

Chapter 7

Corporate governance

7.1 Audit committees

Audit committees and their functions

- 7.1.1** **R** An *issuer* must have a body or bodies responsible for performing the functions set out in **■** DTR 7.1.3 R.
- 7.1.1A** **R**
- (1) A majority of the members of the relevant body must be independent.
 - (2) At least one member of the relevant body must have competence in accounting or auditing, or both.
 - (3) The members of the relevant body as a whole must have competence relevant to the sector in which the *issuer* is operating.
- [**Note:** article 39(1) of the *Audit Directive*]
- 7.1.2** **G** The requirements for independence and competence in accounting and/or auditing may be satisfied by the same members or by different members of the relevant body.
- 7.1.2A** **R** The chair of the relevant body must be:
- (1) independent; and
 - (2) appointed by the members of the relevant body or by the administrative or supervisory body of the *issuer*.
- [**Note:** article 39(1) of the *Audit Directive*]
- 7.1.3** **R** An *issuer* must ensure that, as a minimum, the relevant body must:
- (1) monitor the financial reporting process and submit recommendations or proposals to ensure its integrity;
 - (2) monitor the effectiveness of the *issuer's* internal quality control and risk management systems and, where applicable, its internal audit, regarding the financial reporting of the *issuer*, without breaching its independence;
 - (3) monitor the statutory audit of the annual and consolidated financial statements, in particular, its performance, taking into account any

findings and conclusions by the Financial Reporting Council under article 26(6) of the *Audit Regulation*;

- (4) review and monitor the independence of the *statutory auditor* in accordance with paragraphs 2(3), 2(4), 3 to 8 and 10 to 12 of Schedule 1 to the *Statutory Auditors and Third Country Auditors Regulations 2016* (SI 2016/649) and article 6 of the *Audit Regulation*, and in particular the appropriateness of the provision of non-audit services to the *issuer* in accordance with article 5 of the *Audit Regulation*;
- (5) inform the administrative or supervisory body of the *issuer* of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the relevant body was in that process; and
- (6) be responsible for the procedure for the selection of *statutory auditor(s)* and recommend the *statutory auditor(s)* to be appointed in accordance with article 16 of the *Audit Regulation*.

[Note: article 39(6) of the *Audit Directive*]

- 7.1.4 **R** [deleted]
- 7.1.5 **R** An *issuer* must make a statement available to the public disclosing which body carries out the functions required by **■ DTR 7.1.3 R** and how it is composed.
[Note: article 39(4) (part) of the *Audit Directive*]
- 7.1.6 **G** An *issuer* may include the statement required by **■ DTR 7.1.5 R** in any statement it is required to make under **■ DTR 7.2** (Corporate governance statements).
- 7.1.7 **G** In the *FCA's* view, compliance with Provisions 14, 24, 25 and 26 of the *UK Corporate Governance Code* and following the statement of good practice set out in paragraph 63 of the 'Guidance on Board Effectiveness' published by the Financial Reporting Council in July 2018 will result in compliance with **■ DTR 7.1.1 R** to **■ DTR 7.1.3R** and with **■ DTR 7.1.5R** except as regards disclosing how the body which carries out the functions required by **■ DTR 7.1.3R** is composed.

7.2 Corporate governance statements

7.2.1 **R** An *issuer* to which this section applies must include a corporate governance statement in its directors' report. That statement must be included as a specific section of the directors' report and must contain at least the information set out in **■ DTR 7.2.2 R** to **■ DTR 7.2.7 R** and, where applicable, **■ DTR 7.2.8AR** and **■ DTR 7.2.10 R**.

7.2.2 **R** The corporate governance statement must contain a reference to the following, where applicable:

- (1) the corporate governance code to which the *issuer* is subject;
- (2) the corporate governance code which the *issuer* may have voluntarily decided to apply; and
- (3) all relevant information about the corporate governance practices applied over and above the requirements of national law.

