Welcome to markettalk
issue 15

While market conditions remain testing, the Exchange is pleased to report a record £106 billion was raised on our markets during the financial year up to 31 March 2009. Of that, £99 billion was raised from further issues, a testament to the quality and efficiency of our markets. During the first quarter of this financial year, a record £35.5 billion was raised, of which £25.2 billion was raised through secondary issues. The Main Market continues to perform a vital function in helping companies to raise equity finance. The capacity of the London markets to support this is partly due to a high proportion of institutional investors, who develop long-term relationships with issuers, making it easier for companies to return to the market to access further capital.

We hope you find this issue of markettalk useful and informative.

Tracey Pierce

Investor Relations Conference

Our 3rd annual Investor Relations conference on 23 September 2009 presents thought leadership and best practice advice on investor relations from industry experts, and features a keynote presentation from Sir Martin Sorrell, CEO, WPP plc.

Click here to view the full agenda and reserve your place.

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FRC’s Review of the Combined Code

Background

Since the last major revisions of the Combined Code (the Code) in 2003, following the Higgs and Smith reports on non-executive directors and audit committees respectively, the Financial Reporting Council (FRC) has reviewed the impact and implementation of the Code every two years. This is the third such review. The 2007 review found that the Code had a broadly beneficial impact and contributed to good corporate governance standards with the ‘comply or explain’ approach working well. However, there were some concerns from investors about the overall usefulness of disclosures by companies and some issuers voiced concerns about the level and quality of engagement by investors on governance matters.

Since the last review, much has changed within the market environment that companies operate and the principle of ‘comply or explain’ is under scrutiny. While there is no assumption that the Code is fundamentally flawed or that a different corporate governance regime might have prevented some of the current problems, the FRC considers it appropriate to review the content and application of the Code to ensure it remains effective.

In addition, HM Treasury has asked Sir David Walker to conduct a review of corporate governance standards for financial institutions. This review will examine areas of corporate governance including risk management, board effectiveness, the functioning of committees and shareholder engagement. Some of the issues that the Walker Review will be addressing may also apply to companies that are in other sectors. The FRC has therefore brought forward its review of the Code by a few months in order for relevant research and evidence to be shared with the Walker review team.

These reviews of the corporate governance standards in the UK are taking place against the backdrop of reform of financial regulation system across Europe and further afield in light of the financial crisis.

Key areas of focus

The FRC issued a call for evidence in March 2009 which invites general comments on any aspect of the code, but in particular is seeking views on both the content of the Code and the way that it has been applied by companies and monitored by investors using the “comply or explain” mechanism.
Specific areas of focus for the FRC include:

**On the content of the Code:**

- the composition and effectiveness of the board as a whole;
- the respective roles of the chairman, the executive leadership of the company and the non-executive directors;
- the board’s role in relation to risk management;
- the role of the remuneration committee;
- the quality of support and information available to the board and its committees; and
- the content and effectiveness of Section 2 of the Code, which is intended to encourage institutional investors to proactively engage with companies based on the mutual understanding of objectives and for investors to make considered use of their votes.

**On the application of the Code:**

The FRC is re-examining the effectiveness of the “comply or explain” principle. Under the Code boards have the flexibility to decide their own governance arrangements. In order for the Code to be effective, it requires boards to provide investors with the necessary information on which to make a judgment as to whether these arrangements will be in their long term interest, in particular where a company may have chosen not to follow the Code. It also requires a sufficient number of investors to take a long-term view and to engage with company directors constructively.

The FRC has asked for views on the usefulness of company disclosures and the level and quality of engagement by investors on governance matters.

The review of the Code can be found on the FRC’s website at the following link:


**Our response**

Reflecting feedback from a variety of Primary Listed, Main Market companies and their advisers, the London Stock Exchange has responded to the FRC’s call for evidence. The Code has a direct bearing on the Main Market as all UK domiciled, Primary Listed Main Market companies are required to report on their application of the Code.
In our response, we note that the current economic conditions have tested the effectiveness of the Code and we therefore welcome the timely review. However we ask the FRC to consider the broader market context of the Code, particularly in relation to:

- the international response to the financial crisis which focuses on classifying and reviewing systemic risk in certain areas of the financial sector;

- the wide variety of companies that follow the Code, nearly half of which are smaller companies where the effect of unnecessary additional regulatory burden will have a disproportionate impact; and

- the important role the Code plays in contributing to the competitive position of London as a leading financial centre.

