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ICGN perspectives on the revision of the Shareholders' Rights Directive
by Kerrie Waring, ICGN Managing Director

Introductory remarks

Good afternoon ladies and gentlemen. I am Kerrie Waring, Managing Director of the International Corporate Governance Network (ICGN). I am grateful for the opportunity to present to the Legal Affairs Committee of the European Parliament on the subject of the revision of the Shareholders' Rights Directive.

The ICGN is an investor-led network, established 20 years ago and my remarks today draw upon our experience of promoting shareholder rights and responsibilities. We have 650 members based in 50 countries, including investors responsible for assets under management in excess of $US 18 trillion. The breadth of ICGN members from investment, business and the professions enables us to actively engage with policy makers in an informed way - in fact my colleague here today from EuropeanIssuers, ISS and AVIVA are all ICGN members. It is also important to stress that the ICGN takes a global perspective on governance issues, and my remarks reflect this global viewpoint.

The ICGN shares your mission in striving to create a modern and efficient corporate governance framework in Europe and to foster better engagement between companies and investors. Our own mission is to inspire and promote effective standards of governance to advance efficient markets world-wide. We do this by connecting governance professionals at global meetings, informing debate on emerging issues, and influencing the development of good governance policy.

We are supportive of the aims of the Shareholder Rights Directive and welcome enhanced shareholder rights relating to voting on remuneration plans and significant related party transactions. We also agree that more engagement between companies and investors, accompanied with a more efficient cross-border voting system, will contribute to a stronger single European market and economy.

The ICGN has responded over the years to consultations relating to the development of the EC Corporate Governance Action Plan. I also relayed the ICGN position on shareholder identification and related party transactions in October at the 5th European Corporate Governance Conference under the Italian Presidency and this is reflected in the letter we sent to the European Commission on 4 November. My comments today will therefore draw upon this submission and also the following key ICGN publications:

- ICGN Global Governance Principles (June 2014)
- ICGN Statement of Principles for Institutional Investor Responsibilities (June 2012)
- ICGN Viewpoint on Obstacles to Cross Border Voting (March 2014)

For the purposes of my remarks to the Legal Affairs Committee I would like to focus on the following:

- Firstly, I would like to address corporate governance and the integral role shareholders play in the effective functioning of capital markets;
- Secondly, I will like to address the specific proposals in the Directive.

Corporate governance and the role of shareholders

Corporate governance has an important role to play in maintaining confidence for the future of European capital markets. Good governance, overseen by responsible shareholders, addresses management of risk in a way that underpins prudential supervision and regulation. It is consistent with open and transparent markets and reduces the justification for prescriptive regulation.

Most importantly the proper oversight of good governance involves securing and maintaining the rights of shareholders and developing the transparency needed for them to exercise these rights in a responsible, informed and considered way. Properly equipped shareholders can play an important role in holding companies to account for the way they manage risk and incentivise board directors.

Shareholders cannot play a useful role if their rights are limited. It is crucial that they are able to appoint and dismiss boards, are treated fairly, and be able to exercise influence in proportion to their capital at risk. Shareholders also need a disclosure framework which gives the ability to exercise their rights in an informed way.

In jurisdictions where shareholder rights are weak, they should be strengthened and, in all jurisdictions, shareholders must be encouraged to exercise rights responsibly. Our members believe in the long term benefits of governance and strive to make this an integral part of their approach to investment. This is not restricted just to governance itself but extends to broader environmental and social issues which impact society at large.

It is in this spirit that the ICGN encourages members to exercise shareholder rights and promote shareholder responsibilities to help ensure the effective functioning of capital markets and in helping to ensure long-term sustainability and growth. We do this primarily through the ICGN Principles on Institutional Shareholder Responsibilities, first published in 2007, and most recently incorporated into our Global Governance Principles which was approved by ICGN members in June. Our Guidance stresses the importance of institutional investors addressing their conflicts of interest, ensuring balance in their own governance structures, allocating proper resources to governance oversight and recognising their own accountability to their end-beneficiaries.

