THE ASSOCIATION OF GLOBAL CUSTODIANS

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December 16, 2004

DG MARKT G4
European Commission
B-1049
Brussels
BELGIUM

Re: **Comments on Consultation Document of the Services of the Internal Market Directorate General**

Dear Sirs and Madams:

This letter is submitted on behalf of the Association of Global Custodians (the "Association") in response to the invitation of the European Commission (the "Commission") to comment on the consultation document entitled, "Fostering an Appropriate Regime for Shareholders' Rights" (the "Consultation Document"). The Association is an informal group of nine banks, headquartered in North America, with extensive European branches and affiliates that provide securities safekeeping services and related asset-servicing functions to cross-border institutional investors, including pension funds, investment companies and insurance companies. Many clients of Association members invest actively in the full range of securities traded in European markets, and many such clients and their money managers are located outside Europe.[1]

The Association appreciates the Commission's request for comment on the important issues and proposed regulatory and legislative approaches identified in the Consultation Document. We believe that the Commission is prudent to give careful

[1] The Association members are listed on the letterhead above.

attention to matters of shareholder voting and corporate governance. The Association encourages the Commission – in considering ways to shape and unify the processes for issuer communications and shareholder voting throughout European markets – to take fully into account the existing and various arrangements and communication processes that prevail generally among intermediaries in most established markets, as outlined and explained below.

**Current Intermediary Approach**

Global custodians routinely facilitate voting by their institutional investor clients at shareholder meetings of issuers in which the clients hold shares. This facilitation is realized through careful coordination and communication throughout the intermediary chain (the "chain approach").

For example, global custodians typically utilize subcustodians in European and other markets to hold and service their clients' securities. In those markets where a global custodian offers proxy voting services, the global custodian routinely arranges for its subcustodian – who is typically the legal titleholder and thus the person entitled to cast the vote – to forward proxy voting information it receives to the global custodian. The global custodian in turn delivers these materials to its clients (*i.e.*, the beneficial owner[2]), or to the client's investment manager or voting agent, as appropriate. Voting instructions are then transmitted back through the chain of custody to the legal titleholder and processed in accordance with the client's instructions.[3]

Under well-established proxy-handling procedures, custodians are notified of issuing company meetings by their subcustodian (or by the securities holding system) in the relevant market. The custodian, in turn, notifies the beneficial investor and solicits its voting instructions pursuant to the chain approach set out above. Unfortunately,

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[2] We recognize that the Consultative Document routinely refers to the "ultimate investor" rather than "beneficial owner." However, due to the lack of clarity regarding the definition of "ultimate investor", we have used the term "beneficial owner" or "beneficial investor" in our comments. We intend for these terms to refer to the last natural or legal person holding a securities account in the chain of ownership.

[3] Global custodians typically utilize third-party voting services to deliver voting instructions to subcustodians on clients' behalf. Such services are also used to send meeting notices to appropriate parties.

inconsistent practices and company laws across markets make this chain approach to shareholder voting difficult to implement uniformly.[4]

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[4] In a letter, dated June 12, 2002, to Corinne van Ginkel, Dutch Ministry of Justice, the Association provided comments on the Consultative Document on Cross-Border Voting Issues in Europe (April 2002). Specifically, the Association set out its views on those areas needing improvement to make proxy-handing processes more uniform across markets, noting the need to –

- Standardize the procedures for the communication by issuers to their shareholders of meeting dates and agendas.
- Standardize the disclosure requirements concerning matters to be voted on.
- Make the voting process transparent. Public companies should be required to confirm that votes tendered have been properly cast and to communicate this confirmation to the shareholder of record. There should be an audit trail by which the proper handling of votes can be verified.
- Standardize and simplify the method for determining who is the shareholder of record entitled to vote in cases where shares have changed hands after the announcement of the meeting.
- Simplify the nature and number of the voting rights applicable to particular securities and require issuers to communicate this information to the first intermediary in the chain. In some cases, for example, one share may carry multiple voting rights; in others, the issuer may have imposed a cap on the percentage of votes that can be cast by a single entity.
- Require country laws to accept split or partial voting. If the ultimate investors have not all directed that their shares be voted in the same manner, the intermediary is unable to implement their instructions.
- Eliminate the practice of blocking of holdings, which is very cumbersome.

