INVESTMENT COMPANY INSTITUTE

December 15, 2004

Pierre Delsaux
Head of Unit
European Commission
DG Internal Market/G/4
Rue de la Loi 200
B-1049 Brussels

Dear Mr. Delsaux:

On behalf of the Investment Company Institute, we are writing to support fully the Commission's efforts to improve shareholder rights and the ability of shareholders to vote cross border. The Institute is the national association of the US investment company industry. Our members manage approximately 1,000 US funds (with over $569 billion in assets) that have a global or international focus, and many of these global and international funds invest in Europe. Moreover, many of our members manage investment companies and pension funds outside the United States, including mutual funds domiciled in the European Union that are sold under the EU UCITS Directive. Our comments reflect their experiences both investing and managing assets in the European Union.

We agree with the Commission that a directive in this area must cover certain essential elements to improve the ability of shareholders to exercise their voting rights. Specifically, as proposed by the Commission in its consultation document, a directive on shareholder rights should address: (1) a shareholder's entitlement to vote, especially where shares are held through a chain of intermediaries; (2) shareblocking requirements; (3) information to shareholders before a general meeting; (4) shareholders' rights with respect to the general meeting, especially the ability to vote in absentia without undue constraints; and (5) shareholders' ability to receive the results of votes and minutes after the general meeting.

The Commission requests specific comments on a number of issues set forth in its consultation paper. In particular, we strongly urge the Commission's Directive to define persons entitled to control voting rights to cover non-EU investors that hold EU-listed securities through non-EU intermediaries, to eliminate shareblocking requirements, and to facilitate the ability of shareholders to vote in absentia. We address these and other matters in detail below.

<u>Entitlement to Control Voting Rights</u>

To improve the ability of the ultimate beneficial owner to exercise voting rights when the owner holds shares through a chain of intermediaries, the Commission proposes to provide a definition of a person "entitled to control the voting rights." This person would be defined in the consultation paper as the last natural or legal person holding a securities account in the "chain" who is not a securities intermediary admitted as a participant in the securities holding systems operated in Europe by Central Securities Depositories or International Central Securities Depositories. In describing this option, the Commission notes among its potential pitfalls that it could define global and local custodians and non-EU securities intermediaries as the person entitled to control the voting rights rather than the ultimate owner of the securities.

US institutional investors are significant investors of EU securities, and US mutual funds typically hold shares of foreign securities through global and local custodians.[1] Under the Commission's proposed definition, US mutual funds would not be entitled to control the voting rights of the securities that they own. Moreover, the other proposals to improve shareholder rights (*e.g.,* information to shareholders before a general meeting, rights to vote in absentia, and right to receive results of votes and minutes after a general meeting) would not benefit investors that hold EU-listed shares through a non-EU intermediary because these investors would not be deemed the ultimate owner. It would be unfortunate and at odds with EU's interest in attracting foreign investment if the benefits of a directive on shareholder rights did not extend directly to US mutual funds and pension funds.

As a result, we recommend that the Commission define the person entitled to control the voting rights as the last natural or legal person or entity who holds a securities account in the "chain" or to whom the responsibility to exercise voting has been given but who does not hold the securities on behalf of another natural or legal person or entity. This definition would permit clients of global and local custodians and non-EU securities intermediaries to control the voting rights. If the Commission intends to improve the ability of investors to exercise voting rights cross border, the Commission should provide equivalent access and protection to non-EU investors to prevent discrimination against these investors and encourage foreign investment in EU securities.

Recognizing that the definition in the consultation paper may not identify the actual investor, the Commission also raises the question of whether securities intermediaries identified as the ultimate investor should be required to disclose the identity of their clients at the request of the issuer if the issuer suspects that the ultimate investor holds the shares on behalf of others. The sanction for non-disclosure would be that the issuer could disregard the votes cast on the shares held by the ultimate investor. We strongly disagree with this proposal. If, as proposed by the Commission, an investor such as a US mutual fund that holds securities through a global custodian is not identified as the ultimate investor (and does not receive the benefits of being the person entitled to control the voting rights), we see no reason why the identity of the investor should be disclosed or its votes disregarded. Clients of non-EU securities intermediaries would receive none of the benefits and protections of being deemed an investor of EU-listed securities but could potentially be subject to punitive sanctions. We strongly urge the Commission not to take this position.

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[1] Generally, mutual funds and Employee Retirement Income Security Act of 1974 (ERISA) plans are required to have assets in custody with US custodians or with eligible foreign custodians when they invest in non-US securities.