Specific proposals in the Directive

Article 3a: Identification of shareholders

Several EU Member States have already adopted legislation that enables companies to identify their beneficial owners or holders of voting rights. Whereas this enhances the opportunity for companies to enter into a dialogue with their investors, we believe that shareholders should have the possibility to benefit from the shareholder identification framework. Therefore shareholders that want to distribute information related to the exercise of shareholder rights to other shareholders should be provided with the opportunity to make

use of available shareholder identification instruments. An example could be a situation where a shareholder has filed a shareholder proposal and wants enter into a dialogue with fellow shareholders. This is in line with the EC objectives of encouraging more cooperation between shareholders themselves.

ICGN is supportive of having a relatively low threshold included in a provision in article 3a. We support recent compromise text in the Council whereby holders of a company's outstanding share capital would be identified through available instruments. A minimum threshold would ensure that corporations are able to identify their main shareholders, while at the same time respects the anonymity of investors with limited exposure. This is consistent with the spirit of the Directive in terms of enhancing the effectiveness of company and shareholder engagement.

We also support calls for Member States to ensure that companies publish on their website at least, the twenty shareholders with the largest stake in the company that have been identified.

Article 3b: Transmission of information

With regards to the transmission of information, the time taken to execute vote instructions often leads to a squeeze on the time available for investors to read information to make decisions on resolutions ahead of a voting deadline and to engage with the company if necessary.

Intermediaries, particularly custodians, should not hold vote instructions for longer than is absolutely necessary to exercise the processing of the vote. The introduction of a universal cut-off date for all intermediaries may be helpful in this regard, while recognising the need for flexibility in some markets.

Article 3c: Facilitation of the exercise of shareholder rights

We support more efficient mechanisms, such as voting by electronic means, to facilitate the exercise of shareholder rights. We believe this will actively encourage more engagement by foreign investors, particularly if inefficient mechanisms which impede voting are discouraged such as requirements of personal attendance at general shareholder meetings, appointment of Powers of Attorneys and share blocking.

The exercise of voting rights by electronic means has been widely adopted and has enabled investors with international equity portfolios increasingly to vote their shares. However, there is no commonly applied system for voting by electronic means and human intervention is still regularly employed in many jurisdictions. This increases time lags and also the risk of error. Effort should be focused on developing a mutually beneficial, universally applicable, cost free (or at least low cost) interface to accept and process electronic votes throughout the custody chain.

Regulators should encourage the adoption of a common approach to improve the accuracy and timeliness of vote execution and thus allow for efficient processing on a real time basis. In this regard, we refer you to the work of the industry standards produced on communication along the investment chain by the Joint Working Group for General Meetings.

We support proposals to require companies or intermediaries to transmit vote confirmations to shareholders. Investors currently do not always receive confirmation that their votes have been cast in accordance with their instructions. This creates uncertainty and impedes their ability to report to beneficiaries that their votes have been lodged and taken into account by the company. Custodians, vote aggregators and registrars, should obtain confirmation that voting instructions have been received and properly recorded by the company and transmit this information to shareholders at no additional cost /surcharge to tariffs they may currently be paying to service providers.

Article 3d: Transparency on costs

The overlay of multiple fees incurred along the voting chain can lead to high costs and outweigh the benefit of exercising the right to vote itself. We therefore strongly support enhanced transparency around the level and make-up of fees, for example in terms of registration costs, translation, meeting attendance or vote lodgment. This would provide investors with assurance that costs incurred are commensurate with the benefits received, particularly in relation to the lodgment of vote instructions and confirmation thereof.

Article 3f: Engagement policy

We support the proposal in article 3f requiring investors to disclose on an annual basis their engagement policy and how it has been implemented however, in terms of publishing the results of a particular engagement experience we query how this will work in practice noting that it is not always clear how such results would be directly measured and over what time frame.

Our Global Governance Principles call for investors to have a clear approach to engagement which should be communicated to companies as part of an engagement policy. We also call for clarity around steps that will be taken in the event initial engagement fails. Furthermore, engagement should extend beyond traditional financial factors and embrace discussion around environmental, ethical and social issues. In this regard, the ICGN was awarded a mandate by the European Commission in 2011 to educate investors on how to integrate environmental, social and governance factors into decision-making and we have since delivered programmes in multiple jurisdictions.

We also welcome the proliferation of national codes for investors around the world, many of which have taken inspiration from the ICGN Principles, and most recently in Japan and Malaysia. These codes outline investor responsibilities when it comes to engagement and many ICGN members now have statements available on their websites. In this regard, we appreciate that investors with thousands of holdings need to develop risk-based approaches to prioritise engagement efforts. Engagement activities may vary, for example, depending on the nature of the investment mandate or size of shareholding and this will affect the appropriateness of the engagement approach taken with investee companies.

