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December 26, 2019
Hon. Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

U.S. Securities and Exchange Commission, Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 17 CFR Part 240 [Release No. 34-87457] (Nov. 5, 2019)

Email: rule-comments@sec.gov

Dear SEC Chairman,

I very much welcome the opportunity to participate in the public consultation in relation to the SEC Proposed Proxy Rules. I will not comment on all the proposed rules included in this Consultation as I will focus on matters directly related to 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 is Professor of Capital Markets Law and Corporate Governance at the University of Glasgow. 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.

SEC Proposals on proxy advisors

Notwithstanding the laudable objectives of the proposed reform (investor protection, accountability etc.), the SEC proposals on proxy advisors frame the dialogue with investee companies in a formalistic, stringent and counter-productive fashion. Such proposals will most probably have serious and negative effects on proxy advisors' services, independence and overall efficiency within the investment chain. Subjecting proxy advisors to a forced dialogue with issuers (two opportunities for review) and obliging them to comply with very specific measures (submission of analysis to management and inclusion of issuers' opinion on their final report) will impede the way they perform their duties and will reduce their overall usefulness and efficiency.

I would also expect and welcome a SEC proposal that acknowledges the fact that some proxy advisor firms do not provide vote recommendations; in such cases, further clarification is needed since, under the current proposals, it remains unclear on how these firms will be able to function if such proposals come into force.

Ensuing problems related to competition, the proxy advisory industry being largely dominated by two firms, inevitably arise: under the current proposals smaller firms will be impeded from developing their activities and growing their clientele. The market will be further concentrated amongst the two big proxy advisory firms, whereas the SEC should be fighting for more competition and consequently an overall rise of the service quality provided to investors. Rotation mechanisms amongst proxy advisory firms could be a way forward so as to enable smaller firms to access more clients and hopefully be prepared to meet the current challenges.

The proposed rules are by far the most constraining and counter-productive, especially taking into account other examples across the globe. Most importantly, they will drive proxy advisors to a formalistic, 'black and white' approach since they will be more concerned about following the SEC guidelines and avoiding potential liability instead of exercising their independent evaluation skills in relation to issuers. In my research, I have warned against such risks (see below under 'General comments'). Forcing the dialogue between proxy advisors and issuers by giving to the latter two opportunities for review of proxy advisors' evaluation will also shorten the period during which investors can review issuer documents before voting.

The SEC proposed rules are diametrically different from similar rules that aim to regulate proxy advisors across the globe. Lessons can be learnt by following other examples so as to avoid draconian measures.

The revised Shareholder Rights Directive (SRD II)[1] that aims, among others, at improving corporate governance via encouraging effective and sustainable shareholder engagement and improving transparency along the investment chain, frames the *modus operandi* of proxy advisors via disclosure obligations. Proxy advisors are required to publicly disclose on an annual basis a variety of items related to the preparation of their research, advice and voting recommendations; one of the most relevant items for the purposes of this public consultation is the disclosure obligation on whether proxy advisors 'have dialogues with the companies which are the object of their research, advice or voting recommendations […], and, if so, the extent and nature thereof'.[2] The SRD II approach acknowledges therefore market reality and the need to maintain flexibility while nudging towards the maintenance of a dialogue with issuers.

In parallel, the Best Practice Principles Group for Shareholder Voting Research (BPPG) has introduced, and recently revised, the Best Practices Principles, an international code of conduct with many interesting features that promotes transparency while acknowledging flexibility and the different profiles of proxy advisory firms. Most importantly and in relation to the themes analysed on this occasion, Principle 3 of the BPP states that 'with regard to the delivery of Services, BPP Signatories should explain their approach to communication with issuers, shareholder proponents, other stakeholders, media and the public. BPP Signatories should disclose a policy (or policies) for dialogue with issuers, shareholder proponents and other stakeholders. BPP Signatories should inform clients about the nature of any dialogue with relevant parties in their research reports, which may also include informing clients of the outcome of that dialogue.'

Its guidance further states that the disclosure of such policy should cover issues, such as 'whether and how issuers are provided with a mechanism to review research reports or data used to develop research reports prior to publication to clients'. The BPP framework addresses in a targeted and efficient way such dialogue by carefully avoiding subjecting proxy advisors to a series of constraints in a way that the current SEC proposal regrettably does.

France has also attempted to frame such dialogue since 2011 via an AMF Recommendation by suggesting that "the proxy advisor submit its draft report to the relevant company for review, failing which the proxy advisor shall clearly state in its analysis report that the draft was not submitted for review and explain the reasons

[1] Directive 2017/828/EU of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ L132/1.
[2] Article 3j(2)(f), ibid.

why" (AMF, 2011, p. 3).[3] Moreover, under the condition that the company has informed the proxy advisory firm of its resolutions, the board's reports and any other documents, at least 35 days before the general meeting, it has at least 24 hours to communicate any eventual remarks or comments. The firm has to include in its analysis report, upon the company's request, its comments on its voting recommendations, under the condition that those comments are precise, enlighten the shareholders on the draft resolutions and do not discuss the general voting policy. If applicable, the firm corrects any material mistakes detected in its analysis report and previously noted by the company concerned and ensures disclosure to the investors as quickly as possible (AMF, 2011, p. 3). The 2011 recommendation provoked a series of reactions amongst proxy advisors due to the creation of a disadvantageous and stringent framework. Nevertheless, it is not as stringent as the SEC proposal, which goes way beyond what could be reasonably expected from proxy advisors when they communicate with issuers prior to the provision of their services to their clients.

