FSA CONSULTATION PAPER CP10/10 CHAPTER 10: PROPOSED CHANGES TO THE CONTROLLERS REGIME IN THE SUPERVISION MANUAL: GUIDANCE ON AGGREGATION OF HOLDINGS FOR THE PURPOSE OF PRUDENTIAL ASSESSMENT OF CONTROLLERS

JOINT RESPONSE OF THE LAW SOCIETY AND THE CITY OF LONDON LAW SOCIETY

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1. INTRODUCTION

1.1 This response is a joint response from The Law Society and the City of London Law Society ("CLLS").

1.2 The Law Society is the representative body for over 100,000 solicitors in England and Wales and negotiates on behalf of the profession and lobbies regulators, governments and others.

1.3 The CLLS represents approximately 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. Members of the CLLS Regulatory Committee advise a wide range of firms in the financial markets.

1.4 This response has been prepared by the Society's Standing Committee on Company Law and the Regulatory Committee of the City of London Law Society. This response is supported by the Law Reform Committee of the General Council of the Bar.

1.5 This document uses the FSA's numbering for ease of reference. In addition to commenting on the proposed changes to Chapter 11 of the Supervision

Manual, we are also raising a number of issues in relation to Part XII Financial Services and Markets Act 2000 (***FSMA***) which could usefully be addressed when a legislative opportunity arises. These issues are set out in Section 4.

2. SUMMARY OF KEY COMMENTS

2.1 Our principal comments are as follows:

(a) given its context in the various directives amended by the Acquisitions Directive and the purpose of the "qualifying holdings" provisions in those directives and the controller regime more generally, we are firmly of the view that the "acting in concert" wording is designed to capture situations where two or more persons act together in their acquisition of, and the ongoing exercise of rights relating to, an interest in a financial services firm. Each acquirer is attributed with the shares or voting power held by the other because of their continuing relationship with each other. It follows from this that an agreement should have three key elements if the parties to it are to be treated as "acting in concert" for the purposes of Part XII FSMA:

(i) the contemplated acquisition of shares or voting power;

(ii) the imposition of restrictions on the parties to the agreement in relation to the exercise generally (rather than on specific issues) of the voting power, or the rights attaching to shares, held by them (including those so acquired); and

(iii) an ongoing or durable nature.

In this regard, the approach in the answer to Question 5 in the proposed guidance is helpful, since it recognises the second and third elements above. However, we strongly disagree with the FSA's approach in the proposed guidance in relation to the first element above. The concept of "acting in concert" is <u>not</u> relevant in a situation where parties who already hold relevant shares or voting power simply come together to act in relation to their respective holdings. The question in this

situation is whether the parties have made an agreement within section 422(5)(a)(i) FSMA (a ***Common Policy Agreement***) rather than whether they are acting in concert. As a matter of law, the "acting in concert" concept must be interpreted and applied in a manner consistent with the Acquisitions Directive, which is a maximum harmonisation directive. Our view regarding the first element is clearly supported by the wording of the various directives amended by the Acquisitions Directive, the CESR/CEIOPS/CEBS "Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC" (the ***Guidelines***) and, against this background, the drafting of section 178 FSMA itself. It is also a more helpful approach than that in the guidance from the point of view of shareholder engagement with companies and the responsibilities of institutional investors. It would allow institutional shareholders to engage with companies for corporate governance reasons without having to be concerned about whether there is an acting in concert issue. If the "acting in concert" concept is not interpreted and applied in a manner which is consistent with the Acquisitions Directive, it will make it much harder for shareholders to do so;

(b) for the reasons indicated above, we also strongly disagree with the FSA's approach to the analysis of "acting in concert" in another key respect. In section 178 FSMA, the expression "acting in concert" is **not** designed to catch situations where two or more persons come together solely to acquire ownership but (following that acquisition) make ownership and voting decisions separately. In a number of places (for instance, the answer to Question 14), the guidance incorrectly focuses on matters which are not relevant, such as the manner of acquisition and the arrangements relating to that acquisition. Instead, the guidance needs to concentrate (as in the answer to Question 5) on the proposed ongoing relationship between the parties following an acquisition;