Shareblocking

Universally, shareblocking requirements are cited as a key barrier to the exercise of voting rights. US mutual funds, for example, are required by US securities laws to invest substantially in liquid assets and to price their shares daily. The practice of "shareblocking," which is used to determine the shares entitled to vote, requires investors that want to vote to surrender the right to dispose of their shares for a defined period of time. Shareblocking makes it difficult for US funds to comply with mutual fund pricing and liquidity regulations under US laws and restricts an asset manager's ability to make portfolio decisions.

We believe that eliminating the practice of shareblocking in the EU would represent one of the most significant advances in facilitating the ability of shareholders to exercise voting rights. We strongly urge the Commission to use the Directive to eliminate shareblocking and propose an alternative system for Member States to determine which shares are entitled to participate and vote at the general meeting. We recommend a record date system in which a date is set before a meeting to determine those shareholders that are entitled to vote. We believe the record date should be set at least two weeks before a general meeting to allow for authentication (discussed more below) and reconciliation of positions.

Voting In Absentia

We believe that the ability to vote in absentia is critical to European companies attracting investors from around the world. We strongly believe that the Commission's Directive on shareholder rights should require Member State to introduce the possibility for all companies to offer shareholders the option of voting in absentia (by post, electronic or other means). Institutional investors invest on a global basis, and it would be extremely burdensome if these investors were required to attend meetings in person to vote.

We also strongly recommend that the Commission's Directive on shareholder rights contain provisions to further facilitate the use of proxy voting across Member States and to eliminate requirements in Member States that either make it difficult to vote by proxy (*e.g.,* wet signature requirements) or marginalize votes by proxy (*e.g.*, permitting vote by show of hands at the meeting).

Application to Listed Companies

We support the Commission's proposal to apply the Directive on shareholder rights to companies whose shares are admitted to trading and to invite Member States to extend these provisions to non-listed companies. Non-residents, for whom cross-border voting is of significant concern, are more likely to hold securities of listed companies rather than non-listed companies. Thus, we agree that the need to improve shareholder rights is greatest with respect to listed companies. At the same time, we believe the Commission should encourage Member States to adopt similar requirements for non-listed companies.

Exercise of Voting Rights

The Commission proposes to provide four different measures to ensure that the ultimate investor can exercise the entitlement to control voting rights. To respect the differences in national company laws, the Commission proposes the following options: (1) the ultimate investor is acknowledged as shareholder entitled to vote in bearer share systems; (2) the ultimate investor is designated in the shareholders' register as entitled to vote in registered shares systems; (3) the ultimate investor is given a power of attorney by the intermediary; and (4) the ultimate investor instructs the intermediary who is the formal shareholder to vote as instructed.

We agree with the Commission but believe that, at a minimum, the ultimate investors should in all cases be offered the possibility in Member States to provide the financial intermediary with voting instructions or to be given a power of attorney by the same financial intermediary. These two provisions would help ensure that investors are provided with the minimal means to exercise their voting rights.

Authentication of Ultimate Investor

We recommend that the Commission require the intermediary closest to the issuer to have the ultimate responsibility for the authentication and certification of the ultimate investor if the Commission adopts our definition of who should be entitled to control the voting rights. Under our proposed definition, clients of non-EU intermediaries would be the ultimate owners. We recognize that the EU may not have jurisdiction over non-EU intermediaries to impose an authentication requirement directly. The intermediary closest to the issuer, however, could by contract require other intermediaries down the chain to certify the holding of the ultimate investor.

The Commission also asks whether securities intermediaries should certify to the issuing company who the ultimate investor entitled to control the voting rights is and for how many shares. We believe, if securities intermediaries are required to identify the ultimate investors to issuers, adequate protection should be provided for the protection of investor privacy. We believe to avoid frontrunning, the Commission should require that the disclosure of investor identities be limited to issuers and should prohibit issuers from further disclosing this information. The disclosure and use of this information should be restricted because portfolio holdings information could reveal proprietary investment strategies. We strongly believe that the use of this information should be strictly limited to use in connection with shareholder meetings or vote verification and not for any other general purpose.

Stock Lending

The Commission seeks comment on whether securities lending creates problems for the exercise of voting rights. As a preliminary matter, we understand that there is no EU-wide or individual Member State obligation on investors to exercise their voting rights. Under these circumstances, there is no policy reason to consider restricting the practice of lending at the time of the annual meeting. Moreover, it would be difficult to include in a directive covering EU-listed companies any restrictions on securities lending practices because the issuers would not be a party to the securities lending arrangements.

