

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

Consultation Paper

CP19/21*

June 2019

How to respond

We are asking for comments on this Consultation Paper (CP) by **26 July 2019**.

You can send them to us using the form on our website at: www.fca.org.uk/cp19-21-response-form

Or in writing to:

Law and Policy
Enforcement and Market Oversight
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Telephone:

020 7066 1000

Email:

cp19-21@fca.org.uk

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1 Summary

Introduction

- 1.1** The revised Shareholder Rights Directive (SRD II) sets out new obligations on proxy advisors. In this Consultation Paper (CP), we set out how we will amend the Decision Procedure and Penalties manual (DEPP) and Enforcement Guide (EG) to implement these obligations in the UK.
- 1.2** Proxy advisors provide research, advice and recommendations to shareholders and their intermediaries. This advice includes how to vote in general meetings of listed companies. While proxy advisors support the exercise of shareholder rights, they can also have an important influence on how their clients vote.
- 1.3** The new obligations in SRD II aim to encourage greater transparency in the way proxy advisors carry out their work and the accuracy and reliability of their activities. These obligations include the requirement to:
- publicly disclose a code of conduct which governs the provision of proxy advisor services and explain how and to what extent it has been complied with
 - publicly disclose information about the preparation of research, advice and voting recommendations, to give clients assurance about the accuracy and reliability of their services
 - identify and disclose actual or potential conflicts of interests or business relationships that may influence the preparation of research, advice and voting recommendations
- 1.4** To give effect to SRD II, the Treasury laid an implementing Statutory Instrument (SI), the Proxy Advisors (Shareholders' Rights) Regulations 2019 (PA Regulations) before Parliament on 14 May 2019. These regulations came into force on 10 June 2019.
- 1.5** In the PA Regulations, the Treasury confirmed the FCA as the competent authority and gave us powers to discipline and investigate proxy advisors.

Summary of proposals

- 1.6** The changes introduced in the PA Regulations mean we need to amend DEPP and EG.
- 1.7** We propose decision making procedures to:
- remove an advisor from the public list of proxy advisors if they stop providing services but have not given us notice to be removed from the list
 - investigate and discipline proxy advisors that must meet the PA Regulations but are not authorised by us or the PRA under the Financial Services and Markets Act 2000 (FSMA) (unauthorised entities)

Who does this consultation affect?

- 1.8** These proposals will be of interest to anyone who may come under the PA Regulations, or anyone who uses the services of proxy advisors. This will include proxy advisors, listed companies, their shareholders and intermediaries.

Is this of interest to consumers?

- 1.9** The proposed changes to DEPP and EG do not directly affect consumers. The proposals in this paper intend to improve the transparency of proxy advisors in the UK and so may be of general interest.

2 Proposed changes to DEPP and EG

Introduction

- 2.1** In this chapter, we cover the proposals to amend DEPP and EG for the PA Regulations. The PA Regulations give us new powers over proxy advisors. We must also maintain a public list of proxy advisors.
- 2.2** Our new powers include:
- removing a proxy advisor from the list of proxy advisors
 - investigating a proxy advisor for contraventions of the PA Regulations
 - imposing a censure or a financial penalty on a proxy advisor

Changes to DEPP

- 2.3** We propose changes to DEPP 2 Annexes 1 and 2 to set out the decision-making procedure for:
- Removing a proxy advisor from the public list of proxy advisors. We will use executive procedures to take the decision to remove a proxy advisor from this list.
 - Determining when to publish a statement about a proxy adviser contravening a relevant requirement. We will take the decision to impose a public censure under the RDC procedure in contested cases. In settled cases, the settlement decision makers will take the decision.
 - Determining when to impose a financial penalty on a proxy advisor. In contested cases, we will take the decision to impose a financial penalty under the RDC procedure.
 - Determining when to impose a restitution requirement. We will use the RDC procedure when taking the decision to require a person to pay restitution.

Q1: Do you have any comments on our proposed changes to DEPP 2 Annexes 1 and 2 as set out in Appendix 1, Annex B?

Applying the penalty policy

- 2.4** The PA Regulations give us the power to impose a penalty on proxy advisors who contravene the regulations. They require us to consider several factors when deciding whether to impose a penalty, and the amount. We consider that the factors set out in the PA Regulations are compatible with our existing penalty policy. We do not consider that there are particular circumstances or special features of the PA Regulations that will require us to apply any different policy from that already set out in DEPP 6. Accordingly, we propose that the relevant decision-makers will apply the existing penalty policy in DEPP 6 as currently applicable. This involves considering

all the relevant circumstances of the case including those factors set out in the PA Regulations.