(c) we do not believe that parties to restrictions on the transfer of shares are acting in concert merely by being party to such restrictions. As indicated above, "acting in concert" implies an agreement to act together in the ongoing exercise of rights relating to an interest in a financial services firm - i.e. an ongoing 'control' arrangement. We do not see how, on any purposive interpretation of the expression "acting in concert" in the context of the controller regime, an agreement to restrict the transfer of shares could, by itself, constitute such an arrangement. If it were to be regarded as such, this would lead to an impracticable and unnecessary extension of the controller regime, given the prevalence of transfer restrictions in private company articles, joint venture agreements and similar agreements relating to limited liability partnerships and other entities.

2.2 These issues are commented upon in more detail below.

2.3 We believe that the FSA's approach is out of line with the approach taken in other European jurisdictions. This is likely to bring added complexity and conflicting advice on cross border transactions. Freshfields Bruckhaus Deringer has surveyed the position in several other EU member states: Austria, Belgium, France, Germany, Italy, Netherlands and Spain. The result is that these Member States see "acting in concert" as relevant only in the context of an acquisition or interpret the expression consistently with their implementation of Article 10(a) of the Transparency Directive, so that the acquisition issue is academic as there is no distinction between "acting in concert" and a Common Policy Agreement.

2.4 As indicated above, we disagree with some key aspects of the analysis in the paper and do not believe it to be consistent with the Acquisitions Directive. In any event we consider that the FSA should have conducted a cost benefit analysis since we believe that, if the FSA maintains the view expressed under Question 14, then there will be a material new burden and firms and the FSA will face significant additional costs, compared with the position which would arise under the approach which we believe to be correct. Firms and their

advisers will have to consider a significant number of people as potential controllers, with the attendant need for advice and completion of forms (which themselves are complex). There will be more questions to the change of control team and a significant amount of processing required. We think the FSA should have taken more steps to understand the likely impact of its proposals, on the FSA as well as on firms. The members of our Committees, based on their experience of transactions, consider the amount of work (and related cost) that will be required will be considerable.

3. DETAILED COMMENTS

SUP11.3.1A G

3.1 This paragraph rather overstates the extent of the proposed guidance, as it currently stands. The guidance very much focuses on "acting in concert" and says little about the provisions of section 422(5)(a) FSMA, even those of Common Policy Agreements, despite their similarity to the concept of "acting in concert". Further, we do not think it helpful to refer to section 422(3) FSMA, which has no relevance to the obligation to notify in section 178, which does not use the word "controller".

3.2 As a matter of drafting, in the second line of SUP11.3.1A G "that" should be substituted for "those".

SUP11 Annex 6 G

Question 1

3.3 We suggest the relevant part of the answer to this question is amended to read "as a result of this aggregation, *one or more persons* needs to give notice to the FSA in writing in accordance with section 178 of the Act *before an acquisition is made*", for reasons explained by our comments in paragraph 3.8 in relation to the answer to Question 3.

3.4 It would be helpful if the guidance could state that there is no obligation to notify under section 178 FSMA if a person acquires a holding of shares or voting power above the threshold level passively (e.g. through a reduction in

share capital by the company) rather than by making a *decision* to acquire or increase control, since this is a change from the position prior to implementation of the Acquisitions Directive. This would be especially useful as paragraph 12 of the Guidelines suggests otherwise.

3.5 The answer to Question 1 indicates, correctly, that the proposed guidance addresses the aggregation of shares or voting power in the context of determining whether a notification obligation arises under section 178 FSMA. However the guidance refers in a number of places to "controllers" in a way which is confusing and, in some respects, circular. The expression "controller" is not used in Part XII FSMA in the context of the obligation to notify[1]. Moreover, it is possible for a person to become a controller without coming under an obligation to notify under section 178 FSMA, so a "controller" is not necessarily under an obligation to notify. It would be preferable for the guidance to use different terminology when referring to persons who come under an obligation to notify. This is commented on more specifically below in the context of relevant sections of the guidance.

