Investment Management Association

3 October 2008

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Dear Mr Swyngedouw

**3L3 Consultation on Guidelines for the assessment of mergers and acquisitions**

The Investment Management Association (IMA) represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes.

They are responsible for the management of £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies).

Particularly in the current climate it is vital that the 3L3 Guidelines recognise the need for UCITS and pension funds, to take two examples, to be able to operate freely so at to invest and, especially, disinvest for the benefit of the retail consumers and pensions in the EEA, given that the funds will not invest to exercise control.

Our response focuses on the implications of the Directive and Guidelines for asset and fund managers. While these companies will occasionally have a 10% or more holding in a financial institution, they would do so purely for the investment returns of those holdings, not in order to merge, acquire or control that company:

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- Asset managers do not generally own, or have any economic interest in, the securities of the companies held by the funds or portfolios that they manage. Rather, the securities are owned by the funds (which are legal entities separate from the investment manager) or the underlying clients themselves;
- They have no interest in acquiring control of the companies in which they invest: their sole business is to act as asset managers and achieve long term investment value for their clients and funds;
- Asset managers based within the EU will already be regulated entities that are appropriately authorised and supervised.

The Directive and proposed Guidelines apply the principle of proportionality to the information that should be provided and to the assessment procedures. We appreciate that this proportionality principle means that appropriate, lower standards of evidence will be required for acquirers who are not in a position (or do not intend) to exercise a decisive influence over the target institution. This principle should be extended as far as possible with regard to firms, such as asset and fund management companies, which are not seeking to merger, acquire or control the target firm. This is doubly so as these companies are already regulated and supervised as financial institutions.

IMA generally welcomes the Joint Level 3 Committees' intentions to develop guidelines. Please find our detailed comments to the proposed Guidelines in the attached Paper. We would like to highlight the following key points:

- We support the application of the proportionality principle as provided in the Directive. This is a key element to avoid overly burdensome requirements on the acquirer and delays in the assessment process, as well as to ensure a level playing field across Europe. Overall we welcome a streamlined approach, but have to emphasise the importance of considering mergers and acquisition on a case-by-case basis.

- A distinction should 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 Guidelines should make reference to the need to distinguish between different kinds of holdings, by following the principles established in the earlier Transparency Directive: see Articles 9 and 10 of Directive 2004/109/EC, referred to in the Directive. This would reduce the workload on competent authorities and allow them to focus their resources on true instances of changes of control.

- Useful exemptions are already recognised in other Community measures which establish a proportionate regime limiting the obligation to notify changes in holdings to the kinds of changes that concern supervisors, thus avoiding significant cost and barriers to transactions about which there are no supervisory issues:
    - 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.

  As a result we consider that an EEA asset management firm should not need to aggregate its holdings with those of either its parent (whether based in the EEA or not) or other non-EEA asset management firms in its group. Such a reading would result in fewer notifications being made where there is no intention of 'acting in concert', and thus no possibility of any element of control. It would be most helpful if the 3L3 Guidelines could confirm this, possibly in the definition of 'Qualifying Holding' in Appendix I.

  The same rationale would seem to apply to sub-funds of an ICVC umbrella or similar structure, that should not need to aggregate holdings, as the investment decisions in relation to each sub-fund, needs to be separate as their investors/shareholders will not be the same.

- The structure of many large listed groups is such that they contain one or more regulated entities (e.g. subsidiaries formed for the purpose of group pension management, financing or captive insurance companies, which themselves are generally not listed). These subsidiaries generally would be covered by the Directive. Where these groups are the 'target' this would mean that portfolio investment in them will be caught by the regime. Asset managers may be put off such investments by the delays and bureaucracy involved, placing unnecessary restrictions on the introduction of capital into the European markets.

The problems that market participants face in addressing these notification and approval requirements are significant: listed companies may, in their groups, have numerous regulated subsidiaries across Europe. Identifying these and complying with multiple, differing methods for calculating thresholds and notification and consent requirements is a major and growing burden. Unless the Guidelines recognise the different nature of holdings by asset management companies, it may have the unintended consequence of deterring them from investing in these top tier operating companies.

Looking at the Directive it is noticeable that Article 3(3) which inserts Article 10b into MiFID states that the competent authority's assessment is to:
- "ensure the sound and prudent management of the investment firm in which an acquisition is proposed"; and
- "having regard to the likely influence of the proposed acquirer on the investment firm, appraise the suitability of the proposed acquirer and the financial soundness of the proposed acquisition".

As explained above, the holding of shares in other companies by asset or fund managers would have no impact on the management of the target company, nor would the asset or fund manager wish to have any influence on the target firm. Thus the suitability or financial soundness of the proposed acquirer should be moot, rendering requirement to assess against the criteria irrelevant.

I look forward to hearing from you if there is any clarification that you would find useful on the points we have raised, either above or in the attached paper.

