

**The Financial Services and Markets Act 2000  
The Two Year Review**

**Response to the consultation document  
dated 27 February 2004 setting out  
proposed changes to secondary legislation**

**A Comments on the proposed exclusions in connection with the sale of a body corporate**

**B Answers to selected questions**

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**A Sale of a body corporate (Chapter 6)**

**1 The “approved structure”**

1.1 In my view, it is indeed necessary to impose some restrictions on the “may reasonably be regarded” test set out in the existing article 70 (1)(b)(ii) of the Regulated Activities Order. I had in fact always thought that the existing article 70 should have provided that the “may reasonably be regarded” test should apply only if the condition in paragraph (2)(c) (without “in either case”) was met. Paragraph (1)(b)(ii) should therefore have read: “the conditions in paragraph (2)(a) and (2)(b) are not met, but the object...”.

1.2 It is exactly because the condition in the existing paragraph (2)(c) presently does not need to be met where the “control” condition is used that the exemption is too wide and now needs to be narrowed. I would applaud the new way in which the Treasury now proposes to deal with this (see 1.5 below).

1.3 Given the intention behind the current exclusion in article 70 (as explained in paragraph 6.9 in Volume 1), however, I agree that it is necessary to provide a wider

“acting in concert” test than the concept of a “group of connected individuals”.

1.4

For the reasons given by the Treasury, it is clearly right to change the formula used for the purposes of the existing paragraph (2)(c) to refer instead to “a single person or a group of persons acting together” as now appears in the definition of “T” in the draft new article 70(1) as used for the draft new article 70(3).

1.5

The draft new article 70 (in article 4 in the draft Amendment Order in chapter 15) is written in a clever way to show that the various exclusions apply only in relation to a party that satisfies the condition in paragraph (2) or the condition in paragraph (3), as described in paragraph 6.15. Indeed they will now apply even if the other side does not satisfy either condition. Conversely, however, if the other side does not satisfy them, the exclusions will not apply to it or its advisers.

1.6

This result is much preferable to the original requirement in the Financial Services Act that both parties had to satisfy the condition before the exclusion could apply to either of them (paragraph 21(1) of schedule 1, as replicated in the existing paragraph 2(c)). It provides much more flexibility for the exclusions to apply to the side of the transaction which does satisfy the relevant condition.

1.7

I think, however, that it would be helpful to show that the condition in paragraph (3)(b) must actually be satisfied by T. Accordingly, in line 2, after “acquisition” **insert** “by T” and in line 3, after “disposal” **insert** “by T”.

1.8

In addition, the draft needs to use in paragraph (2) a different word from “holds” (which is always used to refer to a person “on the register” as shareholder). This is because the acquirer may want to appoint a nominee or trustee to hold the shares for him but cannot do so as the wording refers to the holding after the acquisition. So it should use instead the word “owns”. I should point out that the existing article 70(2)(b) also uses the word “held”. However, it is used only in relation to the existing shares already held by the acquirer before the acquisition (which is not as important as the shares held after the acquisition and the existing shareholding can normally be reorganised so

as to comply). If, however, the shareholder is the beneficial owner, the result is the same as if “holds” had been used.

1.9 Accordingly, in paragraph (2), line 2, please would the Treasury **delete** “holds” and “held” and **insert** instead “owns” and “owned”.

1.10 It is surely also important to provide that the exclusions now to be based on the condition in paragraph (3) should apply not only to “a group of persons acting together” but also to “a group of connected individuals”. I would urge that the condition in paragraph (3) should therefore refer also to an S (which may acquire control but not a 50 per cent holding). Otherwise, S cannot take advantage of the new relaxed condition, which surely it should be able to.

1.11 Accordingly, please would the Treasury **amend** paragraph (3)(a) and (b) to read as follows:

“(a) under which S or T acquires or disposes of voting shares in BD; and

(b) the object of S or T in entering into which may reasonably be regarded as being the acquisition by S or T (taking into account any voting shares already owned by S or T), or the disposal by S or T, of the day to day control of BD.”.

