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European Commission  
DG Internal Market and Services  
Unit F2  
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BELGIUM

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Via E-Mail: Markt-COMPLAW@cec.eu.int

Dear Sir/Madam,

**Response to the European Commission's consultation on "Fostering an appropriate regime for shareholders' rights"**

I am writing to give Hermes' views on the European Commission's consultation document on "Fostering an appropriate regime for shareholders' rights" which deals with a number of issues that may be dealt with in a Recommendation supplementing the Shareholders' Rights Directive.

By way of background, Hermes Pensions Management Limited is owned by, and is the principal fund manager for, the BT (British Telecom) Pension Scheme, the UK's largest. Hermes also manages portfolios for Royal Mail Pension Plan and over 200 other clients including many major pension schemes. In total, Hermes manages approximately €105 billion (31 March 2007). As part of its Equity Ownership Service (EOS), Hermes also advises non-investment clients on environmental, social and governance matters in respect of a further €25 billion of equities (31 March 2007). These include the British Coal Staff Superannuation Scheme, the BBC's Pension Fund and Pensionskassernes Administration A/S, one of the largest administration companies for occupational pension funds in Denmark. Hermes is an acknowledged global leader in the field of corporate governance and shareholder responsibility. We actively exercise our clients' rights and responsibilities as share owners worldwide, which includes but is not limited to voting at general meetings of their portfolio companies and engaging with companies to promote long term value.

Hermes very much appreciates the opportunity to comment in the consultation process. Our responses to the specific questions asked in the consultation document are set out below. We are happy for the Commission to make these public.

## **Language of meeting documents**

### **1.1. Do you think there is a need for action in that area?**

To encourage and facilitate responsible cross-border ownership of shares, it is important that foreign shareholders can access and readily use relevant meeting documents. These documents and where necessary and deemed appropriate translations into a language customary in the sphere of international finance should be available well in advance of the meeting to allow for intelligent cross-border voting taking into consideration the extra lead time which foreign shareholders may be subject to when exercising voting rights. Depending on the meeting agenda it may also be necessary to provide translations of other company documents such as the articles of association and rules governing the working of the board and committees.

### **1.2. If your answer is yes, do you think a recommendation along the following lines would go in the right direction?**

We are in favour of a “comply or explain” approach with regard to translations. We believe that as a general principle all listed companies should produce meeting documents in a language customary in the sphere of international finance. However, we also think that the decision whether meeting documents ought to be translated should be taken by boards which are better placed than regulators to assess the business case for translations in respect of each individual company.

Boards of listed companies with a wide foreign shareholder base or actively seeking foreign investment have a clear incentive to publish meeting documents in a language customary in the sphere of international finance. But clearly this may not be the case for all companies and translations should thus not be made compulsory. However, if boards believe that it is not necessary or cost-efficient for their companies to produce the relevant documents in a language customary in the sphere of international finance, they should briefly explain this to shareholders in their annual report and on their website.

We are concerned that the use of any criteria or thresholds, such as those contained in the Fourth Directive, to define an exception from a general requirement to produce meeting documents in a language customary in the sphere of international finance will not provide the flexibility required with regard to this issue.

## **Depositary Receipts**

### **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”.**

We welcome the proposal with regard to depositary receipts. It would limit the possibility for boards or management to influence the voting process and also prevent “empty voting”, i.e. the exercise of voting rights in the absence of an equivalent, underlying economic interest.

We do not believe that there should be grandfathering for existing agreements. The recommendation should make it clear that going forward all depositories should seek explicit voting instructions or authority to exercise discretion by the depositary receipt holders.

## **Stock lending**

### **3.1. Do you believe that stock lending needs to be addressed at EU level? Please give your reasons.**

Stocklending plays an important role in ensuring market liquidity and thus the efficient pricing of securities. As such, we regard it as fundamentally beneficial to capital markets. However, it has become clear over recent years that certain stocklending practices, such as borrowing shares ahead of shareholder meetings for the sole purpose of voting in order to influence their outcome, should be discouraged, as they allow the exercise of voting rights without exposure to the underlying economic risk.

