

EUROPEANISSUERS' COMMENTS ON THE CONSULTATION ON A STEWARDSHIP CODE FOR INSTITUTIONAL INVESTORS OF JANUARY 2010

Position
15 April 2010

We welcome the UK Stewardship Code for Institutional Investors, in particular, Principle 6 that requires institutional investors to have a clear policy on voting and disclosure of voting activity.

I - General Statement

As the European association representing listed companies, we strive for closer ties with long term shareholders, because we believe that companies and long term investors have convergent interests. EuropeanIssuers is working on several initiatives to restore the dialogue between companies and shareholders and to allow shareholders to fully enjoy their rights and take up their responsibilities.

The crisis related legislation should not just streamline and improve the securities markets, but also re-establish their link with the real economy. The authorities should take care to balance their striving for efficient capital markets with good corporate governance and a responsible share ownership. We believe that we must find a sound balance between:

- a) the interests of the markets, its players and its users and
- b) the welfare of the company and its ability to achieve its economic purpose.

We fully endorse the “comply or explain” principle applied in the majority of EU Member States. The corporate governance codes which are in place are satisfactory and there is no need to enlarge the companies’ obligations covered by these codes. Clearly if a company does not apply the codes, it should explain why not. Having said that, there is no need to increase the already existing reporting obligations in this respect. Rather we should focus on encouraging and enabling the investors to attend the general meetings and exercise their voting rights, allowing them to enforce the “comply or explain” principle in practice.

II- Issues for Comment

“Section 1: Introduction

QUESTION: “The FRC would welcome views on the policy objectives against which the FRC should judge its approach to a Stewardship Code (paragraph 1.14), the proposed objectives being to: (...) Contribute towards improved communication between shareholders and the boards of the companies in which they invest.” (p.21)

ANSWER: This objective stresses the importance of communication between shareholders and their companies, to which we fully subscribe. However the Stewardship Code alone will not be able to achieve this goal. Companies are often hampered from establishing a communication line with their shareholders because they do not know who their shareholders are. This is a real problem today which finds its origin in the intermediation, dematerialisation and globalisation of the securities landscape. The issuer cannot initiate the dialogue if it does not know its shareholders.

Nowadays investments are done on a cross-border basis. Securities are often held in a dematerialised manner with financial intermediaries located in various countries. A security is not any longer a piece of paper. It is represented by a credit entry in a securities account that one can open with his local bank. In an international context, this account provider will in turn have opened a securities account with a global custodian in the country where the issuer is located. This is but an easy example, in reality there is often a lengthy chain of financial intermediaries between the shareholder and the company. As a consequence, issuers and shareholders have no direct relationship, they have no direct communication channel. The issuer literally doesn't know who his shareholders are. Using a share register doesn't really help as in many cases the registration is done in the name of a so-called nominee, meaning a financial intermediary.

For years, EuropeanIssuers has been advocating that companies must have the right and the ability to identify their shareholders. How can you communicate with your shareholders if you don't know them? Recent studies show that investor disclosure is necessary to ensure good corporate governance as well as correct price setting.¹ Boards should be clear about the identity of the shareholders and their respective information requirements. Such would allow Boards to tailor the information with the level of detail and means of delivery appropriate to each category.

Action is needed at 3 levels:

- We need a EU wide harmonised legal regime that establishes the right for companies to obtain disclosure of the shareholders: unfortunately nothing concrete is planned by the European Commission despite our continued pleading.
- We need EU legislation to make the securities accounts providers (the financial intermediaries) to co-operate in view of such disclosure: the future Securities Law Directive currently in preparation with the European Commission is the perfect instrument for this, but unfortunately nothing is foreseen in this sense. Indeed, shareholder identification could already effectively happen in most Member States of the EU, even in the current legal environment without a harmonised legal regime, provided that all concerned parties would be willing to co-operate. The difficulty derives entirely from the fact that the account provider does not pass on the information. The account providers' refusal or reluctance to co-operate could have various reasons: data protection; banking secrecy; lack of knowledge of the requirements that should be complied with; confusion because of conflicting legal or

¹ "[The case for Mandatory Ownership Disclosure](#)" by Michael Schouten.

regulatory regimes; lack of level playing field with competing account providers; sheer unwillingness.

