EXPLANATORY MEMORANDUM TO

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

2010 No. 1192

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.

4.3 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.

4.4 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

6.1 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 extends 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 purchases 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

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

Summary: Intervention & Options

Department /Agency:	Title:	
HM Treasury	Impact Assessment of	
Stage: Implementation	Version: 1	Date: 11 February 2010

Related Publications: Davies Review of Issuer Liability, Liability for misstatements to the market, March 2007; Davies Review of Issue Liability: Final Report, June 2007.

Available to view or download at:

http://www.

Contact for enquiries: Andy Donald

Telephone: 020 7270 4725

What is the problem under consideration? Why is government intervention necessary?

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 statement 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.

What are the policy objectives and the intended effects?

The purpose of the statutory regime is to clarify the common law 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.

What policy options have been considered? Please justify any preferred option.

Extension of the statutory regime was initially compared against a base case of making no changes to the existing statutory regime. The preferred option of extension was selected on the basis of the recommendations made by Professor Davies who undertook an independent review of issuer liability and reflects his conclusions after consultation as to the policy that best balances the rights of investors with incentives placed on issuers.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? In line with good practice, the Government would expect to review the policy within three years.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

.... Date: 11/02/10

Summary: Analysis & Evidence

Policy Option:	Description:

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	Yrs	Legal advice on the changes to the statutory regime and ongoing costs of increased levels of litigation.
£ **£3.5m - £5.2m**		
Average Annual Cost (excluding one-off)		
£ **£0.4m - £1.3m**		Total Cost (PV) £ **£11.7m**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	Yrs	More reliable and detailed reporting
£ **N/A**		
Average Annual Benefit (excluding one-off)		
£ **1.7m**		Total Benefit (PV) £ **£14.6m**

Other **key non-monetised benefits** by 'main affected groups'

Easier for parties harmed by fraudulent misstatements to secure compensation. More security for issuers in making disclosuers to the market.

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) £ **N/A**	**NET BENEFIT** (NPV Best estimate) £ **N/A**

What is the geographic coverage of the policy/option?			Worldwide	
On what date will the policy be implemented?			2010	
Which organisation(s) will enforce the policy?			HMT	
What is the total annual cost of enforcement for these organisations?			£ To be determined	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			Yes	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ N/A	Decrease of £ N/A	Net Impact	£ N/A

Key: Annual costs and benefits: Constant Prices (Net) Present Value

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

INTRODUCTION

A statutory liability regime with regard to issuer liability in damages for inaccurate statements made to the market upon which investors rely to their detriment was introduced in the Companies Act 2006 which inserted section 90A into the Financial Services and Markets Act 2000 (FSMA).

The Financial Services And Markets Act 2000 (Liability Of Issuers) Regulations 2010 (hereinafter "the Regulations") amend 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.

PURPOSE

The statutory regime introduced in 2006 clarified the existing position with regard to issuer liability in damages by imposing liability for fraudulent misstatements in respect of disclosures under the Transparency Directive by issuers of securities admitted to trading on regulated markets.

The revised statutory liability regime will supplement public enforcement through FSA investigation and sanctions, 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.

COSTS AND BENEFITS

Both issuers and investors support regulatory intervention by means of an extension to the existing statutory regime, reflecting a belief that the benefits exceed the costs. In general issuers and their advisers have been the more enthusiastic promoters of the statutory regime. Clarifying issuer obligations by means of a statutory liability regime may increase the overall level of litigation. However, the use of a demanding fraud test for misstatement means that the majority of issuers will face less risk of speculative litigation and less risk of the courts unexpectedly extending remedies for reckless or negligent misstatement. Institutional investors have also generally supported a statutory regime, although less enthusiastically than issuers. They have welcomed the facilitation of legal action in respect of fraudulent misstatements and dishonest delay but have been concerned by the demanding threshold a claim must meet and the fact that statutory clarification reduces the potential for the courts to extend remedies in this area.

In the Government's consultation paper it was estimated that there are approximately 3,500 issuers of securities admitted to trading on regulated markets (e.g., the main market of the LSE) and on MTFs (such as AIM and PLUS-quoted) in the UK. Respondents did not make comments on the assumptions which underpinned these figures and therefore it is valid to retain them.

