

## THE ASSOCIATION OF GLOBAL CUSTODIANS

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June 12, 2002

### **BY AIR COURIER AND E-MAIL**

Ms. Corinne van Ginkel  
Ministry of Justice  
Department WODC (k210)  
Koninginnegracht 19  
2514 AB, The Hague  
The Netherlands

### **RE: Consultative Document on Cross-Border Voting in Europe**

Dear Ms. van Ginkel:

The Association of Global Custodians (the "Association")<sup>1</sup> appreciates the opportunity to comment on the Consultative Document on Cross-Border Voting Issues in Europe (April 2002) ("Consultative Document") released by the Expert Group assembled by the Ministry of Justice of The Netherlands. The Association welcomes the Ministry's determination to explore the barriers to cross-border voting by shareholders of listed companies in the European Union. Initiatives such as this project are key to enhancing the integration of the European capital markets and to strengthening Europe's role in the international financial system.

### **Overview of the Association's Position**

The members of the Association are committed to facilitating the ability of their clients to vote at shareholder meetings with respect to the issuers in which they hold shares. As is recognized in the Consultative Document, global custodians typically

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<sup>1/</sup> The Association of Global Custodians is an informal association of nine banks that are major providers of cross-border custody services to institutional investors. The members of the Association are listed above.

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utilize subcustodians in European and other markets to hold and service their clients' securities. In those markets where a global custodian offers proxy voting services, the global custodian will have arranged for its subcustodian -- who is typically the legal titleholder and thus the person entitled to cast the vote -- to forward proxy voting information it receives to the global custodian. The global custodian in turn delivers these materials to its clients, or to the client's investment manager or voting agent, as appropriate. Voting instructions are then transmitted back through the chain of custody to the legal titleholder and processed in accordance with the client's instructions.

Unfortunately, inconsistent practices and company laws across markets make this "chain approach" to shareholder voting difficult to implement. The Association believes that, instead of rejecting the chain approach and trying to create a substitute, the Expert Group should formulate recommendations that would remove the obstacles to its effective operation throughout Europe. These roadblocks include --

- The absence of a standardized procedure for the communication by issuers to their shareholders of meeting dates and agendas.
- The absence of standardized disclosure requirements concerning matters to be voted on.
- The lack of voting process transparency. Public companies should be required to confirm that votes tendered have been properly cast and to communicate this confirmation to the shareholder of record. There should be an audit trail by which the proper handling of votes can be verified.
- The absence of a standardized and straight-forward method for determining who is the shareholder of record entitled to vote in cases where shares have changed hands after the announcement of the meeting.
- Complexity concerning the nature and number of the voting rights applicable to particular securities and the failure of issuers to communicate this information to the first intermediary in the chain. In some cases, for example, one share may carry multiple voting rights; in others, the issuer may have imposed a cap on the percentage of votes that can be cast by a single entity.
- The refusal in some countries to accept split or partial voting. This creates difficulties in markets where the nominee concept is recognized (whereby

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financial intermediaries can validly represent their clients). If the ultimate investors have not all directed that their shares be voted in the same manner, the intermediary is unable to implement their instructions

- The practice of blocking of holdings, which is very cumbersome.

While these types of obstacles need to be removed, the Association believes that voting rights should continue to follow legal title, and that disclosure to the issuing company of the identity of the ultimate investor is not necessary to ensure that the ultimate investor is afforded the opportunity to vote. Permitting or requiring issuers to by-pass the legal titleholder would create uncertainty and confusion in the market and would have undesirable consequences for both investors and custodians.

First, the direct approach would undermine investor privacy. Various European markets have established different legal requirements relative to the disclosure of ultimate investor information to issuing companies. In a number of markets, issuing companies simply do not have a legal right to force a market intermediary to provide the issuer with identifying information concerning its clients that have invested in the issuer's securities. Many investors highly value such privacy rights. The required disclosure of investor information to issuing companies under a direct approach system would conflict with these existing rights and may have a chilling effect on investor activity in those markets.

Second, the direct approach could prove quite burdensome for the ultimate investor. Investors would be subject to an excessive number of contacts and communications from potentially hundreds of issuing companies. The investor would be required to interface with every issuer in which it holds shares in order to receive materials and to issue voting instructions. In contrast, under the chain method, the ultimate investor interfaces with its global custodian, which delivers and processes voting instructions as directed.

