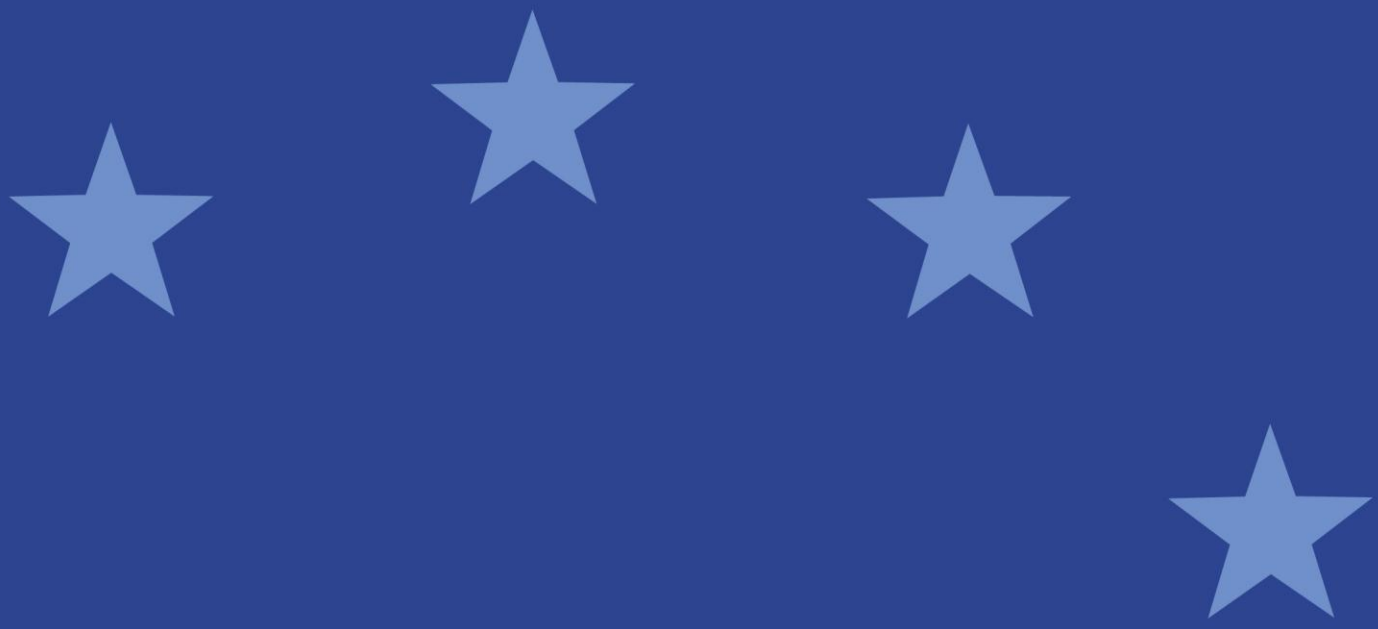
esma European Securities and Markets Authority

Feedback Statement

Call for Evidence on Empty Voting



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European Securities and Markets Authority

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Acronyms used

EC	European Commission
ESMA	European Securities and Markets Authority
EU	European Union
SRD	Shareholders' Rights Directive (2007/36/EC)
TBD	Takeover Bids Directive (2004/25/EC)
TD	Transparency Directive (2004/109/EC)

I. Background

1. The separation of the economic interest relating to shares from their voting interest (decoupling of voting rights), usually achieved by using derivative instruments and trading strategies in the securities markets, has led to discussion about the need for possible regulatory action. In this context, issues and potential problems relating to empty voting (i.e. having voting rights attached to shares without corresponding economic exposure) have also been raised.

2. The topic was first addressed during the European Commission work on the review of the Transparency Directive (TD), in the report on the operation of the TD[1] and the related staff working document[2] in May 2010, which identified a number of possible regulatory issues relating to empty voting and hidden ownership; consultation on the modernization of the TD, which also raised a number of questions relating to these issues. On the basis of the feedback statement published by the Commission in December 2010[3], it seems that while there was support for enhancing the transparency of hidden ownership, the majority of the respondents did not support the introduction of mechanisms to enhance the transparency of empty voting.

3. ESMA decided to take a further step by launching a Call for Evidence on Empty Voting in September 2011 to analyse the topic in more depth. The main objective of the consultation was to assess issues relating to empty voting as a whole. Therefore, the call for evidence was not restricted to transparency or corporate governance issues, or to a specific piece of European legislation. Rather, ESMA was seeking views in a broader context on the occurrence of empty voting and the possible market failures that could arise from such occurrence.

4. The reason for collecting information and evidence on the extent to which empty voting practices exist within the EU, and the effects of such practices, was to help ESMA to assess whether there is need for further work with regard to empty voting.

II. Results of the consultation

5. ESMA received 29 responses to the call for evidence on empty voting. Responses were mainly received from the investment services, banking, and asset management sectors.

6. Most respondents welcomed the opportunity to respond and highlighted that the topic is relevant even though it is very problematic both to exactly define the extent of the phenomenon and to recommend appropriate solutions, if any are needed.

7. Respondents expressed very different views on this issue. These views reflect the heterogeneity of respondents and range from the view that there is no need for regulatory action to recommending the prohibition of empty voting practices.