[**Note:** article 20(1)(a) first paragraph of the *Accounting Directive*]

7.2.3 **R**

- (1) An *issuer* which is complying with **■ DTR 7.2.2 R (1)** or **■ DTR 7.2.2 R (2)** must:
 - (a) state in its directors' report where the relevant corporate governance code is publicly available; and
 - (b) where it departs from that corporate governance code, explain which parts of the corporate governance code it departs from and the reasons for doing so.
- (2) Where **■ DTR 7.2.2 R (3)** applies, the issuer must make details of its corporate governance practices publicly available and state in its directors' report where they can be found.
- (3) If an issuer has decided not to refer to any provisions of a corporate governance code referred to under **■ DTR 7.2.2 R (1)** and **■ DTR 7.2.2 R (2)**, it must explain its reasons for that decision.

[**Note:** article 20(1)(a) second paragraph and article 20(1)(b) of the *Accounting Directive*]

7.2.4 **G** A *listed company* which complies with **■ LR 9.8.6R (6)** (the comply or explain rule in relation to the *UK Corporate Governance Code*) will satisfy the requirements of **■ DTR 7.2.2 R** and **■ DTR 7.2.3 R**.

- 7.2.5** **R** The corporate governance statement must contain a description of the main features of the *issuer's* internal control and risk management systems in relation to the financial reporting process.
[Note: article 20(1)(c) of the *Accounting Directive*]
- 7.2.6** **R** The corporate governance statement must contain the information required by paragraph 13(2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) (information about share capital) where the *issuer* is subject to the requirements of that paragraph.
[Note: article 20(1)(d) of the *Accounting Directive*]
- 7.2.7** **R** The corporate governance statement must contain a description of the composition and operation of the *issuer's* administrative, management and supervisory bodies and their committees.
[Note: article 20(1)(f) of the *Accounting Directive*]
- 7.2.8** **G** In the *FCA's* view, the information specified in Provisions 14, 20, 23, 26, 35 and 41 of the *UK Corporate Governance Code* and paragraph 63 of the 'Guidance on Board Effectiveness' published by the Financial Reporting Council in July 2018 will satisfy the requirements of **■ DTR 7.2.7 R**, except as regards a description of the composition of the *issuer's* administrative, management and supervisory bodies and their committees.
- 7.2.8A** **R**
- (1) The corporate governance statement must contain a description of:
 - (a) the diversity policy applied to the *issuer's* administrative, management and supervisory bodies and the remuneration, audit and nomination committees of those bodies with regard to aspects such as, for instance, age, gender, ethnicity, sexual orientation, disability or educational, professional and socio-economic backgrounds;
 - (b) the objectives of the diversity policy in (a);
 - (c) how the diversity policy in (a) has been implemented; and
 - (d) the results in the reporting period.
 - (2) If no diversity policy is applied by the *issuer*, the corporate governance statement must contain an explanation as to why this is the case.
- [Note: article 20(1)(g) of the *Accounting Directive*]
- 7.2.8B** **G** **■ DTR 7.2.8AR** does not apply to an *issuer* which qualifies as a small or medium company under **■ DTR 1B.1.7R**.
- 7.2.8C** **G** For the purposes of the description in **■ DTR 7.2.8AR(1)(d)**, the *issuer* may, where it considers appropriate, include numerical data on the diversity of the members of the bodies and committees referred to in **■ DTR 7.2.8AR(1)(a)**.

7.2.9 **R** An *issuer* may elect that, instead of including its corporate governance statement in its directors' report, the information required by **■ DTR 7.2.1 R** to **■ DTR 7.2.8AR** may be set out in:

- (1) a separate report published together with and in the same manner as its annual report; or
- (2) a document publicly available on the *issuer's* website to which reference is made in the directors' report.

Under (1) or (2), the corporate governance statement must contain the information required by **■ DTR 7.2.6R** or a reference to the directors' report where that information is made available.

