EUMEDION
CORPORATE GOVERNANCE FORUM

Submitted by e-mail

European Securities and Markets Authority
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Amsterdam, 21 November 2011

Ref: B0211.59
Subject: ESMA's call for evidence on 'empty voting' (Document No. ESMA/2011/288)

Dear Sirs, dear Madams,

Eumedion welcomes the opportunity to respond to ESMA's call for evidence on 'empty voting' (Document No. ESMA/2011/288). By way of background, Eumedion is the Dutch based corporate governance forum for institutional investors. Our 69 Dutch and non-Dutch participants have together more than EUR 1 trillion assets under management. They invest for their clients and their beneficiaries and in listed companies worldwide.

As our activities are mainly focused on the Dutch market, our answers refer to our experiences in that market, unless otherwise stated. Moreover, our answers only refer to the subject of "empty voting" – meaning, in ESMA's words, "situations where shareholders have voting power without corresponding economic interest". The reverse situation - "hidden ownership" – is the situation whereby a party is not the legal owner but is entitled to exercise influence and eventually to direct the votes as if he was a shareholder. Such a situation should also be addressed, but that should be a subject for another call for evidence or consultation document.

Q1. Please identify the different types of empty voting practices and the frequency with which you think they occur within the EU. Where possible, please provide data supporting your response.

The following types of empty voting has been identified by us:

1.1 Vote borrowing

Securities lending is the lending of shares to a party that needs those shares temporarily.

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The borrower of the shares will become the owner of the shares in a legal sense. The lender keeps the economic risk on the shares and mostly also has the right to demand the return (recall) of the shares at all times. The borrowing of shares makes it possible for a party to have a legal interest in a company that is not in proportion with his economic exposure. If the party borrows the shares just before the voting record date of a shareholders' meeting, he can exert influence in this general meeting without bearing the economic risk.

Situation in the Netherlands: In order to combat the problems of empty voting, Eumedion suggested its participants twice in 2007 to recall any lent shares in the company in question, due to extraordinary movements in the lending market. This was done in connection with the ABN Amro general meeting in April 2007 and with the extraordinary general meeting of Fortis (currently known as Ageas) in August 2007. In Eumedion's estimation there was a significant risk at that time that certain borrowing parties would use the voting rights on the borrowed shares to dictate the decision-making process at this shareholders' meeting. According to media reports, institutional investors responded well to this suggestion, particularly where the extraordinary general meeting of Fortis was concerned[1].

1.2 Depositary receipts or certificates of shares

Depositary receipts or certificates of shares do not always carry the votes which are attached to the underlying shares. Voting rights attached to the shares may lie with the depositary, rather than with the receipt holders who are the actual investors in the shares and bear the economic risks.

Situation in the Netherlands: 15 (out of around 120) Dutch listed companies have issued all or a large proportion of their common shares to a so called Trust Office ('administratiekantoor') which in turn has issued certificates of shares (or depositary receipts). Only the certificates of shares are listed and can be bought by investors. The certificates of shares do not have voting rights, but have dividend rights. Voting rights can only be exercised by the Trust Office. However, since 2004 Trust Offices are legally obliged to grant voting proxies in non-takeover situations (in so-called 'peacetime') to holders of certificates of shares who so request. The holders of certificates of shares thus authorised can exercise the voting rights at their discretion. The Trust Office will exercise the voting rights for those holders of certificates who did not request a proxy to vote, which is in fact empty voting. With an average turn-out of holders of certificates of shares of around 50-60%, the Trust Office has still a large influence on the voting outcome. In hostile takeover situations (in 'wartime' situations) Trust Offices have the legal possibility not to grant voting proxies to holders of certificates of shares. However, the Dutch Corporate Governance Code recommends companies not to make the distinction between 'peacetime' and 'wartime' situations, so that Trust Offices shall, without limitation and in all circumstances, grant proxies to holders of certificates of shares who so request (best practice provision IV.2.8). Out of the 15 companies that still use certificates of shares still 4 (=27%) report a deviation of best practice provision IV.2.8, meaning that in 'wartime' the Trust Office can – in some

[1] See the article "Fondsen halen aandeel Fortis massaal terug" in Het Financieele Dagblad of 28 July 2007.

cases – vote on (nearly) 100% of the shares, although he does not bear the economic risk on these shares.

1.3 Anti-takeover foundations

Dutch corporate law, in general, allows a wide-ranging set of mechanisms that can be used to defend companies against hostile takeovers. One of the most popular mechanisms is the establishment of a so-called anti-takeover foundation. This foundation has typically been granted a call-option to acquire so-called anti-takeover preference shares up to 100% of the issued ordinary shares at the time of the exercise of the preference share option. The preference shares can be acquired at par value (normally 1 euro or lower, so in most cases for lower than the actual share price). Moreover, only one-fourth of the subscription price is payable at the time of initial issuance of the preference shares. Therefore, the execution of the voting rights attached to the anti-takeover preference shares can be considered as empty voting, as the voting power does not correspond with the economic exposure of the foundation.

