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Is there yet a “European Shareholder” ?

How to develop the attractiveness of European capital markets ?
Should certain categories of shareholders be favoured, in particular individual shareholders ?

Executive summary:

In order to sustain sufficient economic growth of the European economy, Europe needs to further integrate its capital markets in order to attract more capital and reduce costs for European companies. Capital markets remain indeed among the most efficient fund resources for corporations, big or small, to finance their activity and development.

At present a significant proportion of the excess of savings of European households is still invested outside Europe and in particular in the US.

The issue therefore is to define the actions required for making European capital markets more attractive for shareholders and for retaining a larger proportion of individual savings.

The European Commission has made proposals to increase the attractiveness and accessibility of European capital markets. These should ensure equal rights for shareholders across the EU (which is not the case today) and increase the participation of shareholders to corporate governance processes (currently less than 1% of shareholders attend General Assemblies on average): directive on shareholders' rights (exercise of cross-border voting rights, organisation of General Assemblies...), transparency directive, tax harmonization, etc...

In addition a certain number of market-led initiatives are bringing further progress:

- There is an on-going dialogue in the European Corporate Governance Forum and with business representative associations and market players such as UNICE, ECODA, Euronext... to define possible actions to improve corporate governance such as exchanging best practices, encouraging coordination and convergence of national governance codes.
- The integration of European trading and post-trading infrastructures is making progress through eg the Euronext model integrating trading platforms from Belgium, the Netherlands, Portugal, France and Great-Britain (Derivatives), and the creation of LCH Clearnet.

There is currently a strong diversity in shareholding structures across Europe and different behaviours have been observed among shareholders:

- The relative proportion of shareholders (financial and non-financial corporations, funds, states, individual shareholders) varies significantly across the EU countries for historical, cultural and legal reasons.
- Shareholders have different objectives and levels of involvement in the management of the company, certain being more speculative such as hedge funds and therefore less involved in the long term development of the company.

The level of influence that shareholders have on the strategy and control of companies also varies significantly within EU countries, but in most EU countries the

interests of other stakeholders (in particular employees) are taken into account to a certain extent in strategic decisions.

However the decrease of individual shareholding is a common trend to most EU countries to the benefit of investment funds or institutional shareholders, confirming the trend observed in the US.

Debates have emerged on the need to favour certain categories of shareholders, to differentiate governance rules and improvements proposed among different types of shareholders and to provide different rights to different types of shares (against the “one share one vote principle”).

But at this stage there has been no consensus in the market on these issues. In particular on a potential economic advantage of favouring individual shareholders or on the need to favour domestic shareholders.

Many observers consider that the real issue at stake is how to attract the right shareholders (that will be committed to the long term development of the company and potentially ready to be involved in its management decisions to a certain extent).

The need and possible ways to develop the access of small and mid caps and non-listed companies to EU capital markets is another significant issue to be addressed. Some industry players consider that additional actions at the EU level should be considered to encourage investment in these companies and that the current proposals of the Commission should be adapted to the size and flexibility needs of these companies.

Main questions to be addressed during the workshop:

On-going proposals for further developing integrated EU capital markets:

- Are the present actions and proposals to develop a further integrated EU capital market sufficient (actions undertaken by the Commission, market led initiatives) ?
What additional actions could be required ?
- Should individual shareholding be developed in the EU ?
 - o For which reasons and potential benefits for the different stakeholders ?
 - o If yes are the on-going actions and proposals sufficient to develop individual shareholding ?
 - Does the current European policy and the improvements proposed take enough into account the needs of individual shareholders in particular related to potential tax issues ?
 - How to manage efficiently the relationship with individual shareholders through General Assemblies or other occasions ?
 - What concrete benefits does MiFID bring to individual investors ? (transaction costs, investor protection, quality of service ?...)
- Should the European and national legislators diversify the rules according to the typology of shareholding and simplify the rules whenever possible ?
- Would the implementation of a harmonized “one share one vote” principle throughout Europe contribute to the development of integrated capital markets ?

Impacts of the harmonisation and consolidation of EU financial markets on individual shareholders :

- What impacts of the potential consolidation of EU infrastructures (trading / post-trading) for shareholders and issuers ? Concrete benefits / potential concerns / specific actions needed ? What concrete impacts of the implementation of integrated platforms (ex: Euronext) ?
- What potential concrete benefits for shareholders and issuers of the harmonisation of EU securities markets through the lifting of the 15 Giovannini barriers ? Illustration of these benefits.

Development of private equity in Europe:

- Which actions would be necessary to develop private equity further and what potential impact on EU capital markets ?

