Association of British Insurers

REVIEW OF CERTAIN ASPECTS OF THE REGULATION OF TAKEOVER BIDS – PROPOSED AMENDMENTS TO THE TAKEOVER CODE

The ABI's response to Takeover Panel consultation paper PCP 2011/1

Introduction

1. The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

2. We believe the Panel was right to undertake its original consultation in PCP 2010/2 to address questions that were raised by ministers in the previous Government but to ensure that other Code matters would also be considered. We responded to that consultation making clear our view that the Takeover Panel and the Code are fundamentally sound and that the current regime has stood the test of time but this does not mean that it cannot be improved.

3. We welcome the opportunity to comment now on the detailed proposed changes to the Takeover Code to implement the Panel's decisions in the light of responses to PCP 2010/2.

General comments

4. The detailed proposals for modification of the Code substantially confirm the initial intentions that the Panel announced following the 2010 consultation. These changes on the whole are designed to give greater powers to offeree boards to maintain control of the process and provide enhanced transparency. We agree with these objectives but note that it is not always possible to achieve both. On balance we believe the Panel has reached the correct decisions where these objectives are in conflict.

5. We welcome the Panel's confirmation of the bulk of their proposals which, we consider, constitute a proportionate and appropriate response to the concerns that the playing field had become tilted away from offeree company boards and their legitimate defence of the company and its long-term interests. If left unaddressed this would not be in shareholders' interest or, indeed, that of the economy taken as a whole.

6. The increasing prevalence of 'virtual' bids has been a particular area of concern and we support changes to address this, notably that for greater transparency as to the identity of prospective bidders. We also support the general prohibition with regard to inducement fees.

7. These and other changes should achieve the necessary levelling of the playing field. However, in the event that this package were not to be considered sufficient we think that genuine consideration should be given to reintroduction of the SARs as an appropriate additional remedy. That would be a way of allowing an appropriate period for an offeree company to make the case to shareholders as to why the offeror gaining a large shareholding may not be in their interests, therefore allowing for a more measured progress of stake building. This would be a much more appropriate modification of the Code than radical options for reform such as disenfranchisement of short term holders or a changing of the finishing line from 50% +1 to, say, 60% which the Panel is right to have rejected.

8. We said in response to PCP 2010/2 that there is a case for some extension in scope of the Panel's jurisdiction which seems restricted, unnecessarily so, to the narrow 30 to 50 % envelope. However, we do agree that it is inappropriate for the Panel to impose via the Code a requirement for shareholder consent at the offeror company. This is a matter, in respect of UK-listed offerors, that is dealt with by the FSA through the Listing Rules which accords protection of shareholders under the Class Tests. We remain cognisant of the wider context of the initiatives in the UK to promote long-termism and at European level to consider the corporate governance framework where the rights of minority shareholders vis a vis controlling or dominant shareholders are considered.

9. We are pleased at the significant improvements proposed in transparency as regards the scope of required disclosure of financial information. This will now extend to all-cash offers and this will help ensure that the financing of such offers is subject to greater market testing. Directors of the offeree company will be better able to form a judgment as to whether the offer is in the interest in the company, and therefore to permit them to fulfil their directors' duties. However, we are surprised by the reversal by the Panel of its original decision to require provision by the offeror of a pro forma balance sheet. Indeed, given various other rule changes proposed we are concerned about the apparent reduction in the requirements for provision of accounting information which is necessary for investors to form an understanding of the financial position of the combined group and for shareholders to reach an informed judgment on the merits of the proposed transaction.

10. We agree with revisions of the Code to facilitate recognition of the interests of offeree company employees and in particular to improve the quality of disclosure by offerors and offeree companies in relation to the offeror's intentions regarding the offeree company and its employees. We believe this will assist directors in the discharge of their duties to take decisions in the interest of long-term value for the company and its shareholders as codified under the Companies Act 2006.

ANNEX

Questions for Consultation

We have responses to make to a number of the specific consultation questions.

Q1 Do you have any comments on the proposed new Rule 2.4 and the proposed new Note 3 on Rule 2.2?

We agree with the change to require identification of the potential offeror when the target company makes its initial announcement. This will redress the present imbalance whereby the target company is put into play but the potential offeror can continue to enjoy the cloak of anonymity. This should ensure that approaches are made on a more considered basis. It is for the parties jointly to ensure that confidentiality is maintained until an announcement is made to the market.

We also agree with the new Note 3 which clarifies that there is a need for an announcement during an offer period where there is rumour or speculation as to the identity of a potential offeror which has not previously been announced.

We emphasise that as regards ability to avoid premature exposure of the identity of possible 'white knight' competing offers the offeree board can do much to protect its room for manoeuvre (and similarly the prospective 'white knight' to protect its own interests) through careful management of their own processes to avoid information leakage. However there is still a need for information to be provided to the market without undue delay and we do not think this period of delay in practice should extend beyond the point at which there is a material likelihood of that information leaking.

Q3 Do you have any comments on the possible alternative approach to the identification of potential offerors?

We concur with the Code Committee's conclusion, on balance, that the benefits of transparency in regard to potential competing offers are not outweighed by the possible advantages of giving offeree boards the discretion as to whether to grant anonymity to parties who are potential offerors but whose existence has been referred to in relevant announcements. The greater transparency this provides as well as the more equal treatment of potential offerors are also points in favour.

Nevertheless, the arguments are relatively finely balanced and we are concerned at the possibility of unintended consequences particularly if that were to the confidential engagement of offeree boards with potential offerors whom they consider to be acting in good faith. The Code Committee needs to give careful thought to the drafting before finalising the rule changes here.

Q9 Do you have any comments on the proposed new Rule 21.2?

