Share Issuances Without Preemptive Rights (Continental Europe and Asia)

Background

Unlike in authorized capital markets (such as the U.S.), companies in many markets in Europe and Asia are not legally permitted to issue any additional share capital without a specific authority granted by shareholders. It is therefore common for companies incorporated in many European and Asian markets to request that shareholders approve a general (i.e. non-specific) authority to issue new shares up to a certain maximum limit, sometimes, but not always, limited to a specific timeframe. In most cases, management will not have a specific intention to issue new shares at the time when shareholders consider and vote on the authority, and therefore there will be no intended purpose that shareholders can consider. Companies' rationale in seeking such a general authority is that management may need some ability to issue new shares quickly and flexibly from time to time, and that having to seek shareholder approval for each individual capital increase, no matter how small, would represent an unjustified time and cost burden, particularly as it could require the company to convene frequent EGMs. Therefore, some level of general authority is usually considered appropriate, but investors will tend to be concerned to ensure that unlimited or inappropriately broad authorities are not given that could lead to unwanted dilution or other loss of value.

Preemptive rights are a legal protection giving shareholders the rights to subscribe to new share issuances in proportion to their existing holdings, and thus are important in helping to manage the risk of unwanted dilution. In the markets concerned, shareholders will generally have preemptive rights by law, unless waived by shareholder approval. Most investors consider preemptive rights to be an important shareholder right that should only be waived to a limited degree, or under specific circumstances.

In the case of general share authorities that may waive preemptive rights, ISS currently has a policy approach that sets a maximum limit of 20 percent of share capital, with this maximum limit being lowered in markets where local best practice recommends a lower limit.

According to ISS' 2013-14 policy survey results, 93 percent of investor respondents indicated that size of the requested authority is important when voting on general share issuance authorities in conditional capital markets in Europe and Asia.

ISS notes the following facts:

In some European markets (for example, Belgium and Switzerland), it is still common market practice for companies to propose capital resolutions without preemptive rights that exceed 20 percent of share capital. In some other markets, for example Germany, market practice is still often higher than 20 percent, but appears to be moving downwards towards a 20 percent standard. Except for the UK, Ireland, and now France, there are no other best practice recommendations in Europe that recommend limits below 20 percent for share issuances without preemptive rights. In European markets other than the UK, Ireland, and France, votes on this issue occur relatively infrequently. In the recent ISS coverage universe, 66 percent of all such capital authorizations voted at European companies concerned companies in the UK, Ireland, and France.

In Asia, companies in Hong Kong, Singapore, Malaysia, and India routinely seek shareholder approval for share issuance authority. Currently, there is no local best practice recommendation, but in Hong Kong and Singapore, the stock exchanges impose a 20 percent authority limit, and, in Malaysia, the mandatory limit under the exchange is 10 percent. In India, while there is no mandatory limit, possible dilution typically exceeds 20 percent. In Hong Kong, while the size of the share authority is capped at 20 percent, this type of proposal typically receives the most against votes from shareholders, and, at several companies, these proposals have not received support from a majority of shares cast.

Current ISS Benchmark Policy

ISS policy in Europe and Asia for general share issuance requests where preemptive rights can be excluded is currently to recommend against such requests if the authority represents more than 20 percent of existing issued share capital. This 20 percent limit is lowered in markets when local best practice recommendations are themselves lower (for example, in the UK where the limits recommended by the UK Corporate Governance Code are a maximum of 5 percent and 10 percent, depending on the size of the company involved). ISS also applies a 20 percent authority limit for most Asian markets, with the exception of Hong Kong. In Hong Kong, the limit can be as low as 10 percent for proposals seeking share repurchase or share reissuance mandates.

For 2014, ISS will be introducing a lower limit of 10 percent for France, in line with a new recommendation of the AFG (Association Française de la Gestion Financière), the French Asset Management Association

For clarification, ISS policy for specific share issuance requests (i.e. when the company discloses a specific reason for the capital increase being requested, and therefore shareholders are able to consider the specific circumstances) remains unchanged. For such proposals, whether with or without the waiver of preemptive rights, ISS evaluates each on a case-by-case basis.

Policy Directions

ISS is evaluating the development of benchmark policy regarding share issuance authorities without preemptive rights for 2015 or beyond. To date, ISS benchmark policy has taken the approach that 20 percent is an appropriate maximum limit to apply, with lower limits in markets where lower limits are recommended by local best practice standards. We are aware that investors differ in their views on such limits and would therefore appreciate feedback on different views on this matter.

Request for Comment/Feedback

Please feel free to add any additional information or comments on this policy area. In addition, ISS is specifically seeking feedback on the following:

1. Does your organization agree with the current ISS policy approach as outlined above? If no, please explain.
2. What is your organization’s view on applying a maximum limit in these situations?
    a. A maximum limit should not be applied (please explain)
    b. higher than 20 percent (please specify)
    c. 20 percent (the current level)
    d. 15 percent

e. 10 percent
f. 5 percent
g. Zero (no such authorities should be approved)

3. What other factors, if any, should be taken into account when evaluating general share authority resolutions without preemptive rights?

To submit a comment, please send via email to policy@issgovernance.com. Please indicate your name and organization.