

# IMPLEMENTATION OF THE TRANSPARENCY DIRECTIVE (MAJOR SHAREHOLDINGS NOTIFICATION)

## PARTIAL REGULATORY IMPACT ASSESSMENT

### Objective

1. The Transparency Directive<sup>1</sup> is an important part of the Financial Services Action Plan. The Financial Services Action Plan is the European legislative framework for developing the Single Market in financial services. The purpose of the Transparency Directive is to enhance transparency in EU capital markets in order to improve investor protection and market efficiency. It does this by establishing rules on periodic financial reports and disclosure of major shareholdings for issuers whose securities are admitted to trading on a regulated market in the EU. The Directive must be implemented into national law by all Member States no later than 20 January 2007.

### Background

2. The Directive requires Member States to impose obligations on:
  - *issuers* of securities, which are traded on a regulated market in the Member State, to disclose certain information; and
  - *shareholders*, and certain parties able to exercise control of voting rights, to disclose certain information to the issuer of the shares in question.
3. Implementation of the Directive is proceeding in two tranches. The requirements of the Directive in respect of periodic financial reporting, continuing reporting obligations, and the dissemination and storage of regulated information, can be implemented by secondary legislation using powers under Section 2(2) of the European Communities Act 1972. The Treasury will consult on proposed regulations in due course. However, the proposed approach for those parts of the Transparency Directive relating to the disclosure of shareholdings – historically part of company law – requires primary legislation. The Government therefore proposes to include the necessary provisions for this in the Company Law Reform Bill.
4. The existing requirements for shareholders to disclose substantial shareholdings are set out in Part 6 of the Companies Act 1985, for which the DTI is responsible<sup>2</sup>. In order to bring together supervision of all Transparency Directive obligations under one competent authority, the Government proposes to transfer this responsibility to the Financial Services Authority (FSA). Part 6 of the Companies Act 1985 will be

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<sup>1</sup> Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004

<sup>2</sup> Different legislative provisions apply in respect of Northern Irish companies

repealed in so far as it relates to a shareholder's continuing disclosure obligations.

### **Scope of the new disclosure regime for major shareholdings**

5. The Company Law Reform Bill will establish the scope of the new disclosure regime and give the FSA powers to make rules with regard to shareholder notification. Before the FSA can make rules, it must, under the provisions of the Financial Services and Markets Act 2000 (FSMA), undertake extensive consultation with stakeholders and publish cost-benefit analysis of its proposals for public comment.
  6. It is proposed that the scope of the new regime would be broadly similar to the scope of the regime under Part 6 of the Companies Act 1985. However, the Government is proposing to make changes to the current disclosure regime in order to reduce regulatory burdens, and also to give the FSA flexibility to deal with changes in financial instruments and market structure.
- **Basis of disclosure obligation.** The obligation of disclosure under Part 6 of the Companies Act 1985 relates to “interests in shares”. The Government is proposing to redefine disclosable interest in terms of “control of exercisable voting rights”.
  - **Issuers subject to the regime.** The Directive requires disclosure in relation to holdings of shares of an issuer (including those incorporated outside the UK<sup>3</sup>) whose shares are admitted to trading on a regulated market. The Government proposes to give the FSA, subject to the usual consultation and cost-benefit requirements in FSMA, the power to extend the regime to other – non-regulated – markets in the UK where appropriate for market transparency reasons. Non-traded public limited companies will be excluded from the scope of the regime.
  - **Sanctions for breach of notification obligations.** The Government has concluded that it would be appropriate and proportionate to repeal the current criminal sanctions for breaches of the notification rules and to give the FSA equivalent powers to those it has to deal with breaches of rules under FSMA.
  - The Government proposes to maintain the flexibility of the current Companies Act regime in respect of the **disclosure of holdings of financial instruments**. In order to retain the ability to require wider disclosure where appropriate for market transparency reasons, the Government proposes to give the FSA equivalent powers to those the Secretary of State currently has to require disclosures in respect of holdings of financial instruments.

