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SUMMARY OF THE INFORMAL DISCUSSIONS CONCERNING THE INITIATIVE ON SHAREHOLDERS ENGAGEMENT

March 2013

1. OVERVIEW

In December 2012 the European Commission has adopted the Action Plan on European Company Law and Corporate Governance.

Since then, the Services of the European Commission have been working on the actions set out in the Action Plan and, in particular, on measures aimed at increasing long-term shareholder engagement which might be proposed through a targeted revision of the current Directive on the exercise of certain rights of shareholders in listed companies (2007/36/EC).

In order to stimulate the reflection process in preparing this targeted revision, the Services of the Commission engaged in informal discussions, with a number of stakeholders. They aimed to collect the views and get an early feedback of practitioners and experts and to benefit from their insight and expertise in the field of corporate governance in general and shareholder engagement in particular. To cover all interest groups and to receive a diversified feedback the services of the Commission invited a variety of stakeholders to these roundtable debates, such as asset owners, asset managers, issuers, proxy advisors, consultants, stock exchanges, public authorities, customers, employees and trade union representatives. The roundtable debates took place in Brussels between Tuesday the 29th of January and Friday the 1st of February.

The subsequent summary of the roundtable debates gives an overview of the main issues and arguments raised by the stakeholders. It outlines their most frequent observations and main concerns regarding the actions set out in the Action Plan, especially a possible revision of the current directive on the exercise of certain rights of shareholders in listed companies (2007/36/EC).

2. SUMMARY/ DETAILED ANALYSIS OF RESPONSES

a) Shareholder engagement

All participants acknowledged that, in the past years, shareholders have often been insufficiently engaged with companies and did not exercise sufficient oversight over management. Therefore, all stakeholders said that shareholder engagement is an important issue of corporate governance and that more and better shareholder engagement could enhance the European corporate governance framework.

Some explained the fact that the majority of investors do not engage with the "free rider problem". Others explained the lack of shareholder engagement with market failures and missing incentives for institutional investors to engage. Especially in an environment of highly diversified portfolios, a lot of participants saw difficulties for institutional investors to engage in single companies or to monitor in depth the asset managers. Thus, a concentrated investor portfolio was generally regarded to be beneficial for shareholder engagement but at the same time found to be more risky. Therefore, it was not recommended to impede the diversification of portfolios or to prescribe concentrated portfolios. In addition it was pointed out that rules such as Solvency II or MIFID lead to more diversification as they do not allow to offer a concentrated portfolio to a risk averse investor.

Beside that, institutional investors and their relationship to asset managers were generally regarded to be of major importance for the debate concerning shareholder engagement.

Some experts asked to bear in mind that sometimes the "financial literacy" among institutional investors is surprisingly low and that financial products in general tend to become more and more complex and more difficult to understand.

Furthermore, there was a widespread agreement throughout the participants that effective shareholder rights are a key prerequisite for shareholder engagement. In this context, a number of experts referred to the U.S. where they considered shareholder engagement to be weak, which – to their mind – is due to weakness of shareholder rights.

In exchange for more shareholder rights some recommended that shareholders should be subject to obligations comparable to those set up in the "UK Stewardship Code" which was also paraphrased as "Ownership Code". Some argued with respect to the UK Stewardship Code that it is just one example which should not be imposed on whole Europe as the European markets are very different and no "one size fits all". Moreover, it was argued that there is a lack of resources in the institutional investors industry to offer stewardship. According to that, asset managers already publish reports, but asset owners do not have sufficient time and resources to analyse information.

Others pointed out that engagement in general and stewardship in particular should be competitive issues by creating marked demands for engagement and stewardship. It was suggested to create this demand by going beyond the UK Stewardship Code on the basis of a European "opt in" standard concerning engagement – possibly on a "comply or explain basis". Thus, an acknowledged standard would create a level playing field for the financial industry. Others suggested enhancing stewardship and engagement by making clear that fiduciary duty includes these issues.

b) “Long-term” shareholder engagement

There was a widespread recognition amongst the members of the roundtable debates that the focus of shareholder engagement should be placed on the quality of the engagement and not on the quantity as shareholders in the past tended to concentrate on short-term profits. Therefore some participants proposed to grant asset owners financial incentives for their long-term engagement. Others pointed out that the asset managers are important players as well. Thus, one should turn to them if the engagement policy of asset owners should be shifted towards long-term perspectives. It was argued that the average mandate for asset managers is 2-3 years which was not seen as long-term. Therefore it was proposed to design the mandate given to the asset managers in a way that they enhance engagement in general and long-term engagement in particular.

Moreover, it was argued that short-term incentives are sometimes even generated by legislation, such as Solvency II. Others mentioned that the common understanding of fiduciary duties (that is to say the obligation to act in client’s best interest) is a possible impediment for long-term shareholder engagement. In this context it was argued that long-termism is nothing else but an accumulation of short-term events and that sometimes it is a fiduciary duty to sell shares spontaneously, e.g. when a share prize is highly overestimated. Therefore, some stated that it is difficult to encourage more long-term investment in equities in a system that is short-term orientated (e.g. investors relying on daily figures or quarterly reports).

Moreover, it was noticed that all investment strategies somehow relate to benchmarks which tend to define the fiduciary duty. It was criticised that the fiduciary duty has become the duty to follow the rest of the industry which promotes herd behaviour. Furthermore, it was argued that due to the herd behaviour (caused by the fiduciary duties), anomalies in corporate governance might remain undetected and little events might add up to a crisis (black swan problem). Hence some proposed to revise the definition of fiduciary duty and also to take long-term perspective and ESG (environmental and social governance) factors into account. In this context, some criticised average main-stream investors as they look at corporate governance and risk management in a traditional sense whereas responsible investors have a broader understanding of risks and also take diversity, long-term and ESG-issues into account.