8. Due to the potential connection with other related issues, some respondents have insisted on

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[1] Commission report on the operation of the Transparency Directive (May 2010) http://ec.europa.eu/internal_market/securities/docs/transparency/directive/com-2010-243_en.pdf

[2] Commission staff working document - The Review of the operation of Directive 2004/109/EC: emerging issues http://ec.europa.eu/internal_market/securities/docs/transparency/directive/sec-2010_611_en.pdf

[3] Consultation on the modernisation of the Transparency Directive 2004/109/EC - Feedback Statement http://ec.europa.eu/internal_market/securities/docs/transparency/transparency-consultation-summary_en.pdf

the necessity to treat empty voting as strictly connected to other topics, as for instance stock lending activity, voting processes or the use of derivative instruments. According to this view, an improvement in regulation in these areas would increase the likelihood of reducing the persistence of empty voting practices.

9. Other respondents have focused on the relationship which may exist between empty voting and the framework of several EU Directives (e.g. Market Abuse, Shareholder's Rights and Transparency), and consequently the possibility of addressing the empty voting issue through one or several of these Directives.

10. A few respondents also have drawn attention to some recent legislative measures on empty voting adopted at their own national level, hoping that they could be extended to other EU countries.

11. In general, contributors were not able to provide the evidence needed to corroborate their answers about the frequency and intensity of empty voting practices and, therefore, the overall conclusion of the consultation is that there appears to be insufficient evidence to require further analysis or action at this stage.

Responses to the questions

Ways of exercising empty voting

Q1: Please identify the different types of empty voting practices and the frequency with which you think they occur within the EU. Where possible, please provide data supporting your response.

12. The majority of the respondents who replied to this question (20 out of 29) agree that the examples illustrated in the call for evidence, namely (i) voting on borrowed stocks (linked to share lending) and (ii) exercising voting rights even when the shares have been disposed between the record date and the shareholder's meeting[4], are cases of empty voting.

13. These are deemed to be the most common ways through which empty voting may take place in the market. But only a small number of respondents provided any data/evidence supporting their answers. This lack of evidence has been roughly attributed to several, not necessarily interconnected reasons: no direct awareness of cases of empty voting, no proper assessment of the relevance of the phenomenon, very rare frequency in the EU compared to the US (though no data has been provided to support this latter consideration)[5].

14. Other examples of empty voting mentioned either stem from national market conditions or the use of derivative instruments. With regard to the former, local conditions such as for instance the existence of "depositary receipts"[6] or "anti-takeover foundations"[7] (both in the

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4 As also mentioned several times in the responses received, the period may range from a minimum of very few days (2 days in UK and Ireland, 3 days in France) to a maximum of more than three weeks (21 days in Germany for bearer shares and even 28 days in The Netherlands).

5 On the other hand, one respondent affirmed that one or more of the situations giving rise to empty voting practices likely occur at most if not in all general meetings in EU but without providing supporting data.

6 In the Netherlands about 1/10 of listed companies have issued all or a large part of their common share to a so called Trust Office, which in turn has issued certificates of shares (or depositary receipts). Therefore, the Trust Office is able to have a large influence on the voting outcome although the system in place allows holders of certificates of shares to exercise the

Netherlands) may naturally lead to an increase of the occurrence of this practice; from the other end, different specific domestic conditions may diminish its incidence (e.g. in the UK).[8] As far as derivatives are concerned, their extensive use also for corporate governance purposes[9] , through instruments such as contracts for differences ("CFDs") or equity swaps or any other instrument for hedging purposes, may permit investors (like hedge funds) to exert more voting powers than their real economic interest on the company. For such reasons, at times it is very difficult to separate cases of hidden ownership from cases of empty voting, since they can be (although they are not necessarily) mirror images of a single transaction/trading strategy.

15. Two respondents focus only on one form of empty voting ("voting on borrowed shares"), considering it as the most relevant form of empty voting, while another respondent makes the attempt to circumscribe the exact definition of empty voting by means of two conditions.[10]

ESMA's view:

16. In light of the feedback received, ESMA believes that it is too complex to come to a unique definition of empty voting, and, consequently, to achieve a comprehensive identification of the phenomenon and of its implications.[11] Moreover, as shown by the responses, empty voting may be closely related with other activities (e.g. stock lending, use of derivatives and, thus, hidden ownership, omnibus custodial accounts, proxy advising) or simply depending on specific local market conditions.

17. Therefore, to the extent that any underlying problem does exist, it may be inappropriate to attempt to deal with it in a "one-size-fits-all approach"; rather, an approach taking into account the multi-layered nature of the phenomenon could be desirable.

18. Lastly, ESMA tends to agree with the consideration coming from most of the responses that the most risky practice related to empty voting is when an investor borrows shares (or

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voting rights trough grant voting proxies. Empty voting may finally arise when the Trust Office exercises the voting rights for those holders of certificates who did not request a proxy to vote.

7 Dutch corporate law allows a wide range of mechanisms that can be used to defend companies against hostile takeovers. One of the most used is the establishment of a so-called anti-takeover foundation, which typically holds the right to purchase so-called anti-takeover preference shares up to 100% of the issued ordinary shares. The execution of the voting rights attached to the preference shares can be seen as empty voting.

8 UK-based respondents have highlighted that the short period between the record date and the general meeting holding in UK (48 hours) and, above all, the standards in place within the investor community (e.g. Code of Practice and GMSLA industry documentation), are, in their opinion, powerful tools to deal with the empty voting issue.

9 This has been widely recognised as the issue that pioneered the literature on the "decoupling of voting rights" (we may refer at Hu & Black's trilogy at first instance; see Annex 1 for further information).