Yours sincerely

Adrian Hood
Regulatory Adviser

# <u>3L3 Consultation on Guidelines for the assessment of mergers and acquisitions</u>

## Specific Comments

<u>Time limits for assessment by the competent authority</u>
Under the Directive the assessment period may last 60 working days, plus a possible extra 20 working days. We note that Recital 5 of the Directive states that “this Directive should not prevent market participants from operating effectively in the securities market.”

As the approval procedure is an ex-ante procedure, we consider this timeframe to be overly long in the context of an asset or fund manager. Investment decisions in this context tend to be implemented quickly, being based on prevailing market conditions and prices. It is very likely that a 60-80 working day delay would result in an order becoming stale before it could be traded. We would therefore welcome wider recognition of the benefits for all concerned of early notification, whereby firms could provide the relevant regulator with a statement of what they may soon acquire in the course of their investment activities that would trigger a notification requirement; or, at the very least, an abbreviated time period for decisions on proposed purchases by investment managers on the basis of the proportionality principle referred to in Recital 5 of the Directive (“the assessment of the compliance with the different criteria should, therefore, be proportionate, among other things, to the involvement of the proposed acquirer in the management of the entity in which the acquisition is proposed”). We believe this to be in accordance with the spirit of the proposed rules.

Another change that could be beneficial would be to encourage, through the 3L3 Guidelines, the competent authorities to revert to the acquirer with their decision as soon as it is made, and not to wait until the full period allowed is expired, and to encourage that this should be done, ideally, within a week. This should apply, particularly, where a regulated company is proposing to hold an interest between 10% and 20% of the target financial institution. This would accord with the proportionality principle raised in Recital 5 (“the assessment of the compliance with the different criteria should, therefore, be proportionate”). This proposal could sit at the end of Section IIA of the Guidelines.

<u>Supervisors’ cooperation</u>
The final 3L3 Guidelines should make more clear that the primary responsibility for approving/disapproving a merger or acquisition lies with the target supervisor, despite the requirement that they should “take fully into account the opinion of the acquirer supervisor” where the acquirer is a regulated entity (§14 & 15 of the Guidelines and Recital 10 of the Directive).

Any uncertainty on this point could lead to practical difficulties, e.g. for international group located in many different jurisdictions. Could the degree of reliance by the target authority on the acquirer supervisor be spelt out in more detail? It should be possible to enumerate the details on which they should be expected to rely on the acquirer supervisor (e.g. reputation, financial soundness, prudential requirements and AML suspicions).

The possibility of having more than one 'target supervisor' for a transaction referring to a group with multiple regulated target entities, each of which has to be notified and each of which has to assess the transaction with respect to its own firm, is a recipe for delay, duplication, obfuscation and confusion. The Guidelines should strive to make clear that there should be early co-operation between all the relevant regulators, including that of the acquirer, to identify one specific target regulator to act as the lead regulator. This should normally be the supervisor of the regulated entity highest up the organisational chain of the group.

An acquirer should not be penalised for being unable to identify every minor regulated entity within a large and complex group, especially where it is not the intention of the acquirer to control that particular firm.

<u>1st Assessment Criterion - Reputation (§41 & 42)</u>

We welcome the recognition that some acquirers will not be acquiring the target company in order to exercise a decisive influence over it. Many such acquisitions will be by asset or fund managers who are acquiring the target company for purely financial returns. We appreciate that the proportionality principle will apply, and that significantly lower standards of evidence would be required of them.

Indeed, as set out above, as the acquirer would be a regulated entity the target supervisor should be able to rely on the opinion of the acquirer supervisor regarding this criterion.

<u>2nd Assessment Criterion - Reputation and Experience (§50)</u>

We consider that all asset and fund managers fall within the scope of this exception, meaning that the second criterion would be unlikely ever to apply to them. It may, of course, be applicable where their group takes over another financial firm.

<u>3rd Assessment Criterion – Financial Soundness (§55)</u>

We foresee that the requirement that the acquirer should produce financial soundness forecasts projecting forwards three years would involve an excessive and unduly onerous amount of work on behalf of asset managers, who invest in the target company as a purely financial transaction.

We note that §59 does indicate that a proportional approach should be taken, depending on the nature of the acquisition, and asset and fund managers would not be involved in the management of the target institution.

We note also that §64 declares that much of the assessment will fall on the home regulator's assessment, as the acquirer would be a supervised entity.

However, we do not consider that these, as they stand, go far enough. Where an acquisition is for purely financial investment purposes then an equivalent clause to that in §50 should entirely disapply this criterion. If this in not possible, then the Guidelines should recognise that where a purely agency holding for investment purposes is being taken (possibly limited to such positions being between 10-20%) then the acquiring firm should be deemed to meet the third criterion if it meets its home state prudential requirements.

