The Association of Corporate Treasurers

Comments in response to
FOSTERING AN APPROPRIATE REGIME FOR SHAREHOLDERS' RIGHTS
Third consultation document of the Services of the Directorate General Internal Market and Services
30th April 2007

July 2007

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through our Policy and Technical Committee.

General

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We appreciate the opportunity to provide you with some feedback. When commenting on policy such as this we comment from the perspective of a non financial corporate issuer and their interests. On this subject of shareholder rights, governance and voting rights we have considered the generic principles that should underlie any decisions on actions as well as the practicalities.

We are strongly of the view that as owner of a share the shareholder should be at liberty to dispose of his property or property rights as he feels fit. That could involve splitting the votes from the economic interest and transferring on just one or the other. It is for the contractual counterparties to agree such terms as they wish, which may cover the giving the party not officially on the share register the ability to direct voting.

Although we support the idea of freedom of contract and the right of the shareholder to deal with his property as he feels fit, we do see that at the extremes there could be a disruption to the normal interpretation of the directors duties to run the business "to promote the success of the company for the benefit of its members" (UK Company Act 2006). This is normally interpreted to mean the creation of long term increase in shareholder value. If the shareholders have disposed of their economic interest it is conceivable that they may vote for the company to be run to achieve some other objective, but if they are the legal owners then this is their right to decide even if it is perverse by normal standards.

In practical terms it is imperative that the issuer should only have to concern itself with instructions received from the registered shareholder and that matters between the shareholder (and other intermediaries where relevant) and beneficial holders is a matter between the latter and not for the company. The company has no way of knowing what secondary arrangements have been made by the shareholder and were such arrangements to be disclosable by law this would introduce a huge complexity to the process. It would place an unreasonable burden on the company which is not itself a party or beneficiary of whatever secondary arrangements have been put in place. In particular the timescales allowed for shareholder meetings and voting by proxy or in person are governed by company law and for certain important company decisions speed is important.

Response to specific questions

Language of meeting documents

Question 1:
Q 1.1.: Do you think there is a need for action in that area?

Q 1.2.: If your answer is yes, do you think a recommendation along the following lines would go into the right direction?
"1. Companies should make available to their shareholders the convocation for a general meeting, the meeting agenda and the documents to be submitted to the general meeting at least also in a language customary in the sphere of international finance, unless the General Meeting decides to the contrary.
2. Point 1 should not apply to companies
- that fulfil at least two of the criteria established by Article 11 of the Fourth Company law Directive on annual accounts (not exceeding a balance sheet total of EUR 3 650 000, a net turnover of EUR 7 300 000 and an average number of employees during the financial year of 50), or
- that neither have a wide foreign shareholder base (on average under 10% of the subscribed capital) nor are actively seeking foreign investment.
For these companies, the obligation referred to in point 1 should only apply where this is requested by shareholders representing at least 1/3 of the subscribed capital."

The ACT is generally in favour of a minimal intervention of regulation and law into matters that can be determined by normal market forces.[1] In this instance on

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- Regulation commonly represents a barrier to entry, restricts competition and innovation and increases costs. It should thus normally only be used as a last resort where there is evidence of an actual or potential market failure or in quasi-monopoly areas where competition is

publishing documents in alternative languages there is no strong need for regulation since if providing translations makes the company's shares more attractive and lowers the cost of capital then there is a commercial incentive for the company to do so. If there is no perceived benefit then why should the company be forced to do so?

We would prefer to avoid any new regulation and leave companies to decide for themselves by reviewing the make up of their share register. However if you do decide to go ahead the formulation proposed is acceptable since for translation to be imposed, shareholders representing at least 1/3 of the subscribed capital must request it. The drawback of your proposal is that it could result in another routine resolution having to be added to every AGM agenda and the added complication this brings to both the company and the shareholders who have to read through all the resolutions to see if any are significant and material to them.

Depositary Receipts

Question 2: *Do you think a recommendation along the following lines would go into the right direction?*
"The depositary agreement should provide that the depositary is not allowed to vote on the shares without instructions given by the depositary receipt holder, unless the latter has given the depositary explicitly such discretion."

The purpose of a depositary receipt is to provide a mechanism for investors to hold shares in a convenient form with convenient settlement procedures and probably in their home currency. The depositary may be the legally registered owner of the shares but the intent is that the economic and voting interests appertain to the depositary receipt holder.

However legal and administrative complications mean the we feel that there is no need for a legal right for the receipt holder to be able to vote nor to prohibit the depositary from voting without instructions, but rather we expect that this should be covered by the contract arrangements and encouragement by regulatory and industry bodies.

We therefore support a Recommendation along the lines you indicate, but with the proviso that we do not expect or desire this to be incorporated into formal law within Member States.

Stock lending

Question 3:
Q 3.1: Do you believe that stock lending needs to be addressed at EU level? Please give your reasons.

Q 3.2: If your answer is yes, would you support recommendations along the

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insufficient, industry codes etc. have failed and where the public good from regulation manifestly exceeds the costs it engenders.

