UKLA Publications

LIST!

Issue No. 21 – May 2009

Welcome to LIST! No. 21, our second edition for 2009. The articles in this May issue reflect the variety of work undertaken on a daily basis at the UKLA in relation to transactions, our Sponsor regime and the monitoring of listed entities' continuing obligations.

An additional inclusion this time is a longer piece: a review of Interim Management Statements (see attached annex).

Thank you for your suggestions; the UKLA appreciates your feedback and we have tried to incorporate it in LIST!, where relevant. If there is an area or rule which you would like us to cover in future editions, please contact Tim Ross at tim.ross@fsa.gov.uk.

Guidance

In this newsletter we have tried to provide a broad coverage of topical issues of both a technical and non-technical nature. We are limited in the way we can address technical matters by the requirements of the Financial Services and Markets Act 2000 (FSMA), which restricts the scope for issuing guidance without prior consultation.

It is important to understand that the contents of this newsletter are not intended to be guidance as contemplated by FSMA, and the contents should neither be interpreted, nor relied upon, as guidance. You should refer to the Listing Rules (LRs), Prospectus Rules (PRs) and Disclosure and Transparency Rules (DTRs) for general guidance and where you need individual guidance, you may approach us. Technical explanations provided in this newsletter are illustrative only and are intended to provide an indication of how the UKLA may expect certain issues to be addressed.

1. Property valuation reports

In the last few months we have dealt with a number of queries on property valuation reports in a prospectus. These have come against a backdrop of unusually difficult commercial property market conditions, with property values falling very rapidly. This has caused practitioners to ask us how up-to-date a property valuation report in a property company's share prospectus should be.

Our starting position on this problem has been that the CESR guidance in respect of property companies should be observed. This requires a property company preparing a share prospectus to include a property valuation report prepared by an independent expert. But it does not explicitly say how recent that report has to be, allowing the valuation to be up to a year old, providing the issuer can confirm in the document there has been no material change since the effective date of the report (see Paragraph 130iv of http://www.cesr.eu/index.php?page=document_details&id=2999).

The point to note here is that the provision requires a 'no material change' confirmation, not disclosure of material changes. This is because the provision is a flexible mechanism designed to ensure the valuation is appropriately dated. The way this provision is intended to work is that if a 'no material change' statement cannot be given, an issuer's valuation is out of date, and a new one that is up to date should be commissioned.

The difficulty that has arisen in recent market conditions is that mainstream commercial property values were believed to be dropping so rapidly that almost any valuation report would be out-of-date before it is completed. In such circumstances, it was argued, no issuer could ever give a 'no material change' statement.

After careful reflection, we concluded that the overarching purpose behind this piece of CESR guidance was to ensure property valuations are as appropriately up-to-date as possible. We therefore decided that in rapidly falling markets, and where a 'no material change' statement cannot be given, it is acceptable for property companies approaching investors for further investment to revalue the portfolio to the latest practicable date before the date of the prospectus. We have also challenged issuers where they proposed an effective date that was not, in our view, the latest practicable, which we believe should not be more than six weeks from the date of the document.

As a result, we have agreed that in these highly-volatile property markets (and only while these conditions last) issuers who cannot declare there has been 'no material change' can instead confirm in the document that the effective date of the valuation is the latest date it can practicably be ahead of the publication. In such circumstances, we would expect the document to be clear on the market conditions the issuer is experiencing and for issuers to consider carefully their disclosure obligations under Article 5(1) of the Prospectus Directive and Ann I 20.9 (significant change) of the Prospectus Directive Regulation. In such circumstances we would also challenge strongly any valuation over six weeks – experience suggests it should not take longer than this to revalue a portfolio.

2. Timetable – Investment Trust rollovers

We have noticed in recent months that there has been a change in the structure of timetables in relation to Investment Trust rollovers. In particular, we have been approached by issuers wishing to use a single EGM process, whereby the proposal, reclassification and appointment of liquidators are all carried out at the same time, with the suspension of the reclassified shares taking place at a later effective date. Historically, timetables were structured to include two EGMs. The first EGM typically covered the proposals and reclassification of the ordinary shares. The second usually covered the appointment of liquidators. The trigger points for the suspension of the shares (and the reclassified shares) are key to the UKLA when reviewing these types of transactions. We therefore thought it would be useful to clarify the UKLA's thinking in relation to these areas and to highlight some of the technical difficulties with the new timetable.

In considering timetables for rollovers, it is essential that the UKLA has a legitimate reason for both suspending the company and amending the Official List to reflect reclassification. In rollover timetables, the suspension is typically triggered when the register of a company is closed and there are no provisions for the registration of subsequent transfers, or when a liquidator is appointed. With regards to the reclassification of the shares, this can only occur if the UKLA are satisfied that the reclassified shares are capable of being listed in their own right.

