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Report of the working group chaired by Yves Mansion on securities lending before general meetings of shareholders

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EXECUTIVE SUMMARY

At the request of the AMF Board, the working group on securities lending before general meetings of shareholders formulate proposals aimed at preventing the separation of the legal and economic ownership of securities during the general meeting season and to assess the possible effect on market functioning of banning certain securities lending practices.

To ensure that general meetings of shareholders are properly conducted, efforts must be continued to promote the active participation and effective involvement of shareholders in meetings. This is a pre-requisite for curbing the relative influence that may be wielded by shareholders without permanent exposure to the economic risk of share ownership.

All the members of the group reaffirmed the contribution that securities lending makes to ensuring orderly markets, notably by enhancing liquidity. Without banning the practice, it seems however appropriate to prevent the use of securities lending for the sole purpose of taking action against a company on a temporary basis.

As a consequence, it seems vital, in the first place, to improve company disclosures about the true influence of shareholders. Both company and market need a clear and distinct picture of the interests that a shareholder actually owns and of interests held as the result of a temporary transfer. The working group recommends that any person that possesses a number of shares making up a minimum percentage – say 2%, of the voting rights following a temporary transfer of these shares or any transaction entailing a right or obligation to resell these shares –inform the company and market regulator on the third day before the general meeting ("record date") of the number of shares held, specifying the number of shares acquired following a temporary transfer, along with the identify of the transferor. By making it possible to distinguish long-term shareholders from those that have acquired shareholder status through temporary borrowing, such disclosures will help to better gauge the influence and objectives of different shareholders.

But while this information might affect the behaviour of other shareholders, it would not prevent a temporary shareholder from voting and, in some cases, shaping the strategic decisions of the company. The only way to prevent it would be to withhold the voting rights attached to temporarily borrowed securities or shares that are covered by special hedges in order for temporary holders to be prevented from unduly influencing companies' strategic decisions in certain circumstances.

INTRODUCTION

The procedures for conducting general meetings of shareholders, and the rights that may be exercised at such meetings, have long been a major corporate governance issue at European and international levels. The topic is a major concern in France, not least because shareholders have a particular oversight capacity over senior management. In recent years, the French legal framework has been amended, notably by the New Economic Regulations Act[1] and the Financial Security Act[2], in an effort to strengthen shareholders' rights. These amendments are linked to the changing pattern of share ownership in France. Listed French companies' ownership structures used to be split between retail and institutional shareholders. Now these firms are attracting powerful new investors intent on shaping strategic decisions while maximising the return on their investment.

Now that the powers of shareholder meetings have been reinforced, it is even more important to continue the debate on the necessary balance between senior management and shareholders in listed companies. Similarly, it is vital that shareholders disclose changes in their holdings to other shareholders, the company and the market. The same good governance considerations that resulted in stronger powers for general meetings mean that the AMF cannot overlook market practices that allow shareholders' rights to be transferred to entities that may "own" shares at the time of the meeting but that do not clearly bear the associated economic risk.

Several cases have raised questions as to whether securities lending is an acceptable practice before general meetings. These examples show that the voting rights attached to borrowed securities may be used to support short-term attempts by some types of investors to influence the outcome of a general meeting or to obtain control of a company without bearing the risks of share ownership and in a way that is not transparent to other shareholders and the market.

For example, in 2002, Laxley Partners, an investment fund and shareholder in British Land, tabled a series of resolutions challenging British Land's Board of Directors. Although Laxley Partners held a stake of just 1% in British Land, it borrowed 8% of the company's shares so that it could influence voting on the resolutions, which were later rejected by the other shareholders.

In December 2004, during Mylan Laboratories' takeover bid for King Pharmaceuticals, Perry Corporation bought 26.6 million Mylan shares and arranged a stock loan with Bear Stearns and Goldman Sachs to give it 10% of the voting rights in Mylan. The deal gave Perry Corporation the biggest block of votes in Mylan and ensured that Mylan's general meeting approved the bid, even though the second-largest shareholder did not approve.

In April 2005, Nippon Broadcasting System in Japan lent 13.88% of the shares it held in its parent, Fuji Television, to Softbank Investment for five years to prevent Livedoor from succeeding in its bid for Fuji Television.

The question of securities lending before general meetings is back on the international agenda and is being hotly debated. Some countries are preparing codes of best practice[3] to prevent misuse of securities lending and to provide a framework for lending during general meetings. In a consultation document dated 30 April 2007[4], the European Commission asked whether stock lending needed to be addressed at the European level. Issuer associations have also voiced concerns about the behaviour of temporary shareholders and the risks they may pose to companies' long-term development strategies.