We agree with the general prohibition on inducement fees and other offer-related arrangements the size and prevalence of which we consider unjustified. However, we are not sure that an adequate case has been advanced to justify departure from

this principle in the case of competing offers at the discretion of the offeree board and where it confirms to the Panel that it considers this to be in the best interests of shareholders. If there is a case for Panel dispensation from the prohibition against inducement fees we think it should be restricted to circumstances where the offeree company is in serious financial distress. Accordingly we would invite the Code Committee to reconsider the appropriateness of the scope of departure from the general prohibition that it proposes.

Q16 Do you have any comments on the proposed new Rules 24.16(a) and 25.8?

We support the Panel's efforts to secure improved disclosure and we agree with the proposed formulation.

Q17 Do you have any comments on the proposed new Note 1 on Rule 24.16?

Shareholders have a legitimate interest in understanding the nature and quantum of fees to be earned by advisers. The fees payable in respect of hedging and other financial services have often been considerable and we are not convinced that they are entirely in the nature of arm's-length treasury transactions. Accordingly we believe that information should be provided as regards margins and fees payable on such services where they are connected to the offer.

Q18 Do you have any comments on the proposed new Rule 24.16(b) and Note 2 on Rule 24.16?

We agree that a reasonable estimate of the quantum or range of fees to be paid, where these are variable or uncapped, should be provided.

Q19 Do you have any comments on the proposed new Rules 24.16(c) and (d)?

We agree with the Panel having an element of discretion around what level of materiality should give rise to the need for an announcement of a change in the level of fees payable but we consider that the final outcome should always be disclosed together with an identification of cases where this has exceeded a previously expressed range or maximum.

Q20 Do you have any comments on the proposed deletion of Rule 24.2(b) and Note 6 on Rule 24.2 and the related amendments?

Q22 Do you have any comments on the decision not to require *pro forma* balance sheets to be included in offer documents?

We are disappointed and surprised by this revised decision by the Panel. We consider that a pro forma balance sheet indeed is the starting point for assessing the financial position of the combined group and we find the stated reason, that certain leading accountancy firms consider it to be too onerous, entirely

unconvincing. We think the Code Committee should reconfirm its original decision and formalise the requirement for provision of a pro forma balance sheet.

We also note with concern that the requirements of current Rule 24.2 are now proposed to be substantially scaled back in favour of an overarching requirement for "a statement of the effect of full acceptance of the offer on upon its earnings and assets and liabilities". The consultation paper does not explain that it is making this change or provide any rationale. Incorporation by reference will make the offer document less useful for many who value the provision of information in one place, while the greater use of electronic delivery of documents will reduce the additional production and postage costs implied by provision of the complete documentation. There are also concerns that there could be unintended consequences on the ability of shareholders to rely on the full suite of documentation including those incorporated by reference.

We consider that the Code Committee needs to revisit its proposals in this area. We think the pro forma balance sheet proposal should be reconfirmed unless more compelling arguments against it can be found. As regards its substantive proposals for streamlining we think a clearer understanding is required of what the actual accounting disclosures of earnings, assets and liabilities will look like and whether incorporation by reference has implications beyond production and distribution costs.

Q23 Do you have any comments on the proposed new Rule 24.3(c) regarding the disclosure of ratings and outlooks?

Yes, we think that any changes made are relevant to investors and should be disclosed.

Q26 Do you have any comments on the proposed new Rule 24.2?

We agree with the main proposed modifications to the Code on these points on the basis that these area reasonable effort to reflect the impact of codification of directors' duties under the Companies Act 2006 and to ensure that the Code helps rather than constrains directors in their efforts properly to discharge them. The primary and long-standing purpose of the Code is, quite properly, to ensure that shareholders are not denied an opportunity to decide on the merits of a takeover and that there is fair and equal treatment of shareholders in respect of actual and prospective offers. However, we think it is clearly within the wider remit of the Panel of providing an orderly framework for the conduct of takeovers, to facilitate directors' decision-making on the merits of any offers. We emphasise, accordingly, that these welcome modifications to the Code should not be misunderstood as the creation of, or recognition of, a public interest duty upon the Code and/or the Panel.

We are not, however, convinced as to the appropriateness of proposed Rule 24.2(c) which requires, if the offeror is a company, information as to the impact on the business, employees etc of the offeror. Such information could well be relevant to the directors and investors of the offeror but it does not seem to be relevant to the scope of the Takeover Code and the decisions that need to be taken by directors and shareholders of the offeree company. Indeed, we think the attempt to impose

extra-territorial jurisdiction in respect of overseas offerors is unjustified and to be avoided.

In our opinion, information of this kind should be provided, to the extent it is relevant, in documentation designed for the use of the investors of the offeror. In the case of UK listed company offerors this is the circular that would be sent to shareholders if the offer is of a level of materiality sufficient to make it a Class 1 transaction. Accordingly, we suggest that the Panel liaise with the FSA in its capacity as UK Listing Authority to ensure that relevant information is required under the Listing Rules to enable shareholders to make an informed judgment of the recommendations of the directors of the offeror in the light of their duties in law.

Q32 Do you have any comments on the proposed new Rule 25.9 and amendments to Rule 32.6?

We concur with the intent of this rule regarding circulation of the opinion of employee representatives. It is not clear, however, that this would be limited to a single opinion. We think that the requirements need to be applied in a proportionate manner both as regards the possibility of multiple employee representative opinions and also in circumstances where an opinion is voluminous in extent. The key requirement is that directors should, in the best interests of the company, communicate to shareholders the information necessary for shareholders to take an informed decision and we think there may, perhaps exceptionally, be circumstances in which that information is best presented in modified form.

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