The Association of Corporate Treasurers

Comments in response to
Davidson Review: Implementation of EU legislation
Neil Davidson QC, The Cabinet Office, March 3rd 2006

May 2006

The Association of Corporate Treasurers (ACT)

Established in the UK in 1979, The Association of Corporate Treasurers is a centre of excellence for professionals in treasury, including risk and corporate finance, operating in the international marketplace. It has over 3,500 members from both the corporate and financial sectors, mainly in the UK, its membership working in companies of all sizes.

The ACT has 1,500 students in more than 40 countries. Its examinations are recognised by both practitioners and bankers as the global standard setters for treasury education and it is the leading provider of professional treasury education. The ACT promotes study and best practice in finance and treasury management. It represents the interests of non-financial sector corporations in financial markets to governments, regulators, standards setters and trade bodies.

General

The ACT welcomes the opportunity to comment on this matter. Contact details are provided at the end of this document.

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This is an important and wide-ranging topic. However we have largely confined our comments to one or two examples drawn from company law and from financial market regulation – the main areas of concern of our members.

Underlying principles

At its simplest, we agree that normally domestic implementation of EU requirements in areas where there has been no prior domestic regulation (broadly defined) should not go beyond what is envisaged in the EU directive/regulation. It is important not to let people take the opportunity of changes required by EU level changes to ride old hobby horses all over the landscape.

However, it is more difficult where there has been prior regulation under domestic provisions. This is especially true where the UK has a long history of such regulation and in relation to activities where the UK has been a material, especially global, player.

In such cases it is necessary to ask

- Does the EU requirement satisfactorily replace the previous UK regulation, i.e.
    - does it have similar requirements or
    - does it have different but equally appropriate or even superior requirements?

  or

- While it may represent status quo or an improvement in much of Europe, does it provides significantly inferior regulation to that previously applied in the UK?

Of course, the EU provisions do not come labelled with easy answers to these questions. Opinions may legitimately vary. We have attached (Appendix 1) an extract from our comments to the DTI on draft amendments to the Company Law Reform Bill earlier this month. In the extract we noted that among the major firms of solicitors in the City of London, opinion varies as to whether one provision is required by the Transparency Obligations Directive, or is not required and therefore constitutes "super-equivalence" or "gold plating" – in this case is of an undesirable kind.

Avoid a chilling effect

However, it should be acknowledged that it would be unfortunate if the EU required provisions were seen as an absolute limit on what provisions the UK should make domestically. It would have a chilling effect on regulation if they were so seen – for any change would require agreement at EU level which can require a lot of time to achieve. Given that financial markets play a larger part in the UK economy than in other EU Member States, for example, it may be that problems arise earlier or in more pointed form in the UK than elsewhere. So where the EU provisions are not "maximum harmonisation" and subject to usual concerns about proportionality and impact assessments, consultation, etc. the UK should be free to implement (perhaps to pioneer for the rest of the EU) a response. We do not automatically fear different regulation in the UK – and see the possibility of it as an important factor in the competitiveness of UK plc. We are particularly aware of this last point as the activities our members are largely engaged in could in principle be carried on from anywhere in the world and are commonly centred in London because it is a good place for the activity, not because it is their natural location.

The importance of regulatory competition with the EU (and wider) for the UK economy as a whole is seen in the recent comments by Valéry Giscard d'Estaing[1]

> "I think the British system of government is the most competent in Europe. I have seen how British diplomacy functions and the financial system in the City. All that gives the impression that the British system is the best, or at least one of the best, in Europe"

To the extent that there is an element of flexibility in interpretation of the purpose and requirements of EU legislation it would stand the UK in good stead if it were to have regard to the manner in which other countries are implementing the same Directives. Given that there effectively is regulatory competition, it is important for the UK economy to maintain the relative attractiveness of the UK business environment and any relevant aspects of the wider social good.

Impact assessment

Where there is any question of retaining UK provisions going beyond EU requirements or of adding new purely UK requirements we consider that, as well as appropriate consultation, a proper impact assessment is required. We are, however, very cautious, of seeing this synonymous with a cost-benefit assessment. In the fields with which we deal most, the purpose of regulation is usually behavioural. While costs may be more easily ascertained, benefits are usually less quantifiable. For example, maintaining confidence in the basically honest nature of financial markets is, we presume, a desirable, but unquantifiable benefit. The concept of proportionality is key.