*See* Letter dated June 12, 2002, to Corinne van Ginkel, Dutch Ministry of Justice, from Daniel L. Goelzer, Counsel to the Association, regarding Consultative Document on Cross-Border Voting in Europe (April 2002). A copy is attached for your convenience.

The Association is aware, however, that in specific cases investors wish to have direct access to the issuing company. This might be the case where:

- in the absence of a full audit trail – providing confirmation to the shareholder of record that votes tendered have been properly cast – the sole method of ensuring that votes are properly cast is to allow the investor to have direct contact with the issuing company in order to cast the vote; and

- investors wish to actively participate in company meetings, either by physical attendance or attendance via electronic communication means, and in that event must be recognized by issuing companies as proper attendees for those purposes.

In these circumstances, the Association believes that financial intermediaries should be able, voluntarily, to designate their clients as entitled to control the voting right.

**Comments on Certain Questions Raised in the Consultative Document**

The Association's views on particular questions raised in the Consultative Document are set forth below.

**4. Scope – listed companies**

***Do interested parties agree that the scope of the forthcoming proposal on shareholders' rights should be restricted to companies whose shares are admitted to trading ('listed companies'), and that Member States could be invited to extend these facilities to non-listed companies?***

The Association believes Member States should be actively encouraged to extend the arrangements and conventions of the forthcoming proposal on shareholders' rights to non-listed companies. However, the Association recognizes that significant challenges exist in attempting to apply rules designed for listed companies to non-listed ones. The Association believes it to be the duty of issuers to inform proactively all of their shareholders of meeting dates and agendas and all information relevant to issues to be voted on. This duty should be broadly established.

**5.1.1. Entitlement to control the voting right**

***Do interested parties consider that the forthcoming proposal for a directive should set up a framework to identify the person entitled to control the voting***

***right as the last natural or legal person holding a securities account in the "chain" of intermediaries and who is not a securities intermediary within the European securities holding systems, nor a custodian?***

We agree that the beneficial investor should have the practical ability to exercise voting rights with respect to the investor's shares. We believe that the current structure allows for this right and certain proposals in the Consultation Document could result in bypassing critical realities of legal title and may create parallel and perhaps inconsistent legal rights for both the beneficial investor and the legal titleholder. However, we do not agree that the proposed framework should require a mandatory identification of the beneficial investor to the issuer as part of the communications and voting process, such that the issuer would have a legal right or responsibility to communicate directly with the beneficial investor or that the beneficial investor should necessarily have the right to directly cast the vote.

In certain markets, issuers are entitled to ask for the identity of the beneficial investor. One example of this is the so-called "Act 212" process in the UK market. In addition, company laws in most markets contain disclosure requirements that are triggered when pre-established substantial shareholding levels are reached. The Association believes that such requirements and practices should not dictate mandatory identification as part of the voting process.

While certain obstacles need to be removed from the proxy voting process, the Association believes that voting rights should continue to follow legal title. Any approach that provides for issuers to interact directly with the beneficial investor will result in the complication of, and possibly the duplication of, existing arrangements. Indeed, any system at the issuer level that seeks to determine who is ultimately entitled to vote shares that are held through one or more intermediaries on behalf of one or more investors would be extraordinarily complex and would duplicate, and might displace, the more manageable structure already maintained by most intermediaries.[5]

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[5] We agree that the last intermediary – the intermediary who is in direct contact with the beneficial investor – commonly has the responsibility to notify the investor of a shareholder meeting, based on information it receives from the intermediaries above it in the chain. However, this can only be accomplished in practice if issuing companies adhere to uniform notification standards and practices. Without timely notification from the local market, the last intermediary may not be able to provide full service proxy voting to its clients.