The response to consultation makes some changes to the draft proposals. The two main ones are: extending the regime to cover holders as well as sellers and buyers; extending the scope of the regime to all cases where English law is found to apply. There are likely to be only a small number of cases where, for example, a holder would be able to bring an action and a small number of UK issuers admitted to trading on regulated markets and MTFs in other countries will also potentially be affected. These small numbers are not likely to have significantly affected the costs quantified in respect of the Impact Assessment for the Draft Regulations; therefore those costs have been retained here in the final Impact Assessment.

COSTS

Some issuers, particularly larger companies with an equity listing, will wish to seek advice on the impact of extending the statutory regime. Equally, larger issuers with an equity listing tend to be admitted to trading on regulated markets and thus are more likely to be familiar with the existing regime.

Issuers range widely in size, with a significant tail of smaller issuers who are less likely to take advice. A reasonable estimate of the one-off cost over the range of issuers would be £1,000 - £1,500 per issuer. Over 3,500 issuers, the potential cost could be in the range of £3.5 – 5.25 million.

There is likely to be little impact on the day-to-day checking process by issuers. Issuers and directors already face significant financial and reputational penalties for misstatements. In line with the requirements set out in the Combined Code (for issuers on the main market) and associated guidance, they are required to have robust disclosure assurance processes, which are capable of detecting at the less demanding threshold of accidental or negligent misstatements, as well as the fraudulent misstatements that are intended to trigger liability under a statutory regime.

The statutory regime is intended to clarify issuer liability and therefore greater certainty for issuers and their advisors provided by the statutory regime has the potential to limit or offset growth in the depth and costs of scrutiny. The Government is not aware of costs increasing significantly with the implementation of the initial statutory regime and see little reason for material changes to processes as a result of extending the statutory regime.

However, clarifying the liability for misstatement, albeit subject to a demanding test of issuer fraud, is likely to increase the incidence of litigation in cases of fraudulent misstatement. The increase is likely to be small. But the potential costs of such cases are significant, even when settled before trial. It is reasonable to envisage perhaps 2 – 3 cases over the next ten years, with costs in the region of £1-2 million for each side. It is reasonable to expect that a similar number of cases would be settled before trial with costs of £0.25 – 0.5 million for each side. This gives a ten year cost range of £5 – 15 million, or an annual average transaction cost range of £0.5 - £1.5 million.

The statutory regime has deliberately been shaped, principally by selecting a demanding fraud test for liability, to minimise the potential for speculative litigation and the corresponding pressure on issuers to settle in order to terminate litigation, rather than compensate for harm done to shareholders.

BENEFITS

The benefits of extending the statutory regime are harder to calculate reliably, although this has not prevented the proposals from gathering widespread support from affected parties throughout the review and consultation process.

By clarifying the liability for and thus increasing the likelihood of litigation and substantial damages in respect of fraudulent misstatement, we expect a statutory regime to reduce the incidence of these misstatements. But the relationship is far from a simple linear one.

Directors contemplating dishonesty already face an array of penalties and are likely to mislead only in extreme and pressured circumstances. Such fraudulent misstatements do harm in two ways. First, they transfer wealth between parties. This can be unjust, but does not impose a net economic cost (or benefit). Secondly, the risk of such transfers increases the cost of capital to issuer and the risk to investors with regard to any particular portfolio of investments.

Reducing the incidence of fraudulent misstatement increases the quality of disclosure and improves confidence in reporting. This is an unambiguous benefit to investors, reducing the risk-adjusted return required from an investment, and similarly for issuers, leading to a comparable reduction in the cost of capital.

SMALL FIRMS IMPACT TEST

The statutory liability regime will apply to issuers with securities admitted to trading on regulated markets and MTFs. These are invariably among the largest companies. It will not apply as a rule to small firms.

COMPETITION

The statutory liability regime is not expected to reduce competition.

ENFORCEMENTS, SANCTIONS AND MONITORING

The statutory liability regime creates obligations in respect of statements by issuers of securities admitted to trading on a regulated market or an MTF. It is enforced by means of civil action by parties alleging harm and the remedy is damages. It exists alongside a public law regime of FSA rules made under FSMA 2000 and governing disclosures by issuers. The FSA has the power to impose criminal and financial penalties and to order restitution.

IMPLEMENTATION AND DELIVERY PLAN

No formal review is scheduled, however in line with good practice, the Government would expect to review the policy within three years.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Annexes