

Statement of the European Corporate Governance Forum on Empty Voting and Transparency of Shareholder Positions

1. According to the prevailing paradigm underlying company law in Member States, shareholders as residual claimants are the ultimate risk bearers and therefore entitled to decide on the essential and ultimate matters relating to the company. Putting their economic or financial interest in the company at stake, their individual votes will be aligned with the interest of the company and thus they are best placed to take the crucial decisions affecting the company's future. In recent times however, the validity of this assumption has come under pressure. Financial techniques are more and more used to separate voting rights from the shareholders' direct financial interest in the company. A shareholder's vote will have no repercussions on his financial position if he has hedged his financial exposure by such techniques, or may even run contrary to that of the company, as he may benefit in another company in which he is also interested. This would conflict with the idea that shareholders have the strongest incentive to take responsibility for the company's future.

2. "Empty voting" refers to voting by a shareholder without corresponding financial interest in the company in which he votes. The reverse situation is "hidden ownership" whereby a party is not the legal owner but is entitled to exercise influence and eventually to direct the votes as if he was a shareholder. Techniques that allow for hidden ownership are often used to circumvent disclosure requirements. Although the Forum is of the opinion that both cases have to be addressed, at the present juncture its statement only refers to "empty voting".

There are many techniques allowing empty voting. When shares are borrowed, the borrower normally has legal title allowing him to exercise voting rights, but the shares have to be returned to the lender, removing his economic risk. By using equity swaps a shareholder may retain title to the shares and therefore remain entitled to vote while he has swapped away the financial return on the shares for an agreed value, protecting himself against price movements of the shares. Similar situations may occur with contracts for difference. In a way a form of empty voting also occurs when shareholders register their shares for voting as per the registration date, whether this is the date of the meeting or a date in advance of the meeting, and at the same time have entered into a contract to sell their shares after the registration date: they can vote without any remaining financial exposure.

3. Empty voting and hidden ownership techniques increasingly exercise significant influence on companies, mostly listed companies, and the key decisions shareholders can take. The Forum is of the opinion that this deserves special attention in order to safeguard the integrity of the governance of European – especially listed – companies and the markets on which their shares are traded.

4. At the European level the issue has not been addressed explicitly. Article 10 of the Transparency Directive¹ extends the notification duty, provided for in that directive, to any person entitled to exercise voting rights in the following case:

"voting rights held by a third party under an agreement concluded with that person or entity providing for the temporary transfer for consideration of the voting rights in question;"

It should be amended to clarify that said agreement can be either an oral or a written, formal or informal agreement. There should be further discussion on whether this provision also covers cases where the agreement did not provide for the transfer of the voting rights but such transfer may be the logical consequence of the agreement. Moreover in cases as contracts for difference, a transfer is not necessary to allow influence on the counterparty's behaviour. Some jurisdictions have introduced additional regulatory responses to these developments. The main approach is to mandate disclosure of the voting rights held within the "empty voting" arrangements.

5. The Forum recommends the introduction of an assumption in company law that shareholders who take part in a general meeting own the corresponding economic interest in the voted shares. A principle should then be introduced that where shareholders who have retained legal title to the shares and exercise the vote that goes with them but have ceded all or part of the economic interest should disclose this to the market above an appropriate threshold. Parties not making the required declarations may be considered to have made an untrue statement.

The Forum has considered whether votes cast without an economic interest should be declared null and void, but does not recommend this, at least at present. Transparency in the first instance should be a useful indicator of the extent of problems and a spur to appropriate behaviour.

6. Borrowing of shares, or securities lending, fulfils a useful role in the functioning of financial markets. It may however be used to allow the borrower to vote although he is not exposed to the corresponding financial risk. Several self-regulatory organisations therefore stipulate that the primary purpose of securities lending should not be the obtaining and exercising of voting rights. Lenders should have the right to recall the securities at any time. This practise is to be encouraged.

7. According to prevailing company law provisions derived from the Second Company Law Directive², shares held by the issuing company itself cannot be voted for the whole period during which the shares are held in treasury by the company. Companies may have good reasons to lend such treasury shares to obtain a certain revenue from this otherwise unproductive investment. They may, however, also do so in order to allow the borrower to exercise the voting rights attached to these shares, as it is generally understood that the borrower acquires legal title to these shares. As the decision to lend treasury shares is taken by the board of directors, the board might use the securities lending to influence the

¹ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390, 31.12.2004, p. 38

² Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, OJ L 26, 31.1.1977, p. 1

outcome of a general meeting. Instead of prohibiting any form of securities lending by a company of its own shares, the Forum recommends the introduction of a rule that the company and its subsidiaries may only lend the company's own shares if the lending contract stipulates that the borrower will not vote with these shares, and should ensure that later acquirers would not vote either. The company should disclose prior to the general meeting to what extent it and its subsidiaries have lent the company's own shares to third parties.

8. The Forum is fully aware that the issue of empty voting raises many complicated issues that have not been dealt with in this statement. With the current statement the Forum wishes to take a first step in dealing with empty voting. The Forum will continue to review the subject in light of new developments and evidence.