In any case, caution is needed even on the "cost" side of the equation. It is easy for the financial services industry to come up with either high or low costs for a change in regulation and unpicking claims of high costs can be a long and difficult task.

The example we give of (justifiable) over-implementation (below) illustrates the difficulty – and the importance of proper consultation.

Proper "gold plating"

It is our impression that many commentators will seek to provide examples of unsatisfactory gold plating. So we give one example of what we see as desirable gold plating. We do this both as an example and because we fear that others may quote this case as an example of egregious gold plating.

Market Abuse Directive implementation:

The concept of relevant information not generally available.

We quote the City Research Series No. 8, published by the Corporation of London[2]:

[1] "Giscard calls for second chance for treaty", By John Thornhill in Paris, *Financial* Times, May 23 2006

[2] *Comparative Implementation of EU Directives (I) – Insider Dealing and Market Abuse*, December 2005 (www.cityoflondon.gov.uk/economicresearch) at section 2.5

> “The adoption of the Market Abuse Directive in January 2003 inevitably entailed some changes in the FSMA regime. The MAD provisions in relation to insider dealing were similar to but not identical to those in the market abuse regime and the Government chose to adapt the UK regime to comply with the directive, but to maintain any UK requirements which went beyond those in the directive. The Treasury included, for example, an additional super-equivalent offence in the implementing legislation, of misuse of relevant information not generally available, in order to avoid any narrowing of the previous market abuse regime.
>
> ….
>
> “Section 118 C defines inside information as information which “is not generally available” as opposed to the MAD definition of information “which has not been made public”[3].”

Some financial services industry trade groups pressed for the implementation to accept a narrowing of the previous regime. The rationale was the cost of having to train staff about two distinct regimes. This was possibly disputable – as banks teach a boundary, unless they were intending operate in the disputed area in some parts of their business, they only had to teach the wider boundary, the narrower one being encompassed fully by it. After comments on this by the ACT, CBI, ABI and other issuer and investor groups, it was agreed to preserve the scope of the previous regime – but with a three-year sunset clause. The matter may, accordingly, become controversial again.

Our intention here is not to rehearse the arguments for or against the preservation of the old scope of the regime (though we have included our side of the argument it in Appendix 2, together with comment from John Plender of the *Financial Times*).

Rather it is to illustrate three points:

- That a blanket rule against gold plating will in some cases arguably be against the public interest. In some cases the choice is between possibly throwing out the family silver or allowing a little judicious gold plating.
- That a case put forward of increased cost is not necessarily determinative against some gold plating.
- That consultation should include at all stages the wider stakeholders (here issuers and investors) as well as those most directly affected by the cost (here training and systems) of implementing the proposed regulation (here financial intermediaries)[4].

[3] The previous text of s118 FSMA referred to "information which is not generally available to those using the market."

[4] Of course investors were also affected in being prohibited from misuse of information not generally available – but the representatives of professional investors did not want to do that anyway.

Appendix 1

Extract from

The Association of Corporate Treasurers: Comments in response to the Accelerated consultation on Company Law Reform Bill draft liability clauses published by the DTI, 3rd May 2006

12 May 2006

Liability of directors for false or misleading statements in reports required by virtue of the Transparency Directive – new clause after clause 859

Our members find this proposed amendment and the circumstances surrounding it very troublesome.

We know that the TD and the recitals refer variously to the objective of periodic financial reporting as

- allowing investors to make an informed assessment and
- increasing investor protection.

We note the recital that appropriate liability rules should be applicable to the issuer, its administrative, management, or supervisory bodies, or persons responsible within the issuer, as laid down by each Member State under its national law or regulations and that Member States should remain free to determine the extent of the liability.

As the aim of the Transparency Directive is to promote transparency, it would be counterproductive for it, or its implementation into national legislation, to make the directors frightened to report in that spirit of openness.

The House of Lords European Union Committee (15th Report, Session 20033-4, HL Paper 89) noted legitimate uncertainty as to the effects of the Directive. We note also that different firms of solicitors in the City of London take notably different views on the effects as regards liability.

TD Article 7 does require that responsibility and liability for information rests with the issuer or its directors, but this is not necessarily to say that liability must be by way of compensation to holders of securities rather than to sanction by regulators or the Court.