Question 2

3.6 It would be helpful if this answer made clear that where one has an acting in concert situation or a Common Policy Agreement, then all those with shares/voting power who are party to the relevant agreement are deemed to hold each other's shares/voting power but that, in all other situations under section 422(5)(a) FSMA, the deeming operates in one direction only. Further, it would be useful if the guidance could clarify that, where a subsidiary undertaking[2] is a party to a concert party agreement, its parent undertaking is **not** deemed to hold the voting power the subsidiary is deemed to hold under the concert party agreement (this contrasts with the position where the subsidiary undertaking is party to a Common Policy Agreement).

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[1] The expression is used only in section 184(8), and even here its use is incorrect. See paragraph 0.

[2] Note that, in the context of s.422, there is an over-implementation of the Acquisitions Directive in relation to the use of the expression "subsidiary undertaking", in that the definition of "subsidiary undertaking" in the FSMA is wider than required under the Acquisitions Directive, which is a maximum harmonisation directive. See paragraph 4.1.

3.7 It would also be helpful to make clear that it is only shares to which any agreement to act in concert or any matter falling within the deemed voting power provisions actually relates which need to be aggregated. A financial institution with a wide spread of businesses in one corporate entity might hold other shares which are not covered and which should not be deemed held by its concert party (or person with whom it has a Common Policy Agreement).

Question 3

3.8 The first and last sentences of the answer to this question are accurate, but we do not think the remainder of the answer is helpful. First, as indicated in paragraph 3.1, section 422(3) FSMA is not relevant to section 178 FSMA. Second, we do not believe it is correct to say that the "something" is the "holding or acquiring of shares or voting power". For the reasons set out in paragraph 3.11, an agreement should only be a "concert party agreement" if it contemplates an acquisition by one or all of the parties to it. Further, it is wrong to focus solely on the acquisition, rather than also on the ongoing purpose or object of the agreement. The "something" should be the acquisition of shares or voting power coupled with an agreement in relation to the ongoing exercise of rights relating to the shares or voting power held by the parties to the agreement (reflecting the approach in the first paragraph of the guidance in answer to Question 5). The expression "acting in concert" needs to be interpreted in context. In our view, other provisions of the underlying directives - for instance, the "qualifying holding" definition which refers to the ability to "exercise a significant influence over the management of [a firm]" - provide pointers to the aim or objective a concert party agreement needs to have.

3.9 Section 178 FSMA requires a notification to be made before a person decides to acquire (or increase) their shareholding or voting power to or over a requisite threshold, because the regulator needs to approve the person before the person acquires control or increases their level of control. However, the assessment of whether that person is under an obligation to notify must be by reference to the expected position upon completion of the relevant acquisition,

rather than at the time that the obligation to make the notification arises. In other words, persons can co-operate to implement an acquisition of shares or voting power but if, following the acquisition, there will not be any agreement between them relating to the ongoing exercise of their voting power or rights attaching to their shares, those persons are not, for the purposes of section 178 FSMA, "acting in concert" to obtain control (or, in the words of the underlying directives, to acquire or increase a qualifying holding). It cannot be assumed that persons who come together to effect an acquisition will continue to act together post-acquisition (contrast the answer to Question 14).

3.10 This interpretation is consistent with the purpose of the legislation. The controller regime is designed to permit regulatory authorities to scrutinise the fitness and properness of persons who will exercise a certain level of control or influence over a regulated firm. A 10 per cent. shareholding, or control of 10 per cent. of the voting power, is treated as the threshold at which a person can exercise such control[3]. The "acting in concert" definition is to ensure that shares and/or voting power acquired by different persons, but under an agreement which obliges those persons to act together in relation to the their shares or voting power (such that they are, in effect, like a single holding), are aggregated. This prevents persons who in fact have control over a 10 per cent. or larger block from avoiding the requirement to be approved by the relevant regulatory authority because each person individually acquires less than the 10 per cent. threshold.

