Dr Konstantinos Sergakis
School of Law
Stair Building
5-9 The Square
University of Glasgow
G12 8QQ

Proposed Revisions to the UK Corporate Governance Code

Email: codereview@frc.org.uk

Dear Ms Horton,

I very much welcome the opportunity to participate, in my capacity as an interested party, in the proposed revisions to the UK Corporate Governance Code as well as in some preliminary matters related to the UK Stewardship Code (I will provide more detailed comments on the latter once the formal consultation is published later in 2018). I will not answer all questions included in this Consultation as I will focus on matters directly related to my area of academic expertise and my ongoing research in corporate governance that I hope will be useful for your purposes.

Short Biography

Dr Konstantinos Sergakis holds an LL.B. from the National and Kapodistrian University of Athens, an LL.M. in International Business Law from University College London and a Ph.D. from the University Paris 1 Panthéon-Sorbonne. He joined the University of Glasgow as Senior Lecturer in Law in 2015, where he has convened the LL.M in Corporate & Financial Law since 2016 and he has acted as School International Lead since 2017. He is a Fellow of the Higher Education Academy (2014) and a qualified Advocate, a member of the Athens Bar Association since 2004. In 2017, he was elected as a member of the Executive Board of the International Association of Economic Law (AIDE). He is the author of *The Transparency of Listed Companies in EU Law* (Sorbonne - IRJS Editions 2013) and of *The Law of Capital Markets in the EU* (Palgrave Macmillan 2018). His research interests are related to Corporate Law, EU Capital Markets Law and Corporate Governance.

Consultation Questions

Question 3: Companies should introduce and maintain communication channels with stakeholders in various ways, one of which can be manifested through a choice among (or a mixture of) the three options proposed: director appointed from the workforce, formal workforce advisory council and designated non-executive director.

Notwithstanding the difficulties raised and the scepticism expressed by respondents to the Government's Green Paper consultation,[1] it seems that the appointment of individual stakeholder representatives to boards would be the most efficient method of engagement with stakeholders. Such representation on the board would give gravitas to various stakeholder voices and would ensure a more formalized engagement spectrum. It would also allow for a more holistic representation of a variety of interests on the board, highlighting the importance of such interests at the highest level of decision-making processes within companies. Nevertheless, given that the stakeholder director would have the same legal status as any other director on the board, the eligibility criteria and selection process would need to be rigorous and transparent.

Stakeholder advisory panels would also be a preliminary step for companies that may not yet be ready to appoint individual stakeholder representatives to their boards or for which this solution would prove unsuitable or less adaptable to their governance structures. The efficiency of such panels would largely depend on the institutional safeguards, support and resources within each and every company. Therefore, it would be difficult, in practical terms, to predict their usefulness across sectors and different company profiles at this stage. Their presence might act as a facilitator of communication between stakeholders and boards, but the actual impact of their role may be subject to further debate. In order to perform such a role efficiently, advisory panels would need to be given a clear and continuous operational mandate within companies, adaptable to the company size, profile and activities. It will also be useful if such panels could report annually on their activities, the results of their dialogue with the board, as well as their overall objectives.

Making such panels mandatory would not be advisable as it could create a counter-productive effect as far as the conceptual dialogue framework, developed between companies and stakeholders, is concerned. Indeed, the obligation to introduce such panels could make them more a 'formalistic' than a meaningful way of showing engagement with stakeholders and could shift attention from engagement to a mere 'compliance exercise' with the Corporate Governance Code. I therefore believe that such an option should be left to companies and only be recommended as one of the three options available for further engagement with stakeholders.

