

Cross Border Voting in Europe

Summary

Cross-border voting by shareholders in Europe raises a number of practical and legal questions. This is due to the broad variety of regulation and practices that exists in European Union Member States with respect to the organisation of Annual General Meetings of Shareholders ("AGMs") and the present securities holding systems, through which the vast majority of shareholders today hold their shares. The Expert Group on Cross-Border Voting ("the Group") has been asked to investigate the practices, experiences and legal barriers to cross-border voting in Europe. The scope of the analysis by the Group is restricted to the specific issues that are related to listed companies with dispersed (international) share ownership and arise from the fact that the shares of these companies are traded and held through modern securities holding systems. In such securities holding systems shareholders hold shares through securities accounts with securities intermediaries. Transactions in shares are effectuated by crediting and debiting these accounts. The vast majority of shares that are held by investors in other jurisdictions than the jurisdiction of the issuing company are held through securities holding systems, often via complex chains of securities intermediaries.

The Group has identified a number of legal obstacles in the regulations of securities holding systems and in the company laws of Member States that complicate, and often render impossible the exercise of voting rights across borders in the European Union (*Section 2 of the Final Report*). The Group has made a number of recommendations, which are directed to remove these obstacles and create a legal environment which allows for the effective exercise of voting rights across borders with an appropriate level of legal certainty for all involved. The recommendations relate to elements of company law but mostly deal with the rights of accountholders and the obligations of securities intermediaries in securities holding systems.

The Group has identified three major issues that will have to be addressed in order to ensure that shareholders can vote across borders in an efficient way (*Section 3 of the Final Report*).

- a Throughout Europe it should be made clear who is entitled to vote or should have the right to determine how the votes are executed (*Entitlement to control the voting right*);
- b These persons or entities should be enabled to exercise their voting rights (*Voting*); and
- c It should be ensured that these persons or entities receive the relevant information to exercise their voting rights in an informed manner (*Information*).

These three issues are steps in the process of ensuring that investors can exercise the voting rights attached to the shares they hold. To a large extent all three steps boil down to the role and obligations of securities intermediaries in securities holding systems in Europe. They are vital in determining the accountholders in securities holding systems who could or should be entitled to control the voting rights and in certifying their shareholdings. They may perform a role also in the actual process of informing shareholders and ensuring that their votes are actually cast. The European rules that the Group envisages should define the Securities Holding Systems that are subject to the rules, the Securities Intermediaries that participate in these systems and the Ultimate Accountholders who hold accounts in these systems and are not Securities Intermediaries as defined.

Ad a Entitlement to control the voting rights (Section 4 of the Final Report)

The Group considers the legal uncertainty over who in cross-border situations is entitled to determine how the shares are voted and how this must be realised as the main problem for cross-border voting in Europe. The Group has reached the conclusion that the solution for this problem requires regulation by the European Union and has formulated three objectives any solution must meet. First of all, any proposed solution must create certainty about who is entitled to control the voting right. Secondly, the proposed solution should attribute the entitlement to control the voting right as close as possible to the person or entity who really holds the economic interest in the shares. Finally, the proposed solution should not only function well within the jurisdiction of the European Union, but should also be practical and workable in cross-border situations relating to jurisdictions outside the European Union, especially with the United States.

On the basis of the Group's analysis of the problems and the above mentioned objectives, the Group makes the following recommendation.

Recommendation 1:

Member States must ensure that Ultimate Accountholders in Securities Holding Systems are acknowledged to be entitled to control the voting right attached to shares held through Securities Holding Systems (the primary rule)

The Ultimate Accountholder as defined will usually be the person or entity that has the economic interest in the shares, but this will not necessarily be the case. It is possible that the Ultimate Accountholder is an intermediary outside the Securities Holding Systems that are subject to the European Union rules. In this case the entitlement to control the voting right does not attribute to the person or entity with the economic interest in the shares. In order to make it possible to place the entitlement to control the voting rights as close as possible to the person or entity having the economic interest in the shares, a supplementary rule should be formulated that Member States must ensure that the Ultimate Accountholder in a Securities Holding System is authorised to designate clients as entitled to control the voting right, who will as a result be acknowledged as such. This supplementary rule opens the window to look beyond the Ultimate Accountholder in European Securities Holding Systems, also outside the jurisdiction of the European Union.