In terms of conflicts of interests, we call for investors to have robust policies to clarify, minimise and manage conflicts of interest in line with the EC proposals. Any conflicts should be promptly disclosed and there should be effective programmes in place to ensure compliance.

Finally, on collective engagement, we believe that concert party rules or takeover regulations should not prevent shareholders from sharing perspectives about companies in which they have a mutual interest or concern. This is particularly important in cross-border situations where global investors often rely on insights from local colleagues in efforts to engage with companies to improve corporate governance. Collective engagement facilitates efficient company and shareholder dialogue and engagement and should be encouraged.

I would also like to highlight the important role that national investor bodies can play in helping to facilitate engagement and I point to the Investment Management Association in the UK and Eumedion in the Netherlands as examples. These organisations engage directly with companies on behalf of their collective members and this is a powerful and efficient mechanism for constructive engagement. The ICGN itself regularly invites companies to join meetings with global investors to discuss governance and strategy arrangements.

Article 3g: Alignment between institutional investors and asset managers

The ICGN has advocated for many years that institutional investors must recognise their responsibility to generate long term value on behalf of their beneficiaries, the savers and pensioners for whom they are ultimately working. They should also insist that fund managers put sufficient resource into governance that delivers long term value. To ensure this, they should issue mandates which reward fund managers for achieving these objectives.

Shareholders should take governance factors into account and consider the riskiness of a company's business model as part of their investment decision-making. Governance should not be a parallel activity. It needs to be integrated into investment.

We therefore welcome proposals under article 3g to better align the interests of institutional investors and asset managers. This is consistent with the ICGN Model Mandate which we published in 2012 to provide guidance for institutional investors when seeking to align the activities of their fund managers more closely with the long term interests of their beneficiaries. For example, key areas of focus in the Model Mandate include:

- the timescales over which the investment risk and opportunities are considered;
- appropriate internal risk management frameworks;
- Integration of environmental, social and governance factors into investment decision-making;
- Appropriate fees, pay and culture;
- High standards of stewardship;
- Appropriate commission payments for research; and
- Ensuring portfolio turnover is appropriate to the mandate.

We would point out that, while the substance of much of what is described in the sub-points a-f of article 3g should be respected, it risks being overly prescriptive which may ultimately lead to anodyne disclosure which may not necessarily be useful. In many cases, investment mandates will not always be the same and institutional investors should be free to determine what disclosures they require of their asset managers.

Article 3h: Transparency of asset managers

In terms of article 3h, we support enhanced transparency of asset managers and believe this is fundamental to enabling institutional investors to call their fund managers to account. However, we caution against prescribing the regularity of reporting. In practice some asset managers report to their clients on a quarterly basis, some half-yearly, some annually and so on. This should be left to the discretion of the institutional investors when setting the parameters in the mandate with the manager.

Article 3i: Transparency of proxy advisors

In terms of services provided by proxy advisors under article 3i, we wish to emphasize the important role they play in facilitating efficient company and shareholder engagement through voting and research services. We welcome enhanced transparency for proxy advisors and refer to the self regulatory measures already introduced in March 2014 by virtue of the Best Practice Principles for Providers of Shareholder Voting Research & Analysis. It is our understanding that this has been widely adopted by the proxy advisory industry and ESMA has committed to monitoring the effectiveness of this code.

In terms of disclosure, the ICGN Global Governance Principles call for disclosure around the extent to which proxy research is used, including the identity of the provider and the degree to which recommendations are followed. I note here that many of our investor members rely on more than one source of advice and that the primary guide in voting decisions is often the investor's own internal voting guidelines. Many investors using proxy advisors develop their own policies, which in turn, are applied by proxy advisors. This allows for a bespoke approach to voting, even if the actual voting instructions are applied by the proxy agencies.

In the event there is an issue of contention in a particular vote, we encourage, when possible, for the rationale to be communicated to companies in advance of the general meeting. However this may not always be feasible, and in such situations we believe investors should follow up with companies after the vote to ensure that the company is aware of the investor's rationale for not supporting a specific company resolution.

