

17 June 2005

Annette Grunberg
Corporate Law and Governance Directorate
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET

Dear Ms Grunberg

**DIRECTIVE PROPOSALS ON COMPANY REPORTING, CAPITAL
MAINTENANCE AND TRANSFER OF THE REGISTERED OFFICE OF A
COMPANY**

The IMA is the trade body representing the UK asset management industry. IMA Members include independent fund managers, the asset management arms of banks, life insurers, investment banks and occupational pension scheme managers. They are responsible for the management of approximately £2 trillion of funds (based in the UK, Europe and elsewhere), including institutional funds (for example, pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK-authorized investment funds (collective investment schemes).

In managing assets for both retail and institutional investors, IMA Members are major investors in companies whose securities are traded on regulated markets. It is from this standpoint that we have an interest in the proposals in the above consultation on company law.

We welcome the consultation paper (CP) and the Government's approach that company law should be seen as "facilitative, providing the key vehicle through which enterprise and entrepreneurship can flourish". We support a requirement for a corporate governance statement throughout the EU. This should help investment, as potential investors will receive equivalent information regardless of the Member State in which a company is listed. That said, we believe the Directive should not go further than requiring a statement that describes the key elements of corporate governance, it should not set out in detail what those key elements should be. This would allow some flexibility so that the matters reported could evolve over time and adapt to the changing corporate governance landscape. Furthermore, certain of the disclosures proposed could undermine the "comply or explain" disclosures under the UK's Combined Code and result in lengthy descriptions in the interests of complying with the Directive as opposed to informing shareholders.

The other proposals in the CP where we have reservations are set out below.

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- We do not agree that the 18 month period during which a company can be authorised by shareholders to repurchase its own shares should be extended or that the limit whereby the amount cannot exceed 10% of share capital should be removed. We consider that the existing requirements provide companies with sufficient flexibility and should not be relaxed.
- Companies should only be able to grant financial assistance to a third party to acquire their shares in exceptional circumstances. We would prefer it if the current prohibition was retained but if it is to be relaxed, we believe the conditions in the amended Directive should be the minimum required and do not agree that, as stated in the CP, "they are unduly onerous and complex".

Our answers to the specific questions raised are set out in the attached Annex. (As Section 4, the Anticipated Proposal Concerning the Transfer of Registered Office, is outside the IMA's remit, we have not answered these questions.)

Please call me on 020 7269 4668 if you would like to discuss any of the points in this letter or the attached or if you would like to discuss any issues further.

Yours sincerely

Liz Murrall
Senior Adviser – Corporate Governance

ANNEX

IMA RESPONSE TO THE CONSULTATION PAPER (CP) ON COMPANY LAW – DIRECTIVE PROPOSALS ON COMPANY REPORTING, CAPITAL MAINTENANCE AND TRANSFER OF THE REGISTERED OFFICE OF A COMPANY

The IMA's detailed comments on the questions in the CP are set out below.

Section 2: Draft Directive Amending the Fourth and Seventh Company Law (Accounting) Directives

Consequences for directors; establishing collective responsibility of all board members for the accounts and key non-financial information

Q1 Do you think it is helpful to have the issue of responsibility of directors clarified in EU law or should it be dealt with at national level only?

The IMA supports the board being collectively responsible to the company for the accounts and key non-financial information. This is preferable to the US's approach under Sarbanes Oxley which places an unfair burden on individual directors.

However, we do not believe that this should be prescribed in EU law in that it should be left to national frameworks – prescribing at an EU level could give rise to difficulties in implementation given the different national frameworks that exist.

Should the Commission decide to proceed with clarifying directors' responsibilities in EU law then it is important that any definition is general as opposed to specific (i.e. by referring to every step of the process for preparing, deciding on and disclosing information). A general definition is consistent with the principles-based approach to corporate governance that the Commission has sought to foster elsewhere and will allow developments to be addressed.

Q2 Do you agree that board members should be responsible to the company?

The IMA believes that anyone who relies on the information (whether a shareholder, creditor, employee or other) should have recourse to legal action in the event the information proves to be erroneous. If making the directors responsible to the company achieves this then we do not believe that it is necessary to take up the option of extending responsibility to individual shareholders, investors and other stakeholders.

(There is no question 3.)