Recommendation 2:

Member States must ensure that the Ultimate Accountholder in a Securities Holding System is authorised to designate clients as entitled to control the voting right, who will as a result be acknowledged as such (the supplementary rule)

The supplementary rule could be taken a step further, in the sense that the person or entity identified by operation of the primary rule as the Ultimate Accountholder can be required to disclose the identity of its clients at the request of the issuing company that suspects that the Ultimate Accountholder is not the ultimate investor, but an intermediary holding the shares on behalf of others. However, the Group believes such a rule should not be imposed on a European wide basis and therefore recommends that the European Union does not impose such an obligation on Ultimate Accountholders who are intermediaries. The Group does believe that Member States should be free to introduce such an obligation on Ultimate Accountholders holding shares in issuing companies subject to their jurisdiction.

Recommendation 3:

The European Union should not impose an obligation on Ultimate Accountholders who are intermediaries (but not Securities Intermediaries as defined) to disclose the identity of their clients to issuing companies, but Member States should be free to introduce such an obligation on Ultimate Accountholders holding shares in issuing companies subject to their jurisdiction

Ad b Voting_(Section 5 of the Final Report)

Exercise of the entitlement to control the voting right by the Ultimate Accountholder

The Group believes that the adoption and implementation of the primary rule and the supplementary rule will be an important step towards an efficient infrastructure for voting at AGMs throughout Europe. However, the proposed rules alone are not sufficient. Additional measures will have to be taken in each Member State to ensure that the Ultimate Accountholder can effectuate his entitlement to control the voting right. The Group believes that this can be done without changing national company laws with respect to the formal voting right.

Recommendation 4:

Member States must ensure that Ultimate Accountholders (or their designees under the supplementary rule) can exercise the entitlement to control the voting right through one of several options:

a The Ultimate Accountholder is acknowledged as shareholder entitled to vote

b The Ultimate Accountholder is designated in the shareholders register as entitled to vote

c The Ultimate Accountholder is given a power of attorney by the Securities Intermediary formally entitled to vote

d The Ultimate Accountholder instructs the Securities Intermediary who is the formal shareholder to vote as instructed

Option d) should always be available to Ultimate Accountholders. In order to allow for this Member States must ensure that split votes cast by Securities Intermediaries are accepted as valid votes

Each of these options in itself should be sufficient to ensure that the Ultimate Accountholder will be able to exercise the entitlement to control the voting right. Each Member State should be free to implement the solution(s) that best fit(s) its present legal infrastructure. Member States should implement at least one of the suggested measures.

Options b), c) and d) require Securities Intermediaries to perform certain services to Ultimate Accountholders to ensure that they can exercise their entitlement to control the voting right.

The Group believes that the obligation of Securities Intermediaries to positively provide services to Ultimate Accountholders to ensure that they can control the voting right should be complemented by a negative obligation of Securities Intermediaries not to exercise the voting rights on shares held for others if they are formally entitled to do so, unless on the basis of specific instructions of Ultimate Accountholders or when Ultimate Accountholders have explicitly allowed the Securities Intermediary to exercise the voting right without any instructions.

Recommendation 5:

Member States must ensure that Securities Intermediaries provide the options to control the voting right available under the laws of the relevant issuing company to the Ultimate Accountholder and that Securities Intermediaries are not allowed to exercise voting rights unless on the basis of specific instructions of Ultimate Accountholders or on the basis of an explicit agreement with Ultimate Accountholders

The moment determining the entitlement to control the voting right

In determining who is formally entitled to vote as shareholder, company law inevitably has to decide at what time one has to be shareholder in order to have the voting right. In this respect the laws in the Member States are different. Generally speaking, there are two systems: systems where shareholders are required to be shareholder at the moment of the shareholders meeting to be entitled to vote at that meeting and systems where the decisive date is set some time before the meeting, so-called record date systems.

The present company law rules that determine at what time the shareholder must hold the shares in order to be entitled to vote should also apply to Ultimate Accountholders to determine which Ultimate Accountholder is entitled to control the voting right. The Group believes that at this point in time it is neither necessary nor opportune to propose to harmonise the company laws of the Member States on this issue. The Group does feel, however, that the requirement of share blocking as a condition to participation in the vote is an overly restrictive and disproportionate condition that seriously reduces the ability of shareholders to participate in the vote effectively. Share blocking requirements constitute a major impediment to effective cross-border voting by shareholders. Moreover, as alternatives like a short cut-off time before the meeting and a record date are

available and can be operated efficiently with the help of currently existing technology, blocking requirements are no longer necessary to ascertain that someone is entitled to vote at the right time.

Recommendation 6:

Member States must prohibit the application of a share blocking requirement as a condition for shareholders and Ultimate Accountholders to participate in the vote at the shareholders meeting

Authentication of the Ultimate Accountholder

Where shares are held through Securities Holding Systems it is unavoidable that Securities Intermediaries will have to authenticate which accountholders hold which shares at what time. In a fully dematerialised system and a system based on globalisation by definition, and in systems based on immobilisation as a practical matter, there is no other evidence available of share ownership and entitlement to control the voting right than statements made by Securities Intermediaries that a certain accountholder holds a certain number of shares in its account.

