



REGULATORY IMPACT ASSESSMENT

EU TRANSPARENCY DIRECTIVE (2004/109/EC) IMPLEMENTATION – MAJOR SHAREHOLDINGS NOTIFICATIONS, PERIODIC FINANCIAL REPORTING AND EQUAL TREATMENT OBLIGATIONS

PURPOSE AND INTENDED EFFECT

The purpose of implementing the Directive is to ensure compliance with EU requirements with respect to major shareholdings notifications, periodic disclosure and equal treatment obligations by issuers whose securities are admitted to trading on a regulated market in the EU. The Directive is being implemented by giving the Financial Services Authority (FSA) rule-making powers to enable it to impose obligations on issuers for the purposes of the Directive and in relation to matters arising.

CONSULTATION

The proposal to implement the Transparency Directive through FSA rules has been consulted on:

- March 2005: HM Treasury consultation on proposals to implement aspects of the Directive by amendments to the Financial Services and Markets Act 2000 (FSMA), through the Company Law Reform Bill;
- March 2006: Department of Trade and Industry consultation on amendments to the Bill, including the introduction of provisions establishing a liability regime for issuers in relation to disclosures required by the Transparency Directive; and
- March 2006: FSA consultation on its proposals for detailed implementation of the Directive through Transparency Rules.

The provisions implementing the Directive are also being scrutinised in Parliament as the Company Law Reform Bill proceeds through its Parliamentary stages.

OPTIONS

The Government had the options of implementing the Transparency Directive by delegating rule-making powers to the FSA for the purposes of the Transparency Directive, or enshrining the obligations in primary legislation.

The Government has chosen to delegate the responsibility to the FSA. This level of delegation is justified by the FSA's closeness to the market and practitioners, its market knowledge, and by the need for the FSA to respond quickly in response to frequent and fast-moving changes in the behaviour of financial markets and innovation in the design of financial instruments.

The Government has also decided to give the FSA scope to make rules beyond the Directive minima in two principal respects.



1. It will have the power to make rules relating to the scope of issuers and notifiable interests encompassed by the regime for disclosure of information on the voting rights attached to shares.
2. It will have the power to impose additional thresholds and shorter deadlines for the disclosure of information on the voting rights attached to shares.

These broader powers are narrower in scope than the company law provisions which this regime will replace, and were strongly supported in consultation on this proposal. They are also constrained through the statutory requirements for the FSA to consult, and to subject its proposals to a full benefit cost analysis, prior to finalising its rules. This ensures effective and proportionate implementation of the transparency obligations.

COSTS AND BENEFITS

A final assessment of all the costs and benefits of implementation of the Transparency Directive will only be possible when detailed proposals for a disclosure regime have been consulted upon and finalised by the FSA. This RIA therefore sets out a final assessment of the costs and benefits of implementation of the Directive by the Government through the granting of powers to the FSA, by amending FSMA through the Company Law Reform Bill.

Major shareholdings notifications

The Treasury consulted on a range of options for implementing the Directive, and has settled on the option which implements the Directive, providing additional scope for the FSA to impose requirements, while repealing existing Companies Act requirements in relation to ongoing shareholder notifications.

Benefits

This approach has several benefits. Introduction of a more harmonised disclosure regime across Europe would, other things being equal, be expected to have an encouraging effect on cross-border European securities trading and investment and a beneficial impact on compliance costs in pan-European institutions. Over time it would contribute to deeper and more liquid capital markets and greater investment opportunities for investors. However, these benefits cannot be quantified with any confidence.

It would also have concrete deregulatory benefits by removing non-traded public limited companies from the scope of the disclosure regime, eliminating these compliance costs for shareholders and holders of voting rights. At a minimum, we would expect approximately three-quarters of public limited companies, around 8,000 in total, to be removed from scope¹. The FSA has estimated² that in 2005 there were on average 13.5 major shareholding announcements per annum for each FTSE all-share issuer, and a more modest 4 disclosures per annum per issuer on exchange regulated markets. It is likely that even fewer disclosures would be required in relation to issuers with non-traded equity, given the lower frequency of

¹ The FSA's consultation paper, Implementation of the Transparency Directive, Investment Entities Listing Review, 06/4, proposes to impose major shareholding notification requirements on investors in issuers on exchange regulated markets.