Instead, we believe that it would be helpful to clarify at the EU level the rights and responsibilities of the lender and borrower of securities with respect to voting of securities. The Commission should articulate and make clear that lenders would no longer have voting rights during the period securities are lent. The Commission may consider providing guidance to lenders on the types of factors that they should consider in lending securities around the time of the annual meeting (such as the occurrence of a material corporate event that could affect the loaned securities) and whether lenders should have procedures in place to ensure that they are notified of annual meetings and the items up for vote and can recall the securities when appropriate.

Depositary Receipts

We strongly support the Commission's efforts to address voting issues associated with the holding of depositary receipts in the Directive on shareholder rights. As a practical matter, voting rights of depositary receipt holders are limited by standard terms of the depositary agreements or hindered by operational considerations.

The Commission's Directive should explicitly recognize holders of depositary receipts as holding the rights attached to the underlying shares and prohibit EU listed companies from entering into depositary agreements that specifically exclude or limit voting rights of depositary receipt holders. We believe many of the issues with respect to voting by holders of depositary receipts, such as holders not being provided voting materials in sufficient time to be able to exercise their voting rights effectively, would be alleviated if the depositary receipt holders are considered the owners of the underlying shares and afforded the protections of the Commission's Directive. We believe all the rights of those entitled to control the voting rights of the underlying shares also should accrue to the holders of the depositary shares.

Communication of Information of General Meetings

We believe the Commission's Directive on shareholder rights should contain provisions regarding the disclosure of general meeting notices and materials and certain standards for their dissemination. It is of critical importance to the exercise voting rights that investors receive information about the general meetings and the items on which the investor will be asked to vote. Without information on the meeting and the items to be voted upon, the ability of shareholders to exercise their franchise is of limited utility. Moreover, we further suggest that the Commission consider providing certain standardization of disclosure in proxy statements.

We also are of the view that the Commission should set certain minimum standards for the dissemination of general meeting information. We believe a *minimum* EU-wide notice period (*e.g.,* 21 days) would be helpful. Moreover, requiring issuers to provide all their meeting materials on their website would greatly facilitate the ability of investors to obtain this information. We also recommend that the websites contain a description of shareholders' rights in relation to voting (*e.g.*, voting by proxy or in absentia) and with regard to the general meeting (*e.g.*, right to ask questions or table resolutions). In addition, we believe that a single location where investors of EU-listed securities can find information of general meeting information for all EU-listed companies would be helpful. We recommend that the central depository being designed for the information required of issuers under the Transparency Directive also be used to store information about EU-listed issuers for general meeting information.

With respect to whether information through electronic means should be transmitted to ultimate investors, we support providing Member States the choice of either requiring intermediaries to forward the information through the intermediary chain or allowing issuers to transmit information to ultimate investors directly (provided that there is a process for addressing the privacy concerns of ultimate investors).

<u>Shareholders' Rights in General Meetings</u>

We agree with the Commission that its Directive on shareholder rights should prohibit Member States from imposing on companies requirements that act as a barrier to the development of electronic means of shareholders' participation in general meetings. We agree that the market, rather than regulation, should drive the incorporation of advanced technologies into business practices.

With respect to the ability of shareholders to ask questions, we believe that the Commission's Directive on shareholder rights should define minimum standards on the way shareholders' questions should be filed and dealt with at general meetings. In defining the minimum standards, the Commission should balance the rights of shareholders to ask questions against the rights of companies not to disclose commercially sensitive information and to ensure the efficient operation of general meetings.

The Commission's Directive also should address the ability of shareholders to add proposals to the agenda and to table resolutions. If common criteria at the EU-level cannot be established, the Commission should set limits on the maximum shareholding threshold that Member States could impose for shareholders to table resolutions and place items on the general meeting agenda.

<u>Post-General Meeting Information</u>

We believe that companies should, at a minimum, be obligated to disseminate the results of votes and minutes of general meetings on their websites within a reasonable period of time following the meeting. Moreover, we confirm that institutional investors are interested in obtaining verification that their votes have been received.

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We appreciate the opportunity to comment on the Commission's consultation paper on a proposal for a Directive on shareholder rights. We strongly urge the Commission's Directive to define persons entitled to control voting rights to cover non-EU investors that hold EU-listed securities through non-EU intermediaries. We also strongly support the Commission eliminating the practice of shareblocking, which is one of the most significant barriers to cross-border voting in the European Union, and facilitating the ability of investors to vote in absentia.

If you would like further information or would like to discuss any of the issues in more detail, please feel free to contact me at podesta@ici.org or at (202) 326-5826 or Jennifer Choi at jchoi@ici.org or at (202) 326-5810.

Sincerely,

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