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Response to the Consultation Document on the Implementation of the Acquisition Directive

The City of London Law Society (CLLS) represents over 13,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response to the consultation document issued jointly by HM Treasury ("HMT") and the Financial Services Authority ("FSA") on the implementation of the Acquisitions Directive (the "Directive") has been prepared by the Regulatory Committee. The Committee is made up of a number of solicitors from City of London firms who specialise in regulatory law. Members of the Regulatory Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

In preparing this response we have had the benefit of seeing draft responses prepared by the Law Society Company Law Committee (the "Law Society response") and by the Financial Services and Markets Legislation City Liaison Group and fully endorse comments made in those responses. We understand that the Law Society response will incorporate detailed drafting comments on the text of the proposed legislation and FSA Handbook and therefore we do not propose to do the same here.

Key issues

The key issues that we believe the proposals raise are:

1. HMT's view of how exemptions for market-makers and trading book positions should be interpreted deprives them of any meaningful application in the absence of a threshold set below 10%. We do not believe this can have been intended.

   We also think that it would be consistent with the wording and the objectives of the Directive and the approach taken in the Disclosure and Transparency Rules ("DTR") to amend the Financial Services and Markets Act 2000 ("FSMA") to allow a trading book holding of less than 5% or a market-making holding of less than 10% to be disregarded for the purpose of determining whether the 10% threshold (or any other control threshold) has been reached. Disregarding these holdings would mean, for example, that the 10% control

threshold would not be reached in a case where an investment firm holds 4% of a bank's shares in its trading book, 9% of the shares in the capacity of market-maker and 7% of the shares outside its trading book in some other capacity. We believe that the approach to these exemptions proposed by HMT and the FSA is likely to constitute a failure to implement the Directive according to its terms and that sections 178A and 422 should be amended accordingly.

2. Proposals not to elaborate on the meaning of "acting in concert" are unhelpful, in particular, given the intention to increase criminal sanctions attached to a breach. Although it seems clear from the drafting of the Directive that this concept should be interpreted more widely than the concert party arrangements which fall within Article 10(a) of the Transparency Directive ("TD") (replicated in proposed new section 422(6)(a)), the definition put forward in draft guidance published by the three Lamfalussy Level 3 committees (the "Level 3 Guidance") lacks the certainty needed to provide practical guidance for proposed transactions.

   In particular, greater clarity is needed, consistent with the terms of the Directive and the context in which the expression is used, that the term "acting in concert" is about **acquiring** shares, not about those who already hold shares and come together (compare Article 10(a) TD). Otherwise, shareholders of a company may feel constrained not to discuss with each other the exercise of their voting rights in a way that is entirely proper and should be encouraged as the legitimate exercise of shareholder rights.

   We would encourage HMT and the FSA to revisit whether a clearer definition of "acting in concert" should be included in FSMA itself, and, if not, whether this is an issue that might be addressed in FSA and/or industry guidance.

3. We believe that greater consistency is needed across the EU in how the word "indirect" is interpreted in the context of a "direct or indirect holding" in the relevant authorised entity (see section 179). The UK's approach that a holding in a parent undertaking is an indirect holding in its regulated subsidiary undertaking has some advantage in terms of certainty. However, we believe that a different approach is applied in a number of member states, which means that the categories of controller are more limited. The Law Society response deals with this issue in greater detail.

4. Sections 178(2) and 190(2), which impose a notification requirement on a person who acquires or reduces control in circumstances where a pre-notification requirement is not triggered, are not provided for by the Directive. We question whether they should be deleted on the basis that the Directive is a maximum harmonisation measure.

5. The ability of the FSA to adapt the list of information required from an applicant for controller approval in a way that is proportionate to the proposed transaction should be entrenched in FSMA.

6. It remains unclear whether the Directive prohibits acquisitions from taking place before approval has been obtained. We understand that, elsewhere in the EU, it may be possible to proceed with an acquisition prior to the notification period having expired or the competent authority having given its approval without the risk of a criminal sanction, on the basis that the competent authority could subsequently require the transaction to be

unwound. There is some merit in this approach (at, for example, 10%) from the point of view of not impeding market operations.

7. In terms of non-Directive firms, we support the introduction of a simplified regime. A single 20% threshold has the advantage of being consistent with both the close links rules and the controller regime applying to insurance intermediaries under the Insurance Mediation Directive ("IMD").

8. We believe that transitional arrangements for bringing the changes into force are inconsistent with the Directive and need amending.

9. We would encourage the FSA to undertake a full review of its proposed Handbook text. In particular, we note that this part of the FSA Handbook will need to be understood by those who are not authorised by the FSA, who cannot be assumed to have the same degree of familiarity with the Handbook as those working in the industry.

Specific consultation questions

Question 1: Do you have any comments with regard to the draft Statutory Instrument set out at Annex C?

We have the following comments on the draft SI, including proposed amendments to FSMA.

Transitional arrangements – Regulation 6 of the SI appears to be inconsistent with Article 8(2) of the Directive, which provides that notifications of proposed changes of control that are submitted before 21 March 2009 (assuming this to be the date that the new regime takes effect in the UK) should be assessed under the regime applying at the date of notification.

Section 178 (Obligation to notify the Authority: acquisitions of control) – In addition to our comment on section 178(2) above, the proposed drafting of section 178(1) does not make it clear that notification is only required before the proposed acquisition takes place and not before the decision to acquire is taken. We would suggest removing the word "first" and inserting the words "before making the acquisition" at the end of this subsection. A similar concern applies in relation to section 190(1).

