

VIEW FROM OTHER MARKETS: Rest of the World (RoW)

EUROPE: HIGHLY FRAGMENTED MARKET – AUSTRALASIA: PRESSURE ON II

A summary outline of key items to be submitted by members of the international panel

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Connecting issuers and shareholders

The Rest of the World (RoW) shares a lot in common with North American issuers and shareholders. Yet, it differs in many points in trying to connect the two together, with the following characteristics:

- The weight of institutional investors vary considerably from one country to another
- The practice of bearer shares in several countries adds more darkness to the relationship, with some leader issuers spending tremendous amounts of money to set up their own record of nominal shareholders through various incentives
- The velocity of transactions (or rate of equity turnover) is much lower in Europe
- Europe and Asia-Pacific have far greater fragmented markets on a regional basis than North America
- The role of family or of key-reference shareholders (as in France) reduce the actual share of floats and thus barriers to access list of shareholders.
- The Integration of some key players involving exchanges and clearing systems (Frankfurt, Hong Kong and Sidney for example)

1- The case for shareholders across Europe

The increased level of international ownership of shares in the European public companies has led to an increased recognition of the importance of cross-border voting. Over the last few years the European Commission has put significant effort into: identifying barriers to effective cross-border voting in the EU member states and,

facilitating the cross-border exercise of shareholders' voting rights. This effort resulted in the Proposal for a directive on the exercise of shareholders' voting rights of January 2006 (hereafter the Shareholders' Rights Directive), which was approved, with some amendments, by the European Parliament in February 2007.

Each of the European markets within the study currently has separate sets of market regulations and best practice provisions regulating the convocation and conduct of general meetings, meeting attendance requirements, voting rights, and systems used to vote shares at general meetings. Also in the absence of statutory requirements, company by-laws determine specific rules applying to general meetings of a particular company. The main impediments to efficient and successful voting processes in the European markets include the following in the order of priority given by some 380 European issuers to a survey conducted by Manifest in 18 countries (*see document inside Summit folder*).

1. Share blocking (especially share blocking at the custodian level)	10. Stock lending
2. Power of attorney	11. Wet signatures
3. Re-registration of shares	12. Format of proxy cards
4. Record date	13. Physical attendance
5. Length and inefficiency of the chain of intermediaries	14. Adjournment of meetings
6. Availability and timeliness of information	15. Voting restrictions
7. Custodian/sub-custodian cut-off dates	16. Cumbersome registration process
8. Manual involvement in the voting process and proprietary message standards used by securities intermediaries	17. Investors' unwillingness to disclose identity/bearer shares
9. Lack of audit trails	18. Absence of distance voting culture in Europe

The chain approach utilised to vote shares in European companies is considered to be a major source of complexity in the proxy voting process. It is widely recognised to be time-consuming and prone to errors as a result of the large number of different participants, but is often regarded as the only option for crossborder voting. The main problems associated with the chain approach to voting, as identified in the study, include:

- Time factor, i.e. the amount of time needed to pass meeting related information and documentation through the chain of intermediaries;
- Bundling of proxy voting with other services by custodians, resulting in: investors' inability to use a service provider of choice, insufficient transparency in the pricing of the voting service, frequent dissatisfactory quality of voting services, and a distortion of competition in the voting services market;
- Lost votes, mainly attributed to the wide use of pooled accounts by securities intermediaries, where the failures in the reconciliation process can lead to rejected votes; and
- The lack of audit trails, i.e. the absence of the process that would enable a voting service provider to provide an institutional investor with the feedback that the votes reached the issuer.

The inefficiencies brought into the voting process by the chain approach are exacerbated by problems caused by intermediaries within the chain. According to our respondents, such problems include:

- Manual involvement in the voting process;
- The incompetence of securities intermediaries in proxy voting issues;
- Miscommunication between intermediaries in the chain; and
- Lack of resources in proxy voting and priority for voting.

