

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (LIABILITY OF
ISSUERS) REGULATIONS 2010

2010 No. [DRAFT]

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Purpose of the instrument**

2.1 The purpose of these Regulations is to amend the Financial Services and Markets Act 2000 (FSMA) by substituting section 90A and inserting a new Schedule into the Act providing for a new regime for the liability of issuers to pay compensation to third parties who have suffered loss as a result of misstatements, or dishonest omissions in information published by the issuer, or dishonest delay by the issuer in publishing information.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

4. **Legislative Context**

4.1 Article 7 of Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements (the Transparency Directive) requires Member States to ensure that issuers and their managers are responsible for the information disclosed in accordance with the requirements in the Transparency Directive, and to extend their laws on liability to issuers. The Government consulted on extending the scope of the statutory damages regime to disclosures under the Transparency Directive. The responses to that consultation illustrated the complexity of the issues involved, and made it clear that there was little consensus as to the appropriate liability regime in this area.

4.2 Following that consultation, sections 90A and 90B of FSMA were inserted by section 1270 of the Companies Act 2006. Section 90A introduced a statutory liability regime for the disclosures required by the Transparency Directive, confirming the prior common law situation – that issuers are not liable to investors in negligence, and extending the prior common law on deceit, applying it only to issuers and in favour of purchasers of shares.

Section 90B gave the Government power to make further provision about the liability of issuers of securities traded on a regulated market, and other persons.

4.2 These Regulations are made following an independent review by Professor Paul Davies QC of the liability of issuers in respect of damage or loss suffered as a consequence of inaccurate, false or misleading information disclosed by issuers or their managements to the market. That review was conducted to enable Professor Davies to advise the Government whether the power in section 90B should be exercised, and if so, how.

4.3 The Schedule inserted by the Regulations extends the liability regime to apply to all information which is published by an issuer by means of a recognised information service, or the availability of which is announced by the issuer by such means. The Schedule sets out the circumstances in which an issuer is liable to pay compensation to a person who has acquired, sold or continued to hold securities in reliance on published information to which the Schedule applies and suffered loss as a result of a misstatement or dishonest omission. The issuer is subject to liability for dishonest delay in publishing information. The Schedule also exempt the issuer from other forms of liability in respect of loss suffered as a result of misstatements, omissions or delay in publication, except in the cases identified in the paragraph 7(3) of the Schedule.

5. Territorial Extent and Application

5.1 These regulations apply to all of the United Kingdom.

6. European Convention on Human Rights

Lord Myners has made the following statement regarding Human Rights:

In my view the provisions of the Financial Services and Markets Act 2000 (Liability of Issuers) Regulations 2010 are compatible with the Convention rights.

7. Policy background

- *What is being done and why*

7.1 The subject of the UK policy on issuer liability for disclosure arose during the implementation of the Transparency Directive into UK law. After consultation the Government sought Parliamentary approval for a statutory liability regime that was codified in Section 90A FSMA, as introduced by section 1270 the Companies Act 2006. It was acknowledged, however, that further adjustment to the regime might be required; therefore, in section 90B

of FSMA, HM Treasury was given the power to amend, limit or extend the scope of the liability regime.

7.2 Timely, comprehensive and complete reporting by companies is a crucial element in promoting the allocative efficiency of capital markets. Lack of certainty as to the existing common law position with regard to issuer liability in damages for inaccurate statements made to the market was partially resolved by the introduction of a statutory liability regime. These proposals aim to extend the existing statutory regime to ensure complete clarity.

7.3 The purpose of the statutory regime is therefore to clarify the position with regard to issuer liability in damages for inaccurate statements made to the market. The proposed extension of the statutory regime, working in conjunction with the FSA public law regime, aims to ensure optimal incentives for prompt and accurate disclosures, without encouraging costly speculative litigation and settlements by issuers based on a desire to terminate litigation, rather than on the harm done to shareholders.

7.4 The option to extend the statutory regime was selected on the basis of the recommendations by Professor Davies' reviews and recommendations, reflecting his conclusion as to the policy that best balances the rights of investors with incentives placed on issuers.

7.5 The responses to consultation were primarily received from law firms, companies that issue securities and trade bodies for investors – there has not been any wide level of public interest in this policy.

- ***Consolidation***

7.6 The Treasury does not have plans to consolidate the original text with amendments to the Financial Services and Markets Act 2000 at this time. Commercial publishers produce consolidated versions of that Act with amendments, both in electronic and hard copy versions. A consolidated version of the Financial Services and Markets Act 2000 is also available on the Ministry of Justice's free website at www.statutelaw.gov.uk.

8. Consultation outcome

8.1 The Government's consultation which was launched in July 2008 and closed in October 2008 was the result of an independent review by Professor Paul Davies QC of the liability of issuers in respect of damage or loss suffered as a consequence of inaccurate, false or misleading information disclosed by issuers or their managements to the market. Professor Davies' recommendations were the basis for the Government's consultation proposals.

8.2 Respondents were in general supportive of the Government's proposals. A number of the points made in responses related to the text of the Draft Regulations, which were included in the consultation document, stating that the wording used did not achieve the stated policy aim. As a result the

Government has made a number of amendments to the text of the Regulations so that they accurately reflect the stated policy aims.

8.3 The Government received a total of 25 responses to its consultation. A full list of respondents is included in the response to consultation document. In terms of policy there were three areas which received the most attention from respondents.

8.4 The issue of whether the regime should apply just to European Economic Area markets or extend it to all securities issued by UK issuers including securities admitted to trading on markets outside the EEA dichotomised respondents. On the basis of the arguments put forward by each side the Government has altered the regime so that it will extend to all securities issued by UK issuers.

8.5 Similarly the question of whether holders of securities should be brought within the scope of the regime alongside buyers and sellers divided respondents. The Government, having weighed up all the points of view carefully, has decided to extend the statutory regime to include holders of securities as well as sellers. The potential to have two divergent regimes, one for sellers and purchasers but another for holders would not be conducive to investor and issuer certainty.

8.6 The final issue on which respondents made substantive policy points was in relation to the safe harbour provision and how the statutory regime interacts with other forms of liability, whether in statute or common law. The Government has amended the Regulations to address points made by respondents and to ensure there is greater certainty over how the statutory regime will operate in practice and how it will interact with other forms of liability.

8.7 A response to consultation has been prepared, which gives much greater details on respondents' views and the Government's course of action. This document is available on the HM Treasury website.

9. Guidance

9.1 HM Treasury has not issued any specific guidance in the context of these Regulations.

10. Impact

10.1 There is no impact on charities or voluntary bodies. There is an impact on businesses that are issuers of securities which will be covered by the statutory regime.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment is attached to this memorandum.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 No formal review is scheduled. The Government will monitor the impact of the regime to ensure it delivers the intended policy benefits.

13. Contact

Andy Donald at HM Treasury Tel: 020 7270 4725 or email: andrew.donald@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.