The European Commission has recently published a draft directive intended to harmonise ‘transparency requirements’ for information about issuers whose securities are admitted to trading on a ‘regulated market’ (see box). The aim is for member states to implement the directive, which forms part of the Financial Services Action Plan, by 2005 at the latest. The draft directive follows two rounds of public consultation but there are still aspects that remain controversial, especially for smaller companies. The main areas dealt with by the directive are financial reporting, disclosure of interests in securities, and the information provided to holders of shares and debt securities in connection with general meetings. The most significant change in the UK will be the introduction of quarterly reporting requirements. Those wishing to influence the draft will need to lobby the European Parliament, the Council and the Commission. Karl-Heinz Lehne from the European People’s Party and a member of the legal affairs and internal market committee will be appointed rapporteur (he is also responsible for the Takeover Directive). It is also thought that Peter Skinner, a Labour MEP, will draft a report on the proposal for the economic and monetary affairs committee, which will be acting as an opinion-giving committee on the directive.

Non-EU issuers

The directive gives member states the power to exempt an issuer whose registered office is in a non-EU state (and for which the member state is the ‘home’ member state) from having to comply with most of the requirements of the directive, provided that the non-EU state lays down at least ‘equivalent’ requirements; clearly the word ‘equivalent’ could present problems in practice. This power to exempt is particularly important given the requirement in the directive to base financial reporting on IAS. The directive also provides that the Commission has the power to adopt implementing measures to determine whether a country ‘ensures the equivalence of the information requirements’ provided for in the directive. It will be important for the Commission to clarify which countries it believes meet the standards as part of the process of finalising the directive to provide certainty for non-EU issuers.

Financial reporting

The directive is intended to ensure that the financial information provided by issuers is standardised and provided more frequently and more quickly than at present. There are exemptions for states, local and regional authorities, the European Central Bank and national central banks and for issuers of debt securities with a denomination of at least €50,000. Although in practice annual reports etc are publicly available and can be obtained at any time they were originally ‘designed’ as a report to shareholders at a single point in time. The introduction of a legal requirement for delivery to the public and availability for a period raises questions concerning an increase in the potential liability for both issuers and auditors and an updating requirement. In
addition, for annual and half yearly reports the directive requires a Sarbanes-Oxley style responsibility statement to be prepared by 'persons responsible', presumably the CEO and the finance director.

The Commission will adopt 'implementing measures' to clarify some of the requirements, including the period of time the reports must remain available and the scope of an auditor’s 'review'. It is important that the various detailed follow up 'clarifications' are made available as soon as possible so that the impact of the directive can be fully assessed.

**Quarterly financial information**

- To be published 'as soon as possible' but within two months.
- No mandatory audit but negative statement if not produced.
- Full disclosure of audit or review required if made.
- Only applies to equity issuers.

This is one of the most controversial aspects of the draft directive. Eight member states already have mandatory quarterly reporting for at least some regulated markets and another two (including the UK) require it for companies with a track record of less than three years. The Commission believes quarterly reporting should provide better investor protection and increase market efficiency and competition. Claims that it will lead to increased stock market volatility have been rejected as has the suggestion that smaller issuers should be exempted from the requirement. The benefits of quarterly reporting are not universally accepted; for example in the US, where quarterly reporting has been a requirement for a stock exchange listing for many years, a number of companies, including Coca-Cola, Gillette, Intel and McDonald’s, are reported to be sceptical about the practice of offering guidance to analysts and investors on their quarterly earnings outlooks, believing that the practice encourages short-termism, with management becoming overly focused on the next reporting deadline.

Issuers of shares (but not other securities or depositary receipts) must publish a table of financial information (net turnover, and profit or loss before or after tax) and an explanatory statement on the issuer’s activities and profits or losses for the relevant three-month period as soon as possible and in any case within two months of the period end. If the issuer chooses it can also indicate the group’s likely future development for the remaining financial year, including any significant uncertainties and risks that may affect it. The approach to publishing any auditors’ report or review is the same as for the half yearly report with the difference that the Commission has not taken the power to make the auditors’ review mandatory.

The new requirements are likely to have a significant cost implication for companies that do not currently prepare quarterly reports. This is exacerbated by a concern (particularly on the investor side) that the information to be provided in quarterly reports is not sufficiently useful to investors to make it worthwhile because it does not actually require a trading statement: some argue the cost benefit analysis has not been convincingly made.

In addition, there is concern in some quarters that the introduction of quarterly reporting will, in practice, discourage companies from the timely reporting of developments on an ad hoc basis, as they will prefer to wait and include it as part of their quarterly report. Clearly compliance with the Market Abuse Directive should prevent this development but theory and practice may diverge.

In the UK, HM Treasury has been arguing against the introduction of mandatory quarterly reporting for all traded companies, although it now appears that it may have to focus on changes to the detail of the provision rather than the concept at large given the strength of feeling in Brussels and in those countries where it is already mandatory.

What is clear is that the proposals represent a significant change from the current requirements for many companies. According to Bloomberg data in 2002, only 1,100 out of 6,000 publicly traded European companies currently provide interim reports on a quarterly basis following international standards (national GAAP, IAS or US-GAAP).

**Annual reports**

- To be published within three months.
- Must be audited in accordance with IAS.
- Must include a 'management report'.

The issuer must publish audited consolidated financial statements in accordance with IAS and a 'management report’ within three months of the end of the financial year.