1.12 It may be the case that the sellers act together in the disposal, in the sense only of using the same financial adviser or solicitor acting for all, but is that enough to satisfy the “T” test? It would seem to do so but are the Treasury happy that it should, even if there is no *a priori* relationship (for example, as constituted on the acquisition)?

## **2 The “small company” test**

2.1 In the three options for the size of a “small company” as set out in paragraph 6.18, the Treasury have referred to the maximum limit of 50 persons as “a company which is “owned by” no more than 50 persons”; in line 2 of paragraph 6.18, the Treasury have made it clear that they are referring to beneficial owners. However, in the proposed new article 70(1), the definition of “BD” refers in (a) to the voting shares being “held by no more than 50 persons”. As indicated in 1.8 above, the use of the word “held” traditionally refers to shareholders (in other words, persons on the register).

2.2 There is therefore a major difference between these two tests where a shareholder in BD is a trustee or a nominee. The “beneficial ownership” test would look at the number of the

beneficiaries, or the persons for whom the nominee is acting, whereas the “shareholder” test would not. This means that a test based on shareholders could potentially cover a far greater number of persons than the beneficial ownership test. I have no views on which the Treasury should adopt and am merely pointing out this major discrepancy so that the wording in the definition of BD correctly reflects what the Treasury actually want.

## **B Response to specific questions**

### 1 Question 24

1.1 I agree with the narrowing of the “sale of body corporate” exclusion in the Regulated Activities Order.

### 2 Question 25

2.1 I agree that the Regulated Activities Order should be narrowed also so that the “may reasonably be regarded” test will apply only in relation to takeovers of small companies.

### 3 Question 26

3.1 I agree that the best option for the definition of “small company” is option 2.

3.2 It is however important to ensure that the drafting of the definition of “BD” accurately reflects the test which the Treasury want to provide for (“owned” rather than “held?”).

### 4 Question 27

4.1 I agree that the exemption for promotions in respect of takeovers should be subject to the same conditions as the “sale of body corporate” exemption in the Regulated Activities Order (but see section 9 below which sets out my concerns about what is meant by this). Where the offer falls outside the permitted structure, the offer circular from the offeror would in principle need section 21 approval. This is a necessary protection for (at least) small shareholders. Other exemptions may however be available (for example, where the recipient is a high net worth person).

4.2 Conversely, a circular from the target company’s board recommending an offer would indeed (as the Treasury indicate) often fall within the article 43 exemption (promotions to shareholders). It will, however, do so only if the offer consideration is cash. Where the consideration for the offer is, or includes, shares or (as a tax saving device) short-term bonds of the offeror, it would seem that

the exemption in article 43 will not apply (see last two lines of article 43(1) and of its replacement, article 49(1)).

- 4.3 If no other exemption from the need for section 21 approval applies, the target company's circular will need to be "approved" if it recommends the offer (but not if it recommends non-acceptance, because, as the Treasury note, that is outside section 21). However, I understand that the firm providing the advice on which the recommendation is based may well be different from the target company's financial advisers which would normally need to "approve" the whole circular.
- 4.4 In these circumstances, it would seem expensive and time-consuming for the statement of the advice given to the target company's board as to sufficiency of the offer, and its recommendation, to be approved under section 21 by the company's financial advisers. It would be much easier if the firm which gave the advice (if, as normal, it is FISMA-authorised) to give the section 21 approval of the portion of the circular setting out the recommendation by the board, and the advice as to the sufficiency of the offer on which it is based (which is a Takeover Panel requirement), leaving the rest of the circular to be approved by the target company's financial advisers.
- 4.5 However, the Treasury should please ask the FSA to allow approval by the "recommendation" advisers of the relevant portion of the circular only, rather than of the whole circular, and to allow the company's financial advisers to approve the circular other than the "recommendation" portion. It would seem to me that section 21(2)(b) allows this, as the approval is required for the "communication" of the inducement itself. Separate approval of the relevant portions of the circular would therefore seem to me to be satisfactory and it is certainly much more likely to be acceptable to the company's financial advisers than the approval of the whole circular.
- 4.6 Where the board gives its recommendation to shareholders, I agree that it will often not be necessary for the recommendation to be approved by an authorised person under section 21. However, it will in my view be necessary if the consideration is not merely in cash (see 4.2 above).
- 4.7 It seems somewhat inappropriate, however, that the directors of the target company should ever be concerned, as indicated in paragraph 6.22, with the condition in article 69, especially as the target company will not constitute part of either S or T at all. I think that there should be a stand-alone exemption to cover directors if the exemption in article 43 does not apply; as this will be the case if the consideration is in whole or in part in shares or bonds of the offeror, this may in practice