Question 4

3.11 We do not agree with this answer. In our view, there is no "acting in concert" unless there is an acquisition in prospect and that acquisition is contemplated by the agreement between the parties. The Acquisitions Directive (using the amendments to the Markets in Financial Instruments Directive as an example), states that (emphasis added):

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[3] Although it is noted that a lower level of shareholding or voting power could still result in a person being a controller if that holding or voting power permits the holder to exercise a significant influence over the management of the regulated firm.

"*Member States shall require any natural or legal person or such persons acting in concert (hereinafter referred to as the proposed acquirer), who have taken a decision either to acquire, directly or indirectly, a qualifying holding in an investment firm or to further increase, directly or indirectly, such a qualifying holding in an investment firm.....*"

It is also clear from section 178 FSMA, which talks in sub-section (1) of a person deciding to "acquire or increase control": the "acting in concert" concept in sub-section (2) only applies "for the purposes of calculations relating to [sub-section (1)]". The "acting in concert" provisions in section 422(3) FSMA are not relevant to the main operating provisions of Part XII, as the legislation does not, in these provisions use the expression "controller" defined in section 422[4].

The Guidelines provide (so far as relevant and emphasis added):

"In the particular context of Directive 2007/44/EC, persons are 'acting in concert' when each of them decides to exercise his rights linked to the shares he acquires in accordance with an explicit or implicit agreement made between them".

In other words, where existing holders of shares or voting power come together in relation to a financial services firm, but their agreement falls short of a Common Policy Agreement, it is not relevant to section 178 FSMA unless that agreement contemplates that one or more of them will acquire shares or voting power in that firm and one or more them in fact does so pursuant to that agreement[5]. This is consistent with the approach the Takeover Panel takes to acting in concert (see Practice Statement no 26) and also with section 824 Companies Act 2006[6].

3.12 As a matter of law, the "acting in concert" concept must be interpreted and applied in a manner consistent with the Acquisitions Directive. The directive is a maximum harmonisation directive and, accordingly, it is not open to the

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[4] See paragraph 3.5

[5] As the final sentence of the answer to Question 4 acknowledges, a person cannot be a concert party unless they hold shares or voting rights in a relevant entity (or will do so on implementation of the relevant agreement).

[6] Formerly section 204 Companies Act 1985

FSA (or the UK courts) to apply the wider interpretation reflected in the answer to Question 4. Moreover, this wider interpretation is seemingly at odds with the approach adopted in other EU member states (as indicated in paragraph 2.3 above).

3.13 Interpretation in line with the Acquisitions Directive is much more helpful from the point of view of shareholder engagement with companies and the responsibilities of institutional investors, than that advanced in the proposed guidance. See also our further comments on Question 5 in paragraph 3.18.

3.14 Further, if the interpretation that "acting in concert" applies even where existing shareholders come together without contemplating an acquisition were to be correct, section 422(5)(a) FSMA would be redundant, as it would be encompassed by "acting in concert".

3.15 The answer to Question 4 refers to the aggregation provisions relating to the prudential regulation of controllers, as defined in section 422 FSMA. As indicated in paragraph 3.5, in the context of the proposed guidance reference to controllers is confusing. It would be preferable for the reference to be to persons who decide to acquire or increase control.

Question 5

3.16 As indicated above, we are strongly of the view that an agreement should have three key elements if the parties to it are to be treated as "acting in concert" for the purposes of Part XII FSMA:

(a) the contemplated acquisition of shares or voting power;

(b) the imposition of restrictions on the parties to the agreement in relation to the exercise generally (rather than on specific issues) of the voting power, or the rights attaching to shares, held by them; and

(c) an ongoing or durable nature.

3.17 We regard the answer to Question 5 as being helpful on the second two of these key elements; that is, the need for an ongoing agreement between parties

in relation to the exercise of their rights following an acquisition if they are to be treated as "acting in concert". However, as regards the question and the first paragraph, references to "holding" shares or voting power need to be deleted, for the reasons given in relation to the answer to Question 4.