10 According to the respondent, empty voting should be confined to cases where a shareholder casts vote when he:

"(i) does not have any material economic interest in the shares at the time the vote is exercised; and (ii) is voting other than (x) in accordance with the instructions of the person who does have that economic interest or who is entitled to give instructions as to voting shares and (y) where the person who has the economic interest or who is entitled to give instructions as to voting the shares is aware of the way the vote is being exercised and does not take action to require the shareholder to change that vote".

11 On this side it is worth citing a sentence reported by one respondent: "*We believe it is likely that listed issuers would raise any concerns they have that empty voting is affecting the outcome of resolutions so, in the absence of many publicised examples, we do not believe there is cause to assume that this has been a frequent problem*".

puts in place similar operations using derivatives to reach the same result) in order to vote in a way that is perceived to be against the long-term interest of the company and which may be with the objective of pursuing a personal gain from the trading position built up (often taking advantage from the share's price falling).[12]

Q2: Please identify specific examples where empty voting practices have occurred within the EU. Where possible, please provide data supporting your response.

19. Most respondents who replied to this question (20 out of 29) believe the empty voting practices exist but comment that it is difficult to measure the frequency and scale of them across the EU. That might be the direct consequence of many different reasons which have been mentioned in the responses, e.g.: the privacy/secrecy of some of the transactions involved, the fact that hidden ownership cases are much more frequent and sometimes it is difficult to separate the two phenomena, or because of the possible link to other activity, e.g., proxy advising. One respondent expressly asserted that: "*we see regular cases of empty voting/hidden ownership [...] but our systems do not allow us to assess precisely its importance*".

20. A few of the respondents (8) recognise a small number of actual cases and provide references (mainly related to cases reported by the media). The most cited is the famous Laxey/British Land dispute, which happened in the UK in 2002.[13] Other cases are strictly related to some national contexts (e.g. The Netherlands)[14], while other ones appear to be more connected to examples of hidden ownership (as stated before). Only one respondent specified concrete examples stemming from its own daily activity on the market (though more related to unintentional practices resulting from common technical movements between the record date and the meeting date).

ESMA's view:

21. The feedback received on this question confirmed the fact that amongst the majority of respondents there was a shared view on the fact that empty voting practices are occurring in the EU markets. However it is clear that there is a lack of evidence to support the responses. In fact, apart from a few cases reported by the media, almost no respondents were able to measure the frequency and the scale of them across the EU. Furthermore, several cases cited may be actually classified under the category "hidden ownership" instead of "empty voting".

Consequences of empty voting

Q3: a) What in your view are the negative consequences that can occur as a result of empty voting (relating to e.g. transparency, corporate governance, market abuse)?

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12 It is worth mentioning that to a certain extent this kind of operations should be already taken into account under the Market Abuse Directive regime.

13 Other cases reported by the media and cited in the responses (most of them are actually cases of hidden ownership) were: OMV/MOL in Hungary, P&O Princess in UK, Deutsche Bourse and Porsche in Germany, Sulzer in Switzerland, LVMH in France; and, outside EU, Perry Mylan (US) and Henderson Land (Hong Kong).

14 See footnotes 6 and 7.

22. Almost all respondents who replied to this question (23 out of 29) believe that in a certain way empty voting may be seen as a negative practice from several different points of view. A small minority of respondents (3) affirmed that they have not experienced any problem regarding empty voting.

23. For most of the contributors who mentioned the transparency issue, the main concern is the potential disconnection between the economic ownership and the voting right, which may be harmful for the majority of the shareholders if this behaviour is against the long-term interest of the company. Some of the respondents pointed out that this turns to be particularly cumbersome when investors vote the "wrong way" for pure trading reasons (either following their own strategy or submitting voting instructions proposed by a third party), thus allowing their personal interest to prevail against the interest of the company.[15]

24. Few respondents also highlighted some concerns about corporate governance that may arise, e.g., when engaging with people having no economic exposure and still able to some extent to affect the decisions which have to be taken. One respondent argued that the effects on corporate governance stemming from empty voting practises are not always negative.[16]

25. Several respondents were firmly convinced that empty voting practises may be considered as a form of market abuse, especially when there may be an incentive to spread false stories (e.g. if the empty voter has a net short position).

26. As for question Q2, some respondents consider that this practice is stemming from local market conditions (e.g. in countries where the period between the record date and the general meeting is relatively long)[17]. Moreover, most of respondents confirm that in their view the problem exists but it is very difficult to properly identify and measure it.

b) To what extent do you consider those consequences to occur in practice?
c) To what extent have you encountered those consequences in your own experience?
Where possible, please provide data supporting your response

27. Responses to the questions above have been treated together to better reflect the answers received.

28. As for previous questions, responses vary. A few respondents asserted that they are not aware of cases of empty voting; some others affirmed the phenomenon can be considered as exceptional; other contributors described their own national context, highlighting the measures undertaken to discourage the practice (as mentioned before, some countries seem to be less impacted by empty voting practices); some of them also listed the local

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15 One respondent underlined that the separation between voting and economic interest which may cause this phenomenon may be more frequent where it is relatively inexpensive to carry out. On this side it may be worth reminding the empirical paper from A. Brav & R. D. Mathews, *Empty Voting and The Efficiency of Corporate Governance*, 99 J. of Fin. Econ. 289 (2011).

16 According to the respondent, there might be an improvement of the decision-making process of general meetings when the vote buyer is more informed about the items on the agenda than the vote seller and, at the same time, they have coincident interests.

