



**December 2016**

## **ICGN Viewpoint on Vote Confirmation**

### **Importance of voting as a key component of investor stewardship**

This Viewpoint explores ongoing challenges investors face in the area of cross-border voting- an issue long-cited as problematic<sup>1</sup>. It focuses on the importance of voting as a key component of investor stewardship, and presents a framework for establishing a vote confirmation system- something that investors have sought to achieve as a way to confirm that their exercise of voting rights has been appropriately received and registered. This framework remains aspirational, as other actors in the voting process need to cooperate for this to be successful. Further concerns exist with regard to cost – and who should cover any incremental costs associated with the proposed framework. While these questions remain open the investment community continues to keep the debate and discussion alive, and seeks to work with other groups to bring about the necessary changes from the status quo. A starting point in this regard is for investors to begin to insist on segregated accounts, throughout the custody chain where necessary, to facilitate bespoke voting and confirmation, and to show willingness to cooperate with issuers with regard to shareholder identification.

In the wake of the financial crisis, shareholders are increasingly relied upon to play a role in the checks and balances of the companies in which they are invested. To encourage shareholders to be more engaged with their portfolio companies, stewardship codes have been launched in growing number of markets in recent years. ICGN's Global Stewardship Principles have also been launched to provide a global frame of reference for stewardship<sup>2</sup>. What ICGN's Stewardship Principles and all other stewardship codes share in common is an emphasis on the need for institutional investors to make effective use of their voting rights at shareholder meetings. The exercise of voting rights by shareholders (and less frequently for bond investors) is one of the most important means investors have available to hold management accountable and to influence corporate decision making processes. As most institutional investors around the world manage widely dispersed global equity portfolios, most shares need to be voted cross-border. Because most shareholders do not attend shareholder meetings, voting of shares to elect directors and approve or reject major corporate transactions occurs principally via solicited proxies. The corporate proxy is the principal means by which shareholders exercise their voting rights<sup>3</sup>.

### **Complexities of the voting chain**

But is the existing proxy voting system up to the task? It is widely recognised that the voting chain is long, complex and that obstacles need to be overcome. In 2012 the Australian Council of Superannuation Investors (ACSI) commissioned a study on institutional proxy voting in Australia – a research report examining the inner workings and anomalies of Australia's proxy voting process for institutional investors. This study found evidence of operational weaknesses in the system used by investors to cast votes. Last year the Canadian Coalition for Good Governance urged the Ontario

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<sup>1</sup> This is not a new issue. For example, the need to fix the "plumbing" of cross-border voting had been identified by the High Level Group of Company Law Experts report (2002) commissioned by the European Commission.

<sup>2</sup> See ICGN policy web page: <https://www.icgn.org/policy>

<sup>3</sup> Exceptions to this are in cases when votes are conducted by a show of hands or an acclamation, which ICGN opposes given the disenfranchisement of those voting by proxy.

Securities Commission to fix systemic problems with the country's voting policy. At the beginning of 2014 the Dutch Authority for Financial Markets (AFM) concluded in a study that the system for voting by proxy at shareholders' meetings is flawed and in need of improvement. Weaknesses in the crossborder proxy voting system were also addressed in the consultation documents on the revised European Shareholder Rights Directive, still under negotiation.

In this Viewpoint report we suggest best practices for the introduction of vote confirmation as a means to shed some light on the "black box" called proxy voting. Vote confirmation can contribute to confidence in the proxy voting process by providing investors with confirmation that their vote instruction has been lodged by their intermediaries through to the issuer, and recorded by the issuer, as the investor instructed. It will enable investors to identify instances where their vote may have been 'lost' or errors made in transmission, bringing light to any underlying issues in the voting process. At the moment it is normally not possible, or sometimes very cumbersome, for shareholders to learn if votes have been cast and received in line with their voting instructions.