Off-Balance Sheet Arrangements

Q4 Do you agree with the proposal in principle? If not why?

The IMA would welcome greater transparency and consistency in the disclosures in companies' accounts internationally. Thus, in principle, we support the disclosure of off-balance sheet arrangements and their financial impact if material to an assessment of a company's financial position.

Q5 Do you think the proposal is clear enough to make it workable and capable of consistent application?

As acknowledged in the CP, a requirement to disclose "arrangements not included in the balance sheet" is broad and could capture certain operational arrangements, such as purchase orders and contracts of employment. Furthermore, identifying items that are "material and of assistance in assessing the financial position" will require considerable judgment and interpretation.

Thus to ensure that the requirement is applied consistently, we consider that the above should be clarified by the standard setters and IFRS as opposed to incorporating detailed definitions and guidance in a Directive. That said, requiring the directors collectively to use their judgment in determining what should be disclosed should enhance their understanding of the business and the risks it faces.

Q6 If you draw up accounts, do you think that the changes to UK disclosure requirements set out in paragraph 4.2 will add significant burdens?

As managers of collective investment schemes, the IMA has an interest in disclosures in accounts both as preparers of funds' accounts and from the perspective of our Members' clients as investors. In this respect, we do not believe that the disclosure of "arrangements not included in the balance sheet" will add a significant burden as there are few, if any, off balance sheet arrangements in funds' accounts that would fall to be disclosed.

Q7 If you are a user of company accounts, do you believe that this additional information will be useful, and, if so, what is the added value?

As major investors in companies whose securities are traded on regulated markets, the IMA has an interest in the requirements governing how such companies prepare their accounts and the information disclosed to our Members as users. We believe that, in principle, the disclosure of off-balance sheet arrangements and their financial impact if material to an assessment of a company's financial position would assist in achieving greater transparency and facilitate the integration of capital markets and cross-border investment. In this respect, as noted in question 5 above, a requirement to disclose "arrangements not included in the balance sheet" is broad and runs the risk that it may be applied inconsistently. We believe that it is important that the standard setters and IFRS clarify this as opposed to detailed definitions being incorporated in a Directive.

Related Party Disclosures

Q8 Do you agree with the proposal in principle? If not why?

In principle, the IMA agrees with the proposal in the CP that companies within a group that currently do not prepare their accounts under IFRS should no longer be exempt from disclosing transactions between subsidiaries and other group members. Thus companies that are not required to report in accordance with IFRS will be standardised with those that are. We also consider that the definition of related party transactions in IAS 24, 'Related Party Disclosures' should be adopted throughout the EU. Member States should not adopt their own definitions.

Q9 If you draw up accounts, do you think that in practice it will increase your disclosure requirements?

As preparers of funds' accounts and from the perspective of our Members' clients as investors, we do not believe that this will increase the disclosures in funds' accounts, as there are already comprehensive disclosures of related party transactions.

Q10 If you are a user of company accounts, do you believe that this additional information will be useful, and, if so, what is the added value?

From the perspective of IMA Members as users, the additional information is likely to be of limited use. Our main interest in accounts is from the perspective of our Members as investors in listed companies. Under the International Accounting Standards Regulation all listed companies in the EU will have to prepare their consolidated financial statements in accordance with adopted IFRS. Although there are unlikely to be many listed companies that are not parent companies preparing group accounts, in the interests of consistency, we support the proposal in principle that any listed companies outside the scope of the Regulation, will have to disclose related party transactions in accordance with IAS 24.

Corporate governance statement

Q11 Do you think the introduction of a new corporate governance statement would contribute to the objectives set out in paragraph 3.5.2 above?

The IMA believes that introducing a requirement for a corporate governance statement throughout the EU will help investment, as potential investors will receive equivalent information regardless of the Member State in which a company is listed. Thus listed companies should be required to disclose whether they apply a code on corporate governance or not and, if they do apply one, in what aspects they deviate from its provisions.

Q12 Do you agree with what the Commission wants to be included in the corporate governance statement or do you think there should be something else included?

Whilst the IMA welcomes a requirement for a corporate governance statement, we believe that the Directive should not be more explicit than requiring "a comply or explain" statement on the key elements of a corporate governance code. This would allow some flexibility so that the matters reported can evolve over time and adapt to the changing corporate governance landscape. We do not believe that the Commission should be prescriptive and set in statute the detail of those key elements and we have reservations about certain of the elements in Article 46a and 36(2) of the 4th and 7th Directives, respectively, as set out in our answer to question 13 below.

