EuropeanIssuers

aisbl - ivzw
Rue Belliard 4-6
B-1040 BRUSSELS

Tel : +32 (0)2 289 25 70
Fax : +32 (0)2 502 15 60

info@europeanissuers.eu
www.europeanissuers.eu

EUROPEANISSUERS' POSITION ON THE REVISION OF THE SHAREHOLDER RIGHTS' DIRECTIVE AND ON THE RECOMMENDATION ON 'COMPLY OR EXPLAIN'

27 March 2014

SUMMARY

EuropeanIssuers welcomes the Commission proposal revising Shareholder Rights Directive and the recommendation on 'comply or explain'.

We particularly appreciate that the draft directive clearly sets out the need for Member States to grant companies a right to identify their shareholders, given that there is the need for better two-way dialogue between companies and their shareholders. Such a right should be cost effective and reach as many shareholders as possible. Clear definitions and sanctions will be needed in order to ensure that the right is effective.

EuropeanIssuers is also very supportive of the provisions on shareholder rights, which are in line with the work that over the years was done by ourselves together with the financial services industry on standards for general meeting and on corporate actions[1]. We believe that it is important that the end investors are able to exercise their rights, both via company law and financial regulation.

We also strongly support transparency of costs, but we believe that this should refer to costs levied on both companies and shareholders, not only the latter. Moreover, their calculation should be based on using the state of the art technology.

However, EuropeanIssuers would like to draw attention and provide some suggestions on some specific aspects of the proposals where we see practical difficulties. In particular, we are concerned:

- About certain operational difficulties and additional costs for companies that the proposal on 'say on pay' may create at the time when competitiveness of the European Union, which relies on the performance and growth of its companies, is very much needed. Amongst others we point out that:
    - the remuneration report should be mainly about the disclosure;
    - that the evidence that advisory vote can bring better results than the binding one[2];
    - a potential requirement to call another AGM would be very costly – we would rather prefer to continue with the old system for another year until the next AGM;

[1] See the standards on General Meetings developed by EU associations (AFME, EACB, EACH, EBF, ECSDA, ESBG, EuropeanIssuers, Eurosharehoders, FESE) in order to facilitate the 2007 shareholder rights directive and to implement the recommendations of the Giovannini Report on clearing and settlement. . See also Market standards on corporate actions processing.

[2] See e.g. David F. Larcker, Allan L. McCall, Gaizka Ormazabal, Brian Tayan "Ten Myths of 'Say on Pay'", Stanford Gradulate School of Business, 2012

- publishing the planned envisaged minimum and maximum amounts, that can be awarded by the AGM, would seriously interfere with the negotiations of the remuneration while hiring new directors and a new member of the management board/management;
- practical difficulties of calculation and interpreting of a pay ratio;
- disclosure of financial and non-financial performance criteria regarding variable remuneration components would likely harm companies' interests;
- there is a need to clarify the scope of the remuneration report and its definition as well as to grant companies certain flexibility regarding instrument of disclosure;

- About related party transactions provisions:
  - we strongly believe that transactions within groups of companies should be exempted as otherwise companies' operations would be blocked.
  - we believe that in order to avoid operational problems, involvement of the general meeting should be an "extrema ratio" and should be used only in case of a prior negative opinion on a related party transaction by a board committee of independent non-executive directors
  - "significant impact" term is unclear and could generate uncertain regime
- While welcoming the objective of increasing transparency of institutional investors and asset managers, we are concerned about the tendency of detailing comply or explain requirements in legislation;
- We welcome the Commission proposal on the recommendation on comply or explain. Corporate governance codes are useful instruments to deal with governance issues. But we would like to point out:
  - That not all the codes have compulsory parts and we would like to propose a small amendment that would clarify it is not an intention to recommend introduction of compulsory rules in the codes;
  - That in some countries monitoring to a higher level of detail is performed not necessarily by entities in charge of the Corporate Governance Codes. Therefore, we would suggest a clear indication that all existing public and private monitoring arrangements are allowed.

SHAREHOLDER IDENTIFICATION

EuropeanIssuers welcomes that the draft directive clearly sets out the need for Member States to grant a right to identify their shareholders and thus provides for a harmonised framework for shareholder identification regimes. We believe this is a huge step forward towards improving companies' dialogue with their shareholders, as in some EU Member States, companies face great obstacles while trying to find out who their shareholders are. Therefore, there is the need for better linkage between companies and their shareholders, which should be cost effective and should reach

as many shareholders as possible. It is also important that this works effectively cross-border and that an intermediary cannot use its national legislation to circumvent the EU framework.