- 2.5** We will reflect this approach in the changes to Chapter 19 of EG as set out in Appendix 1, Annex C.

Q2: Do you have any comments on our proposed approach to sanctions set out above?

Proposed changes to EG

- 2.6** We propose to add a new section to Chapter 19 of EG (Non-FSMA powers) to deal with how we will exercise our powers against proxy advisors who are alleged to have contravened the PA Regulations (EG19.37A). Our approach under the PA Regulations will broadly mirror our approach to conducting investigations, sanctioning and the use of regulatory powers under FSMA.

Q3: Do you have any comments on our proposal to add a new EG19.37A as set out in Appendix 1, Annex C?

What do you need to do next?

- 2.7** We want to know what you think of our proposals. Please send us your comments on our proposed changes by 26 July 2019. You can use the online response form on our website or write to us at the address on page 2.
- 2.8** We are consulting for 4 weeks to allow us to consider consultation responses. We believe that a 4-week consultation period is appropriate, as our proposed changes are either consequential or extend our current approach and policy to the enforcement of the PA Regulations.

What will we do next?

- 2.9** We will consider your feedback and publish a Policy Statement in the Autumn of 2019. The PA Regulations came into force on 10 June 2019.

Annex 1

Questions in this paper

- Q1:** Do you have any comments on our proposed changes to DEPP 2 Annexes 1 and 2 as set out in Appendix 1, Annex B?
- Q2:** Do you have any comments on our proposed approach to sanctions?
- Q3:** Do you have any comments on our proposal to add a new EG19.37A as set out in Appendix 1, Annex C?

Annex 2

Cost benefit analysis

Cost benefit analysis

1. This CP proposes applying our current sanctioning policy and disciplinary procedures to breaches of requirements under the PA Regulations. It implements new decision-making procedures for the removal of a proxy advisor from the public list of proxy advisors and specifies the relevant decision-maker for different stages of the process. It also implements new decision-making procedures for publishing a statement for breaching the PA Regulations and imposing a financial penalty for breaching the PA Regulations.
2. The proposed approach will not substantially differ from our current approach to the exercise of our disciplinary and investigatory powers.
3. Our view is that the costs of the proposals will be of minimal significance if compared with any reasonable counterfactual and that no cost benefit analysis is required. Similarly, we see no implications for our competition objective.

Equality and diversity

4. We are required under the Equality Act 2000 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions.
5. We have considered whether there are any potential equality or diversity impacts of this CP. We believe there are none, but would welcome your comments.

Annex 3

Compatibility statement

Compatibility with the FCA's general duties

- 1.** The FCA believes the proposals set out above are compatible with its duties under section 1B of FSMA. The effective and appropriate use of enforcement powers plays an important part in pursuing the FCA statutory objectives, as it increases compliance with rules by making market participants more aware of conduct that may breach these rules, and the potential for sanctions for such conduct.
- 2.** We have considered the regulatory principles in section 3B of FSMA. In particular, the proposals are consistent with the need to use resources in the most efficient and economical way, and the principle that regulators should exercise their functions as transparently as possible.
- 3.** We do not expect the proposed changes to have a significantly different impact on mutual societies.
- 4.** Under the Legislative and Regulatory Reform Act 2006 (LRRRA) the FCA is subject to requirements to consider several high-level 'Principles' as we exercise some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). We have considered the principles in the LRRRA and the Regulators' Code for the parts of the proposals that comprise general policies, principles or guidance.

Annex 4

Abbreviations used in this paper

CP	Consultation Paper
DEPP	Decision Procedure and Penalties manual
EG	Enforcement Guide
EU	European Union
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
Handbook	The FCA's Handbook of rules and guidance
LRRA	Legislative and Regulatory Reform Act 2006
PA Regulations	Proxy Advisors (Shareholders' Rights) Regulations 2019
PRA	Prudential Regulation Authority
RDC	Regulatory Decisions Committee
SI	Statutory Instrument
SRD II	Revised Shareholder Rights Directive
the Treasury	Her Majesty's Treasury
Unauthorised entities	Proxy advisors who are not authorised by the FCA or PRA under FSMA.

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN.

Appendix 1

Draft Handbook text

PROXY ADVISORS (DEPP AND EG) INSTRUMENT 2019

Powers exercised

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of:
- (1) the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 139A (Power of the FCA to give guidance);
 - (b) section 395 (The Authority’s procedures); and
 - (2) the powers of direction, guidance and related provisions in or under the following provisions of the Proxy Advisors (Shareholders’ Rights) Regulations 2019:
 - (a) regulation 16 (Statements of policy);
 - (b) regulation 22 (Application of Part 11 of the Act (information gathering and investigations)); and
 - (c) regulation 26 (Application of Part 26 of the Act (notices)).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [20 September 2019].

