

# Review of the impediments to voting UK shares

Report by Paul Myners  
to the Shareholder  
Voting Working Group -  
an update on progress  
three years on

July 2007

## Introduction

In January 2004 I first reported to the Shareholder Voting Working Group (SVWG)<sup>1</sup> on the Review of the Impediments to Voting UK Shares. This review was undertaken following persistent concerns that the system for casting proxy votes<sup>2</sup> at meetings of UK issuers was not as effective and efficient as it should be - votes were "lost" – raising doubts about the integrity and reliability of the reported outcome. In my report I outlined a comprehensive and practical action plan to improve the process. My report covered the process whereby UK institutional investors appoint proxies to exercise their votes on the shares of UK issuers. It did not cover private investors, nor did it cover UK institutional investors voting their shares in overseas companies, or overseas shareholders voting their shares in UK issuers. This report is an update on the progress made in the three years since my original report: it is my fourth report, following progress reports in March 2005 and November 2005.

Just before I started my review in late 2003, voting levels at company meetings were around 50%. At that time the then Secretary of State for Trade and Industry stated that the aim should be to increase this. I can report that three years after my original report, voting levels for the FTSE 350 are at 61% and the FTSE 100 at 63%<sup>3</sup>. Furthermore, there now appears to be a better appreciation as to what is achievable in practice, in that a significant and rising proportion of UK companies' shares are owned by overseas and private investors, both of whom, for practical reasons, tend not to vote. We also now have a better appreciation that stock lending can also have an important impact on voting levels.

That said, my brief was not to look at the proportion of votes cast at company meetings, but at why voting instructions are lost and not recorded in the final result. To look at what happens in practice, my last progress report in November 2005 encouraged issuers to trace votes, such as the analysis undertaken by Unilever plc in 2003<sup>4</sup>, to determine whether votes are lost and if so, why.

I am pleased to see that in 2006 one such analysis was undertaken by the proxy solicitation arm of Computershare, Georgeson Shareholder Ltd (Georgeson). In summary, Georgeson looked at voting at one FTSE 100 company's Annual General Meeting. It traced the votes of 25 institutional investors who between them held 48.67% of the outstanding issued share capital. Replies were received from 19 investors of which three felt unable to disclose how they had voted due to client confidentiality. Of the total votes that could have been cast on 2,911,459,000

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<sup>1</sup> The SVWG was established in September 1999 under the chairmanship of Terry Pearson, an experienced investment custodian. It was the first industry-wide body to address the issue of improving the voting process in the UK and brought together all the relevant participants.

<sup>2</sup> In this report "casting", "recording", "registering" votes, or simply "voting", refers to the receipt of the proxy appointment and the acknowledgement of its validity and eligibility.

<sup>3</sup> PIRC's Proxy Review 2006.

<sup>4</sup> Following its 2003 AGM, Unilever plc did an ad hoc analysis into voting. It wrote to its ten major shareholders who appeared to have voted 10 per cent or less of their holdings to establish why they had not voted their entire holding. This revealed that three had given instructions to vote which were never received by the issuer.

shares, votes on 144,717,000 shares, or 4.97%, were “lost”. These are analysed in table 1.

*Table 1: Georgeson’s analysis of the reasons why votes were “lost” at an issuer’s Annual General Meeting.*

Reason for “lost votes”	Number of shares where “votes were lost”	Percentage of “lost” votes
More shares voted than available on record day resulting in instructions being rejected	71,834,000	49.6
Loss of corporate representative documentation	42,712,000	29.5
Manual processing error in the chain	3,000,000	2.1
Voting agent not executing nominee instructions	21,979,000	15.2
Missing instructions at nominee level or lending activities	5,192,000	3.6
<b>Total votes “lost”</b>	<b>144,717,000</b>	<b>100</b>

I commend Georgeson in undertaking this exercise. This work demonstrates that the process is still not operating effectively. In particular, the fact that votes were lost due to a processing error indicates that participants are not exercising the care necessary and suggests that voting at company meetings is still not given the importance it deserves. This is clearly unsatisfactory, undermining the considerable work now put into determining how to vote and the reliance placed on votes. Failures in the voting process and consequent lack of confidence in reported outcomes are unacceptable. I will consider Georgeson’s findings as I revisit my recommendations to see what can be done in practice to prevent votes being lost.