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<sup>3</sup> The UK is required by the Directive to regulate shareholder disclosure for the following issuers of shares: a) issuers incorporated in a Member State who have their registered office in the UK; and b) issuers incorporated outside the Community who are required to file the annual information required by the Prospectus Directive in the UK

## Risk assessment

7. Implementation of the Directive is intended to furnish a more market-focused shareholder disclosure regime, affecting the shareholders of a smaller group of issuers than under the current regime, and one more harmonised with other European disclosure regimes. The proposed changes to the regime are generally deregulatory.
8. Moving towards a single financial market in European financial services would benefit business by providing access to deeper and more liquid capital markets and providing investors with more investment opportunities. Estimates of the benefits of single financial market integration are up to 1.1% of GDP and a reduction in the cost of capital of up to 0.5%<sup>4</sup>.
9. Greater harmonisation of disclosure requirements is unlikely to significantly affect companies' choices of EU markets on which to be admitted to trading. Any extension of investor choice arising from greater harmonisation would benefit investors in the UK and across the EU. The scope of the new regime is narrower than the current regime and hence the risk of a significant increase in compliance costs is seen as minimal.
10. Transfer of responsibility for the regulatory regime to the FSA should also bring benefits. The FSA is a specialist security regulator which has responsibility through the UK Listing Authority (UKLA) for regulation of admission and trading of securities. The FSA's rule-making power under the new regime will be a flexible mechanism for responding to developments in financial markets.

## Options

11. There are three principal options for implementation of the Directive.

### ***Option 1 – Implement the minimum Directive requirements and leave in place existing Companies Act requirements***

12. Under this option, minimum Directive requirements would be imposed through FSA rules on issuers admitted to trading on a regulated market. There would be no scope for the FSA to go beyond the minimum requirements of the Directive in the rules it made. Other public limited companies would remain subject to the existing Companies Act disclosure regime.

### ***Option 2 – Implement Directive with additional scope for the FSA to impose requirements, and repeal existing Companies Act requirements***

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<sup>4</sup> *Quantification of the Macro-economic Impact of Integration of EU Financial Markets*, London Economics, November 2002

13. Under this option, minimum Directive requirements would be imposed through FSA rules on issuers admitted to trading on a regulated market. The FSA would have additional powers to make rules, subject to consultation, in respect of issuers traded on non-regulated UK markets, and to extend disclosure requirements to additional classes of financial instruments<sup>5</sup>. By repealing the existing Companies Act requirements, non-traded public limited companies would be excluded from the scope of the regime.

***Option 3 – Implement the minimum Directive requirements and repeal existing Companies Act requirements***

14. Under this option, minimum Directive requirements would be imposed through FSA rules on issuers admitted to trading on a regulated market. There would be no scope for the FSA to go beyond the minimum requirements of the Directive in the rules it made (i.e., it could not extend the regime to cover issuers traded on non-regulated UK markets, nor extend disclosure requirements to additional classes of financial instruments). By repealing the existing Companies Act requirements, non-traded public limited companies would be excluded from the scope of the regime.

***Other options***

15. As with all proposals for regulation, the Treasury has considered the option of making no changes. We have concluded that this option is not appropriate in this case. Failure to implement the Directive requirements would put the UK in breach of our Community obligations and thereby open the UK to infraction proceedings and claims for damages. It would also forfeit the deregulatory opportunities offered by Directive implementation.

**Who is affected?**

16. The current regime covers approximately 11,700 GB public limited companies. The 1,454 UK equity issuers listed on the London Stock Exchange Main Market, the 942 UK equity issuers listed on the Alternative Investment Market (AIM), and the 126 UK equity issuers listed on OFEX are largely a sub-set of this group<sup>6</sup>. The new regime would cover the 1,454 UK issuers whose shares are admitted to trading on the Main Market. The FSA would have powers to extend it to issuers whose shares are admitted to trading on non-regulated markets such as AIM and OFEX.

17. Shareholders, and certain parties able to exercise control of voting rights, in issuers subject to the regime are required to provide details of

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<sup>5</sup> These additional powers would be equivalent in scope to comparable powers of the Secretary of State under, and provisions of, Part 6 of the Companies Act 1985

<sup>6</sup> There is a slight difference in definitions, as public limited companies are recorded on a GB-wide basis, while listing statistics capture UK equity issuers

the proportion of voting rights over which they exercise control at specified thresholds<sup>7</sup>. The FSA would consult on any proposals to add additional thresholds.

## **Costs and benefits**

### ***Option 1 – Implement the minimum Directive requirements and leave in place existing Companies Act requirements***

18. This would cause the minimum of change to the existing regime. However, it would result in the existence of three regimes<sup>8</sup>, administered by different regulatory authorities, with different shareholding disclosure rules, applying to different classes of company. There are no benefits from this duplication but there would clearly be additional costs for shareholders and issuers in complying with different rules and administering different regimes.

