporate governance of a company. We agree with the government’s view that ‘a key strength of the chosen approach to implementation is the degree of flexibility it allows for companies *and shareholders* to establish specific arrangements which are appropriate to their own

circumstances”⁴ (emphasis added). We will also proceed on the basis that the Disclosure Rules and Transparency Rules Sourcebook (DTR) will not prescribe what would constitute independence and expertise of members of a body performing audit functions (i.e. the functions set out in DTR 7.1.3R).

Interaction with the Combined Code

- 2.6 Respondents supported the proposal to implement these elements of the Statutory Audit Directive by way of Part 6 rules while leaving the Combined Code untouched. There was also general support for us including guidance in DTR that compliance with the Combined Code will result in compliance with the new rules.
- 2.7 One respondent asked us to clarify that compliance with C.3.1 of the Combined Code would mean compliance with the DTR. Another respondent requested that we consider making a statement that a company which has complied with the ‘recent and relevant experience’ criterion of Combined Code provision C.3.1 will satisfy the requirement of the DTR.

Our response: We will retain the guidance that compliance with the Combined Code will result in compliance with the new rules. However, as a result of the comments received, we have decided to amend the guidance so that it is clear that, in our view, compliance with Combined Code provisions A.1.2, C.3.1, C.3.2 and C.3.3 will result in compliance with the new rules in DTR.

Monitoring by the FRRP

- 2.8 There was general support for the proposed collaboration between the FSA and the FRRP. One respondent indicated that while the FRRP would determine whether companies had made the necessary disclosures under the new rules, the substance of such disclosures should nevertheless be assessed by shareholders. UK shareholders who are not happy with a board’s explanations have the power to remove directors and would view as unhelpful regulatory intervention which might lead boards to look to us for judgement in matters of governance rather than to shareholders.

Our response: We will continue to put into place working arrangements with the FRRP to monitor whether companies make the necessary disclosures under the new rules. However, it should be stressed that such monitoring should not be seen as an alternative to shareholder scrutiny of a company’s corporate governance practices.

Article 39 exemption

- 2.9 Most respondents that addressed this issue expressed support for exercising the option in Article 39 of the Statutory Audit Directive to exempt public interest entities such as credit institutions and insurance undertakings that are not traded on a regulated market. It was felt that entities not traded on a regulated market attract more sophisticated investors who have a greater awareness of the level of risks associated with these markets.

⁴ See para 2.61 of the government’s ‘Implementation of Directive 2006/43/EC on Statutory Audits of Annual and Consolidated Accounts (8th Company Law Directive): Policy Conclusions and draft regulations’ July 2007.

Our response: We will continue with our proposal to apply the audit committee requirements of the Statutory Audit Directive to traded companies by way of new rules to be inserted into DTR.

Third-country auditors

- 2.10 Several respondents indicated that they appreciated that the European Commission's (Commission) proposals regarding equivalence and transitional arrangements for third-country auditors had not yet been finalised and that the proposed rules might have to be adjusted to take account of these.
- 2.11 A number of respondents also questioned why the proposed amendment to DTR 4.1.7R did not include an exemption, as set out in Article 46 of the Statutory Audit Directive, for those third-country auditors whose local regulatory regime is deemed equivalent by the Commission.

Our response: The Commission agreed transitional measures for third country auditors on 3 June 2008⁵. After carrying out a preliminary assessment of audit regulation in a number of third countries, the Commission was able to take an initial view of the state of audit regulation in these third countries. The Commission will be unable to take final equivalence decisions in respect of these third countries until further assessments have been carried out. There are 36 countries (or jurisdictions) – transitional countries – that fall into this category.

The Commission Decision establishes a transitional period in respect of auditors from the 36 transitional countries to enable the Commission sufficient time to carry out the final equivalence assessments. Transitional country auditors will not have to comply with Article 45 of the Statutory Audit Directive – i.e. they will be able to continue their activities in relation to audit reports concerning annual or consolidated accounts for financial years starting during the period from 29 June 2008 to 1 July 2010, if they provide information about themselves to Member State authorities. In addition, the Commission Decision allows Member States to register transitional country auditors as long as the public is informed of the fact that transitional countries are not yet recognised as equivalent.

