The City of London Law Society

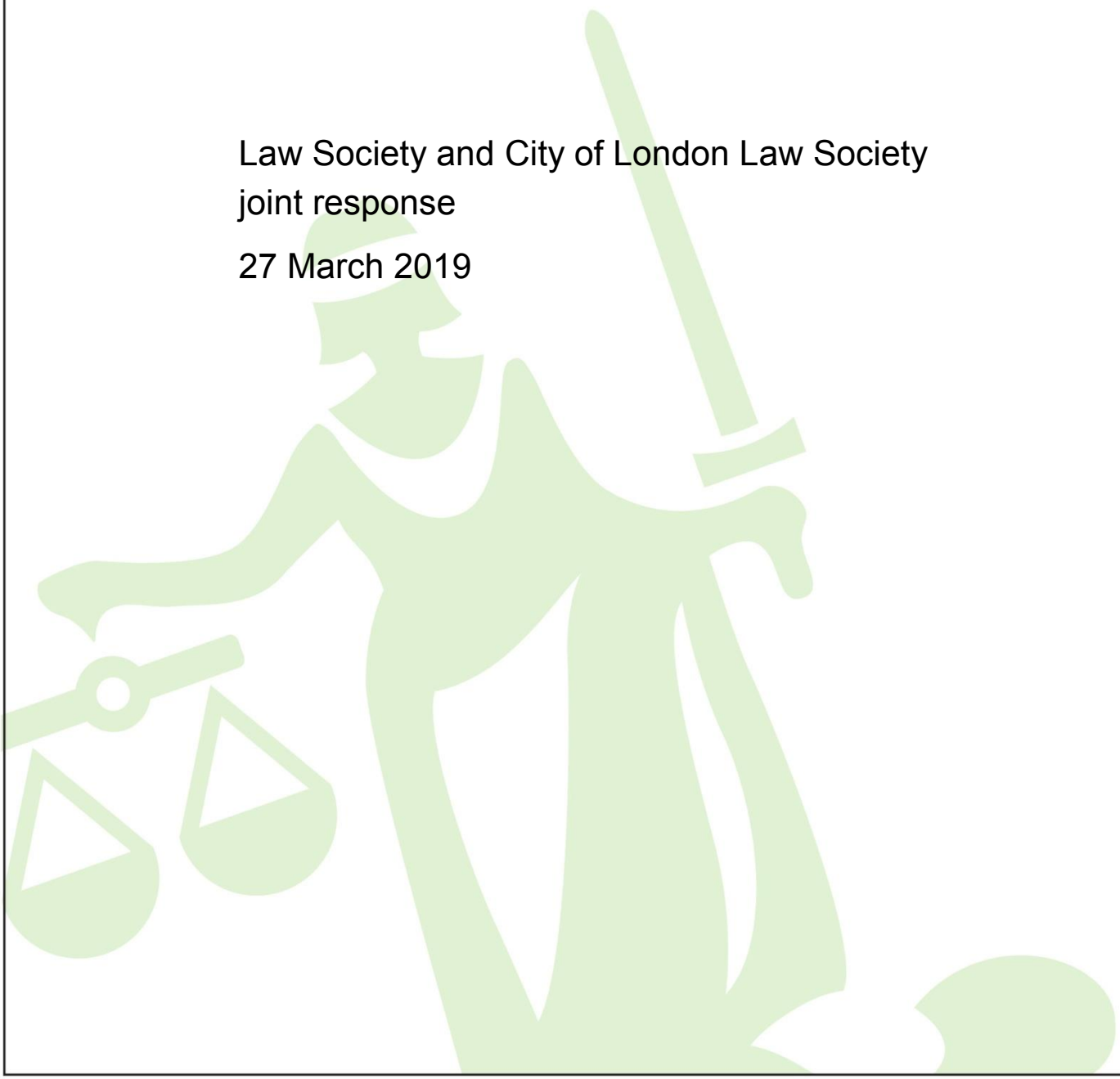
The Law Society

FCA consultation paper – CP 19/7

Consultation on proposals to improve shareholder engagement

Law Society and City of London Law Society joint response

27 March 2019



Introduction

1. The views set out in this paper have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (**CLLS**) and the Law Society of England and Wales (the **Law Society**).

