



Michel Barnier
Commissioner for Internal Market and Services
European Commission
Office: C107 07/42
B-1049 Brussels
BELGIUM

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INSTITUTIONAL INVESTORS' POSITION ON THE UPCOMING PROPOSAL FOR SECURITIES LAW
DIRECTIVE (SECTION ON EXERCISE OF RIGHTS FLOWING FROM SECURITIES)

Copy to Patrick Pearson (by e-mail)

Dear Commissioner,

We write to you with reference to the proposed Securities Law Directive. We understand that the Directive will contain proposals "to ensuring that investors have access to effective voting services and that voting rights are exercised in accordance with the instructions given by those investors", as instructed by consideration 11 of the Shareholder Rights Directive¹. We as representative organisations of institutional investors with large cross-border holdings very much welcome such proposals. For institutional investors a well-functioning voting chain between the issuer and the shareholder is of utmost importance to exercise one of the basic shareholder rights: the right to vote at a shareholders' meeting. Below you will find our views on the current functioning of the voting chain and the provisions that are from an investor's point of view key for effective European legislation facilitating the cross-border exercise of shareholder rights. We hope you will take these thoughts into account when finalising the proposal.

We believe that the ability for shareholders to vote across the board will greatly enhance their ability to act as proper stewards of listed companies and as such is in line with the corporate governance reform agenda of the European Commission.

¹ 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).

I. The problems with cross-border voting

More and more institutional investors 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 countries². Under these circumstances, barriers to cross-border voting are likely to have serious consequences on the voting turnout at shareholder meetings. A study considered by the UK Shareholder Voting Working Group in 2007 showed that in one particular case within the UK nearly 5% of the votes went missing. The presumption must be that the leakage is worse in cross-border voting, 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". Whilst large institutional investors do try to vote cross border, in with their dedication to their governance responsibilities, such resources could be devoted to constructive engagement if there was a more efficient and integer voting chain.

The problems with cross-border voting in Europe originates from the fact that shares are usually held through a chain of securities intermediaries across borders. From a legal perspective it is often not clear who in the chain of intermediaries should be entitled to vote. The ultimate investor, i.e. the investor who has made the investment decision and bears the risks related to the shares, often is not registered in the issuer's share register, but holds a securities account with a broker or bank in his own jurisdiction, which bank or broker holds an account with another securities intermediary in another jurisdiction, holding an account with an international securities depository, holding an account with a local intermediary in the jurisdiction of the issuer who may be registered as nominee in the share register of the issuer or may be a participant in a securities trading system in which one or a multitude of bearer certificates have been deposited.

Each of the jurisdictions involved will probably provide that the account holder in that jurisdiction (rather than the intermediary in that jurisdiction) is entitled to exercise the voting right, which leads to a set of conflicting entitlements. No one would want to deny that ultimately, the ultimate investor should be the one who controls how the voting right is exercised, in the sense that such ultimate investor 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. Such an arrangement can only operate across borders within the EU if an EU wide solution is found. That is the reason why we strongly support the realisation of a functional, effective and strong section on the exercise of rights flowing from securities in the Securities Law Directive.

² Federation of European Securities Exchanges (FESE), "Share Ownership Structure in Europe" (December 2008).

II. Core ingredients for a proposal for a Securities Law Directive

1. Functional approach: We support the functional approach employed by the Commission. In the preparations for the Shareholder Rights Directive it turned out that defining the ultimate investor in a legal sense is difficult. Instead of defining the ultimate investor, and providing for his entitlement to exercise the shareholder rights, it should be possible to clarify who are securities intermediaries and to impose on securities intermediaries the obligations to either pass on powers of attorney to their client ('account holder') allowing them to vote directly, or to pass on voting instructions from their clients to the issuer. In addition to this, it needs to be clear that institutional investors such as pension funds and mutual funds are deemed to hold a security account "for their own account" in the sense of the definition of an ultimate account holder. These entities will therefore vote as part of their fiduciary duty on behalf of their beneficiaries.
2. Duty for securities intermediaries: Specifically it should be provided that any intermediary should have the obligation – and is also liable for the obligation – (i) to grant or pass-on a power of attorney to their clients, until the first client who is not an intermediary, who can then use the power to vote directly, (ii) to pass on voting instructions received from their clients to the issuer and (iii) to confirm to their clients that the voting instructions have been carried out or passed. An extended duty should apply for those securities intermediaries that serve non-EU account holders.
3. No 'broker vote rule': In case the client, for whatever reason, does not want to exercise the rights himself, the intermediary should not do so on behalf of the client. Exercise of rights on behalf of the client should only take place on the base of an authorisation or instruction by the client. 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. This guarantees that shareholder rights are exercised by those with an economic interest in the issuer. To be crystal-clear: we are not in favour of the so-called broker vote rule as is current in place in the United States for several voting items.
4. International aspect: It is important that any proposed Directive provides is internationally compatible, given the global nature of financial markets. Previous endeavours, such as the Hague and Geneva Conventions on Securities should be taken into account when designing the framework.
5. Costs: There must be careful consideration of the cost issue. A possible model would be that the costs that securities intermediaries have to make for the services and for the necessary quality improvements are borne by the issuers. The advantage of such a model is that it is in effect a means of distributing the costs among shareholders in proportion to their stock ownership (and therefore also in proportion to the benefits they receive). As the proposals would result in a higher shareholder 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 and of controlling shareholders. 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 investors who chose not to exercise their stewardship responsibilities but who benefit from the activities of others who spend time and money being responsible shareholders. In the end, all shareholders and other stakeholders will benefit from a better functioning corporate governance structure of the issuer. This is also the reason why we are not in favour of rules regarding the possibility to contract out from the obligation for securities intermediaries to facilitate the exercise of shareholder's rights.

We believe that a Directive that achieves the aims of an efficient, effective and integer cross-border voting regime would greatly enhance the workings of corporate governance, increase shareholder stewardship and is in line with the aim of reforming the European financial markets to promote financial stability and growth.
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We hope that our 'core provisions' can be taken into account so that we have a balanced proposal for a Directive that truly solves the problems with the current voting chain. We would be very happy to discuss these ideas further with you and your officials and look forward to a continued contribution to the realization of the final Directive.

Yours sincerely,



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The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They are also large institutional investors controlling funds worth some £1.8 trillion, with substantial holdings in European markets.



Eumedion is the Dutch corporate governance forum for institutional investors. Eumedion currently has 69 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.



Eurosif, the European Social Investment Forum, is the pan-European stakeholder network whose mission is to address sustainability through the financial markets. Eurosif works at the pan-European level as a partnership of the national Social Investment Forums (SIFs) and with the support and involvement of its member affiliates. Recognised as the premier European forum for sustainable investment, Eurosif's member affiliates are drawn from leading pension funds, asset managers, NGO's, trade unions, academic institutes and research providers, together representing assets totalling over € 1 trillion.

Apart from the members of the above representative organizations, the letter is also supported and endorsed by the First and Third Swedish National Pension Fund and Danske Capital.