

**FSA Consultation Paper 203:**  
**Review of the Listing Regime**  
**Response by**  
**The UK Society of Investment Professionals**

**About UKSIP**

The UK Society of Investment Professionals (“UKSIP”) is a professional organisation whose main aim is to foster and maintain high standards of professional ability and practice in investment analysis, portfolio management and related disciplines. It currently has over 4,000 members, who work or have an interest in the UK financial services industry. UKSIP is the second largest member society worldwide of the Association for Investment Management and Research (AIMR<sup>®</sup>), and the largest in Europe. AIMR is a global non - profit organisation of more than 67,000 investment professionals, and is best known as the organisation that develops and administers the Chartered Financial Analyst (CFA<sup>®</sup>) Program.

UKSIP also oversees the Investment Management Certificate (“IMC”), the benchmark qualification for those working in investment management in the UK and currently held by over 12,500 investment professionals. UKSIP members who successfully completed UKSIP’s former Associate examination, which was similar to the CFA, can use the designation ASIP.

## **Investor confidence in new issues**

Professional investors should be able to make informed judgements on the suitability of new issues, but they also seek some degree of comfort from the requirements of the UK's current listing regime which, in many respects, is more demanding than that in many other markets. The existing listing regime also provides an element of assurance to private investors. The success of London as a major market for raising capital suggests that investors worldwide value the current listing regime. There is evidence to suggest that investors are willing to pay a premium to invest in companies with good corporate governance where such securities are available in well regulated markets.

## **Fixed income credit markets**

UKSIP would like the FSA to play its part in raising UK market standards in relation to debt instruments traded here. Whilst these markets may primarily be the preserve of professional investors, market practitioners are currently lobbying to improve market standards in the sterling and euro fixed income credit markets which they believe to be significantly lower than in, say, the US. UKSIP hopes that the FSA will be able to consider and support proposals such as these which aim to offer market solutions. [Response to Question 14 on page 6 has further details].

## **Listing rules – maintaining standards**

Regarding a number of the specific proposals contained in CP 203, UKSIP feels that there is no case for diluting the requirements of the existing regime and which could impact on the reputation of London as a financial centre. The FSA may believe that, currently, there is an unrealistic expectation of the level of investor protection under the listing rules as they presently stand. Any lowering of the regulatory hurdle is unlikely to make an impact on the consciousness of private investors, in particular, who will expect that any replacement regime will provide at least an equivalent level of protection. In the long run, therefore, any lessening of requirements would, in UKSIP's view, be likely to present a moral hazard to the FSA.

- 1 Do you support the proposed move to a regime which has overarching general principles supported by specific rules and guidance?*

UKSIP is in favour of a principles based approach to regulation and one that is broadly consistent with the regimes in other leading markets.

- 2 Do you foresee any problems with the six proposed Listing Principles? Are there any gaps that you think the proposed Listing Principles fail to cover?*

UKSIP would favour either an additional principle stating that an issuer should never create a false market in its securities or the incorporation in the existing principles of a statement to this effect. UKSIP appreciates the implication in Principles 3 and 4 but believes that clarity on this crucial matter is most important.

The principles appear to be a set of minimum requirements which draw attention to negative behaviour rather than positive behaviour. As stated in the

Society's response to DP 18, UKSIP believes that it is important to encourage issuers to aspire to the highest possible standards. The citing of positive attributes stimulates aspirational attitudes which, in turn, UKSIP believes will encourage market practitioners to adhere to the spirit rather than just the letter of the law.

UKSIP has seen the response from the Investment Management Association (IMA) to this question and it fully supports the IMA's proposals in this area.

- 3 *Do you believe the Listing Rules in this area should be more closely aligned with the rules applying to CISs?*

UKSIP has no comment to make on this point.

- 4 *If so, do you agree that additional rules are unnecessary for schemes subject to the CIS Sourcebook?*

- 5 *Do you support the proposed move to a 'building block' structure for the source book? If not, please explain your objections.*

UKSIP has no comment to make on this point.

- 6 *Do you agree with the three sections that we are proposing? Are there any gaps that you feel we have failed to cover or would have expected to see covered? Do you foresee any problems with the proposed new structure of the sourcebook?*

UKSIP has no comment to make on this point.