[**Note:** article 20(2) of the *Accounting Directive*]

7.2.10 **R** Subject to **■ DTR 7.2.11 R**, an *issuer* which is required to prepare a group directors' report within the meaning of section 415(2) of the Companies Act 2006 must include in that report a description of the main features of the group's internal control and risk management systems in relation to the financial reporting process for the undertakings included in the consolidation, taken as a whole. In the event that the *issuer* presents its own annual report and its consolidated annual report as a single report, this information must be included in the corporate governance statement required by **■ DTR 7.2.1 R**.

[**Note:** article 29(2)(b) of the *Accounting Directive*]

7.2.11 **R**

- (1) An *issuer* that elects to include its corporate governance statement in a separate report as permitted by **■ DTR 7.2.9R(1)** must provide the information required by **■ DTR 7.2.10R** in that report.
- (2) An *issuer* that elects to include its corporate governance statement in a document publicly available on the *issuer's* website to which reference is made in the directors' report as permitted by **■ DTR 7.2.9R(2)** must provide the information required by **■ DTR 7.2.10R** in that document.

7.3 Related party transactions

Transaction

7.3.1

R

A reference in this section:

- (1) to a transaction or arrangement by an *issuer* includes a transaction or arrangement by its *subsidiary undertaking*; and
- (2) to a transaction is, unless the contrary intention appears, a reference to the entering into of the agreement for the transaction.

[Note: article 9c(7) of the *Shareholder Rights Directive*]

Definition of related party

7.3.2

R

In *DTR*, a "*related party*" has the meaning in *UK-adopted IFRS*.

[Note: article 2(h) of the *Shareholder Rights Directive*]

Definition of related party transaction

7.3.3

R

In *DTR*, a "*related party transaction*" means:

- (1) a transaction (other than a transaction in the ordinary course of business and concluded on normal market terms) between an *issuer* and a *related party*; or
- (2) an arrangement (other than an arrangement in the ordinary course of business and concluded on normal market terms) pursuant to which an *issuer* and a *related party* each invests in, or provides finance to, another undertaking or asset; or
- (3) any other similar transaction or arrangement (other than a transaction or arrangement in the ordinary course of business and concluded on normal market terms) between an *issuer* and any other *person* the purpose and effect of which is to benefit a *related party*.

[Note: article 9c(5) of the *Shareholder Rights Directive*]

7.3.4

R

An *issuer* must establish and maintain adequate procedures, systems and controls to enable it to assess whether a transaction or arrangement with a *related party* is in the ordinary course of business and has been concluded on normal market terms. An *issuer* must ensure that the *related party* and any

person who is an *associate, director or employee* of the *related party* does not take part in any such assessment.

[Note: article 9c(5) of the *Shareholder Rights Directive*]

Transactions to which this section does not apply

7.3.5

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■ DTR 7.3.8R does not apply to any *related party transaction* which is:

- (1) a transaction or arrangement between the *issuer* and its *subsidiary undertaking* provided that:
 - (a) the *subsidiary undertaking* is wholly owned; or
 - (b) no other *related party* of the *issuer* has an interest in the *subsidiary undertaking*; or
- (2) a transaction or arrangement regarding remuneration, or certain elements of remuneration, of a *director* of the *issuer*, where the remuneration to be awarded or due to the *director* is in accordance with the *issuer's* directors' remuneration policy as approved by the shareholders of the *issuer* in accordance with section 439A of the Companies Act 2006 and paid in accordance with section 226B of the Companies Act 2006; or
- (3) a transaction offered to all shareholders of the *issuer* on the same terms where equal treatment of all shareholders and protection of the interests of the *issuer* is ensured.

[Note: article 9c(6) of the *Shareholder Rights Directive*]

Material related party transactions

7.3.6

G

Whether a *related party transaction* is a *material related party transaction* is determined by assessing its size relative to that of the *issuer* proposing to make it. The comparison of size is made by using the *percentage ratios* resulting from applying the *related party test* calculations to a transaction or arrangement. The *related party tests* are set out in ■ DTR 7 Annex 1.