- Where regulation is to be applied it should be with a bias towards light-touch- and principles-based regulation to lower costs and preserve as much flexibility as possible.

ACT Policy and Technical Manifesto
http://www.treasurers.org/technical/resources/manifestoMay2007.pdf

following lines?
"1. Stock lending agreements should contain provisions informing the relevant parties of the effect of the agreement with regard to the voting rights attaching to the transferred shares.
2. Member States should ensure that shares can only be lent by financial intermediaries where the investor has explicitly agreed to his shares being used for stock lending in the framework agreement with his financial intermediary.
3. Borrowed shares should not be voted, except where the voting rights are exercised on instructions from the lender.
4. Stock lending agreements should provide that borrowers have to return equivalent shares to those borrowed promptly upon the lender's request."

In the ACT response to "*Fostering an Appropriate Regime for Shareholders' Rights:* Second Consultation by the Services of the European Commission Internal Market Directorate General, May 2005" [2] we said:

"Share lending is a way of enhancing the return on the investment in the shares. It is a right of the property in the shares and should not be fettered. Investors should expect to inform themselves about their decisions, and to make appropriate contractual arrangements as regards share lending – none, unrestricted, or with right of recall. It should be open to the parties to enter into whatever agreement they wish."

We still hold by this comment.

As your paper explains stock lending is strictly speaking a sale and repurchase agreement. The terms which are commonly in use in the market allow for adjustments to reflect any transfers of value to the stock borrower during his period of ownership such as restructuring of the shares, payments of dividends etc. If the parties wish to leave the voting rights with the lender, even though they are not on the share register they should make suitable contractual arrangements such as giving the lenders the right to demand the shares back. Market guidance already exists.[3]

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[2] http://www.treasurers.org/purchase/customcf/download.cfm?resid=1881

[3] The Bank of England / Securities Lending and Repo Committee (SLRC), Securities Borrowing and Lending Code of Guidance
http://www.bankofengland.co.uk/markets/gilts/stockborrowing.pdf

7.3 Securities lending involves the absolute transfer of title to both the securities lent and the collateral taken and any voting rights are transferred along with title. Securities must therefore be recalled by the lender, or collateral substituted by the borrower, if they wish to exercise the voting rights attaching to particular securities. It is in the interests of both parties to a securities lending relationship to understand each other's attitudes to voting from the outset.

7.4 A person could borrow shares in order to be able to exercise the voting rights and influence the voting decision at a particular meeting of the company concerned. There is a consensus, however, in the market that securities should not be borrowed solely for the purpose of exercising the voting rights at, for example, an AGM or EGM. Lenders should also consider their corporate governance responsibilities before lending stock over a period in which an AGM or an EGM is expected to be held. Beneficial owners need to ensure that any agents they have made responsible for voting and for securities lending act in co-ordinated way.

We do not believe that any new Recommendations are required from the Commission and indeed your proposal 3 is totally impractical. Borrowed shares are often used to settle an existing short position and are effectively put back into general circulation in the market and to all intents are not traceable. It would be impossible to identify such shares as "non voting unless the lender instructs". There may be some merit is educating those involved in stock lending and in establishing some market norms, but we feel that this is adequately covered, for instance in the "Guide to the Securities Lending Markets" commissioned by the International Securities Lending Association, the ACT and others.[4]

We repeat our point from the General paragraphs above. It is imperative that the issuer should only have to concern itself with instructions received from the registered shareholder.

Chain of Intermediaries

Question 4:
Q 4.1: Do you consider that the duties of intermediaries in the voting process need addressing?

Q 4.2: If your answer is yes, would you consider recommendations along the following lines as adequate?
"1. Member States should ensure that before entering into relevant agreements, intermediaries explain to clients whether, and if so how, they will be able to give instructions about the exercise of voting rights.
2. Where a client is entitled to give instructions about the exercise of the voting right, Member States should ensure that financial intermediaries that are part of the chain of intermediaries between that client and the issuer either cast votes attached to shares in accordance with the clients' voting instructions or transfer the voting instructions to another intermediary higher up in the chain.
3. Financial intermediaries should keep a record of the instructions and provide confirmation that they have been carried out or passed on for a period of at least one year.
4. Member States should ensure that fees charged by intermediaries for the services referred to above do not exceed substantially the actual costs incurred by that intermediary.
5. Member States should ensure that intermediaries take the necessary measures to have the client's name registered in the register of companies which have issued registered shares. This obligation should not apply where the client objects to his name being registered.
6. "Client" within the meaning of this provision is the natural or legal person on whose behalf another natural or legal person holds shares in the course of a business."

Where shares are held via a chain of intermediaries we agree that the ultimate beneficial holder is logically the person who should have the ability to direct the voting on their shares, even when those shares are actually registered in the name of

[4] http://www.treasurers.org/technical/securities-ebook.cfm

a nominee or agent. While this is the ideal objective it must be recognised that there are practical difficulties in insisting on a right to vote.

