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Cross-border share voting and improving voting chain deficiencies in the 21st century

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Abstract: The purpose of this paper is to explore current difficulties with shareholder engagement in the 21st century in light of complex cross-border voting chains. To improve the quality of shareholder engagement, the study recommends that cooperation between countries needs to be strengthened by improving information flow and transparency. Better disclosure is a fundamental step to improving information flow and cross-border voting. There are a number of legal and practical hurdles in relation to cross-border voting. As it is unlikely that the length of the voting chains will be reduced owing to the inherent structure of the ownership model, a combination of legislative modifications and improved voting facilities with reduced costs are necessary. The initial strong compliance to the concept of 'stewardship' in the UK is difficult to sustain owing to the inherent structure of the complex, equity chain model.

Keywords: cross-border voting; shareholder engagement; shareholder activism; institutional investors; share ownership model; stewardship.

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Biographical notes: Alison Lui is a Lecturer of Law at Liverpool John Moores University. Her first degree is from the University of Bristol. She subsequently obtained a LLM from the London School of Economics and a PhD from University of Liverpool. She qualified as a Solicitor and practised commercial law before entering academia.

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1 Introduction

This paper aims to investigate the value of shareholder engagement and explore current difficulties with shareholder engagement in the 21st century. Whilst the support for the Codes is generally positive, the quality of shareholder engagement is mixed. This is owing to a number of hurdles: first, there is poor cooperation across borders.

Information flow is weak and cross-border voting is problematic. Secondly, cross-border communication has also proved to be difficult. With overseas institutional investors holding approximately 42% of shares in the UK market (Office for National Statistics, 2010), communication has been faceless and from afar. The author will address these problems by reviewing the current literature on stewardship and shareholder engagement. In particular, she will review the EU Green Paper on Corporate Governance Framework; EU Green Paper of Financial Institutions; the Financial Reporting Council's response to both of the EU Green Papers. She will also review the 'Shareholder Spring' phenomenon in the UK and Europe in 2012. Bank shareholders are particularly vociferous in their views on executive compensation. 'Say on Pay' has spread to strategy and succession planning. The author will discuss whether this trend is here to stay. It is seen that well-targeted shareholder-centric activism is necessary to improve corporate governance in the UK and Europe.

Scepticism over shareholder engagement has been expressed as early as 1932 by Berle and Means (1932). In modern corporations, managers decide how a corporation's capital is spent, how resources are allocated and what endeavours the corporation undertakes. They do not however, own the capital or resources. Those in control of the corporation, and therefore:

“in a position to secure industrial efficiency and produce profits, are no longer, as owners, entitled to the bulk of such profits... The explosion of the atom of property destroys the basis of the old assumption that the quest for profits will spur the owner of industrial property to its effective use.” (Berle and Means, 1932)

Thus, separation of ownership and control of a company has turned a shareholder into a “supplier of capital, a risk-taker pure and simple, while ultimate responsibility and authority are exercised by directors and ‘control’” (Berle and Means, 1932). According to Berle and Means, shareholders are ‘quasi-partners’ who had “surrendered a set of definite rights for a set of definite expectations” (Berle and Means, 1932). With only a set of expectations, it is understandable why shareholders have generally been passive in monitoring the activities of managers, especially in the US, where shareholders enjoy less legal protection. In contrast, shareholders in the UK have been more active than in the US primarily owing to stronger legal protection in the UK. UK shareholders are better protected than their US counterparts in relation to calling general meetings, making shareholder proposals and electing company directors (Warner, 2009). In addition to statutory protection, the UK has called for shareholder activism through soft law. The Cadbury Committee of 1992 (Committee on the Financial Aspects of Corporate Governance, 1992), the Hampel Committee of 1998 (Committee on Corporate Governance: Final Report (The Hampel Report), 1998) and the UK Combined Code (Financial Reporting Council, 2003) (now Corporate Governance Code) all encouraged shareholder engagement.

Nevertheless, the financial crisis of 2007–2009 revealed that UK institutional investors failed to engage with investee companies and they exited the market when certain share prices dropped (Warner, 2009). Institutional investors engaged in proprietary trading rather than acting on behalf of the investors. This was driven by performance and investment culture in the financial industry. Lord Myners commented that this culture has led to hedge funds being ‘ownerless corporations’ (Warner, 2009). His fiercest attack on institutional investors however, is on their passive nature.