Aside from the question of securities lending, the real – and overarching – issue concerns the activism of some short-termist shareholders that acquire large blocks of shares just before a general meeting in order

[1] Act 2001-420 of 15 May 2001 on new economic regulations.
[2] Act 2003-706 of 1 August 2003 on financial security.
[3] See for example, the International Corporate Governance Network's *Securities Lending Code of Best Practice* of 15 October 2005.
[4] *Fostering an Appropriate Regime for Shareholders' Rights*.

to disrupt management, without bearing the corresponding risk. By obtaining securities for a brief period spanning the notice of meeting and the meeting itself, these investors may wield enough influence to persuade other shareholders of their credibility and secure the sought-after changes, without assuming the actual risks of share ownership. To make such acquisitions, investors have several options. They can use temporary exchange techniques regulated by France's Monetary and Financial Code, such as regulated securities loans and *pension livrée* (deliver-out repo); mechanisms governed by ordinary law, such as *réméré* (transfer of ownership with right of repurchase) and ordinary securities loans; or outright acquisitions where the economic risk is hedged from the outset either by a derivative instrument or by an agreement to repurchase after a specified time.

Investor protection is one of the core responsibilities of the Autorité des marchés financiers (AMF), the French securities regulator. Accordingly, the AMF has always paid close attention to whether shareholders are able to exercise their voting rights at general meetings. In this regard, on 15 September 2005, a working group chaired by AMF Board Member Yves Mansion issued a report, entitled *Improving the Exercise of Shareholder Voting Rights at General Meetings in France*, that set out a series of recommendations based on four guiding principles: make information more accessible; improve the efficiency of vote processing; oversee investor accountability; and ensure that general meetings are properly conducted.

Building on this initiative, at its meeting of 24 July 2007, the AMF Board asked Yves Mansion to assemble a working group to formulate proposals aimed at preventing the separation of the legal and economic ownership of securities during the general meeting season and to assess the possible effect on market functioning of banning certain practices.

The working group was made up of representatives of issuers, asset managers, securities lending specialists and one lawyer (see Appendix for further details).

Regardless of the proposed course of action, all the members of the group reaffirmed the contribution that securities lending makes to ensuring orderly markets, notably by enhancing liquidity. Stock lending is one of the techniques that helps to make market transactions more efficient by increasing the number of securities that may be made available on a given market. These arrangements enable borrowers to satisfy delivery requirements if they do not have enough securities. They also give collective investment schemes more flexibility when it comes to meeting risk spreading requirements. In addition, securities lending can be used for financing or refinancing purposes. Moreover, securities lending increases in the lead-up to a general meeting for reasons that have nothing to do with voting, but rather so that borrowers can receive dividend payouts. Many institutional investors use this technique as a significant source of revenues.

Without banning the practice, it is appropriate therefore to prevent the use of securities lending for the sole purpose of taking action against a company on a temporary basis. Moreover, whatever arrangements are put in place must come with sufficiently severe penalties to act as a deterrent. At the same time, they must not increase the risk of general meetings being cancelled, since this would create too great a legal risk for issuers. Above all, the penalties must be applicable to non-resident shareholders. Otherwise, French investment managers might suffer, particularly in terms of competitive advantage.

The law offers in this regard a number of mechanisms that are effective but whose consequences may be unsuitable in practice given the legal certainty required for the temporary exchange of securities. Designed as general-purpose arrangements, these mechanisms are rarely applied to listed companies or are not applicable until after the fact, hence the need for a separate system for such transactions that takes effect before the meeting. In this respect, it seems vital, in the first place, to improve company disclosures about the true influence of shareholders. By making it possible to distinguish long-term shareholders from those that have acquired shareholder status through temporary borrowing, such disclosures will help to better gauge the influence and objectives of different shareholders. But while this information might affect the behaviour of other shareholders, it would not prevent a temporary shareholder from voting and, in some cases, shaping the strategic decisions of the company. The only way to attain this goal would be to withhold the voting rights attached to equities borrowed for the sole purpose of influencing a general meeting.

I – STAGE ONE: MAKE BETTER USE OF EXISTING LEGAL CHANNELS

Positive law offers a range of mechanisms to combat the distortions that can be caused by the temporary exchange of securities.

- ***The "spirit of cooperation" of listed companies: a theoretical concept***

In principle, a company is founded on a spirit of cooperation between shareholders (*affectio societatis*), an intention to act in partnership and, where necessary, a commitment to share in losses. Article 1832 of the Civil Code states that "a company shall be formed by two or more persons who agree by contract to appropriate their assets or industry to a common undertaking with a view to sharing in the profits or benefiting from any savings that may arise. […] The partners undertake to share in the losses". Consequently, Article 1844-1 of the same code says that any oppressive clause, defined as one that "assigns all the profit procured by the company to one partner or exonerates that partner from all losses, or any clause that excludes one partner from all profit or assigns that partner all the losses," shall be deemed to have no force. This could provide a disciplinary framework for stock lending in situations where the borrower is not exposed to the risks of share ownership.