Many expressed the opinion that voting in European markets would be much simpler if there were uniform standards with respect to meeting notification periods, record dates and voting deadlines. The Shareholders' Rights Directive is considered to be the first significant step towards more efficient cross-border voting; however, further steps towards harmonisation of rules and procedures in Europe are deemed to be necessary. Every institutional investor would like to see meeting notification periods set sufficiently in advance of the meeting, and vote cut-off dates close to the meeting date. The ideal period for the release of the notice of meeting and meeting materials was considered to be **between 21 to 30 days before the general meeting** (most of our respondents agreed with the 30 day notification period originally suggested in the proposal for Shareholders' Rights Directive). The majority stated that vote cut-off dates for institutional investors should not be set **earlier than four days before the date of the meeting and, ideally, vote cut-off dates should be set at one to two days before the meeting**. It was suggested that shareholders should be able to vote up to the meeting date if an issuer/tabulator knows shareholders' positions and is able to identify a shareholder, and if electronic voting systems are in place. It was emphasised that as a minimum the annual report and accounts, full text of proposals and other documents should be available at the same time as the notice of meeting; otherwise, investors are not able to take informed voting decisions.

The amount of time needed to take informed decisions depends on the clarity of the investors' voting policy and the nature of the issues on the meeting agenda. **The time required can vary from 48 hours to two weeks, or longer if there are controversial issues on the agenda and/or engagement with the company is needed.** The approximate amount of time for voting decision making in the markets suggests:

- In only eight of 18 European markets, are foreign investors provided with sufficient time to make informed voting decisions, even if there are controversial issues on the agenda or engagement with the company is needed;
- In five markets, investors should have enough time to make informed voting decisions on routine issues, but may not have enough time to do additional research or engage with the issuer; and
- In the remaining five markets, investors may not have sufficient time to make informed voting decisions based on a thorough consideration of the meeting-related information and analysis of the company's performance.

Investor demand for 'foreign' securities has increased sharply within the European Union since the introduction of the Euro. However, the EU infrastructure for clearing and settling of cross-border transactions within Europe has remained highly fragmented. And although MiFID1 (*Markets in Financial Instruments Directive - the European equivalent to Reg NMS in the US*) has unleashed European Trading into what some consider to be an even more fragmented - but definitely more price-competitive marketplace, the supporting infrastructure is slow to adapt.

With numerous Central Counterparties and a large numbers of CSD's (19) and ICSD's (2), the Pan-European Investors are still ambushed by national systems with their own practices, tax and legal frameworks. The additional costs are a constant worry for regulators and market-practitioners alike.

As the Giovannini Group (*a study group appointed by the European Commission to reduce barriers of cross-border posty-trading services*) has drily noted in it's report (November 2001) on EU Clearing and Settlement : *rules on beneficial ownership, custody and corporate actions should be harmonized at the EU level.*

To remove the Giovannini Barrier 3 a European Corporate Actions Joint Working Group was launched to standardize the Asset Servicing processes and to reduce costs and operational risks. The beginning of the solution was to define who needs to do what to whom by when and the end result was a toolbox of market standards of which 70% (distribution with options) to 89% (cash distributions) by now have been met.

And then, in July 2007, the first European Directive on European Shareholder rights became effective, requiring EU domiciled issuers to inform all EU resident shareholders about General Meetings (about their right to participate and vote). Europe was starting in earnest to counteract (on the reason of) the non-voting behavior of European shareholders (80% of shares are voted in the US, 70% in Canada, a lingering 40% in the UK and a low of 10% in The Netherlands).

In a similar approach the major industry stakeholders (issuers, CSD's, Custodian banks) decided to form a European Joint Working Group on General Meeting Standards. In 2010 a set of best standard practices was launched *on an operational level*, to facilitate the smooth flow of information between issuers and shareholders, where the end-investors name and address are not on record with the company's share register. The standards cover the processes of The Meeting Notice (format and time-frame), the Record Date and Entitlement (position capture and feasible time frames for cross EU Holdings) and the Notification of Participation (timely proxy voting or AGM attendance).

Outlook

Although the standards are widely endorsed, they are, unlike the EU Corporate actions Standards, not in the implementation process as we speak. National rules (on corporate governance) and lack of practice in cross-border notifications (of General Meetings) prove stubborn obstacles. And also the Shareholder Rights Directive has been

counterproductive in (Art. 7) entitling each member state to determine the record date rather than providing for a harmonized EU solution. Resulting in inadequate short periods between the record date and the date of the GM (for instance in France the record date is 3 days prior the GM date on traded positions and thus calculated -the settlement period being t+3- on settled record date position equal to the GM date.