Third, the direct approach would impose substantial burdens on intermediaries at all levels in the chain of custody. The costs and complexity of maintaining, on an ongoing basis, current identifying information on a security-by-security basis for all underlying ultimate investors, and of establishing a mechanism to consolidate this information from all lower tier intermediaries and to transmit that information to each issuer, would be substantial. These costs and burdens would greatly exceed those associated with transmitting voting materials to the appropriate ultimate investors.

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For these reasons, the Association supports the chain approach and believes that, with improvements in the infrastructure on which it relies, the European voting system can ensure that all ultimate investors have a reasonable opportunity to participate in shareholder voting. We believe that a system that relies on the ability of intermediaries to obtain and act on voting instructions from their clients will accomplish the goal of facilitating voting without compromising other values. The decision whether or not to participate in a vote must rest with the ultimate investor.

**Comments on Questions Raised in the Consultative Document:**

The Association's comments on the specific issues raised in the Consultative Document are set forth below.

**Question 1: Do the problems associated with cross border voting described above require regulation or can they be solved efficiently and in due course by market forces?**

We believe that market forces can, in large measure, be effectively harnessed to address the existing barriers to cross-border voting. However, as discussed above, in order to effectively bring market forces to bear, some structural changes in current market practice are necessary to promote the ability of investors to exercise their voting rights in absentia through the facilities of the intermediaries through which they hold their shares. For example, the Association supports uniform regulation in the European market to require that --

- (1) listed companies on all European Union stock exchanges must furnish all shareholders of record with information concerning issues to be voted on, regardless of whether the record holder is an intermediary or an investor with direct holdings;
- (2) the record date (i.e., the date on which one must be a holder in order to be entitled to vote at a shareholders meeting) must be set a reasonable period prior to the meeting date;
- (3) listed companies must adhere to a uniform standard for timely delivery to shareholders (whether intermediaries or investors with direct holdings) of information concerning issues to be voted on; and

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- (4) the issuing company must confirm that it has accepted and recorded the votes tendered by the shareholder.

**Question 2: If the problems associated with cross border voting require regulation, do they require regulation on a European level or should and could regulation be left to the individual member states?**

As noted above, the Association supports regulation at the European level to establish certain minimum communication standards. We recognize that imposing these standards would require some countries to change their companies and securities laws. We believe that uniform standards as to these basic procedural matters in all markets within the European Union will enable a more effective and efficient voting process.

**Question 3: Do you agree with these assumptions as a basis for regulation of the problems associated with cross border voting?**

- a. **Issuing companies desire to communicate with their shareholders and to offer them structural facilities to exercise their voting rights in absentia.**

We have no basis on which to assess the desires of issuing companies. It seems likely that some issuers wish to communicate with their shareholders and facilitate the ability to vote, while others attach less importance to these goals.

- b. **The ultimate investor, as defined in the Consultative Document, should have the right of a shareholder and the practical ability to exercise the voting rights attached to the shares in his account.**

We agree that the ultimate investor should have the practical ability to exercise voting rights with respect to the investor's shares. However, we do not agree that the ultimate investor should be considered the shareholder, in the sense that the issuer should have a legal right to communicate directly with the ultimate investor or that the ultimate investor should have the right to directly cast the vote. We are concerned that such an approach would bypass the critical realities of legal title and may create parallel and perhaps inconsistent legal rights in both the ultimate investor and the legal titleholder. In a jurisdiction where the law distinguishes between legal and beneficial ownership, such an approach could be explored. However, we question whether, in

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most civil law jurisdictions, this approach would be possible without undermining the concept of legal ownership. Treating ultimate investors (as defined) as the "shareholder" would also fail to take into account the complexities identified in the Consultative Document relating to roles of fund managers, trustees, and non-European Union intermediaries. These issues can most effectively be addressed between the intermediary and its client.

In the Association's view, the Expert Group should focus, not on re-defining the legal rights associated with voting, but on promoting an infrastructure of company law and market practice that facilitates the ability of the ultimate investor to receive meeting information and to exercise its voting rights through its selected chain of intermediaries.

