Linklaters

April 2017

UK Corporate Update.

FCA to clarify rules for sponsors

The Financial Conduct Authority has concluded that it should publish more information on how it supervises sponsors. This is a reaction to the patchy levels of understanding displayed by various responses to its "Call for Views on Sponsor Conflicts".

In its Primary Market Bulletin No.17, the FCA publishes its feedback on the call for views. Although it decided that the current rules in relation to sponsor conflicts were operating effectively it also concluded that there is a need for greater clarity and information. This will be provided in an updated Technical Note, TN 701.3 which will cover:

Perceived conflicts

In relation to sponsor conflicts, the FCA assesses whether a perception exists that a sponsor may not be able to perform its functions properly (the perception test). To introduce a level of objectivity to this test, it is proposing that sponsors should look at the circumstances of a transaction from the point of view of the theoretical reasonable market user when considering whether a situation would fall foul of the perception test.

Provision of finance

The FCA considers that the interests of a firm acting as both lender and sponsor on the same transaction may be misaligned. To give more clarity on this position it is introducing a metric to show what size of loan the FCA considers "material" in this respect. Material loans will be where the amount of the loan (prior to syndication) is equal to or in excess of 0.5% of the sponsor group's total assets by reference to its last published consolidated accounts. Where a loan falls into this metric a sponsor should contact the FCA prior to accepting the sponsor appointment. This reflects the FCA's existing approach.

Systems and controls

The FCA's current guidance states that where a firm is providing sponsor services to an issuer as well as providing loan finance, it would not expect the employees providing sponsor services to be in contact with colleagues working on the loan. Based on feedback that, sometimes, such contact may be necessary for the firm to fulfil its sponsor obligations, the FCA will provide

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in TN701.3 that contact may be appropriate where the sponsor team needs certain factual information. When this is the case, such contact should be carefully managed.

When to contact the FCA

TN 701.3 will set out a number of exceptional circumstances where a sponsor should contact the FCA. These include where a loan meets the new metric set out above and, on a related party transaction, where a sponsor proposes to provide a fair and reasonable opinion as well as acting in another capacity (such as providing loan finance in the context of the transaction).

The FCA is consulting on these changes to TN 701.3. The consultation will end on 10 May 2017.

The Primary Market Bulletin also reports back on a number of changes to the FCA Knowledge Base, following amendments proposed in Primary Market Bulletins 13, 14 and 16. The key changes made from those set out in the previous Primary Market Bulletins are as follows:

- UKLA/TN/520.2 – Delaying disclosure/dealing with leaks and rumours

  The FCA has clarified that an issuer is required to inform the public as soon as possible of all inside information that directly concerns the issuer.

- UKLA/TN/314.1 – Reverse takeover and uncapped consideration

  This has been amended to clarify when a transaction with uncapped consideration will be treated as a class 2 transaction, a class 1 transaction or a reverse takeover.

- UKLA/TN/714.2 – Sponsors: Guidance on the competence requirements set out under LR 8.6.7R(2)(b)

  A minor amendment has been made to update a reference to the Disclosure Guidance and Transparency Rules sourcebook.

Issuers to classify regulatory announcements from 1 October

The Financial Conduct Authority has confirmed that it will amend DTR 6.2 so that when issuers file regulated information with the FCA, from 1 October 2017 they will need to:

- supply a Legal Entity Identifier. An LEI is a 20-character reference code to identify legally distinct entities that engage in financial transactions; and
- classify the information according to the legal obligations under which it is disclosed, eg Article 17 Market Abuse Regulation or Articles 4 and 5 (periodic financial information) under the Transparency Directive. If more than one classification is relevant, all must be specified.

The rules were proposed to comply with new regulatory standards to support the European Electronic Access Point (see our briefing).

The rules will not come into effect until **1 October 2017**. This is because respondents to the FCA's consultation felt that the primary information providers and issuers needed at least six months to make the necessary preparations.

The FCA is encouraging issuers to comply with the new rules as soon as possible. However, until the rules come into force, there is no obligation to provide a LEI or classify the information when making regulatory announcements.

See Handbook Notice No.42.