With further impediments coming from major issues such as share blockings, segregation –and power of attorney requirements, market practitioners have pinned their hopes on the evolving Securities Law Directive if in line with recommendations of the EU Legal Certainty Group).

Both the Shareholder rights directive and the Market Standards for General Meetings have substantial weaknesses which obstruct the handling of (proxy) voting in the European context and which many want to see addressed.

Moreover, most European markets have a tradition of bearer shares (as opposed to registered shares). Not only does this restrict the trading around voting time, it also creates uncertainty for issuing companies who its shareholders are.

Apart from the different initiatives to tackle these hurdles, the most significant one is the use of electronic proxy voting by EU companies for remote simultaneous voting and electronic voting ahead of the meeting.

The ‘Stewardship Code’

While EU Shareholder proponents advocate regulation or voluntary corporate action on key issues such as ‘say on pay’ and ‘proxy access’, an interesting third way emerged last year in the UK: a ‘Stewardship Code’ for institutional investors.

The Financial Reporting Council (FRC), an independent UK regulator responsible for promoting corporate governance and reporting, aims to enhance the quality of engagement between investors and companies. The code itself addresses, in the first instance, the firms who manage assets on behalf of Institutional Investors, but encourages all Investors to report if and how they have applied the Stewardship Code.

Around this time a monitoring exercise is scheduled on how the original principles of the code have been applied and new issues will be considered further, including whether Institutional Investors should disclose their policies on stock lending, what are the arrangements for voting pooled funds and the nature of the disclosure on voting records.

The Stewardship Code is seen, in combination with the EU Shareholder Rights Directive, as the most detailed attempt to date to give form to the belief in the EU that shareholders are part of the solution ‘to reduce the risk of catastrophic outcomes’ and ‘aid the efficient exercise of governance responsibilities’. Not only as a right, but a duty, to engage with the companies in which they invest.

3- The case for issuers in France

Major reforms coming into effect in 2002 are designed to make it easier for Non-Resident shareowners to vote their holdings at French listed companies. This should help market players understand innovations in the New Economic Regulations Act of May 15, 2001, and the implementing Decree dated May 3, 2002 (*see documents in Summit folder*). These measures make progress in streamlining and modernizing the share voting system

Share voting and Proxy Voting Reform in France aims to answer various legal and practical questions arising from the introduction of new remote share voting procedures. It is addressed particularly to:

- Issuing companies
- Investors, in particular Non-Resident investors
- Proxy voting intermediaries
- Global and local custodians; and
- Banks and depositaries keeping securities accounts

Non-Residents hold a large and rising share (some 35 to 40%) of the market capitalization of the Paris Bourse. Institutional investors, both resident and Non-Resident, own an even greater stake (approximately 70%) Their participation in voting is essential if companies hope to meet quorum levels required by law. Moreover, broad participation by shareowners is critical because French statutes give the annual meeting more powers to set corporate policies than in any other major market.¹

In recent years, however, investors have expressed concern that outmoded provisions of French law made it very difficult, or even impossible, for Non-Resident institutions to take part in voting. Complaints centered on three principal issues:

- The law did not explicitly recognize the right of global custodians and other intermediaries legally to cast votes on behalf of Non-Resident shareholders
- Many investors balked at the legal requirement that shares be blocked from trading for a period of up to five days before the shareholder meeting
- Electronic or Internet voting was not permitted, though it could have allowed a substantial reduction in the period needed to process ballot forms

What reform ?

To remedy these concerns, ANSA², the professional, non-profit entity representing issuing companies, proposed reforms that formed the basis of the 2001 legislation. ANSA

¹ For instance, Leading Corporate Governance Indicators 2001 (Davis Global Advisors) ranks France ahead of six other surveyed markets (US, UK, Germany, Japan, Netherlands and Belgium) in giving the most rights to shareholders at annual meetings.