Institutional investors failed to monitor and challenge the boards of the investee companies. The House of Commons Treasury Select Committee Parliamentary Commission on Banking Standards's Final Report 2013 expressed the view that institutional investors are unlikely to "exercise profound and positive influence on the governance of bank" (House of Commons Treasury Committee, 2013). This is owing to the fact that shareholders only own around 2–3% of capital in banks. Further, institutional investors tend to hold shares on behalf of their clients for short-term purposes (House of Commons Treasury Committee, 2013). The author agrees that it is unrealistic to expect a sudden increase of shareholder activism because 42% of company shareowners in the UK are based overseas. This presents difficulties in voting and communicating with company directors. However, shareholder activities exhibited in the 'Shareholder Spring' phenomenon showed some positive influence on governance matters such as remuneration and removal of directors. Sir David Walker (Walker, 2009) recommended that institutional investors should actively engage with individual investors. He thus recommended the Stewardship Code, which was published in 2010. The Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders. The Stewardship Code in particular, sets out the responsibilities of institutional investors owed to the individual shareholders. Under the Stewardship Code, institutional investors should:

- publicly disclose their policy on how they will discharge their stewardship responsibilities
- have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed
- monitor their investee companies
- establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value
- be willing to act collectively with other investors where appropriate
- have a clear policy on voting and disclosure of voting activity
- report periodically on their stewardship and voting activities (Financial Reporting Council, 2010).

Empirical evidence revealed in December 2011 that there are 234 signatories to the Stewardship Code (Financial Reporting Council, 2011). Amongst these signatories, 175 are asset managers, 48 are asset owners and 12 are service providers (Financial Reporting Council, 2011). There are now almost 260 signatories (Financial Reporting Council, 2011). This is particularly encouraging and impressive since it has only been less than three years that the Financial Reporting Council launched the Stewardship Code. Although the numbers are encouraging, the quality of shareholder engagement has been mixed. It is clear that improvements can be made in certain areas. Firstly, there is poor cooperation between countries. Information flow is weak and cross-border voting is problematic. Secondly, communication between countries has also proved to be difficult. With overseas institutional investors holding approximately 42% of shares in the UK market (Office for National Statistics, 2010), communication has been faceless and from afar. Finally, short-termism is still a problem despite the EU Shareholders' Rights

Directive (2007/36 EC). Before the author proposes solutions to the above problems, she will review the existing literature on shareholder activism.

2 Literature review

Berle and Means's theory of separation of ownership and control of a company led to the well-known principal-agent problem (Jensen and Meckling, 1976). Shareholders are principals of companies with merely a set of expectations, having surrendered their rights to the managers, agents of shareholders. Shareholder activism is needed to monitor the managers and to ensure that the parties' interests are aligned. Bainbridge argues that this principal-agent problem did not cause the financial crisis of 2007 and that shareholder activism only "shifts the locus of the problem" (Bainbridge, 2009). In his view, managerial discretion should be the default position since it is economically efficient and vital to preserve directors' authority. Director 'fiat' carries weight and keeps shareholders content (Bainbridge, 2005). He believes that the issue of agency costs has been unnecessarily debated since company directors are in practice, made accountable through legislation and regulation. Shareholder activism would only interfere with management because intervention is often too late (Bainbridge, 2009).

Bainbridge's view is echoed by two other American corporate governance scholars, Hutchison and Alley. Hutchison and Alley (2008) believe that shareholders are hardly powerless since they will sell their shares rather than voice their opinions. Further, it is economically more efficient to run corporations without shareholder participation. There is little incentive for shareholders to take an active part in monitoring company managers. Hill (2010) explains that traditionally, the US corporate law system focused on protection of shareholders whilst the UK and the European systems increased protection to shareholders. The preamble to the US Sarbanes-Oxley Act 2002 confirms the reluctance to shareholder empowerment: "an Act [t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes". The Sarbanes-Oxley Act does not, however, provide any greater opportunities for shareholder activism. Becht et al. (2010) argue that UK institutional shareholders are more active than US ones because the UK's company law is more generous with shareholder rights. Institutional shareholders are also more organised in the UK and frequently act collectively (Becht et al., 2010). The UK Companies Act 2006 and the EU Shareholder Rights Directive (2007/36/EC) confer greater shareholder rights to shareholders in relation to amending the Articles of Association; calling general meetings and electing directors. Increased shareholder rights in the UK are accompanied by the 'enlightened shareholder approach' where shareholders' interests prevail. Under section 172 Companies Act, directors have to "promote the success of the company". Keay and Adamopoulou (2012) studied the annual reports of 50 UK companies recently to see whether shareholder value is still prevalent after the Companies Act 2006 was passed. Their results showed that whilst shareholder value still plays an important role in UK corporate governance, it is not as influential as it used to be. The 'enlightened shareholder approach' has largely been incorporated into most companies' outlook.