The processes by which an intermediary forwards voting information, and to whom it sends and from whom it receives voting instructions in return, are matters established in service agreements between the intermediary and its client. In this regard, there are a wide variety of approaches that institutional investors take as a commercial matter to ensure effective control of voting decisions. Approaches include use of trustees for many types of accounts, appointment of independent voting agents, and mandating that money managers vote on behalf of an account.

***Should it also provide for a securities intermediary who is not admitted as a participant in a European securities system but holds shares on behalf of clients the possibility to designate his clients in its place as controlling the voting rights? And should it be compelled to designate the identity of its clients at the request of the issuer?***

The Association believes that any ensuing directive should permit securities intermediaries *voluntarily* to designate their clients in their place as controlling the voting rights. As indicated above, such designation will typically occur where beneficial investors want to have the certainty of a vote being properly cast in the absence of a robust audit trail and, more importantly, where beneficial investors want to actively participate in the General Meeting ("GM").

However, the Association does not agree that, in the context of the proxy voting process, a securities intermediary be compelled to designate the identity of its clients at the request of the issuer. While impediments to the chain approach need to be removed before uniformity can be achieved, the Association believes that voting rights should continue to follow legal title and voting instructions should continue to be processed through intermediary chains. Disclosure to the issuing company of the identity of the beneficial investor is not necessary to ensure that the beneficial investor is afforded the opportunity to cast its vote. Permitting issuers to obtain such identifying information would create uncertainty and confusion in the market and would have undesirable consequences for both investors and custodians.

For example, and as set forth previously in the June 12, 2002 letter,[6] the Association believes that the mandatory designation of client identity by the intermediary would undermine investor privacy. Various European markets have established different legal requirements relative to the disclosure of beneficial investor information to issuing companies. In a number of markets, issuing companies lack a legal right to force a market intermediary to provide the issuer with identifying

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[6] *See* footnote 4, supra.

information concerning its clients that have invested in the issuer's securities. Many investors highly value such privacy rights. The required disclosure of investor information to issuing companies under a direct approach system would conflict with these existing rights and may limit investor interest in those markets.

In addition, the mandatory designation of client identity by the intermediary would impose substantial burdens and costs on intermediaries at all levels in the chain of custody. The system costs and administrative complexity of maintaining, on an ongoing basis, current identifying information on a security-by-security basis for all underlying beneficial investors, and of establishing a mechanism to consolidate this information from all lower-tier intermediaries and to transmit that information to each issuer, would be substantial. These costs and burdens would greatly exceed those associated with transmitting voting materials through the intermediary chain to the appropriate beneficial investors.[7]

However, as stated above, some beneficial investors wish to actively participate in a General Meeting either by physical attendance or by sending an appointed proxy to the meeting to represent their interest; in such case, and upon request from their clients, securities intermediaries must be permitted to designate their clients in their place as controlling the voting rights

**5.1.2. Exercise of the voting right**

***Do interested parties agree with such provisions to allow the ultimate investor to exercise the entitlement to control the voting rights?***

The Association does not agree that the beneficial investor should be required to be acknowledged or designated to the issuer as being entitled to vote. As discussed above, such approach could lead to direct communications between the issuer and the beneficial investor, which the Association does not believe needs to be a mandatory part of the proxy voting process. Such an arrangement would be extraordinarily complex and would duplicate -- and perhaps displace -- the more manageable structure already maintained by most intermediaries. Any approach that enables beneficial investors universally to bypass the chain and vote directly would require segregation of

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[7] If the Commission ultimately determines to adopt some form of beneficial investor identification, the Association recommends a system under which those beneficial investors that wish to disclose their identity to the issuers in which they have invested, and to receive communications directly from the issuers, may do so, while other investors are not compelled to make such disclosure.

client accounts in each market and would require the creation and maintenance of new systems and procedures at considerable expense. This would also have a direct impact on clients' ability to participate in securities lending programs and could consequently impact market liquidity. In addition, this proposal overlooks the nearly universal use and value of omnibus account structures and communications through the chain of intermediaries.