² Refer to page 16 of Part 1, Annex 1 of the FSA's consultation paper

change in shareholdings. Assuming an upper bound of an average of two disclosures per annum at a cost of £25 per disclosure (a lower cost estimate than used by the FSA because these disclosures do not need to be notified to an RNS), the net reduction in cost over 8,000 companies could be up to **£0.4 million p.a.**

Costs

Additional costs are expected to be modest. Because the new regime is narrower in its scope than the current regime, ongoing compliance costs are not expected to increase significantly. However, the outcome will in part depend on the cost of Level 2 implementing measures. For similar reasons, and also because the FSA has an existing infrastructure for market surveillance, ongoing administration costs over the whole of Government are not expected to increase significantly.

There may be one-off familiarisation and transition costs associated with the transition to the new regime. We estimate that there is a pool of up to 4,700 institutional investors that may be affected by this regime³. However, a significant proportion of these are likely to have delegated their obligations to agents (e.g., custodians and investment managers). These agents, and the larger institutional investors, have systems in place to track the requirement to disclose and to make disclosures. While they are also likely to have in place procedures for modification of disclosure requirements, consultation indicated that there are likely to be some one-off modification costs as a result of systems changes. Consultation did not give an indication of the numbers of firms affected or the costs of these one-off changes but, by way of illustration, if between 500 and 1000 of the firms were affected and needed to engage IT consultants at £750/day for an average of 2 days to implement relevant systems changes, the one-off would be cost of **£0.75 – 1.5 million**. Similarly, if these same firms required a half day of professional advice to familiarise themselves with the changes (at £2,000 per day), the cost would be approximately **£0.5 – 1 million**.

In addition, there will be some need for issuers to familiarise themselves with the new regime. As an indication of scale, if the approximately 2,500 equity issuers on regulated and exchange regulated markets were required to devote an additional half-day of compliance officer time (at £400 per day), the one-off cost would be approximately **£0.5 million**. One submission also noted that there would also be a cost for updating legal advisers which operate in this field, although these might be expected to be captured in ongoing training costs.

The FSA will have powers to make rules extending the disclosure regime beyond the minimum Directive requirements for notification thresholds, to issuers traded on exchange-regulated UK markets and to additional classes of financial instruments. Such powers would provide a flexible means for responding to changes in market conditions and for ensuring appropriate market transparency. The scope of these powers is broadly equivalent to that already existing under the Companies Act. The FSA will have to prepare cost-benefit analysis and consult on any proposed rules, in order to justify any increase in compliance costs that would result from exercise of these powers. The FSA is proposing to increase the notification thresholds above the Directive minima to align these with the notification thresholds under the current disclosure regime. The FSA estimates that this will result in current compliance costs in the region of **£3.1 million** continuing to be incurred⁴.

³ Comprising approximately 1,400 large pension schemes, 200 FSA-authorised life insurers, 300 investment trust companies 1,250 FSA-authorised and regulated collective investment schemes and 1,550 FSA-regulated investment managers.

⁴ Refer to page 16 of Part 1, Annex 1 of the FSA's consultation paper



Periodic disclosure and equal treatment rules

The Directive sets out minimum requirements in relation to the making public by issuers of annual reports, half-yearly reports, and interim management statements. The Directive also requires that issuers ensure that facilities and information necessary to enable holders of securities to exercise their rights are available, including the right to exercise their rights by proxy, and that issuers shall be permitted to use electronic means to convey information to holders of securities. The final scope of periodic disclosure and equal treatment rules will be determined after the FSA consultation on its proposed rules. At present, the FSA makes periodic disclosure and equal treatment rules under the Listing Rules.