### ***Option 2 – Implement Directive with additional scope for the FSA to impose requirements, and repeal existing Companies Act requirements***

19. This would have several benefits. Introduction of a more harmonised disclosure regime across Europe would, other things being equal, have an encouraging effect on cross-border European securities trading and investment and a beneficial impact on compliance costs in pan-European institutions, albeit modest. Over time it would contribute to deeper and more liquid capital markets and greater investment opportunities for investors. These benefits cannot be quantified with any confidence.
20. It would also have concrete deregulatory benefits by removing non-traded public limited companies from the scope of the disclosure regime, eliminating compliance costs for shareholders and holders of voting rights in this class of issuer. At a minimum, we would expect approximately three-quarters of public limited companies, around 8,000 in total, to be removed from scope.
21. Additional costs are expected to be modest. Because the new regime is narrower in its scope, ongoing compliance costs are not expected to increase significantly. The outcome will in part depend on the cost of Level 2 implementing measures currently being negotiated<sup>9</sup>. 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

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<sup>7</sup> Expressed as a proportion of voting rights in the issuer (Article 9)

<sup>8</sup> Including the separate Northern Irish regime

<sup>9</sup> Under the requirements of the Directive, there are a number of exemptions that apply to certain classes of shareholder, such as market makers, parent undertakings of investment firms and management companies. The costs incurred by these shareholders in order to get the benefit of these exemptions will depend on the Level 2 implementing measures being determined by CESR

significantly (although the FSA has yet to assess the costs it expects to incur in administering the regime).

22. There may be one-off costs associated with transition to the new regime. The FSA will have limited establishment costs. While these have yet to be assessed, based on previous FSA experience, the cost of adapting existing systems (should they be deemed to be suitable for the new regime) could be in the order of £250,000 - £500,000. In addition, there will be some need for companies and investors to familiarise themselves with the new regime. Given the diversity of the parties involved these familiarisation costs are difficult to quantify with precision. However, they are unlikely to be significant. As an indication of scale, if the 1,454 Main Market UK issuers were required to devote an additional half-day of compliance officer time costed at £400 per day, the one-off cost would be approximately £290,000. If, for half of these 1,454 companies, a half-day of professional advice was required by shareholders at a cost of £2,000 per day, the cost would be approximately £725,000.
23. The FSA would have powers to make rules extending the disclosure regime beyond the minimum Directive requirements to issuers traded on non-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 such powers would be equivalent to that already existing under the Companies Act. The FSA would 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.

***Option 3 – Implement the minimum Directive requirements and repeal existing Companies Act requirements***

24. This option would furnish many of the benefits provided by option 2, namely the benefits arising from European harmonisation and from reducing the regulatory scope of the current regime. In addition, by not granting the FSA additional powers to make rules in respect of issuers traded on non-regulated UK markets, or to extend disclosure requirements to additional classes of financial instruments, this option would ensure that the minimum possible level of regulation would be applied.
25. However, it would also impose an unduly narrow scope on the FSA's rule-making powers (a scope narrower than that under the current Companies Act regime). The FSA would be unable to change its rules to respond to changing market conditions and improve transparency in important areas. Any such changes would, instead, need to be made at the level of primary legislation, which would be more cumbersome. It seems doubtful that this inflexibility is necessary, given the

requirement for the FSA to consult with stakeholders and justify any increase in compliance costs before making rules.

### **Small firms impact test**

26. The disclosure regime impacts principally on shareholders and controllers of voting rights. Companies must report disclosures made to them but this is the case under the current regime and, hence, the incremental impact on companies' costs is expected to be minimal. To the extent that companies do face costs, the elimination of 8,000 non-traded public limited companies from the scope of the disclosure regime should benefit smaller firms disproportionately<sup>10</sup>.

### **Competition assessment**

27. The proposed disclosure regime represents an incremental change from the existing regime and is not expected to have a significant impact on competition. The impact of any proposed FSA rules on the competitive position of regulated and non-regulated markets would need to be assessed and consulted on during the FSA's consultation process.

### **Consultation**

28. This is the first formal consultation on the implementation of the Transparency Directive. However, informal consultations were held with industry associations and other market participants during the negotiation of the Directive and these consultations helped shape both the final Directive and these policy proposals.

### **Summary and recommendation**

29. Option 2 is recommended. This will provide an optimal mix of regime consistency, deregulatory benefits and appropriate scope and flexibility for the FSA's rule-making capacity to deal with changing market conditions.

HM Treasury  
17 March 2005

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<sup>10</sup> As non-traded public limited companies are more likely to be small firms than traded public limited companies