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Decision Procedure and Penalties manual (DEPP) is amended in accordance with Annex B to this instrument.

Material outside the Handbook

- F. The Enforcement Guide (EG) is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the Proxy Advisors (DEPP and EG) Instrument 2019.

By order of the Board
[date]

Annex A

Amendments to the Glossary of definitions

In this Annex, all the text is new and is not underlined.

Insert the following new definition in the appropriate alphabetical position.

*Proxy Advisors
(Shareholders’
Rights)
Regulations* the Financial Services and Markets Act 2000 (Proxy Advisors) Regulations
2019 (SI 2019/926).

Annex B

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text.

2 Statutory notices and the allocation of decision making

...

2 Annex 1G Warning notices and decision notices under the Act and certain other enactments

...

UK Securitisation Regulations	Description	Handbook reference	Decision maker
...			
<u>Proxy Advisors (Shareholders' Rights) Regulations</u>	<u>Description</u>	<u>Handbook reference</u>	<u>Decision maker</u>
<u>Regulation 11</u>	when the <i>FCA</i> is <u>proposing or deciding to publish a statement under regulation 11</u>		<i>RDC</i>
<u>Regulation 12</u>	when the <i>FCA</i> is <u>proposing or deciding to impose a financial penalty under regulation 12</u>		<i>RDC</i>
<u>Regulation 25</u>	when the <i>FCA</i> is <u>proposing or deciding to require restitution under regulation 25</u>		<i>RDC</i>

...

Sch 3 Fees and other required payments

...

3.2G

The <i>FCA</i> 's power to impose financial penalties are contained in:
...
the <i>Small and Medium Sized Business (Finance Platforms) Regulations</i>
<u>the <i>Proxy Advisors (Shareholders' Rights) Regulations 2019</i></u>

Sch 4**Powers exercised**

...

4.2G

The following additional powers and related provisions have been exercised by the <i>FCA</i> to make the statements of policy in <i>DEPP</i> .
...
Application of Part 26 of the Act (notices) of the <i>UK Securitisation Regulations</i>
<u>Regulation 16 (Statement of policy on imposition of penalties) of the <i>Proxy Advisors (Shareholders' Rights) Regulations 2019</i></u>
<u>Regulation 22 (Application of Part 11 of the Act (information gathering and investigations)) of the <i>Proxy Advisors (Shareholders' Rights) Regulations 2019</i></u>
<u>Regulation 26 (Application of Part 26 of the Act (notices)) of the <i>Proxy Advisors (Shareholders' Rights) Regulations 2019</i></u>

Annex C

Amendments to the Enforcement Guide (EG)

Insert the following new section, EG 19.37A, after EG 19.37 (UK Benchmarks Regulations). The text is not underlined.

19.37A Proxy Advisors (Shareholders' Rights) Regulations 2019

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* in part implement the revised *Shareholders Rights Directive (SRD)*. The *FCA* has investigative and sanctioning powers in relation to breaches of the *Proxy Advisors (Shareholders' Rights) Regulations*.

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* establish a new regulatory framework for *proxy advisors*. This framework imposes requirements on *proxy advisors* that are subject to the *Proxy Advisors (Shareholders' Rights) Regulations*, including, amongst other things, to provide a range of information to *proxy advisors'* clients and the public with the aim of providing greater transparency. The Regulations will ensure that where proxy advisor services are provided in accordance with or by reference to a Code of Conduct it is made public together with a report on the way it has been applied. They will also ensure that information is made public by which the quality and reliability of the *proxy advisor's* services and recommendations can be assessed and the *proxy advisor* will ensure that conflicts of interests and the management thereof are identified and disclosed appropriately. This framework will help to increase transparency in *proxy advisor* services and reduce the harm from investors relying on their services including their voting recommendations, without having the necessary information to assess the approach taken.

19.37A. The *FCA's* approach to enforcement under the *Proxy Advisors (Shareholders' Rights) Regulations* will mirror its general approach to enforcing the *Act*, as set out in *EG 2*. The *FCA* will seek to exercise its enforcement powers in a manner that is transparent, proportionate, responsive to the issue and consistent with its publicly stated policies. It will also seek to ensure fair treatment when exercising its enforcement powers. Finally, it will aim to change the behaviour of the *person* who is the subject of its action, to deter future non-compliance by others, to eliminate any financial gain or benefit from non-compliance, and where appropriate, to remedy the harm caused by the non-compliance.

