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**Recommendations and Best Practice
for Issuers and Institutional Investors**

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INTRODUCTION

The desire to adapt and improve the corporate governance of listed companies is a constant concern not only for regulators, but also for companies and their shareholders.

Through the combined impetus of the European Commission and the national legislators, the relevant laws have evolved (i) to provide a framework for the operations of listed companies' boards of directors (e.g., through the institutionalization of audit committees with Directive 2006/43/EC of 17 May 2006 transposed into French law under article L. 823-19 of the French Commercial Code) and (ii) to increase transparency of their practices (as a recent illustration under French law, take the law of 3 July 2008 implementing directive 2006/46/EC of 14 June 2006 pursuant to which the boards of directors of listed companies must indicate whether they have adopted a corporate governance code, whether they apply the provisions of that code, and, if not, explain why¹).

The professional rules which issuers and institutional investors choose to adopt (professional code of conduct, professional association charters, rules of good conduct, etc.) have also contributed to the creation of a new body of rules, referred to as “soft law”, which are not so much legal as practical, and aim to improve corporate governance effectively. The growth of soft law has been precipitated by the internationalisation of the financial markets, which also contributes to a homogenisation of corporate governance practices. Furthermore, 38% of institutional investors today say they are in favour of a European code of corporate governance².

Even if considerable progress has been made thanks to the combined effect of regulations and soft law, the financial and economic crisis has highlighted the limits of regulation and assessment of systemic risks in financial companies.

The “De Larosière Report” submitted to the European Commission on 25 February 2009 thus indicated that: *“Failures in risk assessment and risk management were aggravated by the fact that the checks and balances of corporate governance also failed. Many boards and senior managements of financial firms neither understood the characteristics of the new, highly complex financial products they were dealing with, nor were they aware of the aggregate exposure of their companies, thus seriously underestimating the risks they were running. Many board members did not provide the necessary oversight or control of management. Nor did the owners of these companies – the shareholders.”*

The European Commission therefore sought improvements in corporate governance. On 30 April 2009, it published a recommendation for the banking and investment company sector setting out general guiding principles for the remuneration policy in banks and investment companies, while also acknowledging that the inappropriate practices concerning remuneration in the financial sector were not the main cause of the financial crisis. The Commission also updated and completed the earlier recommendations of 2004 on remuneration of directors of listed companies and those of 2005 on the role of non-executive directors and board committees particularly in order to amend the rules governing directors' remuneration and to bolster the remuneration committee's role while at the same

¹ Articles L. 225-37 and L. 225-68 of the French Commercial Code.

² Study carried out by RiskMetrics Group in collaboration with BusinessEurope, ecoDa and Landwell & Associés, submitted to the European Commission on 23 September 2009, “*Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States*”, hereinafter referred to as the “RiskMetrics Report”, p. 165.

time ensuring transparency for the shareholders and encouraging them, “*in particular institutional shareholders [...] to attend general meetings when appropriate and make considered use of their votes regarding directors’ remuneration*”³.

The *Commission Europe* of the *Club des Juristes* considers that shareholders and general meetings, which appoint the board⁴ and to which the board must report, can also have a part to play in corporate governance. A reflexion on improving corporate governance in listed companies inevitably gives rise to the question of the role that can be played by shareholders, and in particular institutional investors, as corporate governance cannot be seen exclusively through the prism of the board.

In this respect, discussions so far have mostly focused on shareholders’ rights (voting rights and financial rights) and practices that the issuers should follow to encourage exercise of these rights (e.g., Yves Mansion’s report of January 2005 submitted to the *Autorité des Marchés Financiers* (AMF) entitled “*Improving exercise of shareholders’ voting rights in France*”). The question of the shareholders’ role, particularly during general meetings, and of good practices which could be formulated for institutional investors has however rarely been considered, whereas investors themselves seem favourable not only to an enhancement of their rights but also of their responsibilities⁵. The general meeting, the sovereign decision-making body of the company, which appoints and dismisses the members of the company’s governing bodies and supervises their actions ought, however, to be at the centre of corporate governance supervision.

The recitals to Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies emphasised that “*shareholder control is a prerequisite to sound corporate governance and should, therefore, be facilitated and encouraged*”.

In practice, according to the RiskMetrics Report, institutional investors do not seem to be sufficiently involved in issuers’ governance: out of the 2,000 institutional investors contacted by RiskMetrics for a study on application of corporate governance rules, only a hundred or so accepted to complete the questionnaire. RiskMetrics underlines that the low level of response from investors suggests that there are two categories of institutional investors: a minority of active investors and a majority of investors who are more passive vis-à-vis companies’ governance⁶.

The passivity of these investors in the governance of companies can have major repercussions. In companies having dispersed ownership with a myriad of small shareholders, the absence of a controlling shareholder and high absenteeism at general meetings can give the board and management considerable freedom. Apart from at general meetings, the dialogue between the management and shareholders is still limited.

Even if institutional investors do attend, or are represented at, general meetings, their relations with the board and the management can still be improved. While some institutional investors do not

³ Commission Recommendation complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, published on 30 April 2009.

⁴ The word “board” refers both to companies with a single board of directors and to companies with a two-tier structure (management board and supervisory board).

⁵ RiskMetrics Report, p. 12.

⁶ RiskMetrics Report, p. 15. Investors which accepted to complete RiskMetrics’ questionnaire were mainly British, Dutch and French.

engage with the company, others get closely involved in the management of the company and favour a long-term vision when they vote. More recently, the emergence of “activist” shareholders at general meetings has disrupted certain meetings and has been strongly criticised by some because of the short-term approach sometimes adopted by these funds and their use of securities lending to influence decisions taken at general meetings.

In Europe, some initial steps have been taken through legislation to encourage shareholders to actively engage with the company as well as through certain codes of professional conduct such as that of the *Association Française de Gestion* (AFG) (the French asset management association). As early as 1997, the AFG included in its rules of professional conduct provisions that encourage its members to exercise their voting rights. Since then, it has also defined what its members expect in terms of corporate governance standards and has set up a monitoring system to draw its members’ attention to resolutions which do not comply with these standards. In addition, French regulations provide a framework within which these voting rights are exercised since fund management companies must draw up voting policies⁷. Best practice for institutional investors could be established at a European level to further this initiative through soft law in order to encourage shareholders to supervise corporate governance.

The RiskMetrics Report submitted to the European Commission on 23 September 2009⁸ states that the European Commission could recommend that Member States adopt codes of best practice for institutional investors on the basis of the “*comply or explain*” principle⁹.

In the United Kingdom, the Walker report submitted on 26 November 2009¹⁰ recommends (i) that the Financial Reporting Council (FRC) adopt the recommendations of the Institutional Shareholders’ Committee (ISC) and make it into a Stewardship Code¹¹ and (ii) that the Financial Services Authority (FSA) ensure that institutional investors comply with these recommendations (or, if not, explain why). A consultation was launched in January 2010 by the FRC to obtain the opinions of institutional investors on this matter¹².

In line with these initiatives, the Working Group of the *Commission Europe* of the *Club des Juristes* (the “**Working Group**”) considers that redefining the role of institutional investors and improving their relations with issuers, and reciprocally, the relations that the issuers have with their shareholders, cannot only be provided for by hard law and, in line with the current principles of corporate governance, must originate in soft law and rules of good practice. This is all the more preferable as

⁷ Article 341-100 et seq. of the AMF General Regulations and Chapter 3 of Code of Ethics for Collective Investment Schemes and Discretionary Accounts. This code was recognised as a professional standard by the AMF on 15 December 2009. Its provisions apply to the entire portfolio management industry including AFG Members, non-member investment firms and other providers of asset management services (source: AMF press release of 15 December 2009).

⁸ In order to encourage corporate governance of issuers, the RiskMetrics Report also recommended extending the role of statutory auditors and other organisations (regulators, market-wide monitors, professional associations).

⁹ RiskMetrics Report, p. 18: “*the European Commission could promote the adoption by Member States of national codes of best practice by institutional investors*”.

¹⁰ “*A review of corporate governance in UK banks and other financial industry entities, Final Recommendations*”, 26 November 2009.

¹¹ The section of the Combined Code addressed to institutional investors would then be deleted and the Combined Code dedicated just to issuers (cf. Consultation on the Revised UK Corporate Governance Code, published by the Financial Reporting Council on 1 December 2009).

¹² Cf. FRC press release of 19 January 2010.

involving the various players in preparing the recommendations or codes of good practice should in principle ensure adoption of these recommendations and, to a certain extent, their implementation.

Impetus at a Community level could encourage Member States' regulators to organize consultations in this respect with professional associations and could also lead to the creation of a European core body of good practice rules, which, given the internationalisation of the financial markets and the strong presence of foreign shareholders in issuers' capital, could ensure efficient application of rules of good practice.

The Working Group's aim is therefore to formulate recommendations for institutional investors and issuers. **These good practices must be shared on a reciprocal basis**, it being noted that the recommendations for institutional investors must take into account each investor's particular status (management companies investing under mandate, banking institution or insurance company investing for their own account, etc.).

The term "institutional investor" in this report means the managers of UCITS funds, pension funds, as well as financial institutions or insurance companies. When applicable, certain recommendations will be able to be adapted to take account of the differences between these categories of investors.

Three main themes have been identified by the Working Group in the drafting of these recommendations: transparency of institutional investors' objectives and promotion of long-term vision (**section I**), the exercise of shareholders' voting rights (**section II**) and increased dialogue between the company and its shareholders (**section III**).

I. TRANSPARENCY OF INSTITUTIONAL INVESTORS' OBJECTIVES AND PROMOTION OF A LONG-TERM VISION

A. Knowing who the shareholders are and their objectives

➤ *Context*

Shareholder identification

With the internationalisation of the financial markets and their liberalisation, the shareholders of listed companies now have very diverse profiles and the notion of listed company shareholder today covers numerous, extremely different, situations: pension funds, individual shareholders, institutional investors, public entity investors and sovereign-wealth funds, employee shareholders, etc. The notion of institutional investor is itself very broad and covers many situations depending on whether the investor is acting in his own capacity or on behalf of a third party. This diversity must be taken into consideration in any reflexion on corporate governance of listed companies so that all of the shareholders' objectives can be taken into account or at least heeded by the board.

In practice, it is clear that European issuers are encountering difficulties in knowing who their shareholders are and understanding the diversity of their objectives, even if, in certain countries, the regulator has already intervened in this respect to facilitate their task. Thus, in the United Kingdom (section 793) and in France (article L. 228-2 of the Commercial Code), the regulators allow issuers to ask the financial intermediaries holding securities on behalf of non-resident shareholders to provide the names of the actual holders of the securities.

This transparency should be applied to institutional investors. Therefore, European companies who are members of the organisation EuropeanIssuers¹³ consider that it is essential that initiatives are taken at a European level to make it easier for issuers to know who their shareholders are, in particular when the shares are held by a foreign shareholder through a chain of intermediaries located in different countries. The difficulties that issuers experience in identifying their shareholders are significantly increasing with the growth of a cross-border shareholding environment. EuropeanIssuers believes that an EU-wide harmonized solution is needed to address this situation in a satisfactory manner and that it is essential that European legislation affirms the right of issuers to know who their shareholders are and the duty of intermediaries to disclose to the issuer the identity of the beneficiaries of the accounts. EuropeanIssuers suggests that this obligation on intermediaries could be set out in the future Securities Law Directive. Furthermore, again according to EuropeanIssuers, and in order to encourage the adoption of a European solution, the market should work on a global, swift, timely and cost-effective shareholder identification system. The initiatives of the Target2 Securities Programme with the creation of the European Central Bank's Task Force on Shareholder Transparency will contribute to promoting a shareholder identification system.