4th Assessment Criterion - Compliance

In the quote in §65 there is reference made to the target firm becoming part of the group of the acquirer. It should be noted that this would not be the case where the acquisition is made for purely financial investment purposes by an asset or fund manager. We would argue that this indicates that this criterion should only be applied where the target firm is to form part of the 'group' of the acquirer.

Should the above point not be decisive then, where an acquisition is for purely financial investment purposes there should be no requirement for a there to be a business plan, as is assumed in §68. We presume that the proportionality principle would result in the target company's compliance with prudential requirements being deemed to be unchanged. The requirement in §76, that the business plan should cover at least the next three years would seem to be unworkable, inapplicable and irrelevant where the acquisition is made for purely financial investment purposes.

5th Assessment Criterion – Money Laundering

We would expect the 3L3 Guidelines to make reference to countries deemed to be equivalent AML regimes for the purposes of the 3rd Money Laundering Directive, rather than referring to the FATF.

Rather than the unusual wording in §85, particularly "a country or territory that has not taken sufficient measures to comply with the FATF-GAFI 40 and 9 recommendations", we would prefer to see a reference to the list published in May 2008, by Her Majesty's Treasury, as part of a statement concerning jurisdictions that EU Member States had agreed could be regarded as having equivalent AML regimes for the purposes of the 3rd Money Laundering Directive. This list was drawn up by Member states participating in the EU Committee on the Prevention of Money Laundering and Terrorist Financing.

Where the acquirer is a supervised entity then the target supervisor should be able to rely on the opinion of the acquirer's supervisor.

## Appendix I - Glossary

Acting in Concert

The source of this definition is unclear. No definition appears in the Directive, or in the underlying sectoral directives. For the sake of consistency we consider that the definition should match that from one of the previous Directives covering this concept – either the Transparency Directive or the older Takeover Directive.

Crossing a Threshold Involuntarily (page 28)

A firm should only be required to notify the competent authority after they become aware of crossing a threshold. A "knowledge test" should be provided here in order to define the point of notification immediately after the point of discovery.

Third Countries Considered as Equivalent

We understand from Appendix I that, for matters concerning prudential requirements, third countries are considered equivalent if their regulated financial institutions are subject to a supervisory regime that is determined, by the competent authority of a Member State, to be equivalent to the supervision required by sectoral EU Directives. For legal certainty's sake, it would be helpful to have a list of these countries published on a central website.

Moreover, even if the supervision is equivalent, the arrangements for supervisory exchanges of information will be considered adequate only if it has agreed to establish a MOU for mutual cooperation and if no laws in the third country prevent the exchange of information. Here again, it will be very difficult in practice to check that the two conditions are met in each case and it would be useful to have a central list of countries considered as having adequate arrangements.

## Appendix II – List of Information Required

We welcome the possibility of express exemptions to submitting all of the information that appears on the published list, e.g. in cases where the supervisor already possesses some information or can obtain it from another supervisor (§8 of the Guidelines). Supervisors should be encouraged to use this facility to the fullest extent possible to avoid any duplication.

While §7 of the Guidelines requires that the list is exhaustive, §9 expressly mentions the possibility for a target supervisor to request "additional information" (therefore triggering the interruption of the assessment period), it being expressly specified that "this additional information is not included as such on the list of required information". As a result, in practice, a regulator may seek to require information that is not on the list and hence unduly delay the approval process. Such requests: should only occur where the original information did not fully meet the requirements of the list; should be kept to a minimum; be fully justified; and be made as early in the process as is possible.

The information to be provided pursuant to Appendix II is very detailed. It will be a cumbersome and time-consuming procedure to gather all the requested information. We are of the opinion that this is too extensive, especially in the case of asset and fund managers that are already authorised and supervised in their home country. Given the (possible) dis-application of several of the criteria to asset managers the proportionality principle should be used to the fullest extent possible and much of the list should be dis-applied in the case of such managers (e.g. the requirement to set out all underlying shareholders of the acquiring entity). Further, the proposal to require disclosure of information regarding the intention of the acquirer to increase, maintain or reduce its shareholding could cause problems in the case of an asset or fund manager, where investment intentions are often of great commercial significance and confidentiality: indeed it could be seen to constitute an offence such as "front-running" or even market abuse. In addition, investment managers may change their mind depending on market conditions at the time of trading and therefore might not eventually transact as pre-notified.

Finally, any acquisition should only be governed by the laws and regulations of the home country of the main issuer, to the exclusion of any rules applicable in any third country where non-listed subsidiaries of this issuer should be located (in order to avoid having the same transaction being subject to multiple, and sometime conflicting, notification/approval regimes from various jurisdictions).

We have particular concerns about information requirement 2b(20), as, for large groups, this would be an extremely onerous and time consuming exercise, considering that large financial groups may have several hundred group companies, each with many directors. This requirement should be restricted to ‘relevant companies in the group’, i.e. the head company and any which will have direct control of the target company.