However, whether this framework should apply to stock lending is largely a moot question[5]. Moreover, the fact that regulated securities loans have been recognised in law and are classified as a *prêt de consommation d'actions* ("simple loan of shares") argues against this solution.

- ***Problems proving that voting rights have been abused***

Another approach in the same vein would be to draw on abuse-of-rights theory, which punishes majority or minority votes that go against the corporate interest and that are cast with the sole purpose of favouring a majority or minority shareholder, as the case may be, to the detriment of other shareholders. Penalties include cancelling the contested resolution and awarding damages where appropriate. To apply this solution, however, it is necessary to prove both the shareholder's personal interest and the damage to the corporate interest. Proof is even harder to establish since temporary shareholders often do not have a blocking majority or minority interest and manage to have draft resolutions passed or rejected solely by using their influence.

- ***Trafficking in voting rights: not the appropriate offence in this context***

Under Article L. 242-9 of the Commercial Code, "the fact of securing agreement, a guarantee or a promise of advantages for voting in a certain way or for not voting, and also the acts of agreeing, guaranteeing or promising such advantages" is punishable by two years in prison and a fine of €9,000.

This provision could be applied to stock lenders on the grounds that they are paid for not taking part in a meeting when someone other than the real owner gets to exercise the voting rights attached to the shares. However, aside from the obvious problems of establishing proof, this approach does not reflect the rationale of the offence or the economic rationale that underpins securities lending, because the lender is paid not for the loss of voting rights but for the financial service it renders by lending its securities. Furthermore, the lender does not exercise its voting rights by operation of law[6], because the Monetary and

[5] Note, however, a ruling by the Court of Cassation of 25 April 2006 regarding an attempt to gain control of an unlisted property company specialising in financing schemes for employee housing loans. After gradually acquiring a 40% stake in the property company, a third party contacted other investors with a view to disposing of all the company's assets. The Court of Appeal, whose decision was upheld by the Court of Cassation, ruled that the share acquisitions were null and void insofar as: "although seemingly in accordance with the formalities, the acquisition of the securities of SIIPH was conducted though LMO, a shell company that was held by CMV and that was not guided by *affectio societatis*, since the transaction was carried out not to provide access to accommodation for the employees of shareholder companies, but solely to generate a substantial capital gain by breaking up the assets of the property company under measures far in excess of mere profit-taking".
Note that under the case law of the Court of Cassation's commercial chamber, price clauses contained in "parking" agreements (*conventions de portage*) are not deemed unconscionable if they allow shares held under the agreement to be returned under conditions designed to achieve a balance in the agreements between the parties (and provided no fraud has taken place).

[6] Article L. 432-6 of the Monetary and Financial Code.

Financial Code recognises securities loans as *prêts de consommation d'actions* that entail transfer of title to the borrower. A stock loan conducted solely to influence a general meeting would be hard to punish on these grounds.

- ***Limitations of major holding disclosure requirements***

Under Articles L. 233-7 *et seq.* of the Commercial Code, any person who comes to hold a quantity of shares representing more than one-twentieth, one-tenth, three-twentieths, one-fifth, one-quarter, one-third, one-half, two-thirds, eighteen-twentieths or nineteen-twentieths of a company's capital or voting rights must inform the company and the AMF of the total number of shares or voting rights held. The company's bylaws may additionally require the disclosure of percentages of capital or voting rights that are below one-twentieth but not lower than 0.5% of capital or voting rights.

The penalties applicable in this area chiefly consist in having the shares stripped of their voting rights by the meeting officers or by legal means. At the request of the Chairman of the AMF, an application for an injunction, accompanied where necessary by precautionary measures or a financial penalty, may also be submitted to the presiding judge of the Paris Regional Court, acting in chambers. Similarly, the AMF can impose a fine under the combined provisions of Articles L. 621-14 and L. 621-15 of the Monetary and Financial Code.

The borrower, in the capacity as owner, is required to say whether his holding exceeds one of the disclosure thresholds because of the loan. By contrast, because these shares are considered to be owned, in accordance with Article L. 233-9 of the Commercial Code, the lender is not required to say that its holding has fallen below one of the disclosure thresholds as a result of the loan.

