

**C L I F F O R D
C H A N C E**

CLIFFORD CHANCE LLP
10 UPPER BANK STREET
LONDON
E14 5JJ
TEL +44 20 7006 1000
FAX +44 20 7006 5555
DX 149120 CANARY WHARF 3
www.cliffordchance.com

By Email & Post

The Secretariat
The Walker Review
feedback@walkerreview.org

Your ref:
Our ref:
Direct Dial: +44 20 7006 1041
E-Mail: chris.bates@cliffordchance.com

14 September 2009

Dear Sirs

Walker review – EU Acquisitions Directive

I attach a letter commenting on the FSA response to the issues raised in the report regarding the controller requirements under the EU Acquisitions Directive.

Best regards



Chris Bates

Enclosure

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14 September 2009

Dear Sirs

Walker review - FSA comments on shareholder engagement and change in control requirements under EU Acquisitions Directive

The Walker review pointed out the potential constraints on collaborative shareholder engagement with the boards of banks or other financial institutions imposed by the change in control requirements contained in the Financial Services and Markets Act (FSMA) derived from the EU Acquisitions Directive (paragraph 5.44 of the review). The requirement on persons "acting in concert" to give prior notification to the competent authorities of an intention to acquire 10% or more of the voting shares of a financial institution is a potential constraint on collaborative engagement particularly in the light of the guidance adopted by the EU Level 3 committees, which appears to adopt a very broad interpretation of what it means for shareholders to be "acting in concert".

The letter dated 19 August 2009 from the Financial Services Authority (FSA) to the chairman of the Institutional Shareholders Committee acknowledges this issue but indicates that the FSA's view is that "it is not intended that the phrase "acting in concert" – either in the Directive, FSMA or the Level 3 guidance – should capture ad hoc discussions and understandings in good faith solely aimed at exerting influence intended to promote generally accepted principles of good corporate governance". (see http://www.fsa.gov.uk/pubs/other/shareholder_engagement.pdf) It is clearly helpful that the FSA considers that there are circumstances in which the shareholders can agree to act together in voting their shares without being treated as acting in concert for the purposes of requirements arising under the Acquisition Directive. However, we are concerned that this statement may not give shareholders or their advisers adequate comfort to enable shareholders to participate in discussions with one another if those discussions might include

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understandings on voting action, even of an ad hoc nature. We believe that there is a need for the FSA to develop more detailed guidance on the scope of the restrictions imposed by the Acquisitions Directive on those "acting in concert", working with the Level 3 Committees and/or the European Commission.

In particular, it would be helpful if FSA could clarify its reasoning for its conclusion that "ad hoc discussions and understandings in good faith solely aimed at exerting influence intended to promote generally accepted principles of good corporate governance" do not fall within the Level 3 guidance on the change in control requirements (or the Directive or FSMA requirements themselves). The Level 3 guidance is expressed in such broad terms that it appears to cover any case where investors decide to exercise voting rights in accordance with an explicit or implicit agreement between them. The Level 3 guidance does not appear to allow for any exceptions for understandings or other explicit or implicit agreements which are aimed at particular topics.

It would also be helpful if the FSA would clarify whether other members of the Level 3 committees or the European Commission agree with its conclusions or whether the FSA is engaging with the Level 3 committees or the European Commission to refine the Level 3 guidance in a manner consistent with the FSA's comments. In many cases, UK listed companies that are or own UK regulated banks, insurance companies or other financial firms also have other regulated subsidiaries across the EU and the EU change in control requirements apply to both direct and indirect changes of control. Therefore, in many cases it will be not be enough for investors to believe that the FSA would not regard their cooperation to amount to "acting in concert" if the EU regulators of the other regulated subsidiaries of the UK listed company might take a different view. Investors are also interested in how these rules apply in relation to financial groups listed in other EU countries, whose lead regulator is in another EU state but will have regulated subsidiaries in the UK and other EU countries.

In addition, in some cases, it may be difficult for investors to be sure that proposals under discussion would be regarded as "solely aimed at exerting influence to promote generally accepted principles of good corporate governance". One investor group's idea of the promotion of principles of good corporate governance can be a board's idea of unacceptably aggressive corporate activism. When more than one EU regulator is potentially involved, it is clearly possible that there will be differences of view as to what might be regarded as acceptable or unacceptable conduct in this regard.