### ***Super-equivalence***

- 7 *What are your views on moving towards a requirement for three years' accounts, rather than a three-year track record and unqualified accounts?*

UKSIP supports the move from three year revenue earning accounts to three year accounts as it recognises that some companies - for example, those heavily reliant on research and development costs - may have three years of accounts but that they may not have been earning for that length of time. UKSIP is, however, opposed to the removal of the requirement of unqualified accounts. As investors would be highly unlikely to invest in a company with qualified accounts, there seems to be no good reason why the requirement for unqualified accounts should be removed. Further, the absence of the more stringent requirement may encourage companies with a poor financial standing to seek to obtain a listing, with all that this could entail. If London is to retain its position as a well-regulated market, potential investors should have the right to assume that, at least at the outset of a listing, the accounts can be relied on to indicate a true and fair view of the issuer. Behind a number of the biggest scandals in recent years has been "creative accounting" that has given a misleading picture of a company's financial position. The removal of the requirement for unqualified accounts could, erroneously, suggest that the Regulator condones qualified accounts.

- 8 *Do you consider that we should relax or maintain our requirement that issuers provide a clean working capital statement?*

UKSIP favours the retention of the requirement for a clean working capital statement. Whilst such a statement does not provide any guarantees, it is checked by an outside party and so provides some independent assessment of a company's financial position. Such assessments help to avoid financial wrongdoing. Because of this, investment professionals expect to see a clean working capital statement for any company in which they would invest. Less sophisticated investors would also want to invest in such companies. As few would choose to invest in a company without a clean financial statement, it would seem to be an irrelevance to remove the present requirement. There is also a concern that private investors would be likely to assume that certain standards are present, irrespective of a reality of no clean working capital statement.

- 9 *What are your views on whether the Listing Rules' requirement for the disclosure of directors' experience and expertise should be replaced by the provisions in the PD and by enhanced UK corporate governance standards?*

UKSIP is content with the proposals.

- 10 *What are your views on whether the requirements for independence and control over the majority of assets held should be repealed?*

UKSIP would not wish to see these requirements repealed, as they provide valuable protection to minority shareholders and protect against the construction of pyramids. As the current regulations already provide some flexibility, UKSIP can see no need for them to be repealed.

### ***Debt***

- 11 *Do you support our proposal not to follow the PD definition of debt securities in relation to eligibility and continuing obligation requirements?*
- 12 *What are your views on dropping the requirement for a two-year track record for specialist issues?*
- 13 *What are your views on removing the requirement for a working capital statement and accepting a two-year track record in relation to non-specialist debt issues?*
- 14 *Do you think that the authorised adviser regime should be retained for specialist debt issues?*

As a general comment on the questions relating to this section, UKSIP is not in favour of any relaxation of present regulatory requirements in relation to debt securities. The credit debt market in London has only developed markedly since the arrival of the Euro and - as growth has taken place - practitioners have become increasingly concerned that standards of market practice have failed to keep pace. To address this, a market solution, endorsed by many leading firms, has led to the drawing up of a set of proposals entitled "Improving market standards in the Sterling and Euro Fixed Income Credit markets". (For copy of proposals see: <http://www.uksip.org/pdfs/BOND.PDF>)

UKSIP supports their underlying thrust and believes that their further development along those lines would have a positive impact on market practices and standards.

Given the above, UKSIP would argue that the FSA's attempts to distinguish between the needs of the less sophisticated investor and the professional, and its arguments to reduce the regulatory hurdle of the current listing requirements, are misplaced. As stated previously, UKSIP believes that investors are prepared to pay a premium for operating in a well regulated market. Compared with the US bond market, the UK has very little regulation in this field so further, judicious regulation is unlikely to put the UK at a competitive disadvantage; on the contrary, it is likely to enhance its position.

### *Overseas Issuers*

UKSIP supports the proposals relating to overseas issuers. The Society agrees that overseas issuers with a primary listing should be required to adopt similar standards to UK issuers as this will help to maintain the integrity of the market and a level playing field of high standards. The proposals should help to make it easier for both professional and private investors to understand the financial fundamentals of a company and to make comparisons between different investment opportunities.

*15 Do you agree with our proposals to tighten the rules for overseas issuers with primary listings so that these are brought into line with those applicable to listed UK issuers.*

Agreed.

*16 In particular, do you think overseas issuers with a primary listing should be required to 'comply or explain' against the Combined Code?*

Agreed.

*17 What are your views on whether overseas issuers with a primary listing should be required to report in IAS or US GAAP rather than local GAAP?*

UKSIP is strongly in favour of IAS reporting. The financial data is a key element of any investment decision. Standardised high quality data with the necessary qualitative backing detail is, therefore, essential if investors are to make informed choices and if orderly markets are to be maintained. Providing an appropriate framework to encourage ethical reporting is important.

UKSIP recognises that these rules may need to be relaxed during the transition period to the new IAS and that there may be some confusion during that period.