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*Transparency obligations directive*

Freshfields Bruckhaus Deringer, May 2003
year. At present, under the UK Listing Rules accounts must be published as soon as possible after they are approved and within six months of the year end (although a preliminary statement of annual results must be published within 120 days). The present English company law requirement is to deliver accounts to Companies House within seven months. In addition, directors are currently required to prepare a directors’ report, which must include, among other things, a fair review of the development of the business during the financial year and a description of its principal activities.

The directive has mimicked the Sarbanes-Oxley Act in the US and provides that the accounts must contain a statement signed by the ‘persons responsible within the issuer’ that the information in the report is, to the best of their knowledge, in accordance with the facts and that the report makes no omission likely to affect its import. Member states must ensure that responsibility for the information to be drawn up lies with the issuer or its ‘administrative, management or supervisory bodies’. They must also ensure that their laws on civil liability apply to those responsible persons.

There is concern in some quarters over the content requirement for the ‘management report’, with some issuers fearing a need to produce a ‘prospectus style’ report. However, this seems unlikely as the requirements set out in the directive are not radically different from those that presently apply especially in the UK, where the Companies Act and the Listing Rules already require a wide range of issues to be addressed in the annual report. It is likely that these ‘extra’ requirements will continue to apply to UK companies.

Half yearly reports

- To be published ‘as soon as possible’ but within two months.
- No mandatory audit but negative statement if not produced – Commission is able to make a review mandatory.
- Full disclosure of audit or review required if made.

Issuers must publish a half yearly financial report and an update on the annual management report as soon as possible (and in any case within two months) after the end of the first six months of the financial year. Member states will be able to delay this requirement applying to certain debt issuers for three years after the directive comes into force. There is some ambiguity as to what ‘updating’ the annual report will involve; some issuers are concerned that this will require a complete rewriting. However, it seems more likely that the requirement will be confined to an obligation to update the report to reflect any change in circumstance since the publication of the annual report. Under the UK Listing Rules at present an interim report must be published at the latest within 90 days of the half year end.

The interim report must be prepared in accordance with IAS (or the laws of the issuer’s member state if it has no subsidiaries). The report does not have to be audited but if it has been (or if there is an auditors’ review) that report or review, including any qualifications, must be reproduced in full. The Commission will be able to use implementing measures to clarify the nature of the auditors’ review and, if needed to enhance investor protection, make such a review mandatory.

Language

- A language ‘customary in the sphere of international finance’ or
- A language accepted by the host member state.

At present, an issuer whose securities are admitted to trading in several member states can be required to translate its financial reports into different languages. The directive will allow such issuers to disclose all regulated information (including under other directives) in a language accepted by the competent authority in their home member state and either in a language ‘customary in the sphere of international finance’ or a language accepted by the host member state. Issuers of debt securities with a denomination of at least €50,000 can always choose a language customary in the sphere of international finance.
Disclosure requirements

- EU catching up with the market practice in certain member states.
- Overlap with the proposed Takeover Directive, but the disclosure requirements are not harmonised.
- Requires notification of interests in voting rights or capital of the issuer from 5 per cent.
- Notification required by a security holder or anyone entitled to exercise voting rights for them.
- Warrants and convertibles to be caught.
- Proxies to be caught.

Current European requirements (found in Council Directive 2001/34/EC) require investors who acquire or dispose of interests in public companies whose shares are officially listed in a member state to disclose details of those interests to the public. Twelve member states, including the UK, already have stricter requirements than those set by the existing directive.

Under the draft directive each member state will have to ensure that ‘security holders’ and those entitled to exercise voting rights on behalf of a security holder must notify the issuer of the proportion of voting rights and capital of the issuer when the proportion held goes above 5 per cent. The current starting point is 10 per cent. There would be further notification requirements for every further increment of 5 per cent up to 30 per cent and at 50 per cent and 75 per cent and where an interest falls below one of these thresholds. As at present, member states will be able to impose a lower starting threshold and require disclosure at closer intervals. At present the existing directive requires notification to the issuer and competent authority within seven calendar days and to the public normally within a further nine calendar days. The draft directive will shorten this to five business days for investors and three business days for issuers. It is also intended to require notification of derivative securities such as warrants or convertible bonds that confer the right to acquire or sell shares, although the drafting is not clear on this. The directive envisages a standard form of notification for use throughout the EU.

The definition of ‘security holder’ will catch custodians and those holding securities for settlement and clearing except where the securities are held for clearing and settling ‘within a short period’.

In terms of what this means for issuers and those holding shares in issuers in the UK, the changes may not be that dramatic, although there will be cases where interests not currently caught will be caught in future. The UK is one of the member states that already imposes stricter disclosure requirements than those in the proposed directive and will be able to continue to do so.

Information on general meetings

- Use of electronic communications encouraged.
- Must ensure equal treatment for shareholders and for holders of debt securities.

The Commission is keen to facilitate the use of proxy voting at general meetings and to encourage issuers to provide information electronically. The directive is not yet very clearly drafted and implementing measures are envisaged for these areas. Issuers will have to provide information about meetings and holders’ rights to participate, make proxy forms available with the notice of meeting and generally ensure equal treatment for holders of securities in the same position. Member states must allow issuers to communicate electronically where the security holder agrees and other safeguards are met.

Information about issuers

- Goal: a single source of information for each issuer.

Home member states will have to require issuers to file regulated information with the competent authority, which may (but need not) publish it. The Commission is keen to encourage issuers to use their website with an email alert system and to encourage national securities regulators to develop a one stop shop approach to information about issuers. There are restrictions on the requirements a host member state can impose. This is another area where implementing measures are expected.