17 It should be mentioned, though, that ESMA did not receive any evidence of respondents experiencing problems with this issue in countries, like Germany, where that period is longer.

situations that in other countries might increase the occurrence of empty voting (e.g., the length of time between record date and AGM)[18]. In general the vast majority of the respondents were convinced that it is very difficult to have access to data on empty voting (e.g. two of them expressly invite ESMA and local regulators to collect evidence by consulting the books of central depositories).

29. As with the previous responses, most of the contributors were not able to provide data/evidence to support their responses. In this section, only two respondents have indicated cases other than the famous Laxey/British Land.[19]

ESMA's view:

30. Transparency-related issues seem to be the most relevant (negative) consequences stemming from empty voting practices, although the lack of data provided to support the responses still remains a typical feature of most of the answers received. More generally, the provided feedback also reveals that the local market conditions may either favour or discourage empty voting from impacting on the fields mentioned. If it is the case that local conditions drive the impact, it might be inappropriate to act at the European level in a unique approach.

31. Once again, ESMA tends to agree with the feedback received that the most dangerous form of empty voting is when investors are voting the "wrong way" apparently for trading reasons, thus allowing their own interest to prevail against the interest of the majority of shareholders. In comparison, voting at the general meeting after having sold the shares between the record date and the meeting date may be deemed to raise more theoretical than practical concerns, due to its likely neutrality (in terms of interest alignment with the majority).[20]

32. As for the previous question, the main difficulty for justifying any potential action is the lack of material evidence provided by respondents of the practices described.

Q4: a) Do you believe that empty voting has influenced the results of voting at the general meeting of shareholders within the EU?
b) Has this ever occurred in your own experience?
Where possible, please provide data supporting your response (including the type of empty voting that you are referring to).

33. As before, the responses above have been treated together also to better reflect the answers received.

34. The responses to this question were broadly in line with Q2 and Q3 ("*we presume the phenomenon exists but we do not have data to substantiate it*"). The only case reported in which empty voting has influenced the results of voting has been Laxey/British Land.

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18 An assumption not confirmed by the evidence provided; see also footnote 17.

19 One focused on the Dutch market whereas the other listed non- EU stocks' cases.

20 Furthermore, as pointed out by one respondent, decoupling voting rights from economic ownership seems to be the intended consequence of the introduction of the record date principle in the Shareholders' Rights Directive (2007/36/EC).

Some contributors (5) believe that empty voting has influenced other voting results around Europe but do not have material evidence to demonstrate it.

35. Contributors citing local situations stated that in their countries it has very hardly, or likely never, occurred thanks to the regulatory landscape, which benefited from the introduction either of some form of recommendations or of market standards. One respondent cited the national cases already reported in the previous response while another one stated that the imperfect knowledge of cases of empty voting is also attributable to the lack of information coming from issuers and regulators.

36. One respondent emphasised the concerns surrounding omnibus custodial accounts (over-voting, unvoting), which can hamper an already complex voting process.[21]

ESMA's view:

37. The feedback on this question is the natural extension of the previous answers. Most likely because it is even more difficult than for questions n. 2 and 3, almost all respondents were not able to name additional cases than the famous Laxey/British Land in order to circumstantiate a possible influence of empty voting on the voting outcomes. This is a further confirmation that though almost everyone looks at empty voting as an inconvenient practice in general, the real impact of it on the voting results does not appear to be very significant.

Internal policies relating to voting practises

Q5: What kind of internal policies, if any, do you have governing the exercise of voting rights in respect of securities held as collateral or as a hedge against positions with another counterparty?

38. Only 11 interested parties fully replied to this question, while a few respondents just declared they have no internal policy on the exercise of voting rights within their normal business activity. Five respondents asserted that the voting right attached to these securities is not exercised. Three contributors affirmed that they (or their members) recall (or encourage to act accordingly) any lent shares before the record date, especially when voting in contentious situations or for significant issues. Other replies more specifically stated that e.g. the voting rights cannot be exercised in order to benefit from trading book exemption; or they discouraged the borrowing of securities for the purposes of voting; or simply the rights remain assigned to the beneficial owner.

ESMA's view:

39. According to the feedback received, the internal policies set out to govern the exercise of

[21] In the omnibus custodial accounts securities for more than one beneficial owner are commingled by a custodian or a sub-custodian. The respondent pointed out that "*the omnibus custody system precludes correct registration of shares to vote, and the voting system provided by the custodian requires the issuer to subscribe to services such as their own proxy solicitation service before they will enable shareholders to vote the meeting* [...] *Whilst this is not empty voting in itself, instances where this problem occurs certainly greatly magnify the effects of empty voting on the rest of the shares that do get voted*". Responding to question n. 2, in connection with share lending practice, another contributor affirmed that "*if, however, as frequently happens the lending party is a custodian which does not allocate the lent shares to and notify specific beneficial account holders, it is possible that both the lending beneficial owner and the borrower will vote the shares and over-voting will occur*."

voting rights seem broadly in line with the industry standards in place in Europe.

Need for regulatory action

Q6: Do you think that regulatory action is needed and justifiable in cost-benefit terms? If so, which type of empty voting should be addressed and what are the potential options that could be used to do this? Please provide reasons for your answer. Kindly also provide an estimate of the associated costs and benefits in case of any proposed regulatory action.

40. In general, this question has captured the main attention of most of all respondents (25 out of 29) and also allowing them to summarise the previous answers. Also the few ones who did not answer directly to this question implicitly provided their views on this item, through their responses to other related questions.