Under the proposed rules with respect to the Ultimate Accountholder the holding of the Ultimate Accountholder who participates in the vote will have to be authenticated and certified to the issuing company.

The Group believes that, at least for the time being, an approach which requires an authentication trail through the chain of Securities Intermediaries and certification by the Securities Intermediary at the top of the chain (seen from the perspective of the issuing company), is to be preferred over an approach which would only require authentication and certification by the Securities Intermediary with whom the Ultimate Accountholder holds the account.

The authentication process should be carried out at the request of the Ultimate Accountholder. The issuing company may and must rely on the certificate of the Securities Intermediary at the top of the chain.

Recommendation 7:

Member States must ensure that Securities Intermediaries at the request of Ultimate Accountholders who wish to exercise their entitlement to control the voting right, pass on authentication confirmation to the next Securities Intermediary with whom they hold accounts. The Securities Intermediary at the top of the chain is required to certify the holdership of the Ultimate Accountholder to the issuing company, which may and must rely on this certification

Ad c Information (Section 6 of the Final Report)

An important aspect of the exercise of voting rights is that the persons or entities making the voting decision, the Ultimate Accountholders, are provided with the relevant information about the resolutions on which they will vote. It is evident that modern means of communication will play an increasingly important role in this information process. By making the relevant information widely accessible, for example via the website of the company, it will become easier for interested parties to become informed. Informing the Ultimate Accountholders will become an issue of informing them where they can obtain the relevant information ("pulling" information by the Ultimate Accountholder) rather than sending the information to them ("pushing" information by the company).

Based on the Group's analysis, it makes the following recommendation with respect to the information process.

Recommendation 8:

The European Union should ensure that Member States enable listed companies to communicate with their shareholders and Ultimate Accountholders via electronic means, including websites, as an alternative to traditional means. Member States should ensure that issuing companies are required to publish on their website which rules and procedures have to be followed by shareholders in order to be able to exercise their voting rights, what facilities are available for Ultimate Accountholders to exercise their entitlement to control the

voting right and what they must do in order to be admitted to the vote (either by participating in the meeting or by voting in absentia)

Despite the fact that pulling of information from the company's website by shareholders will increasingly become the normal way of communicating with shareholders, there still will be situations in which companies desire or will be required to inform shareholders individually. In line with the other recommendations, the Group believes this information process will have to be aimed at informing the Ultimate Accountholder. This can be done in various ways, and the Group takes the view that the European Union should not prescribe any particular approach as the single approach to be adopted. The Group does believe that in every Member State at least the possibility should be created for issuing companies to communicate with Ultimate Accountholders directly, with appropriate safeguards to protect their privacy.

Recommendation 9:

Member States must ensure that Securities Intermediaries at the request of issuing companies disclose the identity and contact details of Ultimate Accountholders to issuing companies. The privacy of Ultimate Accountholders should preferably be protected by giving them the ability to opt-out of identification procedures. Further review as to whether an opt-out system sufficiently deals with the privacy issues and bank secrecy rules is to be conducted before such a rule is introduced across the European Union

Finally, the Group addresses two aspects of current securities practice that potentially complicate cross-border voting in Europe (*Section 7 of the Final Report*).

The first aspect relates to the differences in settlement times of securities transactions processed through stock exchanges and their clearing and settlement systems in the different Member States. Based on the information at hand, the Group does not feel there is a necessity to propose any regulatory measures on the issue of the differences in settlement times from the perspective only of the problems of cross-border voting. Having said this, it must be noted that a number of respondents have put forward that harmonisation of settlement times is desirable to avoid any complications with respect to voting entitlement, as well as to solve other problems related to the differences in market practices. However, the expectation is that it will not be possible to realise this harmonisation within the European Union on the short term. These issues are currently being analysed by the Giovannini Group, which is looking into the current cross-border clearing and settlement arrangements in the European Union and the complications that arise as a result of the different market practices. The Group therefore will refrain from making any general recommendations about the differences in settlement times.

The second aspect is the practice of securities lending. The Group has been informed that in practice the effect of securities lending is that the lender loses the control rights. The Group does not disagree with this outcome. If complications do arise from securities lending, the Group would like to note that these complications are a result of an arrangement by investors who enter into a securities lending agreement at their own free will in order to receive lending fees. There are ways of contracting around any potential problems with respect to voting issues.

Cross-Border Voting in Europe; The expert group on Cross-Border Voting in Europe final report

Expert Group on Cross-Border Voting in Europe (Chairman J. Winter)

The Hague, WODC, 2002

Onderzoeksnotities, no. 2002/6