Since the financial crisis of 2007–2009, Hill (2010) asserts that US/UK corporate governance model has started to converge. US legislators have placed shareholder empowerment top on the agenda to restore faith in the market (Bratton and Wachter, 2010). Recent examples include the Securities Exchange Act Rule 14a-11, a new proxy

access rule requiring public companies to include the director nominees of certain shareholders in their proxy materials. Whether shareholder empowerment per se will restore faith in the market after the financial crisis of 2007 is yet to be discovered. Empirical evidence to date shows mixed results. Academics such as Nesbitt (1994), Smith (1996) and Anson et al. (2004) have showed that pressure exerted by powerful pension funds such as the California Public Employees' Retirement System did not necessarily lead to better performance in the investee companies (English et al., 2004). The same argument can be applied to public pension funds (Del Guercio and Hawkins, 1999). Research from Gompers et al. (2003) however, showed that amongst 1500 large firms, those with stronger rights had higher firm value, higher profits, higher sales growth and lower capital expenditures. Thus, there is a positive correlation between stronger shareholder rights and corporate performance. Buchanan et al. (2011) conducted empirical research into 757 US firms and 85 UK firms between the period of 2000–2006. In contrast to previous empirical evidence, their results revealed that shareholder proposals had a positive impact on firm performance and significant effect on corporate policies. Becht et al. (2010) reviewed all forms of public and private engagement with 41 companies. They had unlimited access to Hermes' resources such as reports, transcripts of telephone conversations which documented the work with the companies in which Hermes' UK Focus Fund invested over the 1998–2004. They found that when the engagement objectives led to actual outcomes, there were economically large and statistically significant positive abnormal returns around the announcement date. On these results, Becht et al. (2010) concluded that shareholder activism can produce corporate governance changes that generate significant returns for shareholders. The contrasting results of all these empirical studies are most likely owing to the researchers using different variables. Also, the studies which show a lagged correlation between shareholder engagement and financial benefits had access only to public information and owing to the private nature of many negotiations it is unlikely that some of the activism was made public (Carleton et al., 1998). In contrast Becht et al. (2010), who found a very strong and positive relationship, had rare access to material which was mostly unavailable to the public. They were able to factor this information into their research.

Increased awareness and participation by shareholders in investee companies has become the trend in both the US and UK. The contemporary corporate governance issue is not therefore, whether one should encourage shareholder activism. Rather, the issue is how we should improve the quality of shareholder engagement with investee companies. It is argued that shareholder engagement per se is only a means in itself in improving corporate governance. It has to work in conjunction with other initiatives such as better risk management, regulation and enforcement. Indeed, this is the approach endorsed by the European Commission's Green Paper Corporate governance in financial institutions and remuneration policies of April 2010 (European Commission, 2010). The European Commission acknowledged that regulation alone will not solve behavioural patterns. They called for a holistic review of corporate governance, including changes to risk management; board of directors; external auditors; supervisory authorities and shareholders. The European Commission believes that the major stakeholders within an organisation should take lead roles. Shareholders should thus engage more with the investee companies (European Commission, 2010). The EU Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies (European Commission, 2010) state that short-termism is still a hurdle to better quality of shareholder engagement in the UK. The 'Shareholder Spring' phenomenon in the UK in early 2012 seems to

dispel the long-held view that shareholders are passive. UK shareholders are increasingly vociferous in the views regarding executive compensation. The second part of this paper will deal with this. Wider participation and engagement by overseas institutional investors are required to ensure that all institutional investors are operating on a level playing field. Cooperation on national and global levels are thus necessary. The author will now address the hurdles to shareholder engagement.

3 Hurdles to shareholder engagement

The concept of shareholder engagement promotes shareholders' obligations to monitor companies. It also asks shareholders to engage in dialogues between shareholders and company directors. This emphasis is a shift from the previous position of focusing on shareholders' rights. After the financial crisis of 2007, investors, especially institutional investors of financial institutions, have been criticised for not playing an adequate role in scrutinising companies (Warner, 2009). Dispersed ownership in the UK makes it difficult for individual investors to monitor companies. With Northern Rock, 144,000 of the 180,000 shareholders were found to be individual investors with small shareholdings (Wen and Zhao, 2010). They lacked information or influence to monitor the board's performance. The creation of the role of Senior Independent Director under the Walker Report (Walker, 2009) should hopefully improve communication between shareholders and directors. The Senior Independent Director should be accessible to shareholders if the Chairman is unavailable. The Walker Report can be viewed as an attempt to steer away from the 'exit' approach and towards the 'voice' mechanism by strengthening the roles of both shareholders and non-executive directors. The rationale behind this is to build up good long-term relationships between the owners and managers of a bank. The emphasis is on shared interests and cooperation.