**Question 4: Do you think that the definitions and the principal rule as referred to above should be introduced in all member states of the European Union through a European Directive or Regulation?**

- a. **Identification:** As stated above, the Association does not believe that it is necessary to treat the ultimate investor as the shareholder, or to identify the ultimate investor to the issuing company, in order to afford the ultimate investor a reasonable opportunity to participate in proxy voting. It is sufficient that the intermediaries through which the ultimate investor holds its shares be able to identify to whom they need to transmit voting information.
- b. **Information:** We agree that the ultimate investor must receive timely and accurate information relating to the issues on which it is entitled to vote. We believe, however, that this can best occur through the intermediaries the ultimate investor has retained to assist with its investment activities.
- c. **Voting:** We agree that the ultimate investor should be able to exercise the voting rights associated with the shares, if it chooses to do so. A local market intermediary should cast votes with respect to shares of which the intermediary is the legal titleholder only when an instruction has been received from the ultimate investor.

**Question 5: Do you think in the member states of the European Union a possibility should be introduced for an ultimate investor under the definition, who is an intermediary on behalf of other parties but not a securities intermediary as defined, to designate its clients as**

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**those who are entitled to vote? How should such designation by intermediaries practically be effected?**

The question of whether an intermediary should be permitted to designate its client as the party entitled to vote would only seem to arise under the direct approach. As discussed above, the Association urges that the Expert Group not adopt that approach.

Under the chain approach, the processes by which an intermediary forwards voting information, and to whom it sends and from whom it receives voting instructions in return, are matters established between the intermediary and its client. Any system at the issuer level that seeks to determine who is ultimately entitled to vote shares that are held through one or more intermediaries on behalf of one or more investors would be extraordinarily complex and would in any event duplicate the more manageable structure already maintained by most intermediaries.

**Question 6: Do you think such a rule should be implemented in all member states of the European Union? Under what circumstances could an issuing company require an ultimate investor under the definition to disclose its clients outside the European securities holding systems? Do you think disallowing the votes cast by such an ultimate investor is an appropriate sanction for not disclosing who its clients are?**

As stated above, the Association does not believe that the ultimate investor needs to be treated as the shareholder, or needs to be identified to the issuing company, in order to afford ultimate investors a reasonable opportunity to participate in proxy voting. Therefore, the Association does not believe that a regulation requiring disclosure of ultimate investor information in connection with a voting decision is required or desirable. Moreover, as the Consultative Document recognizes, the EC's jurisdiction stops at the boundaries of Europe. An approach that can be applied regardless of the geographic location of the ultimate investor seems preferable to one that is territorially limited.

If, contrary to the Association's recommendations, a regulation were adopted requiring some form of investor disclosure, we believe that the sanction for nondisclosure should be that the issuing company may not accept the votes cast on behalf of the unidentified holder. More extreme sanctions, such as the withholding of dividend payments, are unnecessary.

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**Question 7: Which of these two approaches is preferable? Is there an alternative approach?**

As stated above, the Association supports the "chain" approach. Under procedures already in place, custodians are notified of issuing company meetings by their subcustodian (or by the securities holding system) in the relevant market. The custodian, in turn, notifies the ultimate investor and solicits its voting instructions.

We agree that the last intermediary -- the intermediary who is in direct contact with the ultimate investor -- has the responsibility to notify the ultimate investor of a shareholder meeting, based on information it receives from the intermediaries above it in the chain. However, this can only be accomplished if issuing companies adhere to uniform notification standards and practices. Without timely notification from the local market, the last intermediary may not be able to provide full service proxy voting to its clients.

We disagree with the view set forth in the Consultative Paper that the direct approach imposes less administrative burden on the securities intermediaries. Some of the unintended negative consequences that we believe may result from the direct approach are discussed above. The chain approach is currently applied in most markets where voting is administratively feasible for intermediaries; the adoption of the direct approach would require the creation and maintenance of new systems and procedures, at considerable expense. The cost of maintaining the necessary up-to-date-share registers and of building and operating issuer/intermediary interfaces would be high. These costs would ultimately be borne by investors.

If the Expert Group concludes that some form of direct communication is essential, the Association recommends a system under which those ultimate investors that wish to disclose their identity to the issuers in which they have invested, and to receive communications directly from the issuers, may do so, while other investors are not compelled to make such disclosure. See response to Question 9.