For these reasons, the Association believes the existing chain approach achieves the end sought and believes that, with improvements in the infrastructure on which it relies, the European voting system can ensure that all beneficial investors have a reasonable opportunity to participate (through their intermediaries or their agents) in shareholder voting. The decision whether or not to participate in a vote must rest with the investor.

As stated above, upon request from their clients, securities intermediaries should be permitted to designate their clients in their place as controlling the right to vote.

**5.1.3. Authentication of the ultimate investor**

***Do interested parties agree that securities intermediaries should be required to certify to the issuing company who the ultimate investor entitled to control the voting rights is and for how many shares? What do you think is the best option to allow for such an authentication and certification process?***

***Should the forthcoming proposal address the issue of which parties would have to bear the costs in this authentication?***

The question of whether an intermediary should be required to designate its client as the party entitled to vote would only seem to arise under a mandatory direct communications approach. As discussed above, the Association urges that the European Commission not adopt that approach.

Under the chain approach, the processes by which an intermediary forwards voting information, and to whom it sends and from whom it receives voting instructions in return, are matters established between the intermediary and its client, governed by service and contractual relationships. Any system at the issuer level that seeks universally to build into the proxy voting process mandatory certification regarding who is ultimately entitled to vote shares that are held through one or more intermediaries on behalf of one or more investors would be extraordinarily complex and would in any event duplicate the more manageable structure already maintained by most intermediaries.

### 5.2. Stock Lending

***Do interested parties consider that the practice of securities lending create problems for the exercise of voting rights, in particular in a cross-border context that should be tackled at EU level? Should such provisions essentially aim at enhancing transparency and protecting the interests of long term investors?***

The Association does not believe that securities lending unfairly deprives the lender of the ability to exercise the right to vote. As the Consultation Document recognizes, securities lending plays an important role in maximizing market liquidity. Shareholders that participate in an intermediary's lending program obtain economic benefits. In exchange, such shareholders typically agree to surrender their voting rights in favor of the borrower. In those cases, if the lender wishes to vote at a particular meeting, the lender may recall the securities on loan.

An effective approach to the challenges discussed in the Consultative Document can be based around the principles of best practices and policies that are observed by the majority of market practitioners. Just as market practitioners should be bound by a code of best practice that deals with these issues, so too should beneficial owners, their fund managers and agents have clear policies that integrate their approach to securities lending into their wider corporate governance responsibilities. These two responsibilities do not have to be mutually exclusive, provided that organizations recognize and are clear about their approach.

### 5.3. Depositary Receipts

***Do interested parties consider that there are problems associated with the holding of depositary rights that should be addressed in the forthcoming proposal for directive? If so, should it allow holders of depositary receipts to be recognised as holding the rights attached to the underlying shares and that any specific exclusion from voting right should be removed?***

The Association agrees with the Commission's approach to address the rights of depositary receipt holders. Holders of depositary receipts should be recognized as owning the rights attached to the underlying shares. Voting obstructions either under company law or depositary agreements should be addressed and depositary receipt holders rather than depositary banks should be able to exercise voting rights, though any recommendations should support the continued use of intermediary chain communications and should not supplant that process with direct communication/voting mandates.

**6.1. Communication of information relevant to GMs**

***Do interested parties consider that the forthcoming proposal should contain provisions regarding the disclosure of GM notice and materials and some standards for the dissemination of such information? What should be these standards?***

The Association believes that listed companies should be required to adhere to a uniform standard for timely delivery to shareholders of information concerning issues to be voted on. These standards should minimally instruct issuers to disclose meeting information on a non-discriminatory basis to all investors (whether intermediaries or investors with direct holdings) reasonably ahead of the date when voting entitlements are being established. The Association recognizes that such uniform standards might be easier to achieve for ordinary General Meetings than for extraordinary ones.

