

## **CBI response to the Public Consultation on Best Practice Principles for Governance Research Providers**

December 2013

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1. The CBI welcomes the opportunity to respond to the Public Consultation on Best Practice Principles for Governance Research Providers. The services provided by the governance research industry play an important part in the way in which a large proportion of shareholders engage with the companies they are invested in. In turn, this engagement and dialogue between shareholders and companies is crucial to the effective functioning of equity markets.
2. The engagement and stewardship provided by shareholders are currently under the spotlight at the UK, EU and international levels. CBI members operating in the UK and internationally have expressed dissatisfaction about some aspects of how the governance research and advisory industry operates and about how its services are put to use by shareholders. In some cases, governance research is perceived by businesses as detracting from the level of purposeful dialogue between companies and their shareholders.
3. The CBI supports the development of Best Practice Principles for Governance Research Providers (the Principles) as a way to address some of these concerns and to support the stewardship role played by shareholders. The overall objective of the Principles, and the “litmus test” of their success, should be to support a greater level of meaningful engagement between shareholders and companies.
4. With this in mind, the CBI makes the following points in response to the proposed Principles:
  - **It is important that the Principles deliver the right message on the responsibility of shareholders**
  - **Comply or explain is the right approach, but the Principles could be more specific in some areas**
  - **Principles around the verification of information and redress in the case of error could be more ambitious**
  - **The Principles need to balance international consistency with respect for national approaches**

### **About the CBI**

The Confederation of British Industry (CBI) is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. We represent a broad cross section of UK businesses from both the financial services sector and non-financial sectors and in all sizes, from family owned businesses to FTSE 100.

The CBI helps create and sustain the conditions in which businesses can compete and prosper for the benefit of all. We are the premier lobbying organisation for UK business on national and international issues. We work with the UK government, international legislators and policymakers to help businesses compete effectively.



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### **It is important that the Principles deliver the right message on the responsibility of shareholders**

5. CBI members operating in the UK and internationally have expressed dissatisfaction about some aspects of how the governance research and advisory industry operates and about how its services are put to use by shareholders. In essence, companies are concerned that the provision and use of governance research may detract from shareholders' ability or willingness to engage in meaningful stewardship activity.
6. Business recognises that reports provided by research providers offer useful guidance to shareholders and that – considering the limited resources for governance research that some investors have – advice given can be a useful starting point for engagement. However, shareholders remain ultimately responsible for engaging with companies in meaningful dialogue, and for any votes cast – not the research provider.
7. We support the fact that the consultation paper highlights this important issue in its introductory section. However, the paper also states that shareholders remain ultimately responsible for monitoring investments and making voting decisions, “unless the third party assumes additional authorities from the client.” We are concerned that this could be interpreted as giving shareholders the option of “outsourcing” their stewardship responsibility.
8. The UK Stewardship Code encourages shareholders to pursue a purposeful dialogue with companies and states that *“Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their responsibility for stewardship. They remain responsible for ensuring those activities are carried out in a manner consistent with their own approach to stewardship.”* We fully support this approach and would be concerned if the Principles introduced a differing interpretation of shareholders' responsibilities.

### **Comply or explain is the right approach, but the Principles could be more specific in some areas**

9. The CBI fully supports the ‘comply or explain’ model as it takes differences between individual governance research providers into account. We believe that this approach will deliver the best outcome as it will allow signatories to design policies based on the Principles in a way that is most appropriate for their business.
10. In particular, giving signatories the option to explain why they have chosen not to comply with one of the Principles, and why they do not believe that the good practice set out in the Principles would lead to the best outcome for their particular business, offers useful flexibility.
11. With this in mind, we believe that it would be useful if the Principles would set out in more detail how the Committee defines “good practice” in respect of Service Quality, Conflict of Interest Management and Communications Policy. Giving examples of what a signatory's policy could contain would offer helpful guidance to signatories. We believe that signatories are best placed to define the specific content of their policies and should remain flexible to do so, but clearly setting out the issues to be addressed could lead to a more ambitious approach and an overall higher standard in developing policies.

### **Principles around the verification of information and redress in the case of error could be more ambitious**

12. The CBI welcomes the fact that verification of information and redress in the case of error are addressed in the Principles, as many issuers are currently dissatisfied with existing practice in this area.

We recognise that the ability of governance research providers to verify information has its limits, but we believe that every effort should be made to obtain up-to-date information and to avoid factual errors. We believe that signatories should disclose the procedures that they have in place to verify information and provide redress in the case of error.

13. An important part of the verification and redress process is engagement with issuers. We believe that discussing information about a company that a signatory intends to publish with the company before it is published is often important, as it gives issuer the opportunity to clarify information and to correct factual errors. At the very least, the Principles should require signatories to clearly set out in their policy how they intend to deal with cases in which factual errors are made and what their procedure for redress is.
14. The timeliness of engagement between signatories and companies is also of significant importance. Where engagement around verification currently exists, companies feel they have insufficient time to address the issues being raised. Timely engagement ensures that companies have the ability to review information and to address factual errors. This is an essential part of signatories making reasonable efforts to verify information.

#### **The Principles need to balance international consistency with respect for national approaches**

15. It is important that the Principles seek to strike the right balance between international consistency and respect for national codes, standards and regulation. This means reflecting the fact that most large companies have an increasingly international shareholder base, but at the same time creating sufficient flexibility at national level so that Codes and Principles directed at different participants in the investment chain can work well together and are effective.
16. From the UK perspective, the Principles should aim to avoid any mismatch with the Corporate Governance Code and the Stewardship Code in particular. For example, as explained under point 8 of this paper, the question of whether the responsibility for stewardship can be outsourced to third-party services by the owners of company shares has already been addressed by the Financial Reporting Council in the UK Stewardship Code.
17. As a further example, the Principles refer to the owners of a company's shares as investors throughout the paper. In the UK, there is a need to make a distinction between investors and registered shareholders. According to UK law, it is the registered shareholder who has the right to vote. Therefore, signatories implementing the Principles in the UK should have regard to this in order to accurately reflect UK law.
18. The CBI would welcome clarity in the wording of the section on "Conflict Disclosure". In the current version, the paper suggests that signatories should disclose any "conflict of interest that cannot be effectively managed" and should then "manage the conflict as further detailed in the signatory's conflicts of interest policy". We are concerned that this may create confusion over the distinction between manageable and unmanageable conflicts of interest, and in turn over how to address unmanageable conflicts of interest.