¹³ EuropeanIssuers is a pan-European organisation whose aim is to promote the common interests of issuers. It represents a vast majority of listed companies in Europe. Its members are issuers or national associations, from 14 different countries, totalling 9,200 listed companies (with a combined market value of some EUR 4,500 billion) all sectors taken together (automotive, food, luxury, construction, health, banking, etc.).

Notification of acquisition or disposal of holdings with respect to certain thresholds (provided for by law or by the articles of association) also offer issuers the possibility of knowing who their shareholders are but it should be noted that the lack of harmonized rules within the European Union makes it difficult for shareholders to understand and sometimes apply these rules. The report of 10 December 2008 on the transposition of Directive 2004/10/EC of 15 December 2004 (the “Transparency Directive”) thus highlighted the diversity of the rules applicable within the European Union, particularly as regards the following¹⁴:

- Time limit for notification: there is a vast difference between the Member States, the time limit being just one day in Denmark, two days in the United Kingdom and four trading days in France;
- First legal notification threshold: even if the Transparency Directive set the first threshold at 5%, certain countries have kept lower thresholds pursuant to national law (2% in Italy and Portugal, 3% in the United Kingdom and Spain);
- Notification thresholds provided in the articles of association: thirteen Member States allow issuers to provide in their articles of association an obligation for shareholders to notify when certain thresholds lower than the legal thresholds are crossed, whereas nine countries expressly prohibit such provisions;
- Thresholds calculated on the basis of capital and voting rights: even if the Transparency Directive only refers to thresholds on the basis of voting rights, about half of the Member States also impose an obligation to notify the crossing of thresholds calculated on the basis of capital (e.g., France¹⁵, Finland, Italy or Sweden);
- Enhanced disclosure requirement - Statement regarding the shareholder’s intent: only a few countries such as France, Germany and the United Kingdom have such a rule. As an illustration, in France, a shareholder who comes to hold more than 10%, 15%, 20% or 25% must make a statement regarding its intent which must also specify the sources of finance for the acquisition and its principal terms and conditions, particularly if the acquisition was financed by debt¹⁶. However, some consider these statements to be insufficient, considering that the right to be able to change one’s “intent” at any time, provided that it is declared, reduces the efficiency of the system. Thus, the *Association de Défense des Actionnaires Minoritaires* (ADAM) (a French association for the defence of minority shareholders’ rights) regrets that statements of intent are not always valid until the next general meeting. Institutional investors also seem to consider that the statements of intent are often ineffective because they are too vague. Nonetheless, it should be noted that the recent changes in the rules governing statement of intent in France oblige parties to file more detailed information and that some

¹⁴ Commission Staff Working Document – Report on more stringent national measures concerning directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

¹⁵ As regards financial sector entities, only thresholds calculated on the basis of voting rights are now taken into account for notifications filed with the *Autorité de contrôle prudentiel* (decree 2009-1223 of 12 October 2009).

¹⁶ Article L. 233-7- VII of the French Commercial Code, article 223-17 of the AMF General Regulations: the notifier must specify in particular: “*The methods of financing the acquisition and the arrangements therefor: the notifier shall indicate in particular whether the acquisition is being financed with equity or debt, the main features of that debt, and, where applicable, the main guarantees given or received by the notifier. The notifier shall also indicate what portion of its holding, if any, it obtained through securities loans.*”

members of the Working Group consider that a new reform in France is unnecessary at this stage, although a reform at an EU level would be welcomed.

Even if investors are generally in favour of harmonisation at a European level of the rules governing notifications of acquisition or disposal of shareholdings with respect to a certain threshold, the disclosure requirement of the shareholders' intent is however sometimes negatively perceived by institutional investors who emphasize that they must be able to follow an active investment policy in certain financial securities without however being activists and having to justify their intentions vis-à-vis the company.

Lastly, it can be noted that the observations made by the persons interviewed by the Working Group were similar to those expressed by the persons interviewed by Mazars in its study carried out for the European Commission on application of the Transparency Directive, according to which 66.6% of those interviewed are in favour of EU-wide harmonisation of the rules governing notification of acquisitions and disposals of major holdings¹⁷.

Transparency of voting policies prior to general meetings

Disclosure of institutional investors' voting policy principles prior to general meetings to the whole of the market, and in particular to the issuers, could be an avenue worth exploring to improve relations between institutional investors and issuers. Even if institutional investors were to decide not to disclose their voting policies, they should explain why they are not doing so (application of the "comply or explain" principle). This idea was moreover referred to in the RiskMetrics Report submitted to the European Commission: "*Investors could be required to disclose their investment and voting policies, as well as voting records for their portfolio companies*"¹⁸. It was also suggested by the persons interviewed by the Working Group that issuers, in their capacity as investors, should also publicly disclose their voting policies for the companies in which they own shareholding interests.

In France, fund management companies must draw up a document entitled "*voting policy*" which sets out how they intend to exercise the voting rights attached to the securities owned by the collective investment funds they manage (article 314-100 of the AMF General Regulations). This allows issuers to better identify the concerns of fund management companies, even if in practice, some criticise that these voting policies are often too vague or are communicated too late. It should be noted however that this voting policy disclosure obligation only applies in the specific case of funds managed by management companies. Such disclosure is therefore only aimed at unit holders and not issuers. That being said, this article also provides that this document can be consulted on the fund management company's website, which in principle means that any issuer can access it.

Transparency of exercising voting rights after general meetings

The RiskMetrics Report indicates that 60% of institutional investors are in favour of the principle according to which they should report on implementation of their voting policy¹⁹. The format this reporting should take could be discussed (detailed report per issuer, summary of the resolutions, details of only the resolutions which the investors voted against) (cf. below, institutional investors at

¹⁷ Transparency Directive Assessment Report, Mazars, March 2010, p. 101.

¹⁸ RiskMetrics Report, p. 18.

¹⁹ RiskMetrics Report, p. 176.

this stage seem reluctant to report in detail on the voting policy for each of the issuers in which they hold ownership interests).

The OECD report published in June 2009²⁰ also supports this idea while noting that one of the reasons why institutional investors do not take part in the vote is that they sometimes find themselves in a position of conflict of interests and that it might be useful in this respect that institutional investors make their voting records public as well as the procedures put in place to avoid any conflicts of interest²¹: “*One of the reasons for inactivity appears to be important conflicts of interest and incentive structures linked to some structural weaknesses in the corporate governance of these investors [...] it should be regarded as good practice for institutional investors acting in a fiduciary capacity to disclose their voting records in order to make more transparent any conflicts of interest and how they are being managed.*” The ISC Code also encourages investors to put adequate procedures in place to manage these conflicts of interest²².

In France, as regards reporting, UCITS fund managers must publish a report which specifies, *inter alia*, “*1° The number of companies in which the portfolio management company exercised voting rights compared to the total number of companies in which it had voting rights; 2° The cases in which the portfolio management company considered that it could not comply with the principles set forth in its voting policy document; 3° The conflicts of interest that the portfolio management company had to manage in exercising the voting rights attaching to securities held by the collective investment schemes that it manages.*”²³ This document is intended to be communicated to unit holders and is not intended for issuers. The latter can nonetheless consult it on the fund management company’s website.

➤ *Examples of good practice*

As regards institutional investors:

Communication of voting policies prior to general meetings

The majority of persons interviewed by the Working Group (representatives of institutional investors, proxy advisers or representatives of issuers) proved to be in favour of the idea that institutional investors should make their voting policies public. The members of the Working Group are also in favour of this recommendation.

Communication of voting policies to issuers and to the market is therefore a good practice which should be encouraged. This would allow issuers and the market to better apprehend investors’ concerns, the main subjects mentioned in these voting policies relating, in particular, to the composition of the board of directors, maximum limits for delegations of authority for share capital

²⁰ OECD, “*Corporate Governance and the Financial Crisis: Key Findings and Main Messages*”, June 2009, p. 52 (hereinafter referred to as the “OECD Report”).

²¹ Several studies quoted in the OECD Report show that in practice fund managers do little monitoring and, as regards more specifically certain funds in the United States, they do not exercise their votes in a way which would empower shareholders at large. It would appear that fund managers are thus reluctant to pressure management. Lastly, stock churning and continually shifting portfolios (which allows fund managers to increase their commissions) encourages a short-term approach by certain institutional investors (OECD Report, p. 52).

²² ISC Code, Principle 2.

²³ Article 314-101 of the AMF General Regulations.

increases with or without preferential subscription rights and the protection of minority shareholders' rights. Three quarters of the institutional investors having responded to RiskMetrics already publicly disclose their voting policies or their policy regarding corporate governance²⁴.

Within the European Union, this recommendation is already included in several codes of good practice. In the United Kingdom, the ISC Code (which is expected to become the Stewardship Code²⁵) published in November 2009 and aimed at institutional investors thus indicates that institutional investors should publicly disclose their voting policies²⁶ as well as their policy on considering explanations given by issuers in relation to the Combined Code.

In other Member States of the European Union, certain codes of good practice applicable to fund management professionals emphasize that besides their voting policies, fund management companies must give the reasons for the decisions that they take on important issues vis-à-vis investors:

“Fund management companies must maintain a shareholder policy and must provide details thereof on their website, for example, and must also justify the positions taken on important issues.” (Swedish Code of Conduct for fund management companies)

Even if institutional investors decide not to vote, except in exceptional cases, they should also indicate this in their voting policy: *“A manager might, for cost benefit considerations, adopt a systematic approach, for example never voting except in exceptional circumstances, rather than evaluating each proxy situation. In such circumstances, this should be explained to investors in accordance with the comply or explain regime”* (Hedge Funds Standards Board - Hedge Fund Standards and Guidance). In France, the AFG Code of Ethics provide that *“if a [fund manager] decides not to vote, he should explain why”*²⁷.

In addition, in the event of a vote against a resolution, it could be recommended that institutional investors inform the issuers beforehand in order to allow the latter to express their point of view. The ISC Code points out that institutional investors should inform the issuers beforehand of their voting intentions and explain the reasons why:

“Institutional investors should seek to vote all shares held. They should not automatically support the board. If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why” (ISC – Code on the Responsibilities of Institutional Investors).

This pre-general meeting disclosure, already practised by certain institutional investors, means that certain misunderstandings on the draft resolutions could be resolved. In order to facilitate this pre-general meeting contact between institutional shareholders and issuers, the documentation for the general meeting could mention the name and contact information of the persons to be contacted to discuss the proposed resolutions.

²⁴ “Out of the sample of 100 respondents, the vast majority has a corporate governance or voting policy, and almost three quarters publicly disclose this information” (RiskMetrics Report, p. 15 and p. 159)

²⁵ cf. Introduction.

²⁶ ISC Code, Principle 1: “Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities. The policy should include [...] the policy on voting and the use made of, if any, proxy voting or other voting advisory service, including information on how they are used”.

²⁷ The AFG Code of Ethics for Collective Investment Schemes and Discretionary Accounts - Provisions.