[Note: article 9c(1) of the *Shareholder Rights Directive*]

7.3.7

R

In *DTR*:

- (1) "*percentage ratio*" means (in relation to a transaction or arrangement) the figure, expressed as a percentage, that results from applying a calculation under a *related party test* to the transaction or arrangement;
- (2) "*related party tests*" means the tests set out in ■ DTR 7 Annex 1, which are used to determine whether a transaction or arrangement is a *material related party transaction*; and
- (3) "*material related party transaction*" means a *related party transaction* where any *percentage ratio* is 5% or more.

[Note: article 9c(1) of the *Shareholder Rights Directive*]

Requirements for material related party transactions

7.3.8

R

If an *issuer* enters into a *material related party transaction*, the *issuer* must:

- (1) no later than the time when the terms of the transaction or arrangement are agreed, publish an announcement on a *RIS* which sets out:
 - (a) the nature of the *related party* relationship;
 - (b) the name of the *related party*;
 - (c) the date and the value of the transaction or arrangement; and
 - (d) any other information necessary to assess whether the transaction or arrangement is fair and reasonable from the perspective of the *issuer* and of the shareholders who are not a *related party*, including minority shareholders;
- (2) obtain the approval of its board for the transaction or arrangement before it is entered into; and
- (3) ensure that any *director* who is, or an *associate* of whom is, the *related party*, or who is a *director* of the *related party*, does not take part in the board's consideration of the transaction or arrangement and does not vote on the relevant board resolution.

[Note: article 9c(2) and 9c(4) of the *Shareholder Rights Directive*]

7.3.9

R

If, after obtaining board approval but before the completion of a *material related party transaction*, there is a material change to the terms of the transaction or arrangement, the *issuer* must comply again separately with ■ DTR 7.3.8R in relation to the transaction or arrangement.

7.3.10

G

The *FCA* would (amongst other things) generally consider an increase of 10% or more in the consideration payable to be a material change to the terms of the transaction.

7.3.11

G

- (1) An *issuer* which complies with ■ LR 11.1.7R (Requirements for related party transactions) in relation to a *material related party transaction* will satisfy the requirements of ■ DTR 7.3.8R in respect of that transaction or arrangement.
- (2) An *issuer* which complies with ■ LR 11.1.10R (Modified requirements for smaller related party transactions) in relation to a *material related party transaction* will satisfy the requirements of ■ DTR 7.3.8R(1) in respect of that transaction or arrangement.
- (3) An *issuer* which complies with ■ LR 11.1.7R as modified by ■ LR 21.5.2R (Transactions with related parties: Equity shares) or ■ LR 21.10.4R (Transactions with related parties: certificates representing shares) in relation to a *material related party transaction* will satisfy the requirements of ■ DTR 7.3.8R(1) in respect of that transaction or arrangement.
- (4) An *issuer* which complies with ■ LR 11.1.10R as modified by ■ LR 21.5.2R or ■ LR 21.10.4R in relation to a *material related party transaction* will

satisfy the requirements of ■ DTR 7.3.8R(1) in respect of that transaction or arrangement.

- 7.3.12 **G** ■ DTR 7.3.8R applies to the variation or novation of an existing agreement between the *issuer* and a *related party* whether or not, at the time the original agreement was entered into, that party was a *related party*.

Aggregation of transactions in any 12-month period

- 7.3.13 **R**
- (1) If an *issuer* enters into transactions or arrangements with the same *related party* (and any of its *associates*) in any 12-month period, and the *issuer* has not been required to comply with ■ DTR 7.3.8R in respect of the transactions or arrangements, the transactions or arrangements must be aggregated.
 - (2) If any *percentage ratio* is 5% or more for the aggregated transactions or arrangements, the *issuer* must comply with ■ DTR 7.3.8R in respect of each of the aggregated transactions or arrangements.

[Note: article 9c(8) of the *Shareholder Rights Directive*]

Compliance with the disclosure requirements

- 7.3.14 **G** An *issuer* should consider its obligations under the *disclosure requirements* in relation to a *related party transaction*.

