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FESE Response to the Commission Third Consultation Document on Fostering an Appropriate Regime for Shareholders' Rights

I. Introduction and Executive Summary:

1. The Federation of European securities Exchanges (FESE) is a not-for-profit international association (AISBL), representing the operators of the European regulated markets and other market segments, comprising the markets for not only stocks and bonds, but also financial, energy and commodity derivatives. Established in 1974 as a small forum of stock exchanges in Europe, FESE today has 24 Full Members representing close to 40 securities exchanges from all the countries of the EU and Iceland, Norway, and Switzerland, as well as several corresponding members from other non-EU countries[1].

2. FESE welcomes the outcomes of the work carried out by the Commission, the Parliament and the Council with regard to the Directive on the exercise of certain rights of shareholders in listed companies. In particular, we are content with the Directive's reference to the "applicable law" as the law of the Member State in which the company has its registered office and we strongly welcome the establishment of a record date principle.

3. The main impediments to the efficiency of the voting process have been already clearly identified and will be removed by the transposition of the Directive. For this reason, we are convinced that most of the subjects that are part of the current consultation should not be addressed at the EU level but rather left to Member States' private law framework, contractual agreements between the parties involved and codes of best practice.

4. In this response, we provide the Commission with our point of view on each of the question addressed. Our main points are as follows:

    - FESE is strongly against any legislative initiative on the language in which General Meeting (GM) related documents are submitted. We are convinced that listed companies should be granted the maximum flexibility when deciding whether to publish GM related document in a different language.

[1] Up to November 2006, the volume of equity trading of European Stock Exchanges was close to EUR 15.5 thousand billion, representing a 31.5% increase compared to a year ago. The equity market capitalisation of FESE Members has reached record levels close to EUR 11 thousand million, an 18% increase over the year. ETFs trading volumes at the end of November were already around 47% higher than for the whole year of 2005, while volumes of Securitised Derivatives were higher by almost 49%. Bond turnover went up 8.3% during the year to November 2006, and is now close to EUR 9 thousand million. The number of derivative contracts traded has increased by 14.4% for equity derivatives and by 13.6% for bond derivatives in the last year. For more information, please go to: http://fese.eu/en/?inc=art&id=3

- FESE supports the idea that there should be some sort of informed consent by holders of Depositary Receipts (DRs) as to how the depositary votes the underlying shares; however, we have concerns over the enforceability of such a proposal.

- The practice of Stock Lending is to be considered as part of the contractual agreement between two parties and therefore falls under the sphere of private law. The treatment of this practice should be left to market forces (e.g. industry, Regulated Markets and their competent authorities) as to avoid the risk of over-regulation.

- The deficient functioning of the chain of intermediaries is one of the major obstacles to efficient cross-border voting. In order to take informed decisions, the end investor should always receive the relevant information in a timely manner.

II. Responses to the Commission's specific questions:

- **Language of meetings document**

Question 1:
Q 1.1.: Do you think there is a need for action in that area?

5. When companies publish the notice (the texts of the draft resolutions, the voting proposals etc.) they should only be obliged to do this in the official language(s) of the MS in which the company is incorporated. Any obligation on issuers to translate the meeting documents into another language would lead to "over-regulation" and be a costly exercise, also considering potential legal costs, such as actions in recession.

6. FESE is strongly against any legislative initiative on this issue. We believe that the decision concerning a specific language regime should be either left to self regulation by issuers or to the assessment of the market forces. In any case, should a Recommendation be adopted, we would welcome the proposal to leave the decision concerning the language of meeting documents to the GM. Large cap companies are those which would benefit the most from publishing GMs related documents into a language "customary in the sphere of international finance" but it should be their choice and not an imposition. Moreover, some Regulated Markets (RMs) already require in their rule book that large cap issuers publish their documents in English. Issuers - and SMEs in particular - should be granted the maximum flexibility in order to avoid additional costs.

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[2] (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."

7. If a threshold above which translation of information is mandatory had to be introduced, and not left to self regulation by issuers or to the assessment of the RM, an objective data should be considered. In general, we believe that cross-border activities of European companies, a wide foreign shareholder structure and the participation of foreign investors should not lead to additional administrative burdens for the companies. The survey conducted by FESE on the share ownership structure in Europe, released in March 2007[3], has shown that foreign investors represent on average 33% of the share ownership structure of European listed companies. We believe therefore that 33% would be a reasonable threshold.

8. However, we highlight the fact that there might be practical obstacles in applying such a criterion, for example due to the difficulties of gathering this information on a continuous basis or due to the large deviation of the average participation of foreign investors in each market from the average participation of foreign investors in all markets, and the large deviation between different segments of the same market from the average participation of foreign investors in that market. Therefore, we believe that this criterion should be further investigated, also taking into account that the participation of foreign investors is an external element, not subject to the company's control. We remain convinced that no proposal on mandatory translation of meeting documents should be issued.

9. In conclusion, for companies with a wide international shareholder base a so-called "convenience translation" could be considered, if needed. If the issuer was obliged to translate the meeting documents of the GM into an additional language, then he should be entitled to specify which version is the prevailing one and which version is the convenience translation to avoid a consistent legal risk.

- **Depositary Receipts**

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."

[2] The Fourth Company Law Directive (78/660/EEC) will be replaced by Directive 2006/46/EC at latest by 5 September 2008. Directive 2006/46/EC will amend part of Article 11 by replacing the balance sheet total of EUR 3.650.000 with a balance sheet total of EUR 4.400.000 and the net turnover of EUR 7.300.000 with a net turnover of EUR 8.800.000.