The Professional Oversight Board (POB) recently published a consultation paper outlining its proposals to regulate third country auditors.⁶ It has stated that as long as transitional country auditors provide the POB with the information set out in the Commission Decision they will be on the UK register of third-country auditors kept for the purposes of Regulation 34 of the Statutory Auditors and Third Country Audit Regulations 2007 (SI 2007/3494). So, in such cases the requirements of DTR 4.1.7R(4)(a) will be satisfied.

However, auditors from non-transitional countries wishing to act as a third-country auditor for UK purposes will still have to comply with all elements of Article 45 of the Directive and thus will have to undergo the complete registration process as the POB proposed. The POB has indicated that it is looking at having full arrangements in place as soon as

5 A copy of the (then draft) decision (Malaysia was subsequently added to the list of transitional countries) can be found at: http://ec.europa.eu/internal_market/auditing/docs/relations/draft-decision-4th_en.pdf

6 A copy of the POB's consultation paper can be found: http://www.frc.org.uk/documents/pagemanager/pob/Third_Country_auditors/Consdoc%2028%2005%2008%20FINAL.pdf

possible. The vast majority of third-country issuers will only need to consider compliance with the new DTR 4.1.7R(4) well into 2009, as the rule applies only to financial years beginning on or after June 29th 2008.

In addition, the POB has indicated that if any of the exemptions in Article 46 are taken up, third-country audit firms will nevertheless still be required to register in the UK. Accordingly, the new DTR 4.1.7R(4) is silent in this respect.

Company Reporting Directive

2.12 We asked:

Q2: Do you agree that LR 9.8.6R(5) should be deleted?

2.13 Most respondents that addressed this question (11 out of 19) favoured retaining the rule though a number emphasised that the requirement is/should be an obligation to report against the main principles of the Combined Code as opposed to reporting against all the 60+ elements of the supporting provisions as well. The main reasons that were given for retaining the rule were (1) the narrative statement provides meaningful and valuable information as it can provide a useful insight into the thinking of and quality of the board; (2) maintenance of transparency about the corporate governance practices of companies which in turn increases confidence in the capital markets; (3) removal of the rule could side-line the corporate governance principles of the Combined Code which could move the UK further towards a rules-based system where the emphasis is placed upon compliance with rules rather than the application of broad, governance principles. Two respondents commented that deletion of the rule would benefit smaller companies.

Our response: We propose to modify LR 9.8.6R(5) to reduce the amount of boiler-plate disclosures so that a company to whom the rule applies will need to include in its annual report 'a statement of how it has applied the *Main Principles* set out in Section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied' (emphasis added). Where a company has applied the Code's Main Principles by complying with the associated provisions it should be sufficient for the company simply to report that it has done so. However, where a company has taken additional actions to apply the principles or otherwise improve its governance, it would be helpful to shareholders to describe these in the annual report. We do not expect this to have any cost implications, and modification will benefit smaller companies by cutting back the amount of boiler-plate.

Q3: Do you agree that the exemption should apply to issuers of preference shares and issuers of securities convertible into shares that do not have such securities admitted to trading on a multilateral trading facility?

2.14 There was widespread support that the exemption should apply to issuers of shares, preference shares and issuers of securities convertible into shares that do not have such securities admitted to trading on a multilateral trading facility.

Our response: We will retain the exemption as proposed.

Q4: Do you agree with, or have any comments on, our proposed approach to the implementation of the Company Reporting Directive?

- 2.15 Responses were largely supportive of our proposals for implementing the Company Reporting Directive. Given the broad nature of our question, we received comments on a range of issues, summarised below.
- 2.16 Respondents generally supported the proposal that companies be allowed to choose where to include the corporate governance statement – i.e. that the rules should not prescribe that the statement be part of the directors’ report. However, some respondents indicated that companies may choose to include the statement in the directors’ report as the disclosure is then likely to be within the liability regime under s. 463 of the Companies Act 2006, which is likely to help encourage more meaningful disclosure.
- 2.17 As with the guidance associated with the Statutory Audit Directive and compliance with the Combined Code, there was concern expressed that the reference to ‘relevant provisions’ in DTR 7.2.8G was too vague.