Lastly, several codes of best practice applicable to fund managers emphasize that fund managers should vote in an independent manner and put in place mechanisms to prevent potential conflicts of interest:

“Voting rights must be exercised independently, whether vis-à-vis entities of the group to which the fund manager belongs or issuers, in the sole interest of the unit holders” (AFG Code of Ethics - Provisions).

“The document called “voting policy” should indicate, in particular:

- *the implementation of “Chinese wall” with related entities,*
- *the identification procedure for managers and associates of the fund management company who may find themselves in a situation of conflict of interest due to their functions or relations with an issuer,*
- *Measures taken vis-à-vis custodians to avoid that the institution centralizing the correspondence voting forms inform in advance the issuer of the fund management company’s intentions.”* (AFG Code of Ethics - Recommendations).

“An institutional investor’s duty is to act in the interests of all clients and/or beneficiaries when considering matters such as engagement and voting. Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client. Institutional investors should put in place and maintain a policy for managing conflicts of interest.” (Consultation on the Stewardship Code launched by the FRC)

Disclosure after general meetings of how voting policies were implemented

It could be good practice if institutional investors publicly disclose how they voted, following what is suggested in the ISC Code (*“Institutional Investors should disclose publicly voting records and if they do not explain why”*).

Certain institutional investors who were interviewed by the Working Group indicate however that they are reluctant to publicly disclose, for each of the companies in which they are shareholders, how they voted (this was suggested by certain issuers in order to facilitate auditing the votes).

Institutional investors consider that this public disclosure makes them lose their voting freedom by obliging them to justify themselves in the event that their voting choice in one issuer is, given its specificities, different. Disclosing detailed voting records for a particular issuer could in the end result in investors adopting a “box ticking approach” in order not to be accused of inconsistency in their voting practice.

Therefore, certain institutional investors consider that they can publicly disclose only general voting policies and voting records without details.

As regards knowing who the shareholders are, the Working Group also discussed whether shareholder associations should, in the event of legal proceedings, disclose the names of the investors for whom they are acting. It could indeed appear legitimate, from the issuers’ point of view, to know the names of the investors having given a mandate to associations to try to dialogue with them directly. However, certain associations emphasize that giving such information is contrary to the legitimate concern of keeping the identity of their members confidential.

As regards issuers:

Certain listed companies have set up shareholder panels or committees to know their shareholders better and better understand their concerns, and some even provide their shareholders with a guide to assist them in taking their decisions and exercising their shareholder rights. Such practices should be encouraged.

➤ Recommendations

For institutional investors:

=> Encourage institutional investors to publish their voting policies sufficiently in advance of the general meeting.

=> For collective investment scheme management activities, publicly disclose the procedures for identifying, preventing and managing conflicts of interest which could affect the free exercise of voting rights.

=> Encourage institutional investors to meet the company's management to discuss any potentially contentious resolutions.

=> Encourage institutional investors, on a voluntary basis, to inform the issuers of their intention to vote against a particular resolution and explain why.

For issuers:

=> Encourage issuers to set up shareholder panels or committees to know their shareholders better and better understand their concerns, provide a guide to assist shareholders in taking their decisions and exercising their shareholder rights.

Ideas to be explored:

=> Harmonise rules concerning notification of acquisition or disposal of major holdings as regards the threshold levels, their nature (voting rights and/or capital), the time-limit for notification, the securities concerned (derivative products taken into account) and transactions in respect of these securities (contracts for difference, for example)²⁸.

=> Encourage an EU shareholder identification process for non-resident shareholders holding shares through registered intermediaries.

²⁸ For example, France and the UK have set up a specific system for declaration as regards these financial instruments.

B. The limitations of short-term strategies revealed by the crisis and development of a long-term approach

➤ *Context*

Certain players tend to have a short-term vision for investments, which is, moreover, claimed by them to be a legitimate right which stimulates corporate governance. Having hedge funds among the shareholders of companies can indeed in certain cases make the management more attentive and optimize the value of the company. The OECD Steering Group on Corporate Governance underlined moreover in 2007 that these funds can play a positive role in corporate governance of listed companies, because they behave sometimes as informed shareholders and as a real partner for the company and its management and play a more active role in monitoring companies' performance and their management²⁹. In practice, however, hedge funds generally do not take part in the vote, except when there are specific resolutions which could affect their interests.

The activism of certain short-term investors, even if they have the same rights as the other shareholders, is sometimes criticised for allowing such investors to exercise an influence on the company's strategy while encouraging short-term yields to the detriment of a longer-term vision.

The limits of focussing only short-term stock exchange performance of the company have now become apparent (the high-level group chaired by J. de Larosière underlined that “*shareholders' pressure on management to deliver higher share prices and dividends for investors [has] meant that exceeding expected quarterly earnings [has become] the benchmark for many companies' performance*”) and the crisis and brought back into fashion the idea that a long-term vision ensures the company's solidity and profitability in the long term.

The creation of the “Long-Term Investors Club” in June 2009 at the initiative of the *Caisse des Dépôts* with the founding members being the *Caisse des Dépôts*, the *Cassa depositi e prestiti italiana*, the European Investment Bank and *KfW Bankengruppe* illustrates this trend. The purpose of this investors' club is two-fold; it aims to:

- “*be a forum for exchange of good practices and for expression of a common identity;*
- *build offers of services dedicated to this category of financial players so they can provide capital to support the development of the economy.*”

It would be unrealistic to want to put an end to the short-term approach. However, defining a certain number of good practices to encourage the development of a long-term vision is key to improving corporate governance. In this respect, it would be worth examining the measures that could be implemented to encourage this long-term approach.

Reciprocally, identification of good practices for long-term investors could, in addition to corporate governance and dialogue with the board, be promoted to limit certain practices (short-selling) and the use of derivative products which can cause an artificial drop or rise in the share price, even if it is

²⁹ The implications of alternative investment vehicles for corporate governance, OECD report, 2007.

naturally not a question of prohibiting such practices which undoubtedly are of use to shareholders, as for issuers (particularly in the event of an issue of convertible bonds as regards short-selling).

➤ *Examples of best practice*

On the initiative of the Secretary General of the United Nations, responsible investment principles, taking into account environmental, social and corporate governance issues, and no longer just economic and financial issues, were drawn up in 2006. According to the United Nations, application of these principles should lead *“in the long term to a better return on investment but should also lead to an alignment of institutional investors’ objectives with those of society as a whole.”*

The International Corporate Governance Network (ICGN), whose members are institutional investors, business leaders, policy makers and professional advisors, has included in its Global Corporate Governance Principles, revised on 9 November 2009, the rule according to which institutional investors must behave in a manner to optimise long-term value creation for their clients:

“Shareholders should act in a responsible way aligned with the company’s objective of long term value creation. Institutional shareholders must recognize their responsibility to generate long term value on behalf of their beneficiaries, the savers and pensioners for whom they are ultimately working” (ICGN Global Corporate Governance Principles: Revised (2009)).

The Dutch corporate governance code states clearly that the creation of long-term value must be encouraged:

“The Code is based on the principle accepted in the Netherlands that a company is a long-term alliance between the various parties involved in the company. The stakeholders are the groups and individuals who, directly or indirectly, influence – or are influenced by – the attainment of the company’s objects: i.e. employees, shareholders and other lenders, suppliers, customers, the public sector and civil society. The management board and the supervisory board have overall responsibility for weighing up these interests, generally with a view to ensuring the continuity of the enterprise, while the company endeavours to create long-term shareholder value” (Dutch Corporate Governance Code – Preamble).

The Danish code attempts to reconcile shareholders’ short- and long-term perspectives:

“As owners of the company, the shareholders can actively exercise their rights and use their influence resulting in the management protecting the interests of the shareholders as best as possible, and ensuring efficient deployment of the company’s funds both in the short as well as the long term.”

Lastly, the amended version of the UK Combined Code³⁰ which is currently subject to a consultation suggests providing that the company's success should be measured over the long term:

“Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.”

and the purpose of the ISC Code (i.e., for institutional investors) is moreover to encourage the creation of long-term value:

“The Code aims to enhance the quality of the dialogue of institutional investors with companies to help improve long term returns to shareholders, reduce the risk of catastrophic outcomes due to bad strategic decisions, and help with the efficient exercise of governance responsibilities.”

In addition, the French minority shareholders' association, ADAM, when interviewed, emphasised that the implication of the shareholders could possibly be encouraged by their being represented on companies' boards, this idea being consistent with the wider context of redefining the composition of boards and appointing (too frequently in ADAM's opinion) independent directors. According to ADAM, it would be preferable for there to be more shareholder representatives, directly involved in the future of the company, and fewer independent directors. Most of the members of the Working Group as well as the persons interviewed by the Working Group appeared to have reservations about this suggestion, emphasising that the members of the board of directors should be chosen first of all for their qualities and skills and not solely because they represent a shareholder. Some members of the Working Group also emphasized that it was important to ensure compliance with the principle pursuant to which the board represents all of the shareholders and acts in the sole interest of the company.

These reflexions are in line with those raised by the AMF in its report on corporate governance and internal control and relating to (i) the clarification of the notions of independence and financial and accounting skills adopted by issuers, (ii) independent directors, the balance between this status and their remuneration and their role on the boards and (iii) the proper balance between independence and skills by participation of directors exercising a relevant professional activity regarding those carried out by the company³¹.

In order for members of the board to be interested in the company's results, it was also suggested during the interviews carried out by the Working Group that directors, whether executive directors or not, hold the equivalent in the company's shares of at least one year's attendance fees. Certain persons interviewed by the Working Group pointed out that the amendment of article L. 225-25 of the French Commercial Code (removal of the legal obligation for directors to hold a number of shares in the company specified in the articles of association) was symbolically contrary to corporate governance good practices for companies whose shares are admitted to trading on a regulated market and that if such an amendment to the articles of association (which must be approved with a 2/3 majority) was proposed by a listed company, several shareholders would probably vote against it.

The possibility of proposing several candidates for a seat on the board of directors, following the example of what already exists in Italy and in certain Scandinavian countries, was mentioned during

³⁰ It has been proposed to change the name of this code to the UK Corporate Governance Code.

³¹ AMF report on corporate governance and internal auditing procedures 2009 (p. 7).

the interviews carried out by the Working Group to improve board composition. Should such a change be envisaged, it would be preferable that the vote at the general meeting for each candidate be set out in a separate resolution. This recommendation was not supported by certain participants or members of the Working Group as it appears that it would be difficult to implement in certain countries and could indirectly have a negative effect by discouraging certain candidates from standing for election.

Other mechanisms to encourage the development of long-term shareownership such as special dividends or double voting rights were mentioned by the Working Group³². These mechanisms are however perceived as “discriminatory” measures by institutional investors who consider that such mechanisms should not be encouraged. Certain investors indeed consider that “what is purchased should be identical to what is sold”, which is not the case for example of double voting rights, the specific right being lost with the sale of the shares.

However, the OECD report published in June 2009³³ acknowledges their benefits (while also noting that such measures must be based on objective and verifiable criteria). Certain representatives of proxy advisers consider moreover that certain mechanisms, such as clauses capping voting rights are of some use, because they aim, under certain conditions and particularly depending on the quorum of a general meeting, to prevent any specific shareholder from having a disproportionate influence at a general meeting and taking control of the company without having to make a takeover bid. When interviewed by the Working Group, RiskMetrics did however indicate that most institutional investors did not share this opinion and were hostile to any measure which is contrary to the principle “*one share – one vote – one dividend*”, considering that the best way of preventing a minority shareholder gaining control is to ensure better participation at general meetings.