Q13 Are there any elements in the corporate governance statement that should be excluded?

As already noted, we do not believe that the Commission should set in statute the detail to be disclosed in a corporate governance statement.

In particular, Article 46a of the 4th Directive requires the disclosure of: the composition and operation of the board and its committees; and a description of the company's internal control and risk management systems. These are currently covered by the Combined Code, and as such they are subject to "comply or explain". Requiring mandatory statements on these matters could:

- undermine the UK's Combined Code and approach to corporate governance by reducing the areas covered by "comply or explain";
- reduce the flexibility available to companies in how they apply best practice; and
- potentially have an adverse impact on the quality of disclosures by resulting in lengthy descriptions to ensure compliance with the Directive, in particular, descriptions of the various processes that make up the internal control system.

In addition, Article 46a requires details on the operation of the shareholder meeting and its key powers, a description of shareholder rights and how they can be exercised, and the information in Article 10 of the Takeover Directive of: (f) restrictions on voting rights; (h) rules on the appointment and replacement of board members and articles of association; and (i) the powers of board members. We consider that this information is factual and does not change. Requiring these disclosures could detract from the more meaningful and subjective information and result in lengthy disclosures in the interests of complying with the Directive as opposed to giving meaningful and subjective disclosures to shareholders.

The CP also states that it is proposed to amend the 7th Directive so that the corporate governance statement includes a description of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts. A company is subject to a variety of risks and must have an effective system that monitors and controls all of them, including financial, operational and compliance controls and risk management systems, to safeguard shareholders' investments and its own assets. Although we believe that the Directive should not set out the level of detail proposed and require a description of controls, if it is to require such a description, it should focus on all controls and not just those over financial reporting. In particular, in the financial sector the distinction between financial and other internal controls is arbitrary and impractical.

Q14 On the assumption that, in implementing the requirement, the Government would wish to avoid duplication of information in the report and accounts, do you believe that the annual report (the directors' report in UK accounts) is the correct place for the statement? If not, would you prefer the statement to stand alone, following the example of the directors' remuneration report?

The IMA believes that, for ease of reference, the corporate governance statement should be disclosed and given due prominence in the annual report.

Section 3: draft Directive Amending the Second Company Law (Capital Maintenance) Directive

Relaxation of the requirements concerning the valuation of non-cash consideration for the allocation of shares

Q 1 Do you think that the proposed changes relating to the valuation of non-cash consideration will make it easier and cheaper for companies to allot shares for a non-cash consideration?

Q 2 Do you agree that the courts are the correct body to review any breaches of the new provisions and that no other independent body needs to be designated to carry out this function?

Q 3 Do you agree that the right of minority shareholders to require a revaluation should be limited to the period before a contract is entered into?

Q 4 Do you see any scope for further simplification of the rules relating to non-cash consideration? If so, please specify and give reasons for your proposal.

Q 5 Do you have any other comments on the drafting of Articles 10a or 10b?

The IMA agrees with the proposals to relax the requirements concerning the valuation of non-cash consideration for the allocation of shares in that:

- it will be easier and cheaper in that there will no longer be a requirement to obtain a prior valuation if a company wishes to issue shares for a non-cash consideration (question 1);
- valuations will still be required if shareholders holding at least 5% of the issued share capital request one or if there are circumstances that could affect the value of the asset contributed;
- it will be for the courts to decide if the conditions have been breached (question 2); and
- the minorities' right to require a valuation will be limited to the period before the contract is entered into (question 3).

Relaxation of the requirements concerning acquisition of own shares by a company (buy-back)

Q 6 Do you think that the proposed changes will give companies more flexibility to acquire their own shares?

Q 7 Do you agree that a requirement to offer to purchase/sell shares to all shareholders would constitute an additional burden?

Q 8 Do you agree that companies should be free to repurchase own shares up to the limit of distributable reserves or do you consider that the current cap of 10% of issued share capital should be retained?

Q 9 If you disagree that a cap of 10% should be retained but consider that there should be a higher cap, what level of issued share capital do you consider would be appropriate?