In a typical two EGM rollover process, the shares are reclassified following approval of the first EGM. While the register is often closed before the first EGM, provisions are made for subsequent transfers to be recorded; as such the UKLA would not suspend the shares at that time under LR5. Following the passing of the resolutions at the EGM, the shares are reclassified to reflect elections under the rollover scheme. The register is then re-opened once the Official List has been amended. The UKLA allows the reclassification because there are no technical reasons to require the suspension at that point. The reclassified shares remain listed until the day of the second EGM, at which the liquidators are appointed. Once the liquidators are appointed, the reclassified shares will remain suspended until cancelled.

We are now seeing timetables with a single EGM, where the liquidators are appointed at the same time as the proposals are put to shareholders, albeit at a later effective date. This raises questions about the correct point at which the company should be suspended and whether it would be appropriate to allow the reclassification.

The UKLA believes, given the certainty that liquidators will be appointed, the suspension should occur at the first EGM. A suspension at a later effective date would not be appropriate, as the conditions set out in LR 5.1.2 would have been met at the time of the appointment of the liquidator, and there are no grounds to allow us to delay suspensions.

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In order to allow the reclassification, the UKLA would need to be comfortable that the reclassified shares were capable of being listed in their own right. Since the shares would be suspended with no reasonable prospect of this being lifted, the UKLA would have no valid reason to allow the reclassification of the shares. We would be unwilling to amend a security that was suspended. The reclassification would therefore not be recognised on the Official List.

In order to avoid both the practical and technical issues raised by these timetables, issuers may wish to consider the continued use of the two EGM process.

3. Date of portfolio analysis (Annex XV, item 8.2)

Paragraph 8.2 of Annex XV of the Prospectus Rules requires collective investment undertakings to give comprehensive and meaningful analyses of their portfolios in prospectuses. We often find that funds with illiquid underlying investments that do not frequently revalue their portfolio (eg. private equity funds) often wish to disclose at the latest balance sheet date.

Paragraph 8.2 does not offer such discretion. The analysis should be provided at the date of the prospectus. This is important because balance sheet date portfolio information may not be up-to-date and new positions could have been entered into or old positions exited.

An objection to disclosure being given at the date of the document is that it is onerous to revalue your portfolio and misleading if you do not. We do not accept this argument because there is no obligation to revalue your portfolio. The reader of the document can reasonably expect any valuation data supplied in the analysis to be in accordance with the valuation policies the fund is obliged to set out under paragraph 6.1 of Annex XV. These should set out when the portfolio is revalued and if there is any doubt around the context of the table then footnotes, cross-references or the addition of a valuation date column in the table can easily make it clear that the valuation is a historic, balance sheet date figure.

4. Risk Factors

We have recently been considering whether the disclosure of risk factors, particularly in prospectuses, could be improved.

The UKLA recognises that in the current challenging financial environment issuers are contending with a wide range of issues, which may have a material impact on their businesses, industries and securities. As a result, risk factor sections within prospectuses are coming under increasing scrutiny.

Consequently, we feel that this would be an appropriate time to revisit the requirements under the Prospectus Rules, to remind issuers to avoid the inclusion of generic and irrelevant risk factors, and to explain the UKLA's approach to vetting these sections.

4.1 The Prospectus Directive and requirements under FSMA 2000

The Prospectus Directive requires all equity issuers to include disclosure of risk factors under Annex I, 4 (and Annex X, 4 for GDR's) that are '*specific to the issuer or its industry*' and under Annex III, 2 (and Annex X, 31.3.1 for GDR's) that are '*material to the securities being offered and/or admitted to trading in order to assess the market risk associated with these securities*'.

In the case of debt issuers, Annexes IV, 4, IX, 3 require an explanation of the risk factors that '*may affect the issuer's ability to fulfil its obligations under the securities to investors*' and Annexes V, 2.1, XII, 2 and XIII, 2 are '*material to the securities being [offered and/or] admitted to trading in order to assess the market risk associated with the securities*'.

While the requirements, as laid out in the Annexes, are broadly drafted and do not prescribe the type of risk factors that should be included, they do state that the risk factors should be specific to the company, its industry and should be relevant to the type of securities being offered.

These disclosure requirements are important to emphasise, as we are of the view that there has been an increasing tendency for risk factors' sections to include more generic, standardised risk factors, which do not appear to be directly relevant for the company or the issue that is the subject of the document.

It is also important to highlight the overarching requirements of FSMA 2000 S.87A(3), which requires the information to be presented in a form that is comprehensible and easy to analyse.

4.2 The UKLA approach to risk factors sections in documents

The UKLA has long considered that the issuers are best placed to assess the material risks that are relevant to them, their industry and the specific issue of securities. The UKLA also remains mindful of the prospectus responsibility regime, whereby the document is the responsibility of the issuer and its directors. Therefore, we do not routinely request that risk factors are substantially redrafted or removed from a prospectus. We believe that this approach is the correct one, particularly in the context of the current challenging commercial environment.