EuropeanIssuers agrees that the right of companies to identify their shareholders should be based on the law of the home Member State of the issuer and so cannot be hindered by corporate or privacy laws of any other Member States.

Intermediaries

At the same time we would like to underline the importance of the use of clear definitions as well as of the sanctions regime in order to ensure that intermediaries do not avoid responding.

In order to ensure that the effectiveness of sanctions, we would recommend granting the ability for the company to withhold the dividend and voting rights, which is a right already existing in the Member States whose regimes are most effective[3]. Even if this is to be implemented at national level, support from the Commission on this point in discussions with the Member States would be highly appreciated.

We would also like to point out that the exclusion of non-European intermediaries from the duties of intermediaries covered by the revised Shareholder Rights Directive may make it too easy to avoid application of the law by moving securities accounts within a group of financial services/intermediaries from e.g. Brussels to Pittsburgh. In order to avoid this, the definition of intermediary should read: "'*Intermediary' means a legal person that has its registered office, central administration or principal place of business or conducts a professional activity relating to financial services in the European Union and maintains securities accounts for clients.*"

Article 3a.2 states that Member States shall ensure that, on request of the company, the intermediary communicates without undue delay to the company the name and contact details of shareholders; the revised directive should ensure the possibility for the company to address the request of identification also through the CSD which can transmit the request down through the chain of intermediaries, as already foreseen in some Member States (like Italy). Moreover, information that should be provided should also regard the number of shares registered in the accounts of the shareholder.

We do not consider that the identification information should be limited to the exercise of shareholders' rights, if this implies that such information serves a purpose only one-way (article 3a.3). It should rather aim to facilitate communication both ways between the company and its shareholders, in order for the company to know who its shareholders are and to understand their concerns. In the UK and Ireland, for example, shareholder identification is regularly used to support the company's engagement with its owners (rather than its legal shareholders) and to ensure early awareness of possible takeover.

Definitions

Regarding definitions, given that companies would like the right to know the end investor in their shares, and not just the legally registered shareholder, the definitions should be clarified to this

[3] See research conducted by Capital Precision for EuropeanIssuers into the effectiveness of 35 different national shareholder identification regimes in 2012.

effect. We would suggest a reference to persons whom the company knows or has reasonable cause to believe to have an interest in shares, or to have had such an interest.

That would result in companies being able to obtain information both on shareholdings and also other financial instruments based on shares such as contracts for difference, as well as on both the fund manager and the pension fund behind the interest, etc. This information is necessary in order for the company to engage with the person deciding how to vote on the company's resolutions. For example, UK legislation states that:

A public company may give notice under this section to any person whom the company knows or has reasonable cause to believe—

(a) to be interested in the company's shares, or

(b) to have been so interested at any time during the three years immediately preceding the date on which the notice is issued.

Data protection (Article 3a.4)

We agree that data protection rules should be set at the level of the home Member State of the issuer. However, we do not agree that there should be a right to privacy for shareholders as against the company, because this would undermine any point in having a law. We believe that the Italian and US systems which allow for this are examples of shareholder identification laws that do not actually work and should not be taken as models.

Moreover, we believe that whether the share register should be a public document available to other shareholders or a private register only available to the company should be left to the Member States. Where it is public, there should be provision for exceptional cases (such as against animal activists in the UK, where the register is normally public, but you can ask for your details to be held by UK Companies House privately rather than on the public register).

SHAREHOLDER RIGHTS

We support the proposals on shareholder rights, which are in line with the work that the issuers together with the industry have done over the years on standards for general meeting and on corporate actions[4]. We believe that it is important that the end investor is able to exercise his or her rights.

Moreover, Member States should ensure that end investors are able to exercise their rights. This could be assisted by implementation of the industry General Meeting Standards and Corporate Actions Standards.

Vote confirmation

Article 3c.2 states that companies should "confirm" votes cast; we think that companies should not confirm votes cast but should instead provide full transparency of voting results of AGM (i.e. as

[4] See the standards on General Meetings developed by EU associations (AFME, EACB, EACH, EBF, ECSDA, ESBG, EuropeanIssuers, Euroshareholders, FESE) in order to facilitate the 2007 shareholder rights directive and to implement the recommendations of the Giovannini Report on clearing and settlement. . See also Market standards on corporate actions processing.

already ensured in some Member States like Italy). Given that there are not currently internationally agreed standards for cross-border vote confirmation, we think that it may be necessary to develop such standards before such a provision could be effective in practice.

TRANSPARENCY OF COSTS

We strongly support transparency of costs, but we believe that costs should be transparent for both companies and shareholders, not only the latter.