Harmonization of corporate governance codes in the EU:

- Is there a need to harmonize corporate governance codes at the EU level ?
- What are the best practices at the EU level ?

No uniformity in the structure of shareholding within the EU

Historically, individual shareholders are the basis of companies' capital structures in the European economic system. They are supposed to be animated by the "affectio societatis", which means that they are not only motivated by a sustainable increase in the value of the company (often related to a long term growth strategy), but are also concerned with the development of the company's activities, the quality of the management team....

There are two theoretical models of corporate control and governance :

- The "widely held model" provides diversification opportunities (spreading corporate risk over a large investor base), market liquidity and consequently a lower cost of equity.
- The "blockholder model" enables very often to exercise a more effective control on the Board and CEO.

In most cases, the structure of companies' shareholding is a mix between the two models, in varying proportions throughout Europe.

In the EU as a whole at the end of 2004 (Appendix 1 for further details):

- 15% of share capital were owned by EU households
- 58,5% were owned by financial and non-financial institutional investors
- 4% were state-owned
- 22,5% were owned by foreign investors.

The relative importance of these different types of shareholders is variable across EU countries for historical, cultural and legal reasons (Appendix 1 for further details):

- In the Netherlands and in Scandinavian countries shareholding is dominated by investment funds, with a high level of internationalization for the NL (where 69% of total shares are owned by foreign investors according to FESE statistics – Appendix 2) and there are rarely reference shareholders. As a result, shareholding is fairly dispersed.
- In the UK, shareholding is also dominated by investment and pension funds alongside a wide and dispersed individual shareholding. This individual shareholding is active through different shareholders' associations, but it remains less influential than investment funds
- In other countries, international institutional investors also represent a large proportion of ownership (~35 % of listed shares are owned by international shareholders in France – Appendix 2). But a strong proportion of the shareholding is also directly or indirectly owned by a certain number of reference domestic shareholders (in France about 33% of CAC 40 companies have reference shareholders and 20% of them are related to family shareholding, in Germany and Italy banks are often reference shareholders, 32% of BEL20 capital are controlled by reference shareholders in 2004 however, coming from 44% in 1998).
- In a certain number of countries, many former public sector companies are still partly state-owned (utilities, companies in strategic economic or defence sectors,...). This is in particular the case for France with EDF / GDF, Thales, Renault,...for Germany with Volkswagen, banks. In certain cases the state retains a golden share that gives them a strategic veto right.
- In some countries, company employees own a large proportion of the capital, in listed companies but also in non listed ones. This is the case in Northern

European countries (eg Germany, NL, and Scandinavia) where employees benefit from specific conditions to purchase shares of their company and in certain French companies (eg Société Générale, Essilor, Auchan).

- In the south of Europe, the block model still seems to be predominant.

All these heterogeneities are considered to hinder cross-border investment as potential investors have to integrate these different situations. This is probably more difficult for individual shareholders than for professional investors such as reference shareholders, institutional investors or funds.

The lack of uniformity may also be an obstacle for issuers (small or medium-sized) to raise funds on European capital markets.

In most EU countries the interests of the different stakeholders of the company, particularly its employees, are taken into account in the main strategic decisions

In certain countries such as the UK most companies tend to be managed to the benefit of their shareholders following guidelines similar to those applied in US companies.

But in most EU countries companies are governed to a certain extent according to the collective and social interest of the company that include in particular its employees. This is particularly the case in Germany.

Therefore in most Continental Europe countries certain decisions can be taken against the short term interest of shareholders according to a long term perspective.

In most EU countries a continuous decrease of individual shareholding to the benefit of investment funds has been observed

Between 1995 and 2004 (detailed statistics in Appendix 1):

- In the EU, the % of total EU shares detained by households decreased from 18.7 % to 14.9%
- The percentage of total EU shares detained by banks and other financial institutions rose from 16.7 % to 20.1 % and the percentage detained by non-financial corporations rose from 26.8 % to 29.4 %.

In the US the trend was similar during the same period: the percentage of shares detained by households decreased from 48.6 % to 37.9 % and the percentage detained by banks and other financial institutions raised in the meantime from 15.3 % to 25.5 % .

This trend which is true for all types of shares could be at least partly explained by:

- The attractiveness for many retail investors of investment funds that provide them with appropriate risk / return performances
- The increasing creativity, expertise and the marketing efficiency of the funds industry in general (asset managers, distributors...).

Structural changes of the international capital markets and financial systems over the last 20 years can also be a further factor of influence (acceleration of new technologies, mergers and acquisitions, deregulation...)