### Tracing votes

Although shares with voting rights attached to them tend to be worth more than non-voting shares, no one seems to take responsibility for ensuring that votes at company meetings are correctly recorded in the final result. In this respect, one of the supporting principles to the Financial Reporting Council’s Combined Code on Corporate Governance states, “institutional shareholders should take steps to ensure their voting instructions are translated into practice<sup>5</sup>”.

There is little evidence that the final stages of the voting journey, transmitting and counting votes, is receiving anything like the attention given to deciding how to vote. It has been put to me that institutional investors can find undertaking such an exercise difficult. The number of different participants between themselves and the

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<sup>5</sup> Supporting principle to Principle E3  
<http://www.frc.org.uk/documents/pagemanager/frc/Combined%20code%202006%20OCTOBER.pdf>

issuer can lead to a disconnect in the contractual relationships that exist. Thus, for example, the majority of UK shares are registered in the name of a custodian's nominee company as the registered owner. As very often the custodian is appointed by the beneficial owner, the institutional investor does not have a contractual relationship with it and is unable to trace its votes through to the issuer unless it has specific authority from the registered owner to do so. Since the Shareholder Voting Working Group was first established, it has become even more difficult to trace votes, in that the voting chain has become longer, as a larger number of votes now tend to pass through agents.

Issuers similarly encounter problems in tracing votes. First, due to issues with client confidentiality, a number of institutions do not feel able to disclose information on how they have voted on their clients' behalf. Secondly, there is a cost in undertaking any tracing exercise and very little economic incentive to do so.

None of this would be a problem if there was a clear audit trail of voting instructions from the entity making the determination and issuing the instruction through to the issuer/registrars who receives it. However, my first report identified that this was not the case, in that those issuing voting instructions could not necessarily be assured that instructions were received and acted upon. Furthermore, it is not possible for an issuer/registrars to confirm that votes have actually been registered until after the meeting and the final position on paper proxies, amended instructions or votes cast at the meeting can be taken into account.

That said, it is important that investors take their stewardship responsibilities seriously, particularly on contentious issues. I, therefore, would encourage institutional investors to show greater determination to follow the practice set out in the Combined Code and take steps to ensure that their voting instructions are translated into practice. The Combined Code places few direct and specific obligations on institutional investors, and even if they find it impractical to follow through every vote, they should certainly follow through a sample. There is a role here for the relevant trade bodies to elevate the importance of addressing shortcomings in the voting process.

I encourage the various intermediaries in the voting chain, in particular the custodians, facilitating institutional investors following through their voting instructions to see if they are acted upon and institutional investors' clients, the beneficial owners, taking explicit actions to encourage them to do so, after all it is their votes that are being lost. I would also like to see more issuers carrying out vote tracing exercises, such as the one completed by Georgeson, and now look to those companies in the FTSE 100 to instruct their agents, the registrars, to analyse voting in relation to their 2007 AGMs. I have been advised that the costs of doing so are relatively modest and by the time I report again in 2008, I would like to see that more companies have traced through their votes to see if any have been lost. To this end, I will be writing to a number of chairmen of companies in the FTSE 100 to encourage them to do so and to report on their findings. It seems to me that company Boards should want to satisfy themselves and their shareholders of the integrity of the voting process, and discuss their findings with their shareholders and report to interested parties. In the latter respect, I will be asking the Institute of

Chartered Secretaries and Administrators' Registrars Group to liaise to ensure that there is consistency of approach and to collate the results of any tracing exercises undertaken so that the information can be presented publicly. The National Association of Pension Funds, the Association of British Insurers and the Investment Management Association, the main trade associations representing the beneficial owners and their agents, have indicated their support for such exercises as they will help ensure the work undertaken in determining how to vote is not undermined by flaws in the voting process.

### **Electronic voting**

Undoubtedly, it would be easier to establish an audit trail and follow voting instructions through to the final result if there was straight through electronic voting<sup>6</sup> from the person issuing the voting instructions to the person recording the vote. One of the main recommendations in my first report was that electronic voting was the key to a more efficient voting system and that all participants should introduce electronic voting capabilities.

