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Joint Industry Trade Associations' Response to the Joint Level 3 Committees' guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC

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Background

This submission has been prepared by the British Bankers' Association (BBA) and London Investment Bankers' Association (LIBA), supported by members of the Financial Services and Markets Legislation City Liaison Group, an informal alliance of major City trade associations and law firms which works jointly on new legislation which affects the financial services industry. Previously this group had commented on the original European Commission proposal for a Directive to amend the financial services directives [COM (2006) 0507].

General Comments

The Directive will apply to a wide range of transactions, both acquisitions of direct stakes or control in a financial institution – such as a bank – and also to the acquisition of the parent of a group which happens to include a financial services firm (however small). It is essential to establish procedures that can deal with both kinds of case appropriately to avoid unnecessary disruption of capital markets transactions.

The UK Joint Industry Trade Associations overall welcome the Joint Level 3 Committee's intentions to develop guidelines. In particular, we support the emphasis on applying the proportionality principle as provided in the Directive. This is a key element in order to deliver a practicable and workable system, avoiding delays in the assessment process and burdensome requirements on the acquirer as well as to ensure a common approach and level playing field across Europe. We welcome a standardised approach but have to emphasise the importance of considering mergers and acquisitions on a case-by-case basis.

Also, we believe that there has to be a careful balance between fast-track approval when there are no problems and a more careful approval process in dubious acquisitions where more scrutiny is needed.

Overall, we feel that the authorities must distinguish more clearly between the kind of information that is needed in the case where the acquirer is focusing on the financial services firm and the case where the financial services firm in the group is not the target of the acquisition (such an approach is already adopted in other contexts – see, eg, the UK FSA's definition of UK financial sector company for the purposes of the recent rules on short selling). Thus the comprehensive list of information to be provided should clarify the information that the competent authorities would not need in the latter case (this proposal builds on the principle already accepted that changes in control differ in kind from

increases of shareholdings. (We comment further on this below – see the 4th Assessment Criteria, and will provide a supplementary note indicating how this could be done.)).

The draft guidelines focus on the kind of information that must be provided but there is also a question about the kinds of holdings that do not need to be notified because they are not relevant to supervisory judgement: there needs to be common understanding about this and our views - as expressed previously – are set out in the Annex to this note. We think that it is essential that it is clear that all the Member States accept the exclusions – as provided for in the Directive's definition of qualifying holdings – and it may be that separate Guidelines will be needed on this point.

What you have to file

Recital 9 of Directive 2007/44/EC suggests less information can be provided under justifiable criteria. With respect to the guidelines, however, we have serious concerns regarding the lists in Appendix II. We believe that the current list of questions in the draft guidelines is too exhaustive and prescriptive given the different kinds of transaction that the authorities will need to consider (as outlined above); this seems to contradict the original proportionality principle set out in the Directive.

The questions contain too many inconsistent and vague terms and references while it remains unclear in some cases how they are relevant. Furthermore, the current list of questions for assessments throw up very impractical questions, for example the ones relating to group structures or every past investigation are unduly burdensome for large groups (It is even questioned whether this information could actually be provided in all cases – eg points (23) and (38)). Also, the list does not consider the materiality of information which is most relevant to the application.

In order to implement the Directive on a proportional scale, we suggest that only a focused list of 'relevant' questions should be adopted that applies to simple and systemically insignificant take-overs. Questions should be limited in the beginning to a simplified core list. In practice the acquirer could apply for a waiver to submit only the core list of limited questions in the early discussion stage in the form of a shadow application. However, we agree that the firm should be aware of the complete list of questions that the regulator may ask should it demand more specific information in cases where more supervisory scrutiny is needed. In practice it would be helpful if the supervisor determines at the beginning or a later point of time in its assessment whether it feels that more information should be filed, whilst accepting that in some complex cases it may not always be possible to identify the full complement of information that will be needed at the outset.

Processes – Implementing Measures

Currently, there is no reference to implementing measures. In order to streamline the process we feel that it would be beneficial to develop a form in one language that could be applied throughout all Member States. As discussed with the assessment question in the previous paragraph it would also make sense here to develop a simplified form for straight forward acquisitions as well as a more comprehensive form for acquisitions that require more scrutiny.