Different debates have emerged on the need to favour certain categories of shareholders, to differentiate governance rules and improvements proposed among different types of shareholders and to provide different rights to

different types of shares. But there is at present no consensus in the market on these issues.

There is no consensus at present on the economic interest to favour individual shareholders:

- Some observers believe that the development of individual shareholding is necessary for the efficiency of capital markets and for the stability of the company shareholding structure. They consider that since individual shareholders are usually looking for a sustainable progress in the value of their shares and / or dividends often related to the long term growth strategy of the company they are more stable and committed to the development of the company.
- Others point out that there is no evidence demonstrating that individual investors are more committed in the long run and believe on the contrary that institutional shareholders should be favoured as they potentially bring more economic efficiency at a lower cost, ensuring market liquidity and that specific rules should be put in place for them.
- Investment funds are quite often said to monitor their participations mainly from a financial perspective with a limited interest in the long term strategy of the firms they invest in. This may be true of speculative funds such as hedge funds but more traditional investment funds such as blue chips equity funds monitor closely their investments with a medium / long term perspective

There is no consensus is the need to favour domestic shareholders:

- Some observers believe that domestic investors should be favoured as they tend to be more committed to the development of their home companies
- Others consider that the real issue is the commitment investors have to the long term development of the company regardless of their nationality and that this is more related to the strategic objectives of the investors (eg speculative investors such as most hedge funds will tend to be less committed than institutional investors such as pension funds).

Many observers consider that the real issue at stake is how to attract the right shareholders that will be committed to the the long term development of the company and potentially ready to be involved in its management decisions to a certain extent, regardless of their characteristics.

The objective of the current proposal of a Directive for shareholder rights is to improve shareholders rights across Europe and to foster their convergence

Shareholder rights currently differ across Europe:

- The way voting rights are exercised varies.
- Access to information is not equivalent

Besides the right to be correctly informed and in due time, the European shareholder should have an uniform easy access to general meetings in EU and be able to vote with the same easiness in all European countries.

Shareholding democracy is supposed to ensure a control and visa on the strategies and the management of the corporations and should be open to the largest possible number of shareholders.

The current proposal for a Directive therefore pursues the following objectives:

1. Ensure that all general assemblies are convened sufficiently in advance and that all documents to be submitted to the general assembly are available in time to allow all shareholders, no matter where they reside, to take a reasoned decision and to cast their votes in time.
2. Abolish all forms of share blocking. These should be replaced by a record date system to determine the entitlement of a shareholder to participate and vote in a general assembly.
3. Remove all legal obstacles to electronic participation in general assemblies. Where the issuer decides to make electronic means available to its shareholders, these will make it much easier for the active shareholders to participate actively in the meeting. However, technology is not advanced enough to permit active electronic participation in all cases with a sufficient guarantee of security, and such facilities are costly to introduce. Therefore, there should not be an obligation for issuers to offer such a possibility to their shareholders.
4. Offer non-resident shareholders simple means of voting without attending the meeting (voting by proxy, in absentia and by giving instructions).

These proposals are generally considered as a significant progress but they raise different implementation issues and additional actions may be required to provide sufficient benefits to all shareholders and types of issuer companies

Technical issues:

Issuers point out the technical complexity of implementing these proposals and in particular cross-border voting. Certain issuers favour the development of proxy voting as an alternative.

Individual shareholders:

These proposals will bring progress mainly for shareholders who take part to General Assemblies ie mainly institutional investors and funds. They will therefore impact individual shareholders indirectly through the funds they hold but only impact direct individual shareholders in a limited way as they often do not take part to General Assemblies.

Individual shareholders are sensitive to fiscal issues that could potentially reduce the yield of their portfolios over the years and require additional administrative work and are not addressed in the present proposals.

Some fiscal issues need to be solved to enable the development of cross-border individual shareholding. In particular the double taxation of dividends and capital gains for cross-border shareholders leads to complicated and time-consuming administrative processes (or to a significant reduction of the yield of the investment if the investor is not ready to do the required paper work) that may discourage certain individual investors.

For example the Belgian shareholder of a French company pays at present twice a withholding tax on dividends (15% in France, and 15 or 25 % in Belgium) and needs

to go through a complicated administrative process to obtain a partial reimbursement of the French withholding tax.

The proposals made may not take enough into account the reality of relations between issuers and individual shareholders. Issuers indeed point out that further requirements are needed to regulate the participation of individual shareholders to General Assemblies:

- At present General Assemblies are the main events organized to enable individual shareholders to participate in the management of the company. But issuers consider that individual shareholders are often not sufficiently or adequately represented and that these events are the opportunity for shareholders with a specific agenda to organize lobbying actions that can be to the detriment of the company, in particular when shareholding is very dispersed. They believe therefore that measures should be proposed to improve the organization of Assemblies (self-regulatory measures or EU standards in particular).
- Issuers are also trying to develop different ways to communicate with their individual shareholders or to inform them of the evolutions of the company: newsletters, individual shareholder clubs...