Some argued that the correlation between good corporate governance and long-term profitability might be difficult to prove as benefits of long-term engagement take a long time to materialize. I t was stated that a good long-term effect of shareholder engagement is also difficult to prove as there are many issues influencing the performance of a company. Some pointed to the instance that there might also be cases in which shareholder engagement turned out to be bad for the long-term perspective of a company. Others underlined that short-term investors do not always have a bad influence and that they are also crucial for the smooth functioning of the system.

c) Transparency of voting policies and engagement policies

Most participants regarded the disclosure of voting policies to be an important issue and recommended a disclosure at least on a “comply or explain” basis. Some also recommended that transparency and disclosure requirements should also entail non-financial issues such as ESG-risks. Some participants considered that the disclosure of engagement is a difficult topic and that disclosure at a policy level might be appropriate whereas disclosure of engagement records might sometimes be harmful to engagement. These participants believed that discussions between shareholders and companies are best conducted on a confidential basis. Therefore, there shouldn't be any disclosure requirements concerning on-going engagement activities and such engagement activities should only be disclosed ex-post on a more generalized and aggregated basis. In this context some participants stated that engagement activities can take several years. Therefore it was recommended only to disclose backward looking and summarized information, or information where shareholders and management have reached a successful conclusion or they are finally stuck in a conflict (and no longer speak to each other). In the latter case, it was argued that public disclosure (to the media) can be used by the shareholder as a means of putting pressure on the board.

Furthermore, some stated that a mandatory disclosure of voting records will practically force people to vote which could have at least two effects. First, it could have a detrimental impact on the quality of votes being cast. Secondly, it could increase the influence of proxy advisors.

d) Proxy Advisors

With respect to proxy advisors, the participants admitted that they are an important link in the chain and that certain players in the equity chain need their advice. It was asserted that especially foreign investors tend to rely on their advice. Thus, it was reasoned that the more international a financial market becomes the greater is the need for proxy advisors and that proxy voting is still better than thoughtless voting.

However, a lot of participants criticised that the proxy advisor industry isn't subject to any rules. On the other hand, it was pointed out that the proxy advisor industry is small and that overregulation could make it shrink. Therefore, some proposed a code of conduct, which could be established by self-regulation. Others proposed that the Commission should endorse such a code and that the code should apply on a "comply or explain" basis.

Some said that there is a lack of transparency as to how proxy advisors operate and reach their decisions. Moreover it was argued that proxy advisors might apply very different standards in different markets, which could create a problem of lack of continuity of advice. Furthermore, some reported on possible conflicts of interest as proxy advisors often have multiple and incompatible duties (also as CG advisors, proxy agents, etc). In this context, the relationship between proxy advisors and proxy solicitors (the former gets paid to advice on votes, the latter gets paid to raise votes) was regarded to be potentially problematic. Therefore, it was proposed that conflict of interest should be disclosed as well as the measures the proxy advisor took in order to prevent such conflicts. With respect to disclosure, some stated that problems might arise if proxy advisors were obliged to disclose their recommendation to issuers before the AGM. In this situation, it could be possible for issuers to outwit or fool the proxy advisors.

Moreover, it was said that proxy advisors usually only have one model of advice, although they ought to offer a variety of recommendations based on the preferences of individual investors.

e) Remuneration

Questions on remuneration and the disclosure of remuneration raised a lively debate. Most participants argued that there should generally be more information and disclosure on the structure of payment, although some expressed their concerns that transparency in this field might lead to a general pay increase. Many regarded it to be problematic that the disclosure requirements concerning remuneration differ throughout the European Member States. In particular, in the southern countries, the disclosure on remuneration was seen to be bad. Therefore, many recommended a European wide standardization of the disclosure on remuneration. Some participants believed that a standardized disclosure would make the information more comparable throughout the different Member States which could also have a positive effect on cross-border activities.

As a remuneration package often comprises fix and variable parts as well as pension plans, some saw practical difficulties in establishing a system of full and comprehensive disclosure reducing the complexity of a remuneration system to a single figure or a range of expected payments. Others argued that it should at least be possible to present full and comprehensive information on 4-5 pages.

In the view of some, it would be good to introduce a general principle according to which one can only pay on the basis of a remuneration policy in which the remuneration can be valued beforehand. As a result, remuneration policy should not be adopted if it is not possible to determine the real value of a pay-package. It was said that such a rule would for example prevent the use of leveraged share schemes.

It was proposed that a disclosure should also reflect the sustainable payment criteria and non-financial (ESG) factors. Moreover it was argued that pay packages should contain long-term perspectives and claw back provisions.

With respect to shareholders vote on remuneration, most participants favoured a vote on the remuneration policy and the remuneration report. Few participants suggested also a vote on the individual remuneration. Certain pointed to two tier systems and stated that these systems will have problems with binding shareholder votes on remuneration as this will challenge the power of the supervisory board. Others saw a risk of increasing short-termism by giving more voting rights to possibly short-term orientated shareholders.

f) Cross border / Electronic voting

With respect to cross border voting, a lot of participants criticised that there are still financial and jurisdictional impediments to cross border voting (e.g. special power of attorney). Some participants stated that in spite of the shareholders rights directive, you can still find share blocking in some Member States.

Others stated that electronic voting remains an important issue and is still not working properly. It was argued that many barriers (also regulatory) must be removed. Moreover some participants expressed their concerns about empty voting.