41. For some respondents (6) there is no need for regulatory action on this field while others (5) believe the current system in place in their own countries is already well-equipped to deal with these issues; either because of recent regulation (for one respondent, the French system should be extended to other countries; for another respondent, on the other hand, that system created some confusion by validating the vote of borrowed shares) or because of business practice (e.g. in the UK[22]). The remaining respondents highlighted the fact there may be some room for enhancing the regime of transparency of empty voting practices, even though introducing new regulation may be counterproductive to some extent..

42. The common feeling emerging from several respondents is the need for collecting more accurate data before proposing any kind of new regulation. Practically speaking, they suggested that it may be accomplished by, e.g.:

- waiting for and analysing the application of new (just introduced or forthcoming) disclosure regimes[23], like, e.g., (a) the one for net short selling positions; (b) the one proposed in the review of the TD for cash settled derivatives; or (c) the ones set out in Portugal and France to specifically address, in that order, the record date capture and the temporary detention of shares, as well as analysing compatibility with existing regimes such as the Shareholders' Rights Directive; or
- relying on ESMA and national supervisors to collect evidence on empty voting practices by consulting books of the central depositories.

43. For some contributors a commonly agreed definition of empty voting and its different forms should be achieved before reasoning about any measures. Other respondents would favour an improvement of the overall voting process, including more consideration to issues that may be associated, or even may amplify, empty voting practices, such as stock lending activity, omnibus accounts and the identification of the ultimate shareholders, in order to lessen the impact of these practices.

44. Another shared view is that by reducing the period between the record date and the meeting date of the shareholders meeting it would be possible to substantially reduce scope

22 See footnote 8.

23 See Annex 1 for more details

for empty voting. Nevertheless, for some respondents, since each Member State has its own civil, commercial law framework that reflects local specific situations, the promotion of any harmonised action at the EU level might be too onerous.

45. Some comments (4) are more critical towards empty voting practises, and to a certain extent favourable of banning them. Voting borrowed stocks in particular, when cited, is seen as an unscrupulous practice that may raise also concerns in terms of market abuse.

46. A few contributors identified more areas where they thought ESMA could act. There are fields other than the ones cited before, such as e.g.:

    - sponsoring an in-depth study to determine the incidence of empty voting;
    - to identifying more precisely the behaviour that causes a problem, why it is a problem, and the best way to tackle the problem; or,
    - reviewing and to foster extensive use of some market standards to significantly improve the vote transmittal and vote execution process.

ESMA's view:

47. The final question summarises all the main issues arising from the paper. In this context, the heterogeneity between respondents has been very marked and fully reflects their different backgrounds/experiences. Overall, the main issues arising from the Call for Evidence are:

    - It is extremely difficult to achieve a clear, unique definition of empty voting; rather, empty voting should be thought of as a multidimensional phenomenon;
    - There is a substantial lack of data/evidence about the occurrence and the relevance of the phenomenon, together with great variety between the responses in terms of how it overlaps with other market practices and also in relation to the costs and benefits associated with any measure proposed to deal with it;
    - The existence of local specific features may favour/limit empty voting practices and, consequently, such practices should be (potentially, to the extent their occurrence justifies it) addressed only at a national level and in a very specific way.

III. Final remarks

48. The main objective of the consultation was to look for supportive evidence about the occurrence and the extent of empty voting practices in Europe. After the analysis of the responses received, also taking into account the work conducted by the EC with regard to the TD review (and the specific responses to the question on empty voting), ESMA believes that the feedback has not been sufficiently decisive to justify any regulatory action at European level. At this stage, and also taking into account the need for prioritisation of ESMA resources, it does not justify the need to conduct further analysis on this topic. Therefore, ESMA will not conduct any further research on empty voting for now. Of course, ESMA is and will remain interested in any information on this topic and especially any element that could justify a change of action.

49. The decision of concluding the work on empty voting at this stage gains further support when ESMA considers that there are many initiatives at European level in several fields that may or will be able to contribute to addressing empty voting issues. Therefore, they can represent one of the means by which these practices would be incidentally taken into account without the need for activating a specific piece of legislation or for additional specific work from ESMA at this stage.

50. More details about the current regulatory framework can be found in Annex 1. At this stage it is worthwhile mentioning that the current revision of the Transparency Directive as well as the just introduced Regulation on Short Selling or the proposed Security Law Directive may potentially cover some of the issues discussed by the respondents with regards to empty voting. In this regard, ESMA will monitor the evolution of legislations covering the issue of empty voting and their possible impact on the phenomena.

51. Similarly, current market standards, and any desirable further diffusion/enforcement/improvement of them, can play an important role in limiting the practices, if any, which are considered as the most potentially damaging for the correct functioning of the transparency of the voting structures and corporate governance.

52. A review of the academic literature addressing empty voting is also available in Annex 2 for informative purposes.

53. In light of the circumstances mentioned above, the last step will be to inform the European Commission about the findings and the fact that ESMA will not move forward with further work on this issue at the moment. This does not prejudge any possibility that the topic might be taken into consideration again and subject to further analysis if empty voting would turn to be a critical issue in the future, especially if clearer evidence of the significance of the phenomenon emerges from the markets.

Annex 1. Current regulatory framework in the EU

At the European level empty voting has not been addressed explicitly so far. Below a non-exhaustive list of the legislative measures (EU Directives or specific measures taken in some EU countries), official statements and market standards which cover or may be covering the issues arisen from it. Most of them have been mentioned to a greater extent in the responses to the Call for Evidence.