The feedback we have received from companies is very supportive of the ‘comply or explain’ model, and suggests there is no substantive evidence for wholesale changes. However, we highlight some areas which may warrant further examination, including:

- **Shareholder engagement**: the need to encourage increased and direct engagement by shareholders with non-executives;

- **Risk management**: for boards to consider contingency planning for ‘high impact, very low probability’ macro risks;

- **Non-executive directors**: the determination of independence within the Code and to allow more flexibility for companies with widely differing business models to balance the need for independence with the need for sector expertise; and

- **Positioning of the Code**: the need to reinforce the authority of the Code in light of third party interpretations and commentary which have introduced some confusion to the debate on corporate governance.

A copy of our response can be found at the following link:

Next steps

On 28 July 2009 the FRC published a progress report on the current review of the Combined Code. The report identifies and invites views on the main issues to emerge from the first phase of the review. The FRC would welcome any additional comments or other evidence on the issues identified in this document by 9 October 2009. A copy of this progress report is available at the following link:

http://www.frc.org.uk/corporate/reviewCombined.cfm

With regard to the Walker Review, a consultation document was published on 16 July 2009. The second consultation period will run until 1 October, with conclusions in November 2009. The consultation document can be found at the following link:

http://www.hm-treasury.gov.uk/walker_review_information.htm
IMPROVING YOUR LIQUIDITY

The importance of increasing liquidity in smaller quoted companies’ (SQCs) shares has never been more acute than in the current economic climate. Maintaining a reasonable level of liquidity can ensure that the overall cost of capital for public companies remains as low as possible, particularly if SQCs feel the need to return to the market to raise further capital.

This article looks at ways in which SQCs can seek to improve liquidity in their shares and the initiatives that the Exchange has introduced to support issuers in their activities to achieve better liquidity.

Over the last decade, many advisers and issuers have discovered the importance of Investor Relations (IR) and how effective IR can have a direct affect on liquidity levels by promoting companies to both existing and potential investors.

The IR function and its execution of an effective IR strategy have proven increasingly important in current market conditions, as these help to drive investor interest and ultimately demand in a company’s shares. IR activities do, however, require an investment of time and resource by senior management teams which needs to be managed alongside ‘business as usual’ responsibilities. This can be particularly challenging in the current economic climate when a careful balance needs to be struck between senior management openly engaging with shareholders and seeking to drive growth in their business for the ultimate benefit of shareholders.

To assist with the challenges outlined above, the London Stock Exchange is currently promoting several new initiatives that have the express aim of helping and empowering senior management teams of SQCs to take a manageable level of control of their IR program and seek to enhance the liquidity in their shares.

These initiatives include:

**Paid for Research**

Information is the lifeblood of efficient and transparent capital markets. Where companies proactively disclose information to raise awareness of their business, they are most likely to build long-term trust with their investors and may benefit from enhanced liquidity and access to capital on more favourable terms.

Companies who commission research from an independent firm make an important and positive statement about their business. They are demonstrating a
desire to enhance their exposure to a wider investor base and boost their profile through the provision of objective and detailed research.

Research is particularly important for smaller companies that often have fewer analysts covering their securities in comparison to their larger peers.

The availability of equity research can have a significant impact on a company’s visibility and investors’ understanding of its performance. Greater analyst coverage may increase liquidity and may have a positive impact on share price and the company’s overall valuation, ultimately reducing the cost of capital for companies.

The Exchange supported the initial development of PSQ Analytics in March 2009 to provide SQCs with a tool to help them attract investor interest and is complementary to the existing research services offered by brokers and equity research providers.

For more information on the benefits of equity research and the services available please visit:


**Private Client Brokers**

The Exchange is delivering a number of Growing Companies Investor Days throughout the UK. These bring together small and mid sized issuers with Private Client Brokers (PCBs), who can be a valuable source of funding as well as offering much needed liquidity.