Also, notwithstanding who bears the cost, their calculation should be based on using the state of the art technology.

REMUNERATION

While understanding the goal of the European Commission to better align executive pay with corporate objectives and performance, European companies are concerned that the proposal on 'say on pay' may not meet this objective while causing some operational difficulties and imposing additional costs on companies at the time when competitiveness of the European Union, which relies on the performance and growth of its companies, is very much needed.

We see certain operational difficulties of having both an ex ante vote of remuneration policy and ex post vote on the remuneration report, as problems could arise if they are contradictory which would lead to a paradox given that remuneration report is based on the earlier approved remuneration policy. In some cases that could be due to a high shareholder turnover meaning that it would be different persons voting on the policy than those voting on the report. Therefore, remuneration report should be mainly about the disclosure.

It is also important to note the evidence that advisory vote can bring better results than the binding one[5].

Moreover shareholders do not have the necessary expertise and do not necessarily want to decide on technical matters (such as remuneration) which would also increase the cost (this is one of the main reasons for institutional investors to ask an opinion of one or even more proxy advisors for each decision).

European quoted companies have also a number of more specific concerns regarding the proposal on remuneration:

<u>Vote on remuneration policy</u>

European companies are very concerned about a potential requirement to call another general meeting in the event that the proposal for a remuneration policy is turned down. This would be very difficult operationally and would impose significant additional costs on companies and investors alike. For instance, for large listed companies, the organisation of an Annual General Meeting (AGM) costs between 500 000 and 5 million euros, depending on the size of the company and the number of its shareholders. Investors wishing to participate in an AGM also incur costs, especially in

[5] See e.g. David F. Larcker, Allan L. McCall, Gaizka Ormazabal, Brian Tayan "Ten Myths of 'Say on Pay'", Stanford Gradulate School of Business, 2012

countries where General Meetings' electronic solutions are not in place. Another potential problem could arise if the specially convened General Meeting would again not approve the remuneration report.

Therefore, a more feasible alternative would be to continue with the old system for another year and propose a modified remuneration policy at the following Annual General Meeting. This is the case in the UK, for example.

At the same time, in order to allow the board of directors (supervisory board in some jurisdictions) to properly address shareholders' concerns and improve its proposals and to attribute a major role to the remuneration committee, it is important that investors, who vote against a resolution, disclose their motivations. Shareholders may vote against a remuneration report for different reasons, which might be contradictory and not necessarily linked to a remuneration issue (for instance, they may oppose the combination of the functions of Chairman and CEO). Disclosure of shareholder motivations would be especially important in case of companies with dispersed ownership as sometimes they face problems determining shareholders' expectations. This issue could be addressed through stewardship codes.

As mentioned earlier, we would also like to point out a possible inconsistency between an approval vote on the remuneration policy and a disapproval of a remuneration report. The question would be how to deal with it in cases where the remuneration reported is result of principles and mechanisms set up and approved under the remuneration policy. This can be particularly complicated in case of significant changes in company ownership, which may be resulting from mergers and acquisitions or a high level of turnover in shares due to short-term trading strategies.

Remuneration policy components

EuropeanIssuers would also like to point out some components of remuneration policy listed in the proposal, which may be especially problematic:

- **The requirement of defined minimum and maximum amounts that can be awarded by the AGM**

Publishing the planned envisaged minimum and maximum amounts, that can be awarded by the AGM, would seriously interfere with the negotiations of the remuneration while hiring new directors and a new member of the management board/management. This would lead, for the first time in the history of private law, to a statutory obligation of disclosure of the negotiating framework of one of the parties which would be clearly to the detriment of company's interests as the candidate for e.g. the Management Board would now know exactly what remuneration the company is prepared to pay at least and at most. Naturally, the candidate would align his negotiations to the transparent maximum and not at the minimum.

- **Pay ratio**

EuropeanIssuers is also concerned about inclusion of a ratio between the remuneration of directors and the average remuneration of full time employees other than directors (articles 9a.3(c) and 9b.2(b)) in the remuneration policy and in the remuneration report. The calculation of the ratio raises some practical difficulties. In the case of multinational companies, the employees of which are mostly located in countries with very low average cost of living (i.e. in Asia), this information may be

misleading. On the other hand, if the Commission intends to limit the scope to employees located in the country where the company is registered, it would not give the right picture either in cases where for instance only 10 % of employees are located in that country, which is frequent for international blue chip companies.

Moreover, in medium/large companies, remuneration policy depends on many factors including: company history, type of development, field of activity, strategy, organization of production, subcontracting and outsourcing policy, distribution of categories of employees. This complex reality will make it difficult to compare ratios.