occur rather more often than the Treasury's hypothesis (in paragraph 6.22) that it will occur "only on limited occasions".

5 Question 28

5.1 I agree that it is desirable that telephone campaigns during a takeover should be subject to some form of regulation (or some condition equating with regulation).

6 Question 29

6.1 I agree that broadly speaking regulation should be similar to existing legislation.

7 Question 30

7.1 I prefer option (ii), albeit with some variation, for the regulatory structure for telephone campaigns.

7.2 I agree that the FSA should in principle not regulate unauthorised persons. However, quite apart from the cited articles in the Financial Promotion Order, it does of course also regulate unauthorised persons in relation to market abuse (which in extreme cases may be involved in telephone campaigns). As in market abuse, there should be some stand-alone (but hopefully much shorter) FSA rules governing telephone campaigns, with similar sanctions for contravention.

7.3 If this is too radical, the FSA can simply introduce a rule that an authorised person must use reasonable endeavours to ensure that every unauthorised person on his side in the telephone campaign during the takeover he is involved with complies with the telephone campaign rules.

7.4 If those rules are contravened, the FSA can then exercise sanctions against the authorised person, and the recourse referred to in paragraph 6.31 will be available in relation to the authorised person, if he had not used reasonable endeavours to ensure compliance. The telephone canvasser will also be subject to the criminal offence of making untrue or misleading statements, even in relation to a recommendation not to accept the offer, (FISMA section 397).

7.5 I am nervous about option (i) because, if the telephone canvasser steps outside the exact words approved, he will be committing a criminal offence merely because he does not have regulatory cover, which seems too big a risk to take. I agree that option (iii) is inappropriate, for the reasons given in paragraph 6.36.

- 8 The proposal in paragraph 6.38
- 8.1 Although the Treasury have not asked any question about it, I think that the slight broadening of the “hard-edged” limb is a helpful proposal.
- 9 Question 31
- 9.1 I agree that the Financial Promotion Order exemptions relating to takeovers of “relevant unlisted companies” do not need to be retained, **but only** if the “sale of body corporate” exemptions apply to a proposing acquirer (as well as or instead of the exemption for financial promotions to him). Otherwise, if a proposing acquirer wants to approach all shareholders, not just the controller (if any), and no other exemption is available, it will be necessary for him to use the “takeover” exemptions (hopefully, in a less detailed form) if he wants to avoid the cost of a section 21 approval. Indeed, the “takeover” exemptions are to help the acquirer and therefore should only be cancelled if the “new” exemption does so as well.
- 9.2 Even though the Treasury understand that the specific exemptions in articles 63-66 are “rarely used”, I would suggest that this may well be because it is much easier to use instead the exemption in article 62. Indeed, it is because these specific exemptions were retained that I thought that article 62 (and indeed article 70) was not necessarily intended to be as wide as it is.
- 9.3 I am therefore somewhat confused by the statement in paragraph 6.39 that the exemption in the proposed article 69 will (still) apply to financial promotions made to significant shareholders. I had thought that the purpose of article 69 was to take the communication out of regulation if the communicator (typically, the offeror) met the conditions in article 69, not to deregulate promotions to particular types of shareholder (in other words, the exemption should depend on who makes the communication not on who receives it). Instead, other exemptions may apply if the communication is to a permitted recipient (typically, if the “target” shareholder qualifies as a high net worth person, which a significant shareholder may do).
- 9.4 I therefore have a major concern here. The Treasury indicate in chapter 6 that a party seeking to acquire or sell shares giving control should be free from regulation (see, for example, the first sentence in paragraph 6.14). In my view, this means that financial promotions by S or T should be exempted from the need for section 21 approval, rather than financial promotions to it. The existing article 62(1) also provides the section 21 exemption by reference to the communicator.