The amount of funds under management within the remit of PCBs is extremely difficult to quantify. A recent study carried out by Broker Profile (using data from the Association of Private Client Investment Mangers), however, suggests that there is £380 billion available from this audience which can be broken down as follows:

- 15% discretionary
- 32% advisory
- 17% execution only
- 22% managed pooled funds
- 14% mixture of banks and solicitors
In another recent study carried out by Capita Registrars, private investors are shown to have ploughed £1.6 billion back into shares over the past six months, almost completely reversing their withdrawal of £1.9 billion in the previous half-year, indicating a renewed enthusiasm for equities.

Clearly there is a great deal of capital under the management of PCBs who have traditionally invested in SQCs. The difficulty for issuers has always been trying to engage with and managing a meaningful dialogue with a class of investor that is traditionally disparate in nature. Often, issuer’s management teams are wary of spending a significant amount of their time trying to communicate with a large number of small investors. Communicating through the Private Client Brokers however, offers an alternative.

The Exchange is running seven Growing Companies Investor Days throughout the UK in 2009, each providing the opportunity for up to eight local small cap issuers to present to local PCBs. The aim is to encourage issuer interaction with this group of investors who have sizeable amounts of assets under management, whilst providing PCBs with access to local issuers in which they can invest. This has been very well received by both issuers and the PCBs.

For a list of upcoming dates and past presentations, please visit http://www.londonstockexchange.com/companies-and-advisors/news-events/ukevents/ukevents.htm

**Training Services**

The Exchange also offers courses, conferences, seminars and workshops on a broad range of subjects, including Investor Relations.

Our 3rd annual Investor Relations conference presents thought leadership and best practice advice on investor relations from industry experts, and features a keynote presentation from Sir Martin Sorrell, CEO, WPP plc.

For the conference and agenda and to reserve your place click here: http://www.londonstockexchange.com/about-the-exchange/training/investor-relations-conference.htm

**Trading analysis**

Understanding which of the Exchange’s 500 member firms are dealing in a company’s shares can be an excellent way of prioritising an IR program. The Exchange enables companies to do this via its Broker Ranking Service which is
available to companies through their Relationship Manager. (Each company has their own dedicated Relationship Manager, a list of which can be found at the link below).

The report produced by the Broker Ranking Service provides a list of member firms dealing in an issuer’s shares and their ranking by value traded over a defined period of time. From this analysis, companies can easily categorise the member firms into three groups. Understanding these different categories and prioritising contact with these firms accordingly, will help companies to decide on appropriate IR activities. The categories are:

- **Institutional Brokers** have a direct relationship with the institutional investor community and will usually comprise an analyst and an equity sales team. The role of the institutional broker is to produce detailed research on issuers and their peer groups to help the institutional investor make informed decisions about their investments. The broker will also carry out any trading activity on behalf of institutional investors. As the institutional broker has a direct influence on an investor’s investment decisions, it is beneficial for an issuer to start a dialogue with these important stakeholders.

- **PCBs** act in both an advisory and discretionary capacity on behalf of high net worth individuals and can be valuable contacts for the reasons mentioned above and if the company wants to actively promote their shares or communicate with the retail investor community. In the majority of cases, PCBs are not only the firms that transact the business but are also the underlying shareholders, making communication with this type of investor much more straightforward.

- **Execution Only Brokers** act on instruction by buying and selling shares on behalf of institutional investors. As Execution Only Brokers do not influence the decisions of institutional investors in any way, there is little point in contacting this group.

Categorising member firms can be done with the help of your advisers and your Relationship Manager.

More details on this service can be found at:

In summary, while time spent by senior management on anything other than running their companies is increasingly under pressure, the need for effective investor relations has never been more apparent. The four initiatives outlined above are only a few which issuers should be considering to increase liquidity and reduce the cost of capital. If you would like to discuss any of the topics mentioned above or indeed any other activities, please do not hesitate to contact your Relationship Manager.

