

EXPLANATORY MEMORANDUM TO
THE PROXY ADVISORS (SHAREHOLDERS' RIGHTS) REGULATIONS 2019
2019 No. 926

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 This instrument transposes Article 3j of the revised EU Shareholder Rights Directive (SRD II) into UK law, in line with the UK's obligations as a member of the EU. Article 3j of SRD II places requirements on proxy advisors, which primarily offer voting services and/or advice to shareholders in publicly listed companies, to make certain disclosures about the way in which they conduct their business.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the UK.
4.2 The territorial application of this instrument is the UK.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 The instrument is made using powers in section 2(2) of the European Communities Act 1972, to transpose Article 3j of the SRD II. The instrument applies some provisions in the Financial Services and Markets Act 2000 (FSMA), with modifications appropriate to the transposition of Article 3j SRD II.

7. Policy background

What is being done and why?

- 7.1 The extension to article 50 of the Lisbon Treaty until 31st October means that the UK continues to hold its status as a member of the EU. The UK therefore continues to

have the membership rights and obligations of a member state. This includes the transposition of any EU Directives that are due to come into force during this period.

- 7.2 One of the aims of SRD II is to improve the stewardship of EEA based corporations. Through voting responsibly on important decisions related to the governance or strategy of the companies in which they invest, institutional investors have an important role to play in robust stewardship. Proxy advisors primarily offer voting services/ advice to shareholders in publicly listed companies, and therefore can have a considerable impact on how their clients exercise their voting rights.
- 7.3 Article 3j of SRD II, which this instrument transposes into UK law, responds to concerns that there is a lack of transparency in the way in which proxy advisors carry out their work, which could lead to institutional investors purchasing poor quality, inaccurate or unreliable advice, undermining their ability to fulfil their stewardship role effectively.
- 7.4 Article 3j requires proxy advisors to make certain disclosures about how they conduct their business. Proxy advisors will be required to:
- 1) disclose reference to a code of conduct which they apply, and report on the application of the code. If proxy advisors apply a code of conduct but depart from its recommendations, they must declare the parts of the code from which they depart, why they depart from it and indicate any alternative measures adopted. Where proxy advisors do not apply a code of conduct at all, they must explain why this is the case.
 - 2) disclose information on their research capabilities and how they produce their advice and voting recommendations (e.g., models, methodologies, information sources and resources); and
 - 3) identify and disclose any actual or potential conflicts of interests or business relationships that may influence the preparation of their research.
- 7.5 The approach taken in this instrument is generally to copy out the relevant provisions of the Directive, only deviating from the text of the Directive where necessary to support the effective operation of the instrument.
- 7.6 The requirements apply to a proxy advisor which,
1. Has its registered office (or where it does not have a registered office, its head office) in the UK; or
 2. Has its registered office or head office in any country or territory other than the United Kingdom, Gibraltar or an EEA State and provides proxy advisor services through an establishment located in the United Kingdom, and
 3. Provides services to investors holding shares in firms whose registered office is in the UK, Gibraltar or an EEA state, and whose shares are traded on a regulated market in the UK, Gibraltar or an EEA State; and
- 7.7 SRD II also requires that Member States include an effective, proportionate and dissuasive enforcement regime for the obligations in the Directive, as transposed into national law. In light of this, this instrument makes the Financial Conduct Authority (FCA) responsible for enforcing the requirements in Article 3j and gives it powers to sanction breaches of the obligations in the instrument through public censure and/or financial penalties.
- 7.8 The instrument does not make a proxy advisor an entity which is regulated or authorised by the FCA for the purposes of FSMA and a proxy advisor cannot hold

itself out as such. The FCA will establish and operate a notification regime for in-scope proxy advisers. The instrument requires that proxy advisers notify the FCA if they consider that they fall within the scope of the regime, such that they can be included on a public list. The only grounds to refuse entry onto the list – or to remove a proxy advisor from the list – would be if a proxy advisor was not in fact within the scope of the regime, or subsequently fell outside its scope.

- 7.9 The instrument applies certain parts of FSMA (which provides the statutory basis for the FCA exercising its general functions with respect to the firms which it regulates) with the necessary modification to allow the FCA to enforce the obligations on proxy advisers as set out in the instrument.
- 7.10 For instance, the instrument gives in-scope proxy advisers access to the Upper Tribunal for the purposes of appealing against FCA enforcement decisions, and gives the FCA powers to investigate potential breaches of the regulations. These provisions of FSMA are modified to ensure that they are appropriate to support the enforcement of the regulations by the FCA in this instrument specifically.
- 7.11 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.
- 7.12 The disclosure requirements are intended to make sure that proxy advisers’ clients will be able to better understand what standards of conduct the proxy advisor adheres to, how the proxy advisor ensures an adequate standard of quality in its advice and how it manages conflicts of interest, in order to help the market for proxy advisor services to function effectively. It is expected therefore that instances of non-compliance with the disclosure requirements will be brought to the FCA’s attention via market participants, meaning that ongoing monitoring and supervision are not necessary or implied by this instrument.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

- 9.1 This instrument does not consolidate any other instrument.

10. Consultation outcome

- 10.1 HM Treasury officials have drawn up the instrument in close collaboration with colleagues at the FCA, who have had significant input into the drafting.

11. Guidance

- 11.1 There are no plans to produce guidance on the regulations.

12. Impact

- 12.1 The impact on business, charities or voluntary bodies is low. Costs for the small number of firms covered (fewer than 10) arise from, a) compliance with the disclosure requirements in SRD II, b) notifying the FCA of their status as a proxy advisor in the scope of the regulations, and c) small fees to cover the FCA's costs in ensuring compliance with the regulations. Total costs are expected to be approximately less than £5,000 per annum per firm.
- 12.2 The impact on the public sector is low. The FCA will be required to oversee the regulations in a proportionate way. Given the narrow breadth of the regulations and the small number of firms subject to them, their costs will be low, and will be recouped through a fee levied on in-scope proxy advisors.
- 12.3 An Impact Assessment has not been prepared for this instrument because of the low level of impact per business and small number of businesses affected.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No particular measures have been included to assist small businesses. The influence of small proxy advisors on the stewardship of large corporations through their advice services to investors can be significant, so it is important that they are captured by the regulations. The regulations have been designed to apply the minimum costs necessary on firms.

14. Monitoring & review

- 14.1 There are no plans to monitor or review this SI.
- 14.2 The regulation does not include a statutory review clause.

15. Contact

- 15.1 David Reeves at HM Treasury, telephone: 0207 270 4586 or email: David.Reeves@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 John Owen, Deputy Director for Personal Finances and Funds at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 The Economic Secretary at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.