Lastly, the participants interviewed by the Working Group highlighted that attractive taxation could encourage long-term shareholdings. This point of view is shared by issuers.

➤ *The specific case of takeover bids*

In the case of a takeover bid, it can happen that the shareownership of the target can change completely by very short-term share purchases by certain hedge funds financed by substantial borrowing.

This short-term substantial borrowing can have an impact on the outcome of the bid because certain hedge funds will tender their shares in the offer so that the offer is closed quickly and that they can sell their shares as soon as possible.

More generally, strong fluctuations in the share price caused by certain hedge funds and their short-term strategies can sometimes have contagious effects on the company’s other shareholders and on their decision whether to tender their shares in the offer or not.

³² For example, Air Liquide proposes an attendance fee of EUR 10 for shareholders attending the general meeting in person and the amount of dividend is increased by 10% for registered shares held for more than two calendar years.

³³ OECD report, p. 49.

Due to the substantial short-term positions taken by certain hedge funds during an offer period, the management of the target is no longer able to know who the shareholders are (the rules for declaring crossing of shareholding thresholds are not always complied with, or, if existing, the rules concerning acting in concert) and engage in a dialogue with them concerning the takeover bid³⁴.

It is stipulated in most codes, applicable to fund management professionals, that during a takeover bid, fund management companies must act solely in the interest of unit holders.

On the other hand, there is no mechanism applicable to institutional investors to ensure transparency of share purchases representing a significant percentage of the share capital of the company which are financed by borrowing in a takeover bid (save for legal and regulatory obligations, for example in France, obliging the shareholders to specify in a declaration of intent whether they have borrowed to finance their acquisition³⁵). Implementation of such a mechanism could be examined to help issuers know who their shareholders are and understand their objectives in a takeover bid.

➤ *Recommendations*

For institutional investors:

=> Remind institutional investors of their duty to be engaged with the company and in particular their duty of vigilance concerning corporate governance matters.

=> Encourage institutional investors to engage in a dialogue with the company in order to improve the creation of long-term value for shareholders.

For issuers:

=> Encourage directors (with the exception, when applicable, of directors representing employees or employee shareholders) to hold a significant number of shares, corresponding, for example, to the equivalent of one year's attendance fees in order to bring the interests of the members of the board of directors more in line with those of the shareholders.

Idea to be explored:

=> In the case of a takeover bid, a special transparency measure could be examined, modelled in particular on the rules applicable concerning declarations of intent (disclosure of the methods of financing the acquisition and in particular whether it was funded by debt, for example³⁶).

³⁴ For a detailed description of the causes of the substantial stock churning in the target and its consequences, “*Le Marché et les Offres publiques*”, S. Tadjbakhsh, P. Hudry, in “*Les offres publiques d’achat*”, Litec, p. 479.

³⁵ As a reminder, this only applies when the thresholds of 10%, 15%, 20 or 25% of the capital or voting rights are crossed.

³⁶ Cf. footnote n°16.

II. EXERCISE OF VOTING RIGHTS BY INSTITUTIONAL INVESTORS

The current issues concerning the exercise of voting rights by institutional investors identified by the Working Group fall into three main categories and concern: the practice of “empty voting” (section A below), the practice of using the services of proxy advisers (section B below) and the exercise of voting rights by non-resident shareholders (section C below).

In each of these fields, the Working Group has considered the good practices which could be drawn up for institutional investors and issuers.

A. *The practice of “empty voting”: the question of securities lending*

➤ *Context*

Originally, voting rights were conceived as the consideration for the capital risk taken by the shareholders. The shareholders, unlike the company’s creditors, had voting rights due to the economic risk they bore.

The growth of securities lending and borrowing has undermined this conception. A borrower can vote without bearing the same type of economic risk that a shareholder who holds the shares without having borrowed them.

Famous cases have illustrated the perversity of securities lending-borrowing with the sole aim of exercising influence at a general meeting, particularly with a view to preventing a merger (Henderson Land) or on the contrary with a view to ensuring a successful outcome to a purchase offer (Halvis/Bae Systems). Professional associations and regulators have unanimously criticised the use of securities lending-borrowing solely with a view to voting at general meetings.

Even if it contributes to the proper functioning of the market and naturally cannot be prohibited, the use of securities lending-borrowing for a general meeting must therefore be regulated in order to avoid any abuse of voting rights at general meetings.

In practice, one third of French fund management companies systematically recall their securities to exercise the voting rights. The other fund management companies do this on a case-by-case basis, when the situation necessitates such a measure (e.g., to vote against a resolution which is contrary to the fund management company’s voting policy)³⁷.

The establishment of good practices could harmonize the conduct of fund management companies, even if there is a risk, as emphasized in the report prepared by the working group chaired by Y. Mansion on securities lending before general meetings submitted to the *Autorité des Marchés Financiers* in January 2008, that recommendations are not sufficient because of their non-binding nature.

³⁷ AFG - Exercise of voting rights by portfolio management companies in 2008.

According to the Transparency Directive Assessment Report published by Mazars in October 2010, 60% of the institutional shareholders are in favour of implementation of a transparency mechanism at an EU level for securities lending and 64% are in favour, in a future revision of the Transparency Directive, of reinforcing mechanisms to prevent empty voting practices³⁸.

It can be noted that besides the use of securities lending-borrowing, the “record date” rules make it possible, in certain cases, to vote at general meetings without having any economic interest in the company on the date of the general meeting.

Lastly, certain shareholder associations quite rightly point out that the recommendation aimed at prohibiting securities lending before general meetings should concern not only investors but also issuers.

➤ *Examples of good practice and projects underway*

The report prepared by the working group chaired by Y. Mansion in January 2008 on securities lending recommended that any shareholder holding more than 2% (or between 1% and 3%) of the voting rights of a company whose shares are admitted to trading on a regulated market, should inform the AMF and the company at 00.00 hours on the third day before the general meeting and specify the number of shares acquired by means of a temporary transfer. This transparency should facilitate determining the “*influence and the objectives of the different shareholders*”. The possibility of suspending exercise of voting rights was also explored by the group chaired by Y. Mansion, but implementation of such a measure would pose difficulties³⁹.

At a European level, the European Commission launched a consultation in 2007 on, *inter alia*, securities lending-borrowing. Upon completion of this consultation, the European Commission did not issue any recommendation. The question is now being examined by the European Corporate Governance Forum. On 20 February 2010, the Forum made a statement addressed not only to investors which borrow shares but also to issuers which sometimes lend their own shares before general meetings⁴⁰:

³⁸ Mazars’ Transparency Directive Assessment Report, p. 127.

³⁹ The report of the working group chaired by Y. Mansion thus envisaged suspension of voting rights attached to the loaned securities during a certain period of time prior to the general meeting. To be properly effective, the working group considered that the suspension of voting rights of temporary shareholders would need to be accompanied by a system of deterrents, such as have the commercial court issue an interim order to place the securities in escrow, a court-ordered suspension of voting rights for a period of five years and/or a fine. Nonetheless, taking into account the votes at the general meeting which should have been suspended pursuant to these proposed rules could create legal uncertainty concerning the validity of the resolutions. The working group recommended that the cancellation of one or more resolutions – or even the meeting itself – because the participation of a temporary shareholder has breached the new regulations should not be mandatory. This risk of compromising the validity of the general meeting itself was also pointed out by one of the participants at the European Corporate Governance Forum and by various respondents to the consultation launched by the European Commission in September 2007 (65% of consultation participants consider that it is not advisable to prohibit the exercise of the voting rights by the borrower, unless the borrower receives specific instructions from the lender).

⁴⁰ Statement of the European Corporate Governance Forum on Empty Voting and Transparency of Shareholder Positions, 20 February 2010.

“The Forum recommends the introduction of an assumption in company law that shareholders who take part in a general meeting own the corresponding economic interest in the voted shares. A principle should then be introduced that where shareholders who have retained legal title to the shares and exercise the vote that goes with them but have ceded all or part of the economic interest should disclose this to the market above an appropriate threshold. Parties not making the required declarations may be considered to have made an untrue statement.”

“Instead of prohibiting any form of securities lending by a company of its own shares, the Forum recommends the introduction of a rule that the company and its subsidiaries may only lend the company’s own shares if the lending contract stipulates that the borrower will not vote with these shares, and should ensure that later acquirers would not vote either. The company should disclose prior to the general meeting to what extent it and its subsidiaries have lent the company’s own shares to third parties.”

Lastly, it can be noted that several codes of good practice already code provide a framework for securities lending:

- The ICGN drew up in 2007 a Securities Lending Code of Best Practice for its members. This code indicates in particular that the borrower of the securities must abstain from voting:

“Institutional shareholders should have a clear policy with respect to lending, especially insofar as it involves voting. A lending policy should clearly state, inter alia, the lender’s policy with regard to recall of lent shares for the purpose of voting them. All lending conducted by the institution or on its behalf should be done in accordance with this stated policy.”

“It is bad practice to borrow shares for the purpose of voting. Lenders and their agents, therefore, should make best endeavours to discourage such practice. Borrowers have every right to sell the shares they have acquired. Equally the subsequent purchaser has every right to exercise the vote. However, the exercise of a vote by a borrower who has, by private contract, only a temporary interest in the shares, can distort the result of general meetings, bring the governance process into disrepute and ultimately undermine confidence in the market.”

“The fund, fund sponsor, or principal manager of a portfolio or fund from which shares are loaned (hereafter the primary lender) should be responsible for drafting and publishing a general policy that clearly sets forth the scope of lending activity, and under what circumstances, if any, this activity is to be subordinated to voting and to the lender’s duties as a long-term shareholder.”

“It is never good practice for borrowers to exercise voting rights with respect to shares they have borrowed, except in the rare circumstances where they are acting pursuant to the lender’s specific instructions. This limitation is not binding upon a subsequent bona fide purchaser of borrowed shares.”

- Securities Borrowing and Lending Code of Guidance drawn up by the Securities Lending and Repo Committee (SLRC) (the UK-based committee comprising international repo and securities lending practitioners and market authorities) does not formally criticise the exercise of voting rights by the borrower, unless such party borrowed the securities solely for such purpose:

“A person could borrow shares in order to be able to exercise the voting rights and influence the voting decision at a particular meeting of the company concerned. There is a consensus, however, in the market that securities should not be borrowed solely for the purpose of exercising the voting rights at, for example, an AGM or EGM. Lenders should also consider their corporate governance responsibilities before lending stock over a

period in which an AGM or an EGM is expected to be held. Beneficial owners need to ensure that any agents they have made responsible for voting and for securities lending act in a co-ordinated way.”

- Lastly, the Hedge Fund Standards Board expressly indicates that hedge fund managers should not borrow shares with the sole aim of voting, except in specific situations:

“A hedge fund manager should not borrow stock in order to vote. HFSB acknowledges that there might be specific situations where it should be acceptable to vote on borrowed stock, e.g., when a fund is invested in shares (and the trade has settled), but the shares have not transferred into their name.”

It can also be noted that these codes encourage issuers to (i) disseminate the information relating to the general meeting well before the record date so that institutional investors can recall the loaned securities and (ii) distance the date for payment of the dividend from the date of the general meeting.