However, the UKLA will challenge risk factors in certain situations as part of its day-to-day vetting, for example:

- where disclosures conflict with or undermine other rule requirements (e.g. by qualifying the working capital statement with references to the requirement for further additional funding in the near future);
- where disclosures conflict with an issuer's eligibility or continuing obligations (e.g. detriment to investors, shares in public hands, etc);
- where disclosure is contradictory to the Listing Principles (e.g. Listing Principle 2, maintaining adequate systems, procedures and controls);
- where sufficient prominence is not given to material risks;
- where there is disclosure elsewhere in the document that seems to clearly present a risk to the issuer, which has not already been disclosed in the risk factor section; and
- where the risk factors are simply statements of fact that contain no explanation of the risk in the context of the issuer's business or the issue of the securities in question.

We would ask issuers and their advisers to consider the factors above when drafting risk factors. We would also ask that proper consideration is given to the real risks that face an issuer and that generic or boilerplate disclosure is avoided. If risks are not relevant to a particular issuer then no disclosure on that issue should be included in the issuer's document. We also suggest that risk factors should be grouped together in a coherent manner, and that risk factors considered to be of the greatest or most immediate significance should be given due prominence at the beginning of each section or group within the risk factors section.

5. Transferring officially-listed securities from a regulated market to a multilateral trading facility (MTF)

The transfer of officially-listed securities from a regulated market to an MTF is primarily a matter for the operators of the relevant markets to coordinate, as the relevant securities will remain listed throughout. Currently, this relates to transfers between the London Stock Exchange's main market and its Professional Securities Market.

However, we would like to advise issuers that they should also notify the UKLA's Listing Applications Team of the details of the transfer, including the effective date, markets concerned and affected securities. The letter should be accompanied by an RIS announcement setting out the details of the transfer.

We ask that issuers also confirm in the letter whether the securities to be transferred are 'specialist securities' within the meaning given in LR Appendix 1, as specialist securities newly admitted to an MTF for listed securities are subject to the requirement to prepare Listing Particulars under LR4.1.1R(2).

6. Principles for sponsors: identifying and managing conflicts

In edition 20 of List! we set out what the introduction of the principle for sponsors, regarding identifying and managing conflicts (LR8.3.7AGff), meant for sponsor firms. Since then, Sponsor Supervision has discussed with a number of sponsor firms how this principle is being applied in practice. We are grateful for the open dialogue we have had with sponsor firms on

This is not FSA guidance.

this topic and we thought it might be useful to share the key points arising from our discussions to support sponsor firms in making assessments of their ability to comply with LR8.3.7AGff.

In edition 20 of List! we set out examples of circumstances when a sponsor may be perceived as unable to carry out its role in a proper manner. One circumstance detailed was:

> 'Listing, capital raising or disposals, which may be perceived as facilitating an exit or realisation for the sponsor's group. The context within which such a transaction takes place will be relevant to determining whether the risk of a perceived conflict remains. For instance, a company subject to a financial rescue may raise concerns about a conflict if the sponsor's group exposure to that company is likely to diminish as a consequence of the transaction.'

The types of transaction that have generated the most discussion with our sponsor community are those where the sponsor or sponsor's group has an interest in the issuer (be it, for example, through an existing loan facility or other interest in the issuer) and the issuer is:

- in financial distress and the transaction has a 'rescue element'; or
- taking pre-emptive action with regards to its current financing structure (perhaps seeking to increase headroom or restructuring to meet banking covenants).

6.1 Assessing the conflict

In the above circumstances, we would suggest that a sponsor firm take the following factors into account when considering the application of the guidance and rules in LR8.3.7AGff.

- The prevailing circumstances of the issuer and transaction, including:
    - a) the motivation for the fundraising;
    - b) the effect of the use of proceeds of the transaction (for example, does the sponsor's group exposure to the issuer diminish, or does the sponsor's group otherwise benefit as a consequence of the transaction?);
    - c) the significance of the loan to the issuer;
    - d) whether the sponsor or sponsor's group is the only provider of finance to the issuer;
    - e) whether the issuer is at risk of breaching any of its banking covenants; and
    - f) whether interim repayments are required as part of the terms of the loan and whether any such payment is imminent.
- The significance of the loan to the sponsor or sponsor's group, including:
    - a) the value of the loan that the sponsor or sponsor's group has with the issuer;
    - b) the materiality of the loan relative to the balance sheet of both the sponsor's group and the specific business area within the sponsor's group that is accountable for the loan;
    - c) if the transaction has a rescue element, the impact on the profit and loss account of both the sponsor's group and the specific business area that is accountable for the loan if the loan was written off;
    - d) whether the loan is syndicated and the priority of the sponsor or sponsor's group within that syndicate; and
    - e) whether the loan is impaired.
- Other exposures (in addition to any loan facility) the sponsor or sponsor group has to the issuer (e.g. other interests or relationships that may create a conflict).