If you are not sure who the Relationship Manager is for your company, the details are available at:

Our Response to the FSA’s Discussion Paper on Short Selling

Introduction

In the last issue of markettalk, we highlighted that the Financial Services Authority (FSA) had published Discussion Paper (DP) 09/1 in February 2009 on the longer term regulation of short selling in the UK. The Exchange has now had the opportunity to review the FSA’s proposals and recently submitted a response to the DP. We set out below the key elements of the FSA’s DP and a summary of our response.

FSA’s Discussion Paper

In the DP, the FSA recognises the benefits that short selling brings to the market and does not seek to impose an outright ban on the activity. The FSA instead explores the possibility of implementing a transparency regime for short selling and proposes that investors publicly disclose when their net short positions in a UK incorporated issuer exceeds 0.50% of the total issued share capital of the company. The FSA proposes a lower threshold of 0.25% for companies undertaking a rights issue.

The FSA hopes that such a disclosure regime will help to detect market abuse, improve pricing efficiency (by providing additional information to the market), and reduce the risk of disorderly trading by acting as a deterrent to large scale aggressive short selling.

Our response

In our response we reiterate our view that short selling is a legitimate investment technique and an important component of well functioning capital markets. Our view is supported by research\(^1\) commissioned by the Exchange and conducted by Capital Markets CRC Ltd which demonstrates that the FSA’s temporary ban on short selling had a negative impact on market quality by widening spreads, reducing depth and increasing volatility in the stocks affected by the ban. We also specify how short selling has contributed to more efficient price discovery and is used as a hedging and risk management tool. We note that some of the risks sometimes associated, rightly or wrongly, with short selling such as market abuse or settlement failure are offset in large part by the safeguards already in

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\(^{1}\) The full report can be found on the Exchange website at http://www.londonstockexchange.com/about-the-exchange/regulatory/effect-short-selling-restrictions-liquidity-evidence.htm
place in the UK market such as the market abuse regime, the short settlement cycle and a robust settlement discipline.

As mentioned above, the FSA is proposing to enhance transparency around short selling. While we recognise that there may be benefits of increased transparency in principle, we see risks to the overall efficiency of capital markets from requiring public disclosure of individual short positions. Introducing a public disclosure regime will discourage market participants and investors from undertaking short selling transactions, for example in order to protect proprietary trading strategies or to avoid potential reputational damage (there seems to still be a stigma attached to the practice). This may have a number of unintended consequences, including for issuers, who may find it more difficult to raise capital through rights issues and/or convertible bonds, as market participants would be constrained in their ability to short sell and hedge a position. The effect of this, together with the adverse impact on market quality as mentioned above would in turn increase the cost of capital for issuers.

In our response, we urge the FSA to clearly set out its key objectives in order for us to be able to comment in more detail about the characteristics of a disclosure regime and assess the associated costs and benefits.

- We suggest that private individual disclosure to the regulator combined with aggregated and anonymous public disclosure could go a long way to meeting some of the FSA’s likely objectives. Private disclosure to the regulator may help the FSA in detecting market abuse, whilst price discovery and pricing efficiency may improve with a disclosure regime that presents information in an aggregated and anonymous form. In addition, the FSA could share information privately with issuers, should they feel this would be a useful contribution to their Investor Relations programme.

- We suggest that setting the disclosure threshold at 0.50% may result in an excessive number of meaningless disclosures which would be costly to produce and of questionable value to issuers. We propose instead a threshold at 1% to apply to all issuers including those conducting rights issues. We note however that there is limited data available to determine at what level the threshold should be set, and that regulators have only recently started to experiment with short selling disclosure regimes. Consequently, we encourage the FSA to be flexible and to revise any thresholds that may be set at the outset if this is later deemed necessary.
Next Steps

In its Discussion Paper the FSA states that “it considers an international consensus on the key issues to be extremely important”. Consequently, we understand the FSA will seek to align its response with other European regulators through the Committee of European Securities Regulators (“CESR”). We expect that the FSA will await the outcome of discussions at CESR before implementing any regime of its own. CESR are expected to publish a consultation paper in the next few months.