ICSA updates its terms of reference for audit committees

ICSA: the Governance Institute has updated its terms of reference for audit committees. These reflect the April 2016 revisions to the UK Corporate Governance Code and the FRC Guidance on Audit Committees which apply to financial years commencing on or after 17 June 2016. They also take into account the changes to the Code in 2014 which required directors to publish a viability statement. The terms of reference draw on the experience of company secretaries and are based on best practice as carried out in some of the UK's top listed companies.

Changes from the last update in June 2013 include:

- a new recommendation that a member of the remuneration committee and a member of the risk committee (if there is one) should sit on the audit committee, where possible;
- a new provision that notices, agendas and supporting papers can be sent in electronic form where the recipient has agreed to this; and
- additional duties for the audit committee, including: (i) the review of statements requiring board information which contain financial reporting; (ii) the review of the role and mandate of internal audit and the annual assessment of the effectiveness of the internal audit function; and (iii) the oversight of the selection procedure for the external auditor.

The terms of reference can be found here.

FTSE 350 urged to improve diversity and inclusion

Business minister Margot James has written to the Chief Executives of all FTSE 350 companies, calling on them to improve diversity in the workplace.

The letter urges the companies to implement the key recommendations from the Baroness Ruby McGregor-Smith Review into black and ethnic minority progression in the workplace. These include:

- publishing a breakdown of their workforce by race and pay;
- setting aspirational targets; and
- nominating a board member to deliver on those targets.

In the Government's response to the review, it stated that a business-led, voluntary approach is right for the present but it will monitor progress and take further action if necessary.

Click here for the BEIS press release.

ICAEW guidance highlights when intragroup loans can be distributions

The Institute of Chartered Accountants in England and Wales and the Institute of Chartered Accountants of Scotland have published updated guidance on realised and distributable profits under the Companies Act 2006 (Tech 02/17). This is based on the guidance previously issued as Tech 02/10 but has been revised following comments on the version on which the Institutes consulted in March 2016.

Tech 02/17 includes:

- additional guidance on the definition of distribution with extensive references to recent case law. The guidance stresses that the purpose and the substance of a transaction are key, rather than the label put on a transaction. The state of mind of those orchestrating the transaction may also be relevant but the key point is not whether they intended to effect a distribution or knew that it was a distribution at law, but whether the intended substance of the transaction was a distribution;
- guidance on the consequences of accounting for intra-group loans on off-market terms in accordance with FRS 102 and the extent this gives rise to a distribution for accounting purposes or as a matter of law. Off-market for these purposes means interest free or not at a market rate of interest, unless the loan is repayable on demand. The guidance analyses interest-free loans from parent to subsidiary, subsidiary to parent and subsidiary to fellow subsidiary, as well as loans above market rate and loans repayable on demand. The guidance is also relevant to loans made to or from shareholders;
- a list of intra-group transactions other than loans that may involve a distribution, such as undervalue received for an asset transferred to a parent or fellow subsidiary, overpayment for services received from a parent or fellow subsidiary, guaranteeing the debt of a parent or fellow

subsidiary without receiving a fee, and the acquisition or surrender of tax losses for a non-arm's length sum;

- additional guidance on distributions in kind. The guidance confirms that:
  - the transfer of an asset can be a distribution as a matter of law even if it has no accounting impact, for example an asset that was not recognised in the balance sheet transferred for no consideration
  - a distribution which arises from the discharge of a liability for a liquidated sum is not a non-cash asset within the scope of Sections 845 and 846 Companies Act 2006
  - a transfer of assets may be lawful in accordance with Section 845 but may be an unlawful distribution of capital contrary to common law, for example where the book value of an asset increases because of additional expenditure after the date of the relevant accounts but before the asset is transferred without a commensurate increase in consideration, such that the company would be left with a deficit of distributable profits after the transfer.
- guidance on the consequences of the changes in the law concerning distributable profits in relation to long-term insurance business made by The Companies Act 2006 (Distribution of Insurance Companies) Regulations 2016.

Tech 02/17 also states that the Institutes consider, based on legal advice, that there is no requirement under law or accounting standards for financial statements to distinguish between realised and unrealised profits or between distributable profits and non-distributable profits. However, the Institutes suggest that listed companies may wish to consider how to address the calls for greater transparency from the investor community.

Tech 02/17 reflects accounting standards in issue as at 31 December 2016.