Our response: We will amend DTR 7.2.8G to refer explicitly to Combined Code provisions A.1.1, A.1.2, A.4.6, B.2.1 and C.3.3.

Scope of rules

- 2.18 A number of respondents commented on the scope of the rules in relation to both the Statutory Audit Directive and the Company Reporting Directive. Responses that addressed the issue of scope revealed a range of opinions – which varied from support for the UK-incorporation approach; to support for applying the rules to both EU and third-country issuers admitted to trading on a regulated market; and support for applying the rules to all primary listed issuers.
- 2.19 One specific concern was that other Member States might implement and enforce the directives differently or inadequately.
- 2.20 There was some concern over the interaction between the proposals in CP07/24 and DP08/1 (Review of the Structure of the Listing Regime). CP07/24 proposed that both the audit committee requirement and the corporate governance statement requirement be implemented on a directive minimum basis – i.e. having rules that would apply to companies incorporated in the UK whose securities are admitted to trading on a regulated market.
- 2.21 DP08/1 noted that overseas companies with a Primary Listing currently do not have to ‘comply or explain’ against the Combined Code and asked for views on how the provisions described under core requirements (which include the ‘comply or explain’ provision) should apply to overseas Primary Listed companies.

Our response: We have raised the issue of implementation across Member States with BERR. In respect of the Statutory Audit Directive there appears to be consensus for a country of incorporation approach; but for the Company Reporting Directive it is too early to say what the likely outcome will be. We will keep the issue under review.

Applying the Company Reporting Directive with the proposed scope would mean that non-EU secondary listed issuers and GDR issuers would not be required to make a corporate governance statement (beyond any that they are required to make in their home jurisdiction).

We will adopt the scope that we consulted upon in CP07/24 (i.e. UK-incorporation approach) on the basis that this scope is directive minimum and that we can re-visit this issue (in the follow-up consultation to DP08/1) if necessary in the light of the responses to the DP (and further information on implementation in other Member States).

It should additionally be noted that a non-EU issuer is in fact already subject to the Listing Rule requirement (LR 9.8.7R) to disclose whether it complies with the corporate governance regime of its country of incorporation and the significant ways in which its actual corporate governance practices differ from the requirements of the Combined Code.

List of Respondents

Association of British Insurers
The Association of Friendly Societies
The Chartered Institute of Management Accountants
Confederation of British Industry
Deloitte & Touche LLP
Ernst & Young LLP
Grant Thornton UK LLP
Hermes Equity Ownership Services Ltd
The Institute of Chartered Accounts in England and Wales
The Institute of Chartered Accounts of Scotland
The Institute of Chartered Secretaries and Administrators
Institute of Directors
International Capital Market Association
Investment Management Association
Ken Rushton
KPMG LLP
London Stock Exchange
Mayer Brown International LLP
Mazars LLP
National Grid plc
PricewaterhouseCoopers LLP
Prudential plc
The Quoted Companies Alliance
Standard Life plc

Final Handbook Text

**DISCLOSURE RULES AND TRANSPARENCY RULES SOURCEBOOK
(CORPORATE GOVERNANCE RULES) INSTRUMENT 2008**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 73A (Part 6 rules);
 - (2) section 89O (Corporate governance rules);
 - (3) section 96 (Obligations of issues of listed securities);
 - (4) section 101 (Part 6 rules: general provisions);
 - (5) section 138 (General rule-making power);
 - (6) section 156 (General supplementary powers);
 - (7) section 157(1) (Guidance); and
 - (8) Schedule 7 (The Authority as Competent Authority for Part VI).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 29 June 2008.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Listing Rules sourcebook (LR)	Annex B
Disclosure Rules and Transparency Rules sourcebook (DTR)	Annex C

Notes

- E. In the Annexes to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- F. This instrument may be cited as the Disclosure Rules and Transparency Rules Sourcebook (Corporate Governance Rules) Instrument 2008.