19.37A. The regulatory powers which the *Proxy Advisors (Shareholders' Rights) Regulations* provide to the *FCA* include:

- the power to require information and appoint investigators;
- powers of entry and inspection;
- power of public censure;
- the power to impose financial penalties;
- the power to apply for an injunction or restitution order;
- the power to require restitution;
- the power to remove a proxy advisor from the public list; and
- the power to prosecute relevant offences.

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations*, for the most part, mirror
5 the *FCA's* investigative, sanctioning and regulatory powers under the *Act*. The *FCA* has decided to adopt procedures and policies in relation to the use of those powers akin to those it has under the *Act*. Key features of the *FCA's* approach are described below.

The conduct of investigations under the Proxy Advisors (Shareholders' Rights) Regulations

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* apply much of Part 11 of
6 the *Act*. The effect of this is to apply the same procedures under the *Act* for appointing investigators and requiring information when investigating breaches of the *Proxy Advisors (Shareholders' Rights) Regulations*.

19.37A. The *FCA* will notify the subject of the investigation that it has appointed
7 investigators to carry out an investigation unless notification is likely to prejudice the investigation or otherwise result in it being frustrated. The *FCA* expects to carry out a scoping visit early on in the enforcement process in most cases. The *FCA's* policy when investigating under the *Proxy Advisors (Shareholders' Rights) Regulations* is to use powers to compel information in the same way as it would in the course of an investigation under the *Act*.

Decision making under the Proxy Advisors (Shareholders' Rights) Regulations

19.37A. The *RDC* is the *FCA's* decision maker for most of the decisions under the *Proxy
8 Advisors (Shareholders' Rights) Regulations* as set out in *DEPP 2 Annex 1G*. This includes the decision to issue a censure and the decision to impose a financial penalty. For the purposes of the *Proxy Advisors (Shareholders' Rights) Regulations*, the *FCA* will follow the procedure for issuing a *warning notice* and *decision notice* as set out in *DEPP 2*.

19.37A. For decisions made by *executive procedures* the procedures to be followed will be
9 those described in *DEPP 4*.

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* do not require the *FCA* to
10 have published procedures for commencing criminal prosecutions. However, in

these situations the *FCA* expects that we will normally follow our decision making procedures for the equivalent decisions under the *Act*, as set out in *EG 12*.

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* do not require the *FCA* to
11 have published procedures to apply to the court for an injunction or restitution order. However, the *FCA* will normally follow its decision making procedures for the equivalent decisions under the *Act*, as set out in *EG 10* and *EG 11*.

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* require the *FCA* to give
12 third party rights as set out in section 393 of the *Act* and to give access to certain material as set out in section 394 of the *Act*.

19.37A. Certain *FCA* decisions (for example the imposition of a financial penalty) may be
13 referred to the *Tribunal* by an aggrieved party.

Imposition of penalties under the Proxy Advisors (Shareholders' Rights) Regulations

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* do not require the *FCA* to
14 issue a statement of policy with respect to the imposition and amount of penalties under the *Proxy Advisors (Shareholders' Rights) Regulations*. However, the *FCA* has decided to issue a statement of policy for the imposition of a financial penalty under the Regulations. The *FCA's* policy includes having regard to the relevant factors in *DEPP 6.2* and *DEPP 6.4* in addition to those set out in the *Proxy Advisors (Shareholders' Rights) Regulations*, where appropriate. The *FCA's* policy in relation to determining the level of a financial penalty includes having regard, where relevant, to *DEPP 6.5* to *DEPP 6.5D* in addition to the factors set out in the *Proxy Advisors (Shareholders' Rights) Regulations*, where appropriate.

19.37A. As with cases under the *Act*, the *FCA* may settle or mediate appropriate cases
15 involving breaches of the *Proxy Advisors (Shareholders' Rights) Regulations* to assist it to exercise its functions under the Regulations in the most efficient and economical way. See *DEPP 5*, *DEPP 6.7* and *EG 5* for further information on the settlement process and the *settlement discount scheme*.

Statement of policy in section 169(7) interviews (as applied by the Proxy Advisors (Shareholders' Rights) Regulations)

19.37A. The *Proxy Advisors (Shareholders' Rights) Regulations* apply section 169 of the
16 *Act* which requires the *FCA* to publish a statement of policy on the conduct of certain interviews in response to requests from *overseas regulators*. For the purposes of the *Proxy Advisors (Shareholders' Rights) Regulations* the *FCA* will follow the procedures described in *DEPP 7*.