We do not believe that a legal enforceable right to direct is a pre-requisite, but rather the granting of such rights should be a matter of contract between the parties. Chains of intermediaries can be long and if each link in that chain undertakes to pass on information or voting instructions, even relatively promptly within a few days, there could be difficulties in ensuring shareholder meeting timetables are met. However if the chains are short and the parties agree to use electronic communication suitable arrangements should be perfectly practical and in that case there is no reason for the parties not to contact to pass on voting rights.

Whatever the contractual arrangements are at each level of the chain of ownership, these should continue to be viewed as a private matter between each set of the contracting parties and should not affect the company. The company need only look, therefore, to how the registered shareholder actually votes the shares.

With the exception of point 5 your proposals would be acceptable as a recommended code of conduct or best practice, but should not be introduced as law since this is really an area where if the desire to vote is strong enough, ordinary commercial pressures should be sufficient to generate the desired contractual positions.

As regards point 5 we entirely reject the idea that companies should keep a parallel share register of ultimate shareholders or the names all the way down the chain. The intermediaries are the parties setting up the chains for commercial reasons and earning commercial fees. If any special arrangements are sought by their customers then it for them to decide on the commercial merits of providing such services and bearing the costs.

Disclosure on investors

Question 5: *Would you agree that the transparency directive, once implemented, will give a breakdown of voting rights and that further action at EU level would be premature?*

As explained in your consultation the Transparency Directive already establishes procedures for notification to the company of shareholdings over 5%. The UK Listing Authority in this area has super-equivalent rules. We agree that at this stage the measures already in place appear adequate for disclosing to a company who their actual investors really are.

Management companies of investment schemes

Question 6: *Do you think there is a need for a recommendation along the following lines?*
"1. Management companies, the regular business of which is the management of collective investment schemes, shall be deemed to be 'clients' for the purposes of the draft recommendations set out in section V.1.
2. Member States should ensure that management companies referred to in point 1 shall be permitted to cast votes attaching to some of the shares differently from votes attaching to the other shares."

Article 13.4 of the draft directive on shareholder rights says “A shareholder referred to in paragraph 1 shall be permitted to cast votes attaching to some of the shares

differently from votes attaching to the other shares." This is a clause that we supported in facilitating dealing with voting instructions coming up a chain of ownership from various end investors. If a further change is required to cater for the circumstance for investment schemes that you mention then we would support that too.

Additional Points

Contract for differences (CFD)

Much of your consultation is dealing with the circumstances where the economic interest in shares is held by a person who is not the registered shareholder and hence not the person with the voting rights. Another example of where this happens is with contracts for differences. Here the registered owner of a share remains on the register but writes a totally independent contract with a second party to pay to or receive from them amounts calculated from movements in the reference share price. The registered owner does not bear the economic effects. These fall to the holder of the CFD.

As mentioned in the introduction one might argue that the directors of a company have a dilemma here as to whether they are running the company to create shareholder value for the CFD holder or whether they are running the company "to promote the success of the company for the benefit of its members" (UK Company Act 2006). We are clear here that from the point of view of the company they must have regard to the legal registered shareholders and that there should be no obligation to look beyond those registered shareholders.

One could envisage some anomalies where by a special interest group, e.g. environmental pressure group or trade union acquires shares and divests itself of the economic consequences via CFDs and then applies its voting rights to pressurise the directors into pursuing a strategy that would favour the pressure group interests at the expense of shareholder value. Although apparently perverse, we are clear that in such a case the directors must submit themselves to the voting wishes of the registered shareholders.

Your consultation is silent on CFDs and since we believe that no changes to shareholder rights are required here, we support your stance.

Special voting shares

Your consultation paper examines circumstances where the formal voting rights are not aligned with the economic interests. This situation can be entrenched into a company's constitution via shares with special voting rights over and above the one share one vote concept. For these companies there is a permanent dislocation of the proportionate voting right with the same proportionate economic interest. We believe that in general these arrangements are inequitable and in the interests of good governance should be discouraged. However there may be good historical reasons for these structures and if these are what the founding or subsequent shareholders have agreed upon then there should be no legal reason to disturb them. If investors do not like such ownership structures, in an open capital market they do not have to buy into those companies. Ordinary demand pressures will normally mean companies with unattractive structures suffer a share price discount

and certainly this seems to be the evidence of the report commissioned by the European Commission from Institutional Shareholder Services.[5]

Your consultation is silent on the one share one vote debate. We agree that this does not warrant any special measures for now and prefer to see such mechanisms dealt with through normal market pressures and developments.

[5] http://www.issproxy.com/pdf/EC_Study_press_release060407.pdf
"80% of investors in the sample expect a discount for companies with control enhancing mechanisms"

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at http://www.treasurers.org/technical/resources/manifestosept2006.pdf.

Contacts: John Grout, Policy and Technical Director (020 7847 2575; jgrout@treasurers.org) Martin O'Donovan, Assistant Director, Policy and Technical (020 7847 2577; modonovan@treasurers.org) Peter Matza, Policy and Technical Officer (020 7847 2576; pmatza@treasurers.org)	The Association of Corporate Treasurers 51 Moorgate London EC2R 6BH, UK Telephone: 020 7847 2540 Fax: 020 7374 8744 Website: http://www.treasurers.org