By order of the Board
26 June 2008

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

<u>Audit Directive</u>	<u>Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.</u>
<u>corporate governance rules</u>	<u>(in accordance with section 89O(1) of the Act) rules for the purpose of implementing, enabling the implementation of or dealing with matters arising out of or related to, any Community obligation relating to the corporate governance of issuers who have requested or approved admission to trading of their securities and about corporate governance in relation to such issuers for the purpose of implementing, or dealing with matters arising out of or related to, any Community obligation. The corporate governance rules are located in chapters 1B, 4 and 7 of DTR.</u>
<u>Fourth Company Law Directive</u>	<u>Council Directive 78/660/EEC on the annual accounts of certain types of companies as amended by, amongst other instruments, Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006.</u>
<i>issuer</i>	... (2A) (in chapters 1A, <u>1B</u> , 4, 6 <u>and 7</u> of DTR) a legal entity governed by private or public law, including a State, whose securities are admitted to trading on a <i>regulated market</i> , the issuer being, in the case of depository receipts representing securities, the issuer of the securities represented; ...
<i>share</i>	... (3) (in DTR and LR, and in FEES where relevant to DTR or LR) (in accordance with section 744 of the Companies Act 1985) a share in the share capital of a <i>company</i> , and includes: (a) stock (except where a distinction between shares and stock is express or implied); and (b) <i>preference shares</i> ; and

- (c) in chapters 4, 5, 6 and ~~6~~7 of *DTR* a convertible share.

...

statutory auditor

a statutory auditor as that term is defined in section 1210 of the Companies Act 2006.

Annex B

Amendments to the Listing Rules sourcebook (LR)

In this Annex, underlining indicates new text and striking through indicates deleted text.

9.2.6A G A *listed company*, whose *securities* are admitted to trading on a *regulated market*, should consider its obligations under *DTR 4* (Periodic financial reporting), *DTR 5* (Vote holder and issuer notification rules), ~~and *DTR 6*~~ (Access to information) and *DTR 7* (Corporate governance).

...

9.8.6 R In the case of a *listed company* incorporated in the *United Kingdom*, the following additional items must be included in its annual financial report:

...

- (5) a statement of how the *listed company* has applied the ~~principles~~ Main Principles set out in Section 1 of the *Combined Code*, in a manner that would enable shareholders to evaluate how the principles have been applied.

...

Annex C

Amendments to the Disclosure Rules and Transparency Rules sourcebook (DTR)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new chapter after DTR 1A. The text is not underlined.

1B Introduction (Corporate governance)

1B.1 Application and purpose (Corporate governance)

Purpose: Audit committees

- 1B.1.1 G The purpose of the requirements in *DTR 7.1* is to implement parts of the *Audit Directive* which require *issuers* that are required to appoint a *statutory auditor* to appoint an audit committee or have a body performing equivalent functions.

Application: Audit committees

- 1B.1.2 R Except as set out in *DTR 1B.1.3R*, *DTR 7.1* applies to an *issuer*:

- (1) whose *transferable securities* are *admitted to trading*; and
- (2) which is required to appoint a *statutory auditor*.

Exemptions

- 1B.1.3 R *DTR 7.1* does not apply to:

- (1) any *issuer* which is a *subsidiary undertaking* of a *parent undertaking* where the *parent undertaking* is subject to *DTR 7.1*, or to requirements implementing Article 41 of the *Audit Directive* in any other *EEA State*;

[**Note:** Article 41.6(a) of the *Audit Directive*]

- (2) any *issuer* the sole business of which is to act as the issuer of *asset-backed securities* provided the entity makes a statement available to the public setting out the reasons for which it considers it is not appropriate to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee;

[**Note:** Article 41.6(c) of the *Audit Directive*]

- (3) a *credit institution* whose *shares* are not *admitted to trading* and which has, in a continuous or repeated manner, issued only *debt securities* provided that:

- (a) the total nominal amount of all such *debt securities* remains below 100,000,000 Euros; and
- (b) the *credit institution* has not been subject to a requirement to publish a prospectus in accordance with section 85 of the *Act*.

[**Note:** Article 41.6(d) of the *Audit Directive*]

Purpose: Corporate governance statements

- 1B.1.4 G The purpose of the requirements in *DTR 7.2* is to implement parts of the *Fourth Company Law Directive* and the *Seventh Company Law Directive* (including those Directives as applied to banking and insurance companies) which require companies to publish a corporate governance statement.