In order to facilitate recalling the securities for general meetings, certain companies such as RiskMetrics have set up an alert system so that their clients are informed of general meetings and can recall their securities, particularly if certain resolutions submitted to the general meeting are important for the investor. The AFG has emphasized that even if recalling loaned securities before general meetings is good practice, it presupposes that the costs related to recalling the securities are not too high for this recommendation to be implemented effectively.

➤ *Recommendations*

For institutional investors and issuers:

=> Include in codes of good practice the principle of a ban on securities lending-borrowing with the sole aim of exercising influence at a general meeting.

=> Encourage lenders to recall the loaned shares to exercise their voting rights⁴¹.

=> Prohibit issuers from engaging in securities lending through banking establishments prior to general meetings.

=> Advise institutional investors to abstain from voting when they do not bear the economic risk attached to the shares.

Idea to be explored:

=> Regulate securities lending with greater transparency by requesting that holders of shares declare, before the general meeting and above a certain threshold (2% for example), the number of shares held directly and the number of shares held as borrower.

⁴¹ Subject to any costs related to recalling the securities.

B. The practice of using the services of proxy advisers

➤ *Context*

According to a study carried out by the AFG, in 2008, 80% of asset management companies monitored in the study referred to the AFG voting recommendations or alerts and more than half of them also used private proxy advisers (Proxinvest, RiskMetrics, Glass Lewis & Co, etc.) to analyse issuers' resolutions⁴². In parallel, institutional investors are also establishing their own voting policies and setting up dedicated teams to analyze resolutions. Thus, for the first time, in 2009, in France, certain general meeting resolutions were rejected although they had received a favourable recommendation by proxy advisers.

The general principles of proxy advisers' voting policies change each year depending on:

- changes in legislation and corporate governance codes;
- the results of the preceding general meeting campaign.

Even if using the services of proxy advisers allows institutional investors to be better informed on the contents of the resolutions, the voting policies of certain proxy advisers sometimes do not take into account the specificities of the companies or their legal environment. The OECD criticizes this approach and warns of the dangers of “*one size fits all voting advice*”⁴³.

In addition, certain shareholder associations have expressed concern about the lack of clarity concerning shareholder composition, the method of operation and the potential conflicts of interest of certain proxy advisers. In particular, as regards the method of operation of proxy advisers and the conditions in which their analysis reports are issued, the Working Group examined the practice of proxy advisers consisting in recruiting and training personnel for the period during which general meetings are generally held.

Lastly, institutional investors are critical of the relations that sometimes proxy advisers maintain with issuers (particularly by providing services for the preparation of general meetings), the resolutions of which they also analyse. This same criticism was relayed by the OECD in June 2009⁴⁴.

➤ *Examples of good practices*

The report produced by the working group chaired by Y. Mansion on the exercise of voting rights at general meetings in France of October 2005 underlined that it would be better if the functions of proxy advisers and proxy voting providers were separated so as to avoid any conflict of interest. Certain proxy advisers who provide resolution analysis services as well as voting platform services

⁴² Source: AFG website.

⁴³ OECD report, aforementioned, p. 54.

⁴⁴ OECD report p. 52: “*A number of institutions rely on proxy advisers yet this is an industry that has its own conflict of interest (e.g. they are often paid by a company to prepare governance ratings) and this is a highly concentrated industry.*”

consider nonetheless that this does not place them in a situation of conflict of interest to the extent that the institutional investors can always make their own choice on each resolution. Moreover, certain proxy advisers offer their clients the option of receiving an analysis report which is adapted to their own voting policy (the recommendations issued by the proxy adviser in its standard analysis report and those issued in the investor-specific report can thus be different).

Nonetheless, institutional investors (particularly foreign) could naturally tend to refer to the proxy adviser's voting policy without forming their own opinion on each of the resolutions proposed. In order to remedy this problem, it was suggested by the people interviewed by the Working Group that the recommendations of other proxy advisers be put online on the voting platform so that the investors could compare several analysis reports and post on one website all of the resolution analysis reports to which they are subscribed. Proxy voting providers are starting to examine this proposition but this requires that proxy advisers accept to divulge their analysis reports to their competitors.

It could also be envisaged that all proxy advisers publicly disclose the general principles used to prepare their analysis reports. In practice, certain proxy advisers such as RiskMetrics already accept to publicly disclose such general principles, the analysis reports for each issuer being however dedicated exclusively to the clients.

In the United States, the Millstein Center for Corporate Governance and Performance published in March 2009 a report in which it set out recommendations for proxy advisers and institutional investors:

- Recommendations for proxy advisers: proxy advisers should in particular (i) give reasons for their resolution analyses, (ii) take earlier practices into account and (iii) entrust the work to a competent person, who has adequate experience and knowledge of the practices of the countries covered by the recommendations. Proxy advisers should also inform their clients whether they send their analyses to the issuers before publication, so that the issuers can correct any errors (if the proxy advisers choose not to send their recommendations to the issuers beforehand, they should explain why).
- Recommendations for institutional investors: these recommendations restate in particular the principles drawn up by the ICGN (Statement of Principles on Institutional Shareholder Responsibilities) on the critical approach institutional investors should have in selecting proxy advisers and in assessing the proxy advisers' recommendations.

In an article of 18 February 2010, the UK institutional investor magazine *Responsible Investor*⁴⁵ published an article by PIRC⁴⁶ which, echoing these recommendations declared that it applied the following six principles:

“Clear voting policy guidelines should be made available to clients, the companies whom the adviser is monitoring and to the market;

⁴⁵ T. Powdrill, “*Corporate Governance agencies: the need for transparent voting decisions*”, *Responsible Investor*, 18 February, 2010.

⁴⁶ PIRC is one of the leading independent proxy advisers in the United Kingdom.

Clear audit trail and explanation of the process for assessing companies and making voting recommendations should be available to clients and the companies monitored;

Possible conflicts of interest should be disclosed to clients and to companies monitored and, where necessary, to market regulators (i.e. paid consulting with companies);

Companies monitored should be given reasonable opportunity to comment on voting recommendations made and the basis of such recommendations;

Voting agencies should routinely report to clients on actions taken on their behalf;

All voting recommendations made by a voting adviser should be publicly disclosed post-meeting.”

These six principles could form a core body of best practice rules for proxy advisers.

As indicated above, the majority of the current recommendations for proxy advisers encourages them to contact the issuer before publishing their analysis reports. Some proxy advisers already apply this recommendation and indicate to their clients that they want to promote dialogue with the issuers (subject to the restrictions related to the general meetings period).

Communication between proxy advisers and issuers is however a delicate subject. Certain proxy advisers point out (i) that it is not for them to contact issuers and that that is exclusively the role of institutional investors which vote according to their own voting policy and (ii) that they would like to remain in a similar situation to that of the other shareholders and analyze the resolutions solely on the basis of publicly available information. These proxy advisers prefer therefore to put issuers and institutional investors in contact with each other by organising “proxy talks”, telephone conferences in which representatives of issuers and institutional investors take part.

In Europe, several codes of good practice emphasize the risks related to a box ticking approach and recommend that institutional investors take into account the specificities of the company when assessing its corporate governance:

“Shareholders should take careful note and make a thorough assessment of the reasons given by the company for any non-application of the best practice provisions of this code. They should avoid adopting a ‘box-ticking approach’ when assessing the corporate governance structure of the company and should be prepared to engage in a dialogue if they do not accept the company’s explanation. There should be a basic recognition that corporate governance must be tailored to the company-specific situation and that non-application of individual provisions by a company may be justified.” (Dutch Corporate Governance Code)

As for the ISC, it recommends that institutional investors publicly disclose their voting policies and specify whether they have used the services of a proxy adviser⁴⁷; when interviewed, the AFG said it was in favour of this recommendation.

Certain institutional investors have set up an internal validation procedure for voting decisions in which the proxy advisers’ positive and negative recommendations can thus be discussed. More wide-scale use of this practice could be encouraged. However, some participants have highlighted that it

⁴⁷ Principle 1.

would be preferable that the investors retain the freedom to organise their internal procedures as regards voting as they wish and considered that a recommendation was not necessary.

The training of the proxy advisers' teams is a measure on which the aforementioned Millstein report, and certain authors also, have insisted⁴⁸, and which could also form the basis of a recommendation in order to ensure that the teams have, *inter alia*, the legal skills necessary to understand the resolutions being analyzed. It has nonetheless been pointed out that the quality of the work provided by the proxy adviser teams was first and foremost assessed by the proxy advisers' clients. This should in principle encourage the proxy advisers to have high standards of quality.

In addition, the sources used to prepare the analysis report, in particular, if they include articles from the press, must be clearly identified.

More generally, a parallel with rating agencies could be drawn by inviting proxy advisers to (i) publicly disclose any conflicts of interest and (ii) indicate whether they have contacted the issuer before publishing their proxy report.

As regards the disclosure of potential conflicts of interest, certain proxy advisers accept to provide clients who make such request with the list of issuers to whom they provide services. This list is not however communicated to the teams who draft the proxy reports in order not to affect their judgment. In practice, RiskMetrics has, moreover, underlined that the services provided to issuers only represent a small percentage of its turnover (8%) and that in most cases, the services were not directly for the issuers themselves but for their advisers. In order to comply with regulations applicable in the US concerning the prevention and management of conflicts of interest, certain proxy advisers have voluntarily registered themselves with the Securities and Exchange Commission (pursuant to an "application for investment adviser registration"). Such a measure could be transposed at a Community level or proxy advisers could register with the national stock exchange authorities.

⁴⁸ A. Omaggio, "Faut-il encadrer l'activité des agences de conseil en vote (proxy advisers)?" (Should the activities of proxy advisers be regulated?), JCPE, 12 November 2009, n° 46, p. 29: "In the same way that other professionals providing advisory services must justify their professional skills, we do not find it abnormal that companies selling voting advice (analysing resolutions and issuing voting recommendations) also justify their professional abilities. This would be an additional guarantee for their clients and would also limit the risk of an issuer being subject to a voting policy which is not suited to the specificities of French law or being subject to a recommendation to vote against a resolution due to incorrect understanding or an inaccurate legal analysis of a resolution."

➤ *Recommendations*

For institutional investors:

=> Avoid a “box ticking approach” and take the specificity of each issuer and the specificities of local law into account.

=> Encourage institutional investors to check the advice received from proxy advisers and compare the advice, when applicable, with the board’s explanations.

=> Indicate whether they have used the services of a proxy adviser and the general principles for considering their recommendations.

Ideas to be explored:

=> Establish European-wide recommendation for the proxy adviser profession, notably to ensure that the necessary measures are taken for the prevention and management of conflicts of interest.

This recommendation could encourage proxy advisers to:

=> Publicly disclose the general principles used to prepare their analysis reports (“policy guidelines”). If the proxy adviser has contacted the issuer, include, when applicable, the issuer’s point of view in the report, and mention the frequency of meetings with the issuer. Otherwise, explain in the analysis report the reasons why, if this is the case, the recommendations were not communicated to the issuer prior to the general meeting (“comply or explain” principle applied to proxy advisers).

=> Ensure proxy adviser teams have the necessary level of qualification to be able to understand the specificities of issuers’ jurisdictions.

=> Publicly disclose, in the analysis report, the relationship – if any - between the proxy adviser and the issuer (provision of services) which could place the proxy adviser in a situation of conflict of interest and the measures taken to avoid and manage any of these potential conflicts of interest.