Furthermore, pursuant to Article L. 233-7 of the Commercial Code, the person required to provide the notification must specify in the shareholding disclosure "the number of securities held by the reporting person that may eventually give access to capital as well as attached voting rights". The Transparency Directive[7] provides for specific disclosures concerning derivatives in Article 13, which states that: "the notification requirements [...] shall also apply to a natural person or legal entity who holds, directly or indirectly, financial instruments that result in an entitlement to acquire, on such holder's own initiative alone, under a formal agreement, shares to which voting rights are attached, already issued, of an issuer whose shares are admitted to trading on a regulated market". These measures concern a huge range of financial instruments, because the notification requirements apply to all transferable securities and "options, futures, swaps, forward rate agreements and any other derivative contracts"[8].

But since this is merely a transparency framework, it cannot prevent the distortions that have occurred; and it may easily be circumvented if lenders and borrowers stay below the trigger levels for notification. In addition, because the published information does not separate owned shares from loaned shares, it may be hard for the issuer and the market to interpret. Moreover, a reporting entity can avoid having to declare its intentions by keeping its shareholding below the disclosure trigger point (point VII of Article L. 233-7).

- ***Difficulties in using the "misleading information" mechanism***

Article L. 465-2 of the Monetary and Financial Code imposes criminal penalties on anyone who "disseminates in public, by any channel or means, false or misleading information concerning the prospects or situation of an issuer whose securities are admitted to trading on a regulated market, or the likely trend of a financial instrument admitted to trading on a regulated market, that would be likely to influence the price thereof".

Article 632-1 of the AMF General Regulation states that: "all persons must refrain from disclosing or knowingly disseminating information, regardless of the medium, that gives or may give false, imprecise or misleading signals as to publicly issued financial instruments, within the meaning of Article L. 411-1 of the

[7] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.
[8] Article 11 of Commission Directive 2007/14/EC of 8 March 2007 implementing the Transparency Directive.

Financial and Monetary Code, including the spreading of rumours and false or misleading information, where the persons making the dissemination knew or ought to have known that the information was false or misleading".

Accordingly, a shareholder that appears to have a substantial interest in an issuer without disclosing the temporary nature of its holding might be considered to be disseminating misleading information. However, the mechanism has never been used in this way. Also, proving that a breach has been committed might be difficult, particularly if notifications are published pursuant to Article L. 233-7 of the Commercial Code and meet the necessary formalities.

- ***The non-binding nature of codes of best practice and guidelines***

Compliance with best practice is another possibility. This could involve including certain guidelines on a voluntary basis in master securities lending agreements – a recommendation made by some members of the working group set up by the AMF in 2005 on the exercise of voting rights at general meetings.

The code of best practice of the International Corporate Governance Network, for example, recommends not exercising voting rights attached to borrowed securities, having lenders recall securities, and establishing a sufficiently long period between the meeting date and the dividend payout. The Myners Report of March 2005, entitled *Review of the impediments to voting UK shares*, recommends that where resolutions are contentious, lenders should recall the stock unless there are good economic reasons for not doing so. Institutional Shareholder Services recommends that stock lending for the sole purpose of increasing voting rights should be banned.

In a published in September 2005, the working group called for transparency in stock lending and recommended that asset management companies recall lent stock when general meetings are held. Recommendation 12 of the report states:

"The provisions of a stock loan contract should inform the contracting parties about the effects of transferring stock on the voting rights. When an intermediary asks permission to use the stock it holds on behalf of a customer, it must explain clearly to the customer how the attached voting rights would be affected if the shares were loaned. Management companies should take back lent stock when general meetings are held."

Meanwhile, at the same time as it adopted the Directive on the exercise of certain rights of shareholders in listed companies[9], the European Commission launched a third public consultation on 30 April 2007 on a possible recommendation to be issued by the Commission at end-2007[10] to supplement the directive on several points, including stock lending, the role of intermediaries in the voting process and language requirements for meeting documents.

On the issue of stock lending, the Commission recommended discouraging the practice of borrowing stock ahead of general meetings for the sole purpose of materially influencing the outcome of general meetings. The proposed recommendations are as follows: stock lending agreements should provide information about the effect of the agreement with regard to voting rights; the lender should explicitly agree to its shares being used for stock lending in the framework agreement with the financial intermediary; borrowed shares should not be voted, except on instructions from the lender; borrowers should be required to return equivalent shares to those borrowed promptly upon the lender's request.

Some respondents to the Commission consultation felt that this contractual approach should be supplemented by lender disclosures to the issuer on any stock lending deal involving a significant number of voting rights, the identities of the lender and borrower, whether or not the holder of the voting rights intends to exercise such rights, and a requirement for institutional investors to disclose their stock lending policy.

[9] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007.
[10] The consultation document is available on the European Commission's website at http://ec.europa.eu/internal_market/company/docs/shareholders/consultation3_en.pdf

The recommendations-based approach however has a limited impact because it is inherently non-binding. It is also easy to circumvent because it applies only to stock loans and not to other arrangements, such as parking, repo, *réméré* and rental arrangements.