Article 9a: Right to vote on the remuneration policy

Shareholders should be able to hold boards to account for the decisions they make on executive and management remuneration. It is not the role of shareholders to take responsibility for the entire remuneration arrangements of companies, but they can ensure that boards develop policies that reward sustained performance, and do not encourage employees to take excessive risks. The ICGN therefore welcomes the EC proposals in draft articles 9 to strengthen the link between pay and performance.

ICGN believes that the board should disclose a clear, understandable and comprehensive remuneration policy which is aligned with the company's long term strategic objectives. The remuneration report should also describe, on an individual basis, how awards are granted to senior management and the CEO were determined and deemed appropriate in the context of the company's underlying performance in any given year.

Shareholders should have an opportunity to vote on the remuneration policy, particularly where significant changes to remuneration structures are proposed or where significant

numbers of shareholders have opposed a remuneration resolution. Share-based remuneration plans should also be subject to shareholder approval before being implemented.

We query the usefulness of requiring disclosure to explain the 'ratio' between the average remuneration of directors and that of employees. There may be many ways to determine ratios of this nature and this may become subject to manipulation. ICGN believes that remuneration should be reasonable and equitable, and that the quantum should be determined within the context of the company as a whole.

Article 9b Information to be provided in the remuneration report and right to vote on the remuneration report

We advise that Article 9b (3) should clarify a threshold to ensure that a critical mass of investors have withheld the remuneration vote in question, for example more than 10%.

Article 9c: Right to vote on related party transactions

ICGN believes that shareholders should have the right to vote on major decisions which may change the nature of the company in which they have invested. Such rights should be clearly described in the companies´ governing documents, unless they are set out in applicable law, regulation or stock exchange requirements.

Therefore ICGN is supportive of the Commission´s proposal to enhance transparency and shareholder oversight on related party transactions. The ICGN strongly advocates that significant related party transactions should be approved by a majority of disinterested shareholders. This approval should be sought before concluding the transaction.

Details of related party transactions necessary for investors to make an informed decision should be disclosed in the company's annual report or general meeting documentation that is made available to the company´s shareholders. Disclosure on significant related party transactions should contain, among other things, the following information:

- the identity of the ultimate beneficiaries including any controlling owner and any party affiliated with the controlling owner with any direct / indirect ownership interest in the company;
- other businesses in which the controlling shareholder has a significant interest; and
- shareholder agreements (e.g. commitments to related party payments such as licence fees, service agreements and loans).

We also emphasise that the board should disclose the process for reviewing and monitoring related party transactions which, for significant transactions, includes establishing a committee or body of independent directors to review such transactions. This may be a separate grouping or an existing committee comprised of independent directors, for example the audit committee (which should normally be 100% independent). The committee should review significant related party transactions to determine whether they are in the best interests of the company and to assess the fairness of the terms. Furthermore, the conclusion of the committee's deliberations on significant related party transactions should be disclosed in the company's annual report to shareholders.

ICGN is supportive of the proposed article 9 to require related party transactions representing more than 5% of a listed company's assets to be submitted for shareholder approval and may not be unconditionally concluded without their approval. For smaller related party transactions that represent more than 1% of their assets, we are supportive of the Commission's proposal that listed companies shall accompany the announcement by a report from an independent third party. This allows our members to objectively assess whether the transaction is on market terms and confirming whether it is fair and reasonable from the perspective of the minority shareholders.

While ICGN is supportive of the proposed article 9, we also acknowledge and understand concerns from companies regarding the very broad scope of the proposals on related party transactions in the current text of the Proposal. We therefore encourage the European Parliament to keep the proposals in article 9 in full, but to provide a clear definition of "related parties" (e.g. to exempt directors/shareholders in subsidiaries).

In order to prevent an inappropriate compliance burden on companies, we suggest that exemptions should be introduced for transactions in the ordinary course of business. Investors do not wish to vote on numerous related party transactions which are small in scale and which are deemed to be concluded in the ordinary course of business and/or conducted on an 'arm's length basis'. This would effectively lead to less transparency and increased difficulty identifying transactions that might be a cause for real concern.

Moreover, shareholders do not wish to micro-manage companies; rather, our members wish to be able to prevent abusive related party transactions that will have a material and detrimental impact on their investments. We therefore encourage the European Parliament to work on a solution that will balance the need for robust shareholder protection and concerns from companies that rules that are too broad in scope will make business less efficient and thus impact on long-term value creation.