Situation in the Netherlands: Approximately 60% of the largest Dutch listed companies have established an anti-takeover foundation. In the last five years, in two cases (Stork and ASM International) the anti-takeover foundation exercised its call-option, thereby dramatically diluting the voting power of the ordinary shares then outstanding.

1.4 Financing preference shares

Financing preference shares carry the same voting rights as ordinary shares but in addition give a right to a fixed dividend percentage before ordinary shareholders become entitled to dividend. Financing preference shares are attractive especially for Dutch banks and insurance companies – investors with a long-term horizon -, because they carry a high and nearly guaranteed dividend, which is free from dividend taxation if the block of shares at least equals 5% of a companies' equity capital. Although the 5% of the nominal paid-up capital can be obtained by buying common stock as well as preferred stock, common shares usually trade for a much higher amount than the nominal value (and are therefore usually more expensive to buy on the stock exchange), whereas preference shares do not. Financing preference shares can therefore be considered as multiple voting rights shares. In that sense, the execution of voting rights attached to the financing preference shares can be considered as empty voting. That is also the reason why the Dutch corporate governance code contains the best practice provision that the voting rights on financing preference shares should be based on the fair value of their capital contribution instead of their nominal value (best practice provision IV.1.2). However, Dutch companies are not obliged to act in accordance with the code, as long as they explain the structure of the voting rights in their annual report ('apply or explain' principle).

Situation in the Netherlands: 6 of the 50 largest Dutch listed companies have issued financing preference shares; 2 of them deviate from best practice provision IV.1.2 of the Dutch corporate governance code.

1.5 Employee Stock Ownership Plan (ESOP)

It is possible for employees to accumulate a share position in the company within the framework of a share scheme that is part of their total remuneration package, and to become (potential) shareholders in this way. Employees can bundle these share positions and place them in a foundation that exercises the voting rights on the shares. The foundation is, however, not only authorised to vote on the shares unconditionally granted to the employees (but 'locked up' for an additional time), but also on the shares that have not been allocated to the employees yet. However, the allocated and unallocated shares have full voting rights and are voted by the foundation, which either exercises discretion in voting or votes in proportion to vested ESOP shares. Effectively, either the foundation may become an empty voter.

Situation in the Netherlands: In the Netherlands, there are 5 listed companies with a rather extensive ESOP: Randstad Holding, Arcadis, Grontmij, Nedap and Holland Colours.

Q2. Please identify specific examples where empty voting practices have occurred within the EU. Where possible, please provide data supporting your response.
For the Netherlands we refer to the examples mentioned in sections 1.1-1.5.

Q3a) What in your view are the negative consequences that can occur as a result of empty voting (relating to e.g. transparency, corporate governance, market abuse)?
Transparency: in the situation that an investor has substantial voting rights, but a negative net economic position (because his short position is larger than his economic position), distorted price signals can be sent out if there is not adequate transparency about the short position. This can be the case, for example, if this investor tries to block a legal merger or a takeover that would be in the interest of the company and its shareholders in the long term. The incentives of this specific investor are not aligned with the incentives of the long term shareholders. If this situation is not transparent prior to a general meeting, the voting outcome of the general meeting can come to a surprise for the company and its long term shareholders, with (wild) share price fluctuations as a consequence. Other shareholders may not be aware of the potential heightened importance of their vote. Without such information, shareholders may have insufficient information as to the need to vote and to take coordinated or other actions to protect their interests.

Corporate governance: We would like to remark that empty voting may <u>not always</u> have negative corporate governance effects. E.g. "informed voters" could potentially improve electoral outcomes through empty voting by acquiring disproportionate voting power (e.g. by temporarily borrowing the shares) from less informed shareholders and casting votes that are more informed and thus more likely to contribute to the market value of the company. In that way, "vote trading" can improve the

decision-making process of general meetings.[2] Of course, this argument requires that the vote buyer and vote seller have coincident interests. If that is not the case, there can be negative corporate governance effects of empty voting. If the voting power in the company is higher than the economic interest, it will be easier to reach certain thresholds in company law, e.g. the threshold for the right to place an item of the agenda of a general meeting or for the right to request that an extraordinary meeting be convened. It may also mean that certain resolutions cannot be passed in a general meeting, or that others can be approved more easily (depending on the position of the empty voting shareholder). The interests of the 'empty voter' can conflict with those of other shareholders, as he may prefer a voting result that is the opposite to that preferred by other shareholders.

