The City of London Law Society

The Law Society

Comments on the proposal for a directive of the European Parliament and Council on amending Directive 2007/36/EC.

Introduction

The comments set out in this paper have been prepared jointly by the Listing Rules Joint Working Party of the Company Law Committees of the Law Society of England and Wales and the City of London Law Society.

The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee.

The City of London Law Society ("**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. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees.

The Listing Rules Joint Working Party is made up of senior and specialist corporate lawyers from both the Law Society and the CLLS who have a particular focus on the Listing Rules (LR) and the UK Listing Regime.

We set out below our comments on the proposal for a directive of the European Parliament and Council on amending Directive 2007/36/EC (the "**Amending Directive**").

Article 3a – Identification of shareholders

We assume that the definition of '*shareholder*' in the Directive 2007/36/EC applies equally to the Amending Directive. This means that, in the UK, the proposals will relate to the identification of the registered holders of shares, rather than the holders of the underlying economic interest. Consequently, the proposals should not have any real impact for UK listed issuers as the use of bearer shares by UK companies is very uncommon and the registered holder of shares will always be identified in a company's register of members.

In paragraph 3, we question the requirement for companies to destroy information relating to shareholders no longer than 24 months after receiving it. We imagine that many companies which are not able to identify their "shareholders" will request relevant details from intermediaries at regular intervals but we are not clear why the law should force companies to delete information after that period. This will impose an unnecessary cost burden on companies where they decide to send out a new request as soon as the relevant time period expires and where they would not otherwise have done so. If this provision is kept, we suggest that shareholders should be free to agree a longer period with companies either individually or by passing a resolution to this effect.

Article 3c – Facilitation of the exercise of shareholder rights

The first sentence in paragraph 2 states that companies must confirm the votes cast in a general meeting by or on behalf of shareholders. It is not clear what is meant by this. Is the intention that the company will confirm to each shareholder who has submitted a vote that its vote has been properly recorded and accepted as valid? This would create a significant administrative burden for companies. Or is the intention that this confirmation should only be given if a shareholder or his intermediary requests it? Some listed companies in the UK pass resolutions by a show of hands at shareholders' meeting and so in that case the companies will not themselves have a record of how particular shareholders voted – we assume that this Article is not to be interpreted as prohibiting this practice.

Article 3i – Transparency of proxy advisers

We note that the Amending Directive provides transparency requirements to be implemented by Member States in relation to proxy advisers. Given that proxy advisers may operate from one Member State or even outside the EU but may provide services in relation to numerous companies based in a range of different Member States, it is not clear which Member State should lay down and enforce the requirements for these proposals. Consequently, we suggest that proxy advisers should comply with the rules of the Member States in which the relevant companies (which are the subject of the voting recommendations) are incorporated or where their shares are traded on a regulated market. We appreciate that this means that proxy advisers may need to comply with requirements in a number of different Member States (depending on the company in question), but we believe that compliance with the requirements in the jurisdiction of the company concerned is logical. In any event, we would expect that advisory firms (which typically provide other financial services across Europe) will be familiar with complying with differing sets of requirements across Member States and in any case the requirements should not be too dissimilar, given that they are derived from the same directive. Furthermore, we note that Article 1(1) of the original directive 2007/36/EC provides that the Member State competent to regulate matters covered in that directive is the Member State in which the company has its registered office. We would appreciate confirmation on how this provision applies to Article 3i.

Furthermore, in relation to Article 3i(2)(d)-(f), a proxy adviser is required to disclose certain information relating to its '*voting recommendations*'. It would be helpful if the Amending Directive would provide whether a particular Member State must require that a proxy adviser's voting recommendations should be disclosed in respect of all EU companies or only those companies incorporated or whose shares are traded on a regulated market in that Member State? The latter would seem more sensible.

Article 9c – Right to vote on related party transactions

Whilst we note that the new regime governing related party transactions is similar to the UK regime contained in Chapter 11 of the Financial Conduct Authority's Listing Rules, the proposals would appear to catch a wider range of transactions than would be caught under the UK regime. The definition of 'related party' in the Amending Directive uses the same definition as set out in the international accounting standards adopted in accordance with Regulation (EC) No 1606/2002 (IAS 24), which is significantly wider than the definition of a related party in the UK. For example, whilst we note that the Amending Directive provides that Member States may allow for transactions between a listed company and its *wholly* owned subsidiaries to be excluded from the regime, a transaction between a listed company and a subsidiary that is not wholly owned would be caught. This would mean that all intra-group transactions with subsidiaries which are not wholly owned would require shareholder approval, whereas, such transactions would not be caught under the UK regime.

In our view, it is not appropriate to apply the wider definition of 'related party' in IAS 24. The latter definition needs to be wide so that shareholders can consider the company's financial position in the context of all the transactions into which it has entered. The related party transaction regime, however, should be narrower and focus on those transactions which may potentially be abusive, or may perceived to be abusive, in relation to shareholders – so for example, transactions with shareholders with significant shareholdings or with those who can exert significant influence over the company.

In addition, the UK regime has a specified list of transactions to which related party transaction rules do not apply. These are set out in detail in the Annex to Chapter 11 of the Listing Rules (click here) but in general, comprise the following transactions:

- transactions or arrangement where each applicable percentage ratio is equal to or less than 0.25%,
- transactions which were agreed to before a party became a related party,
- the subscription of new securities and sale of treasury shares by a related party in a pre-emptive offering, or the issue of new securities made under the exercise of conversion or subscription rights attaching to a listed class of securities,
- the receipt of an asset or an option to securities pursuant to employees share schemes and long-term incentive schemes,
- the grant of credit to a related party on normal commercial terms,
- the grant of an indemnity or loan to a director,
- the underwriting by a related party of all or part of an issue of securities by the listed company on normal commercial terms,
- joint investment arrangements by both the listed company and the related party, and
- a transaction with a party who is deemed a 'related party' by virtue of its relationship with an 'insignificant subsidiary undertaking' of the listed company.

The exemptions have been framed so that only those transactions with related parties which might potentially have a detrimental impact on the remaining shareholders should be caught. Additionally, the exemptions allow the company to avoid being subject to the disproportionate expense of obtaining shareholder approval for transactions which are unlikely to have a significant impact on shareholders.

It would be helpful if the Amending Directive specified in Article 9c(2) what is meant by a transaction which has 'a significant impact' on profits or turnover. We would suggest that the test should be precisely stated if the intent is that there should be consistency in EU markets.

We also query why it is necessary for a company to state that a transaction is '*on market terms'.* The main issue is whether the transaction is 'fair and reasonable' – it may be quite difficult to ascertain what "market terms" are. In addition, we query whether there is any merit in requiring the publication of the third party independent report confirming that the transaction is fair and reasonable. Under the UK listing rules a company is required to obtain such advice from its sponsor but, whilst the company has to confirm in its circular to shareholders that it has obtained such advice, there is no requirement for the actual report of the sponsor to be published. The providers of the report may be concerned that the publication of their report could give rise to an increased risk of liability to, or claims, from shareholders and such advisers may consequently be reluctant to provide these services. If the pool of such advisers is reduced, this could have adverse consequences for issuers in terms of the fees charged for such services.

If you have any queries or would like to discuss any aspect of this response, please contact Richard Ufland.

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