Application: Corporate governance statements

- 1B.1.5 R Except as set out in *DTR 1B.1.6R*, *DTR 7.2* applies to an *issuer*:
- (1) whose *transferable securities* are *admitted to trading*; and
 - (2) which is a company within the meaning of section 1(1) of the Companies Act 2006.

Exemption

- 1B.1.6 R The *rules* in *DTR 7.2.2R*, *7.2.3R* and *7.2.7R* do not apply to an *issuer* which has not issued *shares* which are *admitted to trading* unless it has issued *shares* which are traded on an *MTF*.

[**Note:** Article 46a(3) of the *Fourth Company Law Directive*]

1B.2 Modifying rules and consulting the FSA

- 1B.2.1 R The *rules* and *guidance* provisions in *DTR 1A.2* are deemed to apply to *corporate governance rules* as they apply to *transparency rules*.

Amend the following as shown.

Auditing of financial statements

- 4.1.7 R ...
- (3) ...

[**Note:** article 4(4) of the *TD*]

- (4) An issuer which is a UK-traded non-EEA company within the

meaning of section 1241 of the Companies Act 2006 must ensure that the *person* who provides the audit report is:

- (a) on the register of third country auditors kept for the purposes of regulation 34 of the Statutory Auditors and Third Country Audit Regulations 2007 (SI 2007/3494); or
- (b) eligible for appointment as a *statutory auditor* under section 1212 of the Companies Act 2006; or
- (c) an EEA auditor within the meaning of section 1261 of the Companies Act 2006.

[Note: Article 45(4) of the *Audit Directive*]

Insert the following new chapter after DTR 6. The text is not underlined.

7 Corporate governance

7.1 Audit committees

Audit committees and their functions

- 7.1.1 R An *issuer* must have a body which is responsible for performing the functions set out in *DTR 7.1.3R*. At least one member of that body must be independent and at least one member must have competence in accounting and/or auditing.
- 7.1.2 G The requirements for independence and competence in accounting and/or auditing may be satisfied by the same member or by different members of the relevant body.
- 7.1.3 R An *issuer* must ensure that, as a minimum, the relevant body must:
 - (1) monitor the financial reporting process;
 - (2) monitor the effectiveness of the *issuer's* internal control, internal audit where applicable, and risk management systems;
 - (3) monitor the statutory audit of the annual and consolidated accounts;
 - (4) review and monitor the independence of the *statutory auditor*, and in particular the provision of additional services to the *issuer*.
- 7.1.4 R An *issuer* must base any proposal to appoint a *statutory auditor* on a recommendation made by the relevant body.

[Note: Article 41.3 of the *Audit Directive*]
- 7.1.5 R The *issuer* must make a statement available to the public disclosing which body carries out the functions required by *DTR 7.1.3R* and how it is

composed.

[**Note:** Article 41.5 (part) of the *Audit Directive*]

- 7.1.6 G An *issuer* may include the statement required by *DTR 7.1.5R* in any statement it is required to make under *DTR 7.2* (Corporate governance statements).
- 7.1.7 G In the *FSA's* view, compliance with provisions A.1.2, C.3.1, C.3.2 and C.3.3 of the *Combined Code* will result in compliance with *DTR 7.1.1R* to *7.1.5R*.

7.2 Corporate governance statements

- 7.2.1 R An *issuer* to which this section applies must include a corporate governance statement in its directors' report. That statement must be included as a specific section of the directors' report and must contain at least the information set out in *DTR 7.2.2R* to *7.2.7R* and, where applicable, *DTR 7.2.10R*.
- 7.2.2 R The corporate governance statement must contain a reference to:
- (1) the corporate governance code to which the *issuer* is subject; and/or
 - (2) the corporate governance code which the *issuer* may have voluntarily decided to apply; and/or
 - (3) all relevant information about the corporate governance practices applied beyond the requirements under national law.

