EUROPEAN COMMISSION

Internal Market and Services DG

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FOSTERING AN APPROPRIATE REGIME

FOR SHAREHOLDERS' RIGHTS

Third consultation document

of the Services of the Directorate General Internal Market and Services

Preliminary remark

The following document has been drafted by the services of the Internal Market and Services Directorate-General in order to assess the need and appropriateness of further potential measures in the field of shareholders' rights, to complement the future directive on the exercise of shareholder voting rights[1]. This document contains indications of the topics that may be addressed in such potential measures. These preliminary indications are without prejudice to any future or final decision which may be taken by the European Commission with regard to follow-up measures, if any, in the field of shareholders' rights.

[1] See COM(2005)685 and the resolution of the European Parliament of 15 February 2007 (C6-0003/2006)

I. Introduction

a. Purpose of the consultation

The Commission had already announced in the explanatory memorandum to the proposal for a directive on shareholders rights (Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC {COM(2005) 685 final}) that it might adopt a separate non-binding instrument on shareholders' rights supplementing this directive.

The reason for this announcement was that it had emerged from the discussions in preparation of the proposal for a directive that a number of questions may be left to a recommendation, which could be introduced independently from a directive. This conclusion was confirmed by the negotiations on the draft directive. The Services of the Internal Market and Services Directorate General have therefore decided to launch a separate public consultation on these questions. Following the consultation, an impact assessment will be carried out in order to verify the cost-benefit relation of any possible recommendation on the issues in question.

Responses to this consultative paper should be concise, focused principally on the questions raised and provided **no later than 27 July 2007**. They should be sent to DG MARKT, unit F2, European Commission, B-1049 Brussels. Responses may also be sent by e-mail to Markt-COMPLAW@cec.eu.int.

Unless an explicit request is made for confidential treatment, your contribution will be a document that the Commission can make public.

b. Shareholders' rights in a cross-border context

The importance of shareholder voting for effective corporate governance has already been stressed in the Commission's proposal for a directive on the exercise of shareholders' voting rights. Although the main impediments that had been identified in the consultation process in the years 2004/2005 will be removed by the transposition of the future directive, there are other factors that influence the efficiency of the voting process. In the explanatory memorandum to the proposal for the shareholders' rights directive, the **questions of the language of meeting documents, stock lending and depositary receipts** had already been mentioned. In the course of the discussions since then, additional questions that are of relevance in this context have been identified, such as, in particular, **the role of intermediaries in the voting process.** A number of questions concerning this issue, too, are therefore addressed in the present consultation document. When replying to these questions, it should be noted that the scope of a future recommendation would be limited to **listed companies incorporated in the EU**, in line with the results of the first public consultations and the scope of application of the future directive.

II. Language of meeting documents

In the context of the second consultation on the proposal for a directive, views of respondents were split on the question whether the proposal should provide for a mandatory translation of meeting documents into a language customary in the sphere of international finance. Some respondents pleaded in favour of an opt-in provision that would allow general meetings to decide on this question. However, already at present it is allowed in all EU Member States to

post GM-related documents in other languages, in addition to the national language. The problem is that this is rarely done in practice. This means that communication costs for issuers are low but information costs are high for actual and potential cross-border shareholders, both retail and institutional investors, who have to provide for a translation of the relevant documents themselves if they are not able to read them in the original language provided.

In order to address this problem, translation of the convocation, the meeting agenda and the documents to be submitted to the general meeting could be recommended. The Committee for Economic Affairs (ECON) of the European Parliament, however, stressed in its opinion on the proposal for a directive issued on 27 November 2006 that such obligation should avoid burdens for smaller listed companies or companies that neither have a wide foreign shareholder base nor are actively seeking foreign investment (proposed recital 6a).

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."

III. Depositary Receipts (DRs)

Holders of depositary receipts run the full financial risk of the investment in the shares represented by the receipts, without necessarily holding the corresponding voting rights which lie with the depositary. It should be noted, however, that in recent years a growing number of issuers have decided to eliminate voting restrictions on depositary receipts and treat depositary receipt holders as shareholders i.e., let them determine how the votes attached to the underlying shares are cast.

