



European Commission
DG Internal Market and Services
Financial Services Policy and Financial Markets
B-1049 Brussels
Belgium

28 December 2010

Subject: the Association of British Insurers (ABI)¹, Eumedion² and Eurosif³ response on the second consultation on legislation on legal certainty of securities holdings and dispositions

Dear Sir or Madam,

We welcome the opportunity to submit comments on the Commission services' second consultation on legislation on legal certainty of securities holding and dispositions. As representative organisations of institutional investors with large cross-border holdings, we very much support the Commission services' efforts to establish a safe and efficient post trading landscape across the European Union (EU). For institutional investors and their asset managers a well functioning holding chain between them and issuers is of utmost importance, particularly the ability to receive information and to vote at shareholders' meetings. This is essential for institutional investors and their asset managers in relation to being 'responsible and active owners'. We believe that in principle the entity, who bears the economic risks and receives dividends on any shares or other securities purchased, should be able to have direct input into voting rights effectively in all possible circumstances. We therefore support the Commission services' objective that the ultimate account holder should have the right to exercise and receive the rights on the

¹ Interest Representative Registration ID number of ABI is: 730137075-36.

² Interest Representative Registration ID number of Eumedion is: 65641341034-11.

³ Interest Representative Registration ID number of Eurosif is: 70659452143-78.

basis of a functional approach.⁴ We note that we sent a previous letter on the issue to the Commission in August 2010.⁵ We still fully support the content of that letter.

Some of the themes touched upon in the consultation document are outside the scope of our organisations' objectives. Our response is therefore confined to the sections of the consultation document that we consider key issues for facilitating the exercise of shareholders' rights through a cross border holding chain. Before addressing specific questions, we would like to draw attention to a number of high level remarks.

I. General remarks

The voting chain

Institutional investors and their asset managers acting on their behalf (hereafter ultimate account holders) are generally bound to hold securities issued by listed companies through a chain of brokers, custodians and central securities depositories (hereafter account providers). In cross-border situations, the ultimate account holder holds a securities account with an account provider in his own jurisdiction, this account provider then holds an account with an account provider in another jurisdiction, such as an international securities depository, they in turn hold an account with a local account provider in the jurisdiction of the issuer. The ultimate account holder can exercise the rights attached to the securities, particularly the voting rights, only if the chain of account providers facilitates and ensures sufficient coverage of the securities and the exercise of voting rights. Currently the holding system does not function optimally due to both legal and operational barriers in relation to voting. We therefore support the Commission services' approach to improve the functioning of the voting chain by requiring account providers to facilitate the processing and exercise of securities rights, including voting. In this regard, it needs to be clear that institutional investors, such as pension funds and mutual funds (and asset managers acting on their behalf), are deemed to hold a security account "for their own account" in the sense of the definition of an ultimate account holder. These entities should be able to vote as part of their fiduciary duty on behalf of their beneficiaries.

Current problems with cross-border voting

More and more ultimate account holders own shares of foreign listed companies. By the end of 2007, investors located outside their 'home market' owned 37% of total market capitalization in EC countries⁶. In some countries, like the Netherlands, this figure is even higher: on average around 72% of the shares of the largest Dutch companies are owned by foreign investors⁷. Under these circumstances, barriers to cross-border voting are likely to have serious consequences on the voting turnout at shareholders'

⁴ Principle 3.1(1) of the consultation document.

⁵ http://www.eumedion.nl/page/downloads/SLD_-_investors_position_2010_DEF_II.pdf.

⁶ Federation of European Securities Exchanges (FESE), "Share Ownership Structure in Europe" (December 2008).

⁷ Source: Eumedion, based on figures in the 2009 annual reports of the Dutch listed companies.

meetings. Ultimate account holders are facing a number of legal and operational problems. In some cases their authority to exercise voting rights attached to 'their shares' is denied simply by account providers and/or issuers. When their authorisation is acknowledged, ultimate account holders sometimes struggle to have their voting instructions passed through the chain. Moreover, studies have shown that in quite a few cases votes casted simply went missing. The presumption must be that these problems are worse in cross-border situations, with the currently fragmented cross-border voting system characterised by inconsistency, ineffectiveness and a lack of transparency. This often leads to bureaucracy and substantial additional costs. These costs stem from the extra manpower and other resources required to 'get the vote through'.