The above list is not exhaustive and sponsor firms should contact their relationship manager in Sponsor Supervision at the UKLA at an early stage in the transaction if they have any concerns about the application of the guidance and rules in LR8.3.7AGff.

6.2 Managing the conflict

A sponsor firm is required by LR8.3.9R to take all reasonable steps to put in place and maintain effective organisational and administrative arrangements, which ensure conflicts of interest do not adversely affect its ability to perform its functions properly under Chapter 8 of the Listing Rules. This may, for example, include establishing Chinese Walls between the sponsor team and other areas of the business with an interest in the issuer.

In addition, LR8.6.13AG(4) guides a sponsor firm to maintain appropriate records to support conflict assessments (including the basis upon which the firm has reached its conflict decisions).

We accept that the sponsor team will need to know certain information about the existence of a loan facility provided by its group, to ensure that there is appropriate disclosure in the relevant shareholder circular, Listing Particulars or Prospectus, and to ensure that it is able to undertake due and careful enquiry before reaching a conclusion on working capital. However, we would not expect employees providing or responsible for sponsor services to be apprised of the significance of the loan to the sponsor or sponsor's group, nor to be in contact with colleagues that are accountable for the loan. As a result, Sponsor Supervision would expect to hold detailed conflicts discussions with respect to the significance of the loan to the sponsor or sponsor's group, with the sponsor firm's compliance or legal department only.

6.3 Liaising with the UKLA

Because of the varied nature of both sponsor firms and the transactions on which they act, we are not able to define a set of criteria for when the UKLA would expect to discuss a conflicts assessment with a sponsor firm. If after considering the points set out above, a sponsor is comfortable that it can act on a transaction, the UKLA would not necessarily expect to discuss the conflicts assessment process with the sponsor. However, sponsor firms may wish to contact their Sponsor Supervision relationship manager to determine the extent to which conflicts issues and their management should be discussed with the UKLA before providing sponsor services.

We would, however, suggest that a sponsor firm contact its Sponsor Supervision relationship manager before the submission of a document for vetting by the UKLA if:

- the issuer is in severe financial distress and the transaction provides the sponsor or sponsor's group with an exit, or its exposure to the issuer is significantly diminished as a result of the transaction; or
- there is otherwise any doubt whether the sponsor should act on the transaction.

The UKLA may request the following confirmations from a sponsor when considering LR8.3.7AGff.

- Employees providing or responsible for the provision of sponsor services have not been in contact with the team responsible for the loan within the sponsor firm or sponsor's group.
- Compliance or legal staff at the sponsor have reviewed and signed off on the conflicts assessment and are comfortable for the sponsor firm to act on the transaction.
- The sponsor has put in place and will maintain effective organisational and administrative arrangements, which ensure that any conflicts of interest do not adversely affect the ability of the sponsor to perform sponsor services properly.

Where the UKLA and sponsor are able to get comfortable with a sponsor providing sponsor services on a transaction, we would nonetheless expect the sponsor to notify us as soon as possible should any of the circumstances surrounding the transaction change. Please also be aware that the UKLA may delay providing comments on a document until any conflict queries have been resolved and a conflicts declaration has been submitted.

7. Further consultation on rights issues

7.1 Rights issues and other capital raising initiatives

This article reports on the progress that has been made to improve the capital-raising regime for UK listed companies. It also discusses forthcoming initiatives in relation to compensatory open offers and accelerated rights issues.

7.1.1 Rights Issue Review Group (RIRG)

The RIRG report was published on 24 November 2008 (http://www.hm-treasury.gov.uk/prebud_pbr08_rightsissues.htm). It made recommendations to the Chancellor of the Exchequer for improving the efficiency and orderliness of the UK capital-raising process.

This is not FSA guidance.

By the end of the first quarter of 2009, a number of the RIRG recommendations had been implemented and taken forward.

- On 5 January the ABI announced revised guidelines that allow companies to issue new shares, equivalent to up to two-thirds of their existing capital, without holding a general meeting. (http://www.abi.org.uk/Newsreleases/viewNewsRelease.asp?nrid=17120)
- On 6 February we published our Discussion Paper, DP09/1, on short selling. This included a discussion of rights issues in the context of short selling. (http://www.fsa.gov.uk/Pages/Library/Policy/DP/2009/09_01.shtml)
- On 10 February we amended our Listing Rules by reducing the minimum subscription period for a rights issue from 21 days to ten business days. (http://www.fsa.gov.uk/pages/Library/Policy/Policy/2009/09_02.shtml)
- On 10 February, the London Stock Exchange amended the Admission and Disclosure Standards to reduce the minimum duration of open offers to ten business days. (http://www.londonstockexchange.com/NR/rdonlyres/BA98D7FC-5ABF-4D4A-9B5B-4398D96ECB5B/0/N0709.pdf)
- We have made a joint submission with the Treasury to the European Commission, advocating short-form prospectuses for rights issues. This was in response to the Commission's consultation on the review of the Prospectus Directive.[1]

The amendment to the Listing Rules, together with the ABI's revisions to its guideline, implemented a key recommendation of the RIRG report to reduce the duration of rights issues.[2]

7.2 Further consultation on rights issues and other capital-raising issues

We intend to take forward the remaining issues from the RIRG report in a consultative paper, which we will issue later in 2009. Set out below is a description of issues the paper is likely to address.