EC/EU Directives/Regulations

Transparency Directive (2004/109/EC)

Empty voting practices may be discovered (under the TD regime) at any time acquisition or sale of voting rights triggers a threshold under Articles 9ff. of the TD and, consequently, has to be disclosed. This includes acquisitions and sales which take place between the record date and general meeting. The proposal for amending the TD currently under negotiations (COM(2011) 683 final[24]) provides with a new regime for the disclosure of major holdings, which will be extended to all instruments of similar economic effect to holdings of shares and entitlements to acquire shares. Although the provision is deemed to be tailored for detecting hidden ownership, the proposed option will also help address the practice of empty voting (see the Impact Assessment – full text - footnote n. 111, p. 66[25] "*by better informing the market on the actual holders of economic interest in shares, this option would help identify holders of voting rights which do not hold the corresponding economic interest in the shares (empty voting) and therefore could use their votes in the detrimental manner to the invested company*").

Takeover Bids Directive (2004/25/EC)

Empty voting practices would be of interest of the TBD when the voting rights are not precisely aligned with economic interests in the context of a takeover bid. In the context of a takeover offer, there are strong reasons for requiring persons who are connected with bidders or target companies, or who have significant interests in relevant securities of such companies, to make public disclosures of their dealings and positions in relevant securities and for such disclosures to include both their long and short interests. The Takeover Panel in the UK believes that in these cases enhanced disclosure requirements to be appropriate. More in general, the forthcoming publication of the external study on the TBD and the Commission report on the application of the Directive might provide more clues also about this issue.

Shareholders' Rights Directive (2007/36/EC)

The fact that voting rights and economic ownership may be separated is the consequence of the decision to introduce the record date principle in the SRD, which entered into force in 2007. Under Article 7(1b) of this directive, the right of shareholders to sell or otherwise transfer their shares during the period between the record date and the general meeting to which it applies may not be subject to any restriction to which they are not subject at other times. This provision

[24] http:// http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0683:FIN:EN:PDF

[25] see the Impact Assessment – full text - footnote n. 111, p. 66, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2011:1279:FIN:EN:PDF: "*by better informing the market on the actual holders of economic interest in shares, this option would help identify holders of voting rights which do not hold the corresponding economic interest in the shares ("empty voting") and therefore could use their votes in the detrimental manner to the invested company*").

was intended to meet the market's need for shares to be tradable and liquid at all times, including the period prior to a shareholders' meeting (and, indeed, against the share blocking).

(*draft*) Directive on legal certainty of securities holding and transactions (Securities Law Directive – SLD) – to be adopted by the EC in 2012, according to the timetable of the project

The Commission Services are currently preparing the draft. The Directive is expected to address three issues:

a. the legal framework of holding and disposition of securities held in securities accounts, covering aspects belonging to the sphere of substantive law as well as conflict-of-laws;
b. the legal framework governing the exercise of investor's rights flowing from securities through a "chain" of intermediaries, in particular in cross-border situations;
c. the submission of any activity of safekeeping and administration of securities under an appropriate supervisory regime.

The fact that this Directive should take into consideration, among other things, the harmonisation of the concept of ownership in the Member States concerning securities, lastly aiming at allowing the ultimate account holder to exercise the rights flowing from the securities, may represent an example of current discussions where some aspects of empty voting might be implicitly addressed.

Short Selling Regulation (EU) No 236/2012

The recent introduction of this regulation (14 March 2012) can help to address some cases of empty voting in which a person has a negative interest, as now it will be made transparent under the new disclosure regime for net short selling positions. Since the threshold for the disclosure of net short positions to the public (and, thus, also to the issuer) has been set at 0.5%, the issuer will obtain a transparent view on the amount of votes represented in the general meeting that are being exercised by persons with a negative interest in the issuer.

Measures adopted at national level

Portugal

Following the approval of Decree-law n. 49/2010, May 19th, that brought into force in the Portuguese regulatory system the Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 (on the exercise of certain rights of shareholders in listed companies) Portugal has been experiencing the consequences of its implementation.

Although the implementation period is still narrow at this stage, empty voting practices soon raised some concerns, particularly when transmission of shares ownership occur when a General Meeting has already started but for any reason is suspended and follows in another moment (this can mean a few days or even a few weeks after the start and suspension of the General Meeting). Portuguese companies' law allows this possibility and it happens in practice quite often, mainly in case of problematic general meetings.

This led to the establishment of the rule stating that whoever has declared the intention to participate at the general meeting and has transferred the shares' ownership between the registration date and the end of the general meeting, shall immediately communicate it to the Chair of the General Meeting and to the CMVM.

The disclosure/transparency requirement might be sufficient to discourage empty voting practices, but its effectiveness is yet to be demonstrated.

France

In accordance with the Rule introduced on October 2010, any holder of shares held under a stock-lending agreement or any type of agreement providing for the return of the shares to the original seller (lender) and representing at least 0,5% of the voting rights of the issuer (except for shares held by investment firms in their trading book), is required to declare the holding of such shares to the issuer and to the AMF at the latest three days prior to the date of a general meeting. Failing such declaration, the holder of such shares will be deprived of his voting rights for all future shareholders' meetings.

The aim of this provision was to improve company disclosures about the true influence of shareholders. By making it possible to distinguish long-term shareholders from those that have acquired shareholder status through temporary borrowing, such disclosures should help to better gauge the influence and objectives of different shareholders.