2. The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

3. The Law Society is the professional body for solicitors in England and Wales, representing over 160,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

4. The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to capital markets.

Response

5. We refer to the FCA's consultation paper on proposals to improve shareholder engagement (CP 19/7) (the "**Consultation Paper**") which sets out the FCA's proposals to implement parts of the Revised Shareholder Rights Directive 2017/828 in the UK (referred to in this response as "**SRD II**" or the "**Directive**").

6. Our Joint Working Party is responsible for considering any proposed changes to the regulation of the UK's equity capital markets. We set out below our responses to certain questions set out in the Consultation Paper which we consider to be within our remit for review.

Questions

Q1: Do you agree that the territorial scope of the rules framework should extend beyond that envisaged by the Directive?

Yes.

Q2: Do you agree with our proposed amendments to the Handbook to implement the Directive requirements around engagement policies? If not, please explain what alternative approach you would like us to take.

We have no additional comments to raise on the proposed amendments, save that where there is any overlap with the Stewardship Code (Code), either the Code or the new rules should state to what extent compliance with one will be deemed compliance with the other. For example, the annual disclosure requirement proposed under SYSC3.4.4(b) should be satisfied by compliance with the relevant parts of the Code, but it would be helpful if there were express confirmation of that fact.

Q3: Do you agree with our proposed approach to implementing Article 3h of the Directive? If not, please explain what alternative approach you would like us to take.

Yes.

Q4: Do you agree with our proposed amendments to implement the Directive requirements on asset managers reporting to asset owners? If not, please explain what alternative approach you would like us to take.

Overall, we support the proposed amendments.

Furthermore, we suggest that, in addition to requiring asset managers to disclose whether they use proxy advisers for the purpose of their engagement activities, asset managers should also be required to disclose whether the proxy adviser has been instructed to use its own standard guidelines or bespoke guidelines of the asset manager. Additionally, it would be helpful to disclose the asset manager's approach to following the proxy adviser's recommendations and whether and how it, or the proxy adviser, would engage with issuers.

Q5: Are there any other points we should address in the Handbook in relation to SRDII, for example by adding clarificatory rules or providing further guidance?

In paragraph 3.25 of the Consultation Paper, we note that the FCA does not propose to provide any guidance on what might constitute a "significant" vote on which the firm would want to report. However, we suggest that it would be helpful if the FCA were to provide some guidance in its Handbook as to what might potentially constitute an insignificant vote with reference to Recital 18 of the Directive (and as referred to in the Consultation Paper). This guidance would provide that:

"Such insignificant votes may include votes cast on purely procedural matters or votes cast in companies where the investor has a very minor stake compared to the investor's holdings in other investee companies. Investors should set their own criteria regarding which votes are insignificant on the basis of the subject matter of the vote or the size of the holding in the company, and apply them consistently."

Q6: Do you agree with how we are proposing to implement SRD II requirements on related party transactions in the DTRs (including our proposal to replicate existing LR provisions so far as possible and choosing a threshold of 25%)?

Subject to our response to Q7, we agree with the FCA's proposed approach to implement SRD II requirements on related party transactions in the DTRs and that the implementation of those requirements should reflect the minimum standards imposed by the Directive.

Additionally, we agree with the FCA's proposal to replicate existing LR provisions so far as possible, including the choice of the 25% threshold. The current related party transaction regime as set out in LR 11 is well established and understood by market participants and, consequently, building on this seems sensible.

Q7: Do you agree with our proposed amendments to the LRs – in particular, that we should extend our rules for related party transactions to all issuers with a premium listing (except those subject to LR16) or with a standard listing of shares that have their registered office outside of the UK or other EU Member State? Further, do you agree that we should give recognition to compliance with equivalent standards in non-EU jurisdictions and, if so, what are your views on how this could best be achieved?