In sections 178(1) and (2) (and see section 188 for similar), the words "(whether alone or acting in concert)" are unnecessary given that the concept of "acting in concert" is already incorporated into the definitions of control and increased/reduced control in sections 179, 180 and 181. We also question, however, whether the phrase "whether acting alone or in concert" makes sense as it is currently applied in those definitions to the holding of shares or voting power. We note the proposal in paragraph 3.4(g) of the Law Society response, which we believe is helpful.

Section 182 (Notification) - Section 182(2) should make clear that the FSA has power to waive the requirements for any information/documents listed. This is important as the information requirements established by the Level 3 Guidance are highly prescriptive and the Directive establishes a clear requirement for them to be applied proportionately. For example, we think there is a strong case for reducing the amount of information required where one or more regulated entities happen to be a small part of what is in effect a largely unregulated group. An example would be an oil and gas producing business that happened to have a small investment firm entity within its group to undertake commodity derivatives business.

Section 183 (Duty of Authority to decide the application) - Section 183(6), which provides that approval is treated as having been given if the FSA has failed to comply with any of its procedural requirements under section 183, appears too wide. It would mean, for example, that a failure to comply fully with requirements to consult other supervisory authorities would preclude the FSA from objecting to a change of control regardless of concerns it may have under the relevant prudential criteria. A similar result would follow from a failure to serve a warning notice within two days of its determination. The only requirement in the Directive in this regard is that approval is deemed to have been given if the relevant supervisory authority does not oppose the proposed acquisition within the assessment period in writing. Based on this provision, perhaps deemed approval should instead follow from a failure to issue a warning notice within the assessment period.

Section 185 (Approval with conditions: further provisions) - We consider that the FSA's power to impose conditions on a proposed acquisition should be limited to conditions that are justified by reference to section 184(1).

Section 189 (Restriction notices) - Section 189 does not deal satisfactorily with a case of an indirect acquisition of shares in either a UK or non-UK holding company of an authorised person. For example, section 189(3) appears only to apply to shares in the authorised person and not to shares in the parent undertaking of the authorised person. (The existing section 189 is unclear on this issue as well). In addition, it does not deal adequately with attributed voting power i.e. where the shares are not held by the person in question but are attributed to it. The following changes may help:

- insert "in a UK authorised person or the parent undertaking of a UK authorised person" after "shares" in line 2 of section 189(1) (a similar amendment would be required to section 189A(1)); and

- change the end of section 189(3) so that it reads "...shares in the UK authorised person or the parent undertaking of the UK authorised person held by the person in question (or any person acting in concert with that person or any person whose voting power is treated as held by that person by virtue of section 422(6))." In this respect, we note the use of the words "concerted exercise" in section 422(6)(a)(i).

These changes reflect the need to ensure that the FSA has proper powers to freeze shares held by unwanted acquirers. Nonetheless, we accept that it is not clear how jurisdictional issues raised by applying the restriction to shares in a non-UK parent undertaking could be resolved.

Section 422 (Controller) - In relation to section 422, we support comments made in the Law Society response in relation to the definition of "voting power", including the suggestion that guidance equivalent to that at DTR 5.2.2G(3) would be helpful.

In Section 422(6)(a)(v) - the reference to undertakings "controlled by" H needs to make clear that "control" for these purposes is in accordance with the definition in article 2(1)(f) TD (as to which please see the drafting provided in the Law Society response).

Question 2: Do you have any comments with regard to the changes the FSA propose to make to its Handbook as set out at Annex D?

For reasons described in the Law Society response, we believe that parts of the FSA Handbook that deal with the controller regime would benefit from being substantially rewritten. We also agree with detailed drafting comments contained in that response.

Question 3: Do you agree that the UK should have a threshold at 30 per cent (rather than 33 per cent)?

We agree that this is a helpful change because it brings the controller regime more closely in line with the Takeover Code and with disclosure requirements derived from the TD.

Question 4: Do you agree that it should be possible to stop the clock for 30 days in the case of non-authorised and non-EC acquirers?

We agree that this should be possible, subject to the overriding requirement that stopping the clock should be proportionate in any given case.

Question 5: Do you agree with the respondents to the previous consultation and hence with the Government's proposal to simplify the regime for non-directive firms by having a single threshold at 20 per cent?

We agree with the proposal that non-directive firms should be subject to a simplified regime and that 20% is an appropriate threshold to set for these purposes.

Question 6: Would you find it helpful if the provisions concerning acquisitions of holdings in investment exchanges were amended to improve consistency with the regime for other financial institutions?

We support the proposed changes on the basis that they are intended to improve consistency.

Question 7: Do you agree that £5000 is not a sufficient deterrent and therefore there should be the possibility of an unlimited fine after a trial by jury?

We agree that the threat of a £5000 fine is likely to have little effect as a deterrent in this context. However, we are concerned about any increase in the criminal penalties attached to breach of the regime in the absence of greater clarity about the meaning of the term "acting in concert" (see comments above).

Structurally we would prefer the prohibitions to be formulated as FSA rules made under statutory authority (like the voteholder disclosure rules in the DTR) so that FSA has the relevant enforcement powers and can impose (unlimited) administrative fines. This would be preferable as it would better enable the FSA to assist market participants through interpretation of the relevant provisions (as they would be FSA rules). Arguably, this structure would also provide a more credible deterrent than criminal prosecution. In particular, it may be more effective to deter non-UK market participants from contravention because of the FSA's ability to use civil enforcement remedies against UK assets. It would also be in line with the approach taken in the DTR as regards the parallel issue of voteholder notifications.

Question 8: Do you agree with the proposed approach to restriction notices and orders for sale?

See our comments on section 189 in response to Question 1 above.

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