The Directive applies to an overlapping, but slightly different group of issuers than that which is covered by the Listing Rules. Listing Rules are applied to issuers whose securities are admitted to the official list, irrespective of the country in which they are registered. The Directive applies to issuers whose securities are admitted to trading on a regulated market in the EU. Under the Directive, the FSA will have the power to regulate financial disclosures by UK-based issuers, and issuers incorporated outside the EU, which have to file their annual information with the UK under the Prospectus Directive. The FSA will also have the power to regulate issuers from another EU member state whose securities are admitted to trading solely in the UK.

Benefits

Financial benefits can be difficult to quantify with precision. The Directive updates and expands minimum requirements for periodic disclosure and equal treatment obligations on an EU-wide basis. As the Directive minimum requirements are in many respects similar to the existing requirements imposed by the Listing Rules and UK company law, benefits to investors in UK listed companies would be limited. However, the imposition of expanded minimum requirements is likely to result in fuller and more consistent information disclosures across the EU, which in turn should enhance investor confidence and contribute to deeper and more liquid capital markets across the EU. An earlier study estimated that the benefits of single financial market integration could be up to 1.1% of GDP and a reduction in the cost of capital of up to 0.5%⁵.

As part of the UK's implementation of the Directive the Government has chosen to establish in statute the liability regime for issuers in respect of disclosures required by the Directive, thereby reducing the legal uncertainty for issuers in their reporting obligations. While the benefit of this is not quantifiable, it limits the contingent cost to business that may otherwise have arisen.

The FSA proposes to take advantage of the Directive's requirements to remove two existing Listing Rule requirements – the requirement that issuers publish half yearly reports in newspapers or send these to holders of securities and the requirement that issuers must produce preliminary statements of annual results. Depending on the extent to which issuers respond to these, these could result in cost savings of up to **£20 million p.a. and £10 million p.a. respectively**. In addition, the FSA proposes⁶ to remove several other provisions of the

⁵ *Quantification of the Macro-Economic Impact of Integration of EU Financial Markets*, London Economics, November 2002

⁶ Refer to paragraphs 2.39 – 2.55 of chapter 2 of the FSA's consultation paper



Listing Rules where benefits are not clear, with an estimated saving in the region of **£6 million p.a.**

Costs

As the Directive minimum requirements are in many respects similar to the existing requirements imposed by the Listing Rules and UK companies legislation, the incremental costs of compliance for UK listed companies are not expected to be significant.

In respect of annual and half-yearly reports it is anticipated that there could be ongoing compliance costs to the approximately 2,800 issuers of debt and equity on regulated markets affected by the Directive. Assuming costs in the region of £500 per issuer, reflecting increased managerial time and professional adviser fees, one might have a range for these costs of between **£1 - 2 million p.a.** across all issuers. There have also been changes to the timing for publication of these accounts. At present, listed companies are required to produce annual accounts as soon as possible after they are approved and at the latest within six months of the end of the period. The Directive shortens this period to four months at the latest. Half-yearly reports are required to be produced within 90 days under the Listing Rules, and the Directive shortens this to two months. Feedback to the FSA indicates that reducing the production timeframes is unlikely to impose significant additional costs on firms.

The Directive also requires issuers to make public interim management statements twice yearly. As UK listed companies are required to make ad hoc disclosures under the continuing disclosure obligations of the Listing Rules, which commonly take the form of trading statements, broadly consistent with the interim management statement requirement, the costs of this requirement could be restricted to familiarisation and thus be minimal. However, should all issuers decide to produce new interim management statement, rather than simply amend the content of existing trading statements, the FSA estimates that ongoing costs could be in the region of £4,000 per issuer, or up to **£5 million p.a.** for the 1,200 issuers of equities on regulated markets.

While the Directive removes the requirement for wholesale debt issuers to provide an annual report, the FSA proposes to retain its current requirement to this effect, given the indications of support for this that it has received from stakeholders. The FSA estimates that the approximately 100 – 130 issuers who could be affected might have avoided costs of between £05,000 - £100,000 annually per issuer, with an aggregate cost therefore of **between £0.6 million and £13 million p.a.**⁷

The transparency rules will also apply to issuers incorporated outside the EU, which have to file their annual information with the UK under the Prospectus Directive. These companies that have their securities traded on UK regulated markets are already required to comply with the Listing Rules; therefore, these requirements should not impose any significant additional costs on these issuers.