[Note: article 9c(9) of the *Shareholder Rights Directive*]

The related party tests

Related party tests

This Annex sets out the following *related party tests*:

- (1) the gross assets test;
- (2) the profits test;
- (3) the consideration test; and
- (4) the gross capital test.

The gross assets test

- (1) The gross assets test is calculated by dividing the gross assets the subject of the transaction by the gross assets of the *issuer*.
- (2) The “gross assets” of the *issuer* means the total non-current assets, plus the total current assets, of the *issuer*.
- (3) For:
 - (a) an acquisition of an interest in an undertaking which will result in consolidation of the assets of that undertaking in the accounts of the *issuer*; or
 - (b) a disposal of an interest in an undertaking which will result in the assets of that undertaking no longer being consolidated in the accounts of the *issuer*,the “gross assets the subject of the transaction” means the value of 100% of that undertaking’s assets irrespective of what interest is acquired or disposed of.
- (4) For an acquisition or disposal of an interest in an undertaking which does not fall within paragraph (3), the “gross assets the subject of the transaction” means:
 - (a) for an acquisition, the consideration together with liabilities assumed (if any); and
 - (b) for a disposal, the assets attributed to that interest in the *issuer’s* accounts.
- (5) If there is an acquisition of assets other than an interest in an undertaking, the “assets the subject of the transaction” means the consideration or, if greater, the book value of those assets as they will be included in the *issuer’s* balance sheet.
- (6) If there is a disposal of assets other than an interest in an undertaking, the assets the subject of the transaction means the book value of the assets in the *issuer’s* balance sheet.

The *issuer* should consider, when calculating the assets the subject of the transaction, whether further amounts, such as contingent assets or arrangements referred to in ■ LR 10.2.4R (indemnities and similar arrangements), should be included to ensure that the size of the transaction is properly reflected in the calculation.

The profits test

- (1) The profits test is calculated by dividing the profits attributable to the assets the subject of the transaction by the profits of the *issuer*.

- (2) For the purposes of paragraph (1), “profits” means:
 - (a) profits after deducting all charges except taxation; and
 - (b) for an acquisition or disposal of an interest in an undertaking referred to in paragraph 2R(3)(a) or (b), 100% of the profits of the undertaking (irrespective of what interest is acquired or disposed of).
- (3) If the acquisition or disposal of the interest will not result in consolidation or deconsolidation of the target then the profits test is not applicable.

The amount of loss is relevant in calculating the impact of a proposed transaction under the profits test. An *issuer* should include the amount of the losses of the *issuer* or target, i.e. the *issuer* should disregard the negative when calculating the test.

The consideration test

- (1) The consideration test is calculated by taking the consideration for the transaction as a percentage of the aggregate market value of all the ordinary shares (excluding *treasury shares*) of the *issuer*.
- (2) For the purposes of paragraph (1):
 - (a) the consideration is the amount paid to the contracting party;
 - (b) if all or part of the consideration is in the form of *securities* to be traded on a market, the consideration attributable to those *securities* is the aggregate market value of those *securities*; and
 - (c) if deferred consideration is or may be payable or receivable by the *issuer* in the future, the consideration is the maximum total consideration payable or receivable under the agreement.
- (3) If the total consideration is not subject to any maximum (and the other *related party tests* indicate the transaction to be a transaction where all the *percentage ratios* are less than 5%) the transaction is to be treated as a *material related party transaction*.
- (4) For the purposes of sub-paragraph (2)(b), the figures used to determine consideration consisting of:
 - (a) *securities* of a class already *admitted to trading*, must be the aggregate market value of all those *securities* on the last *business day* before the announcement; and
 - (b) a new class of *securities* for which an application for *admission to trading* will be made, must be the expected aggregate market value of all those *securities*.
- (5) For the purposes of paragraph (1), the figure used to determine market capitalisation is the aggregate market value of all the ordinary *shares* (excluding *treasury shares*) of the *issuer* at the close of business on the last *business day* before the announcement.