3.18 The second paragraph is clearly designed to address concerns raised by institutional shareholders about their responsibilities and joint engagement with investee companies, which were not fully allayed by Sally Dewar's letter of 19 August 2009 to the ABI. We agree with the views expressed in this paragraph, which indicate that a concert party agreement needs to have an element of durability. It might make more sense to move the last sentence into Question 11, rather than dealing with the same point in two separate places.

3.19 We assume that the answer to Question 5 holds good even in circumstances where the shareholders who engage in the concerted exercise of voting power agree to acquire shares or voting power in order to vote on a specific issue. It would be helpful to make this clear in the guidance.

3.20 It would also be helpful if the guidance could state that parties entering into irrevocable undertakings to vote on resolutions at a specific shareholder meeting would not be treated as acting in concert. This is consistent with the approach indicated in the answer to Question 5 but we consider would be worth mentioning given the difficulties with such undertakings which arose under Part XII prior to implementation of the Acquisitions Directive.

Question 6

3.21 We would be interested to know what the "wider issues" referred to in the second sentence of this answer are, bearing in mind that the Acquisitions Directive is a maximum harmonisation directive, although we accept that the Guidance does not expressly address Common Policy Agreements. We do not really understand what the third and later sentences are intended to convey. In particular, we would not agree that all rights linked to shares are rights which, if the subject of an agreement between shareholders relating to their exercise, would result in the parties "acting in concert" for the purposes of Part XII

FSMA. For instance, conversion rights attaching to shares which would, on exercise, covert the shares into another class of share, we would not see as being rights which, if the subject matter of an agreement, would constitute that agreement as a concert party agreement.

Question 7

3.22 We suggest it may be preferable to use different examples here. First, a Common Policy Agreement is different from all the other provisions of section 422(5)(a) FSMA in that it is not a unilateral deeming provision: it operates in both directions. Second, we do not believe that voting power held by virtue of a "temporary transfer for consideration" is familiar in UK markets and it would be better to use a more comprehensible example.

3.23 We also suggest that it would be helpful for the guidance to incorporate the guidance given in DTR5.2.2G and relevant guidance elsewhere in the DTRs so that this is applicable also to Part XII FSMA. For instance, DTR5.8.5G helpfully provides that "a proxy which confers only minor and residual discretions (such as to vote on an adjournment) will not result in the proxy holder (or shareholder) having a notification obligation".

3.24 Further, it might also be useful for the guidance to say that the Level 2 measures which apply under the Transparency Directive are a sufficient, but not a necessary, condition to the application of exemptions/provisions in Part XII derived from that directive and also to explain how it considers that Part XII applies in relation to outright transfer collateral and securities borrowing/lending (things which were thought sufficiently difficult in relation to the Transparency Directive to be expressly addressed in DTR5).

Question 8

3.25 We think this answer needs to be slightly more expansive. It needs to note the limitations to the deeming provision: certain kinds of interest held by a subsidiary are **not** deemed to be those of its parent under section 422(5)(a)(v) FSMA, including importantly, the interests held by a UCITS manager or an asset manager (see section 184(7) and (9) and DTR5.2.2G). Further, we are of

the view that interests a subsidiary is taken to hold because it is acting in concert, are not deemed to be interests of its parent under section 422(5)(a)(v). It would be helpful for this point to be dealt with in the guidance.

3.26 For the reasons indicated in paragraph 3.5, we think that it would be helpful, in the context of the issues being addressed by the proposed guidance for Question 8, and the answer, to address the circumstances in which a subsidiary's acquisition of 10% of the voting power in a firm will put the parent, H, under a notification obligation under section 178, rather than referring to the subsidiary's 10% holding making H a controller.

3.27 It would also be useful for the guidance to make clear that, in order for the parent, H, to come under a notification obligation, it would need to participate in the subsidiary's decision to acquire the relevant holding and to distinguish a situation in which the parent has no involvement in the decision and is entirely passive in the process, in which case the parent would not come under the section 178 notification obligation. This may, for example, occur if the subsidiary is a remote, indirect subsidiary or if the decision by the subsidiary to acquire is made behind an information barrier and the parent has not been taken over the information barrier in relation to that decision.