I am encouraged by the fact that since 2004 the voting system has become more automated. According to figures from the Institute of Chartered Secretaries and Administrators, all FTSE 100 companies now allow electronic voting and there has been a substantial increase in the number of companies that facilitate it in the next 250 – see table 2 for the percentage of meetings actually held (as opposed to announced) where there were electronic voting capabilities. Issuers and their agents deserve to be congratulated on the significant progress made in this important area.

*Table 2: Institute of Chartered Secretaries and Administrators' analysis of the percentage of company meetings where there were electronic voting capabilities.*

	<b>FTSE 100 %</b>	<b>FTSE 250 %</b>
2003	47	10
2004	88	41
2005 (6 months)	83	51
2006	100	74

As regards the actual utilisation of electronic voting, the percentage of issued share capital voted electronically has also risen, mainly attributable to the increased use at meetings for companies in the FTSE 250. This is set out in table 3 according to the percentage of issued share capital voted. This represents good progress.

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<sup>6</sup> Throughout this report electronic voting refers to electronic proxy appointment as opposed to conducting polls electronically.

*Table 3: Institute of Chartered Secretaries and Administrators' analysis of the percentage of issued share capital voted by electronic proxy appointment or by paper<sup>7</sup>*

	FTSE 100 %		FTSE 250 %		Other %		Total %	
	EPA*	Paper	EPA	Paper	EPA	Paper	EPA	Paper
2004	22	40	14	42	1	30	16	38
2005 (6 months)	42	16	28	33	2	33	26	24
2006	45	11	41	17	13	31	39	17

\*Electronic Proxy Appointment

Despite this encouraging progress, Georgeson's analysis of voting at one issuer's Annual General Meeting noted that a manual keying error during processing resulted in three million votes being lost and that not all accounts were enabled for electronic voting in that 437,244,000 shares, or 15% of the total shares voted, were still voted via paper proxy.

I continue to believe that an automated process is key to an efficient voting system. Although progress has been made, electronic voting has to involve all participants and I would urge all involved to take further steps to effect accurate and efficient straight-through processing.

## **Designation**

Over-voting was another reason identified by Georgeson as to why certain votes were lost. In summary, if a participant submits an instruction to vote more shares than they are entitled to, it can result in their instruction not being acted upon and their votes being in effect "lost". I believe that this can be exacerbated when omnibus accounts are used where clients' shareholdings are pooled such that the shares of several beneficial owners are registered in the name of one nominee company. Although all the main custodians now appear to offer designated nominee accounts, where the holdings of each client are recognised by a separate designation relating to a specific investor, the majority of holdings still tend to be registered in omnibus accounts which can:

- make over-voting difficult to analyse and prevent; and
- mean that a participant can over-vote their shares and find that all their votes are recorded because the over-voting is compensated by those that under-vote, or do not vote at all (to put it simply: investors innocently, but incorrectly, exercise votes belonging to another shareholder without that shareholder's knowledge or agreement).

My initial report concluded that registering title in the name of a nominee company with a specific designation has benefits when it comes to voting in terms of

<sup>7</sup> N.B. A smaller sample provided an analysis of share capital voted in 2006 as compared to earlier years and hence it may appear that a smaller of the total share capital was voted.

transparency and accountability. I continue to believe that omnibus accounts are more of an obstruction than a threat to good governance and voting, and that my recommendations in this area do not need to be strengthened. But investors and their advisers should consider the benefits of designation against the costs involved when choosing their custody arrangements. This is a matter of judgement for the beneficial owners and it is important that custodians and advisers help ensure that this judgement is informed. Failure to show serious endeavour in this and other areas only serves to support those who argue that owners and institutions do not take seriously the responsibilities of ownership and are willing to live with outcomes that we might associate with unaccountable regimes.

## **Record date**

In the UK, in accordance with the Uncertificated Securities Regulations, the record date, when voting entitlements are set, is required to be not more than 48 hours before the meeting<sup>8</sup>. The Companies Act 2006 specifies that the time limit for the receipt of proxy appointments, i.e. instructions, similarly cannot be more than two business days before the meeting<sup>9</sup>. Due to the time it takes for instructions to be transmitted, in effect this means that shares have to be voted before voting entitlements are set.

To address this, at the time of my review, some put it to me that there would be advantages in having a record date in advance of 48 hours. Indeed recently, Euroclear SA<sup>10</sup> wrote to me proposing that the Uncertificated Securities Regulations should be amended so that the date when voting entitlements are set, i.e., the record date, is not more than 96 hours before the meeting. No change would be necessary to the Companies Act in that instructions would still have to be received not more than two business days before the meeting.