In order to facilitate the decision making process, we believe that it is essential that supervision should rest with the lead supervisor of the firm at the top of the group. Thus, acquirers should only file once with the lead supervisor. The lead supervisor would be responsible for cascading down to other relevant supervisors to obtain their views but would be responsible for the final decision on approving the transaction.

With regard to the previous point we believe that it would also be of value for the 3L3 guidelines to point out to supervisors that it is of utmost importance (as seen in the MiFID implementation) to make early contact with other supervisors. The initial discussions between cross-border supervisors need to establish the practical lines of communications (i.e. determining language) as well as setting the framework for the sharing of confidential information about mergers and acquisitions.

Specific Comments

“Exhaustive and harmonised list of Information” (paragraph 5 point iii.)

As pointed out in the general comments, it is important that the list of information to be provided in the first instance is not unduly burdensome and is proportionate to the systemic risk of the acquisition. But also this should not prevent supervisors to make subsequent detailed inquiries if they have concerns about the fitness of the potential shareholder [also see the end of paragraph 7 in the guidelines].

Decision to Acquire Notification (paragraph 11)

We support this paragraph. We think the reference to “decision to acquire, increase, or reduce a qualifying holding” is helpful because it clarifies when notification is needed.

Competent Supervisory Authority and Target Supervisors (paragraph 15)

With regards to considering subsidiaries and respective “target supervisors “in other EEA competent authorities we believe that the principle of proportionality should be exercised on a case-by-case basis to avoid any unduly burdensome reporting. Also see our comments above on the role of the lead supervisor and our comments below on paragraph 16.

Preliminary Contacts by the Acquirer with the Target Supervisor (paragraph 16)

We would seek guidance and clarification if any target supervisors have authority to prevent the formal timetable for considering an acquisition commencing if they consider that it seems probable that further investigations will be needed due to suspicions that they may have about the acquirers motives.

Reputation of the Proposed Acquirer - Definition and Scope regarding “unregulated entity” (paragraph 20)

“The assessment of the reputation is of particular relevance if the proposed acquirer is an unregulated entity but should be facilitated if the acquirer is authorised and supervised within the European Union.”

We believe it would be appropriate to extend this scope of facilitation to include foreign acquirers if their entity is supervised by a comparable regulator of another major financial centre [eg by the Fed].

Personal Attestation of the Acquirer (paragraph 30 - 31)

With regards to the attestation and approval of persons, we believe it should suffice that only an attestation of ‘good conduct’ be required as the production of evidence for ‘good conduct’ is impossible to provide. If the acquirer is formed by a large group of people we also believe that only a subjective statement for the group should be filed which is based on ‘the best knowledge’ of the group. It would also be helpful for the supervisor to provide a checklist of “wrongdoings” to guide the proposed acquirer in the disclosure of any business failings, regulatory breaches or criminal offences (this is the approach adopted, eg, in the UK under the FSMA when the FSA assesses whether persons should be approved to undertake specified controlled functions within firms).

Application of the Proportionality Principle (paragraph 35)

“The integrity requirements should be applied regardless of the level of the qualifying shareholding that a proposed acquirer intends to acquire, and of his involvement in the management or the influence that he is planning to exercise on the target institution.”

We do not feel that this paragraph meets the principle of proportionality when the financial services firm is not a major part of the group (see our comments above on the case where the firm is not the acquirer’s target).

4th Assessment Criterion - Definition and Scope (Paragraph 68)

As noted in our general comments, it is the acquirer’s responsibility to perform the necessary due-diligence to identify the underlying business streams of target firms. However, we also think the guidelines should recognise that there are cases where an acquisition of a group may include a

financial services entity which is not driving the acquirer's decisions (especially if the financial subsidiary is only a small operation). In such cases we believe that the requirements of the Acquisitions Directive should be applied proportionately. Put another way, where the focus of the acquisition is not really to obtain control of a regulated business, the information notification and approval requirements should be suitably downscaled.

We believe it would be helpful for the guidelines to provide examples for supervisors, 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.

Also, on the drafting, the reference to Recital 3 seems to be incorrect.

List of European Supervisory Authorities (Paragraph 101)
We support this proposal for the purpose of transparency and because it will facilitate notifications.