7.2.1 Compensatory open offers

The RIRG report identified the desirability of taking forward consultation on a new type of open offer, which will provide compensation for non-accepting shareholders.

The current Listing Rules allow compensatory open offers. While LR 9.5.10R(1) limits the discount at which an open offer can be made to 10%, LR 9.5.10R(3)(a) disapplies paragraph (1) to allow open offers to be made at a greater discount if the terms of the offer at that discount have been specifically approved by shareholders. The London Stock Exchange's new requirement for open offers to last a minimum of ten business days is broadly the same as the 14 clear days' notice needed for convening a general meeting of shareholders. The two periods could be run together.

There are, however, some technical issues relating to compensatory open offers including the authority to issue shares. These also relate to accelerated rights issues and we will be discussing them with a number of stakeholders.

7.2.2 Accelerated rights issues

The second key recommendation in the RIRG report was that accelerated rights issues could be introduced in the UK.[3]

The essential components of accelerated rights issues are that: they are fully pre-emptive; they deliver compensation to non-accepting shareholders; they allow the bulk of the capital-raising process to be completed within just a few days at the start of the period; and they allow those shareholders not in a position to go fast to participate on a conventional timescale – such as the ten business days now in place for rights issues and open offers. The RIRG identified the Australian RAPIDS model as one that could be adopted in the UK, but that further work would be needed to assess its viability. We are currently undertaking such work and intend to include this important topic in the consultative paper.

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[1] Directive 2003/71/EC.

[2] Paragraph 1.21 RIRG Report.

[3] Paragraph 1.22 RIRG Report.

7.2.3 Other topics for the consultative paper

Other topics for inclusion are:

- possible changes to our fee tariffs to ensure that the fees for vetting equity shelf registration are more aligned to those for single prospectuses; and
- whether a satisfactory framework can be put in place for conditional rights issues.

7.2.4 Other initiatives

Other matters arising from the RIRG report are:

- BERR[4] are to implement the Shareholder Rights Directive[5] (SRD) by 3 August 2009. Those issuers not able to offer shareholders appropriate electronic voting will be required to extend the notice period for general meetings from 14 to 21 clear days. The SRD will also require issuers to obtain annual authority to convene general meetings on 14 days' notice. BERR's consultation, which closed on 30 January 2009, is available at: http://www.berr.gov.uk/consultations/page48666.html.
- BERR have consulted on reducing the statutory rights issue subscription period from 21 to 14 days and, in the consultation, stated the intent to bring the relevant draft regulations into force on 1 October 2009. The paper can be found at: http://www.berr.gov.uk/files/file50486.pdf.
- We are working with a number of market participants to facilitate the development of non-prescriptive guidance for issuers to consider when embarking on a rights issue.

8. Segmentation and labelling of officially-listed securities

In CP08/21 we consulted on proposals to improve the transparency of the Official List. In part we proposed that this should be achieved by making it clearer which standards apply to various types of listed security, through improved labelling of securities in the Official List. It is therefore proposed to categorise each officially-listed security with a segment, reflecting the application of super-equivalent standards or EU-minimum standards, and a security category to reflect the nature of the listed security regarding the application of the Listing Rules. We are currently in the process of considering the responses to the consultation and preparing feedback.

However, on the assumption that the enhanced categorisation of listed securities goes ahead in one form or another, it is likely that we will need to contact all listed issuers later this year to validate the proper categorisation of their listed securities. In order to ensure that any validation exercise is as successful as possible, we encourage issuers to contact us now to verify that we hold the most appropriate and recent contact information, and to discuss whether the Official List reflects an accurate record of the securities which the issuer believes to be officially listed.

Please contact the Listing Applications Team on 020 7066 8333 (option 3) or by email at: listingapplications@fsa.gov.uk, if you wish to verify that the records we hold for an issuer are accurate, or to advise of more up-to-date or appropriate contact information.

9. Application of LR 6.1.19R(4)(e) in light of changes to the DTR 5 regime

It has come to our attention that there may be a need for clarification of LR 6.1.19R(4)(e) given upcoming changes to DTR 5 from 1 June 2009 and the potential read-across between the scope of financial instruments covered by the respective provisions.