Harbinger Capital Partners, SRM Global and RAB Special Situations are three hedge funds which owned shares in Northern Rock before it was nationalised on 22 February, 2008. There is little empirical evidence as to how active these hedge funds were in monitoring Northern Rock prior to the financial crisis. Harbinger Capital Partners are now playing an active role in challenging the value of Northern Rock shares (<http://www.northernrockvaluer.org.uk/tribunal-documents.aspx>). Recent empirical evidence in the UK revealed that institutional investors are generally passive. Simon Wong, a partner at Governance for Owners, states that passive fund managers should easily become stewards in theory (Wong, 2010). This is because passive funds managers aim for long-term gains in the share market without any forecasting. This is in line with the long-term nature of stewardship. In practice however, most passive fund managers allow little time or resources for stewardship or engagement of the investee companies (Wong, 2010). Wong noted a particularly worrying feature: a particular UK exchanged trade fund has decided to rely on stock lending instead of charging management fees to generate income (Wong, 2010). Stock lending is common practice as it improves liquidity in the market and investors will make significant gains gradually (Hermes Fund Managers Limited, 2013). Stock lending however, would harm stewardship because this ends the opportunity for investor and investee company to engage in dialogues. Further, conflicts of interest may arise as an asset manager may wish to keep shares rather than sell them to maximise profits for investees. Incentives are thus misaligned and this is a reflection of the agency problem.

Empirically, there is evidence that the decisions of institutional investment managers are affected by agency considerations. Brown et al. (1996) have found evidence that mutual fund managers act like chess players, where they have a strategic plan and make changes to the risks that they take. This is in response to their performance, which is rated. Chevalier and Ellison (1997) provide more detailed evidence on risk taking and the incentives created for mutual fund managers by the funds flow-performance relationship, and Chevalier and Ellison (1999) find evidence of junior fund managers having more conventional risk portfolios than senior managers. Junior fund managers are concerned with their job prospects and are thus more risk averse.

The European Commission's Green Paper of 2010 found that the separation of ownership and control model illustrated problems in the financial crisis of 2007. Incentives were misaligned; the multiple agents/intermediaries in the chain magnified risk-taking, which was driven by short-term targets. Shareholders failed to take an active role in monitoring investee companies owing to costs of engagement, conflict of interests, loss of responsibility owing to the long intermediary chain and cross-border voting difficulties. It has therefore launched a review into improvements of corporate governance of companies in general (European Commission, 2011a) The author has discussed the multiple agency problems in banking elsewhere (Lui, 2011) but it is important to note that the multiple agency problem exists in cross-border voting. Voting at annual general meetings is important to investors, especially so if they are playing active roles as stewards. Clear, accurate and useful information is necessary for informed decisions. In its Green Paper of 2011, the European Commission called for more transparency in voting policies and disclosure of general information about their implementation while respecting the equal treatment of shareholders (European Commission, 2011b) Transparency is difficult to achieve when information transcends boundaries. As we have seen earlier, overseas institutional investors now own approximately 42% of UK public companies (Office for National Statistics, 2010). Yet, the 'Achilles' heel of the UK Stewardship Code is that it only targets domestic institutional investors and thus overseas institutional investors are not bound by the Stewardship Code (Cheffins, 2010). Cheffins argued that this is a lacuna which needs to be remedied. Overseas institutional investors play an important role in improving corporate governance practice globally (Mallin, 2008). Owing to the physical separation and distance, overseas institutions are more willing to voice their opinions, while domestic investors who have business dealings with companies at home may feel obliged to remain loyal. For example, BusinessWeek (2006) reported that Fidelity Investments was more aggressive on governance issues in Europe, but passive in comparison in the USA where it manages several corporate pension accounts.

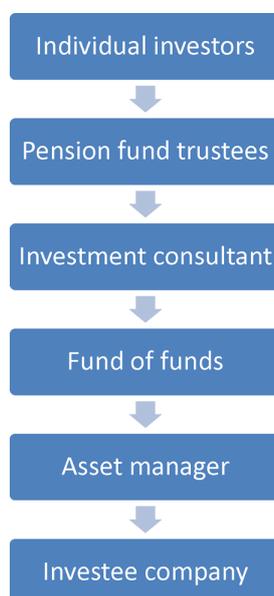
The disclosed voting turnout in AGM meetings in 2013 of FTSE 350 companies is 69.19% in comparison in 70.08% in 2012 (Computershare Investor Services Plc, 2013). The voting percentage in 2009 is 59.80%; 65.15% in 2010 and 67.20% in 2011 (Computershare Investor Services Plc, 2013). According to Jean-Nicolas Caprasse, European governance head at Institutional Shareholder Services: "Shareholder participation at UK meetings significantly increased for 2011 [up from 68% in 2010] following the implementation of the Stewardship Code" (Sullivan, 2011). It is evident that shareholder participation in the UK has improved since the implementation of the Stewardship Code. Good voting turnout at AGMs does not necessarily lead to better engagement as shareholders can purely make noise rather than constructive suggestions. Yet, shareholder engagement in some UK companies such as Aviva, AstraZeneca and

WPP during the ‘Shareholder Spring’ period shows that shareholders can play a positive role in corporate governance by removing non-performing directors and challenging executive pay packages.