Undoubtedly there are benefits with such an arrangement in that:

- those submitting voting instructions know the exact number of shares they are entitled to vote when they submit their instructions;
- as the number of shares to be voted is known earlier, there is more time to identify discrepancies and resolve them;

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<sup>8</sup> The Uncertificated Securities Regulations 2001, Statutory Instrument 2001 NO 3755, Section 41(1).

<sup>9</sup> Section 327(2), Companies Act 2006. The Companies Act 2006 modifies the equivalent provision in the Companies Act 1985 so that bank holidays and weekends are no longer taken into account in determining the 48 hours. This will be effective from 1 October 2007

<sup>10</sup> Euroclear SA is one of the world's main settlement systems for domestic and international securities transactions covering bonds, equities and investment funds. Market owned and market governed, Euroclear provides securities services to major financial institutions in more than 80 countries. In addition to being the leading International Central Securities Depository (ICSD), Euroclear also acts as the Central Securities Depository (CSD) for Dutch, French, Irish and UK securities. CIK, the CSD of Belgium, joined the group in January 2006 and was renamed Euroclear Belgium.

- it enables custodians to identify earlier those who have purchased shares since the notice was circulated and send them copies and supporting documentation; and
- it reduces difficulties over when reconciliations should be completed with consequential cost benefits.

That said, others have argued against such a move. The main objection being that an advanced record date increases the risk that the right to vote remains with someone who may have no continuing economic interest in the shares. Thus, a person may have a voting entitlement at the record date and vote their shares, but then dispose of them and not have an economic interest in the company when the vote is registered. It was also felt that it disenfranchised new shareholders when a purchase settled between the record and meeting date. Although this could happen with the current record date, the general view was that it is sufficiently close that it minimises the risk and yet can still be administered. For example, with the current 48 hour time frame, T+3 trades within five days of the meeting will not be registered in time for the purchaser to vote at the meeting. Extending the time frame to 96 hours, as proposed, would extend this period to seven days before the meeting.

Shareblocking, where trading between the record date and the date of the meeting is prohibited, ensures that those that vote still have an economic interest in the shares when the vote is registered. However, the restrictions this places on the ability to trade shares means that this does not have my support. In any event, it is not practiced in the UK, and in accordance with Article 7 of the EU Shareholder Rights Directive<sup>11</sup>, Member States are required to ensure that it does not happen within EU Member States.

Furthermore, changing legislation so that the record date cannot be more than 96 hours before the meeting would not be effective unless a minimum timeframe was also set. Otherwise, companies could set record dates at different times before the meeting and could continue with the existing 48 hour time frame, obviating any benefit from the proposal.

In conclusion, although there may be benefits in an advance date for setting voting entitlements, at the time of my review there was no clear consensus and I did not propose that the existing timeframe should be changed other than to address weekends and bank holidays so that only business days are counted in the 48 hour time frame. In this respect, I welcome the fact that the Government has amended the Companies Act to address this so that only business days are taken into account when setting the time frame for the receipt of voting instructions. It is now important that steps are similarly taken to amend the Uncertificated Securities Regulations. Otherwise, as only business days are counted in setting the time frame for the receipt of voting instructions, it is possible that instructions would have to be

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<sup>11</sup> Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC.

submitted before voting entitlements are set. However, I do not believe that there have been any developments since my original report that should cause me to consider that the time frames should be amended further. Indeed, with the improved take up of electronic voting in the UK and the increasing automation of the process, it is difficult to see that there is a case for changing the law to allow more time and provide for an advanced record date.

### **Cut off**

One of Georgeson's findings that particularly concerned me was that voting agents often set a deadline for the receipt of voting instructions that is much earlier than that allowed in legislation. Thus, whereas the Companies Act 2006 specifies that issuers cannot require instructions to be with them more than two business days before the meeting<sup>12</sup>, i.e. it is not possible under current law to extend this period but it is possible to shorten it, agents or custodians can specify that voting instructions are submitted much earlier.