The *issuer* should consider whether further amounts should be included in the calculation of the consideration to ensure that the size of the transaction is properly reflected in the calculation. For example, if the purchaser agrees to discharge any liabilities, including the repayment of inter-company or third-party debt, whether actual or contingent, as part of the terms of the transaction.

The gross capital test

- (1) The gross capital test is calculated by dividing the gross capital of the company or business being acquired by the gross capital of the *issuer*.
- (2) The test in paragraph (1) is only to be applied for an acquisition of a *company* or business.
- (3) For the purposes of paragraph (1), the “gross capital of the *company* or business being acquired” means the aggregate of:

- (a) the consideration (as calculated under paragraph 6R);
 - (b) if a *company*, any of its *shares* and *debt securities* which are not being acquired;
 - (c) all other liabilities (other than current liabilities) including for this purpose minority interests and deferred taxation; and
 - (d) any excess of current liabilities over current assets.
- (4) For the purposes of paragraph (1), the “gross capital of the *issuer*” means the aggregate of:
- (a) the market value of its *shares* (excluding *treasury shares*) and the issue amount of the *debt security*;
 - (b) all other liabilities (other than current liabilities), including for this purpose minority interests and deferred taxation; and
 - (c) any excess of current liabilities over current assets.
- (5) For the purposes of paragraph (1):
- (a) figures used must be, for *shares* and *debt security* aggregated for the purposes of the gross capital percentage ratio, the aggregate market value of all those shares (or if not available before the announcement, their nominal value) and the issue amount of the *debt security*; and
 - (b) for *shares* and *debt security* aggregated for the purposes of paragraph (3)(b), any *treasury shares* held by the *company* are not to be taken into account.

Figures used to classify assets and profits

- (1) For the purposes of calculating the tests in this Annex, except as otherwise stated in paragraphs (2) to (7), the figures used to classify assets and profits must be the figures shown in the latest published audited consolidated accounts or, if an *issuer* has, or will have, published a preliminary statement of later annual results at the time the terms of a transaction are agreed, the figures shown in that preliminary statement.
- (2) If a balance sheet has been published in a subsequently published interim statement then gross assets and gross capital should be taken from the balance sheet published in the interim statement.
- (3) (a) The figures of the *issuer* must be adjusted to take account of transactions completed during the period to which the figures referred to in (1) or (2) relate, and subsequent completed transactions which the *issuer* would have been required to notify under ■ LR 10.4 or ■ LR 10.5 if the *issuer* had a *premium listing*, provided that for such subsequent completed transactions the figures for the transactions are reasonably available to the *issuer*.
- (b) The figures of the target company or business must be adjusted to take account of transactions completed during the period to which the figures referred to in (1) or (2) relate, and subsequent completed transactions which would have been a class 2 transaction or greater for the purposes of the *listing rules* when classified against the target as a whole, provided that for such subsequent completed transactions the figures for the transactions are reasonably available to the target.
- (4) Figures on which the auditors are unable to report without modification must be disregarded.
- (5) When applying the *percentage ratios* to an acquisition by a *company* whose assets consist wholly or predominantly of cash or short-dated *securities*, the cash and short-dated *securities* must be excluded in calculating its assets and market capitalisation.
- (6) The principles in this paragraph also apply (to the extent relevant) to calculating the assets and profits of the target company or business.

The *FCA* may modify paragraph 9R(4) in appropriate cases to permit figures to be taken into account.

Anomalous results

If a calculation under any of the *related party tests* produces an anomalous result, or if a calculation is inappropriate to the activities of the *issuer*, the *FCA* may modify the relevant *rule* to substitute other relevant indicators of size, including industry-specific tests.

Adjustments to figures

Where an *issuer* wishes to make adjustments to the figures used in calculating the *related party tests* pursuant to 11G they should discuss this with the *FCA* before the *related party tests* crystallise.

The profits test: anomalous results

Paragraph 14R applies to an *issuer* where the calculation under the profits test produces a *percentage ratio* of 5% or more and this result is anomalous.

An *issuer* may, where each of the other applicable *percentage ratios* are less than 5%, disregard the profits test for the purposes of classifying the transaction.