4 Hurdles to cross-border voting

The real hurdle in shareholder engagement is the long and complex voting chain. Even if the Stewardship Code targets overseas institutional investors, practical measures have to be taken to improve information flow and costs to encourage shareholders to vote, especially across countries. At the European level, institutional investors encounter a poor flow of information (European Commission, 2010) The flow of information is poor owing to a long chain of intermediaries in ownership of shares by institutional investors. Further, there is poor cooperation between the parties involved. The author will highlight the specific issue of agency problem in share ownership of pension funds. Indeed, the phenomenon of ‘separation of ownership from ownership’ is recognised at the judicial level: Delaware Chancery Court Judge Leo Strine is of the opinion that this multiple layer of intermediaries ‘presents its own risks to both individual investors and more generally to the best interests of our nation’ because fund managers may be as likely ‘to exploit their agency [as] the managers of corporations that make products and deliver services’ (Wong, 2010).

Figure 1 Example of a long chain of intermediaries in a share purchase (see online version for colours)



Source: Wong (2010)

Information is a commodity and free flow of information is important to investment decisions. Unfortunately, the current European system of buying shares is too complicated. There are too many parties involved in the process. If a UK fund wants to

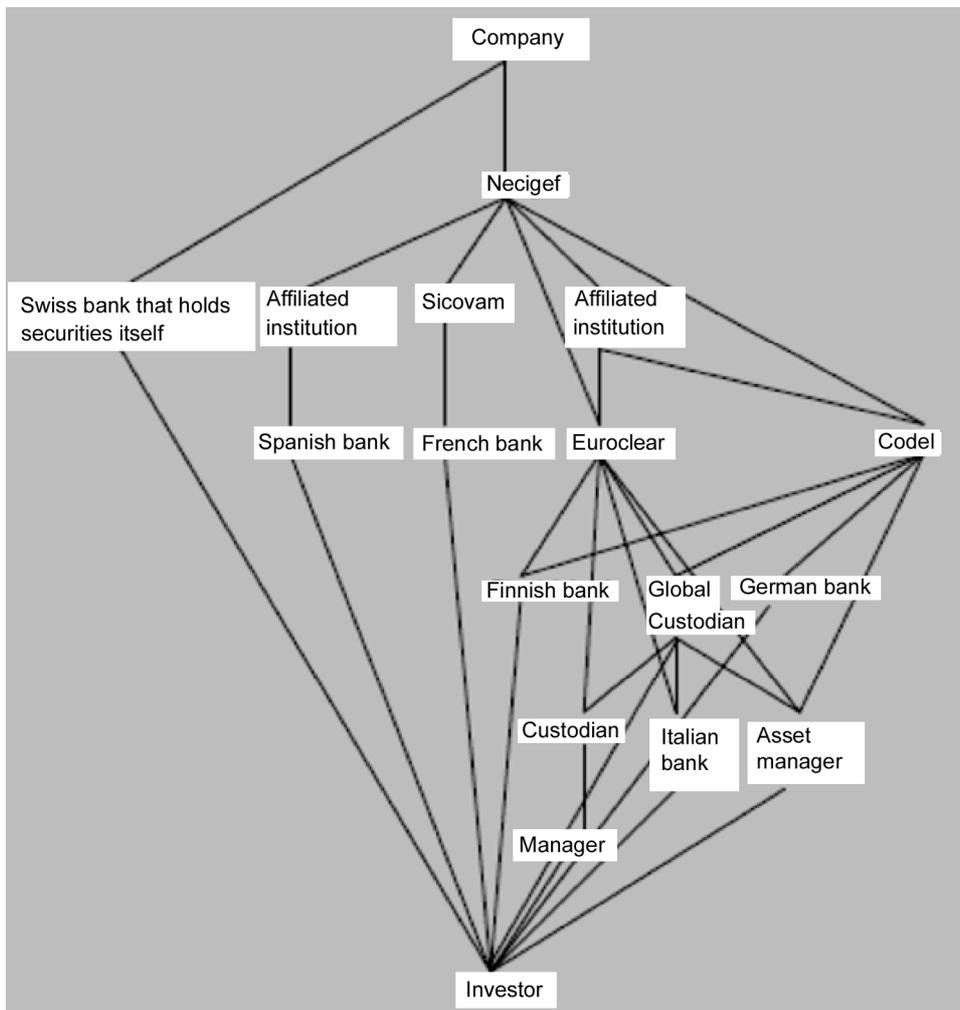
buy shares in France, the fund needs to appoint a custodian in the UK, which uses a global custodian and then uses a French bank to hold the shares. Spanning intermediaries across different countries make it hard to ascertain who has the legal right to vote. Further, if an investor in France has owned shares for more than two years, he accumulates more voting rights as a reward for long-term ownership. Long-term ownership of shares should in theory encourage responsibility and thus improve shareholder engagement. The French system however, has revealed some weaknesses. First, the division of controlling shareholders with more voting rights from minority shareholders has left the latter vulnerable. Controlling shareholders have more information and are more likely to participate in the firm's management. This increases the likelihood of exploiting minority shareholders. In fact, this creates an agency conflict between controlling and minority shareholders (Ben Ali et al., 2009). Controlling shareholders have more information and voting rights, so the incentive for managers to disclose information reduces accordingly. Secondly, there is the added bureaucratic burden where custodians have to be changed to exercise those additional voting rights with the French system (Greene, 2010). Figure 1 provides a clear illustration of the long chain of intermediaries in share purchase.