For example, the Investment Management Association's survey of 33 managers' engagement in 2006<sup>13</sup> showed that over 50% of the managers had to submit their voting instructions at least ten working days or two weeks before the meeting. As the Companies Act 2006 requires public companies to give their members 21 days or three weeks notice of an annual general meeting<sup>14</sup> (the Combined Code requirement for listed companies is 20 working days or four weeks), this can mean that managers have only one week to decide how to vote. This can result in managers having to vote before the voting agencies have issued their voting recommendations.

Early cut off dates have an added complication in that, as under the Uncertificated Securities Regulations, the record date when voting entitlements are set cannot be more than 48 hours before the meeting, voting instructions have to be submitted before voting entitlements are set. This can result in discrepancies arising between the number of shares actually voted and the voting entitlement at the record date, and votes being "lost" in that:

- voting instructions can be rejected if they are for more than the correct entitlement and are over-voted; or
- fewer shares are voted than should be.

I, therefore, consider it important that realistic time frames are set for the receipt of instructions. To this end, I will be writing to the main voting agents and custodians to encourage them to do so and will follow this matter up in a year's time to see if the situation has improved. This is another area where owners, their agents and trade associations should be evidencing much greater engagement and concern to improve standards and confidence in voting outcomes. The accuracy of the vote

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<sup>12</sup> Section 327(2), Companies Act 2006.

<sup>13</sup> The Investment Management Association undertakes an annual survey of its members' engagement with investee companies. The 2006 survey covered 33 firms, managing £640 billion of UK equities, representing 68% of the market.

<sup>14</sup> Section 307 (2), Companies Act 2006.

should not be subordinated to administrative convenience. It is for beneficial owners and their advisers to do much more to insist on improving standards in this area. I would hope that the National Association of Pension Funds, the Association of British Insurers and others will take an active interest in this and related matters.

## **Other issues**

When I issued my last progress report, I noted the importance of ensuring that ownership and voting rights are aligned, and as other types of transactions are gaining increasing prominence, I agreed that in the future I would look at transactions/instruments/participants such as stock lending, contract for differences, hedge funds and ADRs, and their effect on voting. My observations on these are set out below.

## **Stock lending**

Stock lending affects voting in that the lender does not retain the right to vote. I first alerted participants to this fact in my initial report of January 2004, when I emphasised that it was important that beneficial owners are made fully aware of the implications for voting, if they agree to their shares being lent, and that a balance needs to be struck between the importance of voting and the benefits derived from stock lending. I also recommended that stock should automatically be recalled when a resolution is contentious, unless there was a good economic reason for not doing so. The progress report in March 2005 noted that, according to Makinson Cowell, the specialist capital market advisory firm, the average proportion of outstanding shares lent in the FTSE 100 companies increased in 2005. Similarly in 2006, Makinson Cowell reported that stock lending had increased and that the level appeared to depend on the size of the company - the larger the company, the smaller the proportion of stock that is lent. Thus, as US companies tend to be larger than UK companies, less than 1.9% of aggregate stock by value is lent, whereas for UK companies it is 3.6% by value.

As regards recalling lent stock, the Investment Management Association's survey in 2006 into investment managers' engagement with investee companies showed that of the 33 managers covered, seven do not lend at all, only one never recalls, and of the 25 managers that do endeavour to recall, 23 are always notified when stock is lent by the custodians/stock lending agents. However, I understand from Makinson Cowell that although institutional investors believe they know when stock is on loan and can recall it, in practice this is seldom seen. In particular, custodians tend to be appointed by the beneficial owners and may enter into an automated stock lending programme. Thus, investment managers have no contractual relationship with the custodian or manager of the stock lending programme and may not be aware that stock is lent. This can, and does, result in more shares being voted than should be and the voting instruction being rejected.

In view of this, I re-emphasise my recommendations on stock lending, which were strengthened in my March 2005 progress report, such that I recommended that beneficial owners should satisfy themselves as to the arrangements between the custodian and the person initiating the voting instruction to ensure there is no

disconnect and that the latter is notified of the correct number of shares to be voted and whether any are on loan. Furthermore, those responsible for initiating voting instructions should seek to anticipate contentious votes and consider recalling the related stock, and recommend to beneficial owners that the stock should not be lent.