[**Note:** Article 46a(1)(a) first paragraph of the *Fourth Company Law Directive*]

- 7.2.3 R (1) An *issuer* which is complying with *DTR 7.2.2R* (1) or (2) must:
- (a) state in its directors' report where the relevant corporate governance code is publicly available; and
 - (b) to the extent that it departs from that corporate governance code, explain which parts of the corporate governance code it departs from and the reasons for doing so.
- (2) Where *DTR 7.2.2R*(3) applies, the issuer must make its corporate governance practices publicly available and state in its directors' report where they can be found.
- (3) If an issuer has decided not to apply any provisions of a corporate governance code referred to under *DTR 7.2.2R*(1) and (2), it must explain its reasons for that decision.

[**Note:** Article 46a(1)(a) second paragraph and Article 46a(1)(b) of the *Fourth Company Law Directive*]

7.2.4 G A *listed company* which complies with LR 9.8.6R(6) (the comply or explain rule in relation to the *Combined Code*) will satisfy the requirements of DTR 7.2.2R and 7.2.3R.

7.2.5 R The corporate governance statement must contain a description of the main features of the *issuer's* internal control and risk management systems in relation to the financial reporting process.

[**Note:** Article 46a(1)(c) of the *Fourth Company Law Directive*]

7.2.6 R The corporate governance statement must contain the information required by paragraph 13(2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) (information about share capital required under Directive 2004/25/EC (the Takeover Directive)) where the *issuer* is subject to the requirements of that paragraph.

[**Note:** Article 46a(1)(d) of the *Fourth Company Law Directive*]

7.2.7 R The corporate governance statement must contain a description of the composition and operation of the *issuer's* administrative, management and supervisory bodies and their committees.

[**Note:** Article 46a(1)(f) of the *Fourth Company Law Directive*]

7.2.8 G In the FSA's view, the information specified in provisions A.1.1, A.1.2, A.4.6, B.2.1 and C.3.3 of the *Combined Code* will satisfy the requirements of DTR 7.2.7R.

7.2.9 R An *issuer* may elect that, instead of including its corporate governance statement in its directors' report, the information required by DTR 7.2.1R to DTR 7.2.7R may be set out:

- (1) in a separate report published together with and in the same manner as its annual report. In the event of a separate report, the corporate governance statement must contain either the information required by DTR 7.2.6R or a reference to the directors' report where that information is made available; or
- (2) by means of a reference in its directors' report to where such document is publicly available on the *issuer's* website.

[**Note:** Article 46a(2) first and second sentence of the *Fourth Company Law Directive*]

- 7.2.10 R Subject to *DTR 7.2.11R*, an *issuer* which is required to prepare a group directors' report within the meaning of section 415(2) of the Companies Act 2006 must include in that report a description of the main features of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts. In the event that the *issuer* presents its own annual report and its consolidated annual report as a single report, this information must be included in the corporate governance statement required by *DTR 7.2.1R*.

[**Note:** Article 36(2)(f) of the *Seventh Company Law Directive*]

- 7.2.11 R An *issuer* that elects to include its corporate governance statement in a separate report as permitted by *DTR 7.2.9R(1)* must provide the information required by *DTR 7.2.10R* in that report.

TP 1 Disclosure and transparency rules

Sourcebook - Transitional Provisions

(1)	(2) Material to which the Transitional provisions applies	(3)	(4) Transitional provision	(5) Transitional Provision: dates in force	(6) Handbook Provision: coming into force
...					
<u>5A</u>	<u><i>DTR 4.1.7R(4)</i></u>	<u>R</u>	<p><u><i>DTR 4.1.7R(4)</i> shall have effect as follows:</u></p> <p><u>An issuer whose financial year begins before 29 June 2008 must comply with <i>DTR 4.1.7R(4)</i> as of the beginning of its next financial year.</u></p>	<u>From 29 June 2008</u>	<u>29 June 2008</u>
...					
<u>14</u>	<u>All of <i>DTR</i> chapter 7</u>	<u>R</u>	<p><u><i>DTR 7</i> shall have effect as follows:</u></p> <p><u>An issuer whose financial year begins before 29 June 2008 must comply with <i>DTR 7</i> as of the beginning of its next financial year.</u></p>	<u>From 29 June 2008</u>	<u>29 June 2008</u>

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