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Existing mechanisms may provide companies with useful tools to track changes in their shareholding structures, in particular through major holding disclosures, compliance with which requires particular attention on the part of meeting officers company's and, if necessary, the AMF. By the same token, the inclusion in company bylaws of additional disclosure requirements that are triggered when a shareholding exceeds 0.5% should be encouraged. Introducing a sufficiently long period between the meeting date and the dividend payout date would be another way to lessen the problems associated with securities lending before general meetings.

II – MAKE TEMPORARY EXCHANGES MORE TRANSPARENT

The working group began by considering ways to make the temporary exchange of securities more transparent. It was proposed that borrowers should have to make specific disclosures when engaging in temporary transfers of shares that involve a percentage of capital or voting rights in excess of a statutory threshold, to make the system more flexible, under company bylaws. The disclosure would cover the legal nature of the transfer and its duration to give guidance about the borrower's objectives. This would enhance the information provided to the market and the issuer, and deter the use of lending solely for the purpose of influencing a meeting. Obviously the risks of disruption by temporary shareholders would remain, but the market would be aware of the circumstances, procedures and length of the investor's commitment and would be better able to decide how much credence to give positions supported by the investor.

The aim is to identify and disclose the shareholder's actual influence by revealing the possible disconnect between an interest presented at the general meeting and the economic risk associated with share ownership.

- ***Scope of application: affected transactions***

Insofar as introducing this disclosure requirement would entail a legislative amendment, its scope has to be defined since no single concept encompasses all the different mechanisms that could be used to separate economic risk and legal ownership. In this regard, the choice must be made between using a generic concept, which would eliminate all risks of circumvention but might prove hard to interpret and create problems at meetings, or enumerating all existing mechanisms, a solution that would not be exhaustive, making it easy to circumvent.

Whatever the approach, establishing the scope of the new regulation will entail addressing the issue of whether the transparency framework should apply to equities that are totally or partly hedged. The UK's Financial Services Authority (FSA) launched a public consultation on 12 November 2007 on strengthening disclosure requirements for contracts for difference (CFDs)[11]. This issue clearly compounds the problems of finding a "one size fits all" concept.

Several generic concepts are possible. One option would be to use the notion of the economic risk attached to share ownership. For want of a definition, this approach might cause disputes.

Another possibility would be to target temporary transfers of securities. While not yet defined in law, the notion is already used in the Commercial Code, for example in Article L. 233-9, which refers to equities or voting rights "held by a third party with whom that person [the person required to make a notification under point I of Article L. 233-7 of the Commercial Code] has entered into a temporary transfer agreement covering those shares". Similarly, the notion is used in a section heading of the Monetary and Financial Code devoted to determining the legal regime for securities loans and repurchase agreements.

However, there is nothing under law requiring a court to feel bound by a section heading of the Monetary and Financial Code. Furthermore, while the notion might be agreed to encompass securities loans and repurchase agreements, there would be no certainty in the case of securities loans governed by the Civil Code or *réméré*, or reciprocal promises. According to a strict reading, these mechanisms, far from being temporary transfers – a notion that, remember, cannot be defined other than by the effects of the mechanism in question – could be legitimately interpreted as outright sales from the beginning, admittedly with a return facility. Under the Civil Code, a *prêt de consommation* (simple loan) is defined as a contract in which one party delivers a given quantity of a thing to the other party. It is specified that the effect of the loan is to make the borrower the owner of the loaned item. Such loans are not therefore considered to be temporary transfers. Similarly, it could be argued that a repurchase clause does not alter the nature of the transaction: the repurchase option is a facility in the hands of the seller. As long as it is not exercised, the acquirer owns the shares. Ultimately, it is only the seller's exercise of the repurchase option that makes the

[11] http://www.fsa.gov.uk/pubs/cp/cp07_20.pdf

exchange a temporary one, thus necessitating a backward-looking view. Above all, derivatives could easily be used to get round a framework based on the concept of temporary exchange.

Another solution would be to target any arrangement whose sole purpose is to transfer voting rights. Although perfectly suited to the objectives, this approach would be hard to implement, firstly because proof would be hard to establish and secondly because demonstrating the acquirer's intentions might generate considerable discussion. Also, as with the previous solution, hedging instruments could easily be used to get round this mechanism.

For this reason, though it has its drawbacks, enumerating all the mechanisms seems to be the best course of action. One member of the working group proposed including all mechanisms that allow "apparent" ownership to be separated from "economic" ownership of a security. The principle of such a solution would be based on a broadly-defined scope of application that would cover all affected situations while providing for exceptions to give the framework the necessary flexibility. A suggested though non-exhaustive list of exceptions would include transactions that are only partly hedged, say less than 20%, and cases where the hedge is part of a transaction aimed at fostering long-term shareholdings (e.g. leveraged shareholder ownership schemes). In addition, the framework should cover only shares hedged in the lead-up to a general meeting, i.e. during a given period – one year was proposed – before the meeting.