In this respect, I particularly welcome the fact that the Institute of Chartered Accountants in England and Wales revised FRAG 21/94<sup>15</sup> in 2006, now entitled AAF01/06<sup>16</sup>, Assurance Reports on Internal Controls of Service Organisations Made Available to Third Parties, to include a specific control objective covering the systems for communicating to the entity initiating the voting instruction, stock positions and whether any stock has been lent. I also support the International Corporate Governance Network's Stock Lending Code of Best Practice<sup>17</sup>, which was issued in 2005. This applies three broad principles to the parties engaged in stock lending which seek to ensure that:

- stock lending is transparent and subject to the same visibility and safeguards as other transactions;
- consistent and clear policies are applied as to when shares should be lent, withheld from lending and recalled; and
- shareholders ensure that votes on their shareholdings are not cast in a manner that is contrary to their policies and economic interests.

The issues that surround stock lending are complex. I support the attention this area is receiving from a variety of parties/organisations. It is important that those that lend their stock monitor the risks and are aware that when they lend their stock they lose the right to vote, and as a consequence, their stock may not be voted in a manner that is consistent with their own policies and economic interests.

### **Contracts for differences**

In recent years hedge fund activity, both by taking short positions and trading via contracts for differences (CFDs), has increased. My understanding is that with a CFD an investor contracts with a counterparty, typically its prime broker, usually an investment bank, to receive the gain or bear the loss from the change in share price from holding of a number of shares over a set period. Thus:

- with a short equity CFD, the prime broker may hedge the contract by selling shares that it does not own so that it can pass on the gain, when the share price falls, to the hedge fund; and

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<sup>15</sup> The Audit Faculty of the Institute of Chartered Accountants in England and Wales periodically issues guidance to its members. One such guidance note was FRAG 21/94, Reports on Internal Controls of Investment Custodians Made Available to Third Parties, which the Audit Faculty updated in 1997.

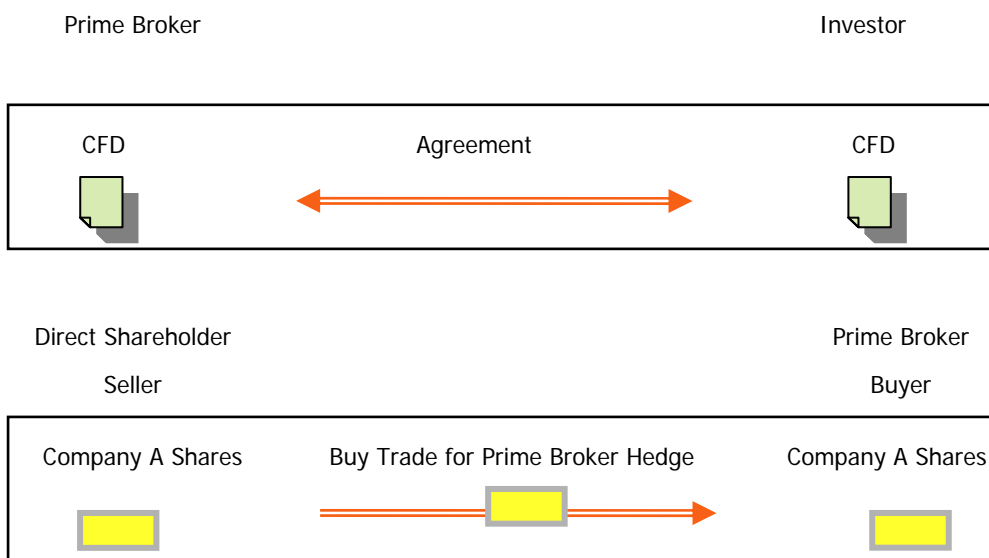
<sup>16</sup> <http://www.icaew.co.uk/index.cfm?route=136450>

<sup>17</sup> [http://www.icgn.org/organisation/documents/slc/code\\_final.pdf](http://www.icgn.org/organisation/documents/slc/code_final.pdf)

- with a long equity CFD, the prime broker may purchase shares so that the gain from the increase in the share price can be passed on to the hedge fund (the prime broker may in practice purchase other instruments or shares as a hedge rather than the shares to which the contract applies).

When the CFD position is closed the counterparty will then close its position, in the case of a long CFD, by selling its shares or hedging instrument, or in the case of a short CFD, by purchasing shares or hedging instrument to fill its short position. Set out below is a diagram which illustrates a common long position held through a CFD.

