

Empty voting

Q1: Please identify the different types of empty voting practices and the frequency with which you think they occur within the EU. Where possible, please provide data supporting your response.

Some types of empty voting practices can be found in the following situations:

Firstly, the situation when shares are bought and sold between the record date and the general meeting date. In this case, it is impossible to accurately identify the ownership of the beneficial owners on the record date who are granted with the right to vote. As the number of shares traded within this interval increase, so the number of shares subject to empty voting at the shareholders' meeting increases. In our opinion, this is the most encountered type of empty voting within the EU.

Due to the large market in borrowing and lending shares for various purposes, and due to the fact that the respective shares are entitled to the vote, the so called “over voting” phenomenon arises. This means that for the same number of shares a larger number of votes are registered, comparing to the actual number of shares. Most beneficial owners have no idea whether their shares have been lent to third parties by their custodian agents and as a result believe, wrongly, that they have the right to vote the lent shares held in their accounts. In the same time, the borrowers believe they have acquired the right to vote pertaining to the borrowed shares.

Moreover, borrowing shares immediately prior to a record date and repaying the shares immediately after the record date can be used by hedge funds or other type of investors to acquire a large number of voting rights at a small cost with practically no exposure.

Modern hedging techniques permit investors to separate ownership of the economic risks of stock from ownership of the right and ability to vote those shares. As a result, activist investors sometimes create large hedge positions solely to gain the vote, while avoiding

economic exposure to the market. These empty voting positions are used solely to affect the outcome a shareholder vote.

Q2: Please identify specific examples where empty voting practices have occurred within the EU? Where possible, please provide data supporting your response.

As previously mentioned, an example of frequently occurring phenomenon is when the same share is voted twice. This is commonly the result of the vast increase in share lending that now permeates the equity markets. Developed in the context of short sales, the practice of share lending has dramatically increased in the recent years and frequently represents a significant source of income for investors and for brokers and other custodians. The lent shares being are accompanied by full voting rights, so that the party borrowing the stock or its transferee can vote the shares which it holds on a record date. If, however, as frequently happens the lending party is a custodian which does not allocate the lent shares to and notify specific beneficial account holders, it is possible that both the lending beneficial owner and the borrower will vote the shares and over-voting will occur. Nor will over-voting be readily noticed if the total number of proxies cast by the custodian does not exceed its book position at the record date.

Q3: a) What in your view are the negative consequences that can occur as a result of empty voting (relating to e.g. transparency, corporate governance, market abuse)? Where possible please provide data supporting your response.

While the trader may sometimes reduce efficiency by ultimately selling to a net short position and then voting the wrong way, from a firm value perspective, the cost of these possible manipulations can be offset by a greater probability that the trader will vote the right thing and vote to maximize firm value. In other words, in equilibrium both the presence of the strategic trader and the ability to separate votes from economic ownership can increase overall efficiency by making the right outcome more likely to appear. This occurs when either the establishment of an empty voting stake on the record date is relatively expensive or other shareholders' votes are not very highly correlated with the true state. However, a negative efficiency effect is likely when separating votes from shares is relatively inexpensive and other shareholders are relatively likely to vote the right way.

Vote trading in the share lending market can increase efficiency because information about proposals can be costly to acquire.

b) To what extent do you consider those consequences to occur in practice?

We cannot know how often empty voting occurs, either by accident or by design, nor do we have a very good idea of how often it is the measure of difference in a shareholder vote.

c) To what extent have you encountered those consequences in your own experience?

In our experience, the practices related to empty voting did not occur so far.

Q4: a) Do you believe that empty voting has influenced the results of voting at the general meeting of shareholders within the EU?

Some hedge funds may use “empty voting” to manipulate shareholder vote outcomes and generate trading gains. This practice is possible even when one share, one vote is the explicit rule.

In our opinion, empty voting practices affecting the voting results occur frequently, especially in cases of large companies traded on an exchange, where the number of shareholders is large. The shares are subject to empty voting, as they are bought before the recording date and then sold by investors in order to make profit.

b) Has this ever occurred in your own experience? Where possible, please provide data supporting your response (including the type of empty voting that you are referring to).

In our experience, these practices related to empty voting did not occur so far.

Q5: What kind of internal policies, if any, do you have governing the exercise of voting rights in respect of securities held as collateral or as a hedge against positions with another counterparty?

In our company, the voting rights afferent to the securities held as collateral or as a hedge against positions with another counterparty remain assigned to the beneficial owner of the respective securities.

Q6: Do you think that regulatory action is needed and justifiable in cost-benefit terms? If so, which type of empty voting should be addressed and what are the potential options that could be used to do this? Please provide reasons for your answer. Kindly also provide an estimate of the associated costs and benefits in case of any proposed regulatory action.

In our opinion, regulatory action would be needed for preventing and limiting the empty voting practices, but we cannot know the extent to which it is controllable. Moreover, the costs associated to it could prove to be relatively high. The process of buying and then selling shares should be better monitored, especially when this occurs around the registration and the payment date.

Some form of regulation, like additional disclosure requirements, could prove necessary to reduce the negative effects of the empty voting practices. Regulators have expressed significant concern over empty voting, particularly due to the boom in the hedge fund industry and the increasing number and importance of items requiring a shareholder vote. The practice of empty voting is almost certainly going to force further regulatory response to ensure that investors' interests are protected.

Corporate law makes voting power proportional to economic ownership. In this way, economic ownership gives shareholders incentives to exercise voting power well. The coupling of votes and shares makes possible the market for corporate control. Theory, as well as evidence supports the importance of linking votes to economic interest. Yet the derivatives revolution and other capital markets developments now allow both outside investors and insiders to readily decouple economic ownership of shares from voting rights. This issue remains mostly untouched by current regulation.

A second problem with some potential regulatory responses is that the variety of hedging strategies and the substitutability of one strategy for another makes restrictions on empty voting hard to draft and hard to enforce. Enhanced disclosure may provide the information needed to write substantive rules to limit empty voting.

Another solution would be to eliminate the time gap between the record date and the meeting date. A cause of some of the empty voting opportunities is the relatively long time gap between record and voting dates. Elimination of that gap would reduce the empty voting practices, and in the same time would help in keeping track of the borrowed and lent shares. The record date could be as late as the close of business on the night preceding the meeting, with a voting period at or in conjunction with the meeting lasting several hours or perhaps a full working day. Assuming the various book entry systems supporting the equity markets could be put into connection electronically, voting could likewise be electronic, and a real time voting system should be feasible.