The problems with cross-border voting in Europe partly originate from the fact that from a legal perspective it is often not clear who in the chain of account providers should be entitled to vote. The ultimate account holder who has made the investment decision and bears the risks related to the shares, often is not registered in the issuer's share register. Instead, each of the jurisdictions involved may provide that the account holder in that jurisdiction is entitled to exercise the voting right, which leads to a set of conflicting entitlements.

There are significant operational barriers as well. In some cases account providers simply fail to pass voting instructions by the ultimate account holders. In other cases, account providers have blocked shares in advance of shareholders' meetings without proper or legitimate justification and thereby limiting voting abilities for ultimate account holders. In some member states, another barrier for cross border voting is that new powers of attorneys are required for every shareholders' meeting. Further, in some member states it is required to fill in detailed proxy instruction forms, which is also rather burdensome and costly. A balanced proposal for a Directive could truly solve these problems resulting from the current voting chain and practical challenges associated therewith.

Functional approach

While the legal environment should primarily facilitate market practices, the existing legal framework in the EU – predominated by national laws – actually appears to obstruct efficient cross border voting practices. At EU level harmonised entitlement of securities ownership would be the strongest protection for ultimate account holders to exercise shareholders' rights. However, as the way that the preparation of the Shareholders' Rights Directive⁸ turned out, it would be very complicated to achieve this within a reasonable time. That is the reason why we support the alternative of an effective functional approach to the exercise of rights flowing from securities.

⁸ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ L 184, 14.7.2007, p. 17).

Essential in this approach should be that ultimate account holders can actively exercise the right to vote and engage with the companies they invest in, regardless whether they are formally legal holder of the shares under the relevant national law. Only few would want to deny that ultimately, the ultimate account holder should be the one who controls how the voting right is exercised, in the sense that such ultimate account holder should be able either to vote himself or on the basis of a power of attorney provided by the party in the chain who formally is seen as shareholder or to instruct the formal shareholder how to vote on his behalf.

Progress

We are concerned about the lack of progress on the exercise of voting rights through cross-border holding chains. While IT services and infrastructure for cross border voting have significantly improved over the years, there is still no uniform EU framework that governs issues that are of crucial importance for exercising voting rights cross-border. More than six years after the European Commission set out a roadmap for action to enhance the safety and efficiency of post-trading arrangements, we are still in the process of consultation of regulatory options. We believe it is time for the Commission services' and member states' representatives to 'bite the bullet' and finalise the legislation needed within reasonable time. Effective abilities to vote and the execution of other rights across the board will greatly enhance institutional investors' ability and appetite to act as proper stewards as such is in line with the corporate governance reform program of the Commission.

II. Answers to questions

A number of questions from the consultation document that are relevant for shareholders in listed companies will be considered below.

Section 3 - Account-held securities

Q5: Would a principle along the lines described in the consultation document provide member states with a framework allowing them to adequately define the legal position of account holders?

Yes. Account holders need to know to what extent rights linked to a securities position can be exerted. They expect to be able to use securities and the various rights flowing from those securities. This sometimes appears to be difficult in practice. As the legal status of the securities right credited to accounts may change in a holding chain which crosses borders, account holders may have differing rights depending on their position in the chain and the applicable national law. The optimal solution for maximal harmonisation of national company laws has proven to be too complicated on this issue. We therefore support the proposed principle 3.1 – on the basis of a functional approach – proposing that an account holder at least has a minimum set of attributes in all member states. These should include the ultimate account holder's ability to exercise all rights flowing from the securities held through the chain.