**Question 8: What type of rules must be implemented to make the preferred approach possible?**

Obstacles that currently hamper the operation of the chain approach are listed on pages 2 to 3 of this letter. The Association would support rules or changes in market

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practice to alleviate these problems. Some suggestions for the establishment of basic, procedural minimum standards are set forth in our response to Question 1.

**Question 9: If regulation is introduced that makes it possible to identify the ultimate investors, should there be an opt in or opt out possibility? Which do you prefer?**

The Association does not favor regulation that is predicated on the identification of ultimate investors. As the Consultative Document correctly points out, identifying the ultimate investor to the issuing company would raise privacy concerns. Investor privacy and investor identification are competing and inconsistent goals. As has previously been discussed in this letter, we do not believe that it is necessary to choose between these goals in order to facilitate shareholder voting. Instead, the Expert Group should focus on removing the obstacles to efficient functioning of the chain approach.

If, despite our views, the Expert Group nonetheless concludes that issuers should have the ability to communicate directly with investors, the Association would favor an opt-in approach. In the case of investors who do not affirmatively act to release their identity to the issuer, the system should facilitate their ability to receive information from their intermediary and to vote their shares through the chain approach.

**Question 10: Do you agree that the securities intermediaries should be required to certify, at the request of the issuing company, who the ultimate investor is and for how many shares he is entitled to vote, on which certification the issuing company may and must rely in determining the entitlement to vote at AGMs? Which of the approaches do you then prefer, the direct approach, the chain approach, a combination or an alternative approach?**

The Association does not support a certification requirement. The necessity for such certifications is one of practical complexities that would arise from the direct approach. In the chain approach, a certification requirement is unnecessary. Under the chain approach, the intermediary is responsible for ensuring that the voting instructions it transmits are those of the ultimate investor. The intermediary discharges that responsibility by soliciting voting instructions from the ultimate investor, and by submitting to the subcustodian only those voting instructions that the intermediary has received from the ultimate investor.

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**Question 11: To what extent does an efficient regulation of the issues mentioned in the sections B and D require a record date system? Do you think that reconciliation up to the date of the AGM is practically achievable and efficient, with the use of modern technology?**

The Association supports a uniform European requirement that the record date must be set a reasonable period prior to the meeting date. This would provide the most efficient method of determining shareholder eligibility to vote. Without a record date system, ultimate investors who purchase securities just prior to a meeting are entitled to vote, but may be unable to exercise their voting right due to the time required to solicit their voting instructions. A record date requirement would also relieve the administrative burden on issuers or intermediaries of performing a detailed reconciliation of trading records to determine who is eligible for voting.

**Question 12: Do you think there should be one uniform system in the European union with respect to the issues raised in questions 10 and 11?**

The Association believes that there should be one uniform system in the European Union with respect to the issues raised in Questions 10 and 11.

**Question 13: Do registered shares and bearer shares require a different kind of regulation of the issues mentioned in sections B and D?**

The Association believes that holders of bearer shares should be treated the same as holders of registered shares with regard to all aspects of cross-border voting.

**Question 14: How should these issues be solved? Do you believe that they should be solved in one uniform way within the European Union?**

The Association recommends a uniform system within the European Union to address issues relating to settlement times and securities lending. We believe that, if the period between the record date and the meeting date was uniform and was of reasonable length, issues relating to settlement times would be eliminated.

The Association does not believe that securities lending unfairly deprives the lender of the ability to exercise the right to vote. As the Consultative Document recognizes, securities lending plays a critical role in maximizing market liquidity. Shareholders that participate in a lending program obtain economic benefits. In exchange, such shareholders agree to surrender their voting rights in favor of the

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borrower. If the lender wishes to vote at a particular meeting, the lender may recall the securities on loan.<sup>2</sup>

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The Association appreciates the opportunity to comment on the issues raised in the Consultative Document. We look forward to the Expert Group's final report on cross-border shareholder voting. If you have any questions concerning this letter, please contact the undersigned at 202/452-7013.

Sincerely,



Daniel L. Goelzer  
Counsel to the Association

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<sup>2/</sup> The Association believes that the description of issues presented under the heading "Settlement Times and Securities Lending" in the Consultative Document may contain some incorrect interpretations of cross-border settlement practices. For example, we believe that the illustration provided of a sale from the United Kingdom to Germany is incorrect; the buyer does not receive title before a seller surrenders title. Association members would be pleased to discuss cross-border settlement practices with the Expert Group.