We have a number of reservations with the proposals:

1. We suggest that further consideration should be given to the proposal to extend the new DTR rules to issuers which fall outside the scope of the Directive, being issuers whose premium or standard listed shares are admitted to trading on UK regulated markets and whose registered offices are not in the UK or any other EU member state ("**Non-EU Issuers**").

This creates a particular issue for non-EU Issuers which have a standard listing. The raison d'être of the standard market is to provide a listed market which complies with minimum Directive

standards and accordingly offers notably lighter regulation than the premium market on the basis that, in relation to corporate governance arrangements, issuers on that market will disclose these rather than being tied to any particular code and that investors will appraise the relevant company in the knowledge of these arrangements. So it seems to run directly counter to these principles now to seek to apply a "super-equivalent" regime to Non-EU Issuers with a standard listing as regards their related party transactions.

We believe that a standard listing is increasingly being seen as an attractive and viable platform for certain companies, particularly overseas issuers, who wish to obtain a listing in the UK but only to be subject to EU directive minimum requirements and that it would be damaging to reduce the attractiveness of a standard listing to such persons.

Consequently, whilst we acknowledge the FCA's intention to reconcile the scope of the Directive with the established principle that all issuers in a given listing category should be subject to the same requirements, we suggest that this approach should be reconsidered given that imposing additional or new (as the case may be) related party transaction requirements on Non-EU Issuers may deter companies from considering a listing in the UK, or perhaps, may encourage some issuers to de-list.

It is possible that other EU member states in implementing the SRD II requirements may not require non-EU issuers listed on their regulated markets to be subject to the same requirements as those issuers who fall within the scope of the Directive. This would be likely to represent a material disadvantage for the UK markets at a time when, in the light of the UK's anticipated exit from the European Union, it is of particular importance that our markets should remain competitive.

2. We also query the extent to which the proposed new DTR requirements will result in more meaningful disclosure for the market. The Market Abuse Regulation requires public disclosure of inside information and we suspect that details of a related party transaction which is material within the meaning of the proposed new rules may require disclosure on that account. So we question the merit of imposing additional requirements on Non-EU Issuers which are likely to be duplicatory for the most part. (In addition, it is perhaps less likely that certain Non-EU Issuers, as opposed to EU Issuers, will draw up their accounts in accordance with IFRS and, given that the term "related party" is to bear the IFRS meaning for these purposes, it may be more difficult and costly for such Non-EU Issuers to obtain timely advice on what is or is not a related party transaction.)

3. We also note that the FCA proposes that the new rules will not apply to standard-listed GDR issuers as they do not fall within the scope of the SRD II and, consequently, the same logic should dictate that Non-EU Issuers that also fall outside the scope of SRD II should not be subjected to them.

4. We also have reservations about the likely effectiveness of the proposed exemption from the new DTR requirements for Non-EU Issuers which have related party measures imposed under equivalent legislation having similar effect to the requirements set out in DTR 7.3. (as set out in the proposed new LR 9.2.6C). We believe that other regimes may often not provide for related party measures or, if they do, there may be considerable difficulty for the issuer concerned and for the FCA to determine whether they have similar effect. Moreover, if the issuer is subject to a different domestic regime as well, it may suffer from having to comply with two separate regimes. So we suspect that the likelihood is that the default position will be for Non-EU Issuers to follow the new provisions in DTR7.3 with the potentially adverse consequences for the standard market.

Q8: Are there any other points we should address in our rules for related party transactions in relation to SRD II?

We have no comments to raise.

Q9: Do you agree with the conclusion and analysis set out in our cost benefit analysis?

We have no comments to raise save that we do question the conclusion that the cost benefits for overseas non-EU incorporated issuers outweigh the associated costs of implementing, and complying with, the regime, for the reasons set out under question 7 above.

FOR FURTHER INFORMATION PLEASE CONTACT:

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