The third and last option of appointing an existing non-executive director could be seen as valuable for stakeholder engagement provided that the role of such a director could be enhanced and given proper consideration within the board. Such safeguards may not always be present, and the non-executive director's role may be confined to a 'cosmetic' representation of stakeholder interests on the board, which would ultimately make such a requirement less significant. As has previously been suggested, I firmly believe that non-executive directors for stakeholder representation could see their role take on greater importance if combined with stakeholder advisory panels. Such a cooperation framework could give the opportunity for the implementation of a more co-ordinated communication channel between panels and directors, and could stand as a viable and convincing alternative

[1] https://www.gov.uk/government/consultations/corporate-governance-reform.

to the first option above (appointment of a director from the workforce), which may be difficult to introduce across the board at this stage.
Examining all three options, I believe that – at least at the current stage – companies should be allowed to choose one of the three options that would be most suitable to their governance structure, with more constraining measures possibly being introduced in a future revision of the Corporate Governance Code. This would allow companies to gradually evolve within this new 'stakeholder representation' framework and adapt themselves to the emerging challenges.
As a more general comment, meaningful engagement should also (and primarily) be seen as an ongoing dialogue between companies and shareholders/stakeholders and should not be solely confined to the spectrum of formal representation of any of the forms mentioned above. It will ultimately be up to the company to decide how it engages with various constituencies, in parallel to the proposed mixture of the three representation scenarios. Such an objective is undoubtedly challenging and will prove to be an arduous task for some companies – at least in the beginning – depending on their profile, size, ownership structure and variety of stakeholders. It is nevertheless one of the most crucial issues that companies, market actors and stakeholders all must pay attention to.

Question 5: 20% of votes against resolutions at AGMs is significant enough to trigger explanations from companies of how further consultation with shareholders will take place to interpret this voting result.
Nevertheless, reservations may be formulated with regard to the update that will need to be published no later than six months after the vote. Although the rationale behind this measure is clear and laudable, and the benefits of publishing such an update are significant, it should be borne in mind that some companies may find it difficult to produce such information within six months. This may be due to the nature, the specificities and the challenges that may emerge within the context of a vote against resolutions. The variety of shareholder profiles and their own priorities and objectives, as expressed through votes against resolutions, may also complicate the consultation process that the company will have to develop and report on within six months after the vote.

Questions 9-11: Improving diversity in the executive pipeline is the next big challenge for corporate governance, and enhancing efforts towards that goal should be one of the main priorities for companies. I fully support the formulation of Principle J since diversity has a much broader conceptual framework than the gender balance alone, and it needs to be understood and implemented as such across the board.
The slow – but constant – rise in female participation in the boardroom in the UK operates within a soft law framework (compared to hard law obligations introduced in other countries) and has produced positive results to date. Given this reality, soft law measures should be maintained to allow companies to evolve harmoniously with the new emerging challenges and not transform diversity into a mere 'legal compliance' process with hard law requirements.
Female participation in executive committees still needs to improve, and the 'gender balance' disclosure obligations put forward in the proposed Provision 23 are very welcome. Reporting on gender balance is a valuable transparency tool with a clear rationale for companies in the FTSE 350, and the same approach could be adopted for ethnic diversity data so as to encourage companies to disclose information on a wider range of diversity issues.
Extending the disclosure obligations on gender balance data beyond the FTSE 350 should be welcomed given the increasing familiarity of all types of companies with this matter, as well as the growing importance of female participation for all constituencies.

The inclusion of a disclosure obligation on ethnic diversity data is a welcome idea since it could create, in theory, a much more holistic view of diversity in the UK. Nevertheless, the implications of such a disclosure obligation for companies that are not yet entirely familiar with such priorities may prove to be onerous and make them appear not 'up-to-date' with other companies although such a comparison may not be necessary given the different profiles that companies may have. Leaving it open to these companies to adhere voluntarily to these policies (as is currently the case with the proposed Principle J) without disclosing such data could be a much more feasible and workable solution, at least at the current stage: further disclosure measures could be introduced in a future revision of the Corporate Governance Code.