Companies can view our response to the FSA consultation on our website at:

http://www.londonstockexchange.com/about-the-exchange/regulatory/responsetothesasconsultationonshortselling.htm

The FSA’s Discussion Paper on short selling can be found at:

http://www.fsa.gov.uk/Pages/Library/Policy/DP/2009/09_01.shtml
Segmentation and labelling of listed securities

In the FSA’s Consultation Paper CP08/21 (Consultation on amendments to the Listing Rules and feedback on DP08/1 (A review of the Structure of the Listing Regime)) published in December 2008, a number of proposals were put forward to improve the transparency of securities admitted to the Official List. The FSA proposed that one of the ways in which greater clarity can be achieved is through improved labelling - making it clearer and more visible to market participants which regulatory standards apply to the various types of listed securities. The FSA plans to categorise all officially listed securities into one of two segments; Premium (currently Primary) and Standard (currently Secondary) and one of eight security categories as shown in the diagram below. The segment will reflect whether an issuer complies with super-equivalent regulatory standards or EU-minimum standards. The category will reflect the nature of the listed security regarding the application of the Listing Rules.

The UK Listing Regime

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<thead>
<tr>
<th>Issuer Segment</th>
<th>Premium</th>
<th>Standard</th>
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<tr>
<td>Securities Category</td>
<td>Equities</td>
<td>Equities</td>
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<td></td>
<td>Commercial Companies</td>
<td>Closed Ended Investment Companies</td>
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The Feedback Statement to CP08/21 is likely to be published in the Autumn. On the basis that this enhanced categorisation and labelling will go ahead, the FSA is planning to contact all Main Market issuers later this year to validate the categorisation of their listed securities.

To ensure that the validation exercise is successful and with the aim of improving overall transparency and clearer labelling, we would encourage issuers to engage fully with the FSA on this validation exercise.

For more information, please read the FSA’s UKLA publication LIST! Issue number 21: http://www.fsa.gov.uk/Pages/Library/Communication/NewsLetters/newsletters/index.shtml
A review of Interim Management Statements

The Financial Services Authority (FSA) recently undertook a review of Interim Management Statements (IMS) that are required under the Disclosure and Transparency Rules. The objective of the review was to assess how far a market led approach to IMS has progressed since the requirement was introduced two years ago and whether there is a need for the FSA to be more prescriptive. Key areas of focus included an assessment of compliance with the requirements to produce IMS and the content of IMS.

The FSA has concluded that it should remain the issuer’s decision on how they best meet their IMS obligations and that more detailed rules should not be introduced.

The main conclusions from the review are:

- a significant number of issuers are still failing to meet the basic requirements to publish IMS, either at all or within the required timeframe;
- there are a number of areas where specific IMS content requirements are not being met, in particular providing coverage of an issuer’s financial position and an explanation of the impact of material events on its financial position; and
- in general, larger companies are complying more effectively with the IMS requirements.

The FSA reiterates that if issuers fail to comply with these obligations, they may be subject to enforcement action, as they would be for non-compliance with any of the other Disclosure & Transparency Rules.

During the course of the review, the FSA has examined practices and approaches that have been undertaken by companies in producing their IMS. For example, the FSA has identified that when an issuer provides information about its financial performance in its IMS, it may not always be meaningful to the reader if it is not referenced accordingly. The FSA therefore recommends that if an issuer states that its financial performance is meeting expectations, it must clarify which expectations it is referring to by stating specifically whether it is those expressed by management in from previous statements, or analyst or market expectations.
More examples of IMS practices which issuers may find useful are detailed in the FSA’s UKLA publication LIST! Issue number 21. Please click on the following link to access this publication:

http://www.fsa.gov.uk/Pages/Library/Communication/NewsLetters/newsletters/index.shtml
Implementation of the Shareholder Rights Directive in the UK

Background

The Shareholder Rights Directive (the Directive) was initially proposed by the European Commission on 5 January 2006. In particular it seeks to ensure that shareholders in companies registered in another Member State may vote without difficulty at these issuers' meetings. The underlying objective of this is to improve shareholder rights and corporate governance and ultimately improve the conditions for cross-border investment and business competitiveness. The Directive applies to issuers that are incorporated in the EU and that are admitted to trading on an EU regulated market - such as the London Stock Exchange's Main Market.