Figure 2 below reveals a concrete example of securities ownership in a Dutch company. Schouten's illustration demonstrates that often, it is the financial intermediary who votes rather than the ultimate investor. For example, in the second left relationship shown in Figure 2, there are three financial intermediaries: first, Necigef; secondly, an affiliated institution of Necigef and finally, a Spanish bank (Schouten, 2009). Under sections 15 and 39 of the Giro Securities Transactions Act 1977, it is the Spanish bank which is entitled to vote, not the ultimate investor.

To reduce the agency problem and flow of information, it has been suggested that there should only be three parties in the ownership chain, namely investors, intermediaries and investee company (Greene, 2010). Jean-Nicholas Caprasse suggested a 'push, pull and through' model to increase information flow and shareholder engagement. This model requires companies to produce more information regarding voting options before AGMs and EGMs. Companies should also send a confirmation to each investor confirming each vote free of charge. The 'pull' element reminds investors of their fiduciary obligations to vote. Finally, it has been submitted that financial intermediaries should provide voting services for free (Greene, 2010). This would reduce the free-rider problem where passive investors benefit from active investors. Zetzsche (2008) believes that cost is a major hurdle to shareholder engagement at the moment. This is particularly serious in cross-border voting and therefore reforms in reducing cost will encourage foreign institutional investors to vote. There is however, a hurdle to cost reduction at the custodian level. The European Market Standards for General Meetings ('the Market Standards') were implemented in 2010 and were intended to improve cross-border voting. The Market Standards deal with three areas: meeting announcements; notice of entitlement and notice of participation (Computershare Investor Services Plc, 2013). The UK has complied well with the market standards generally but since most of the issued share capital is held by financial organisations which act as custodians to institutional investors, voting services are affected by two problems. First, custodians are not legally obliged to provide voting services to clients. Therefore, investors have to 'opt-in' for voting services and pay the custodians (Computershare Investor Services Plc, 2013). Secondly, custodians tend to use 'omnibus accounts', where the assets of investors are mixed. The forthcoming European Market Infrastructure Regulation should simplify

the existing complex voting chain by requiring intermediaries and custodians to offer the options of omnibus client and individual segregated accounts (Computershare Investor Services Plc, 2013). Individual segregated accounts should simplify the voting process and is more transparent. However, it is more expensive since tracking individual accounts and transactions involves more work. The extra cost may be reflected in the price, which is then passed onto the investors. A solution to reduce cost is to have a tiered model of segregation with different prices attached. This will offer flexibility and options to investors.

Figure 2 Example of securities ownership in Necigef, a Dutch company



Source: Schouten (2009)

On the European dimension, the first and second Giovannini reports of 2001 and 2003 respectively discovered 15 barriers to a single post-trading market within the European Union (European Commission, 2014). A European Commission Legal Certainty Group was then established to find ways to break down the barriers. Recommendations 12–14

are of particular interest to the author since they deal with the differences in national law affecting the process of corporate actions (European Commission's EU Clearing and Settlement Legal Certainty Group, 2008). Recommendations 12 and 13a deal with removing legal obstacles in cross-border voting and recommendation 14 deals with improving information flow (European Commission's EU Clearing and Settlement Legal Certainty Group, 2008).