### **Issues in the vote confirmation concept**

One of the continuing problems facing investors is the complexity that their chosen share-ownership arrangements can bring to an apparently simple process – casting a vote. The current proxy voting chain can involve a large number of intermediaries. The 'chain of intermediaries' is the chain of custodians and depositories that separates the ultimate investor (the investor who bears the financial risk and has directly invested into a security) from the company that issued the shares.

The voting chain becomes even more complex when it concerns a cross-border shareholding. In that case an investor may own shares of a foreign company through a securities account of a bank in another, usually the investor's own, country. The bank will typically hold these shares in an omnibus account within a foreign bank, comprising all the shares held on behalf of its clients and spanning intermediaries across different countries which makes it hard to ascertain who has the legal right to vote.

In Europe the cross-border ownership of shares through a chain of intermediaries has increased dramatically in recent years. So much so, that since 2005 foreign investors have held the majority of shares in EU Member States companies. Many of these shares are held through the highly complex chains of intermediaries.

Generally this complexity will not lead to problems concerning an investor's financial rights. The company pays the dividend in accordance with local market processes, either through the Central Securities Depository (CSD) or directly, to all top level account holders. Where these top-level account holders are acting on behalf of underlying investors, the dividend funds are passed down through the ownership chain until credited to the end investor with economic entitlement to the payment. This process seems to work.

However, when it comes to the effective use of other rights attached to securities, mainly voting rights, problems emerge which are caused by differing duties and practices of intermediaries. Not all of these problems can be solved by national legislators, as one of the main problems often is the difference between national laws. Vote confirmation can be a mechanism to identify instances where votes are not appropriately passed through the chain of intermediaries and recorded on behalf of the investor. We continue to recommend action be taken by the market and its participants before legislators address outstanding issues in the underlying proxy processes .

We note that currently there is a lack of common agreement among market participants on the parameters for confirmation. First, we see the widely spread concept of omnibus accounts as the core obstacle to vote confirmation. Use of segregated accounts can ease the difficulty in identifying share ownership for confirmation. However, custodian fees associated with segregated accounts can be more costly than omnibus account structure. Second, the impact of different protocols for voting at company meetings -- e.g. the use of show of hands, poll and direct voting -- create additional complexities to the provision of vote confirmations. Third, numerous meetings are still voted on paper, which makes the whole process expensive, risk-prone and slow. Fourth, issuers can only confirm votes cast by registered or disclosed end investors but not votes cast in the name of intermediaries. Finally, the important question - who carries the costs of implementation - remains unresolved among the various actors in the voting chain.

### **The Approach to a Solution: the building blocks are there**

In 2014 ICGN published a Viewpoint report on obstacles to vote execution. In it six issues were identified leading to particular problems in the voting process. One of the issues was the absence of an electronic vote confirmation system.

To contribute to the development of a workable process of vote confirmation, ICGN seeks to define common vote confirmation principles that can allow institutional investors to receive a standardized vote confirmation. The latter should primarily serve as a confirmation of compliance with legal requirements or other fiduciary duties (including stewardship codes).

To address the issues preventing a sound vote confirmation system, ICGN views the practices presented as critical from an institutional investor perspective. Investors encourage all market participants to engage in these practices in their proxy voting process and administration. For practical and economic reasons, the vote confirmation need only be provided when the vote is cast electronically. The vote confirmation principles should complement existing principles or standards<sup>4</sup>. In particular, the vote confirmation principles could help to develop suitable working processes and electronic tools for vote execution and vote confirmation.

The use of modern Distributed Ledger, based on blockchain technology, has the potential for use in corporate actions and communications, and could lead to the development of a reliable electronic solution. Information transferred is processed in a trusted, digitally signed and decentralised way. A Distributed Ledger could record each vote transaction in an immutable way allowing a transparent and efficient monitoring of the vote.<sup>5</sup> Since the maintenance of the Distributed Ledger is performed by a peer-to-peer network, a verification of the vote is not deemed necessary.