INITIAL CONSULTATION ON FUTURE DIRECTION OF UK STEWARDSHIP CODE

Question 17: The UK Stewardship Code should maintain its current version and the publication of separate codes for different signatory categories would not, in my opinion, improve disclosure practices and the usefulness/relevance of the information disclosed. Maintaining a single document of reference for stewardship purposes also facilitates the maintenance and enhancement of a more holistic view of the concept of stewardship for the entire investment chain. Different parties (institutional investors, asset managers, proxy advisors and others) will benefit from referring to the same document and operating under the same conceptual framework.
Expectations of best practice stewardship should remain generic, at least at the current stage, and should not lead to a fragmented soft law framework composed of a series of different reference points for each and every concerned market actor in the investment chain. Nevertheless, if it is desirable to provide more details regarding the expectations of best practice stewardship, this could be done via the provision of a non-exhaustive list in the form of guidance notes so as to allow the concerned parties to adhere to some generally accepted principles while maintaining their own operational methods.

Question 18: By expanding disclosure obligations in relation to best practice expectations, the UK Stewardship Code needs to maintain the 'comply or explain' principle. As analysed in our study,[2] the 'comply or explain' principle is vital for disclosure obligations that are still at a relatively recent stage since it allows the concerned parties to gradually develop their activities within an evolving soft law framework that purports to transform itself into an 'expectation driven' operational framework.
Given the difficulty in determining what best practice is (hence my reservation about 'expectations of best practice stewardship' as mentioned under question 17 above), non-exhaustive lists containing generic examples should be used at this stage. More detailed provisions could be included in UK Stewardship Code once concerned of market actors have shown a minimum of common understanding of such expectations in the future. Dictating more specific best practice expectations might make the exercise of stewardship more arduous and might deter some actors from pursuing their own distinctive way of exercising their stewardship responsibilities.

---

[2] K. Sergakis, 'Deconstruction and Reconstruction of the "Comply or Explain" Principle in EU Capital Markets' (2015) 5(3) Accounting, Economics and Law: A Convivium 233, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2516741.

Question 19: Highlighting a select group of signatories that engage in a 'best practice' reporting fashion is currently the most realistically achievable way to give greater visibility to such practices without incurring burdensome costs. I have also recently supported the idea that it will be particularly challenging for national regulators to enforce the stewardship duties, as provided in the Shareholder Rights Directive,[3] given the limitations in terms of resources that will inevitably be tested in the presence of a multitude of statements that will result from the compulsory disclosure obligations applicable to institutional investors, asset managers and proxy advisors.[4]
The UK Stewardship Code should enrich its informational content by adding the additional elements provided by the SRD so as to align itself with the EU rules, independently of the current Government's negotiations with the European Union. This will allow the UK Stewardship Code to maintain its reputation, visibility and attractiveness across the EU in the future and keep on being considered one of the most advanced Codes in this area.

Questions 21-22: The encouragement of investors' role in contributing to the company's long-term success needs to be expressed via the recommendation for an ongoing dialogue so as to understand better the company's culture and to keep on engaging with different constituencies. Any other formulation of provisions aiming to include ESG/long-term success/section 172 of the Companies Act 2006-oriented informational elements into investment strategies needs to be very carefully designed so as not to create an extraneous operational framework for some of the affected parties. Indeed, the inevitably variable range of duties to clients may prevent the undertaking of such strategies and could drive stewardship statements towards declarations of 'non-compliance' with the Code's provisions. I am of the opinion that it is better to rely on investors to develop their own such strategies and to contribute to the long-term success of investee companies and to require such disclosure of information only when their own mission is aligned with ESG/long-term success/section 172 of the Companies Act 2006-oriented informational elements.
Notwithstanding the attractiveness of extending the disclosure spectrum by requiring signatory parties to show how they contribute to the long-term success of investee companies, it needs to be borne in mind that generalising such requirements may create more confusion and burdensome compliance tasks for market actors.
The incorporation of 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors may also create a less flexible and more arduous operational framework given the difficulty in defining the notion of 'wider stakeholders', as well as the categories of all parties that could be included in such definition. The variety in the interpretation of such term by various actors may result in discrepancies/inconsistencies in the information disclosed.