***Do interested parties consider that the forthcoming proposal for a directive should deal with the way information is "pushed" by the issuer to the ultimate investor? If so, which of the two approaches (chain or direct) is preferable? Should the possibility be given to the ultimate investor to opt out of such identification system?***

As discussed above, the Association does not support any framework that would require the identification of beneficial owners to issuers. As a result, the Association does not support a direct approach whereby information is "pushed" from the issuer directly to the beneficial owner. The chain approach, whereby information is delivered through the intermediary chain to the beneficial owner, is sufficient to ensure that beneficial owners receive necessary issuer information.[8] As noted above, any approach that provides for issuers to interact directly with the beneficial investor would be extraordinarily complex and would duplicate, and might displace, the more manageable structure already maintained by most intermediaries.

If, despite our views, the Commission nonetheless concludes that issuers should have the ability to communicate directly with investors, the Association would favor an opt-in approach. In the case of investors who do not affirmatively act to release their

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[8] Difficulties that are currently encountered in transmitting issuer information through the intermediary chain to the beneficial owner should be considered in light of the suggested regulatory changes set forth in footnote 4 of this letter regarding improvements to proxy-handling processes.

identity to the issuer, the system should facilitate their ability to receive information from their intermediary. If the Commission does not adopt such an approach, investors, at a minimum, should be given the opportunity to opt out of such identification system.

**6.2. Admission to/Participation in GM – Share blocking**

***Do interested parties consider that share blocking requirements represent a barrier to the exercise of voting rights, especially for cross-border investors?***

***Do interested parties agree that the forthcoming proposal should require the abolition of share blocking requirements and propose an alternative system States to determine which shareholders are entitled to participate and vote at the GM?***

The Association believes that, by preventing trade activity, share blocking requirements represent an important barrier to the exercise of voting rights. It is widely recognized that investors tend to vote less in countries where blocking requirements are in place.

The Association supports a uniform European requirement that the record date must be set a reasonable period prior to the meeting date. This would provide the most efficient method of determining shareholder eligibility to vote. Without a record date system, ultimate investors who purchase securities just prior to a meeting are entitled to vote, but may be unable to exercise their voting right due to the time required to solicit their voting instructions. A record date requirement would also relieve the administrative burden on issuers or intermediaries of performing a detailed reconciliation of trading records to determine who is eligible for voting. In addition, the establishment of a record date would work well for corporate events and income events, not just for proxy events, and is a well-practiced process in most markets.

**7.1. Participation in the GM via electronic means**

***Do interested parties consider that Member States should be prevented from imposing requirements on companies regarding the venue of the GM that would act as a barrier to the development of electronic means of participation? Should additional criteria be defined at EU level to enable shareholders participation to the GM by electronic means?***

The Association believes that electronic voting should be encouraged as a mechanism that allows investors to participate in meetings via electronic means. It is

essential that any national solutions provide for electronic connectivity of intermediaries and voting agents to the system, thereby enabling a full electronic interface to global electronic voting solutions.

### 7.4.1. Voting by correspondence

***Do interested parties consider that the forthcoming proposal should oblige Member States to introduce in their national company law the possibility for all companies to offer shareholders the option of voting in absentia (by post, electronic or other means)?***

The Association believes that issuing companies should be obliged to facilitate as much as possible the exercise of the voting rights. Requiring physical attendance at a meeting is impractical, would effectively deter many cross-border investors from participating in meetings, and would inject prohibitive costs into the performance of corporate governance duties. Therefore, the Association believes that the forthcoming proposal should require Member States' national companies law to allow voting in absentia.