- ***Adding to the information requirements for major holding disclosures***

The working group explored several different disclosure frameworks. One option would be to supplement the mechanism provided under ordinary law for major holding disclosures, adjusting it to address the issue of the temporary exchange of securities before general meetings. An amendment to this effect of Article L. 233-7 of the Commercial Code could be accompanied by an amendment of Article R. 225-85 of the same code, which deals with the record date, to require the "temporary owner" of the securities to send the issuer or the agent bank any voting instructors on individual resolutions received from the transferor prior to the meeting. This information should be sent along with the voting ballot and should arrive no later than three days before the meeting.

Article 223-14 of the AMF General Regulation sets out the content requirements for these disclosures. While the reporting party must say why the shareholding threshold was breached, it is not required to distinguish directly owned shares from shares held under a temporary transfer, nor is it required to identify the lender or give the date and maturity of the loan. However, there is nothing under law to prevent this article from being supplemented to add these content requirements, since the provisions of Article 223-14 result from the transposition into French law of the Transparency Directive[12] which is not a maximum harmonisation directive.

But the party in question simply has to remain below the disclosure trigger points for the issuer and the market to receive no information about the temporary exchange. Furthermore, if the exchange is merely unwound within five days, which is the deadline for reporting major holdings to the issuer and the AMF, the penalty of automatic suspension of voting rights[13] becomes a purely notional punishment. Court-ordered suspension, however, would still be a possible measure insofar as it could be applied to all the shareholder's voting rights[14]. Accordingly, the framework would need to be supplemented with shorter notification deadlines, such as the day before or three days before. Another suggestion was to add new reporting thresholds and to require disclosures every time a threshold is crossed, e.g. at 2% then 3%. This would entail setting the new thresholds (e.g. at increments of 1% from the initial trigger level).

[12] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

[13] Commercial Code Article L. 233-14, paragraph 1: If they have not been properly declared as stipulated in I and II of Article L233-7, shares in excess of the fraction which should have been declared, when they are admitted to trading on a regulated market or a financial instruments market which permits trading in shares which may be entered in the books of an authorised intermediary as provided for in Article L211-4 of the Monetary and Financial Code, are stripped of the voting right for any shareholders' meeting held within two years of the date of effective notification".

[14] Commercial Code Article L. 233-14, final paragraph: "The commercial court having jurisdiction at the place where the company has its registered office may, having sought the opinion of the public prosecutor, and at the request of the company's chairman, a shareholder or the [AMF], order a total or partial suspension of voting rights, for a period not exceeding five years, against any shareholder who has not made the declarations referred to in Article L233-7 […]".

But amending the disclosure requirements for major holdings under ordinary law by adding new thresholds and shortening reporting deadlines, solely to adapt them to one-off actions that might affect the outcome of general meetings, may be a disproportionate response. Such an approach might cause the market to be flooded with information that is relevant only during the general meeting season.

- ***Specific reporting requirements for the general meeting season***

The working group considered a second avenue that consisted in introducing a special regime with a limited timeframe and scope of application. Under this approach, anyone with more than 2% of an issuer's voting rights would have to comply with special disclosure requirements if their holding resulted at least in part from a temporary transfer of securities. However, opinions were divided on the 2% threshold, with some issuers calling for it to be lowered to 1%, while others, particularly financial institutions, said that if it were set at 2%, it should include only borrowed securities. The notification would be made to the company and would not be subject to the major holdings regime.

The group also discussed the need to provide information to the market. This could be done by the company based on the reports it receives. Thus, the issuer would publish the information centralised at the record date in a news release of which it would be responsible for full and effective dissemination. At the very least, other shareholders would have to be informed, otherwise the mechanism would be partly ineffective.

The group also considered the question of requiring the lender to make the disclosure, notably to enable the company to conduct cross-checks. The problem with this approach is that if there is a series of loans or transfers, the lender will not necessarily know who actually ends up holding the securities.

Accordingly, the working group recommends that if a company's shares are admitted to trading on a regulated market, any person that possesses a number of shares making up a minimum percentage – say 2%, of the voting rights following a temporary transfer of these shares or any transaction entailing a right or obligation to resell these shares – shall inform the company and the AMF at 12 midnight CET on the third day before the general meeting of the number of shares held, specifying the number of shares acquired following a temporary transfer, along with the identify of the transferor, and the date and maturity of the temporary transfer agreement. Where applicable, the borrower shall indicate whether it has a voting agreement with the lender and provide this to the company. Failure to make such disclosures shall be punished under the disciplinary regime for major holding disclosures, i.e. automatic withdrawal of all voting rights until the securities are resold, total or partial court-ordered suspension of voting rights (not exceeding five years). The AMF may also impose a fine based on the combined provisions of Articles L. 621-14 and L. 621-15 of the Monetary and Financial Code.