Question 23: The FRC's remit is clear and legitimate, according to its flexibility imperative, since, when it comes down to deciphering the informational content of disclosure related to stewardship (or of the explanation of non-compliance), it is particularly difficult to delineate the contours of overall compliance due to the inevitably variable circumstances surrounding engagement and investment strategies that also impact the content of the

[3] Directive (EU) 2017/828.
[4] K. Sergakis, 'Legal versus social enforcement of shareholder duties' in K. Sergakis and H. Birkmose (eds), *Enforcing Shareholder Duties* (Edward Elgar 2018) forthcoming. More generally, as far as the coexistence of SRD and the UK Stewardship Code is concerned in the area of proxy advisors, see my written evidence submitted to the BBPG in December 2017: http://bppgrp.info/wp-content/uploads/2018/01/Konstantinos-Sergakis.pdf

engagement shareholder duties and the overall understanding of whether such duties are effectively complied with. Indeed, it is this vast range of information that cannot be monitored (and eventually sanctioned) with legal enforcement mechanisms as it will be particularly challenging to draw the line between violations of disclosure (or explanation) duties and simple 'borderline cases' that cannot and should not be sanctioned given their specificities and the perils of bluntly turning to legal enforcement.

I will therefore focus upon the current operational spectrum of the FRC[5] and would argue that social enforcement should be preferred in such cases and that the only way to encourage the efficient implementation of stewardship provisions would be the empowerment of recipients of the disclosed information via enhanced educational efforts and ongoing dialogue with other market actors. The discreet reinforcement of social sanctions through the use of disclosure as an exposure tool vis-à-vis other market actors should be a welcome evolution, but its ultimate efficiency will depend on the behavioural patterns of these actors. For social sanctions to take on a meaningful dimension and to act as a counterbalance to various 'borderline practices', market actors must already have the necessary education and evaluation skills to act responsibly when they receive any information related to stewardship. Education is key here, as it will prove critical for market actors that must reprioritise their strategies and not focus solely on the financial implications of stewardship activities.

Question 28: It would be advisable to allow shareholders to develop their own form of engagement in relation to the board and executive pipeline diversity at this emerging state. Institutional investors have more recently exercised their activism strategies in a convincing way with regard to board diversity. This fact shows that the market is moving towards such an engagement on its own, seeing the benefits of nudging companies for more diversity. Therefore, dictating such issues in a generalised way in the form of a blanket expectation of investor engagement that is applicable to all investor profiles would not necessarily improve the current situation. This is because it would force a dialogue that may not need to occur with all signatory parties and all investee companies at the same time.

A more meaningful engagement would result from investors pursuing their own distinctive purpose in the benefit of their clients and dedicating the necessary time needed to nudge the matters that define their relationship with their clients instead of attempting, *inter alia* for compliance reasons, to show engagement at a more generalised level and across a variety of areas. Channelling investor engagement via explicit expectations in the Code may also leave out other important areas of engagement that will emerge in the future and might restrict innovative ways of engagement at the current stage.

Question 29: The UK Stewardship Code could encourage (but not explicitly request) investors to take into account company performance and reporting on adapting to climate change so as to maintain flexibility in this emerging framework.

Question 30: Definitely.

Question 31: Definitely.

[5] Alternative monitoring mechanisms that can maintain the FRC's neutrality could also be proposed: see my proposal for an 'institutionalised dialogue spectrum' presented in K. Sergakis (2015) footnote 1, above.

I strongly believe that the review of the UK Corporate Governance Code and the UK Stewardship Code will contribute to the enrichment and maintenance of a more meaningful disclosure framework. I hope the comments provided in this letter are of interest for the Consultation's purposes.

Should you require any further information on the points raised above, please do not hesitate to contact me at Konstantinos.Sergakis@glasgow.ac.uk.

Yours sincerely,

Dr Konstantinos Sergakis

Senior Lecturer in Law
School of Law
Stair Building
5-9 The Square
Room 533
University of Glasgow
G12 8QQ