In any case, the FSA's comments on the change of control requirements do not appear to cover cases where investors wish to influence a board's decisions on corporate strategy or on other corporate events (such as acquisitions or disposals). The comments appear to be directed at cooperation on issues of process rather than substance, in contrast to the FSA's

comments in the annex to its letter on the market abuse regime and the rules on the disclosure of major shareholdings which appear to apply more broadly (although the letter itself does not appear to make this distinction).

These issues are particularly important to investors and their advisers as contravention of the controller rules is a criminal offence and has other potential consequences (e.g. as regards freezing of shareholdings). The FSA's comments do not have the status of formal guidance (as the rules are not rules made by FSA) and the FSA is not the sole potential prosecuting authority under FSMA. In addition, there are the potential consequences in other EU member states.

Therefore, while the FSA response is helpful comfort, it seems to us that investors would welcome further guidance involving the Level 3 committees and/or the European Commission which addresses the issues of shareholder collaboration more fully.

As already noted, one of the primary reasons for our concern is that the Level 3 guidance appears to take a very broad view of when investors should be treated as acting in concert. However, it seems to us that there are questions as to whether the broad interpretation of the Level 3 guidance is itself consistent with the Acquisitions Directive.

The Acquisitions Directive requirements apply where "any natural or legal person or such persons acting in concert... have taken a decision either to acquire, directly or indirectly, a qualifying holding in [a regulated firm] or to further increase, directly or indirectly, such a qualifying holding [through specified thresholds]". In that case, they must first notify the competent authorities before they acquire the qualifying holding or increase it through the relevant threshold.

This seems to suggest that it is not enough to trigger the requirements of the Directive that two or more investors simply "come together to act in concert" by agreeing to vote together on a particular issue. (If that were the case, it would also render redundant the provisions incorporated by reference into the Acquisitions Directive from the Transparency Directive requiring the aggregation of shareholdings of investors who adopt a "lasting common policy".) There must also be some form of concerted acquisition of shares. However, conversely, it should also not be enough that two or more investors acquire shares under an agreement or understanding between them, unless there is also an agreement or understanding as to how the rights attached to their shareholdings are to be exercised.

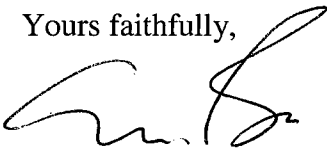
Such an approach would be more in line with other related regimes. For example, the provisions of section 824 Companies Act (which deal with when shareholders are regarded as acting in concert for the purposes of a response to a company's request for information on interests in shares) requires the existence of an agreement between the parties with respect to

the acquisition of shares (and the acquisition of shares in pursuance of that agreement) as well as the acceptance of obligations or restrictions with respect to, among other things, the exercise of voting or other rights. Even the UK Takeover Code does not regard the fact that parties come together to act in concert on voting (even on a "board control-seeking" resolution) as itself triggering any requirements unless there is also an acquisition of interests in shares taking the parties over or beyond the Panel's control threshold (see Takeover Panel Practice Statement no. 26), although it appears that independent purchases can count for these purposes. Indeed, the Level 3 guidance on the Acquisitions Directive itself is potentially ambiguous as to whether it is intended to cover simply "coming together to act in concert" without the concerted acquisition of shares or whether it requires that the explicit or implicit agreement between the shareholders in question covers both the decision to vote (or otherwise to exercise rights attached to shares) and the acquisition of shares.

A more general review of the Level 3 guidance should also mean that it is possible to consider whether it is possible to focus the guidance further on cases where shareholder collaboration is of direct concern to supervisors. In particular, it is notable that the Takeover Panel's guidance focuses on cases where those who "come together to act in concert" do so in relation to a "board control-seeking" proposal (rather than covering any form of voting cooperation). Following an approach on these lines may go further to address the concerns of investors about the extent to which the Acquisitions Directive limits collaborative behaviour in relation to listed companies.

We would be pleased to discuss these concerns further if that would be helpful.

Yours faithfully,



Chris Bates