The Directive has been through a number of iterations as the various Member States have provided feedback at each stage of the consultation process. There have been several consultations in the UK during the last few years issued by the Department for Business Innovation & Skills (BIS) (formerly known as the Department for Business, Enterprise & Regulatory Reform (BERR)) on the UK's proposed implementation of the Directive. The last UK public consultation closed on 30 January 2009. The draft implementing regulations were revised following responses to this consultation and are still under review. The final regulations are due to be published on BIS's website and were effective from 3 August 2009.

The changes proposed in the Directive will not have a significant impact on UK companies listed on the Main Market issuers as many of the Directive's provisions are already implemented in the UK legislative framework. BIS's approach to implementation of the Directive has been to build on the existing framework by amending the Companies Act 2006 in a way that will minimise the burdens on issuers.

The key focus for the Directive has been how issuers run their shareholder meetings including the notification period ahead of general meetings, the content of notices, documents available before the meeting and shareholders' rights at these meetings.

Key changes

The key changes of the Directive that will impact Main Market issuers are as follows:
Length of Notice Period to call a General Meeting

- Once the Directive is implemented, the standard notification period required to call an EGM will be 21 days. (Originally the proposal was 28 days and the Exchange successfully lobbied to reduce this period). However, an issuer will have the opportunity to call an EGM with a 14 day notice period if:
  
  (a) approval has been given by members (those that are on the company’s share register at any given time) by passing an appropriate resolution at a previous AGM; and

  (b) the issuer offers “the facility for members to vote by electronic means accessible to all members.”

- BIS is still consulting on how companies can satisfy the requirement for electronic voting, but it is probable that it will be defined as voting functionality that is available on a website. The functionality may not need to be available directly on the company’s website but can be accessible via the registrar’s electronic voting service.

- It is also worth noting that members with five per cent of the issuer’s share capital (amended from 10 per cent) can require the directors to call a general meeting.

Approval by resolution

- The Directive requires the passing of a resolution as required in (a) above by a two thirds majority.

- BIS however is consulting on whether the majority should be three-quarters instead to be better aligned with the current UK regime for special resolutions.

Such resolutions can be passed either on a show of hands or on a poll.

It is worth noting that if Main Market issuers want to conduct a general meeting on a 14 day notice period after 3 August 2009 they will need to consider passing such a resolution at their next AGM. The resolution is valid up to the next AGM of the company and would need to be renewed at each AGM.
Contents of notice of a General Meeting

There are requirements in the Directive for additional information to be provided by issuers in the notice of a general meeting. These are:

- A statement giving details of the website on which information about the meeting will be published;
- A statement detailing procedures with which members must comply in order to attend and vote at the meeting;
- A statement that the right to vote at the meeting is determined by reference to the register of members at a time that is set in accordance with the Companies Act;
- Forms to be used to appoint a proxy;
- Any information detailing the process for members to vote in advance or by electronic means; and
- A statement of the right of members to ask questions.

Ahead of an AGM, the notice must also include a statement of the shareholder’s rights to require the company to:

- Provide notice of a resolution to be moved at the meeting; and
- Include a matter in the business to be dealt with at the meeting.

Website publication of information before a general meeting

The Directive requires the following information to be published on a website before a general meeting:

- The notice of the meeting;
- The total number of members which are entitled to exercise voting rights at the meeting; and
- The total number of voting rights that members are entitled to exercise at the meeting in respect of the shares in each class.

After the general meeting, the issuer is required to publish any poll results on its website.

Shareholders’ right to add items to AGM agenda

The Directive will allow members to add items to the agenda at the AGM and the issuer will be required to include them if:
• members making the request represent at least five per cent of the total voting rights of all members who have a right to vote; and

• at least 100 members who have a right to vote on the resolution at the AGM to which the requests relate and hold shares in the company on which there has been paid up an average sum, per member, of at least £100.

Notification of agenda items should be provided to members in the same manner as the notice of the meeting. The Directive also establishes rights for the asking and answering of questions at general meetings.

**Timetable**

BIS will add the new regulations to its website during the next few weeks and the new rules will be effective from 3 August 2009.

The latest draft implementing regulations on BIS’s website can be viewed at the following link: