

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

### Explanatory Note

**Date:** 19 February 2009

**Subject:** The requirement to prepare a corporate governance statement under Directive 2006/46/EC.

*The Malta Financial Services Authority invites comments by 5 March 2009 on the draft amendments that have been made to Listing Rules 8.36 to 8.39 in order to transpose Article 1(7) of Directive 2006/46/EC. These amendments are being attached herewith as Appendix A. The documents being circulated are in draft form and consist of proposals. Accordingly these proposals are not binding and are subject to changes and revisions following comments received. Since the attached document includes the input of the Working Committee representing the major stake holders in the industry, which Committee was set up by the Listing Authority to review the Listing Rules, the Authority decided to grant a period of two weeks for purposes of consultation. Interested parties are invited to send their comments in writing addressed to The Deputy Director, Company Compliance Unit, MFSA or via e-mail on [cocomp@mfsa.com.mt](mailto:cocomp@mfsa.com.mt).*

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### Introduction

#### Background

Directive 2006/46/EC (hereinafter referred to as the “Company Reporting Directive”) amends Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings.

#### Corporate Governance Statement

Article 1(7) of the Company Reporting Directive has introduced a new article 46a to Directive 78/660/EEC (Fourth Company Law Directive) that requires companies whose securities are admitted to trading on a regulated market to include a corporate governance statement in their annual report. Currently Listing Rules 8.36 to 8.39 already require issuers listed in Malta to include in their report a statement of compliance providing an explanation of the extent to which they have adopted the Code of Principles of Good Corporate Governance contained in Appendix 8.1 to the Listing Rules. However, the said Listing Rules need to be amended so as to fully transpose the provisions of article 1(7) of the Company Reporting Directive.

A new Listing Rule 8.35a is being proposed which defines the term “national law” for the purposes of the corporate governance statement. This term, according to the amendments

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

being proposed, means the law of the country in which the registered office of the issuer is established.

It is being proposed that Listing Rule 8.36 be substituted by a new rule that contains the general principle, found in Article 46a(1) of the Fourth Company Law Directive, requiring a company whose securities are admitted to trading on a regulated market operating in Malta to prepare a corporate governance statement. Article 46a(1) of the Fourth Company Law Directive requires the corporate governance statement to contain the following minimum information:-

(a) a reference to:-

- (i) the corporate governance code to which the company is subject; and/or
- (ii) the corporate governance code which the company may have voluntarily decided to apply; and/or
- (iii) all relevant information about the corporate governance practices applied beyond the requirements under national law.

Where points (i) and (ii) apply, the company must indicate where the relevant texts are publicly available and where point (iii) applies, the company shall make its corporate governance practices publicly available;

(b) to the extent to which a company, in accordance with national law, departs from a corporate governance code referred to under points (a)(i) or (ii), an explanation by the company as to which parts of the corporate governance code it departs from and the reasons for doing so. Where the company has decided not to apply any provisions of a corporate governance code referred to under points (a)(i) or (ii), it shall explain its reasons for doing so;

(c) a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process;

(d) the information required by article 10(1), points (c), (d), (f), (h) and (i) of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids where the company is subject to that Directive;

(e) unless that information is already fully provided for in national laws or regulations, the operation of the shareholder meeting and its key powers, and a description of shareholders' rights and how they can be exercised; and

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

(f) the composition and operation of the administrative, management and supervisory bodies and their committees.

Paragraphs (a) to (f) of Article 46a(1) of the Fourth Company Law Directive will be implemented through an amendment to Listing Rule 8.37.

Moreover, the introduction of a new Listing Rule 8.36a is being proposed providing that the requirement to prepare a corporate governance statement is not applicable to collective investment schemes, other than the closed-ended type.

### The applicability of Appendix 8.1

The introduction of new Listing Rules 8.36b to 8.36d is being proposed so as to indicate which issuers are required to comply with Appendix 8.1 of the Listing Rules. These draft Listing Rules will provide as follows:-

- (i) If an Issuer is registered in Malta and its securities are admitted to trading on a regulated market operating in Malta, new Listing Rule 8.36b will provide that the Issuer is encouraged to adopt the Principles contained in Appendix 8.1 and require it to prepare a report explaining how it has complied with the provisions of the said Appendix. This will also apply to an Issuer whose securities are only admitted to trading on a regulated market operating in Malta.
- (ii) If an issuer is not registered in Malta but its securities are admitted to trading on a regulated market in Malta as well as on a regulated market in one or more EEA States, the issuer will be given the option to choose to report on its compliance either with Appendix 8.1 or with any other code of corporate governance to which it may be subject.<sup>1</sup>
- (iii) Draft Listing Rule 8.36d refers to an issuer that is not registered in Malta but whose securities are admitted to trading on a market operating in a non-EEA State as well as on a regulated market operating in Malta. Such issuer will be required to report on its compliance with the code of corporate governance to which it is subject and highlight, in such report, the significant ways in which its corporate governance regime differs from Appendix 8.1, unless the Listing Authority determines otherwise following the submission of an application by the said issuer to that effect.

It is our opinion that Appendix 8.1 should be applicable to all issuers registered in Malta and having their securities admitted to trading on a regulated market in Malta. Moreover, it is reasonable to require an issuer whose securities have only been admitted to trading on a regulated market in Malta to endeavour to adopt Appendix 8.1 given that the securities are only traded in Malta.

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<sup>1</sup> New Listing Rule 8.36c.

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

On the other hand, a distinction will be made between EEA and non-EEA States since only those issuers whose securities are admitted to trading on a regulated market in an EEA State (apart from Malta) may choose whether to report on Appendix 8.1 or on any other corporate governance code to which they may be subject. Since all the Member States are required to transpose the Company Reporting Directive, this implies that there should be a level of harmonisation across the EU Member States as regards the content of the corporate governance statement.

With respect to issuers whose securities are admitted to trading on a market in a non-EEA State, it is being proposed that such issuers are allowed to report on the corporate governance code to which they may be subject, provided that they highlight the significant differences between their applicable code and Appendix 8.1. However, in order to retain some flexibility, it is being proposed that the Listing Authority be granted the discretion to exempt a third country issuer from the requirement to highlight such differences.

### Auditors' report on the corporate governance statement

Listing Rule 8.39 (re-numbered as Listing Rule 8.38) will be amended so as to provide that the issuer's auditors are to include a report in the annual report to shareholders on the corporate governance statement.

### Other ways of publishing the corporate governance statement

New Article 46a(2) of the Fourth Company Law Directive allows Member States to permit the minimum information that the corporate governance statement has to contain to be set out (i) either in a separate report published together with the annual report or (ii) by means of a reference in the annual report where such document is publicly available on the company's website. Such provision also states that in the event of a separate report, the corporate governance statement may contain a reference to the annual report where the information required in paragraph 1, points (c) and (d) of article 46a of the Fourth Company Law Directive is made available.

It is being proposed that Malta adopts the option granted by the above provision of the Fourth Company Law Directive and, thus, draft new Listing Rule 8.39 will permit issuers to set out the information required by new Listing Rule 8.37 either in a separate report that is published simultaneously with the annual report or by means of a reference in the annual report where such document is publicly available on the issuer's website.

Moreover, according to Article 46a(2), if the corporate governance statement is published as a separate document, the second subparagraph of article 51(1) of the Fourth Company Law Directive applies to the provisions of paragraph 1, points (c) and (d) of article 46a of the Fourth Company Law Directive. The second subparagraph of

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

article 51(1) requires the statutory auditors to express an opinion concerning the consistency or otherwise of the annual report with the annual accounts for the same financial year. As regards the remaining information referred to in Article 46a(1) of the Fourth Company Law Directive, the statutory auditor has to check that the corporate governance statement has been produced.

This provision will be transposed in the new draft Listing Rule 8.39a. The said Listing Rule will provide that, if the corporate governance statement is contained in a separate report, such statement would have to include the auditors' report on such statement as well as an opinion of the auditors concerning the consistency or otherwise of the information prescribed by paragraph 1, points (c) and (d) of article 46a of the Fourth Company Law Directive (to be transposed in draft Listing Rules 8.37.4 and 8.37.5) with the annual report for the same financial year. This means that the issuer's auditors will always prepare a report on the corporate governance statement, irrespective of whether such statement is contained in the annual report or is published in a separate report.

### Exemption from the corporate governance statement requirement

Subarticle (3) of Article 46a of the Fourth Company Law Directive allows the Member States to exempt companies that have only issued securities other than shares admitted to trading on a regulated market from the application of the provisions of paragraph 1, points (a), (b) (e) and (f) of Article 46a, unless such companies have issued shares which are traded in a multilateral trading facility, as defined in Article 4(1), point (15) of Directive 2004/39/EC.

It is being proposed that we adopt this exemption and subarticle (3) of Article 46a of the Fourth Company Law Directive will be implemented by new Listing Rule 8.39b.

### Transitional period

It is being proposed that those Issuers whose securities are already admitted to trading be granted a transitional period to comply with the above. Therefore any changes that would need to be carried out so that the Corporate Governance Statement complies with the new Listing Rules would need to be included in the Annual Report to be laid before the annual general meeting due to be held in 2010.

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

### Other amendments to the Listing Rules

Article 41(1) of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts provides that:

“Each public-interest entity shall have an audit committee. The Member State shall determine whether audit committees are to be composed of non-executive members of the administrative body and/or members of the supervisory body of the audited entity and/or members appointed by the general meeting of shareholders of the audited entity.”

This article is already transposed in Listing Rule 8.56 as follows:

8.56 The Issuer shall establish and maintain an audit committee of at least three (3) members all of whom shall be directors. The majority of such members shall be non-executive...”

It is being proposed that Listing Rule 8.56 is slightly amended so as to clarify the drafting and remove any doubts as to whether the audit committee should be composed entirely of directors of the listed entity.

It is therefore being proposed that Listing Rule 8.56 is amended as follows:

The Issuer shall establish and maintain an audit committee composed entirely of Directors and having at least three (3) members. The majority of such members shall be non-executive Directors. At least one member of the audit committee shall be independent and shall be competent in accounting and/or auditing. The committee shall be chaired by a non-executive Director.

It is being proposed that this amendment will come into immediate effect once approved by the Listing Authority.

## **Appendix A**

### *Corporate Governance*

- 8.35a For the purposes of this section:  
“national law” means the law of the country where the registered office of the Issuer is established.
- 8.36 An Issuer whose securities are admitted to trading on a Regulated Market operating in Malta shall prepare a corporate governance statement in terms of Listing Rule 8.37.
- 8.36a This section is not applicable to Collective Investment Schemes, other than the closed-ended type.
- 8.36b An Issuer registered in Malta and having securities admitted to trading on a Regulated Market operating in Malta should endeavour to adopt the Principles outlined in Appendix 8.1 to this Chapter and shall prepare a report explaining how it has complied with the provisions of the said Appendix. The same rule shall also apply to an Issuer whose securities are only admitted to trading on a Regulated Market in Malta.
- 8.36c An Issuer not registered in Malta but whose securities are admitted to trading on a Regulated Market operating in Malta as well as on a Regulated Market operating in one or more EEA States shall have the option to report on its compliance either with Appendix 8.1 or with any other code of corporate governance to which it may be subject.
- 8.36d An Issuer not registered in Malta but whose securities are admitted to trading on a market operating in a non-EEA state as well as on a Regulated Market operating in Malta shall report on its compliance with the code of corporate governance to which it is subject and highlight, in its report, the significant ways in which its corporate governance regime differs from Appendix 8.1, unless the Listing Authority determines otherwise following the submission of an application by such Issuer to that effect.
- 8.37 Issuers shall include in a specific section of their Annual Financial Report a corporate governance statement which shall contain at least the following information:
- 8.37.1 a reference to the corporate governance code to which the Issuer is subject; and/or a reference to the corporate governance code which it may have voluntarily decided to apply, together with an indication of the place where the texts are available to the public; and/or
  - 8.37.2 all relevant information about the corporate governance practices applied beyond the requirements under national law;
  - 8.37.3 to the extent to which an Issuer departs from a corporate governance code referred to in Listing Rule 8.37.1, an explanation by the Issuer as to which parts of the corporate governance code it has departed from and the reasons for doing so and where the Issuer has decided not to apply any provisions of a corporate governance code referred to in Listing Rule 8.37.1, it shall explain its reasons for doing so;
  - 8.37.4 a description of the main features of the Issuer’s internal control and risk management systems in relation to the financial reporting process;

- 8.37.5 the information referred to in Listing Rules 9.43.3, 9.43.4, 9.43.6, 9.43.8 and 9.43.9, where applicable;
- 8.37.6 the manner in which the general meeting is conducted and its key powers together with a description of shareholders' rights and how they can be exercised; and
- 8.37.7 the composition and operation of the Board of Directors or equivalent body, of the audit committee and of any other committee that may be established by the Board.
- 8.38 The Issuer's Auditors are to include a report in the annual report to shareholders on the corporate governance statement.
- 8.39 An Issuer may elect to set out the information required by Listing Rule 8.37 in a separate report published together with the annual report or by means of a reference in the annual report where such document is publicly available on the Issuer's website. In the event of a separate report, the corporate governance statement may contain a reference to the Annual Financial Report where the information required in Listing Rules 8.37.4 and 8.37.5 is made available.
- 8.39a Where the corporate governance statement is contained in a separate report, such statement shall include the Auditors' report referred to in Listing Rule 8.38 and, in addition to this, the Issuer's Auditors shall express an opinion concerning the consistency or otherwise of the information referred to in Listing Rules 8.37.4 and 8.37.5 with the Annual Financial Report for the same financial year. For the remaining information that is required to be disclosed under Listing Rule 8.37, the Auditors shall check that the corporate governance statement has been produced.
- 8.39b Issuers that only issue Securities other than Equity Securities shall be exempt from the requirement to disclose in their corporate governance statement the information prescribed by Listing Rules 8.37.1 to 8.37.3, 8.37.6 and 8.37.7, unless such Issuers have issued Equity Securities which are traded in a multilateral trading facility in terms of Article 4(1), point (15) of Directive 2004/39/EC.