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The appropriate solution is therefore to require specific disclosures to the market during the general meeting season concerning significant holdings resulting from temporary transfers. This will entail refining the definition of significance holding thresholds for this kind of holdings.

III – SHOULD VOTING RIGHTS BE AUTOMATICALLY STRIPPED FROM SECURITIES HELD UNDER TEMPORARY ARRANGEMENTS?

Aside from the question of share ownership transparency, the group examined ways to reconcile the exercise of voting rights at general meetings with actual exposure to the economic risk of having a stake in the company, for it is this risk that justifies the shareholder's rights, in particular the right to oversee the actions of senior management. It justifies the balance between the powers of shareholders and senior managers, as well as the different means of oversight available to shareholders. For this balance to work, the actions of senior management should not be challenged on grounds that do not serve the corporate interest. In this sense, one-off, short-termist actions by shareholders that possess only an "apparent" interest in the company may be considered illegitimate.

This risk of disruption can be completely prevented only by deploying a set of deterrents that not only prevent the temporary shareholder from exerting an influence on other shareholders that it does not have in the long term, but also from using this influence at the general meeting. The risk is particularly acute in the event of restructuring or a bid targeting the company. When shareholders decide whether to tender their securities to a bid, it is right that they should not be influenced by the temporary actions of a shareholder whose positions, whether taken before or at the meeting, are not dictated by a long-term interest in the company. Once a company is listed, however, the dividing line between what is legitimate and what is not can indeed be very thin. Moreover, purely speculative actions by a shareholder may only become apparent after the fact, for example when the company's assets are broken up or management is ousted. Hence the need to act earlier, at the meeting, by "forcing" the shareholder to reveal himself and by preventing him from exercising his voting rights, under terms to be determined under law.

Because such an approach would call into question one of the fundamental attributes of shareholders, it is vital to establish a precise scope of application that cannot be circumvented using mechanisms or products not covered by the ban. The more restrictive the framework is intended to be, the harder it is to determine the appropriate terms.

The group explored two avenues.

- ***Only the lender exercises voting rights***

One possibility would be to require lenders to recall securities during the general meeting season, or even ban lending transactions. In their voting policy literature, many management companies, for instance, include provision for recalling securities loaned by the funds that they manage.

But securities lending makes a major contribution to market liquidity, so banning it during the general meeting season would impede the orderly operation of the markets. Moreover, securities lending is a significant source of revenue for many institutional investors, who borrow securities a few days before the meeting in order to receive dividends. In addition, since a ban on lending before and during general meetings would probably apply only to French managers, it would be easy to get around and would create a competitive disadvantage that would be detrimental to resident investors.

Another possibility would be introduce measures so that only the lender could exercise the voting rights attached to the loaned shares, either by separating ownership of securities and exercise of voting rights, or by requiring the borrower to give the lender a voting form. This would be hard to implement, notably in cases where loaned securities are resold, because of their fungibility. There is therefore no reason to prevent the acquirer of the securities from exercising the voting rights at the meeting. Moreover, such a solution could increase the voting rights attached to shares and make securities lending transactions less transparent by separating the transfer of voting rights from the effect of transferring ownership, which must remain attached to the transactions to meet the market's needs for liquidity.

- ***Suspend voting rights attached to loaned securities***

Since the legitimacy of securities lending is not at issue, the group gravitated towards a solution based on suspending the voting rights of shares acquired through a temporary transfer or hedged shares. Specifically, the suspension would apply to the holder of the shares and not to the shares, which would address the problems of identification involved in successive loans or resales. A broad scope of application would make it possible to cover all affected situations, while providing for exceptions in situations not involving the targeted practices.

The framework could therefore include temporary transfers in the broad sense (regulated stock loans, repos, loans under ordinary law, *réméré* and reciprocal promises), whether these involve shares or voting rights (under rental arrangements, for example) as well as shares whose economic risk is specifically hedged, a practice sometimes called empty voting.

A broad scope of application would include situations where holdings have been hedged, but without impinging on the company's *affectio societatis* in the long term, such as transactions that are only partly hedged (this level would have to be determined), or cases where the hedge is part of a transaction aimed at fostering long-term shareholdings, such as leveraged shareholder ownership schemes.

