

25 November 2011

To Whom It May Concern

Please find enclosed the Hermes Equity Ownership Services response to the above consultation.

By way of background, Hermes is one of the largest asset managers in the City of London. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from around Europe and the world, including Lothian Pension Fund, PNO Media (Netherlands), Canada's Public Sector Pension Investment Board and VicSuper of Australia; (only those clients which have expressly given their support to this response are listed here).

We are grateful for ESMA's attention to this issue. We regard empty voting as a rare but troubling phenomenon the threat of whose existence serves to undermine confidence in capital markets.

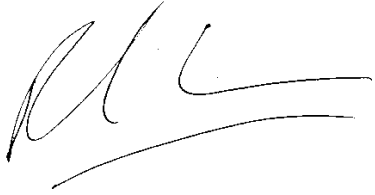
We have long argued that voting borrowed stock should be deemed market abuse, and indeed we are puzzled as to why anyone argues against this approach. All parties to the stocklending market agree that it is not appropriate to vote borrowed stock. This approach does not have any implications for those who buy stock that has been borrowed – they clearly buy stock and are economically exposed in the same way as all shareholders that is unencumbered and so need to be able to vote – the bar on voting would apply only to the party which itself has borrowed the stock. We believe that establishing this rule would go a long way to removing the current degree of concern about empty voting. We believe that voting borrowed stock is market abuse because a party is attempting to exercise the rights of ownership without paying the market price for ownership. The market price thus cannot adjust to reflect this control seeking behaviour. The bulk of the market is thus misled as to the appropriate value for the shares.

We would also take this opportunity to repeat our regular call that the record dates for dividends should be separated as far as possible from AGMs and their record dates. Given that such a proportion of lending is driven by tax arbitrages in relation to dividend payments, ensuring that these dates are significantly separated will reduce the level of lending at the crucial moment for voting purposes. This will both boost the level of voting by long-term owners whose holdings might otherwise be reduced by lending and it will make any abuse more apparent by reducing the background level of lending.



We answer the specific questions below.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Paul Lee', with a long horizontal stroke extending to the right.

PAUL LEE
Director

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.

We firmly agree with ESMA that voting borrowed stock is empty voting. As noted above we remain clear that this should be treated as market abuse and so subject to the regulatory constraints which apply to all activities which are an abuse of the market.

We do not share ESMA's concern about those who vote because they held the stock at the record date and have sold subsequently. This is simply a natural consequence of the record date approach to voting – the aim of record dates being to ensure there is certainty over the shareholder base at a given time so that voting rights apply. In effect, record dates are the date at which the shareholder base for the purposes of voting is fixed and certain – holders at this point are the relevant shareholders for the purposes of the AGM and EGM, not those who hold at the time of the meeting itself. The record date approach by its nature imposes this time shift. To the extent that this generates concerns and the risk of empty voting, it can best be addressed by ensuring that record dates are as close to General Meetings as is possible. We believe that the technology around voting can and should be significantly upgraded – and indeed would urge ESMA to consider how it can best facilitate such an upgrade – and we believe that the window between record dates and actual meetings can also be significantly reduced as part of such an upgrade. We would welcome discussions on how such an improvement to voting infrastructure could be effected.

Further on the issue of record dates, the discussion in the literature which we have seen about empty voting in relation to record dates indicates that abuses have typically occurred through the voting of borrowed stock and so we believe that abuse can best be addressed through an approach to this issue.

In all the discussion which follows we use the term empty voting to mean the voting of borrowed stock, not the voting of stock because of record date entitlements where the shares have been sold prior to the General Meeting.

We are not aware of significant events of empty voting beyond those that have already been directly alleged or considered in business media and in academic journals (for example, British Land, Mylan Pharmaceuticals, Henderson Land). By its nature, empty voting is something which occurs in the shadows and thus is not apparent to most active participants in the market. However, the mere concern that it occurs is damaging to confidence in European markets. We

believe that the market abuse approach to the voting of borrowed stock is a measured and appropriate approach to these concerns.

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

As discussed above, we are not aware of specific instances beyond those which have already been broadly discussed in the press and journals. The shadowy - indeed secretive - nature of empty voting means that we are not aware of any data being available.

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)?

The consequences are that votes can be cast against the interests of long-term owners. This can lead to the removal of certain directors, the appointment of others, and corporate actions being approved or blocked in ways which serve the interests of those employing empty voting but not those of other shareholders.

A further consequence is also lower confidence in the market prices of European shares because where borrowed stock is voted these prices will not reflect the control premium which ought to be paid by those seeking to exercise ownership rights, as discussed above.

A knock-on consequence is a nervousness among long-term shareowners that their stock subject to lending programmes may be borrowed and subject to empty voting, which we regard as an abuse of the market. A number of our pension fund clients are so concerned about this risk that they ask us to produce a list of companies which we fear may be subject to such untoward activities, so that they can consider whether to withdraw those stocks their lending programmes. This we believe does lead to some of these pension funds choosing to block lending of some of these stocks. These long-term owners are prepared to give up some of their income from lending to protect their interests from potential abuse.

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

Significant changes at companies arising from empty voting are rare, but the consequences of such instances are very substantial indeed.

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

The British Land incident in 2002 drew our attention to the significance of this issue and the scale of the risks surrounding it. Specific instances since then are hard for us to identify given the secret nature of empty voting, and we believe our efforts to manage stocklending more actively since have reduced the risk of our own direct exposure to empty voting risks.

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

(b) Has this ever occurred in your own experience?

Answers as above in response to Q3.

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?

Given our approach to see such activity as market abuse, it should not come as a surprise that we do not vote stock held as collateral or a hedge.

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.

We do not believe that there would be significant costs to deeming the voting of borrowed stock as market abuse. As with other activities which are deemed market abuse, the regulators need only become directly involved in any costs as and when they investigate an incident, and we believe that the costs of any such investigation would be more than justified by the significant benefits to practitioner confidence in the proper functioning of European capital markets. This approach would also not impact on the market generally because only those seeking to abuse the market would feel constrained.