Question 9

3.28 This seems a slightly pointless question, given the lack of detail, and could be swept up into the answer to question 7. The expression "managed funds" should be avoided and "assets under management" used instead.

Question 10

3.29 This seems to be a rather badly phrased question. First "new" is open to two interpretations - "shares they do not already own" or "unissued"[7]. To the extent this answer suggests that there is no need for an acquisition of shares or voting power not already owned, as explained in relation to Question 4, we strongly disagree with this view in so far as it relates to the "acting in concert"

[7] Under section 422, shares need to be allotted to be caught.

provisions. Second, the answer could helpfully say that an agreement which is conditional upon FSA consent does not breach section 178 ("binding" is not a helpful word to use, as the agreement likely will be binding at this stage, albeit conditional). Although this point is also addressed in the answer to Question 15, that answer equally does not address the point in a helpful way. It might also be worth the guidance saying something here (or in the answer to Question 15) about the need to consider undertakings put in place between exchange and completion, to ensure that a potential acquirer does not come under a separate notification obligation as a result of such undertakings.

Question 11

3.30 Part of this answer suggests that the acting in concert provisions do not require an acquisition. We disagree with this, as explained in relation to the answer to Question 4 above. Also, we consider that the second sentence is a truism, not helpful to the point being made and should be deleted.

Question 12

3.31 We agree with this answer. We consider that it would also be helpful to make clear that an agreement between shareholders in a financial services firm giving certain shareholders veto rights over key decisions - which are common arrangements in shareholder agreements and joint venture agreements - would, similarly, in the absence of an agreement as to how shares would be voted on particular issues, not constitute a "concert party agreement" or a Common Policy Agreement triggering a requirement for the shareholders with the benefit of the veto rights to notify.

3.32 Also, shareholder and joint venture agreements typically contain provisions requiring the shareholders who are party to them to exercise all powers available to them, including the exercise of voting rights at shareholder meetings, to ensure that the agreement is complied with but we do not see that this, in itself, would make the agreement a "concert party agreement" or a Common Policy Agreement. It would seem to be rather akin to the situation addressed in DTR5.8.5G referred to in paragraph 3.23 above.

3.33 The FSA may wish to consider whether the guidance should address in the answer to Question 12 the alternative test of "able to exercise a significant influence over the management of [a financial services firm]" since it is possible to envisage circumstances where this might come into play in the situation discussed in the answer.

3.34 As a drafting matter, we think that, in the Question, "specific" should be substituted for "future".

Question 13

3.35 The first paragraph of this answer is not particularly helpful. We think what it is trying to say is that this kind of arrangement may be relevant because of section 178(2) FSMA (i.e. in our view, in the context of an agreement which contemplates acquisitions) or because of section 422(5)(a) FSMA.

3.36 Although we do not necessarily disagree with the analysis in relation to 'passive shareholder agreements' it seems to us to be an unusual and rather unrealistic example. It seems very peculiar to suggest that the passive shareholder (A) is acting in concert with the active shareholder (B) and that therefore A should be regarded as having the right to exercise B's votes. In the example given, assuming all shareholders (other than A) chose to exercise their votes, B would cast 27.2% of the votes cast so it also seems strange to suggest B should be regarded as exercising 33% of the voting rights. We think it would be better to use a more realistic example.

3.37 A fund manager might agree with its client that it would not exercise the votes on the client's shares managed by it, but this simply leaves the voting power with the client.

Question 14

3.38 For the reasons indicated in paragraph 3.5, in the context of the purpose of the guidance, the reference to the definition of 'controller' in the Question is not helpful as it is not relevant to the issue of whether a notification obligation

under section 178 arises. It would be preferable for the reference to be to their combined shareholding meeting the threshold for control in section 181(2).