The development of individual shareholding also requires issuers and financial intermediaries to provide sufficient information on the level of risk of their investment. This issue is taken into account in the proposals of MiFID and in the transparency directive in particular.

Small and medium-sized companies:

New rules should also provide issuers of different sizes with enough flexibility to adapt their communication to the size, stage of development, culture and current or expected shareholding.

Another issue to tackle is the access of small and mid cap and non-listed companies to EU capital markets. Certain industry players consider that the present proposals of the Commission should be adapted to the size and flexibility needs of these companies and that additional actions at the EU level should be considered to encourage investment in these companies.

Some additional proposals are being debated currently, related to shareholder democracy in particular within the EC Forum groups.

As the previous proposals they will potentially impact in priority shareholders who take part to General Assemblies:

1. One-share one-vote principle: should this principle be enforced throughout Europe?
2. Rights of shareholders: nomination and dismissal of directors, shareholder communication, investigations in the code of conduct of company affairs...)
3. Obligations of shareholders: should institutional and professional shareholders in particular have the obligation to participate actively to the management of the company?
For example, France has implemented a legal “comply or explain” obligation

for investment funds to take part to the decisions impacting companies (voting at General Assemblies) but this obligation is not extended to other institutional shareholders such as pension funds or banks. Certain observers think that this should be the case.

In addition EU capital markets need to be further integrated to favour their development

This should be possible through the lifting of the Giovannini barriers (technical, legal and fiscal barriers that hinder further integration of EU securities post-trading markets) and through possible consolidation or inter-connection of trading and post-trading infrastructures to reduce the costs incurred by individual shareholders for their cross-border transactions.

The implementation of a single order book within the Euronext zone for example will display the real benefits for individual shareholders of a further integration of EU capital markets.

It is also currently not always easy for issuers to have a clear view of the structure of their individual shareholding in the different EU countries. Further progress in these areas would be required within the EU from the infrastructures dealing with these matters (CSDs, registrars...)

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Appendix 1

Evolution of the breakdown of shareholding between 1995 and 2004 in the EU and the US for all companies

(Source: National Accounts, OEE – Observatoire Européen de l'Épargne analysis)

Breakdown of shares and other equity holdings at end of 1995 (%)

	Households	Non-financial corporations	General government	Banks and other financial institutions	Insurance corp. and pension funds	Rest of the world	Total
Germany	20,2%	40,9%	6,5%	16,9%	5,4%	10,1%	100,0%
Spain	29,1%	26,6%	9,0%	9,6%	1,6%	24,2%	100,0%
France	12,4%	44,8%	8,0%	14,9%	4,5%	15,5%	100,0%
Ireland	36,0%	25,1%	13,4%	13,9%	3,5%	8,0%	100,0%
United-Kingdom	19,0%	12,0%	0,4%	13,9%	36,7%	18,0%	100,0%
Total EU*	18,7%	26,8%	7,1%	16,7%	12,2%	18,6%	100,0%
USA	48,6%	na**	0,3%	15,3%	28,7%	6,5%	100,0%

* be, de, gr, es, fr, it, hu, nl, at, pl, pt, fi, se, uk & no

** National accounts are consolidated in the US. Hence holdings of corporations equities by other corporations are not taken into account.

Breakdown of shares and other equity holdings at end of 1999 (%)

	Households	Non-financial corporations	General government	Banks and other financial institutions	Insurance corp. and pension funds	Rest of the world	Total
Germany	17,3%	34,3%	2,3%	24,4%	7,0%	14,6%	100,0%
Spain	26,0%	28,1%	5,2%	17,2%	2,0%	21,4%	100,0%
France	9,9%	41,6%	5,0%	17,9%	4,7%	21,0%	100,0%
Ireland	35,8%	25,1%	4,9%	20,2%	4,4%	9,6%	100,0%
United-Kingdom	18,1%	13,8%	0,1%	14,3%	31,8%	21,8%	100,0%
Total EU*	17,8%	26,0%	3,9%	18,6%	12,3%	21,4%	100,0%
USA	47,0%	na**	0,6%	20,3%	23,9%	8,3%	100,0%

* be, de, gr, es, fr, it, hu, nl, at, pl, pt, fi, se, uk & no

** National accounts are consolidated in the US. Hence holdings of corporations equities by other corporations are not taken into account.