*18 Do you agree that in future overseas issuers with a primary listing should be required to comply with the Listing Rules on pre-emption rights for shareholders or provide appropriate alternative protections?*

Agreed. Pre-emption is a vital right to shareholders as it protects their stake in a company. UKSIP considers it to be a cornerstone to investor confidence in the UK. There is no justification for overseas issuers with a primary listing in

the UK to be treated any differently.

- 19 *We also invite comment on whether there are any other areas of company law or practice that you consider are fundamental to shareholder protection.*

UKSIP, in principle, supports the DTI's proposal to make the OFR compulsory, as it should provide valuable information to shareholders. UKSIP therefore believes, in principle, that all listed companies should be required to produce an OFR.

- 20 *Do you agree with our proposal to retain secondary listings?*

Agreed.

- 21 *Do you believe that the argument for comparability of data is sufficiently strong for us to introduce a requirement for equity issuers with a secondary listing to use either IAS or US GAAP?*

As its response to question 17 shows, UKSIP is strongly in favour of the use of IAS, as soon as this is feasible. The Society recognises, however, that it is unreasonable to expect all companies to migrate across during the same year.

- 22 *Do you agree with our proposals for non-UK EU issuers?*

Agreed. If market integrity is to be maintained, there is no reason why there should be different standards for non-UK EU issuers.

### ***Corporate Governance***

- 23 *Do you agree that the introduction of Listing Principles 1 and 2 (coupled with a subsidiary rule) will provide sufficient investor protection or would you like to see more prescriptive rules or guidance as to what systems and procedures we consider appropriate?*

Prescriptive statements hinder effective corporate governance monitoring. Further prescription should, therefore, be avoided though additional guidance would be welcome.

- 24 *Would you favour our having the power to disqualify a director of a listed company, where he has been involved in a serious breach of the Listing Rules? Do you have any views on whether this power should be exercised through the tribunal process or through the courts?*

UKSIP is in favour of the FSA having such powers but the Society has no view on whether it should be exercised through the tribunal process or through the courts.

### ***Continuing Obligations***

- 25 *Do you agree that we should maintain a requirement for shareholder approval of Class 1 transactions?*

Yes, shareholders should always be consulted where transactions are likely to

have a fundamental effect the value of the security.

- 26 *Do you support our proposed extension to the Class 1 regime? How do you think securitisations should be treated under the new regime? Are there any other kinds of transactions that you consider should be caught or not caught by this new approach?*

UKSIP is in favour of a principles based approach for the Class Tests and considers that they should be applied to linked companies and joint ventures. Securitisations should also be treated by adherence to principles rather than prescriptive rules: the latter encourage the less scrupulous to seek ways of getting round the rules.

- 27 *We welcome views on the quantitative criteria that should be applied to classifiable transactions.*

The existing rules would appear to be working well. Quantitative criteria are difficult to define. The principle to be applied is that shareholders should always be consulted where transactions are likely to have a fundamental effect the value of the security.

- 28 *What are your views on our proposals to strengthen shareholders' rights where a company intends to cancel its listing?*

UKSIP supports these proposals.

- 29 *What issues would you like us to address in streamlining the Model Code?*

UKSIP has no comment to make on this point.

- 30 *What are your views on giving the company secretary the role of giving clearance/approval to deal?*

This would seem to be a sensible suggestion.

### ***Financial Information***

- 31 *Do you agree with our proposal enabling issuers to publish additional information provided that the source of such information is full disclosed and it is made clear whether or not such information is unaudited and that there is subsequent comparability?*

UKSIP supports the availability of as much significant, advance information of all types as possible, as this would help to prevent the creation of a false market. (See also answer to question 2)

- 32 *Do you agree that the introduction of the two overriding concepts will adequately replace paragraph 2.20? If not, what do you think the current requirements add and what alternative might be introduced?*

The two principles set out in 10.6 may be regarded in themselves as adequate but the FSA should be careful, in replacing paragraph 2.20, to see that if there is anything useful in the private confirmation by the FSA which is currently in

place (as a result of 2.20) it is added to the new over-riding concepts. UKSIP would certainly be in favour of allowing issuing companies to provide as much financial information as possible (and indeed as much non-financial information as possible).

- 33 *Do you agree that companies should be allowed to disclose non-statutory figures alongside statutory ones, or do you think such disclosures should only be allowed if the disclosures are audited?*

Most companies have a keen desire to provide their own definition of the outcomes for a year, and in particular a figure for earnings. In many, if not most cases, the earnings figure that a company chooses will not be used as such by analysts and investors but such a figure may indicate the way the company thinks; this may be a factor of use in itself. Hence UKSIP would agree with allowing non statutory figures to be disclosed and believes that the arguments put forward in paragraphs 10.12 and 10.13 are very good. In particular, there must be a reconciliation with the statutory numbers.