More recently, Japan has launched a public consultation in relation to the new Stewardship Code and includes for the first time Principle 8 that aims to frame proxy advisors' activities. More specifically, Principle 8.3 states that 'the proxy advisors, in providing proxy recommendations, should not only rely on the disclosed information of companies, but exchange views actively with companies upon necessity. When a subject company for the recommendation requests, it is considered to contribute to secure accuracy of the information based on the recommendation and transparency that the proxy advisors provide the company with an opportunity to confirm whether such information is accurate, etc., and provide the submitted opinion of the company to its clients together with the recommendation.'

Even if I do not wholly agree with this approach (that could adopt the respective BPP or SRD II norms), the proposed Japanese code does not impose further obligations upon proxy advisors and functions in an overall soft law spectrum, which further allows for legitimate deviation from the Principles if needed ('comply or explain' approach). With regards to the communication with issuers, proxy advisors are encouraged to proceed to a series of actions but the conditions that trigger such actions are not comparable to the stringent framework proposed by the SEC.

In conclusion, it would be preferable to frame the dialogue with issuers through disclosure obligations and to avoid creating a truly stringent operational spectrum that will ultimately favour issuers at the expense of proxy advisors' independence and the need to protect their clients and the market.

[3] *Autorité des Marchés Financiers* (*AMF*), '*Recommandation AMF n° 2011-06 sur les agences de conseil en vote*', 18 March 2011.

General Comments

Enforcement mechanisms applicable to proxy advisors: why we need to maintain social enforcement tools and to avoid framing the dialogue with issuers in a stringent, 'black and white' fashion

In my research,[4] I argue that the focus on public enforcement mechanisms may prove detrimental to the inculcation of stewardship and overall improvement of investment chain issues. By considering that proxy advisor vote recommendations are solicitations and thus subject to Rule 14a-9 (prohibition to contain any materially false or misleading statements) will trigger highly complex interpretation issues that will weaken engagement in the investment chain and proxy advisors' independence since their statements will be challenged by issuers who may not have been successful in altering proxy advisors' evaluation during the two 'opportunities for review'. The assimilation of such recommendations to solicitation is also misguided since proxy advisory activities do not fulfill the criteria of solicitation.

This will create a continuous threat to proxy advisors' *modus operandi* by either forcing them to align to corporate management and not to hold them to account or to pursue their independent evaluation by facing potential liability for not having taken into account the 'accurate' information provided by issuers. This situation shifts the capacity to resolve issues from market actors to the SEC and risks killing overall shareholder engagement and the issuer accountability to investors.

There are **four main concerns** about public enforcement of the stewardship duties the way it is potentially triggered under the proposed SEC rules.

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 and independence. 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. The fear of litigation may also drive some of them to align with issuers and reduce the quality of their services to their clients.

Secondly, public enforcement does not fit harmoniously with the conceptual premise of engagement within the investment chain whose main benefit is to increase the educational benefits of market actors via disclosure obligations in this area, and gradually fight against shareholder apathy and lack of communication. This is because concerned

[4] 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.

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 SEC objectives of investor protection. Framing the dialogue with issuers in a stringent way, as mentioned above, and assimilating proxy advisor activities to solicitation will only trigger liability concerns and is unlikely to improve the quality of proxy advisory services.

Thirdly, in the presence of public enforcement, the recipients of disclosure will rely mechanistically upon the SEC instead of engaging with shareholders. Indeed, they will probably perceive SEC initiatives 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. Issuers will simply initiate litigation and aim to further reduce proxy advisors' independence; similarly, investors will remain apathetic since they will not be called anymore upon the task of monitoring other actors in the investment chain.

Lastly, public enforcement will risk legitimizing certain borderline proxy advisors' practices in the absence of actions taken by national authorities. Indeed, if the SEC fails to investigate non-compliance elements and, subsequently, to sanction them, the disclosure duties and overall proxy advisor stance (methodologies, activities etc) 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.

Conclusion

Notwithstanding the laudable efforts made to protect investors, the Proposed Proxy Rules will have many unintended consequences: by restricting proxy firms' independence and by subjecting their work to issuers' stringent exchange of communication (as explained above), proxy firms' clients will not be able to receive high quality and independent services; this will impact the entire investment chain and will crystallise engagement into specific, pre-determined and counter-productive behavioural patterns. I argue for a measured approach, based on disclosure obligations similar to those adopted by the BPPG, 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 SEC 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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