Section 16 - Passing on information

Q 32 Is the duty to pass on information adequately kept to the necessary minimum? Is it sufficient? If applicable, would there be any (positive or negative) repercussion of such a Principle on your business model? Please specify.

We generally support this principle. All information that is necessary for the exercise of rights should be passed in a timely manner not only downstream to the ultimate account holder but certainly also upstream to the issuers. We concur with the Commission services that only information stemming from the issuers and the ultimate account holder should be passed on. A general obligation for account providers to pass on information stemming from third parties seems to be unnecessary, since ultimate account holders wanting to vote have the ability to check corporate websites and use services from voting advisory agencies in order to obtain more information. We also support the Commission services' view that the duty to pass on information should not be made subject to a possible contractual opt-out. Opt-outs on a large scale may negatively affect the environment for effective exercise of rights by account holders.

Q33. How do you see the role of market-led standardisation regarding the passing on of information? What are your views on a regulatory mechanism for streamlining standardisation procedures?

At this stage, we generally support the Commission services' proposal for a market-led standardisation regarding the passing on of information. Some developments to such a standardisation are already there. For instance, the Joint Working Group on General Meetings has taken initiatives to develop market standards on general meeting related issues including the information flow. If it would turn out that the market developments fail to achieve streamlined standardisation practices, it would be appropriate to introduce a regulatory option within a reasonable period of time.

Section 17 - Facilitation of the ultimate account holder's position

Q34 If you are an investor, do you think that a principle along the lines described would make it easier any cross-border exercise of rights attached to securities, provided that technical standardisation progresses simultaneously?

Partly yes. The proposed principle would make it easier for ultimate account holders to exercise rights. This is of significant importance, since a fundamental aspect in the field of effective exercise of rights through a holding chain is that the person who made the investment decision and bears the risks related to the shares, has sufficient and timely abilities to exercise these rights. This should be top priority in EU legislation above identifying in detail the position of the formally legal shareholder under the applicable

national law. Ultimate account holders should be able either to vote and exercise other rights themselves or on the basis of a power of attorney provided by the party in the chain who formally is seen as shareholder or to instruct the formal shareholder how to vote or exercise other rights on his behalf. We believe that the proposed principles 17.1 and 17.2 may fulfil these objectives.

However, the proposed principles 17.1 and 17.2 would not be sufficient in all aspects. The duty to facilitate the exercise of rights by the ultimate account holder should not only apply to the account provider of the ultimate investor, but also include other account providers in the chain. It should be provided that *each* securities intermediary in the chain should have the obligation to facilitate the exercise of rights by the ultimate account holder along the lines above. Under the proposed principles 17.1 and 17.2, however, the effectiveness of the exercise of shareholders' rights will case by case depend on whether the account provider of the ultimate account provider succeeds to make appropriate arrangements with all other links in the chain. We are concerned that this model would be rather vulnerable to failure, as investors have to lean on the contractual power of individual account providers to achieve an effective system of the exercise of shareholders' rights through a holding chain. Therefore, we strongly advise broadening the scope of principles 17.1 and 17.2 to ensure that each linkage in the chain has a regulatory duty to facilitate exercise of rights by the ultimate account holders.

Concerning principle 17.3, we endorse the Commission services' approach to limit the abilities to contractually opt-out of the obligation to facilitate the exercise of rights by account providers. We share the view that opting out from the obligation should not be allowed with respect to material investors' rights (like the collection of dividends and the acceptance of takeover bids), but believe that such material rights should definitely also include the exercise of voting rights. Effective exercise of voting rights is an essential element in the process of strengthening the corporate governance within listed companies across Europe. Limiting opt-outs from account providers' duty to facilitate voting, would avoid situations in which weak links in the cross border holding chain hamper the development of high quality corporate governance mechanisms in Europe. Opt-outs should only be allowed under very specific circumstances and on request of ultimate account holders that do not have institutional responsibilities.

Section 18 - Non-discriminatory charges.

Q36: If you are account holder, have you encountered differing prices for the domestic and the cross-border exercise of rights attached to securities? If yes, please specify.