USKIP cannot see how this question is related to the question of auditing. If the matter is simply one of rearranging figures from the Income Statement, the fact that it is audited will fall out automatically. If something more fundamental is involved, the market has every reason to ask for it to be audited.

- 34 *Do you think that the requirement to report on forecasts should be removed where the information is not disclosed in a prospectus?*

UKSIP does not support the removal of this requirement. Forecasts provide some measure of how the company perceives its future performance and they provide a benchmark against which senior management/directors' performance can be measured. UKSIP acknowledges that there is a risk that forecasts could be deliberately slanted to create a more favourable impression although management will ultimately have to account for underperformance. Probably the greatest risk to investors of inflated forecasts is in a bid situation. At such a time, UKSIP would recommend that any forecasts should be examined by someone from outside the company so to provide comfort about the process used to produce the forecast. This should help to avoid the issuing of unscrupulous forecasts at the worst possible time for potential investors.

The publication of forecasted profits has drawbacks. Profit forecasts can lead management to engineer outturns to correspond with the forecast figures; also, public attention, such as in the press, tends to concentrate on whether or not a particular forecast has been met, which can be a distorting influence on the activities of the company. The markets, led by the professional investors and analysts, will make their own judgment as to whether a misforecast is a bad piece of news or not. But this is not generally understood. On balance forecast profits should not be excluded (as in some jurisdictions) but the rules concerning the origins of the figures, future comparability etc should be tight. All other areas - qualitative and quantitative forecasts of specific items or areas of business - are extremely helpful to the markets in valuing securities.

- 35 *Do you agree that the proposed approach will continue to allow appropriate information to be released to investors? Is the list of key attributes that financial information must possess adequate or are there other elements you*

*believe should be included?*

In principle what is proposed (as in the FSA paragraph 10.33) seems absolutely reasonable. In practice, however, UKSIP entertains grave doubts about whether companies will present information in a way suitable for investment analysis, as opposed to the picture they wish to give. If all the principles in 10.33 are followed by the issuer, it is probably possible to unravel the matter. Of course, when companies rearrange figures they do so to present the company in the best possible light, which may not be the light best suited to the investment analysts.

36 *What are your views on removing the requirement for a significant change statement in Class 1 circulars, if quarterly reporting is introduced?*

UKSIP supports the retention of the requirement for a significant change statement.

37 *What do you think should be meant, in this context, by the word 'significant'?*

Good news, as well as bad, should qualify as should price sensitive information. Any definition of 'significant' should be based on principle because prescription discourages voluntary disclosure.

It should be noted that in the setting of accounting standards there has always been a resistance to any term, such as "significant", which is different from "material". A material item is defined as one which could cause the user to make a revision of an economic decision, which is virtually the same as saying that a material item is "price sensitive". UKSIP suggests that this particular question could usefully be discussed by the International Accounting Standards Board.

38 *We would welcome your views on whether the Listing Rules should require issuers that do not have subsidiaries (solo companies) to prepare their accounts in accordance with IAS.*

All these companies should follow IAS. By providing a common standard, investors are to make comparisons between different companies more easily. If they are unable to make such comparisons, investors may place the non-IAS companies (that is solo companies) in a separate and lower investment class. Apart from any other consideration, computer databases, which would otherwise be coherent across listed companies, would have to have a separate section. This is an important consideration since some of the smaller quoted companies often feel themselves discriminated against in various ways as compared with the larger companies. Whatever truth there may be in this matter, it would certainly be inappropriate if the Listing Rules re-emphasised the point by having different accounting requirements.

### ***Sponsors***

The functions undertaken by a sponsor will be needed by most issuers irrespective of whether sponsors are required by the listing rules. UKSIP has no other comments to make on this section.

### *Cost Benefits*

When considering the cost/benefit analysis of the requirements which apply to listed companies, UKSIP wishes to limit comments to two.

First, it should be borne in mind that better information and better regulation leads to a fall in the cost of capital. This is the justification for transparent accounting and for strict regulation. In this way, society as a whole benefits, as well as the issuing company. Some of the costs involved in following the Listing Rules are therefore recompensed by lower cost of capital although the latter is often invisible. It is nonetheless real.

Secondly, it may be that the benefits through a lower cost of capital do not in all cases flow to companies with smaller capitalisation. This is a significant problem but should be solved not by any derogation in the main listing requirements but by the existence of secondary or tertiary markets where the requirements are less onerous, and which can be chosen by the smaller companies if they judge that the cost/benefit analysis of a full listing is unsatisfactory.