Long Positions Held Through Contracts for Difference



There are a number of reasons why participants choose to trade through CFDs:

- in the UK stamp duty reserve tax is not believed to be payable on CFDs and the prime broker will generally benefit from an exemption available to intermediaries;
- they are a flexible way of short selling i.e., disposing of shares that are not owned, as compared to through the cash market when shares have to be borrowed to settle short positions; and
- CFDs can be traded on a leveraged or margined basis and the investor does not have to fund the full purchase price. Thus, as the investor may only have to provide collateral of between 10-15% of the initial nominal value, a position of £10,000 can be taken in the underlying shares for a deposit of £1,000 to £1,500.

It should be noted that CFDs are normally associated with hedge funds, but hedge fund managers are not the only users of these instruments as a broader community appreciate the way in which CFDs facilitate the avoidance of UK stamp duty reserve tax in effecting many investment strategies.

My brief is to look at voting. The situation regarding CFDs is not clear. My understanding is that the normal legal position is that investors have no right to direct the prime broker on how to vote the underlying shares. That said, when the Takeover Panel consulted on disclosure of derivatives and options, its consultation paper stated, *“the holder of a long CFD is able in practice to exercise a significant degree of de facto control over the shares held by the counterparty to hedge its position. The counterparty normally has no economic exposure in respect of the transaction and will naturally wish to obtain repeat business from the holder of the long CFD. As a result, the counterparty will often exercise the voting rights attaching to the hedge shares according to the wishes (or likely wishes) of the long CFD holder<sup>18</sup>”*.

It would appear that in practice there is considerable flexibility as to whether the prime broker will take account of the CFD holder’s wishes in exercising voting rights. Some will do so. Others will not as a matter of policy. Finally, others will be unable to do so as they will not hedge the position or hold the related shares.

In conclusion, I make no recommendations in relation to the voting of shares represented by CFDs. However, CFDs require holders to provide collateral to the prime broker. In holding collateral, the broker accordingly acquires voting rights in shares when they have no economic interest. In this respect, I reiterate one of the recommendations in my initial report in that, on the basis that voting should relate to a participant’s economic stake in the company, the holders of collateral should not vote shares held as collateral. The fact that this could happen is another example of how complicated the system for exercising and recording shareholder votes has become.

## **ADRs**

ADRs were first developed to enable U.S. investors to trade in international securities within the U.S. without having to deal directly in unknown foreign capital markets. ADRs are negotiable certificates issued by a bank or trust company and represent interests in securities of a foreign issuer that are held by a depositary in the country of the issuer but which are traded internationally. Thus, by using ADRs, a U.S. investor who is interested in buying shares in, for example, Telefonica De Chile, may do so by transacting with a local broker dealing in ADRs, rather than placing his order on a stock exchange in Chile.

As regards voting, the corporate law of the issuer’s jurisdiction specifies the rights of shareholders, among others: to receive notice of and to attend meetings; to submit shareholder proposals; and to vote by proxy. However, most countries’ laws recognise the depositary as the owner of the security that underlies the ADR and not the ADR holder. Thus, the right of an ADR holder to exercise voting rights is largely dependent on the terms of the depositary agreement.

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<sup>18</sup> <http://www.thetakeoverpanel.org.uk/new/consultation/DATA/PCP200501.pdf>

Under some agreements, the issuer agrees to “recognise” the ADR holder as a shareholder and the depositary is expected to pass corporate communications, proxies, and other materials to them. However, this is not always the case in that, for example, many agreements provide that ADR holders:

- only have the right to vote when the issuer formally requests the depositary to ask them to; and
- are not allowed to vote on a dividend waiver and that the depositary will vote all the underlying shares in favour of any such proposal.

There are undoubtedly issues that surround ADRs and voting. However, my brief was to review the impediments for voting UK shares by UK institutional shareholders. It did not relate to the processes and procedures for voting shares in overseas companies in overseas markets. Thus, as ADRs are issued to enable overseas investors to deal in shares in unknown capital markets, they are strictly outside my scope. But it must be clear that this is another area pregnant with hazard and with a risk, in some cases, that the issuer or its board is able to make voting decisions.