Yes, there appears to be significant differences in pricing for the cross-border exercise of rights depending on the member states in which the securities involved are issued. This is most likely a result of the fact that in some member states the exercise of rights, in particular voting, is more burdensome than

in others. We also note that account providers have been applying different fees for voting services with respect to shares issued in the same member state.

We believe the main priority of the new EU legislation ought to be to ensure an efficient and safe system for the cross-border exercise of rights through holding chains to solve existing problems in this field. This would not be achieved when the costs of possible additional processing services by account providers become excessive. The proposed introduction of a non-discrimination rule to ensure that the account provider fees for cross border exercise of rights are not higher than fees for domestic holdings might to some extent discourage unreasonable high fees, but would not be sufficient enough.

Additionally, effective safeguards are needed. One possible additional measure would be that account providers' services relating to passing on vote instructions should be available at an affordable price, meaning that the level of fees as such must not be a barrier to vote. The European Securities Markets Authority (ESMA) could be given powers to monitor and, when appropriate, ensure transparency and competition in pricing to ensure an effective and users friendly voting chain.

Another possible measure refers to the allocation of costs. Although we realise that it may have serious operational implications, we note that a model in which the costs account providers have to make are borne by the issuers would have many benefits. As the proposals would result in a higher ultimate account holder participation in the shareholders' meetings, the issuer and all its shareholders and other stakeholders will benefit. If the decisions taken by the shareholders' meeting are truly representative, this would ensure a better monitoring of management. Moreover, the risk that an activist shareholder with a minority stake will sway the meeting will diminish and help address the 'free-rider' problem associated with those ultimate account holders who choose not to exercise their stewardship responsibilities but who benefit from the activities of others who spend time and money in being responsible shareholders.

Section 19 - Holding in and through third countries

Q38: Have you encountered difficulties in using non-EU linkages as regards the exercise of rights attached to securities? If yes, please specify. If not, please explain why.

We believe there is a need for a rule promoting the future EU legislation to facilitate effective exercise of shareholders' rights through the holding chain outside the EU. A considerable part of cross-jurisdictional holding situations involves account providers outside the EU. Therefore, we clearly support the Commission services' proposal for an extended duty for those EU account providers that serve non-EU account holders and/or are linked with non-EU account providers.

Section 20 - Exercise by account provider on the basis of contract

Q40: Do you think that a general authorisation to exercise and receive rights given by the account holder to the account provider should be made subject to certain formal requirements?

Yes. In case the ultimate account holder, for whatever reason, does not want to exercise the rights himself, the account provider should not generally do so on behalf of the ultimate account holder. The automatic exercise of the rights by the account provider could undermine corporate governance, for instance when there are certain conflicts of interests with the account provider. Exercise of rights on behalf of the ultimate account holder should only take place on the base of an authorisation or instruction by the ultimate account holder. This applies not only for decisions regarding voting rights, but also for – but not limited to – conversions, subscription rights, acceptance or refusal of takeover bids and other purchase offers. Such a model would guarantee that shareholders' rights are exercised by and/or in the interests of those with an economic interest in the issuer. To be crystal-clear: we oppose to the so-called broker vote rule as is current in place in the United States for several voting items. General and permanent authorisation on the base of contracts to exercise shareholders' rights should be discouraged. Consequently, we believe that exercise of rights by the account provider should be made subject to formal requirements.

We believe that a Directive that achieves the aims of an efficient, effective and integer cross-border voting regime would greatly enhance the functioning of corporate governance, increase ultimate account holder voting and stewardship and is in line with the aim of reforming the European financial markets to promote financial stability and growth.

If you would like to discuss our views in further detail, please do not hesitate to contact us.

Yours sincerely,



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Eumedion is the Dutch corporate governance forum for institutional investors. Eumedion currently has 70 Dutch and non-Dutch members which represent more than € 1 trillion invested capital. Eumedion promotes their interests as shareholders and furthers good corporate governance and sustainability.



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