Other statements / market standards

European Corporate Governance Forum (ECGF): Statement on Empty Voting and Transparency of Shareholder Positions (2010) (addressed not only to investors which borrow shares but also to issuers which sometimes lend their own shares before general meetings) - http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_empty_voting_en.pdf

Paragraph 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.

Codes of good practice

ICGN Securities Lending Code of Best Practice (2007) - http://www.icgn.org/files/icgn_main/pdfs/best_practice/sec_lending/2007_securities_lending_code_of_best_practice.pdf

Paragraph 7.7 It is bad practice to borrow shares for the purpose of voting. Lenders and their agents, therefore, should make best endeavours to discourage such practice. Borrowers have every right to sell the shares they have acquired. Equally the subsequent purchaser has every right to exercise the vote. However, the exercise of a vote by a borrower who has, by private contract, only a temporary interest in the shares, can distort the result of general meetings, bring the governance process into disrepute and ultimately undermine confidence in the market.

ISLA Securities Lending and Corporate Governance (2005) - http://www.bankofengland.co.uk/markets/Documents /gilts/slcgjun05.pdf

Page 5 "Shares should not be borrowed for the purpose of voting" - Borrowing shares for the purpose of acquiring the vote is inappropriate, as it gives a proportion of the vote to the borrower which has no relation to their economic stake in the company. This is particularly the case in takeover situations or where there are shareholder resolutions involving acquisitions or disposals.

Securities Borrowing and Lending Code of Guidance (2009) drawn up by the Securities Lending and Repo Committee (SLRC), together with Securities Lending: Agent Disclosure Code of Guidance (2010) - http://www.bankofengland.co.uk/markets/Documents/gilts/stockborrowing.pdf

Paragraph 7.4 A person could borrow shares in order to be able to exercise the voting rights and influence the voting decision at a particular meeting of the company concerned. There is a consensus, however, in the market that securities should not be borrowed solely for the purpose of exercising the voting rights at, for example, an AGM or EGM. Lenders should also consider their corporate governance responsibilities before lending stock over a period in which an AGM or an EGM is expected to be held. Beneficial owners need to ensure that any agents they have made responsible for voting and for securities lending act in co-ordinated way.

Hedge Fund Standards (2012) - http://www.hfsb.org/sites/10188/files/hedge_fund_standards_-_february_2012.pdf

Borrowing stock to vote [28]

Borrowing stock to vote – Governance Standards and Guidance [28] 28.1

A hedge fund manager should not borrow stock in order to vote. The HFSB acknowledges that there might be specific situations where it should be acceptable to vote on borrowed stock, e.g. when a fund is invested in shares (and the trade has settled), but the shares have not transferred into their name.

Annex 2. Review of the literature related to empty voting

A selected, non-exhaustive, bibliography of academic papers (traditionally focused on the US market[26]) contributing to the debate on empty voting follows, together with a short comment to summarise the main findings of each of them.

Shaun Martin & Frank Partnoy, ENCUMBERED SHARES, 2005 University of Illinois Law Review 775 (2005)

The authors affirm that the argument supported by the corporate law literature, that the one-share/one-vote rule is, and should be, the dominant rule and practice, is based on assumptions that do not hold. Given the proliferation of financial innovation and economic and legal encumbrances, the one-share/one-vote principle no longer constitutes a uniformly efficient rule of corporate governance, if it ever did.

Decoupling trilogy (similar content, but directed towards different audiences)

Henry T. C. HU & Bernard Black, THE NEW VOTE BUYING: EMPTY VOTING AND HIDDEN (MORPHABLE) OWNERSHIP, 79 Southern California Law Review 811, 815, 816 (2006)

Henry T. C. HU & Bernard Black, EMPTY VOTING AND HIDDEN (MORPHABLE) OWNERSHIP: TAXONOMY, IMPLICATIONS, AND REFORMS, 61 Business Law 1011 (2006)

Bernard Black & Henry Hu, HEDGE FUNDS, INSIDERS, AND EMPTY VOTING: DECOUPLING OF ECONOMIC AND VOTING OWNERSHIP IN PUBLIC COMPANIES, 13 Journal of Corporate Finance 343 (2007)

Decoupling the economic rights of shares from the voting rights associated with those shares has been one of the consequence of the rapid growth and increased sophistication in the derivatives markets, combined with the growth of hedge funds and other capital market developments. Therefore, the presumption that shareholders will vote in a way that they believe will maximize their return on investment and add to the value of the corporation to them is called into question. They proposed a series of reform directed at short-term enhancement of disclosure and longer-term strategies based, among the others, on potential voting rights limitations in empty voting situations.

Jonathan J. Katz, BARBARIANS AT THE BALLOT BOX: THE USE OF HEDGING TO ACQUIRE LOW COST CORPORATE INFLUENCE AND ITS EFFECT ON SHAREHOLDER APATHY, 28 Cardozo Law Review 1483 (2006).

The use of hedging in order to gain influence may cause several concerns; among the others (i) a negative impact on the value of the stock due to the detrimental effect on the influence of large

[26] Please refer to "Identifying the Legal Contours of the Separation of Economic Rights and Voting Rights in Publicly Held Corporations", Rock Center for Corporate Governance at Stanford University Working Paper No. 90 (2010) for a more comprehensive analysis/review.

shareholders e.g. “control premium” and (2) (ii) an even less interest for shareholders to exercise their voting rights feeling not able to influence corporate policy due to presence of investors – e.g. hedge funds - who are supposed to reach their desirable outcome.

