

EXTENDING THE SCOPE OF THE STATUTORY DAMAGES REGIME FOR DISCLOSURES REQUIRED UNDER THE TRANSPARENCY DIRECTIVE

Government response to consultation

12 October 2006

Consultation question 1

We would welcome stakeholder views on the desirability of putting on a statutory footing the regime for liability in damages in respect of loss flowing from disclosures made under the FSA's disclosure rules (including the obligations to disclose price sensitive information), and, if so, the appropriate scope of such a regime (including whether this should be by extension of the liability regime for transparency disclosures).

The emerging consensus from the consultation was that consistency of the regime across all disclosures and greater certainty as to liability rules that would result from a statutory liability regime are in principle desirable. Crucially, though, there was no agreement on what the scope and the form of any liability regime should look like.

We concluded that it is not possible to consider such a complex issue within the time constraints of the Companies Bill.

However, we are persuaded that the common law position with regard to liability toward disclosures required by laws other than the Transparency Directive is uncertain enough to warrant a serious examination of the public policy considerations of and surrounding the establishment of a comprehensive liability regime that covers all financial disclosures.

The Government has therefore decided to announce a formal review to examine whether a statutory liability regime for financial disclosures is necessary and, if this is the case, what it should look like.

We have decided to take this option as the issue needs a proper examination by someone with sufficient authority to conduct a full review of the liability of issuers of securities on regulated markets and the consequences of any particular new regime for the persons affected.

The Government considered two alternative options when coming to this decision:

1. Take no action

This was not considered suitable as taking no action carries risks:

- there is real concern among stakeholders that increasing regulation of financial disclosures, along with the liability proposals in the Bill, could

lead to a change in what has until now been considered to be the common law position on civil liability;

- at the same time, stakeholders have pointed out that there is considerable uncertainty as to what the law in fact is in this area;
- while liability is traditionally an area of judge-made law, and one where judges have traditionally put a high premium on balancing the interests of the company, its directors and shareholders and the interests of its creditors and others doing business with it, the implications of a substantial increase in civil liability are far-reaching. Such a regime would allow shareholders, in contrast to the traditional view, to be paid in respect of their interest as unsecured creditors of the company rather than as shareholders whose entitlement is limited to what is left on a liquidation after all the employees and the unsecured creditors are paid in full; and
 - another concern with this is that if we take the option of waiting and seeing and a judgment with undesirable consequences is made, there would be scope for many more actions on the basis of the decision since the judgment will have determined what the law is. Any new legislation, even if rushed through, could only determine future lawsuits.

Taking no action could also:

- provide legal firms incentives to promote damaging claims;
- limit the amount of information that companies would be willing to publish; and
- act as a disincentive to companies considering listing on a UK regulated market.

2. Extend the proposed statutory regime to cover financial disclosures generally

This was not considered suitable, as:

- while, in practice, public policy has always tended to be cautious of providing significant redress to people who rely on financial disclosures, it is important that any existing rights that investors may have are not eroded without due consideration;
- it is also important to consider the effects of any extension on incentives for issuers to provide accurate, while timely, financial disclosures; and
- we do not have the time to give due consideration to the fact that we would be creating a narrow area where issuers would certainly be liable to investors, whereas currently there exists uncertainty.

Consultation question 2

We would welcome stakeholder views on the desirability of extending the statutory liability regime for transparency disclosures to preliminary announcement of results (whether mandatory or voluntary).

There was a general consensus that any regime should on pragmatic grounds be extended to preliminary announcements of results. Preliminary announcements contain practically the same information as annual and other reports required by the Transparency Directive, so it is sensible to cover the similar information with the same liability regime. There was also concern from investors that if the liability regime was not extended to cover preliminary announcements then issuers may cease to publish them, and that this was undesirable as investors regard them as highly useful.

In light of this clear support we propose to extend the liability regime in this area. However, in the light of the issues raised under consultation question 1, it will be important that the scope of the liability regime is not extended by too broad a definition of 'preliminary announcement', for example, in such a way that covers other disclosures made under the FSA's disclosure rules.

Consultation question 3

We would welcome stakeholder views on the desirability of putting on a statutory footing the regime for liability in damages in respect of loss flowing from disclosures by companies with securities quoted on the AIM market and, if so, the appropriate scope of such a regime (including whether this should be by extension of the liability regime for transparency disclosures).

Further, is your position affected by the decision on possible extension of the Transparency Directive liability regime to disclosures required under the FSA's disclosure rules by issuers on a regulated market?

As there was no support from Stakeholders to mandatorily extend the liability regime for financial disclosures to the AIM, **the Government does not propose to take any action in this area.**

Consultation question 4

We would welcome stakeholder views on the desirability of ensuring the statutory liability regime covers all issuers subject to UK transparency rules, including issuers for which the UK is the home or host Member State, and other situations in which UK law is applicable.

Stakeholders pointed to some confusion as to how the liability provisions would apply in certain situations where either the issuer or the investor was situated in the EEA but outside of the UK.

In order to clarify this, **the Government proposes to change the territorial coverage of the regime to ensure the liability regime covers securities of all issuers for which the UK is the home Member State as well as those issuers whose securities are traded on a regulated market situated in the UK and for whom the UK is the host Member State.**

Expressing the clause in this way should ensure that we cover as many eventualities as desirable. We are not seeking to cover those situations in which UK investors have invested in securities traded only on markets outside the UK and in respect of which the UK is neither home state nor host state.

Consultation – additional points

Many stakeholders expressed concern that the wording in the current Bill that makes senior officials and not just Directors responsible for an issuer's financial publications is not clear. Government policy is for only directors of companies and senior executives of issuers that are not companies to bear liability. Therefore, **the Government proposes to amend the wording of the Bill to clarify this area.**