Acting in Concert (page 27)
The current definition of *'acting in concert' w*ould result in any form of alliance that is formed in the future, to be retrospectively held to this definition. It is not clear why the Guidelines definition is needed given the provisions of Directive 2004/109 – eg Article 10 – and it would be perhaps beneficial to adopt clearer definitions from other EU general law i.e. the Take-over Directive.

Crossing a Threshold Involuntarily (page 28)
We propose that that a reference to a "knowledge test" should be provided here in order to do define the point of notification immediately after the point of discovery.

Qualifying Holding (page 28)
There is no reference to the Transparency Directive exclusion provisions here. Also, it is not clear how the decision making process is defined. Do competent authorities of other "cascading holdings" have powers to influence the final decision?

Significant Influence (page 28)
The proposed definition is too broadly formulated. The fact that having the possibility to appoint one representative on the board of directors is not, in our view, sufficient to conclude that the acquirer has a significant influence. Reference to the CRD definition (threshold of 10%) would avoid a subjective assessment.

Question 25: Detailed Organisation Chart (page 33)
Reporting entire corporate structure can be highly burdensome for cross-border groups burdensome and is not necessarily relevant to the assessment – again, the nature of the acquisition should determine the information to be provided.

Annex

When you have to file - Notifications important to supervisor/exemptions)

Directive 2007/44/EC references various notification exclusions set out in the Transparency Directive. The exclusions were introduced to rule out any unnecessary obstacles to capital markets transactions. Also, it is important to include these exemptions in order too emphasise proportionality and national discretion as well as the practicality of the directive in what it actually sets out to achieve.

Specifically, a distinction has to be made between transactions where the acquirer is taking a controlling or strategic stake and the case where no such influence is intended. The proposed guidance needs to reference this need to distinguish between different kinds holdings by following the principles established in the earlier Transparency Directive: see Articles 9 and 10 of Directive 2004/109 (as cross referenced to in the Directive).

Furthermore, clarity and certainty needs to be provided about the kinds of transactions that can be excluded from the notification rules. There is a risk that unless the Member States' implementation measures reflect the exclusions, a common approach will not be found and disproportionate reporting requirements will result.

Here we would like to point out exemptions already recognised in earlier Community measures which - for ease of reference - establish a proportionate regime that limits the obligation to notify changes in holdings to just the kinds of holding that supervisors have concern for, thus avoiding significant cost and barriers to transactions about which there are no supervisory issues.

- Achieving clarity is important for the operations of the financial markets. Thus, for example, it is important to ensure that the holdings of a custodian on behalf of clients are not subject to the directives' notification and approval requirements when voting rights can only be exercised on instructions from the clients.

- In the same vein, firms engaging in market making and trading activities should not be prevented from providing liquidity to markets where they do not exercise voting rights in the investee company, simply because of uncertainty about whether prior approval of an investment is needed.

- Likewise, the underwriting of rights issues by regulated firms should not be required to go through burdensome and lengthy pre-approval processes with multiple regulators simply because of the possibility that investors may fail to take up their rights, when influence through the exercise of voting rights is not an issue and investors will promptly dispose of their holdings.

- Similarly, fund management companies and portfolio managers should be able to use the systems designed to monitor compliance with the Transparency Directive to monitor their compliance with the shareholding limits under the sectoral directives – there is no need to aggregate their holdings with those of other group companies, for these purposes where the positions are managed independently of other group companies, and it is essential to avoid a regime where investment decisions [on behalf of clients] cannot be taken because of uncertainty about whether prior approval may be needed.

- While the Directive notes that Articles 12(4) & (5) of the Transparency Directive (2004/109/EC) should be taken into account, we would appreciate it if the 3L3 Guidelines made it clear that this should also be seen as incorporating Article 23(6) of that same Directive, which makes it clear that Article 12 should be read as referring to non-EU parts of such firms, as well.

The problems that market participants face in addressing these notification and approval requirements are significant: listed financial groups may have dozens of regulated financial services subsidiaries across Europe - many commercial and industrial companies now own financial sector entities. Identifying these and complying with multiple, differing methods for calculating thresholds and notification and consent requirements would be a major and growing burden.