SMALL FIRMS IMPACT TEST

Smaller firms are not expected to suffer a disproportionate impact from the requirements. The Directive disclosure requirements fall on issuers whose securities are traded on regulated EU markets. These issuers tend to be larger companies. In any event, the cost of new periodic

⁷ Refer to page 8 of Part 1, Annex 1 of the FSA's consultation paper



disclosure and equal treatment obligations is modest, given their broad consistency with current requirements under the Listing Rules and companies legislation. Small firms will disproportionately benefit from this reduction in the class of companies subject to the disclosure requirements of the major shareholdings notifications regime.

COMPETITION ASSESSMENT

The Directive's obligations are not expected to diminish or distort competition in the market or to have a disproportionate impact on particular groups, particularly given the support for extending the major shareholdings notification obligations to exchange-regulated markets. Periodic disclosure requirements will impact on a broadly similar group of issuers to that affected by the Listing Rules and will impose similar obligations on them. Nor are costs expected to change significantly, or disproportionately for different parties.

ENFORCEMENT, SANCTIONS AND MONITORING

The FSA will be responsible for monitoring compliance with the obligations arising from the transparency rules that will implement the Directive.

The FSA is also being given regulatory powers to enable it to respond to breaches of the transparency rules. The FSA will have the power to call for additional information in relation to disclosures required under the Directive, including the type of information and the parties from whom it can be sought. This power is similar to other powers it has in FSMA in relation to enforcement. It is also being given enforcement powers similar to its existing powers under FSMA, including public censure, and the power to suspend and prohibit trading. The FSA will also have different powers in relation to issuers where the UK is a host member state, which will be set out in FSMA.

IMPLEMENTATION AND DELIVERY PLAN

The rule-making power would be granted to the FSA on the date the Company Law Reform Bill is given royal assent. In anticipation of this date, the FSA has been consulting on proposals for the detailed major shareholdings notification, periodic disclosure and equal treatment obligations to be imposed on issuers.

The Directive must be implemented into UK law no later than 20 January 2007. The FSA plans to finalise its rules in October 2006, subject to level 2 implementing measures being agreed in time.

POST IMPLEMENTATION REVIEW

The Treasury will monitor the FSA's implementation of the Transparency Directive through its Transparency Rules. Once the Transparency Rules are in force, the FSA will continuously monitor their effectiveness.



SUMMARY AND RECOMMENDATION

The following table sets out the estimated costs and benefits that will be fall on issuers and investors as a result of the implementation of the EU Transparency Directive.

	One-off costs	Ongoing costs	Benefits
Major shareholdings notification			
Investor familiarisation and system changes	£1.25 – 2.5 million		
Removal of disclosure requirements for investors in 8,000 public companies			Up to £0.4 million p.a.
Possible retention by FSA of existing disclosure thresholds above directive minima		In the region of £3.1 million p.a.	
Issuer familiarisation	£0.5 million		
Periodic disclosures			
Issuer compliance with requirements for annual and half-yearly reports	.	£1 - £2 million p.a.	
Issuer preparation of interim management statements		Up to £5 million p.a.	
Establishment of statutory liability framework			Limits contingent costs that would otherwise have arisen
Possible removal by FSA of the requirement to distribute and publicise half-yearly reports			In the region of £20 million p.a.
Possible removal by FSA of requirement to publish preliminary statements of annual			Up to £10 million p.a.



results			
Possible retention by FSA of requirement for wholesale debt issuers to provide an annual report		£0.6 – 13 million p.a.	
Total	£1.75 - £3 million	£4.7 – 23.1 million p.a.	Up to 30.4 million p.a.

Accordingly, it is recommended that the UK implement the EU Transparency Directive by giving the FSA rule-making powers for the purposes of the Directive as set out in this Regulatory Impact Assessment.

DECLARATION AND PUBLICATION

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the Responsible Minister

Date: 1 / 10 / 2006

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