- **Financial and non-financial performance criteria regarding variable remuneration components**

Disclosing financial and non-financial performance criteria regarding variable remuneration components, especially related to targets of performance criteria for current or future fiscal years, could be problematic. These targets are business and operating secrets of companies and their public disclosure is likely to harm companies' interests, given that the information would be available to competitors to draw conclusions.

Remuneration report

As to the remuneration report, we suggest two alternative approaches, although we would like to stress that the first one is preferred:

OPTION 1: no shareholders vote on remuneration report

In principle, the vote on the remuneration report (i.e. on the remuneration actually paid) is unnecessary because there is already a vote on the remuneration policy. Furthermore, even a negative vote on the report cannot lead to a change in the remuneration without a previous change of the remuneration policy.

In our view, it should be up to the board - possibly giving greater responsibility to independent directors (I.e. a remuneration committee composed of independent directors) in line with other EU measures - to apply in the correct way the policy and report to the AGM.

OPTION 2: shareholders vote on remuneration report and company's reaction

The provision states that "*where the shareholders vote against the remuneration report the company shall explain in the next remuneration report how the vote of the shareholders has been taken into consideration*".

We wonder how the company can really take into consideration the vote against given that, on one side, the company is linked by the remuneration policy, and on the other side, by the contractual agreements signed with the administrators. Therefore, we would like to suggest:

- "where the shareholders vote against the remuneration report the company shall explain in the next remuneration report, **where possible**, how the vote of the shareholders has been taken into consideration**. In any case, the company shall explain in the next remuneration policy how the vote against the remuneration report has been taken into account"**

Scope

With regard to the scope of the remuneration report (article 9b.2) and while the definition of a director is the standard wording used for the definition of the board in all EU legislation, we would like to suggest the following drafting amendment in order to avoid potential confusion:

"Member States shall ensure that the remuneration report is clear and understandable, provides a comprehensive overview of the remuneration granted to individual directors in the last financial year ***by the company and its consolidated subsidiaries*** *and contains a summary of the remuneration policy on which it is based."*

Otherwise, we fear that some inconsistencies may arise with Member States' rules and the Prospectus Regulation.

EuropeanIssuers would also suggest that the decision to disclose certain components of the remuneration report required by the draft directive, like an explanation of how the performance criteria were applied and the remuneration awarded to each former director should, rather be handled at the national level.

Definition and instrument of disclosure

There is a need to provide a clear definition of the remuneration report, coherent with the Recommendation 2004/913. In fact, according to the Recommendation (art. 3, par. 1, and 5 par. 1)), the "Remuneration report" includes in the first part the remuneration statement (with the remuneration policy) and in the second part the overview of the remuneration granted. This provision was implemented in many EU countries. In contrast, the proposed directive lacks an explicit definition and provides for a remuneration report only in art 9b referring just to the disclosure of the remuneration awarded.

We propose that the new SHRD explicitly defines the remuneration report composed of two parts: the first part a "remuneration statement" including the remuneration policy of the company (art. 9a); the second one should include the remuneration awarded (in art. 9b).

In addition, we propose to keep the flexibility of the Recommendation and allow companies to publish the remuneration report within the corporate governance statement or in the annual accounts or as a separate stand alone document instead of obliging issuers to put the remuneration report in the corporate governance report. Therefore, article 2 of the proposal should be deleted.

Verification by auditors (Art. 2 amendments to directive (EU) n. 2013/34)

The draft provision requires that the remuneration report is a part of the corporate governance statement and the statutory auditors must check whether the information required has been provided. The intervention of auditors proposed by the Commission could be very costly. Given that all the information is public, this does not seem necessary and we would advocate for refraining from adding costs to European companies already facing competitive challenges comparing with companies overseas.

RELATED PARTY TRANSACTIONS

EuropeanIssuers agrees with the objective of enhancing transparency and shareholder oversight on important related party transactions, but it is important not to block companies' operations. Companies perform a large number of intra-group transactions that are necessary from the operational point of view and awaiting shareholders' approval could cause problems. This will not only be the case from an operational point of view (loss of time while waiting months until the AGM or costs for a time-consuming extraordinary general meeting) but it may be necessary to disclose trade secrets in order for the shareholders to make an informed decision. The details will not only be interesting for shareholders but also for competitors.

Therefore, transactions within groups of companies should be exempted by the proposed regime.