At this stage, therefore, there seems to be no need for providing that receipt holders should be formally granted voting rights on the underlying shares or given the right to decide how the votes attached to their shares are cast.. However, it is questionable whether depositaries should have the possibility to exercise the voting rights attached to the shares they hold without the receipt holders' express authority to do so.

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."

IV. Stock lending

In most EU Member States stock lending is at present exclusively subject to contract and codes of best practice.[2]

Stock lending actually consists in the outright transfer of securities by the 'lender' to the 'borrower' who undertakes to transfer these equivalent securities back to the 'lender'. Voting rights pass with the transfer of the securities. Stock lending plays an important role in ensuring market liquidity. Some investors, however, actively borrow stock ahead of general meetings for the purpose of voting in order to materially influence the outcome of general meetings. Such practices, which distort votes, should be discouraged as much as the recall of lent stock ahead of general meetings should be encouraged.

Other cases of stock lending per se do not seem to cause major difficulties with regard to cross-border voting; however, it appears to be not always sufficiently transparent, despite the existence of codes of conduct referred to above. The consequences of stock lending with regard to voting are not always made clear to lenders. Further, it happens that stock held for the account of investors can in some instances be lent without informing investors.

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 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."

[2] See for example the Code of the International Corporate Governance Network of 15 October 2005, http://www.icgn.org/organisation/committees/SLC_committee.php

V. Chain of intermediaries

In the recitals of the future directive on the exercise of shareholders' voting rights, emphasis is put on the role of financial intermediaries in the voting process.[3] Furthermore, the ECON opinion contained a proposal for additional provisions concerning duties of intermediaries[4].

1. Duties of intermediaries

In order to be able to vote, investors rely on the chain of intermediaries to provide them with the information received from the issuers and to channel their voting instructions back where an intermediary is supposed to act for them as a proxy. However, this mechanism does not always function in practice, and sometimes services are only provided against unreasonably high fees, in particular in a cross-border context.

This problem does not only arise in the case of bearer shares but sometimes also for companies with registered shares, as the investor does normally not have the possibility to make sure that his name is entered into the company's register.

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.[5]"

[3] Recital 7ab of Council document 5760/07 of 29 January 2007
[4] ECON amendments 53, 54

2. Disclosure of investors

Companies have an interest to know who their actual investors are. However, even companies using registered shares cannot necessarily rely on the register as the investor does not in all cases have to be identical with the legal shareholder.

The Transparency Directive, in its Articles 9, 10 and 13, imposes on holders of voting rights the obligation to notify to the issuer whenever the share of the voting rights they hold reach, exceed or fall under certain thresholds. This obligation falls not only on shareholders, but also on depositary receipt holders, holders of share options, and persons who otherwise control voting rights, e.g. as a result of a shareholders' agreement or by way of proxies. Issuers are to publish all such notifications within three days of receipt. It should be added that, by virtue of Article 3 of the Directive, Member States may impose on their issuers lower disclosure thresholds than that of 5% provided for in the directive.

The Transparency Directive was to be transposed in national law by 20 January 2007 and the Commission is to review its operation by 30 June 2009.

The Services of DG Internal Market and Services take the view that the Transparency Directive puts in place a comprehensive framework, which should give issuers a fairly precise picture of the breakdown of voting rights. In any event, taking further action on the disclosure of voting rights at this stage, i.e., before the operation of the Transparency Directive has been assessed, would seem premature.

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?

VI. Management companies of investment schemes

The ECON committee of the European Parliament, in its opinion of 27 November, proposed a specific rule for management companies of investment schemes concerning the exercise of the voting right[6]. These companies manage funds on behalf of their investors, but often at the same time also portfolios for institutional investors. Given that they are therefore not the legally recognized shareholder for all the shares they manage in the same account, they will normally not be able to benefit from the future rule on split voting contained in Article 13 of the draft directive on the exercise of shareholders' voting rights. The question is whether rules are justified that would address specifically the situation of these companies.

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.

[5] The wording reflects the definition contained in Article 13 of the draft directive on the exercise of shareholders' voting rights, see footnote 1.
[6] ECON amendment 50

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."

VII. Other suggestions

This consultation paper reflects the questions brought up during the discussions of the last two years.

Interested parties are invited to indicate in their responses whether, in their view, any additional aspects should be taken into account to facilitate cross-border voting.