² ANSA Report on "l'identification des actionnaires des sociétés cotées" (the identification of shareholders in listed companies, January 1997) and on "l'utilisation des moyens de télétransmission dans les assemblées générales d'actionnaires" (the use of remote-transmission resources in meetings of shareholders, January 2000).

undertook this action in consultation with representatives of constituencies within the capital market. The new legislation marks important progress. Headline improvements include the following:

- Global custodians, along with any other intermediary which declares itself as such³ are now expressly permitted by law to cast votes on behalf of Non-Resident shareholders provided that the ultimate shareholder agrees to be identified if the issuing
- Blocking is abolished. No shareholder may be deprived of the right to sell securities during the few days preceding the meeting of shareholders. Instead, issuers will set a brief verification period in advance of the meeting to assure that shareholder or agent is eligible to vote and to ascertain the precise number of shares that may be voted
- Internet voting is now legally permissible. Companies will be able to amend their bylaws to allow it, and experts are in the process of engineering appropriate technical systems to enable e-voting to operate smoothly, accurately and securely. Some of the nation's largest companies may be expected to wish to launch it quickly⁴

4- The case of Australia and other Asian countries

The mapping of institutional share voting in Australia, done by Mercer for the Australian Institute of Company Directors, reveals the following (*see full document in Summit folder*)

- The institutional share voting environment is characterised by high volume decision making in a compressed time, and this has an impact on how institutional share owners (both managed funds and superannuation funds) conduct share voting – in particular what functions they do themselves, and what functions they outsource.
- About 80 per cent of votes cast by institutional investors on listed company resolutions occur in a six- to eight-week period (the “peak proxy season”); approximately 80 percent hold their annual general meetings in October - November each year. At the peak of the season there may be 30 or more company meetings to be considered in a week⁵.
- Superannuation funds and large managed funds are broadly invested, often including small-capitalisation (“small cap”) investments. This means they will have resolutions

³ See below, Part II, Chapter II, Intermediaries registered in accounts, and the glossary

⁴ See below, Chapter IV, Internet voting

⁵ The Corporations Act requires all listed companies to hold their annual general meeting within five months of the end of their financial year. In Australia, this means there is a “mini” proxy season in April-May and a main proxy season from early October to early December. Almost all company meetings are compressed into these two periods. These volumes are confirmed in the course of interviews with institutional investors, and material made available by both ISS and Glass Lewis.

- from 300 public company meetings or more to deal with in a year.
- The pressure generated by this number and concentration of meetings has while the ‘lumpiness’ of the work in the proxy voting season means also that there is a disincentive to in-source.
 - That institutional share voting is a high volume, compressed time business, shapes how the parties in the institutional share voting process communicate with each other:
 - Access by companies to institutional share owners and proxy advisory firms is limited in the peak proxy season with communication restricted to exceptional matters – institutional share owners are busy with voting lodgment at this point. Company directors, however, wish to have greater access to institutional share owners and proxy advisers during the peak proxy season.
 - Communication between companies and institutional share owners is likely to be more effective outside of the peak proxy season.
 - Although opinion is divided on this matter, most participants (including company directors) do not think that continuous disclosure provisions pose any real barrier to effective communication with share owners prior to the issue of the Notice of Meeting for instance, discussions could be held following interim results, and/or discussions could focus on principles rather than specific outcomes (for example, on remuneration matters).
 - Institutional share owners have been increasingly active in voting their shares and are increasingly willing to vote “against” company resolutions if it is in their interests to do so – there is also some evidence (from interviews) that superannuation funds are becoming more active in voting and that they are doing more of the voting themselves rather than leaving this function with managed funds.
 - When directors think of institutional share owners, they think of managed funds rather than superannuation funds. Although this is changing, directors tend to underestimate the importance of superannuation funds.
 - The directors interviewed for this research tended to automatically think of managed funds as the investor, and would generally not speak of superannuation funds at all if not prompted to do so. Nonetheless, directors were aware of the power of superannuation funds even if they did not first think of them as the ‘investor’.
 - Directors did not have a clear idea on how to communicate with superannuation funds – nor were they clear on who they would contact within a superannuation fund.
 - Share voting policies of institutions, proxy advisers and industry groups are important influences on institutional share voting.
 - There are many share voting and governance policies, such as the Financial

Services Council's "Blue Book" and the Australian Council of Superannuation Investors' (ACSI) *Governance Guidelines*. Companies listed on the Australian Securities Exchange (ASX) must report against the ASX *Corporate Governance Principles and Recommendations*. These policies are very similar, differing only at the margins.