The procedure proposed gives an important role to the shareholders not only if the transaction is above a specific threshold, but also if it has a "significant impact". It is very difficult to understand what "significant impact" means: this approach could generate uncertainty There should be no doubt as to whether a shareholder vote is necessary or not. If the term stays as unclear as it is, a responsible and prudent management will have to hand over any larger transaction with a related business partner to the AGM in order to avoid the nullity of the transaction and their own accountability. This will cause problems especially for smaller or younger companies as transactions may more likely have a significant effect on their turnover. We suggest deleting the following sentence: "transaction which can have a significant impact on profit or turnover".

Also shareholders' involvement for aggregated transactions exceeding 5% should be deleted.

In any case, the involvement of the general meeting should be an "extrema ratio" and it should be adopted only where a board committee made up of independent non-executive directors has given a prior negative opinion on a related party transaction.

Therefore, we think that the Commission should put more weight on the role of independent directors who are representing the interest of all shareholders**.**

Furthermore, the mandatory confirmation of substantial transactions with related parties by an independent advisor (in addition to the supervisory body) would demonstrate a level of mistrust towards the supervisory bodies which normally supervise these transactions as well as add considerable costs. We would rather suggest approval by independent directors instead.

In terms of the purpose, given that goals of shareholders may be diverse, and that shareholders may change frequently, it would be more feasible and appropriate to confirm that the transaction is fair and reasonable from the perspective of the company.

TRANSPARENCY OF INVESTORS

European quoted companies welcome the objective of increasing the transparency of institutional investors and asset managers.

We therefore support the idea of shareholders disclosing their voting and engagement policies etc., but at the same time, as a matter of principle, some of our members are concerned about the tendency for detailing comply or explain requirements in legislation. EU legislation should state the obligation to disclose compliance to a code both for institutional investors and issuers, as with art.

20 of the directive 2013/34/EU (accounting directive), but we are wary of legislation listing the content to be covered by such codes.

COMPLY OR EXPLAIN

European quoted companies welcome the recommendation on comply or explain.

Corporate governance codes are useful instruments to deal with governance issues. At the same time, issuers' credibility will depend on both the effective application of code recommendations ("comply") and the correct use of the mechanism to be applied when compliance is not in the best interest of the companies and their shareholders ("explain").

Most of the requested information seems reasonable. However, we have two major comments on the proposed text.

Section I General provisions, point 2 provides that "*It is recommended that, where applicable, corporate governance codes make a clear distinction between the parts of the code which cannot be derogated from, the parts which apply on a comply or explain basis and those which apply on a purely voluntary basis".*

Our concern here is the reference to parts of the codes that "cannot be derogated". Currently, not all the codes have compulsory parts (in fact, usually, if a provision is "compulsory" it will be in the law or in the regulation by the competent authority or in a listing rule, not in the code). The only relevant exception is UK where just the "main principles" of the UK Code are in the listing rules, thus compulsory (often repeating other binding rules for reading purposes)..

Therefore, we fear that the reference to parts that cannot be derogated could be interpreted by Member States as a Commission recommendation to introduce those parts in the code. As a consequence, countries could be tempted to weaken their corporate governance main principles to make them mandatory for all companies (even for newly listed SMEs). Thus, to make it clear that this is not the intention of the Commission, a recital could be added explaining that Commission is not recommending the introduction of compulsory rules in the codes and modify point 2 as follows:

OPTION 1: "It is recommended that, where applicable, corporate governance codes make a clear distinction between the parts of the code ~~which cannot be derogated from, the parts~~ which apply on a comply or explain basis and those which apply on a purely voluntary basis".

or

OPTION 2: "It is recommended that, where applicable, corporate governance codes make a clear distinction between the parts of the code ~~which cannot be derogated from, the parts~~ which apply on a comply or explain basis and those which apply on a purely voluntary basis.

Where a code contains parts which cannot be derogated from (or reference to legal requirements), those parts should also be clearly indicated"

The second comment regards the monitoring. Here, it is important to note that in some countries monitoring is performed by the bodies in charge of corporate governance codes, but often not to the level of detail that the Commission envisages. *I*n many countries, including UK and Italy, monitoring arrangements provided by the entities in charge of CG Codes (FRC in UK or the Corporate

Governance Committee in Italy) do not produce analysis on the explanations on ALL the CG recommendations, while they may be produced by other private entities (Grant Thornton in UK and Assonime /Emittenti Titoli/Consob in Italy).

Therefore it may be necessary to adjust the wording of section IV article 11 in order to allow for other national arrangements:

*"In order to give incentives to companies to comply with the relevant corporate governance code or to better explain departures from it, efficient monitoring needs to be carried out at national level, within the framework of the existing (**public or private)** monitoring arrangements".*

***