

POSITION PAPER "Ultimate Investor"

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The Ultimate Investor and Securities Intermediaries in Cross-Border Voting

In Europe a particular problem arises for investors who wish to exercise their voting rights in listed companies, when they invest in companies in other jurisdictions. Shares are usually held through a chain of securities intermediaries across borders. From a legal perspective it is often not clear who in the chain of intermediaries should be entitled to vote. The ultimate investor, i.e. the investor who has made the investment decision and bears the risks related to the shares, often is not registered in the company's share register, but holds a securities account with a broker or bank in his own jurisdiction, which bank or broker holds an account with another securities intermediary in another jurisdiction, holding an account with an international securities depository, holding an account with a local intermediary in the jurisdiction of the listed company who may be registered as nominee in the share register of the company or may be a participant in a securities trading system in which one or a multitude of bearer certificates have been deposited. Each of the jurisdictions involved will probably provide that the account holder in that jurisdiction (rather than the intermediary in that jurisdiction) is entitled to exercise the voting right, which leads to a set of conflicting entitlements. No one would want to deny that ultimately, the ultimate investor should be the one who controls how the voting right is exercised, in the sense that such ultimate investor should be able either to vote himself as formal shareholder or on the basis of a power of attorney provided by the party in the chain who formally is seen as shareholder or to instruct the formal shareholder how to vote on his behalf. Such an arrangement can only operate across borders within the EU if an EU wide solution is found. That is the importance of the proposed directive on shareholders' rights the EU Commission is currently preparing for.

The Expert Group set up by the Dutch government to investigate this problem of cross-border voting suggested to include two rules in such a directive:

primary rule: the ultimate investor has the right to control the voting right (either as formal shareholder, or on the basis of power of attorney or by giving voting instructions)

secondary rule: if the ultimate investor in the chain in the EU is a securities intermediary himself, he should be able to designate his clients as ultimate investor who have the right to control the voting right.

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After a first consultation the Commission has organised on its proposal for a directive, it has found that defining the ultimate investor in a legal sense is difficult. It is struggling with the definition. In its second consultation document it also suggests that providing for a legal entitlement to control the voting right for ultimate investors would only bring limited benefits, as most of the difficulties with cross-border voting lie elsewhere. Removing those other obstacles should be enough. In the second consultation document it therefore suggests not to define the ultimate investor and, as a result, not to have the primary and secondary rule suggested by the Expert Group.

Many have since argued with the Commission that this is a mistake. The ICGN has argued strongly for providing for the legal entitlement of the ultimate investor to control the voting right. The European Corporate Governance Forum has urged the Commission to solve this particular obstacle for cross-border voting effectively (see minutes 20.06.05 at http://www.europa.eu.int/comm/internal_market/).

A solution discussed within the Forum was that, instead of defining the ultimate investor and providing for his entitlement to control the vote, it should be possible to define who are securities intermediaries and to impose on securities intermediaries the obligations to either pass on powers of attorney to their clients allowing them to vote directly, or to pass on voting instructions from their clients to the company. This would build on the definition of intermediary suggested in the second consultation document (par 7). Specifically it should be provided that (i) any intermediary as defined should have the obligation to grant or pass-on a power of attorney to their clients, until the first client who is not an intermediary, who can then use the power to vote directly, and (ii) to pass on voting instructions received from their clients to the company. This would elaborate on the obligations suggested by the Commission in its second consultation document (par 7, page 17-18).

The effect of this is that the ultimate investor is defined by default: he is the first accountholder in the chain who is not an intermediary as defined and as a result, he does not have the obligation to grant or pass-on a power of attorney or voting instructions but can use the power of attorney himself or can issue instructions to the intermediaries in the chain. The primary rule would in this system effectively be achieved by formulating obligations of all intermediaries in the chain (in the second consultation document such obligations are only

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considered for the intermediary who is formally entitled to vote; it should extend to all intermediaries in the chain). The secondary rule would not be achieved by this system, and it would be left to the relationship between the first accountholder in the EU chain who is not an intermediary as defined, and his clients to establish to what extent such first accountholder is required to vote on the instruction of his client or to grant his clients powers of attorney.