Market abuse: if the voting power exceeds the economic interest e.g. the market player has a net short position, there can be an incentive to spread false stories in the capital market.

Q3b) To what extent do you consider those consequences to occur in practice?
We refer to our answer 1.1 for an example of the lack of transparency about the possible use of empty voting.
In the recent past we have witnessed some cases in which the voting power of the Trust Office, referred to in section 1.2, was decisive in adopting a number of management proposals at the general meeting of shareholders. At the 2011 Fugro AGM, 55% of the votes cast by holders of certificates of shares were cast against the proposal to grant the management board the authority to issue new shares in the coming 18 months. Because of the voting power of the Fugro Trust Office (42.5% of the votes cast), the resolution was however officially passed with a majority of 68.6% of the votes cast. At the same AGM, 52.3% of the votes cast by holders of certificates of shares were cast against the proposal to limit or exclude the pre-emptive right for existing shareholders. Because of the voting power of the Trust Office, the resolution was passed with a majority of 70.1% of the votes cast.
At the 2010 AGM of ING Group 71% of the total number of votes cast at the meeting by holders of depositary receipts were cast against the resolution on how the ING Group had implemented the revised Dutch Corporate Governance and it was only with the "help" of the ING Trust Office that this resolution was passed after all with a large majority (70%) of the total number of votes cast at the meeting.

Q3c) To what extent have you encountered those consequences in your own experience?
See our answers to question 3b.

Q4a) Do you believe that empty voting has influenced the results of voting at the general meeting of shareholders within the EU?
See our answers to question 1 and 3b.

[2] See e.g. S.E.K. Christoffersen, C.C. Geczy, D.K. Musto and A.V. Reed, "Vote Trading and Information Aggregation", *Journal of Finance*, 2007 (62), p. 2897-2929.

Q5) What kind of internal policies, if any, do you have governing the exercise of voting rights in respect of securities held as collateral or as a hedge against positions with another counterparty?

- Eumedion already took the position in 2006 that securities lending by institutional investors should be discouraged in event-driven situations for the listed company. There is a risk that certain borrowing parties will use the voting rights on the shares borrowed to dictate the decision-making process at the general meeting, while the voting behaviour of these parties can be diametrically opposed to the voting policy of the parties that bear the economic risk on these shares (the institutional investors). If it is possible that a certain general meeting will produce an event-driven situation of this kind, Eumedion brings this to the attention of its members and suggests that they recall any lent shares before the record date. Between 2006 and 2011 this happened twice (see our answer 1.1).
- Furthermore, Eumedion supports the Securities Lending Code of the International Corporate Governance Network, which was published in July 2007 and which summarizes the points for the attention of institutional investors with regard to the lending of securities.

Q6) Do you think that regulatory action is needed and justifiable in cost-benefit terms? If so, which type of empty voting should be addressed and what are the potential options that could be used to do this? Please provide reasons for your answer. Kindly also provide an estimate of the associated costs and benefits in case of any proposed regulatory action.

- Eumedion is in favour of legal regulations that stipulate in the event of an application for a certain subject to be placed on the agenda or for an extraordinary general meeting to be convened, that the applicant must disclose its whole position (legal and economic interests) to the company and to the public.
    - Such a transparency requirement would be an effective instrument to address 'vote borrowing'.
    - As the right to submit shareholder proposals is not frequently used by shareholders (in the Netherlands between 2005 and 2011 in total 40 shareholder proposals were submitted against around 7500 management proposals), we expect that the total costs will be moderate, while the listed company and its shareholders will get a better understanding of the intentions of the shareholder that has submitted the proposal.
- Notification of substantial gross short positions in parallel with the notification of substantial gross long positions (starting at the 5% threshold as included in the Transparency Directive).
    - This would be an instrument to increase transparency in order to detect possible voting behaviour that is not in the interest of the company and its stakeholders.
    - The recently adopted short selling regulation[3] already contains the requirement to notify the regulator of significant net short positions. Short positions larger than 0.5% have to be made public.

[3] Regulation of the European Parliament and of the Council on Short Selling and certain aspects of Credit Default Swaps (Interinstitutional File: 2010/0251 (COD)).

  - As investors already have to establish and/or adapt their notification systems as a result of the short selling regulation, the increase in the investor's administrative burden to notify substantial gross short positions will be moderate.

- Trust Offices and anti-takeover foundations should not vote on those agenda items that are not crucial for the company's continuity (e.g. remuneration policy, appointment of auditor, etc).
  - This would be an instrument to strengthen the corporate governance structure of companies that use a Trust Office and/or an anti-takeover foundation.
  - The costs of this measure would be zero (the Trust office and anti-takeover foundation should withhold their votes), while the benefits of a strengthened corporate governance structure are clear.

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

Yours sincerely,

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