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Public consultation response on Report submitted by the working group on issues related to Proxy Advisors (PA)

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I very much welcome the opportunity to participate in the public consultation in relation to the Proxy Advisors Report. 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 Biography

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 is Professor of Capital Markets Law and Corporate Governance at the University of Glasgow, where he has convened the LL.M in Corporate & Financial Law since 2016 and he has acted as School Director of Internationalisation 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, Capital Markets Law and Corporate Governance.

Comments on Working Group’s recommendations

R. 10: SEBI needs to maintain market forces dynamics: as I have argued on several occasions,¹ there is a strong case for flexibility and social enforcement in this area. I thus agree with the Working Group’s recommendation.

R.15: I agree with the Working Group’s recommendation. Flexibility combined with disclosure items is very welcome.

R. 24: Boilerplate statements can weaken the benefits of a flexible regulatory approach. The BPP cover a considerable range of issues that, if combined with the related guidance, give the market the chance to receive a considerable amount of information on proxy advisory firms. Their model should be thus adopted in India.

R. 51: I welcome the proposal for a Stewardship Code.² I would also like to draw the attention to the ‘**apply and explain**’ element that aims to improve some shortcomings arising from the ‘comply or explain’ principle. Indeed, I agree with the Group that there is a growing demand and need to move away from a formalistic/‘box ticking’ approach. The ‘comply or explain’ principle has proven to be an important and efficient tool to increase transparency and awareness, but its implementation has also been problematic at times.³ The formalistic ‘box-ticking’ approach and boilerplate statements show, in some cases, no particular attachment to meaningful compliance. It therefore becomes difficult to decipher the interpretation of compliance and of corporate governance systems. As experience has shown in this area, if proxy advisors decide to deviate from a provision by explaining this deviation (as expected according to the ‘comply or explain’ principle), market expectations may be rigid and compromise the benefits of providing (even meaningful) explanations since the latter are as seen as ‘failure’ to comply and not as an attempt to be transparent.

As an alternative, the ‘apply or explain’ principle is an ‘outcomes-based’ compliance that sets out what companies can achieve if corporate governance principles are implemented effectively: ethical culture, good performance, effective control and legitimacy are amongst these benefits. The only problematic aspect with this approach is that it may give the right not to benefit from this opportunity for more transparency by giving the option to explain. This approach has now paved the way for the ‘**apply and explain**’ principle;⁴ this is the same principle but application is assumed and the explanatory part

¹ See my response to the BPPG consultation in 2017, <https://bppgrp.info/wp-content/uploads/2018/01/Konstantinos-Sergakis.pdf>.

² On the benefits of such an initiative, see K. Sergakis, ‘The UK Stewardship Code: Bridging the Gap Between Companies and Institutional Investors’ (2013) 47 *Revue Juridique Thémis* 109, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2365439.

³ For an overview of these and other related topics, see K. Sergakis, ‘Deconstruction and Reconstruction of the “Comply or Explain” Principle in EU Capital Markets’ (2015) 5(3) *Accounting, Economics and Law: A Convivium* 233, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2516741.

⁴ See for example the revised BPP in 2019, available at <https://bppgrp.info/wp-content/uploads/2019/07/2019-Best-Practice-Principles-for-Shareholder-Voting-Research-Analysis.pdf>.

is accentuated to allow the recipients of the information to have a more holistic view of the overall stance of companies.

To the extent that the ‘apply and explain’ mindset serves the same purpose within the Proxy advisor regulatory framework (i.e. departure from ‘mindless compliance’), it should be adopted.

Whichever principle is adopted in this framework, appropriate guidance (additional guidelines by periodic educational events, continuous dialogue with proxy advisors upon request) is needed. If such guidance is not provided, there are risks of subjective interpretation of the rules and – ultimately – discrepancy in the desired outcomes (i.e. lack of consistent interpretation of outcomes).

R.72: BPP should be followed indeed as they represent the most complete and satisfactory soft-law framework in this area. Their revised 2019 version⁵ shows concrete efforts to further improve informational value and move away from boilerplate reporting. The Guidance notes are truly helpful and can be used by proxy advisors so as to increase the value of their statements to any interested party.

R. 83, 89, 92: BPP should function as a model for the shaping of a code of conduct in India (see my comments above). Alternatively, SEBI could accept adherence to the BPP (by both domestic and foreign firms) as satisfactory for compliance purposes. A Stewardship Code should be also developed (by either SEBI or investors).

R.95: Enforcement mechanisms applicable to proxy advisors: why we need to maintain social enforcement tools (comments also relevant to R.72, R. 86 and R. 89 as well as to any future regulatory initiatives in India based on R. 95)

In my research,⁶ I argue that the focus on public enforcement mechanisms may prove detrimental to the transposition of any rules in relation to duties imposed upon proxy advisors.

There are **four main concerns** about legal - public and private enforcement - (i.e. administrative sanctions or measures, such as pecuniary sanctions, or redress mechanisms as analysed under R.95) in this area.

⁵ <https://bppgrp.info/wp-content/uploads/2019/07/2019-Best-Practice-Principles-for-Shareholder-Voting-Research-Analysis.pdf>.

⁶ 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.

First, legal 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, legal 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. Legal enforcement may therefore transform educational tools into liability risks and severely undermine the regulatory objectives.

Thirdly, in the presence of legal enforcement, the recipients of disclosure will rely mechanistically upon national competent authorities or courts 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, legal 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 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.

I appreciate the arguments developed under R. 95 and I very much welcome the filtered process, according to which only egregious acts like abuse of power or violations of basic levels of code of conduct could be eligible for SEBI to examine further. It is also encouraging that judicial means of protection are seen as a last resort mechanism and not as a facilitated redress mechanism that could trigger counter-productive effects as mentioned above.

In relation to SEBI's involvement in this area, **further action 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, if followed in the future, or even complete absence of such statements). **SEBI should be able simply to verify if such disclosure**

(or the explanation required) **has been published, and should be in a position to proceed as analysed under R. 95 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.**

I hope that the comments provided in this letter are of interest for SEBI's consultation 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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