The Commission rightly considered it necessary that the Securities Law Directive should include provisions on the duties of intermediaries to make sure that the investors' corporate rights can be effectively exercised. In our view, nothing would be more logic than to take this excellent opportunity to extend the duties of intermediaries to include the disclosure of the shareholder's identity. By doing so, the legislator would help out all these Member States where the right of disclosure already exists independently from the arrival of a EU wide legal regime that would establish the universal right of the company to know its shareholders².

- We need an EU wide technical solution to support shareholder transparency: Target2Securities, the central settlement platform project currently developed by the Eurosystem could assist with delivering (part of) the technical solutions. In fact, a Target2Securities taskforce was set up recently within the ECB to look at shareholder transparency.

"Section 3: The Coverage of the Code

QUESTION: *"The FRC is keen to hear from foreign investors in response to this consultation, and would in particular welcome comments on: (...) Any barriers or other potential difficulties for foreign shareholders seeking to engage with UK companies." (p. 22)*

ANSWER: Shareholders must be able to enjoy their rights and assume their responsibilities vis-à-vis the company of which they are co-owners. In Europe the corporate governance model is based on the "Comply or explain" approach which can only work if enough shareholders engage. Engagement should be a core part of investment activity. But it is also true that shareholders deserve more efficient voting procedures.

Principle 6 of the Stewardship Code requires institutional investors to have a clear policy on voting and disclosure of voting activity: institutional investors should seek to vote all shares held; when abstaining or voting against resolutions, they should inform the company in advance and justify their reasons; they should also publicly disclose voting records.

We fully subscribe to that principle. However for institutional investors to be able to comply with this principle they need to be practically enabled to vote!

Indeed while foreign ownership of shares continues to grow, the exercise of corporate rights, in particular the right to vote at the general meeting, is too often hampered by technical and legal barriers. Difficulty to access information, for instance, is believed to be an important impediment. When an investor decides to buy and hold foreign shares, a chain of financial intermediaries intervenes in the process, each of them operating in different markets with different rules, customs and practices.

² In the assumption that such right could not be taken for granted.

Over the last four years A European Working Group³ composed of companies, investors, banks and infrastructures worked to make it easier for foreign investors to participate to shareholder meetings. This initiative, sponsored by the European Commission, recently resulted in a set of market standards for cross-border communications and operations: the [Market Standards on General Meetings](#).

In essence, the standards pave the way for a timely and efficient exchange of meeting related information. They offer a practical toolbox to implement some key aspects of the Shareholder Rights Directive of July 2007.

The standards are built on three pillars: 1) a system to bring the key elements of the meeting convocation in a quick and uniform manner to the end investor, 2) a practical solution to define who is entitled to vote and 3) a mechanism for casting votes ahead of the meeting.

The standards bring a practical solution by harmonising and streamlining the way in which the parties in the chain communicate: Who should communicate What, When and How.

The JWGGM submitted the market standards to the involved European associations for endorsement by the end of 2009: most of these associations endorsed the standards. In the meantime the JWGGM has drafted Frequently Asked Questions (FAQs) in order to clarify some remaining doubts concerning the interpretation of the standards. The FAQs should trigger the endorsement by the credit sector associations. Afterwards local markets will have to undertake a gap analysis to check the standards against national law and market practices and draw up an implementation plan, after which implementation in practice can follow.