=> Encourage proxy advisers to be subject, on a voluntary basis, to the control of the European securities and markets authority or, when applicable, the national authorities, in order, in particular, to monitor any potential conflicts of interest that the proxy advisers may have.

C. Facilitate the exercise of voting rights by non-resident shareholders

➤ *Context and examples of ideas*

Most non-resident shareholders do not directly hold their shares, which are in fact recorded in registers held by financial intermediaries or custodians. Participation of non-resident shareholders therefore depends on the custodian, and when applicable, a network of sub-custodians, who alone can forward to the shareholders, within the applicable time-limits, the forms for voting by correspondence or by internet.

It is therefore important to encourage financial intermediaries to relay information, modelled on the example of financial intermediaries and payment of commissions. Use of SWIFT messages concerning an issuer sent by the establishment organising the general meeting to all of the financial intermediaries and custodians, for a minimal fee, has improved communication of information to bearer shareholders. Further progress could still be made, by including in the SWIFT message for example a link to the issuer's website or a summary of the resolutions.

Naturally the voting form dispatch and collection procedure carries a cost for the custodians which, passed on to the clients, could discourage the latter from taking part in the vote.

In a consultation in July 2007, the European Commission had thus envisaged asking Member States to ensure “*that the costs invoiced by the financial intermediaries for such services do not significantly exceed the costs they actually bear*”.

In order to overcome this difficulty it could be proposed to the financial intermediaries and custodians that the issuer bear, in whole or in part, the costs of sending and collecting the voting forms.

It can also be noted that, to facilitate the exercise of voting rights, Directive 2007/36/EC of 11 July 2007 sought to offer shareholders the possibility of appointing a non-shareholder third party as proxy. Article 10 of the directive therefore provides that “[*e*]very shareholder shall have the right to appoint any other natural or legal person as a proxy holder to attend and vote at a general meeting in his name. The proxy holder shall enjoy the same rights to speak and ask questions in the general meeting as those to which the shareholder thus represented would be entitled”. Transposition of this directive into French law (which should have taken place by 3 August 2009) could allow shareholders to take part in the vote by appointing a non-shareholder third party of their choice. In this respect, it would be important to ensure that this does not result in institutional investors taking no interest in the company's life as they would no longer directly exercise their voting rights.

In order to encourage shareholders to vote directly, it appears necessary to facilitate internet voting for shareholders, currently essentially used in France by employee shareholders. The pre-general meeting voting system is currently little used (only seven companies of the CAC 40 in 2009 offered their shareholders the possibility of voting by internet) and has not met with the success that was counted on, even if French law n° 2001-420 of 15 May 2001 lifted most of the legal obstacles to implementing electronic voting.

The constraints are now essentially of a practical nature:

- As regards documents in preparation for the general meeting being sent in electronic format, according to current regulations the formal prior consent of the registered shareholders is required in order for general meeting documents to be sent electronically instead of by post. AFEP, ANSA and AFTI have requested that this burdensome formality of obtaining the shareholders' prior consent be abolished, with, however, the shareholders having the possibility of requesting to receive the documents by post again.
- As regards internet voting, the current systems presuppose that bearer shareholders first of all contact their financial intermediaries to obtain the access codes, and then these intermediaries forward this request to the company or the establishment organising the general meeting which then directly returns the codes to the shareholder concerned. In addition to these practical difficulties are the legal difficulties, the question of the legal form of an electronic signature (ordinary or secure) still not having been resolved⁴⁹ and implementation of which is proving complicated and, as regards the secure signature, expensive. AFEP, AFTI and ANSA have therefore proposed to simplify the mechanism: the principle of an electronic signature could be provided for by law but the methods for identifying the holder of the voting rights would be defined pursuant to a common position approved by market participants.

In order to overcome these issues and facilitate the process for internet voting (or for requests for "*attestations de participation*" (certificates proving ownership of shares on the record date allowing attendance at the general meeting)), the SWIFT system has been adapted for preparing general meetings so that banks can forward proxy forms by internet. This system (which should be ready next autumn) should reduce considerably the cost of forwarding votes and encourage foreign shareholder voting.

Other organisations (e.g., AFTI) are working on developing pre-general meeting voting⁵⁰ by internet thanks to setting up an electronic voting platform open to all shareholders, whatever their place of residence and the form of securities they hold, which would in particular be accessible via the website of the financial intermediaries (allowing the system to be based directly on the custodians' registers); in the interviews carried out by the Working Group, the members of the AFTI working group on the development of the internet voting platform emphasized that it was important that the Ministry of Justice and the AMF encourage this initiative to remove any remaining legal uncertainties on the use of a voting platform which the shareholders would access via their financial intermediary's website.

Moreover it can be noted that the growth of internet voting may satisfy the shareholders' increasing concern to obtain a receipt confirming their votes.

Lastly, works have been carried out by the European Commission's Clearing & Settlement Advisory and Monitoring Expert Group and in particular by EuropeanIssuers to find an operational process which, at a European level, would facilitate the participation of non-resident shareholders at general meetings by removing the obstacles to unrestricted communication between the issuer and the

⁴⁹ F. Garrouste, "*Les actionnaires vont pouvoir voter par internet*" (Shareholders are going to be able to vote by internet), Agefi Hebdo, week of 1 to 7 October 2009, p. 36.

⁵⁰ A website has also been set up by Proxinvest to allow shareholders to print their voting form and vote by internet but the voting form must then be sent by post.

shareholders. This initiative would be worth developing. It aims, in particular, to make it obligatory for the intermediary to forward standardised information to the end-investor by no later than the day following⁵¹ receipt of the message from the issuer and to forward immediately the voting instructions (so that the information is quickly passed along the chain of intermediaries).

➤ *Recommendations*

For issuers:

=> Include a link to the issuer's website in SWIFT messages.

=> In accordance with applicable regulations, systematically send, by email, in French and in English all of the documents concerning the general meeting to shareholders whose email address the issuer has and make them available for consultation on the issuer's website.

=> Make institutional investors, particularly non-resident investors, more aware that they have voting rights.

=> Remind shareholders, particularly non-resident shareholders, of the legal consequences of abstaining from the vote (in certain countries, including France, abstention counts as a vote against the resolution whereas in other countries such as the United Kingdom, only votes for and against a resolution are taken into account, abstentions not being counted).

Idea to be explored:

=> Encourage and simplify internet voting, making voting websites accessible, particularly to foreign investors.

=> Examine the possibility of promoting at a European level a harmonised system of internet voting.

⁵¹ Or within two days if the holder of the shares is the end-investor.

III. REINFORCE THE DIALOGUE BETWEEN THE COMPANY AND ITS SHAREHOLDERS

A. Establishment of a permanent dialogue with shareholders prior to general meetings

➤ *Context*

General meetings, even if they offer an ideal opportunity for debate between shareholders and the company, must not be the only occasion for discussion between the company and its shareholders. Most issuers already organise road shows in order to meet with institutional investors and at which corporate governance issues can be raised by the institutional investors' officers responsible for corporate governance matters or the exercise of voting rights. Reciprocally, the shareholders should inform the issuer of their concerns prior to the general meetings.

This permanent dialogue must naturally be limited on both sides, given, in particular, that the company should not communicate privileged information.

➤ *Examples of good practice*

As regards institutional investors:

Most corporate governance codes or codes of good practice recommend establishing a dialogue between the shareholders, particularly institutional investors, and the issuer:

“Shareholders shall act in relation to the company, the organs of the company and their fellow shareholders in keeping with the principle of reasonableness and fairness. This includes the willingness to engage in a dialogue with the company and their fellow shareholders.” (Dutch Corporate Governance Code)

“The members must behave as loyal partners, in compliance with the rules of the profession, vis-à-vis the companies in which they invest. They shall define their degree of active contribution with the executives of these companies. Each member must be able to fulfil properly its role as shareholder.” (Code AFIC, France)

“The Committee believes that it is in the best interests of the issuers to establish a continuing dialogue with the generality of the shareholders and in particular with institutional shareholders, in compliance with rules and procedures governing the disclosure of price-sensitive information.” (Italian Corporate Governance Code)

Certain codes are more specific and recommend that institutional investors use appropriate means in the event of a breakdown in the dialogue.

Thus, the ISC Code considers that in the event of unsatisfactory answers from the company on the concerns expressed by the institutional investors, the latter must take appropriate and progressive measures, such as: (i) holding additional meetings with management specifically to discuss concerns, (ii) expressing concerns through the company's advisers, (iii) meeting with the Chairman, senior independent director, or with all independent directors, (iv) intervening jointly with other institutions on particular issues, (v) making a public statement in advance of the AGM or an EGM,

(vi) submitting resolutions at shareholders' meetings, and (vii) requisitioning an EGM, possibly to change the board.⁵² Certain investors interviewed by the Working Group regretted in this respect that in certain countries such as France, it was not possible for them, when they held a large stake in an issuer's capital, to directly convene a general meeting (without making such request in court).

In a memorandum dated 5 June 2009, the ISC also pointed out that institutional investors had to try to relay their concerns to other investors, particularly sovereign wealth funds whose investments are long-term, to have more influence with the company's directors:

“Many institutional investors seek regular dialogue with companies on corporate governance matters. Mostly this is conducted on an individual basis, and works well. When it is failing, the ISC believes a collective approach may be useful to ensure that their message is heard. We need to build on existing approaches to enhance investors' ability to ensure that the whole board, led by the chairman, responds to concerns.

A key objective is to establish a simple, non-bureaucratic approach that would enable and encourage more institutions to participate so that there is a critical mass of involvement. A broader network might include foreign investors and sovereign wealth funds with an interest in long-term value. The resulting dialogue should be outcome-focused. The Chairman of the ISC will consult with senior practitioners from the investment industry to develop ways of achieving this.”

Following this communication, the ISC Code now provides that institutional investors should act collectively when it appears appropriate for them⁵³:

“At times collaboration with other investors may be the most effective manner in which to engage. Collaborative engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten the ability of the company to continue. Institutional investors should disclose their policy on collective engagement. Institutional investors when participating in collective engagement should have due regard to their policies on conflicts of interest and insider information.”

This initiative was expressly restated in the Walker report submitted on 26 November 2009:

“Institutional investors and fund managers should actively seek opportunities for collective engagement where this has the potential to enhance their ownership influence in promoting sustainable improvement in the performance of their investee companies. Initiative should be taken by the FRC and major UK fund managers and institutional investors to invite potentially interested major foreign institutional investors, such as sovereign wealth funds, public sector pension funds and endowments, to commit to the Stewardship Code and its provisions on collective engagement.”⁵⁴

And echoes the recommendations of the OECD:

“Institutional shareholders (and others) should not be discouraged from acting together in individual shareholders meeting, both through consultation before the meeting and the presentation of common proposals, provided that they do not intend to obtain the control of the company.”⁵⁵

⁵² Principle 4, Code on the Responsibilities of Institutional Investors, 16 November 2009.

⁵³ Principle 5, Code on the Responsibilities of Institutional Investors, 16 November 2009.

⁵⁴ Recommendation 21 of the Walker Review.

⁵⁵ OECD report, p. 54.

This presupposes however that institutional investors cannot be suspected of acting in concert.⁵⁶ Certain investors interviewed regret in this respect that the definition of acting in concert is not sufficiently precise.

