Norges Bank Investment Management

Shareholder rights in equity issuances

Position paper

Norges Bank Investment Management position

1. Existing shareholders should have the right to approve new share issuances in order to evaluate significant capital decisions and prevent dilution of their ownership without their prior consent. The board should submit requests for specific share issuances or for general authorities to a shareholder vote.

2. Share issuances should treat all existing shareholders fairly. Existing shareholders should have the right to participate pro rata to maintain their voting share and benefit from any potential discount. Issuances without pre-emptive rights should not exceed 10 percent of the existing share capital.

3. The approval for a general authority should be reasonably close in time to the intended capital allocation to allow for an informed voting decision. General authorities to issue shares should last no longer than 15 months, or until the next annual shareholder meeting.

Background

Major corporate events can alter the risk profile and the nature of a company and therefore require shareholder approval in many markets. This position paper considers the structuring and approval process for new share issuances.

Raising capital to strengthen the balance sheet or grow the business is typically in the interest of long-term shareholders. However, share issuances carry a number of risks. The structuring of the issuance may lead to more favourable treatment of certain shareholder groups and can dilute the holdings of existing shareholders. Furthermore, the capital raised may be deployed in a value-destructive way.

We note that approval processes and the structuring of share issuances are determined by laws, stock exchange rules and market practice, which vary between markets. While shareholders must approve share issuances in most countries, management typically needs board approval only to issue common stock in the United States and a few other markets. In a majority of US states, pre-emptive rights are not given to shareholders by default unless explicitly stated in the company's charter, making such rights the exception.

Arguments for the position

Shareholder approval increases focus on value creation
Management may have incentives to deploy capital at a return below shareholders' expectations. Submitting the issuance to a shareholder vote encourages the board to demonstrate that the issuance is beneficial to all shareholders.

Pre-emptive rights avoid unfair dilution of existing shareholders
Pre-emptive rights ensure that existing shareholders can maintain their ownership stake. Issuances without pre-emptive rights may dilute the investment and control rights of existing shareholders.

Limits on general authorities discipline management
A shorter time horizon forces the board to consult and seek approval from shareholders more frequently. A timely approval also links the request for a share issuance more closely to the intended capital deployment.

Arguments against the position

The board is best placed to make capital decisions
The board knows more about investment opportunities and the company's capital needs. In time-sensitive situations, the board can swiftly approve a large share issuance to support the company.

Share issuances without pre-emptive rights can benefit all shareholders
Issuances without pre-emptive rights are typically faster and often less expensive from the company's perspective. They can benefit all shareholders by allowing quick access to capital markets at minimum cost.

General authorities provide flexibility for management
Frequently requesting approval may increase costs and reduce flexibility. Management may also feel unwanted pressure to use the authorities before they expire, which may lead to suboptimal capital allocation decisions.

Norges Bank Investment Management's considerations

Weighing the arguments, we believe that share issuances should be subject to shareholder approval. Issuances and the distribution of equity affect the core economic rights of shareholders and require particular consideration. It is the role of the board to guide and monitor the capital allocation process, and the responsibility of management to identify investment opportunities and associated capital needs. Shareholder approval serves as a safeguard and encourages the board to demonstrate that the issuance is beneficial to the company and all shareholders.

We believe that share issuances should by default carry pre-emptive rights, only to be disapplied following appropriate shareholder approval. Pre-emptive rights allow for the fair treatment of all existing shareholders and remove the risk of unwanted dilution. There are market practices allowing for a rapid share issuance process and pre-emption at the same time. While we recognise differences in market standards, we believe that 10 percent is a reasonable threshold, allowing for smaller issuances without pre-emptive rights. In an issuance without pre-emptive rights for other purposes, it is the responsibility of the board to protect existing shareholders in the allocation process.

The board should submit a request for a general authority to shareholders, setting out the size, terms and rationale. We believe that seeking a renewed approval for a general authority at each shareholder meeting neither creates significant extra work, nor unduly restricts management.

This position will serve as a basis for our discussion with boards.