An example of this practice is the apparent attempt by hedge funds to block the bid by Fortis to buy parts of ABN Amro (see Financial Times, 26 July 2007, p. 23). As reported in the Financial Times, there has been significant borrowing of Fortis shares in the period before the company's extraordinary general meeting on 6 August 2007. At this meeting Fortis will seek approval of the funding required for the proposed acquisition. At the same time traders have reported strong demand for August and September call options over Fortis shares. As Fortis needs 75 per cent investor approval for its proposed rights issue at the meeting and given the expectation that the share price will rise, if the funding is voted down and the bid stopped, the borrowing of shares for voting purposes could facilitate a lucrative arbitrage on the calls.

We believe that the right approach to the issue of stocklending is greater transparency, and in particular coverage under the Transparency Directive. We therefore believe that it is appropriate for this issue to be handled at EU level. Companies have a right to know who their shareholders are, and as the Transparency Directive makes clear, this needs to be knowledge of which investors hold voting rights over shares not just legal or beneficial ownership. At present, stocklending and certain forms of derivatives (such as contracts for difference) make it impossible for companies to know who holds the voting rights over their shares. We would welcome the Transparency Directive being extended so as to encompass these issues.

#### **3.2.1**

While we would favour lenders retaining voting rights over lent stock, we do not believe that this is in practice possible. We believe that it would in effect end the practice of stocklending as lent shares would not be fungible with other stock in the market. We therefore would focus on the need for owners to recall stock if relevant circumstances arise - and on the need to ensure that this is effectively possible and enforceable at short notice.

The International Corporate Governance Network (ICGN), a global membership organisation of institutional and private investors, corporations and advisors with capital under management in excess of €10 trillion, has provided guidance in this area by developing an ICGN Code of Best Practice (the ICGN Code). We endorse the ICGN Code and have also developed our own stock lending rules which are available on our webpage.

### **3.2.2**

We believe it is fundamental to the underlying beneficial owners' rights that their shares cannot be lent without express permission. After all, a stocklending transaction is not legally a loan, but a sale with various attached rights.

### **3.2.3**

As discussed above, we do not believe that in practice it is possible for the lender to retain the vote - nor to have a practical right to instruct its borrower how to vote (in this regard we would note that only on rare occasions will shares remain with the borrower). However, we are strongly of the view that a borrower of stock should not be able to vote that stock. The ICGN Code's guidance in this regard is instructive.

Because a borrower has not bought stock in the market, the market price will not reflect the fact that the borrower is seeking to exercise ownership rights. This therefore seems to us to amount to market abuse, particularly while borrowed share positions remain invisible to the market and to investee companies.

### **3.2.4**

We agree with the proposal.

As a final comment, we would encourage the Commission to undertake a thorough study of the impact of stocklending on European capital markets. In particular, such study should focus on the timing of stock lending and its impact on voting at general meetings. We would also encourage a thorough assessment of the financial impact of regulation along the lines of the ICGN Code.

## **Chain of intermediaries**

### **1. Duties of intermediaries**

#### **4.1. Do you consider that the duties of intermediaries in the voting process need addressing?**

We believe that after addressing share blocking through the Shareholders' Rights Directive further progress in encouraging cross-border voting and thus corporate accountability will come principally from tackling the ineffectiveness of the various cross-border proxy voting arrangements across the EU.

At the moment cross-border voting is complex, bureaucratic and costly. A significant part of the costs stems from the resource required to "get a vote through" from the ultimate beneficiaries to the meetings. Even for large institutional investors, who wish to act as responsible owners, it may be difficult to justify these costs for voting. We strongly supported the objective of a proposed amendment to article 13 of the Shareholders' Rights Directive, which would have imposed an obligation on financial intermediaries to facilitate the exercise of voting rights attached to the shares held by them on behalf of the natural or legal person for the account of whom the shares are held. We had also recommended some additional wording in the amendment which makes it clear that the decision on how to exercise the voting rights ought to vest with the natural or legal person who is the ultimate beneficiary.