“Section 5: Reporting, Monitoring and Review

QUESTION: “Views are invited on whether public disclosure of such information is appropriate and useful, and whether other information might also usefully be disclosed.” (5.6, p. 17 and 23)

ANSWER: Institutional investors and voting agents have a loyalty duty towards their clients and beneficial owners. Any voting policy needs to be established on the grounds of these obligations and, in any case, must serve the purpose of maximising the benefit for the beneficial owners. Even incentives to further a long-term interest of investors in their investee companies must operate within the limits of this purpose. In the light of this, any public disclosure (i.e. to an indefinite number of addressees and, thus, not only

³ The Joint Working Group on General Meetings (JWGGM), that is chaired by EuropeanIssuers’ Secretary General, is composed of delegates from the main European associations representing Issuers (EuropeanIssuers, previously EALIC), Registrars (Institute of Chartered Secretaries and Administrators - Registrars Group), Central Securities Depositories (ECSDA), Intermediaries (EBF, ESG, EACB and ESSF), Stock Exchanges (FESE) and Investors (Euroshareholders, the Association of British Insurers and the UK Institutional Shareholder Committee).

to the beneficial owners) might go beyond what is needed to incentivise institutional investors in the intended way. Public disclosure may produce conflicts of interests in that voting records are made known not only to the beneficial owners, the only ones with an economic stake, but to the public in general which may well have other interests. This can subject institutional investors to undue pressure which, in the end, will be detrimental for a constructive dialogue between issuers and institutional investors. Whereas disclosure of voting records to beneficial owners is appropriate, informing the public about voting records should not be pursued per se as good stewardship.

III – Encouraging Long-term Investment

Not all investors are interested in the long term welfare of the enterprise. Some look at the security as a financial instrument that allows them to make as much profit as possible in the shortest possible time. They might own their shares for no more than a month, a week, a day or even minutes. There are examples of a multiple market turnover of the complete free float of a company's shares in a single day.

Such shareholders cannot or do not want to exercise their voting rights and many simply do not wish to assume their "responsibilities as owners". Nevertheless these investors enjoy the same corporate rights and hold the same decision power as other shareholders do regarding the strategy of the company. Indeed despite this diversity in shareholders, traditionally it has been a principle of good corporate governance that all shareholders should enjoy equal treatment: all have the same rights towards the issuer.

We believe that short term owners should not enjoy the same rights as long term owners. At the same time, we believe that long term shareholders should be rewarded for assuming their responsibility as owners. We are in favour of putting mechanisms in place to this effect. There are a number of options we would like to explore further. For instance, we could make shareholder rights - voting, dividend, corporate action, etc – conditional or differentiate them depending on certain criteria. Long term shareholders could be entitled to multiple voting rights or to a loyalty dividend. One determining factor would be the duration of share ownership, but there may be other criteria. The objective of a possible differentiation of treatment should be to reward responsible owners and "stabilize" the shareholder base, not to make the management complacent. This proposed measure should be viewed as a measure of good corporate governance. Finally, we could think of rewarding the actual exercise of the voting right.

These are but a few ideas to serve as a basis for further discussion. Indeed we are very much in favour of a direct dialogue between companies and their shareholders to define adequate measures to encourage long-term investment which are agreeable to both parties.

As the representative association of listed companies in Europe, EuropeanIssuers is convinced that companies and long-term shareholders' interests are convergent. This is the message we brought at several occasions and we will continue to do so in the future. Our association has been actively seeking contact with investors' associations

representing the institutional and the retail side. Our experience so far is that such direct communication proves to be very rewarding for both parties and we are determined to continue on this path.

In this respect we would welcome any initiative that the Financial Reporting Council would envisage to promote the dialogue between issuers and investors and would be most happy to cooperate where possible.

EuropeanIssuers is a pan European organisation set up to promote the interests of issuing companies. Its members are national associations and companies from 14 European countries counting together some 9.200 listed companies with a combined market value of some € 5.000 billion. As such it represents the vast majority of publicly quoted companies in Europe. The members of EuropeanIssuers come from various sectors including automotive, nutrition, energy, health care, construction, financial services and many more. What brings them together in EuropeanIssuers is that they are all owned by the public, making them subject to an impressive set of complex and stringent rules and regulations. Through EuropeanIssuers listed companies can engage in direct discussions with the decision makers at European, trans-Atlantic and global level. Typical areas of interest include shareholder rights, corporate governance, transparency, clearing and settlement as well as financial reporting and auditing. Our ultimate goal is to achieve fully integrated, liquid and well functioning European financial markets combined with good corporate governance and responsible share-ownership. More information can be found on www.europeanissuers.eu.