European Challenges for Institutional Shareholder Engagement – is Mandatory Disclosure the Answer?

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Agenda

• Background and the emerging EU agenda
• A European system of mandatory disclosure
• Challenges for a system of mandatory disclosure
• Does mandatory disclosure increase shareholder engagement?
• The way forward
Critique of the shareholders’ engagement

• The discussion is not new, but has been revitalised after the financial crisis

• The EU Commission stated that ‘shareholders do not seem to have fulfilled their role of “responsible owners”’

• The EU Commissioner Michel Barnier said in 2010 that ‘[w]e have spoken for years about shareholder rights. It is time to also talk about shareholders’ obligations’
The emerging agenda in the EU

• 2010 Green Paper: Corporate governance in financial institutions and remuneration policies
• 2011 Green Paper: The EU corporate governance framework
• Report of the Reflection Group on the Future of EU Company Law
• 2012 Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies
• Initiatives directed at shareholders – some only at institutional investors
A system of mandatory disclosure

• The Commission plans an initiative in 2013, possibly through modification of the Shareholders Rights Directive, on the disclosure of voting and engagement policies as well as voting records by institutional investors
Existing frameworks in the EU

• Regarding the management of UCITS funds:
  • Member States shall require management companies to develop adequate and effective strategies for determining when and how voting rights attached to instruments held in the managed portfolios are to be exercised, to the exclusive benefit of the UCITS concerned

• Similar provision regarding the management of alternative investment funds
Existing regulation in Member States

- National principles/codes of best practice
  - Industry-related: France, Belgium
  - Independent: the Netherlands and Germany
  - Regulatory bodies: UK and Greece
  - Included in the corporate governance code: Malta and Slovakia

- International codes: EFAMA and ICGM
Features of a EU system of mandatory disclosure

• No proposal has been set forward yet
• Possible inspiration in the UCITS and AIFM requirements
  • Only voting policy
• What is to be included in an engagement policy?
• Disclosure of voting records
  • How about engagement records?
Challenges for a EU system of mandatory disclosure

• The missing duty to vote or engage
• The lack of incentives to vote or engage
• The changing investment landscape
• Lack of collective action
• What should be disclosed?
• Enforcement of a mandatory disclosure system
The missing duty to vote or engage

- The EU framework largely builds on corporate governance theory
  - Assumption: Shareholders engage with companies and hold the management accountable
  - Shareholders have no duty to engage with investee companies
- Company law does not require shareholders to vote
- Institutional investors have a duty to act in the best interest of their beneficiaries
The lack of incentives to vote or engage

- Lack of benefits
  - Free rider problems
- Cost of engagement
- Incentives for long-term investment?
- Does the duty to disclose have an effect on the beneficiaries of institutional investors?
The changing investment landscape

- More foreign investments
- More shares are held by institutional investors
- Wide-spread use of intermediaries
  - Asset managers
    - What are their obligations?
    - Short-term practices
- The scope of the disclosure requirements?
Lack of collective action

- Need for a critical mass of shareholders
  - Diversified portfolios
- Collective action
  - Issues
    - Acting in concert rules
    - Identification of shareholders
What should be disclosed?

• Voting policy and engagement policy
  • The content?
• Are the policies binding?
• Comply or explain?
• Voting records, but not engagement records
Enforcement of a mandatory disclosure system

• Formal compliance
  • Formal enforcement

• Monitoring of whether the content of the policies is appropriate
  • Who will do it?
Ensuring the right level of engagement

• Will a system of mandatory disclosure be sufficient to overcome the barriers to shareholder engagement?

• Some barriers, e.g. conflicts of interest, are not affected

• Other barriers, e.g. acting in concert rules, require regulation at EU level
The way forward

• The level of ambition?
• Threat of more regulation?
• Is a European solution realistic?
• Change of investment culture