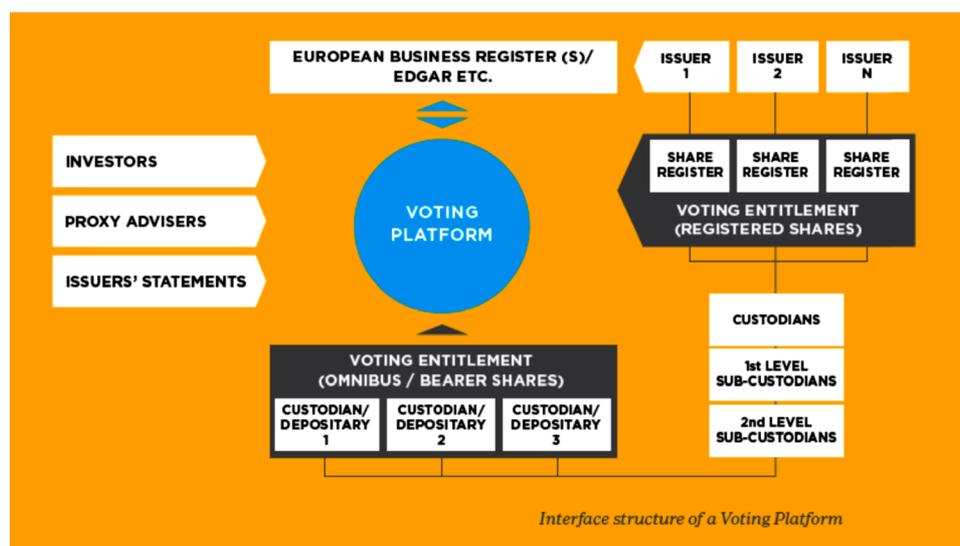
There are currently two EU directives addressing shareholder engagement, namely the Transparency Directive 2004/109/EC and the Shareholder Rights Directive 2007/36/EC. The Transparency Directive emphasises better disclosure of information to shareholders before AGMs and EGMs. However, cross-border voting is not dealt with properly by the Transparency Directive. The Shareholder Rights Directive thus steps in and tries to deal with this issue. The Shareholder Rights Directive has made improvements to shareholder engagement in that shareholders are more informed and have more time to make decisions. Further, reducing the threshold of requisitioning a meeting enables more shareholders to participate in general meetings. However, voting results of some companies should be made more transparent, especially the results of resolutions. Rather than just stating a resolution is 'passed' or not, it would be helpful to show how many shareholders voted 'for', 'against' or 'withheld'.

Strenger and Zetzsche (2013) submit that there is a flaw with the Shareholder Rights Directive in that it does not identify shareholders. They found 30 different requirements for shareholders to exercise their voting rights across the European Economic Area. They are sceptical that any regulation can resolve technical inconsistencies across banks and depositaries in the various European Member States. The complex intermediary chain in voting therefore remains a problem. The European Commission has realised that this is an issue after consulting relevant stakeholders. Therefore, the Shareholder Rights Directive was revised in April 2014. The changes are aimed to improve the problems arising from complex voting chains. They include the possibility that listed companies can discover who the shareholders are and directly communicate with them (clause 4); improving the information channel between intermediaries along the equity voting chain (clause 5); preventing cross-border price discrimination in an attempt to harmonise fees and charges of intermediaries (clause 7); and proxy advisors should ensure voting recommendations are correct and reliable. This is important since it is with reliable information that investors can make informed decisions. Proxy advisors should also avoid conflicts of interest, potential or actual (clause 14). The author submits that one further issue should be addressed: intermediaries should ensure that they carry out voting instructions accurately. In 2003, Unilever investigated why their voting turnout was so low when three large institutional investors said that they have voted (Millstein Center for Corporate Governance and Performance & Yale School of Management, 2009). It became apparent that Institutional Shareholder Services, the voting intermediary, had incorrectly completed the voting card. The registrar, Lloyds TSB Bank, then rejected the voting card and around 12.6 million votes were lost. Lloyds TSB Bank did not have a duty to inform Institutional Shareholder Services that the voting card was completed incorrectly (Millstein Center for Corporate Governance and Performance & Yale School of Management, 2009). It is thus hoped that the European Commission will insert a clause to the Shareholder Rights Directive that intermediaries must ensure that they vote accurately.

5 Proposed solutions

Having seen the difficulties encountered in a cross-border equity voting chain, Strenger and Zetzsche (2013) suggest that a global, internet-based voting platform owned by institutional investors would reduce technical issues and standardise cross-border voting standards. Their vision of the platform is that it is owned by large institutional investors, at least at the beginning. Their model is shown in Figure 3.