3.39 Although the first sentence correctly draws a distinction between purchasers who are simply parties to the same agreement and those who are purchasing with a view to continued co-operation once the purchase is completed, the FSA's presumption and many of the factors cited in the main part of the answer look at the wrong thing, namely the process of acquisition and not what the position will be following completion. The correct question is whether the purchasers have an agreement in relation to the ongoing exercise, following completion, of rights relating to the shares or voting power held by them in the target financial services firm (or its parent undertaking) and not whether they have come together to make that acquisition possible. The focus of the FSA's attention should be any shareholders' agreement or, if none, any provisions of the sale and purchase agreement which are equivalent to a shareholders' agreement or which go to the shareholders' relations with each other in relation to the target firm *following* completion, rather than the mechanics and circumstances which surround the sale and purchase itself. We do not believe it is reasonable for the FSA to suggest that simply because there is more than one purchaser who is a party to the same agreement, this gives rise to a presumption of concertedness for the purposes of Part XII.

3.40 Assume, for example, a vendor wishes to sell a financial services firm. He is unable to find a single buyer, but management identify several institutional investors, who are prepared to take 25% each. The vendor insists on a condition that the sale will not complete unless each purchaser performs its obligations (as he does not wish to retain any shares) and also on the inclusion of a provision that if there is to be any action against him under the warranties, it must be taken by all of them together. Each purchaser's liability is several, but the terms of the purchase are the same for each as each is buying the same sized stake and a single firm is acting for them. None of the purchasers wants to see shares being transferred to a competitor and/or the management team want control over the identity of the shareholders so there is a tight restriction in the acquisition agreement (or the target company's articles) on whom a

shareholder may transfer to, without following a pre-emption process. Each of the purchasers remains entirely free to exercise its voting rights as it pleases and (subject to the pre-emption rights and transfer restrictions) to sell as and when it pleases. We would suggest that the purchasers should **not** be treated as acting in concert with each other, but an examination of this situation against the answer to Question 14 might well suggest otherwise.

3.41 Any transaction involving the sale of a financial services firm is as likely to involve several purchasers as it is a single purchaser. This is particularly so where there is a management buy-out or other transaction financed by private equity and/or other similar investors. Members of management and non-executive directors may also acquire shares. It is virtually unheard of in modern commercial transactions for there to be anything other than a single share purchase agreement where there are a number of purchasers; this is for any number of reasons including efficiency and clarity. A presumption that parties acquiring shares under a share purchase agreement are acting in concert does not reflect the likely situation, it creates the odd situation that the less likely situation is presumed to exist, which is counter intuitive. The factors listed in the proposed guidance as relevant for a rebuttal of the presumption would not be present in many transactions where in our view the parties would not be acting in concert.

3.42 We agree that factors such as whether or not the purchasers agree, following completion of the acquisition, to act together in appointing directors or in any other way are relevant to the question of whether or not they are acting in concert. However, we view transfer restrictions (see (v) in the answer) in the same way the FSA views as pre-emption rights. The self-serving provision referred to in (vi) is one which should not significantly influence the FSA either way. The key issue, in our view, in determining whether purchasers who are party to a share purchase agreement are to be treated as acting in concert is whether the agreement has the critical elements referred to in paragraph 3.16.

3.43 We agree with the final paragraph of the answer, although it implies too much significance for the question of whether persons are party to the same agreement. Further, it may mislead people as regards the availability of the exemption in section 184(6) FSMA, unless this exemption is at least cross-referred to.