The European Commission has already emphasized that the broad definition of acting in concert in certain countries could discourage certain investors from cooperating to improve corporate governance:

“Given the size of holdings, investors normally need to cooperate among themselves in order to engage in this kind of promotion of corporate governance. However, this cooperation will largely be hindered because of the uncertainty created by the broad definitions of acting in concert: the dividing line between shareholder activism and acting in concert is not fully clear. In order not to take the risk of infringing the legislation, investors are likely to refrain from cooperating with other shareholders.”⁵⁷

In order to overcome this difficulty, the FSA sent a letter to the ISC informing it that *ad hoc* discussions and collective engagement at general meetings to promote compliance with corporate governance codes should not *a priori* constitute acting in concert⁵⁸.

Nonetheless certain representatives of institutional investors interviewed by the Working Group proved to be sceptical about this collective engagement of investors and wonder which type of measures could effectively be taken and with which types of institutional investors.

As regards issuers:

Corporate governance codes aimed at issuers are generally less precise concerning good practice that the management bodies must apply in their relations with institutional investors. Generally, they simply state that the board of directors is responsible for this dialogue. This supposes in practice that the concerns expressed by the institutional investors to the company’s management must be properly relayed to the board.

To this end, the UK Combined Code emphasizes the role of the chairman and the board in establishing this dialogue and provides that the non-executive directors may attend, if they wish, meetings organised between the management and the main shareholders of the company. The Combined Code also provides for the appointment of a “lead independent director” charged, amongst other things, with attending meetings with the major shareholders and to help develop a balanced understanding of the main shareholders’ issues and concerns. Lastly, according to the Combined Code, the board should set out in the annual report the measures taken to understand the shareholders’ objectives:

“The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend meetings with major shareholders and should expect to attend them if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major

⁵⁶ Recommendation 20B of the Walker Review.

⁵⁷ Commission of the European Communities, Commission Staff working document, *Report on more stringent national measures concerning directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market*, 10 December 2008.

⁵⁸ Letter from the FSA to the ISC dated 19 August 2009.

shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders”.

“The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company, for example through direct face-to-face contact, analyst brokers’ briefings and surveys of shareholders opinion». (Combined Code, United Kingdom).

The appointment of a lead independent director on the board is common practice in common law countries and less frequent in continental law companies (a few French companies have however already appointed the equivalent, an “*administrateur référent*”).

The appointment of a lead independent director was mentioned by the Working Group to improve the functioning of boards. The lead independent director could assist the chairman of the board or committees to ensure proper operation of the board. He could thus suggest to the chairman that certain items be added to the agenda or organise, in certain situations, meetings of the independent directors, the minutes of which could be provided to the board. He could also give his opinion on decisions submitted to the board so that the board can carry out its supervisory role as effectively as possible.

The *Autorité des Marchés Financiers* recently indicated that the appointment of a lead independent director is good practice if the Chairman also holds the position of CEO in order to avoid potential conflicts of interest⁵⁹.

Lastly, encouraging the practice of raising corporate governance issues (in particular with respect to governance bodies and upcoming general meeting) at road shows and the introduction of half-yearly or quarterly telephone conferences between the issuer’s management and institutional investors could be an avenue worth exploring to improve the dialogue between issuers and investors, provided that these practices do not themselves lead to unequal treatment between institutional investors and the other shareholders. In addition, certain participants interviewed by the Working Group insisted on the importance that should continue to be attributed to general meetings. They also insisted on the fact that the general meeting should remain the prime occasion for disclosure of information, ensuring equal treatment of shareholders.

⁵⁹ AMF report on corporate governance and internal auditing procedures 2009 (p. 19).

➤ *Recommendations*

For institutional investors:

=> *Encourage institutional investors to contact the issuer, as soon as they have concerns about the company's governance or its strategy.*

=> *In the event of persistent disagreement with the management, encourage institutional investors to gradually step up measures, such as contacting the non-executive chairman of the board of directors, when applicable, or other non-executive directors (lead independent director, for example), warning other shareholders, informing the market of such disagreements, submitting resolutions to the general meeting, and, if necessary, convening a general meeting.*

=> *In the event of a breakdown in the dialogue, encourage institutional investors to act collectively in accordance with applicable provisions regarding acting in concert.*

For issuers:

Subject to the nature of the information exchanged (no communication of insider information):

=> *Encourage managers to mention corporate governance matters at road shows prior to general meetings.*

=> *Recommend that managers report to the board the principal concerns expressed by institutional investors on corporate governance matters, particularly those discussed at road shows.*

=> *In the event of a persistent disagreement on a specific matter following meetings between the issuer's management and main shareholders, organise another meeting specifically to discuss the disagreement in the presence of the non-executive chairman of the board of directors or a non-executive director (the lead independent director, if there is one) or if the disagreement concerns the appointment or the remuneration of corporate officers, the chairman of the nomination or remuneration committee accordingly.*

B. *Preparation of general meetings and the dialogue at general meetings*

➤ *Context*

The general meeting is, as mentioned above, the forum *par excellence* for dialogue between the company and its shareholders. In this respect, there need to be major improvements, both as regards preparation and as regards proceedings at the meeting itself.

As regards preparation, institutional investors regret that certain determining information for their votes is only disclosed by the companies shortly before the meeting, for example, the biographies of the directors whose appointment or renewed appointment is proposed to the general meeting or the statutory auditors' report on related party agreements. They consider that the directors should be more involved in determining the general features of the proposed resolutions as they do not always correspond to the strategy declared by the company.

In addition, it is important, in order to help shareholders to understand the resolutions put to the vote at general meetings, that the resolutions are presented and explained sufficiently clearly. All the persons interviewed by the Working Group insisted on the importance for issuers to give the reasons for the resolutions, taking account of the company's strategy, objectives and specific features. 78% of investors who responded to RiskMetrics' survey indicated that they had voted against a resolution because of insufficient explanations given by the issuers⁶⁰.

The aforementioned RiskMetrics report⁶¹ points out that institutional investors also regret that the explanations given by issuers in the annual report for not having complied with a particular provision of their reference code of good practice are sometimes insufficient, too general and do not allow the shareholders to be properly informed.

As regards the proceedings at general meetings itself, it should be strongly recommended that directors be present at general meetings, especially when the renewal of their appointment is to be voted on by the general meeting.

Lastly, the shareholders would like, to the extent possible, general meetings to be spread over a longer period of time.

➤ *Examples of good practice*

There are already several recommendations which have been issued by the regulators.

These recommendations relate principally to:

- communication of the documents in French and in English prior to the general meeting via the company's website;
- resolutions containing a single voting item;
- internet broadcasting of the general meeting;
- publication of the voting results.

Thus, the report of the working group led by Y. Mansion on the exercise of voting rights at general meetings in France of October 2005 recommended, in particular, that to make resolutions submitted

⁶⁰ RiskMetrics Report, p. 161.

⁶¹ RiskMetrics Report, p. 165.

to shareholders easier to understand, the resolutions and their reasons should be drafted clearly and there should also be a relevant and objective summary of each one.⁶²

Most of these recommendations have been included in the aforementioned directive 2007/36/EC.

Codes of good practice complement these recommendations well by giving precise and practical instructions to issuers. Thus, the German code of corporate governance provides in particular that *“the chairman of the general meeting of the shareholders shall ensure that the general meeting of the shareholders lasts a reasonable period of time. He should thus try to close an ordinary general meeting within 4 to 6 hours”*.

In the same way, the ICSA (Institute of Chartered Secretaries and Administrators) has advised organisers of general meetings to limit the discussion time of each resolution.

The UK Combined Code encourages the board to use the AGM to communicate with investors and to encourage their participation.

The Italian code of corporate governance should also be mentioned as it recommends that issuers implement internal rules, submitted to the general meeting for approval, to regulate the proceedings at general meetings.

In France, the recommendations drawn up by ANSA (a major French business association comprising joint stock companies and law firms) also give issuers a practical framework to ensure proceedings at general meetings take place in due and proper form. ANSA’s recommendations relate in particular to:

- the conditions for admission of shareholders at the last minute;
- conditions for admission of non-shareholders;
- management of incidents during discussions (answers to indiscrete questions, management of abusive use of speaking time by a shareholder, use of an aggressive tone by a shareholder during the debate, etc.);
- one resolution for each autonomous voting item;
- drafting of reasons for a resolution and the titles of the resolutions;
- presentation of resolution summaries;
- limitation of discussions to questions on the meeting agenda.

There is also the Handbook for Members of General Meeting Committees (*Vade-mecum à l’attention des membres du bureau des assemblées générales*) which was drawn up by AFEP in cooperation with ANSA in 2005 at the request of organisers of general meetings and management companies. This document, which is regularly updated, sets out the principal rules governing general meetings, including in particular, those concerning the exercise of voting rights, legal difficulties and the main incidents which can arise during the meeting, and gives indications on how to deal with them, etc. It also

⁶² AMF report “Improving exercise of shareholders’ voting rights in France”, p. 20.

allows members of the meeting committee to have a practical guide to ensure proceedings at general meetings go smoothly.

On the other hand, for investors, the recommendations concerning dialogue at general meetings are less specific.

This could be explained by the fact that institutional investors generally rarely attend meetings in person and ask few questions concerning the role of the chairman, the general meeting or the meeting committee. However, certain recent cases (e.g., Sacyr/Eiffage, Gecina) have made shareholders more aware of the role and powers of the meeting committee, and certain shareholder associations would like the meeting committee's role and powers to be defined. Certain recommendations from the Handbook for Members of General Meeting Committees could be included in the codes of good practice for issuers and an initiative at a European level could be organised to try to define a common basis of good practices for proceedings at general meetings.

Institutional investors are above all interested in the draft resolutions and the reasons for such resolutions.

In this perspective, several principles should guide issuers in drafting the documents for the general meeting: simplicity, clarity for comprehension and consistency of the proposed resolutions with the issuer's strategy.

To this end, issuers should explain the proposed resolutions in simple terms avoiding Anglicisms and explaining the objectives pursued. It has therefore been suggested that heads of investor relations should be involved in the drafting of the resolutions and the reasons for such resolutions in order to simplify the terms employed in order to facilitate comprehension of the resolutions by the general meeting. To the extent possible, issuers should ensure, while remaining flexible thanks to financial authorisation mechanisms (e.g., authorising the board to carry out share capital increases up to a certain amount), that they do not propose resolutions to the general meeting which are not totally relevant (e.g., the issue of share warrants in the event of a public offer when the structure of the company's capital in fact makes a takeover bid impossible anyway).

It has been proposed that it should be possible to debate each important resolution at the general meeting. From the issuer's point of view, this recommendation would, however, risk considerably extending the duration of general meetings.

In order to encourage and harmonize access to information prior to general meetings, it has been suggested that issuers' websites should contain a section having the same format providing links to general meeting information and that conversely a single website should provide links to these "general meeting" pages on issuers' websites (the AMF website which contains links to issuers' regulated information has been quoted as an example).

As regards institutional investors and as indicated above, they could disclose their voting policies prior to general meetings and inform the issuers of their intention to vote against any resolutions.

➤ *Recommendations*

For issuers:

=> Encourage issuers to explain the reasons for each of the resolutions in a presentation indicating, in particular, which of these resolutions are deemed by the board to be important. In order to facilitate the comprehension of the resolutions by as many shareholders as possible, involve investor relations managers in the drafting of the resolutions as well as in the presentation of the reasons for the resolutions.

=> Communicate sufficiently in advance all of the documentation relating to the general meeting.