Figure 3 Strenger and Zetzsche's model of a voting platform (see online version for colours)



Source: Strenger (2012)

Strenger and Zetzsche (2013) claim that the proposed global voting platform is better than the Eurovote platform because the former focuses on shareholder identification as well as reducing costs for cross-border voting, more informed voting for overseas investors and greater legitimacy of shareholders' resolutions (Strenger and Zetzsche, 2013). The concept of market users owning the platform appeals to the author since better compliance is achieved this way than through legislation. Further, the Kay Review in the UK equity markets and long-term decision making (Kay, 2012) also supports this, arguing that incentives are better aligned when regulation is directed towards the interests of market users. Ownership of the platform is important for shareholder identification purposes. As seen in Berle and Means's theory, separation of ownership from control leads to principal-agent problems and so a sense of ownership is necessary for institutional investors. The Kay Review however, proposes a different model of equity investment. Under this model, asset managers act as mentors and play a key role in a shorter, equity investment chain. The asset managers will develop relationship with issuers through trust (Kay, 2012). Asset managers will emphasise the importance of long-term investment. The Kay Review envisages that trading in the UK primary equity markets will decrease as an initial public offering is no longer widely used by new issuers to raise funds. Financial restructuring is preferred (Kay, 2012). As a result of this, banks are increasingly reliant on issuance on behalf of foreign companies in London.

Acting for foreign companies would seem to indicate the presence of long, complex voting chains. Whilst shorter voting chains would reduce a number of corporate governance problems identified above, it appears that long voting chains are here to stay.

Gilson and Gordon (2013) believe that the UK's concept of 'stewardship' is unlikely to work because the inherent structure of the equity voting chains discourages intermediaries to monitor and they lack the competence to be 'stewards'. They said that 'shareholder activism is what the stewardship movement desires but cannot achieve on its own terms' (Gilson and Gordon, 2013). In a roundtable meeting about voting integrity held at The Millstein Center of Corporate Governance and Performance at Yale School of Management, one participant expressed the view that there is little incentive to shorten the equity voting chain since all the parties in that chain will benefit economically (Millstein Center for Corporate Governance and Performance & Yale School of Management, 2009). If the voting chain is shortened so that there is direct communication between the issuers and investors, then the intermediaries will become redundant. It is clear that incentive is thus a hurdle from the perspective of the investors and issuers. Unless there is a complete overhaul of the equity ownership system whereby intermediaries are absent from the equity chain, it is difficult to see how 'stewardship' will succeed in the long-term, despite the encouraging signs of compliance with the Stewardship Code in the UK. As seen earlier in Section 3 and in this section, intermediaries vote on behalf of investors and long voting chains seem to remain given that 42% of shares in UK companies are owned by overseas investors. The question is therefore how to improve the current weaknesses of the equity chain approach to share ownership and not comparing between the equity chain approach and the direct ownership approach advocated by Strenger and Zetsche. To address the weaknesses of cross-border voting, the author supports Strenger and Zetsche's model of a global, internet-based voting platform with a tiered system of accounts. The amended Shareholder Rights' Directive has already targeted the issue of identification of shareholders and Strenger and Zetsche's model will also support it. A tiered model of individual accounts will provide choice and reduced costs for investors, especially overseas investors.

6 Conclusion

Quantity and quality of shareholder engagement are both important to improve corporate governance. Evidence in 2012 showed that shareholders in the UK have been more active in engagement and voting. This is owing to the combination of the UK Stewardship Code 2010 and the implementation of the Shareholder Rights' Directive 2007/36/EC into the Companies Regulations 2009. There has been opposing view on the quantity of shareholder engagement in banks. This is because shareholders only own 2–3% of capital in banks and they focus on short-term profits. It would be unrealistic to expect such shareholders to closely engage with bank directors all the time. Recent evidence revealed in this paper suggests that there is a slight decrease in voting turnout at AGMs held in 2013. The author believes that this trend will stay unless hurdles to cross-border voting are removed. The revised Shareholder Rights Directive 2007/36/EC and the global, voting platform proposed by Strenger and Zetsche will identify shareholders thus providing more incentives for shareholder to monitor companies and giving them a sense

of connection to the companies. To reduce voting costs for investors, a tiered model of individual segregated accounts will reduce costs and offer choice.

The quality of shareholder engagement however, can be improved in three areas. First, cooperation between countries needs to be strengthened by improving information flow and transparency. It is evident from the extant literature that researchers are hindered by accurate and up-to-date information from companies. The Transparency Directive 2004/109/EC already calls for improved transparency but we need better enforcement mechanisms to improve disclosure. Better disclosure is a fundamental step to improving information flow and cross-border voting. Secondly, accurate information needs to be provided by proxy advisors under the revised Shareholder Rights Directive. A clause should be inserted to the Shareholder Rights Directive stating that intermediaries must vote correctly. Otherwise, investors' votes would be wasted and any changes made to improving cross-border voting will be futile. Thirdly, a tiered model of individual accounts will provide choice and reduced costs for investors, especially overseas investors. By improving the flow and quality of information given to investors; imposing reasonable duties on proxy advisors and intermediaries, as well as providing a tiered model of individual accounts, it is hoped that the quality of shareholder engagement will improve with time.

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