The Association believes that in order to effectively bring market forces to bear, some structural changes in current market practice are necessary to promote the ability of investors to exercise their voting rights in absentia through the facilities of the intermediaries, preferably via electronic means, through which they hold their shares. The Association would support a proposal for national company laws that would support this possibility.

In addition to provisions allowing all shareholders the option of voting in absentia, the Association supports uniform regulation in the European market to require that –

(1) listed companies on all European Union stock exchanges furnish all shareholders of record with information concerning issues to be voted on, regardless of whether the record holder is an intermediary or an investor with direct holdings;

(2) the record date (i.e., the date on which one must be a holder in order to be entitled to vote at a shareholders meeting) be set a reasonable period prior to the meeting date;

(3) listed companies adhere to a uniform standard for timely delivery to shareholders (whether intermediaries or investors with direct holdings) of information concerning issues to be voted on; and

(4) the issuing company confirm that it has accepted and recorded the votes tendered by the shareholder.

Imposing these standards would no doubt require some countries to change their companies and securities laws. We believe that uniform standards as to these basic procedural matters in all markets within the European Union will enable a more effective and efficient voting process.

**8.1. Dissemination of GM results and minutes**

***Do interested parties consider that companies should be obliged to disseminate the results of votes and minutes of the GM to all shareholders and/or to post these on their website within a certain period following the meeting?***

The Association believes that companies should be obliged to make results of votes and minutes of the GM publicly available within a reasonably short amount of time after the meeting. For those companies that maintain a website, the Association believes that the website posting of these results and minutes of GMs will naturally follow.

**8.2. Confirmation of vote execution**

***Do interested parties consider that the non-confirmation of vote execution hinders significantly the exercise of their voting rights? If so, do they consider the forthcoming proposal should address the issue by defining obligations on issuers and securities intermediaries to provide and pass automatic confirmation of vote execution along the chain from the issuer to the ultimate investor?***

The Association believes that the lack of voting process transparency significantly hinders the exercise of voting rights and should be addressed in the forthcoming proposal. Public companies should be required to confirm that votes tendered have been properly cast and to confirm this information to the shareholder of record or its representative in the market. There should be an audit trail by which the proper handling of votes can be verified.

**9. Additional issues**

The issue of quorum is not raised or addressed in the Consultation Document. In our experience, the existence of a quorum requirement below which a meeting is not valid creates a strong incentive for issuers to ensure that shareholders are appropriately represented. The quorum level should be set so as to reasonably ensure that shareholders are fairly represented at a GM but should not be unrealistically high. The existence of a quorum is also generally linked to issuer commitments to bear the cost of shareholders' communications.

The Commission should also try to address the issue of simplification of the nature and number of the voting rights applicable to particular securities and require issuers to communicate this information to the first intermediary in the chain. In some cases, for example, one share may carry multiple voting rights; in others, the issuer may have imposed a cap on the percentage of votes that can be cast by a single entity. The directive should consider this issue and require the uniform application of voting rights (one share = one vote) within the same class of shares. Shares that have different voting rights must be a distinct share class.

**Conclusion**

The Association appreciates the opportunity to convey its views regarding the Consultation Document and the issues it notes and raises for discussion. We believe that the Commission's legislative efforts should be directed toward enhancing the utility of the chain approach and making the voting process more efficient by removing existing obstacles to cross-border voting through intermediaries.

Please direct any questions to either of the undersigned.

Sincerely yours,

Dan W. Schneider/mrs

Dan W. Schneider
Baker & McKenzie
Counsel to the Association

Margaret R. Blake

Margaret R. Blake
Baker & McKenzie
Counsel to the Association

Attachment -- Letter dated June 12, 2002, to Corinne van Ginkel, Dutch Ministry of Justice, from Daniel L. Goelzer, Counsel to the Association, regarding Consultative Document on Cross-Border Voting in Europe (April 2002).