3.44 More generally, we do not think that the mere existence of a shareholders' agreement, as is common in a private equity transaction, is of itself sufficient to establish that the shareholders are acting in concert. As noted in paragraph 3.31, such agreements commonly include provisions whereby the consent of a certain percentage or class of shareholder is required to certain acts of the company which are out of the ordinary course of business and the like, but there is no agreement between the shareholders as to how they will exercise their votes in any such matter. The agreement simply regulates the conduct of the company and makes it accountable to shareholders in certain particular respects. We are therefore firmly of the view that the provisions of a shareholders' agreement have to be examined on an individual basis, to determine if, under it, the shareholders are acting in concert, or whether they simply have common rights which they are free to exercise or not as they see fit. Where shareholders are independent of each other, act at arm's length, do not have a common voting policy and are able to vote independently of each other, we see no reason why the type of agreements that are commonly in use would give rise to an acting in concert situation. The existence of a shareholders agreement is not sufficient to establish **or raise a presumption** that shareholders are acting in concert. The term has no specific meaning that gives rise to any implication that all such agreements automatically contain provisions which mean that the shareholders are acting in concert. Each agreement will have to be considered in the light of facts including the existence, nature and extent of any rights and obligations between shareholders.

Question 15

3.45 It would be preferable for this answer to make clear that it is permissible to enter into a conditional agreement without notifying the FSA before doing so, but the FSA welcomes early notification.

3.46 As a drafting matter, reference to "completed" would be preferable to "concluded or closed", especially as "concluded" would probably be understood by most as meaning "entered into".

Question 16

3.47 We also agree with the general proposition that pre-emption and drag-along and tag-along rights alone do not have the result that those who are party to them are acting in concert . However, we do not agree that where someone agrees to sell their shares and another to buy them, vendor and purchaser are acting in concert (see the third and fourth paragraphs). We are not clear if this is what the FSA intends to say by the last words of the answer to Question 16, but we would not agree that a controller issue arises solely because drag along or tag along rights are exercised. If someone agrees to sell and another to buy, the purchaser will need an FSA approval if the purchase will take it to (or through) a new threshold and, in those circumstances, should ensure that there is an appropriate condition to completion of the purchase.

3.48 In addition, as indicated above, we disagree with the view that transfer restrictions suggest the shareholders are acting in concert.

Question 17

3.49 We agree that the focus of the Takeover Code definition of "acting in concert" and that of Part XII are different. It is not simply that the Takeover Code applies in respect of a more restricted class of company.

4. ISSUES ON PART XII FSMA

4.1 There are a number of errors in Part XII FSMA which we consider it is worth mentioning with a view to these being corrected when a suitable legislative opportunity arises.

Definition of Subsidiary Undertaking

4.2 Section 422(5)(v) attributes voting power held by a subsidiary undertaking to its "parent undertaking" in some cases (in line with the Acquisitions Directive and the Transparency Directive). However, the definition of "subsidiary undertaking" in the context of Part XII FSMA is super-equivalent.

4.3 The Transparency Directive (in article 10(e)) refers to "....an undertaking controlled by that person or entity". It defines "controlled undertaking" (in article 2.1(f)) as "any undertaking:

(i) in which a natural person or legal entity has a majority of the voting rights; or

(ii) of which a natural person or legal entity has the right to appoint or remove a majority of the members of the administrative, management or supervisory body and is at the same time a shareholder in, or member of, the undertaking in question; or

(iii) of which a natural person or legal entity is a shareholder or member and alone controls a majority of the shareholders' or members' voting rights, respectively, pursuant to an agreement entered into with other shareholders or members of the undertaking in question; or

(iv) over which a natural person or legal entity has the power to exercise, or actually exercises, dominant influence or control".

The parent/subsidiary undertaking definition in section 420 FSMA (cross-referring to section 1162 Companies Act 2006) is wider than the Transparency Directive definition in two areas:

(i) management on a unified basis and

(ii) section 420(2)(b) FSMA.

Sections 184(7) and (9)

4.4 The exemptions in sections 184(7) and (9) appear only to apply where both controlled undertaking and controller own shares. This is clearly incorrect and represents a reading of the relevant provisions of the Transparency Directive which fails to take account of their purpose in the context of the Acquisitions Directive.

Section 184(8)

4.5 The use of the word "controller" in section 184(8) is incorrect as the Transparency Directive uses the expression "controlled undertaking" (see paragraph 4.3). This results in an over-implementation of the Acquisitions Directive. “Parent undertaking” is the correct expression, subject to the point made in paragraph 4.3.