Q 10 Do you think EU wide relaxation of the requirements concerning acquisition of its own shares by a company should go beyond the proposed changes? If so, what additional changes would you make and why?

Q 11 Do you have any other comments on the drafting of Article 19?

Currently, a company acquiring its own shares cannot acquire more than 10% of subscribed capital or distributable reserves and must be authorised by shareholders for a period of up to 18 months. The Commission proposes relaxing this to allow companies to be authorised to repurchase their shares for up to five years and only to the amount of distributable reserves - removing the limit of 10% of share capital.

The IMA does not consider that companies should have long-term authority to use their distributable reserves and that the existing term of 18 months and cap of 10%

of subscribed share capital should be retained (questions 8 and 9). We consider that the existing arrangements provide companies with sufficient flexibility (question 6). In particular, a company will frequently buy back its own shares in response to a certain situation. In these circumstances it is important that shareholders receive an explanation and are able to approve the acquisition. Furthermore, we believe that all shareholders should be treated equally and that a requirement to offer to purchase/sell shares should be to all shareholders (question 7). That said, we welcome the Commission clarifying that the authorisation applies to aggregate of own shares acquired and not just to a single acquisition.

Relaxation of prohibition on financial assistance

Q 12 Do you agree that the conditions governing the changes proposed will be a disincentive for companies wishing to take advantage of relaxed financial assistance rules?

Q 13 Are there better ways of providing shareholders and creditors with safeguards than the proposed 5-year solvency test?

Q 14 Should the right to contest the resolution be open to any shareholder or should it be a specified majority? Should the right be exercisable only within a certain period of the resolution?

Q 15 Do you have any other comments on the drafting of Articles 23a and 23b?

Currently, a company may not make loans, advance funds or provide security with a view to the acquisition of its shares by a third party. The Commission proposes relaxing this so that companies will be able to do so up to the amount of distributable reserves provided:

- liquidity and solvency are not at risk for at least five years;
- interest/fees are received for providing the assistance;
- a board report justifies the assistance and is agreed at a general meeting;
- the transaction is at a fair price;
- shareholders can contest and apply for a court ruling;
- distributable reserves applies to the aggregate transactions; and
- there are provisions to prevent any conflict between board members and the party receiving the assistance.

The IMA considers that companies should only be able to grant financial assistance to a third party to acquire their shares in exceptional circumstances. We would prefer it if the current prohibition was retained but if it is to be relaxed, we believe the conditions in the amended Directive should be the minimum required and do not agree that, as stated in the CP, "they are unduly onerous and complex" (questions 12 and 13). Furthermore, the right to contest the resolution should not require a majority but a specified minority (question 14).

Relaxation of procedures governing the waiving of pre-emption rights

Q 16 Do you think that this relaxation will remove an administrative burden in practice?

Q 17 Do you agree with the Government's view on the setting of the share price at at least 95% of the market price, in order for the relaxation to apply?

Q 18 Do you have any other comments on the drafting of Article 29?

Currently, when a company issues shares for cash, shareholders have a right to acquire them in proportion to their "old" shares. However, this right can be restricted or withdrawn by the general meeting provided the board submits a written report justifying the issue price. The Commission proposes that there will no longer be a need for a written report when the shares are issued at the market price at the time of the issue.

The IMA fully supports the principle of pre-emption rights in the Directive. We do not consider that the written report provides shareholders with added protection and relaxing this requirement will remove an administrative burden for companies (question 16). Shareholders almost always expect some explanation before they agree to disapply pre-emption rights above 5% and it is not necessary for this to be set out in a report.

Enhancing standardised creditor protection in all Member States in situations of reductions of capital

Q 19 Do you agree with the above proposal to standardize creditor protection across the EU?

Q 20 Do you think that there is economic benefit in standardizing creditor protection across the EU?

Q 21 Does this achieve the right balance of interests between companies and their creditors?

Q 22 Do you have any other comments on the drafting of Article 32?

Currently, creditors can apply to court to object to a reduction in a company's capital. The Commission is proposing that creditors will only be able to apply where they can demonstrate that the reduction will prejudice the satisfaction of their claims and that the company has not given them adequate safeguards.

In principle, the IMA supports the right of creditors to object to a capital reduction being limited to circumstances where they can demonstrate that the result will prejudice the satisfaction of their claims. We also believe that this should be standardised across the EU (question 19).