Marcel Kahan & Edward B. Rock, HEDGE FUNDS IN CORPORATE GOVERNANCE AND CORPORATE CONTROL, 155 University of Pennsylvania Law Review 1021 (2007).

The authors document and examine the nature of hedge fund activism, how and why it differs from activism by traditional institutional investors, and its implications for corporate governance and regulatory reform. They conclude that “market forces and adaptive devices adopted by companies individually are better designed than regulation to deal with the potential negative effects of hedge fund short-termism, while preserving the positive effects of hedge-fund activism”.

Michael Lee, EMPTY VOTING: PRIVATE SOLUTIONS TO A PRIVATE PROBLEM, 2007 Columbia Business Law Review 885 (2007).

The author takes the position that while empty voting poses real concerns, it may not be as problematic as some commentators have suggested. Although some issues do remain, many of the more extreme dangers may be adequately addressed under existing law. While acknowledging that some public sector regulation would be beneficial, the author argues that many of the unaddressed problems posed by empty voting are ones that private institutions have both the ability and the incentive to solve. Based on these assessments, suggestions on some possible private sector solutions are described on the article.

Henry T. C. Hu & Bernard Black, EQUITY AND DEBT DECOUPLING AND EMPTY VOTING II: IMPORTANCE AND EXTENSIONS, 156 University of Pennsylvania Law Review 625 (2008).

After the decoupling trilogy, Hu & Black returned to the issue of empty voting with an article in which they described more than 80 examples of decoupling arising in more than 20 countries.

Based on their findings, they reaffirmed that the principle “one share, one vote” and the meaningfulness of the concept of share ownership are seriously under dispute due to the use of derivatives, the existence of hedge funds and the growth of the share lending market. They proposed to go beyond enhanced disclosure requirements and identified potential responses, including amendments to corporate law that would allow charter amendments limiting empty voting (e.g. require large shareholders to attest to non-empty voter status). The also addressed the increasingly serious problem of overvoting, as identified by Kahan, Rock and other scholars.

Onnig H. Dombalagian, CAN BORROWING SHARES VINDICATE SHAREHOLDER PRIMACY?, 42 UC Davis Law Review 1231 (2009).

The author noticed that academic literature and financial press has voiced concerns over so-called “empty voting”. In particular, these commentators worried about the consequences of freely decoupling the economic interests and voting power of shares. He argues that a transparent market for borrowing public shares, if made available to institutional shareholders committed to long-term wealth maximization, could alleviate many of these concerns. Moreover,

this market could empower institutional shareholders to take steps to improve corporate governance without the need to expand shareholder rights.

Brian T. Sullivan, CSX CORP. V. CHILDREN'S INVESTMENT FUND MANAGEMENT AND THE NEED FOR SEC EXPANSION OF BENEFICIAL OWNERSHIP, 87 North Carolina Law Review 1300 (2009).

The author investigates the case, CSX Corp. v. Children's Investment Fund Management, which emphasised the conflict between hedge fund strategies for influencing corporate policy and SEC disclosure requirements for the mass accumulation of securities.

Alon Brav & Richmond D. Mathews, EMPTY VOTING AND THE EFFICIENCY OF CORPORATE GOVERNANCE, 99 Journal of Financial Economics 289 (2011).

The authors provide some guidance on the efficacy of proposed regulatory reforms designed to curb or eliminate the negative effects of empty voting. Departing from Hu and Black's approach (2006, 2007), they suggest that disclosure of a change in economic position relative to voting rights between the record and voting dates would have the effect of reducing or eliminating any trading profits the strategic trader could otherwise generate. This would reduce the trader's willingness to gather information and vote. Thus, the efficiency effect of such a rule would depend case by case on whether the model predicted a positive or negative effect from the trader's presence. Overall, Brav-Richmond results imply that regulators should consider the possibility that curbs to empty voting behaviour could be costly in cases where there is significant uncertainty about the value of a proposal.

Michael C. Schouten, THE CASE FOR MANDATORY OWNERSHIP DISCLOSURE, 15 Stanford Journal of Law, Business & Finance 127-182 (2010)

The author shown that the use of equity derivatives to exert undisclosed influence on issuers or to facilitate creeping acquisitions ("hidden ownership") severely undermines the mechanisms through which ownership disclosure improves market efficiency and corporate governance. The same holds for the use of equity derivatives, securities lending or short selling to hedge economic exposure while retaining full voting rights ("empty voting"). Since ownership disclosure is important from a double perspective - improving market efficiency and corporate governance – the author demonstrates why these phenomena are so problematic, finally arguing that financial innovation should lead to an expansion of the rules.

Annex 3. List of respondents

AEM - Associação de Empresas Emitentes de Valores Cotados em Mercado
AFG
AFME Association for Financial Markets in Europe
Amundi
Aviva Investors
BCP
BNP Paribas
Chris Barnard
The City of London Law Society
Computershare Limited
Danish Shareholders Association
Deutsche Bank
Emisores Españoles
Eumedion
Euroshareholders
Eurosif
GDV
German Banking Industrie Committee
Hermes Equity
ICSA Registrars Group
International Securities Lending Association
JP Morgan
Manifest Information Services
PROXINVEST and ECGS
SC Depozitarul Sibex SA
SNS Asset Management
Swedish Corporate Governance Board
Swedish Securities Dealers Association
The Takeover Panel