Tech 02/17 is available here. The ICAEW's web page, linking to copies of the Tech 02/17 marked up to show changes from the March 2016 consultation draft and Tech 02/10, is available here.

Joint Committee on Human Rights calls for a tougher approach to human rights reporting

The House of Lords and House of Commons Joint Committee on Human Rights has highlighted the short-comings of the Modern Slavery Act 2015 and has urged improvements, in its latest report.

Among the key problems is that there is no central list of companies required to report under the Act, which makes it difficult to monitor compliance. In addition, the report points out the weaknesses in the reporting requirements which has allowed many companies to produce generic, overly cautious reporting statements.

The Joint Committee is calling for the Government to facilitate the passage of a private members' bill, Baroness Young of Hornsey's Modern Slavery (Transparency in Supply Chains) Bill. The Joint Committee feels this Bill would solve a number of the problems with the Act by amending it to:

- include public bodies in the transparency in supply chains requirements of the Act;
- require companies and public bodies to publish their statements in their company reports, lodging them with the appropriate bodies such as Companies House or the Charity Commission;
- require the Secretary of State to compile a list of companies that should be compliant with Transparency in Supply Chains, to make it possible for NGOs and others to find the information for effective monitoring; and
- prevent public bodies from procuring services from companies that have not conducted due diligence.

The report also strongly favours a greater role for Government procurement in the fight against human rights abuses in business. The Joint Committee recommends that companies that have been found to have been responsible for abuses or where a settlement indicates that there have been human rights abuses, should also be excluded from public sector contracts for a defined and meaningful period.

FRC to publish names of companies whose reports and accounts it has reviewed

The Financial Reporting Council's Conduct Committee has published a revised set of its operating procedures for reviewing company reports. The main change is to permit the Conduct Committee to publish the names of those companies whose reports and accounts it has reviewed, once the cases are closed. Where a premium listed company's report has been the subject of review, the company's audit committee is expected to report on the nature and extent of interaction (if any) with the FRC's corporate reporting review team. This is consistent with the FRC Guidance on Audit Committees.

The changes took effect on 1 April 2017 and are in substantially the same form as the consultation draft published in October 2016.

The FRC's press release and a link to the revised operating procedures and updated frequently asked questions can be found here.

Takeover Panel lines up for fixture with Rangers FC Chairman

The Takeover Panel has initiated proceedings to seek an order requiring Mr. David King, the Chairman of Rangers FC, to make an offer for the football club under Rule 9 of the Takeover Code. This is the first time the Takeover Panel has used its statutory powers under s. 955 Companies Act 2006 to seek enforcement by the Court where a person has not complied with the Takeover Code.

This follows Mr King's failure to meet the 12 April 2017 deadline set by the Takeover Panel to make the offer. The deadline was set following the Takeover Panel's finding that Mr King had acted in concert with three other individuals in the acquisition of more than 30% of the voting rights in Rangers FC.

Click here for the Takeover Panel announcement.

Takeover Panel clarifies pre-announcement responsibilities

The Takeover Panel has made a series of amendments to the Takeover Code, including clarification of pre-announcement responsibilities.

Practice Statement No. 20

This practice statement (dealing with pre-announcement responsibilities) has been amended to clarify that:

- **"Rule of Six" applies to a potential offeror who has not been identified:** the requirement to consult the Takeover Panel before more than a total of six parties is approached about an offeror or possible offer continues to apply during an offer period in relation to a possible offer by any potential offeror which has not been publicly identified; and
- **Chaperoning of meetings/calls with shareholders prior to offer period:** a meeting or call with a shareholder or other relevant person before an offer period begins which either relates to the possible offer or would not be taking place but for the possible offer, must be attended by an appropriate financial adviser/corporate broker. The financial adviser/corporate broker who attends the meeting must, by no later than 12 noon the following business day, provide a written confirmation to the Takeover Panel (under Rule 20.2(c) or Note 1 on Rule 20.2 of the Takeover Code) unless (a) no representative of, or adviser to, the offeror or offeree was present other than the financial adviser or the corporate broker, and (b) no material new information or significant new opinions relating to the possible offer were provided during the meeting.

If conditions (a) and (b) above are met, then no written confirmation is required (as per the exemption available when a meeting is attended by advisers only, as set out in Note 3 on Rule 20.2).