=> Encourage the general practice of preparing glossaries and organise “training sessions” for private individual shareholders.

=> Encourage the issuers, when they do not comply with a provision of their corporate governance code of good practice to explain why not⁶³; encourage issuers to check the quality of the reasons thus provided so that they are clear for shareholders and thus avoid misunderstandings.

Idea to be explored:

=> Encourage the introduction in the Member States of a practical guide on proceedings at general meetings which could be addressed to issuers, general meeting committee members and organisers of general meetings and would be available to all shareholders so that they can better understand the proceedings at general meetings. Then define a common basis of good practice for proceedings at general meetings within the European Union.

⁶³ Pursuant to article L. 225-37 of the French Commercial Code, the chairman’s report on corporate governance and internal auditing procedures and risk management must specify the provisions of the corporate governance code which have not been applied and the reasons why.

SUMMARY OF THE REPORT

RECOMMENDATIONS AND IDEAS TO BE EXPLORED

➤ **Good practices for institutional investors**

The Working Group recommends the introduction of a code of good practice at a European level for institutional investors, which would be applied on the basis of the “comply or explain” principle and whose principal provisions would aim to:

1. Remind shareholders, and in particular institutional investors, of their duty to engage with the company and in particular their duty of vigilance concerning corporate governance matters.
2. Encourage institutional investors to engage in a dialogue with the company in order to improve long-term value for the shareholders.

As regards voting policies and the exercise of voting rights:

3. Encourage institutional investors to publish sufficiently in advance of the general meetings their voting principles.
4. For collective investment scheme management, publicly disclose in the voting policy the procedures aimed at identifying, preventing and managing situations of conflict of interest which could affect the free exercise of voting rights.
5. Recommend that institutional investors indicate (i) whether they have used the services of a proxy adviser and (ii) the general principles for considering their recommendations.
6. Encourage institutional investors to avoid a “box ticking approach” and encourage them to take into account the specificity of each issuer (by comparing in particular the issuer’s point of view with the proxy adviser’s analysis) and local law.
7. Encourage institutional investors to meet with the management of the company prior to general meetings to discuss any potentially contentious resolutions.
8. Encourage institutional investors, on a voluntary basis, to inform issuers of their intention to vote against a particular resolution and explain why.

As regards relations with the issuers:

9. Encourage institutional investors to engage in a dialogue with the issuers as soon as they have concerns about the company’s governance or its strategy.
10. In the event of persistent disagreement with the management, encourage institutional investors to gradually step up measures, such as contacting the non-executive chairman of the board of directors, when applicable, or other non-executive directors (lead independent director⁶⁴, for

⁶⁴ The appointment of a lead independent director on the board is common practice in common law countries and less frequent in continental law companies. The lead independent director’s role is to assist the chairman of the board or committees to ensure the governing bodies function properly. He can thus suggest to the chairman that certain items be added to the agenda or organise, in certain situations, meetings of the independent directors, the minutes of which would

example), warning other shareholders, informing the market of such disagreements, submitting resolutions to the general meeting, and, if necessary, convening a general meeting.

11. In the event of a breakdown in the dialogue with the issuer, encourage institutional investors to contact other investors and act collectively in accordance with applicable provisions as regards acting in concert.

As regards the practice of securities lending:

12. Advise institutional investors not to borrow/lend securities with the sole aim of exercising influence at a general meeting.
13. Encourage lenders to recall loaned securities to exercise their voting rights⁶⁵.
14. Advise institutional investors to abstain from voting when they do not bear the economic risk attached to the shares.

➤ **Good practices for issuers**

In order to encourage shareholders to exercise their voting rights and to promote dialogue with them, including with institutional investors, several good practices for issuers have been identified by the Working Group.

In order to respond more specifically to the demands of individual shareholders:

1. Issuers should be encouraged to set up shareholder panels or committees to know their shareholders better and better understand their concerns, or provide a guide to assist the shareholders in taking their decisions and exercising their shareholder rights.
2. Issuers should be encouraged to explain the reasons for each of the resolutions in a presentation indicating, in particular, which of these resolutions are deemed by the board to be important. In order to facilitate the comprehension of the resolutions by as many shareholders as possible, involve investor relations managers in the drafting of the resolutions as well as in the presentation of the reasons for the resolutions.
3. Issuers should be encouraged to prepare glossaries and organise “training sessions” for private individual shareholders.

In order to meet the demands more specifically of institutional investors:

4. Make shareholders, particularly non-resident shareholders, more aware that they hold voting rights and remind them of the legal consequences of abstaining from the vote, which can, in certain countries, count as a vote against the resolution.
5. Encourage managers to mention corporate governance issues at road shows.

be forwarded to the board. He can also give his opinion on decisions submitted to the board so that the board can carry out its role of monitoring management as best possible.

⁶⁵ Subject to any costs related to recalling the securities.

6. Encourage managers to report to the board the principal concerns expressed by institutional investors on corporate governance matters, particularly those discussed at road shows.
7. In the event of persistent disagreement between the issuer's management and main shareholders, organise another meeting specifically to discuss the issue in the presence of the non-executive chairman of the board of directors, a non-executive director (the lead independent director, if there is one) or if the disagreement concerns the appointment or remuneration of corporate officers, the chairman of the nomination or remuneration committee accordingly.
8. Encourage issuers, when they do not apply a provision of their relevant corporate governance code, to explain why⁶⁶; encourage issuers to check the quality of the reasons thus provided so that they are clear for shareholders and thus avoid misunderstandings.
9. Encourage directors (save, when applicable, directors who represent the employees or employee shareholders) to hold a significant number of shares, corresponding, for example, to the equivalent in the company's shares of one year's attendance fees in order to bring the interests of the members of the board of directors more in line with those of shareholders.
10. As a general rule, and for all the shareholders generally, systematically send, by email, in French and in English all of the documents concerning the general meeting to the shareholders whose email address the issuer has and make them available for consultation on the issuer's website sufficiently ahead of time. For holders of bearer shares, include in the SWIFT messages sent to the financial intermediaries, a link to the issuer's website.

In addition, based on the interviews carried out by the Working Group several ideas worth acting on by the European Commission have been identified:

- **Idea n° 1 – Shareholder identification:** The rules concerning the crossing of shareholding thresholds could be harmonised. Ways of improving the process of identifying the holders of bearer shares could also be examined so that issuers can know who their shareholders are more easily and dialogue with them. In the case of a takeover bid, a special transparency measure could be examined, modelled in particular on the rules applicable concerning declarations of intent⁶⁷ (disclosure of the methods of financing the acquisition and in particular whether it was funded by debt, for example).
- **Idea n° 2 - Transparency regarding securities lending around the time of the general meeting:** Introduce a transparency mechanism concerning securities lending-borrowing prior to general meetings and encourage institutional investors not to vote when they do not bear the economic risk attached to the shares (practice of empty voting).

⁶⁶ cf. footnote n° 59.

⁶⁷ Article L. 233-7- VII of the French Commercial Code, article 223-17 of the AMF General Regulations: the notifier must specify in particular: “*The methods of financing the acquisition and the arrangements therefor: the notifier shall indicate in particular whether the acquisition is being financed with equity or debt, the main features of that debt, and, where applicable, the main guarantees given or received by the notifier. The notifier shall also indicate what portion of its holding, if any, it obtained through securities loans.*”

- **Idea n° 3 – Introduction of a code of good practice for proxy advisers:** In view of the increasing importance of the role played by proxy advisers vis-à-vis institutional investors, introduce a European code of good practice for proxy advisers and/or encourage proxy advisers to be subject, on a voluntary basis, to the control of the European securities and markets authority or, when applicable, the national authorities, in order, in particular, to monitor any potential conflicts of interest that the proxy advisers may have, following the example of what happens in the United States where certain proxy advisers have registered with the Securities and Exchange Commission on a voluntary basis.

Several recommendations have been put forward by the Working Group pursuant to which proxy advisers are asked to:

- Publicly disclose the general principles used to prepare their analysis reports (“policy guidelines”). If the proxy adviser has contacted the issuer, include, when applicable, the issuer’s point of view in the report, and mention the frequency of meetings with the issuer. Failing this, explain in the analysis report the reasons why, if this is the case, the recommendations were not communicated to the issuer prior to the general meeting (“comply or explain” principle applied to proxy advisers).
 - Ensure proxy adviser teams have the necessary level of qualification to be able to understand the specificities of issuers’ jurisdictions.
 - Publicly disclose, in the analysis report, the relationship – if any - between the proxy adviser and the issuer (provision of services) which could place the proxy adviser in a situation of conflict of interest and the measures taken to avoid and manage any of these potential conflicts of interest.
- **Idea n° 4 – Promote internet voting:** Continue to encourage Member States to take the measures necessary to promote internet voting.
 - **Idea n° 5 – Proceedings at general meetings:** Encourage the introduction in the Member States of a practical guide on proceedings at general meetings which could be addressed to issuers, general meeting committee members and organisers of general meetings and would be available to all shareholders so that they can better understand the proceedings at general meetings. Then define a common basis of good practice for proceedings at general meetings within the European Union.

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COMPOSITION OF THE CORPORATE GOVERNANCE GROUP

Patrice AGUESSE	AMF
Daniel BARLOW	MINISTRY OF JUSTICE
Odile DE BROSSES	AFEP
Marielle DE CONINCK	TOTAL
Dominique DE COURCELLES	CNRS
Youssef DJEHANE	GIDE
Jean-Baptiste DUCHATEAU	VEOLIA
Philippe DUPEYRE	VALLOUREC
Martine ELSAKAWI	CAAM
Fabrice FAGES	LATHAM & WATKINS
Clémence FALLET	BREDIN PRAT
Michel FRIOCOURT	PPR
Elisabeth GAMBERT	AFEP
Hubert GASZTOWTT	DGTPE
Marie-Hélène HUERTAS	VIVENDI
Corinne JACQUIOT	SOCIETE GENERALE
Didier KLING	KLING
Didier MARTIN	BREDIN PRAT
Anne OUTIN-ADAM	CCIP
Didier PORACCHIA	UNIVERSITY OF AIX EN PROVENCE
Serge ROGNON	L'OREAL
Emmanuel SUSSET	DGTPE
Jean TARRADE	NOTAIRE
Jean-Paul VALUET	ANSA
Edouard VIEILLEFOND	AMF

INTERVIEWS CARRIED OUT BY THE WORKING GROUP

Tuesday 29 September 2009

Mrs Viviane JOYNES and Mr David DANDO (HQB PARTNERS)

Tuesday 20 October 2009

Mrs Colette NEUVILLE (ADAM)

Mrs Viviane NEITER (APAI)

Tuesday 24 November 2009

Mrs Eliane ROUYER (CLIFF)

Mrs Carla TOPINO (GLASS LEWIS & CO)

Tuesday 22 December 2009

Mr Pierre BOLLON and Mrs Valentine BONNET (AFG)

Mrs Martine ELSAKHAWI (CAAM)

Mr Pascal POMMIER (BNP PARIBAS)

Mrs Catherine SALMON and Mr Jean-Nicolas CAPRASSE (RISKMETRICS)

Tuesday 19 January 2010

Mr Aldo CARDOSO (Member of the board of directors of several companies)

Mr Bernard OPPETT (CENTAURUS CAPITAL)

Mr Charles-Edouard JOSEPH (BOUSSARD & GAVAUDAN)