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Proxy Advisors (Shareholders' Rights) Regulation Implementation (DEPP and EG)

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I very much welcome the opportunity to participate in the public consultation in relation to the transposition of the SHRD II into UK Law. I will not comment on all the proposed revisions included in this Consultation as I will focus on matters directly related to my area of academic expertise and my ongoing research in corporate governance that I hope will be useful for your purposes.

Short Biographies

Professor Konstantinos Sergakis holds an LL.B. from the National and Kapodistrian University of Athens, an LL.M. in International Business Law from University College London and a Ph.D. from the University Paris 1 Panthéon-Sorbonne. He joined the University of Glasgow in 2015, where he has convened the LL.M in Corporate & Financial Law since 2016 and he has acted as School International Lead since 2017. In 2017, he was elected as a member of the Executive Board of the International Association of Economic Law (AIDE). He is the author of *The Transparency of Listed Companies in EU Law* (Sorbonne - IRJS Editions 2013) and of *The Law of Capital Markets in the EU* (Palgrave Macmillan 2018). His research interests are related to Corporate Law, EU Capital Markets Law and Corporate Governance

General Comments

Enforcement mechanisms applicable to proxy advisors: why we need to maintain social enforcement tools

In my research,¹ I argue that the focus on public enforcement mechanisms may prove detrimental to the transposition of the SRD II and is not aligned with the spirit of EU efforts in this area.

There are **four main concerns** about public enforcement (i.e. administrative sanctions or measures, such as pecuniary sanctions) of the new stewardship (governance/engagement) disclosure duties provided by the SRD II.

First, public enforcement risks creating an operational environment that is overly regulated and dissuading proxy advisors from conducting their activities in capital markets with flexibility. Creating unreasonably burdensome conditions for market actors may also impede the development of innovative engagement solutions, since proxy advisors will be primarily concerned by the necessity to comply with a series of legal requirements and not by the effectiveness of their strategies.

Secondly, public enforcement does not fit harmoniously with the conceptual premise of engagement duties whose main benefit is to trigger further engagement in the market, increase the educational benefits of disclosure in this area, and gradually fight against shareholder apathy. This is because concerned parties will inevitably focus on the liability factor of compliance, and might be deterred from disclosing further information. Public enforcement may therefore transform educational tools into liability risks and severely undermine the SRD II objectives.

Thirdly, in the presence of public enforcement, the recipients of disclosure will rely mechanistically upon national competent authorities instead of engaging with shareholders. Indeed, they will probably perceive administrative measures and sanctions as an adequate safeguard from non-compliance risks; hence, they might not be as motivated to interact with proxy advisors to challenge their strategies, or seek to obtain more information relevant to their priorities.

Lastly, public enforcement will risk legitimizing certain borderline proxy advisors' practices in the absence of actions taken by national authorities. Indeed, if national competent authorities fail to investigate non-compliance elements and, subsequently, to sanction them, the disclosure duties will be perceived by the market as complied with and

¹ Konstantinos Sergakis, 'The Perils of Public Enforcement of Shareholders' Duties', 12 September 2018, available at <https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/perils-public-enforcement-shareholders-duties>. See also, Konstantinos Sergakis, 'Legal Versus Social Enforcement' in H. Birkmose and K. Sergakis (ed), *Enforcing Shareholder Duties* (Edward Elgar, 2019) 128.

not raising any further concerns. An inactive regulatory stance can therefore be seen as an ex post certification of dubious practices. The concerned proxy advisors will also be enabled to stop engaging with other parties that may want to challenge their activities and further engage in dialogue with them. The overall risk will therefore be a mutually neutralising effect of engagement and further apathy, from the perspectives of both proxy advisors and the recipients of information.

Questions 2 and 3

To avoid the abovementioned risk and counter-productive effects of the EU shareholder engagement agenda, **FCA administrative measures and sanctions [as included in section 19.37A of the Enforcement Guide, hereinafter ‘EG’] could, where appropriate, be exclusively envisaged for the simple and straightforward lack of disclosure** (namely statements without any associated explanation, as required in such cases according to the ‘comply or explain’ principle, or even complete absence of such statements). **FCA should be able simply to verify if such disclosure** (or the explanation required) **has been published, and should be in a position to impose sanctions or other measures if this is not the case**. The examination of statements should be based on the compliance with a disclosure obligation (or the publication of an explanation where applicable) **and any interpretation of their content for enforcement purposes should not be permissible**.² As the explanatory memorandum to the Proxy Advisors Regulations 2019 (7.11) specifies,

‘The FCA’s investigative and enforcement powers relate solely to the scope of requirements on proxy advisers, namely that the required disclosures have in practice been made, and whether such disclosures have a basis in fact. The instrument does not establish a conduct regime for proxy advisers, nor does it directly set expectations in respect of controls and the quality of proxy advisers’ service provision. Rather, by improving transparency of proxy advisers’ conduct and service provision, the instrument aims to raise standards through the exercise of market discipline.’

This approach, that is also depicted in my research, is the best way forward and should serve as the ‘operational safety valve’ for the exercise of enforcement powers by the FCA.

I also very much welcome FCA’s approach on gradually escalating the severity of sanctions, starting from a warning notice (19.37A.8 EG and DEPP 2). This approach will maintain the necessary amount of flexibility in handling complex cases while

² Konstantinos Sergakis, ‘The Perils of Public Enforcement of Shareholders’ Duties’, 12 September 2018, available at <https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/perils-public-enforcement-shareholders-duties>. See also, Konstantinos Sergakis, ‘Legal Versus Social Enforcement’ in H. Birkmose and K. Sergakis (ed), *Enforcing Shareholder Duties* (Edward Elgar, 2019) 128.

allowing proxy advisors to revisit their position without triggering the abovementioned detrimental effects of straightforward administrative sanctions and measures.

I also find very positive the fact that the FCA has decided to issue a statement of policy for the imposition of a financial penalty under the Regulations (**19.37A.14 EG**), bearing in mind that such penalties should be the very last option that should be used (after having unsuccessfully tried to resolve any matter with written/decision notice).

It is my belief that, at the current stage where ensuring the spirit of the SRD II and allowing market actors to engage further between themselves, the focus should not be on stringent and administrative sanctions but on providing incentives to market actors to fulfil these obligations. The FCA enforcement procedure, as explained in the consultation, is a balanced approach that aims to preserve the goals of the SRD II.

Conclusion

As a consequence, for the time being, social enforcement mechanisms should be maintained, with the exceptions mentioned above, while resources and time should be invested to increase the familiarity of national authorities with these disclosure duties, so as to gradually prepare them for the implementation of enforcement tools in the future. I argue for a measured approach so as to enable the various market actors to interact with clients and service providers. I hope that the comments provided in this letter are of interest for the FCA consultation's purposes.

Should you require any further information on the points raised above, please do not hesitate to contact us at Konstantinos.Sergakis@glasgow.ac.uk.

Yours sincerely,

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