LR 6.1.19R(4)(e) states that shares are not held in public hands if they are held, directly or indirectly, by any person or persons in the same group, or persons acting in concert, who have an interest in 5% or more of the shares of the relevant class. LR 9.2.15R requires issuers to comply with LR 6.1.19R at all times.

PS09/3: Disclosure of Contracts for Difference, published in March 2009, sets out the final rules for the extension of the DTR 5 major shareholdings disclosure regime, beyond the

[4] Department of Business Enterprise and Regulatory Reform.

[5] Directive 2007/36/EC.

This is not FSA guidance.

existing categories of shares and qualifying instruments, to include any financial instruments that have a similar economic effect to a qualifying instrument. This new category of disclosable instruments effectively includes any financial instrument giving a long economic interest in the shares of an issuer (e.g. CFDs).

Paragraph 3.2 of List! 18 clarified that the regulatory purpose of LR 6.1.19R(4)(e) is to ensure sufficient liquidity within the secondary market in the shares rather than to encourage wide public participation in an IPO. As such, the rule seeks to ensure that persons or concert parties do not control significant holdings of shares that are not available for trading on the secondary market. So the rule is less interested in who may be the ultimate beneficiary of the shares, but rather who controls the investment decision in relation to those shares. Accordingly, those financial instruments that give a long economic exposure to shares, but not control of the buy/sell decision in respect of the shares, should not count as an interest for the purpose of the public hands threshold. Therefore, the scope of financial instruments covered by LR 6.1.19R(4)(e) will not change after 1 June 2009.

It should be noted that where a CFD writer has chosen to hedge its position by acquiring a long position in shares underlying the CFD, they would count against the shares in public hands threshold if in their own right, or when aggregated with other shares held, they exceeded 5% of the relevant class of shares.

10. Interim Management Statements (IMS): a review

We have carried out a review of Interim Management Statements (IMS) that are required under the Transparency Directive (TD). The purpose of the review has been to assess how far a satisfactory industry-led approach to IMS has evolved over the last two years and whether we need to adopt a more prescriptive approach. We have also assessed issuers' compliance with the basic requirements to produce IMS, and with the specific requirements for the content of IMS.

Our review found that a significant number of issuers across the market as a whole are still failing to meet the basic requirements to produce an IMS, either at all or within the required timeframe. In addition there are a number of areas where specific IMS content requirements are not being met, in particular providing coverage of financial position and an explanation of the impact of material events on financial position.

In general, larger companies are complying more effectively with the IMS requirements than smaller companies. Issuers that do not comply with the IMS requirements should be aware that they risk possible enforcement action.

In terms of the overall approach issuers follow, our view remains that individual issuers are best placed to consider the approach that they should take to meeting their IMS obligations: we do not believe we should take a more prescriptive approach. Our review also highlights a number of practices and approaches followed by issuers in producing their IMS, which we present as we believe it may be helpful for other issuers to be aware of them.

The full article can be found in the annex to this newsletter.

Annex: Interim Management Statements (IMS): a review

Summary

This article sets out the conclusions of a review that we have carried out on how issuers are meeting their obligations under the Transparency Directive (TD) to produce Interim Management Statements (IMS). The primary focus of the review has been to assess whether we need to issue more prescriptive requirements to issuers on the content of their IMS. We have also assessed overall compliance with the requirement to publish IMS and on specific requirements on the content of IMS.

Our main conclusions are:

- individual issuers are best placed to consider the approach that they should take to meeting their IMS obligations – we do not believe we should take a more prescriptive approach;
- a significant number of issuers across the market as a whole are still failing to meet the basic requirements to publish IMS, either at all or within the required timeframe;
- there are a number of areas where specific IMS content requirements are not being met, in particular providing coverage of financial position and an explanation of the impact of material events on financial position; and
- in general, larger companies are complying more effectively with the IMS requirements.

As part of this exercise, we have gathered the views of a range of stakeholders on IMS. These clearly support the non-prescriptive approach that we have taken so far.

In the course of these discussions we have also identified a number of practices and approaches followed by issuers in producing their IMS. We present some of these here as we believe it may be helpful for other issuers to be aware of them.

Background

When we implemented the TD in January 2007, a number of changes were made to the requirements on issuers to publish periodic financial reports. Among these was the obligation to produce bi-annual IMS.

These new obligations were implemented in the UK by means of the Disclosure & Transparency Rules (DTRs), with the IMS requirements outlined in DTR 4.3. These rules require issuers to publish two IMS per financial year, one in each six-month period, within a ten-week 'window'. The IMS is required to provide information on any material events and transactions and their impact on the financial position of the issuer, along with a general description of the issuer's financial position and performance. IMS are required to contain up-to-date information from the beginning of the period until the date of publication.

