**Blog for December 2018**

Capital increase: It is important to note that subscribing to shares on a “reducible” basis is possible only where the shareholder has first subscribed on an “irreducible” basis.

For capital increases, shareholders may benefit from preferential subscription rights (PSRs[[1]](#footnote-1)) that prevent the dilution of their holding in the capital of a company. By exercising their PSRs, shareholders subscribe on an irreducible basis to the capital increase. In this case, the number of shares allocated to them will be equal to their request. If the issue is also planned on a reducible basis and the shareholder wants to go beyond his or her existing rights, they may, in addition and without exercising their PSRs, subscribe on a reducible basis. In which case, the number of shares allocated may not be equal to the number requested.

This mediation case gives me the opportunity to stress how important it is for shareholders to pay close attention when filling in their reply form to a corporate action (CA) notice and for the account-keeping bank to better distinguish on the form the various methods proposed.

**The facts**

A bearer shareholder of Company A, Mr. P. benefitted from 726 PSRs resulting from a capital increase made by Company A in September 2016. Seeking to exercise his PSRs, Mr. P. deposited the corresponding reply form in the letter box of his bank branch on 19 September 2016.

But a few months later, when making his tax declaration, Mr. P. noticed that his request had not been fulfilled. In response to his written complaint, the customer service department of his bank informed him that no reply form in his name had been recorded in its mail reception process. Disputing this claim, Mr. P. called on my services.

**The analysis**

The bank informed me that as soon as it received Mr. P.'s complaint in May 2017, the customer service department contacted his bank branch, which confirmed that it had not recorded a reply form dated 19 September 2016. However, after further investigation, the securities department finally found a transmission report dated 19 September 2016 including a rejected instruction notice together with a copy of Mr. P.'s reply form.

What actually happened is that when the reply form was received on 19 September 2016, the transaction was rejected by the department responsible for processing CAs because Mr. P. had only ticked the option of subscribing to shares on a reducible basis. The rejection notice was transmitted to the securities department, which sent it on by email to Mr. P.’s branch on 19 September. But the branch failed to contact Mr. P. and inform him that his order had been rejected.

**The recommendation**

The case thus included mistakes on the part of the shareholder as well as the bank.

Mr. P. failed to send the reply form to the address clearly provided in the CA notice and simply deposited it in the letter box of his bank branch rather than sending it to the address specifically provided. I also observed that Mr. P. filled in his reply form incorrectly, since a shareholder can subscribe on a reducible basis only if he or she has already fully subscribed on an irreducible basis.

That said, the subscription form could have been more clearly explained and in particular include information specifying the difference between reducible and irreducible, which is something that, fortunately, other account-keepers do. Furthermore, I consider that the branch had ample time to contact Mr. P. to have him rectify his reply form, given that the deadline for instructions was 28 September 2016 and that it did not dispute that the form was received by the bank's CA department on 19 September.

Consequently, I contacted the bank, which agreed to favourably reconsider the case. To re-establish the position of Mr. P. exactly as if he had subscribed commensurate with his PSRs (but without taking account of a reducible subscription), I suggested, after obtaining the bank's prior agreement, compensation in cash or securities. Mr. P. chose to register 91 shares on his securities account in exchange for a debit for the subscription of €6,900 (corresponding to the amount of the subscription).

**The lessons to be learned**

For professionals:

- Given the risk of confusion between the concepts of “irreducible” and “reducible” subscriptions, account-keepers need to issue reply forms for CA notices that are as informative as possible so that shareholders can make informed decisions. For example, some account-keepers explicitly state on the subscription form that a subscription on a reducible basis is possibly only if the shareholder has first subscribed on an irreducible basis.

- For reply forms filled in incorrectly, and which are thus rejected, it is important, and a best practice, that account-keepers, where time permits, quickly contact shareholders and enable them to rectify their choice before the end of the CA.

For shareholders:

- It is vital to scrupulously follow the instructions on the subscription form, fill it in correctly and, above all, send it to the address marked on the reply form.

- Most importantly, shareholders should keep in mind that before subscribing on a reducible basis they must first subscribe on an irreducible basis. When a shareholder exercises their PSRs (on an irreducible basis), they are sure to obtain the new shares requested. If the shareholder no longer has PSRs but wants to acquire additional securities (on a reducible basis), there is no assurance that their request will be fulfilled and they are likely to obtain new shares only if new, unsubscribed shares remain (in other words, if the other shareholders have not exercised their PSRs). The shareholder’s reducible subscription order is fulfilled within the limit of their request and according to the number of securities the rights of which have been used in support of their irreducible subscription.

1. For more information on PSRs, refer to the blogs of October 2016, “When a holding disappears from an equity savings plan: *understanding how preferential subscription rights work*” and 3 March 2017, “*Preferential subscription rights: beware of the shortening of the subscription period*”. [↑](#footnote-ref-1)