[3] http://www.fese.eu/_lib/files/FESE%20Share%20Ownership%20Structure%20in%20Europe%202006.pdf

10. FESE supports the idea that there should be some sort of informed consent by DRs holders as to how the depositary votes the underlying shares; however, we have concerns over the enforceability of such a proposal. For example, the DRs might be issued outside the EEA, even if the underlying company is within the EEA. In addition, the voting rights of the DR are set out in the terms and conditions (i.e. the buyer of the DR knows at the time of purchase whether or not this includes voting rights).

11. In any case, we would prefer a model in which the DR holder votes, or gives instruction to do so. In this case it would be important to specify the arrangements according to which instructions can be given, because providing for an automatic voting right of the holder could create a risk of absent votes if the DR holders fail to give instructions.

12. Finally, if the depositary is shareholder himself, a conflict of interest may arise and further attention is needed in order to protect the DR holder. Therefore, if the depositary's shareholding in a company exceeded a certain threshold (e.g. 5 % of the share capital) the depositary should only be allowed to vote strictly in line with the instructions of the depositary receipt holder.

- **Stock lending**

Question 3:
Q 3.1: Do you believe that stock lending needs to be addressed at EU level? Please give your reasons.

13. FESE believes that the lending of securities is a practice that has a number of extremely useful applications such as improving and maintaining market liquidity, allowing market operators and asset managers to run short positions and reducing the risk of failed trades. Moreover, investors/lenders could be interested enhancing an additional return on their existing investment by disposing of their voting rights. Therefore, FESE would be very cautious regarding the introduction of regulatory measures which could interfere with the well established use of securities lending[4].

14. Better management and greater awareness by stock owners (well informed through an efficient chain of intermediaries) is the route to ensuring that the stock lending system is not abused. Stock lending should be left exclusively to contracts and codes of best practice and MSs should be free to rely on the application of broad principles based on best practice within the industry. FESE believes that there is no need for EU regulation in this area.

[4] At this point however, one could point out the relevant advantages of a direct holding system with separate account balances for lent and borrowed stocks. This permits the central registration of all borrowers, lenders and actual holders of equities allowing issuers to receive this kind of information in a timely manner.

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."

15. We are against the recommendations above and would not welcome any regulation of stock lending. Stock lending should be considered as part of the contractual engagements between the borrower and the lender and intervening would be a restriction of property rights. We invite the Commission to wait for the Transparency Obligations Directive (TOD) and the Shareholders' Rights Directive to bed down before drafting any other further legislative measure related to the disclosure of information and the exercise of voting rights[5]. In any case, no action should be undertaken without an impact assessment on the effects that a legal intervention could have on the liquidity of our markets.

- **Chain of intermediaries**

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

16. We support the view to encourage all intermediaries who are part of the chain of intermediaries (between the shareholder/final investor and the issuer) to cooperate in forwarding relevant information from the issuer

[5] The TOD, which was to be transposed in national law by 20 January 2007, foresees that if the voting rights are transferred, this piece of information must be published. The Directive on shareholders' rights introduces a record date system that will abolish share blocking thus permitting all investors to know in advance when a GM takes place. This means that any investor, who has lent shares but wants to participate in the GM and vote, can - in those jurisdictions where this is possible – recall his shares before the record date.

to the shareholder and to forward voting rights from the shareholder to the issuer. Furthermore, intermediaries in a custody chain should be enabled to mediate and facilitate the direct or indirect participation of the ultimate beneficial owner in the GM. To enhance cross-border voting, the Commission should ensure that intermediaries comply with the recommendations and the standards developed by the industry[6].

17. For an effective functioning of the information flow through the chain of intermediaries, it is of high importance to ensure legal certainty as to who is entitled to exercise corporate rights. In this perspective, we believe that the Commission should also consider the outcomes of the work of the Legal Certainty Group, when drafting the Recommendation.

18. We also suggest that the Commission bears in mind that whilst in some jurisdictions companies communicate directly with their registered shareholders, in others CSDs play an important role as means to canalise pre-meeting information. As an example, in some Member States the CSD represents the direct contact with the issuers and is able to transmit the information to the first intermediary of the chain, which is a direct participant to the CSD. To avoid situations in which the information does not reach the ultimate shareholder, we suggest that intermediaries are strongly encouraged to inform the next link of the chain[7] appropriately – be it another intermediary or the ultimate investor – who will then decide on the next action to take.

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?

19. Yes we do. The Transparency Directive (TD) has indeed harmonised and improved the minimum requirements for reporting significant shareholdings and provides with the proper procedures for addressing many of the questions relating to shareholders' identification. It is important to leave the TD time to steady down before deciding on further action.

- **Management companies of investment schemes**

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.

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."

20. FESE agrees on the definition of Management Company and the fact that they should be considered as a client. We also agree on the point made in the second paragraph. A management company, managing

[6] In the context of the work of Cesame concerning the Giovannini Barriers, FESE is a member of a Working Group composed of representatives across industries to develop standards in this area that will be coherent with - and complete where necessary - the ISO standards 20022.

[7] According to the existing contractual relationship.

several funds, should be allowed to cast different votes in relation to two (or more) funds it manages, *only if* the company itself is able to demonstrate that there is segregation among the interested funds both of the organisational structures and of the decision-making processes

21. For companies with a large investor base it is crucial that management companies may exercise their votes as in certain cases there is a need for additional GMs in order to achieve the required threshold to take a decision. This increases the costs (increased number of GMs, additional cost for 3rd parties to activate investors both local and foreign).