When we originally consulted on our approach to the IMS requirements, we took the view that the content would depend greatly on the circumstances of the issuer and the markets in which it operates. We believed that any FSA guidance on this issue would have to be of such general application that it would have little or no value. We did, however, provide an informal indication in List! 14 (released in December 2006 and subsequently amended in April 2007) of how issuers may be able to meet the requirements, based on the content of trading statements and other reports, provided they contained all the information required by DTR 4.3.5. We further commented that IMS would not necessarily require financial data in some circumstances, as long as the issuer could provide meaningful narrative description to fulfil its obligations.

We also stated our expectation that market practice would develop in this area and we set out our intention to review the situation in 18 to 24 months, to assess whether we might need to alter this approach. This was supported by the market.

We carried out this review in late 2008 to early 2009, examining IMS produced during 2007 and 2008. In addition to assessing how the market-led approach had developed in practice, we focused on the following areas:

- compliance with the requirements to publish an IMS;
- compliance with the content obligations;
- other significant questions and/or difficulties issuers were facing in producing their IMS; and
- end-users' views on the effectiveness of IMS.

Quantitatively we examined all listed issuers, who were obliged to announce an IMS, to assess whether they complied with their obligation to publish an IMS and whether it was announced within the required timescale.

We also took a sample of IMS announcements from a range of issuers, across both size and sector, to qualitatively assess how far any convergence was occurring, within and across sectors, and how issuers were meeting the requirements on the content of IMS.

Compliance with publication obligations

Our review checked for compliance in all the IMS that should have been produced from implementation of the rules through to the end of 2008. All issuers would have been required to publish a minimum of two IMS during this period, with some, depending on their financial year ends, producing a maximum of four.

Approximately 5% of all issuers required to produce an IMS failed to comply first time. This figure rises to over 10% when examining whether they published the IMS within the required timeframe.

The number of issuers who failed to announce the second IMS was similar, although more did announce within the ten-week window. In terms of the number of issuers publishing their IMS, it appears to be the same for those who should have announced their third or fourth IMS before the end of 2008. There is evidence that less out of the more recent IMS are being announced within the required timeframe.

In terms of market capitalisation, it appears that smaller issuers are complying less effectively with the obligations. Those issuers within the Fledgling Index have the lowest compliance rates (less than 90% published IMS). Those in the other three major sectors show significantly higher levels of compliance.

We have noted that many of those issuers who are suspended from listing are not publishing any IMS. These obligations do not fall away during a suspension and issuers must continue to comply.

We anticipated that, as issuers came to grips with the requirements of the IMS, the levels of compliance with these rules would increase. However, we are noting that this does not appear to be the case, as a significant number of issuers across the market as a whole are still failing to produce IMS.

We emphasize that the requirement to produce an IMS is part of the periodic financial reporting cycle alongside the annual and half-yearly reports and must be treated in the same manner as other reporting obligations. If issuers fail to comply with these obligations, they may risk enforcement action from us (as they may for any other failure to meet their obligations under the Disclosure and Transparency rules).

Content of IMS

Material events and transactions – DTR 4.3.5(1)

Within the sample examined, the majority of IMS clearly stated events from the relevant period and it was rare for a firm not to include previous disclosures made under obligations in DTR 2. From our discussions with issuers, it appears that some use their IMS to report items that, in their view, become material when seen in conjunction with other issues. However, an approaching IMS does not exempt issuers from their continuing obligations. This means, in particular, that the issuer must continue to notify a Regulatory Information Service as soon as possible of any inside information that directly concerns them.

We have also noted that a number of IMS announcements have preceded large downward price movements. It is not acceptable practice to delay the announcement of price sensitive information (DTR 2.2) in order for this to be announced within a forthcoming IMS. Such a delay in releasing market sensitive information could be investigated as a potential breach of the issuer's DTR 2 obligations and could lead to enforcement action.

DTR 4.3.5(1) requires an IMS to provide an 'explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer'. (Should there have been no material events in the relevant period, there would appear to be no obligation on the issuer to make any comment in this regard, as the rules simply state that an explanation be provided for those that have taken place.)

Some issuers have asked if it is possible to provide a more precise definition, in this context, of materiality.

We expect the IMS to contain references to any previous announcements made under DTR 2. Other events or transactions may also be material, but as there will be a wide diversity of specific factors across issuers and sectors, we do not believe that we can usefully provide any more specific definition. However, an issuer might, as a starting point, find it helpful to consider the impact of an event/transaction on its financial position and whether this impact is of a material level. This could help decide whether the event itself is material.

More fundamentally, however, we rarely found that IMS provided any description of the impact of material events on the financial position of the issuer (or even of its financial position at all – see below). Issuers are reminded that this is a requirement.

Financial performance – DTR 4.3.5R(2)

Most of the IMS we examined included some financial performance indicators, but there are a number of issuers who failed to comply with the requirement to provide 'a general description of the financial performance of the issuer' as set out in DTR 4.3.5(2). Failing to provide this information is a breach of the rules.