The general rule in England has been that the directors are liable to the company for their actions and a company can be held accountable by various external authorities. Particularly, a listed company may be subject to administrative penalty from the FSA (UKLA) or subject to certain directions from the Financial Reporting Review Panel and there are reserve provisions for direction of restitution by the company under ss. 382 and 384 FSMA.

With this background, the new amendment, not affecting ss. 382/4 restitution, introduces a new liability and then confines it within certain bounds (notably to those who have purchased securities in reasonable reliance on the misstatements or omissions, with a director having knowledge or reckless as to the position, and excluding any other liabilities except criminal/administrative sanctions.

If this new liability, to investors, is indeed required under the TD, such confinement is appropriate and welcome – and indeed essential if other than the most conservative narrative is to be forthcoming.

We incline to the view that the TD does not require the introduction of new liabilities and constitutes what has become known as “gold plating”. Accordingly we view the introduction of new liability as inappropriate and we would regard the proposed amendment as both unnecessary and undesirable. The amendment to insert the new wording after c. 859 should therefore be withdrawn.

However if the Government takes the view that the new liability is actually required under the TD (and we reluctantly accept that this risk exists), then with some misgiving we conclude that the amendment to insert the new wording after c. 859 would indeed be necessary and the wording would be appropriate.

Holding on to a superior UK practice is not the same as gold-plating

1. ACT comments to HM Treasury on merits of retaining the wider UK scope of regulation in effecting one part of the Market Abuse Directive in the UK – misuse of relevant information not generally available.

This was an e-mail from John Grout, Technical Director of the Association of Corporate Treasurers, to Stephen Hanks at HM Treasury on November 8th, 2004:

We recognise that it is reasonable to set out for the Panel on Regulatory Accountability the full range of possibilities on the outcome regarding super-equivalence content of the implementation of the MAD.

The ACT's view, firmly held, is that super-equivalence is, in general best avoided.

Where that means falling back from the current UK level of protections for market participants, it does need careful thought, however.

We are alarmed at the possibility that existing protections may be weakened in respect of trading by persons possessing information not generally available from that set out currently in the FSA Handbook, Market Conduct, Chapter 1, Code of Market Conduct, September 2004, section 1.4, Misuse of information.

"UK Implementation of the Market Abuse Directive", 18 June 2004, explains (B.23 p. 46) that the concept is used to "explicitly prohibit people from trading to their advantage and to the disadvantage of others on the basis of information not generally available to investors." And, at 3.18, page 18: "This prohibition is important to ensuring that the UK has a flexible insider dealing regime. It enables action to be taken in relation to behaviour based on information which would be taken into account by investors but is not sufficiently precise to be inside information. It might include, for example, information about the state of negotiations over a major contract."

We agree that "This prohibition is important". It would be scandalous if this protection were removed from UK markets. Preservation of the UK position should not be seen as "gold-plating".

2. COMPANIES UK: Oligarchs welcome?, By John Plender, *Financial Times*; Nov 15, 2004

Is the Financial Services Authority's regime on insider dealing about to be seriously diluted when the European Union's Market Abuse Directive is implemented?

The Treasury/FSA consultation document on the directive appeared to favour preserving the existing FSA position on misuse of information, which prohibits people from trading to their advantage and the disadvantage of others on information not generally available to investors. This is less precise than factual inside information in that it catches such price-sensitive things as the state of negotiations on a big contract or discussions about a change of strategic direction. The directive, by contrast, goes for narrower, factual precision.

To the consternation of many big institutional investors, the London Investment Banking Association and the British Bankers' Association have lobbied for moving down to the very narrow EU directive definition. Many bankers feel that differentiating the UK approach from continental markets would require different internal controls and would raise costs in London. Some say it would increase the incentive to decamp.

The bankers are in with a chance because Tony Blair's Panel on Regulatory Accountability will rule on whether implementation involves "gold-plating", or over-implementing EU directives. The prime minister is exercised on this, as are the Conservatives. Yet, as Peter Montagnon of the Association of British Insurers argues, holding on to a superior UK practice is not the same as gold-plating. The Confederation of British Industry agrees.

The technical details are complex but the principles are not. It seems implausible that the biggest banks would leave London because it was easier to engage in insider dealing elsewhere. Those who would be attracted to London by a weaker regime are the ones that the UK would be better off without. The reality is that insider dealing raises transaction costs in the market place and undermines its integrity. London benefits from a higher standard here.

John Grout, of the Association of Corporate Treasurers, argues it would be scandalous if the UK definition were to be dropped. He is right.

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