Introduction of "squeeze-out" and "sell-out" rights

Q 23 Do you agree that this measure should not be included in this proposal and that any further consideration should be in the context of the proposed shareholder rights directive?

Q 24 What should be the basis for computing "fair price"?

Q 25 Do you agree that it should be made clear that the obligation to sell at a fair price should be "in cash"?

Q 26 Do you share the Government's concern about the potential negative impacts of extending these rights beyond takeover situations?

Q 27 Do you have any other comments on the drafting of Articles 39a and 39b?

Article 15 of the Takeover Directive 2004/25/EC introduced a squeeze-out provision such that a shareholder holding 90% of a company's voting rights can require the remaining shareholders to sell him their shares at a fair price, or under Article 16, the minority can require that the majority acquire their shares. This applies following a

bid and the Commission proposes introducing similar rights in the 2nd Company Law Directive, irrespective of whether there is a takeover or not.

The IMA does not object to these rights being available in situations other than a takeover (question 23). This will provide protection where a majority shareholder exceeds the threshold through gradual acquisition, as opposed to a bid situation, and will clarify the minority's position and when they would have to sell when a majority shareholder takes a company private. We do not share the Government's concerns about the negative effects of extending these rights beyond takeover situations (question 26). We also agree with Government that it should be made clear that the obligation to sell at a fair price should be "in cash" (question 25) and that the requirement should not apply retrospectively.

We do not consider that such a proposal should be included in the Shareholder Rights Directive as this Directive is likely to cover the process of voting and conduct at meetings and it would be confusing to include provisions on "squeeze out" and "sell-out" (question 23).

Longer-Term Review of the Capital Maintenance Regime

Q 28 Do you think that the overall package of current proposals will make a significant and positive difference to companies wanting or needing to re-structure their capital? If not, what other changes would you like to see?

Q 29 Do you agree that a fundamental review of the capital maintenance system and of alternative approaches is a high priority for the EU?

The IMA considers that, subject to the comments in this response, the package proposed will help companies wishing to restructure their capital whilst still ensuring that there is adequate protection for shareholders (question 28). We do not believe that there is an urgent need for further reform (question 29).

Cost savings and benefits

Q 30 We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are also welcome on any unintended consequences or other implications.

The IMA has no further comments to make.

Section 4: Anticipated proposal Concerning the Transfer of Registered Office

Q1 Would it be useful to have provisions which enabled companies in the UK and other Member States to transfer their registered office to another Member State? If so, do you think that the right means if facilitating the cross-border transfer of a company's registered office with the EU is through a co-ordination Directive?

Q2 Do you agree that the scope of the Directive should be sufficiently broad to include both public and private limited companies? Are there any regulatory areas where you think special provision has to be made in relation to the transfer of companies?

Q3 Do you agree that the proposal should only address the cross-border transfer of the registered office?

Q4 *Are you satisfied that sufficient clarity is already provided in relation to the issue of transfer of the head office of a company by the European Court of Justice case law? If not, what further issues should be resolved by EU legislation on this matter?*

Q5 *Do you think that the proposed approach in relation to the taking of a decision by a company to transfer (relying on Member States' domestic laws in relation to alteration to a company's Memorandum and Articles) is the right one?*

Q6 *Are there any special provisions (apart from publication and the rules governing the decision to transfer) that you consider should be included to protect shareholders and creditors?*

Q7 *Do you think that the outline proposals are sufficiently clear concerning which national law will govern the transfer decision and the company once the transfer has taken place?*

Q8 *Do you agree that the correct approach in relation to employees participation provisions should be that, as a general principle, the law of the Host State will apply (except where there is a higher level of participation – where such participation rights exist – in the Home Member State)?*

Q9 *Do you have any other comments on the provisions on employee participation?*

Q10 *We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are invited, particularly, on the following aspects of the RIA:*

a) the likely number of UK companies (in particular, small companies) which might choose to use the cross-border transfer of registered office procedure proposed under the Directive;

b) whether section 9 of the RIA correctly identifies all the likely costs of the transfer procedure and the cost estimates used are reasonable;

c) any negative or disproportionate costs for small business that may arise from the proposal.

Comments are also welcomed on any unintended consequences or other implications.

The questions in Section 4 on the Anticipated Proposal Concerning the Transfer of Registered Office are outside the IMA's remit.