Voting rights would be withheld only from shareholders that find themselves in one of these situations and that hold, either alone or in concert, a given percentage of the company's voting rights over a threshold that could be between 1% and 3%. Basing the approach on intent would be too hard to put into practice, so a time-based criterion could be used, with voting rights being suspended only for shares acquired during a specified period before the general meeting. Note that following publication of the Decree of 11 December 2006 introducing a record date system, the right to take part in the general meeting has to be established on the third business day before the general meeting, and a shareholder is entitled to transfer some or all of its shares at any time. The company does not take account of transfers or transactions that take place after the record date.

To be properly effective, the suspension of voting rights of temporary shareholders would need to be accompanied by a system of deterrents. However, this should not create an overly large risk that meeting resolutions will be cancelled.

One solution might be to have the commercial court issue an interim order to place the securities in escrow, since the resulting loss of liquidity should act as a deterrent. This could be accompanied by a court-ordered suspension of voting rights at the request of the company, a shareholder or the AMF. A five-year suspension of voting rights attached to other shares not held as part of a temporary exchange might prove a deterrent. The AMF could also impose a fine based on the combined provisions of Articles L. 621-14 and L. 621-15 of the Monetary and Financial Code.

However, the working group felt it was necessary to avoid a situation in which all the resolutions adopted in a meeting attended by a temporary shareholder would be systematically called into question. Otherwise the mechanism, which is designed to protect shareholders and the company, could actually disrupt the business. For the sake of legal certainty, the cancellation of one or more resolutions – or even the meeting itself – because the participation of a temporary shareholder has breached the new regulations should not be mandatory.

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If the automatic suspension of voting rights attached to temporarily held shares were envisaged to combat the possible distortions arising from stock lending more effectively, the requirements for implementing such a reform should be set in such a way as to ensure an orderly securities lending market and to avoid increasing the legal risks for general meetings.

CONCLUSION

To ensure that general meetings of shareholders are properly conducted, efforts must be continued to promote the active participation and effective involvement of shareholders in meetings. This is a pre-requisite for curbing the relative influence that may be wielded by shareholders without permanent exposure to the economic risk of share ownership.

This requires effective measures to provide greater transparency about shareholders' actual interests. Both company and market need a clear and distinct picture of the interests that a shareholder actually owns and of interests held as the result of a temporary transfer. They also need information about the identity of the lender and the duration of the temporary exchange. Systematic disclosure of voting agreements between lenders and borrowers would also help to reveal the short-term intentions of parties with respect to draft resolutions tabled at the meeting.

Going one step further, only by withholding the voting rights attached to temporarily owned securities or shares that are covered by special hedges, can temporary holders be prevented from unduly influencing companies' strategic decisions in certain circumstances.

The need for a specially designed system to reconcile legal and economic ownership of shares certainly does not obviate the need for a reliable and credible oversight and enforcement system. Civil penalties that suspend the voting rights of non-compliant shareholders could thus be supplemented with penalties that do not create too great a risk that adopted resolutions will be cancelled. An order placing shares in escrow could be issued before the meeting, thus acting as a deterrent. After the fact, the most effective instrument would doubtless be a fine imposed by the AMF.

AUTORITÉ
DES MARCHÉS FINANCIERS
AMF

APPENDIX I - COMPOSITION OF THE WORKING GROUP

Chairman
Yves Mansion (member of the AMF board)

Members

Jean-Pierre Carrafang, Crédit Agricole Investors Services Corporate Trust
Odile de Brosses, AFEP
Isabelle Trémeau, MEDEF
Andrea Rutigliani, BNP Paribas Securities Services
Christian Rabeau, Axa Investment Manager Paris
Pascal Plocque, Suez
Christophe Clerc, Shearman & Sterling
Robert Baconnier, ANSA
Jean-Paul Valuet, ANSA
Antoine Bied-Charreton, Véolia Environnement
Pierre Todorov, Accor
Antoine Courteault, Sequana Capital
Fabrice Remon, Deminor
Patrice Marteau, Acteo
Marianne Paris, Caisse des Dépôts et Consignations
John Glen, Air Liquide
Philippe de Saint-Ours, Air Liquide
Martine El Sakhawi, Crédit Agricole AM
André Dupont-Jubien, Lazard Frères et Cie
Luc Giraud Natixis Corporate Solutions
Aymeric Le Clere, Natixis Corporate Solutions
Patrick Suet, Société Générale
Sébastien Cochard, BNP Paribas
Jacques Espinasse, company director

Also present

Nicolas Namias, Ministry of the Economy, Finance and Employment

AMF representatives

Hubert Reynier (AMF, Managing Director, Regulation Policy and International Affairs)
Olivier Douvreleur (AMF, Director, Legal Affairs)
Benoit de Juvigny (AMF, Managing Director, Corporate Finance)
Samia Mekious (AMF, Regulation Policy and International Affairs)
Carole Uzan, (AMF, Legal Affairs, Rapporteur)