- 9.5 Nonetheless, the financial promotion exemption in the proposed article 69 is for communications “to” the present or proposed controller (S or T) rather than “by” him (see paragraphs (4) and (5)). This is clearly what the Treasury wants (see line 1 of paragraph 6.22).
- 9.6 However, as the Treasury envisage, there may well be no existing controller for a proposing acquirer to make a financial promotion to. Similarly, even if a proposing seller finds prospective acquirers, they can surely not be regarded as constituting an S or a T (so allowing communications to them without section 21 approval) from Day 1. The exemption would therefore normally help only persons wanting to negotiate with the proposing acquirer or seller.
- 9.7 If the Treasury want to enable persons to approach or otherwise communicate with the proposing acquirer or seller, that is of course helpful, in particular in relation to communications to them by advisers and, in addition, by proposed counterparties (if the exemption is retained as “to” rather than “by”). However, what is really important is to exclude the need for section 21 approval if a proposing seller wants to communicate with prospective buyers, and a proposing acquirer wants to communicate with some or all of the shareholders, even if they are not high net worth persons, investment professionals, or outside the UK.
- 10 Question 33
- 10.1 I agree that the scope of products for unauthorised trustees should be expanded as proposed. However, I think that, at least to begin with, pooled investment vehicles which invest in dangerous products (typically, derivatives) should be excluded unless they are used only as a means of avoiding risk in the non-derivatives portfolio.
- 11 Question 34
- 11.1 I do not agree that there should be any relaxation of the “recommendation” condition which must be satisfied before unauthorised trustees can invest in exempt products.
- 11.2 If the condition was relaxed so that the trustees only have to obtain and consider independent advice, they can deliberately go against it, which is far too dangerous.
- 11.3 In addition, if it is true that many advisers are unwilling to consider alternative investments because they do not know enough about them, then surely the trustees cannot obtain their independent advice at all, even if only to consider it. The “adviser” is surely not allowed to advise against a

particular product merely because he does not understand it; he should instead tell the trustees that he cannot advise upon it, rather than advise against it for that reason alone.

12 Question 35

12.1 I agree that unauthorised trustees should be able to act on the advice of professional firms operating under Part **XX**.

13 Question 38

13.1 I agree with the three proposed changes to the Regulated Activities Order.

13.2 The one change that I think really must be carried through is the exclusion for trustees wanting to hold themselves out as being able to arrange custody services by FISMA-authorized custodians. There is no obvious investor-protection rationale for requiring them to be FISMA-authorized for this reason alone.

13.3 I am not sure whether article 77 needs to be amended as referred to in paragraph 8.7. I would have thought that contingent theatrical debentures are already within article 77 and indeed paragraph 15 of schedule 1 to the Financial Promotion Order. They do create indebtedness, albeit only contingent; they will become "real" debts if the contingency is fulfilled, which is outside the control of both sides and gives no room for FISMA authorisation or section 21 approval at that stage.

13.4 It is silly to think that creating indebtedness immediately is not a regulated activity but that, if the indebtedness is only future or contingent, that does require FISMA authorisation. This really seems to be the wrong way round.

13.5