

European Commission Seeks Guarantees of Proxy Advisory Firms' Work

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A coalition of proxy advisory firms, including ISS and Glass Lewis, is disputing the requirements in the proposed EU revisions to the Shareholder Rights Directive related to their services, which could take effect in all EU member states. The proposal focuses on many of the same criticisms that US companies have about the advisors, although we are unlikely to see regulatory action in the near term in the US.

The proposed revisions to the [2007 EU Shareholder Rights Directive](#) was issued in early April in response to calls for improvement of the business environment in Europe. Common EU action is being endorsed as necessary given that non-national shareholders hold about 44% of the shares in EU listed companies, and the cross-border nature of those companies means activities in more than one EU member state. After analyzing perceived corporate governance shortcomings in European listed companies focused on insufficient shareholder engagement and lack of transparency, the initiatives announced includes say-on-pay for directors' compensation (including disclosing a ratio to employee pay), the publication of engagement principles for institutional investors and asset managers and efforts to ensure reliability and quality of advice of proxy advisors.

The European Commission noted that proxy advisors are not subject to any regulation at the EU level and non-binding rules exist only in a few member states, such as the UK. According to the introduction, proxy advisors are viewed to be sufficiently influential so that in some jurisdictions, they are a de-facto "standard-setter" in corporate governance. The failure of proxy advisors to incorporate local market and regulatory conditions in their methodologies and concerns regarding conflicts of interest if the advisors also provide paid services to issuers were the perceived shortcomings that the revised Directive aimed to address.

The Directive proposal requires proxy advisors to adopt and implement measures "to guarantee that their voting recommendations are accurate and reliable." The analysis should be based on all of the information that is available to them, but not affected by any existing or potential conflict of interest or business relationship. The firms must disclose annually information related to the preparation of their voting recommendations, including the extent and nature of discussions with listed companies and whether they have taken into account national market, legal and regulatory conditions. In addition, the advisors must identify and disclose actual or potential conflicts of interests or business relationships that may influence the preparation of voting recommendations.

The recent [position paper](#) issued by the proxy advisory firms in response argues that the proposed Directive seems to reflect concerns raised by the "corporate community" and their representatives, who have "consistently overstated the influence of shareholder voting research providers and misrepresented how shareholders make use of their services." They disagree with the "hard regulatory approach" from the Directive, in particular the requirement that shareholder voting research be "guaranteed" since their research, analysis or recommendations reflect "points of view based on investors' policy preferences." The advisors indicate that the Directive risks compromising their free speech rights, and no other financial services constituents that conduct research or provide advice are subject to similar types of requirements. The regulation would also impose significant compliance costs since it may be implemented differently among the various EU jurisdictions, and operates anti-competitively as it only applies to firms that do business in the EU. The advisors also point out that they have already adopted a set of [Best Practices Principles for Providers of Shareholder Voting Research & Analysis](#) after discussions with the European Securities and Markets Authority, which cover similar subjects and reflects a principled-based approach instead.

The European Parliament and the Council of the European Union are considering the EU Commission's proposal and if approved, each member state will be required to implement the proposal within 18 months.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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