Click here for the updated Practice Statement No.20.

Click here for the Takeover Panel statement about these amendments.

Updated PIRC investor guidelines for 2017

PIRC (Pensions Investment Research Consultants), the independent shareholder advisory body, has updated its Shareholder Voting Guidelines giving support to, among other things, the push for greater diversity in the board room.

The 2017 edition contains few changes, compared to the 2016 guidance, although a number of insertions, while relatively minor, serve to emphasize PIRC's stance on certain issues. The following amendments may be of interest to UK listed companies.

Shareowner rights, capital stewardship and corporate actions

Response to "significant" vote

As before, the guidelines repeat the recommendation in the UK Corporate Governance Code (E.2.2) for companies to provide a statement in their RNS announcements if at a general meeting they receive a significant proportion of votes against a management proposed resolution. The updated guidance goes further and now also requires companies to disclose in the subsequent annual report steps taken to engage with shareholders on the substantive concerns represented by any "significant" votes. A report of this type must be included in the annual report under the Companies Act 2006 for "significant" opposition registered against remuneration resolutions, but not for all resolutions, as PIRC demands.

Sustainability and corporate responsibility reporting

Directors' duties and the strategic report

In this chapter, PIRC has taken the opportunity to refer to questions raised in the November 2016 BEIS Green Paper on Corporate Governance about whether directors should do more to fulfil their corporate governance obligations. In PIRC's view, company reporting and guidance for companies should be improved so that the strategic report explains how directors have fulfilled their duty under s.172 Companies Act 2006 to promote the success of the company, including by reference to the non-exhaustive list of additional considerations and other stakeholders which the directors are required to consider as part of this duty.

The Board

Diversity

PIRC supports the extended diversity targets set out in the Hampton-Alexander review for 33% female representation by 2020 on company boards, but also on executive committees and their direct reports. The updated guidance is also much firmer about a failure to meet such expectations. Where this occurs, at a FTSE 350 company, and there are no "clear and credible proposals for reaching these objectives", PIRC will not support the re-election of the nomination committee chair. The 2016 PIRC guidelines merely stated that companies were expected to disclose gender balance targets and report on attempts to address inequality.

Time commitment/over-boarding

The updated guidelines also appear to take a more streamlined and firmer view of "over-boarding". While there is no change to the number of directorships permitted to be held ("four other significant positions" are the "maximum acceptable"), the 2017 guidance has removed the wording, which previously conceded that "assessing how many positions an individual not in full time employment can manage effectively has an element of subjectivity and much will depend on the nature of the commitments and the individual's private circumstances".

Chairs and chief executives

PIRC continues to maintain that combining the roles of chair and CEO at a listed company can only be justified on a temporary basis in exceptional circumstances. The 2017 guidance goes on to also require "a clear, cogent and compelling rationale" for any such combination.

In addition, the updated guidance now declares that PIRC will oppose the re-election of a chair who is also acting in an executive role, "except in exceptional circumstances".

Board balance

The updated guidelines emphasize PIRC's concerns about the executive representation on the board being limited to the CEO alone or with one other executive, now explaining that in PIRC's opinion "this limits the access of non-executive directors to the executive team".

Director competence and suitability

Where there are serious concerns about a director's conduct, PIRC will continue to review that director's suitability for election, but in the updated guidelines also states that PIRC "would be unlikely to support their nomination unless fully justified by the board".

Others

Certain recommendations have also been removed from the 2017 guidelines, including those which previously set out the responsibilities of the company secretary and PIRC's opposition to holding companies being moved to non-UK jurisdictions (with weaker legal protections) and to alternate directors.

Report and accounts, audit and financial controls

Non-audit work

PIRC believes that where auditors provide non-audit services, there is a significant risk that the auditors ability to confront the directors on difficult issues will be compromised. Consequently, the 2017 guidance has retained the PIRC recommendations against non-audit fees in excess of 25% and 50% of audit fees. The updated guidance also now states that "in PIRC's view tax compliance fees charged by auditors are to be regarded as non-audit fees for the purpose of calculating these percentages, since they cannot be fully separated from tax advisory services."

Remuneration

The only substantial change from the previous guidelines is a call for companies to also disclose the remuneration consultants used and their fees on an annual basis.

Click here for more information on PIRC.

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