## **Conclusion**

In conclusion, I am encouraged by the progress made by the participants in the voting chain in the three years since my original report to improve the voting process. There is evidence that more votes are being cast - voting levels now exceed 60% - and that more consideration is given to voting at company meetings. I also welcome the tracing exercise of voting at one issuer’s Annual General Meeting that was completed by Georgeson in 2006. That said, the system is still complicated and is still prone to error, and not as much progress has been made as I would have liked. In particular, Georgeson’s tracing exercise demonstrated that the process is still not operating effectively – votes continue to be lost. This suggests that the participants in the voting chain are not exercising the due care necessary and that more could, and should, be done. Participants need to take an active interest in addressing the failings that still beset the voting process.

I believe those involved in the process should undertake steps to help make the process more efficient and transparent, establish a clear audit trail and undertake tracing exercises such as that completed by Georgeson. Thus, I now look to those companies in the FTSE 100 to instruct their agents, the registrars, to analyse voting in relation to their 2007 AGMs. When I next report in 2008 I would like to see that more companies have traced through their votes to see if any have been lost. I set out below the other areas where I consider more could be done and ask each of the Shareholder Voting Working Group’s member organisations to monitor the progress of their own members.

The Institute of Chartered Secretaries and Administrators should follow up with issuers so that they:

- conduct analyses to determine whether major institutional investors’ voting instructions are being recorded in the final result, or whether they have been lost, the reasons why, and to publish their findings; and

- all endorse and facilitate electronic voting.

It should also follow up with registrars so that they make every effort to facilitate increased use of electronic voting.

The Association of British Insurers and the National Association of Pension Funds, in representing the interests of the beneficial owners, should follow up with members so that they:

- encourage their agents to follow the practice set out in one of the Supporting Principles to Principle E3 of the Financial Reporting Council's Combined Code on Corporate Governance and take steps to ensure that their voting instructions are translated into practice, even if this is simply on a sample basis;
- enquire whether their agents have electronic voting capabilities and encourage them to be used;
- give full and careful consideration to having their shares registered in a nominee company with a designation in their name, or some other unique identification;
- encourage their custodians to provide a clear audit trail and to facilitate tracing exercises;
- monitor the risks when their stock is lent and are aware that in so doing they lose the right to vote and as a consequence their stock may not be voted in a manner that is consistent with their own policies and economic interests;
- anticipate contentious votes and consider whether to recall the related stock; and
- satisfy themselves as to the arrangements between the custodian and the person initiating the voting instruction to ensure there is no disconnect and that the correct number of shares are notified as to whether they are on loan and are voted.

The Investment Management Association, in representing the interests of investment managers, should follow up with its members so that they:

- follow the practice in one of the Supporting Principles to Principle E3 of the Financial Reporting Council's Combined Code on Corporate Governance and take steps to ensure that their voting instructions are translated into practice, even if this is simply on a sample basis;
- have electronic voting capabilities which are used;
- monitor the risks when their client's stock is lent and are aware that in so doing they lose the right to vote and as a consequence their stock may not be voted in a manner consistent with their own policies and their client's economic interests;
- anticipate contentious votes and take a view on whether to recall the related stock and recommend to beneficial owners that they do not lend the stock; and
- report under the specific control objective covering the systems for communicating to the entity initiating the voting instruction, stock positions and whether any stock has been lent in the revised Institute of Chartered Accountants in England and Wales FRAG 21/94, now entitled AAF01/06.

The British Bankers' Association should follow up with its members, the custodians, so that they:

- have electronic voting capabilities which are used;
- facilitate institutional investors following through their voting instructions to ensure they are acted upon;
- continue to offer designation and review the level of take up by clients;
- seek to provide a clear audit trail from the person issuing the voting instruction to the person registering the vote;
- ensure that they and the voting agents set realistic time frames for the receipt of instructions;
- report under the specific control objective covering the systems for communicating to the entity initiating the voting instruction, stock positions and whether any stock has been lent in the revised Institute of Chartered Accountants in England and Wales FRAG 21/94, now entitled AAF01/06; and
- in relation to CFDs and on the basis that voting should relate to a participant's economic stake in the company, do not vote shares held at collateral.

Furthermore, the Government should take steps to amend the Uncertificated Securities Regulations to accord with the provision in the Companies Act 2006, so that in determining the 48 hour time limit bank holidays and weekends are not taken into account. I shall be writing to the Government to encourage it to make the necessary amendments and also to the voting agents and custodians to encourage them to set realistic time frames for the receipt of instructions and provide a clear audit trail from the person issuing the voting instruction to the person registering the vote.