The proposed amendment to the Shareholders' Rights Directive would have helped to address the current problems with cross-border voting. Unfortunately it did not have enough support when the final version of the directive was agreed upon. Whilst

we would have favoured addressing the problems through a binding instrument, we support tackling the issues through a Recommendation as a good step forward.

**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.”**

This is a good starting point. However, as already explained in our answer to question 4.1, we would like to see a more far reaching obligation placed on financial intermediaries to facilitate the exercise of voting rights attached to the shares held by them on behalf of the natural or legal person for the account of whom the shares are held.

**“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.”**

Please see answer to 4.1. above.

**“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.”**

We support this proposal. Without confirmation from financial intermediaries, it can be difficult for institutional investors to prove to the ultimate beneficiaries that they have exercised voting rights in accordance with instructions given.

**“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.”**

We believe that the negotiation of fees is best left to the contracting parties in the intermediation chain and are against any intervention with regard to pricing.

**“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.”**

We support this recommendation which would improve transparency. However, as registering large numbers of small shareholders along the chain of intermediaries may create significant administrative costs, especially when the chain is long, there may be a case for an exemption.

**“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”.**

We agree with this definition.

## **2. Disclosure of investors**

### **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?**

Yes, we believe that the Transparency Directive once implemented, will give a breakdown of voting rights and that further action at the EU level is not necessary at present. We would also note that the Transparency Directive already allows Member States to introduce stricter rules if deemed necessary. Whilst providing extra transparency, any further lowering of the threshold would also lead to more administrative work and costs for shareholders.

### **Management companies of investment schemes**

#### **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.”**

We support such a recommendation. Management companies should have the possibility of “split voting”. This is particularly important in cases where they have institutional clients with different voting policies and have to follow their instructions.

From our own experience, we would add that it is also important to ensure that “split and partial voting” of other (institutional) investment vehicles are allowed and facilitated across the EU.

### **Other suggestions**

We would also welcome some clarification with regard to the concept of “concert parties” across the EU. The fact that there remain significant uncertainties in a number of countries as to what amounts to acting in concert makes the effective cross-border exercise of shareholder rights, which often necessitates a dialogue with other investors, more difficult.

We believe that shareholders should be allowed to co-operate and co-ordinate their voting behaviour without being obliged to disclose their aggregated shareholdings or to make a mandatory bid, as long as they are not seeking control of the relevant company. The law of certain Member States addresses co-operation between shareholders without clearly distinguishing between co-operation with the objective of gaining control of a company and co-operation aimed at developing and communicating a common message to a company. The legal uncertainty in respect of “concert party action” in Germany, for example, currently discourages institutional investors from communicating with each other regarding corporate governance matters and if appropriate from getting involved, thus preventing them from meeting effectively their responsibilities as owners.

We believe that the Commission should clarify this area of the law across the EU by providing at least a common framework that provides legal certainty. In particular, we believe that there should be an explicit safe harbour for shareholders sharing information or discussing their views on corporate governance issues, particularly

regarding forthcoming voting matters and subsequently acting together, including coordinated voting in respect of particular resolutions, provided they are not doing so with a view to gaining control. It may be that readily accessible and clear rules across the EU in this area may best be implemented by a binding instrument, but addressing this important issue in a Recommendation may be a useful first step.

Finally, we would urge the Commission to monitor closely the implementation of the proposed Recommendation by Member States. This would place the Commission in a position to assess in the medium term whether there is a need for further binding measures to facilitate further the cross-border exercise of voting rights.

We trust that you will carefully consider our comments and suggestions and where appropriate take them as constructive input to the Commission's current and future initiatives in company law and corporate governance. If you would like to discuss our views in further detail, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'H. Hirt', with a stylized flourish at the end.

Dr. Hans-Christoph Hirt  
Associate Director