Breakdown of shares and other equity holdings at end of 2004 (%)

	Households	Non-financial corporations	General government	Banks and other financial institutions	Insurance corp. and pension funds	Rest of the world	Total
Germany	15,3%	32,5%	2,5%	21,6%	8,1%	20,0%	100,0%
Spain	21,2%	39,5%	3,0%	12,4%	1,8%	22,0%	100,0%
France	9,9%	42,9%	4,3%	20,0%	4,5%	18,3%	100,0%
Ireland	37,6%	26,6%	4,5%	16,6%	4,2%	10,5%	100,0%
United-Kingdom	11,1%	18,7%	0,2%	22,9%	22,5%	24,6%	100,0%
Total EU*	14,9%	29,4%	4,0%	20,1%	9,0%	22,7%	100,0%
USA	37,9%	na**	0,5%	25,5%	25,0%	11,1%	100,0%

* be, de, gr, es, fr, it, hu, nl, at, pl, pt, fi, se, uk & no

** National accounts are consolidated in the US. Hence holdings of corporations equities by other corporations are not taken into account.

Appendix 1 continued
Evolution of the breakdown of shareholding between 1995 and 2004 in the EU and the US for listed companies

(Source: National Accounts, OEE analysis)

Breakdown of listed shares holdings at end of 1995 (%)

	Households	Non-financial corporations	General government	Banks and other financial institutions	Insurance corp. and pension funds	Rest of the world	Total
Spain	26,8%	20,3%	4,0%	12,0%	3,5%	33,3%	100,0%
France	14,4%	30,5%	4,0%	21,0%	7,9%	22,1%	100,0%
Italy	29,8%	26,3%	12,5%	14,1%	5,6%	11,6%	100,0%
United-Kingdom	14,1%	12,7%	0,4%	13,2%	46,6%	13,0%	100,0%
Total EU*	16,6%	17,9%	2,8%	14,1%	30,2%	18,3%	100,0%

* be, gr, es, fr, it, hu, nl, at, pl, se, uk & no

Breakdown of listed shares holdings at end of 1999 (%)

	Households	Non-financial corporations	General government	Banks and other financial institutions	Insurance corp. and pension funds	Rest of the world	Total
Spain	24,6%	16,2%	0,1%	23,8%	3,2%	32,1%	100,0%
France	7,7%	20,4%	8,0%	25,1%	6,4%	32,3%	100,0%
Italy	26,1%	31,2%	7,8%	16,0%	3,6%	15,4%	100,0%
United-Kingdom	13,1%	14,7%	0,2%	13,8%	39,4%	18,8%	100,0%
Total EU*	15,9%	16,4%	3,3%	16,8%	23,8%	23,9%	100,0%

* be, gr, es, fr, it, hu, nl, at, pl, se, uk & no

Breakdown of listed shares holdings at end of 2004 (%)

	Households	Non-financial corporations	General government	Banks and other financial institutions	Insurance corp. and pension funds	Rest of the world	Total
Spain	19,0%	27,8%	0,0%	16,5%	4,9%	31,9%	100,0%
France	6,1%	15,9%	5,3%	34,2%	5,8%	32,7%	100,0%
Italy	22,8%	38,6%	6,0%	12,5%	4,6%	15,5%	100,0%
United-Kingdom	9,5%	21,6%	0,1%	20,9%	28,2%	19,6%	100,0%
Total EU*	11,7%	20,5%	3,9%	21,1%	18,4%	24,5%	100,0%

* be, gr, es, fr, it, hu, nl, at, pl, se, uk & no

Appendix 2:

Foreign ownership of listed companies in 2004 in EU countries (percentage of total shares)

Source FESE

Foreign ownership of listed companies in 2004 in some EU-EES countries (percentage total shares)

Belgium	40
Cyprus	10
Denmark	27
Finland	46
France	35
Germany	17
Greece	31
Hungary	72
Iceland	7
Italy	14
Lithuania	52
Malta	31
Norway	28
Poland	53
Portugal	39
Slovak Republic	86
Spain	35
Sweden	33
The Netherlands	69
United Kingdom	32

Source: FESE.

Appendix 3 :

Number of shareholders and holders of mutual funds (in % of the population)

Source OEE analysis

Number of shareholders and holders of mutual funds (in % of population)

	Shareholders	MF shares holders
Germany (2000)	9,7	13,1
Germany (2005)	7,3	12,4
France (2000)	12,7	11,6
France (2005)	13,8	9,9
Italy (2000)	7.9*	12,1
Italy (2004)	7,2	8,8
USA (2001)	21,3	17,7
USA (2004)	20,7	15,0

* 1998 data