When the TD was implemented, market participants asked whether companies could employ financial performance reports as they had previously and whether trading statements would be sufficient to comply with the obligations in the IMS, with regard to financial performance. We indicated that this would be acceptable if the issuer could ensure that the obligations of DTR 4.3.5 were met. We continue to hold this view.

Overall, there was a wide divergence of types of performance indicators employed. Some sectors, such as general retail, have shown convergence toward using indicators, such as year-on-year sales or like-for-like performance, which probably reflects what was included in trading updates before the implementation of IMS. We do not view this variance across sectors negatively, provided that issuers are considering the information requirements of their investors and other users.

When a company gives financial performance information it should be meaningful to the reader and referenced accordingly. Examples of this would be comparing financial performance to previous or expected results, although issuers should be careful to refer to verifiable (that is, publicly stated) expectations. For example, the statement: 'Trading…has been strong, with the Group's adjusted profit before tax, for the first three months of 2008, comfortably ahead of the Board's expectations', may be sufficient to comply with the issuer's obligation. However, care should be taken to ensure that 'the Board's expectations' have been previously stated publicly as a reference point. If a company states that its financial performance or position are 'meeting expectations', unless the company clarifies what these expectations relate to, such as management expectations from previous reports, analyst or market expectations etc, it risks that information not being meaningful to the reader.

It may be useful for issuers to consider that the IMS is part of the broader financial reporting cycle in this regard and that, although it should be capable of providing a 'snapshot' of the company's position, they should also consider how it interlinks with the other reports in that cycle.

Financial position – DTR 4.3.5(2)

It is a requirement of the rules that the IMS includes commentary on the general financial position of the issuer. The review found that this is the weakest area of compliance within the IMS obligations. The majority of IMS did not adequately deal with the financial position requirement, with many containing no information on, or even mentioning, the issuer's financial position. Those IMS that did cover the issuer's financial position included data on the following areas.

- Debt and debt ratios
- Cash balance and liquidity
- Gross and net assets
- Net Asset Value
- Dividend Yield

We provided commentary with specific reference to the question of the financial position in List! 14:

> *'We believe that IMS may not require financial data in certain circumstances. The nature, scale and complexity of the issuer may be such that it can provide a meaningful narrative description of the major events/transactions that have occurred during the relevant period and the financial position of the issuer. If this happens then numerical data may not be required.'*

We envisaged that the use of financial data was likely to be the main approach employed by issuers, but so long as the issuer was able to provide a meaningful description it was not imperative that they do so. This remains our position. However, it appears that a significant number of issuers are failing to provide adequate coverage in either narrative or data.

Other observations

In the course of this review we spoke to a range of issuers, advisers, trade bodies and institutional investors.

Most market participants see the IMS as an important element in the overall reporting framework and a useful tool for disseminating information to shareholders, although some question the value IMS add, given the disclosure of inside information requirements in DTR 2.

The overall view remains that IMS do add value for issuers and users. A number of advisers felt that the introduction of the IMS requirements had actually led to enhanced communication between themselves and issuers on the coverage/content of IMS announcements and that this had helped to strengthen their overall relationship.

All sectors of market participants, including end-users, expressed their continuing support for our non-prescriptive approach on the content of IMS. Most felt that an acceptable market-based solution had been forming. There was a strong feeling among market participants that they did not want IMS to turn into quarterly reporting.

A number of issuers and their advisers highlighted the internal frameworks they put in place to help produce their IMS. These often involved company boards taking an active part in the process of commenting and/or approving the IMS. In some cases issuers looked at the announcements of similar companies, both within their own and other sectors, and discussed their approach with advisers and major shareholders. These points can be potentially useful ways of complying with the company's obligations.

We note that several IMS have gone beyond the requirements and provided forward looking information. While this is not a requirement, such statements may be helpful and demonstrate that companies are giving consideration to their investors' needs.

Conclusions

Overall our view is that, in terms of content, there has been reasonably good progress towards a market-led approach to meeting the IMS requirements. Individual sectors appear to be developing an approach that reflects their specific circumstances, and we do not see variation across sectors as an issue for concern. Our view remains that individual issuers are best placed to consider the approach that they take to their IMS announcements. So we continue to believe that it would be counter-productive to take a more prescriptive 'one size fits all' approach.

Nevertheless, there are areas where it is clear that IMS requirements are not being met, such as:

- general compliance with the obligation to publish an IMS at all, and separately to publish within the requisite ten-week period;
- adequate explanation of the impact of material events on the issuer's financial position; and
- coverage of the financial position of the issuer.

We note that smaller companies appear to be having more difficulty meeting their IMS obligations.

We expect that issuers should by now be familiar with the DTR requirements. So where any issuers are unsure if they are meeting these requirements (or are uncertain of what they are) they should take action now. We will continue to monitor IMS and we will work with stakeholders to help ensure issuers understand their obligations. However, failure to comply with IMS obligations at any stage could, as with any other obligation imposed by the DTRs, lead to enforcement action.