Shareholders themselves should also begin to insist that their custodians offer segregated accounts throughout the custody chain. This question should become mandatory in any request for proposal. Only by actively requesting information on segregated accounts the shareholder will at least have a choice. Asset owners should consider mandating segregated accounts in investment management agreements with asset owners. Additionally, the more shareholders ask for segregated accounts the more it will become a standard in the custodians' offerings. This should help to make these accounts more popular and more efficient.

Furthermore, shareholders should adopt Legal Entity Identifiers allowing a consistent ID from register to securities account. If the identifier is known or accessible to the custodian and the issuer, it will help to track the vote as well as the vote confirmation. Greater clarity on shareholder identification will also be welcomed by the issuer community, and it is important to also have issuers united with investors in attempts to improve global proxy voting practices.

In summary, proxy voting processes remain an ongoing challenge for institutional investors seeking confirmation of their votes as part of fulfilling their stewardship obligations. A potential framework exists for addressing the issue, as presented below. But there remain differences in views between investors, issuer and intermediaries that inhibit progress. ICGN will continue to monitor these challenges and work with other market participants to find ways to realise improvements in the system.

### **Key practices relating to voting and vote confirmation:**

1. All intermediaries and their agents should execute instructions of end-investors and pass to the investor all meeting communications from issuers (including vote confirmations).
2. Subject to the legal environment, issuers should be permitted to use vote instructions in order to update the company's share register.

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<sup>4</sup> Examples include: "Market Standards on General Meetings (MSGM)" published by the "Joint Working Group on General Meetings (JWGGM)" in the European Union- <http://www.ebf-fbe.eu/uploads/Market%20Standards%20for%20General%20Meetings.pdf> or <https://www.icgn.org/policy/viewpoints/cross-border-voting> or the "OECD Principles of Corporate Governance" <https://www.oecd.org/corporate/principles-corporate-governance.htm>

<sup>5</sup> In principal a similar system is already used for the crypto currency Bitcoins.

3. In case of uncertainties with the vote instruction the end investor should be informed by the issuer, its agent or the intermediary without undue delay.
4. All votes are processed and counted in accordance with local market practice and the issuer's corporate law and bylaws. The vote results should be made available to all shareholders.
5. In the absence of a regulatory requirement for vote confirmation in respect of all meetings, investors that lodge their votes electronically should be able to request that its intermediaries or if possible the issuer provide a confirmation in respect of their vote. Where an intermediary respectively issuer cannot meet that request, they should provide an explanation to the investor.
6. Upon request of the investor a vote confirmation should be provided by the next intermediary in the chain or the issuer. The issuer of registered shares shall only confirm votes of investors whose identity is known to the issuer. In this respect it has to be acknowledged that currently there is no system in place that could manage a mandatory confirmation process across all markets.
7. The vote confirmation should contain the following information (based on ISO 20022):
  - a) Mandatory information (intermediaries and issuers):
    - i. Sender Reference – preferably Legal Entity Identifiers (Message reference originated by party sending vote instruction)
    - ii. Meeting Date and Time
    - iii. Type of Meeting
    - iv. ISIN
    - v. Account Identification
    - vi. Sub Account Identification
    - vii. Number of Shares
    - viii. End investor name, e-mail, physical address, contact person and LEI, if known
    - ix. Vote Instruction per resolution
    - x. Time of vote confirmation
  - b) Voluntary information given by intermediaries:
    - xi. Issuer Meeting Reference (Meeting reference originated by issuer)
    - xii. Location
8. All intermediaries should forward the vote instruction and, if applicable, confirmation in a way, which is acceptable to the intermediary respectively issuer and in a timely manner, not impeding the rights of the end investor.
9. Intermediaries should consider adopting new technologies, where relevant, e.g. using block chain for vote instructions and holding information.

### **About ICGN Viewpoints**

ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate, whilst not defining a formal ICGN position on the subject. ICGN Viewpoints are produced by our member-led Policy Committees and we encourage dialogue by contacting Committee chairs or the ICGN Secretariat.

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