- Almost all participants in the system say these share voting policies are (or should be) guidelines only and that votes should be determined according to companies' individual circumstances. However, there is a risk that guidelines become de facto rules because of volume and time pressures.
 - Companies should be aware of these share voting policies and guidelines. If a proposal is important, a company should be prepared to explain to share owners why it should be approved, even if it varies from guidelines.
 - The existence of published share voting policies and guidelines means companies should not be surprised at a high "against" vote on a resolution that contravenes general policy (according to the interviews conducted for this research, few directors are now surprised by high "against" votes).
- Proxy advisory firms are an important influence on institutional share voting in Australia.
 - Proxy advisers are influential is a near universal view of all key participants in the share voting system: company directors, managed funds and superannuation funds.
 - The high-volume, time-pressured environment means proxy advisers perform a function that most institutional share owners would consider prohibitively costly to do themselves.
 - There is a growing acceptance of the role of proxy advisory firms and the evolving relationship between companies and these firms, which is becoming less adversarial and more professional in tone.
- A significant minority of company directors think proxy advisers are improperly influential. They believe too much has been outsourced by institutional investors, making proxy advisory firms de facto decision makers.
 - A significant number of directors felt very strongly that it was the clear responsibility of institutional investors to actively make voting decisions and to devote sufficient time and resources to think about the issues involved. To do otherwise, they argued, was to abrogate an important responsibility. It is significant and logical that where directors held these concerns they also had concerns about the capacity to understand share owner value, independence, training, experience, resourcing and general competence of proxy advisory firms.
 - These views are reflected as follows: 49 per cent of directors thought proxy advisers were influential (see Finding 6); however, 60 per cent of directors thought they had insufficient experience, expertise or knowledge to do their job (see chart

below). This assessment contrasted strongly with the views of institutional share owners (particularly superannuation funds).

- Companies and directors are often not communicating with the real decision makers in institutional investors. Whereas companies think the decision makers are, or should be, at the peak of the organisation (for example, the chief executive or chief investment officer), the reality is that voting decisions are made lower down the organisational chain, at the portfolio manager, analyst or governance officer level.
 - A common assumption on the part of the directors surveyed and interviewed was that communication should be at the most senior level to be effective. This view was at odds with the views of institutional share owners.
 - The difficulty of mapping who (or what role) is responsible for making decisions on share voting should be acknowledged. Nevertheless, this is crucial knowledge for a company that wants to effectively communicate the basis for a resolution that may be controversial or “outside policy”.

- There are basic problems with the share voting process and machinery, which lead to “lost” and miscounted votes.
 - Discussions with custodians, sub-custodians and registry companies reveal a common story:
 - most voting communication, from the custodian or sub-custodian to the registry company, is still by fax and not by electronic lodgment
 - there is currently no effective audit trail for institutional share voting in Australia.
 - It is likely that the problems with the voting system identified by AMP Capital Investors in 2007 which led to lost votes have not substantially changed⁶.
 - Share registries expressed difficulties reconciling the votes received with the correct number of shares held by the share owner within the 48 hours between the receipt of proxy forms and the company meeting.
 - There is a substantial and relatively recent body of work that addresses share voting process and machinery issues, including a report by the Parliamentary Joint Committee on Corporations and Financial Services .

⁶ AMP estimated a vote ‘loss’ rate of about 4% - reported in AMP Capital Investors Corporate Governance Report, August 2006, p. 2.

⁷ Two recent substantive reports on this subject are: the Parliamentary Joint Committee on Corporations and Financial Services *Better Share owners – Better Company, Share owner and Engagement and Participation in Australia*, Commonwealth of Australia, June 2008, and the preceding report by IFSA (now the Financial Services Council) *Improving the Proxy Voting System in Australia*, 14 September 2007.