

20 December 2013

Drafting Committee of the Best Practice Principles for Governance Research Providers

c/o Prof. Dr. Dirk Andreas Zetsche, LL.M.

**Re: Public Consultation on Best Practice Principles for Governance Research Providers**

Dear Dr. Zetsche and Committee,

CFA Institute appreciates the opportunity to respond to the Best Practice Principles for Governance Research Providers public consultation document (the “Principles”) put together by the Drafting Committee of the Best Practice Principles for Governance Research Providers (the “Committee”).

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors’ interests come first, markets function at their best, and economies grow. CFA Institute has more than 120,000 members in 139 countries and territories, including 115,000 Chartered Financial Analyst® charterholders, and 136 member societies.

We appreciate the work of the Committee in producing a document that lays out a set of best practices for proxy advisers and governance research providers that will allow investors to better understand the quality of service they can expect from these firms as well as any potential conflicts of interests present at the firms. We also value the efforts of the Committee to establish best practices around proxy adviser communications policy, which we hope leads to better understanding among proxy advisers, their clients and the issuer community. Although this document is a result of the efforts of the European Securities and Markets Authority and proxy advisers operating in Europe, we believe a final best practices document can be of great use to investors and issuers around the globe, as proxy advisers operate in a global marketplace and the issues covered in this consultation are universal.

**Summary**

In February 2012, upon conclusion of the European Securities and Markets Authority (“ESMA”) consultation regarding the proxy advisory industry in Europe, an industry group formed ( the “Committee”) to develop a set of Best Practice Principles for Governance Research Providers (“Principles”).

The Principles are designed to govern, on a comply-or-explain basis:

- The nature and character of governance research services;
- The standards of conduct that underpin those services; and
- How signatories to the Principles interact with other market participants.

The Principles are intended to complement applicable legislation and regulation, and are not intended as binding rules or regulations in any jurisdiction. This approach is preferable, as proxy advisers and governance research providers operate across dozens of jurisdictions and under a wide variety of regulatory authorities. This code – if adopted – could become a global best practices template for proxy advisers and governance research providers, a commendable outcome that would be in jeopardy if the code aimed to be a rule based document or one bound to the laws of any one jurisdiction. CFA Institute has reviewed the Principles and in this letter sets out our answers to the questions posed by the Committee in the consultation.

## General Comments

What follows are the responses of CFA Institute to the questions posed by the Committee concerning the Principles laid out in the consultation.

### *1. What are your views about the Principles development process?*

The Principles development process has included impressive collaboration among proxy advisers and governance research providers in order to develop a set of best practices for proxy advisers and governance research providers. Along with the consultative process to allow investor and issuer input we encourage the Committee to revisit these Principles on an ongoing basis, and when doing so to canvas both investors and issuers to best understand best practices.

*2. Respondents are welcome to express their expectations regarding the review and monitoring of the Principles. As the ongoing governance of the Principles has yet to be determined, the Committee particularly welcomes suggestions by stakeholders as to how a representative feedback mechanism can be implemented*

CFA Institute encourages the Committee to include investor and issuer input in future review and monitoring of the Principles, as well as opening up the consultative process to a global audience, as the principles covered in the consultative document are ones common to all financial markets in which proxy advisers operate.

### *3. Please share your views on the practicality of a comply-or-explain approach to the Principles.*

The comply or explain framework appears to be the best fit for a set of Principles that will be applied across a number of different marketplaces overseen by dozens of different regulators – especially these principles become used by those beyond Europe. A comply or explain framework can prove inadequate however where an explanation of non-compliance is cursory and uninformative. The Committee should address this issue and ask proxy advisers to provide meaningful explanations of non-compliance, and not simply something to the effect of; “*We did not comply because doing so was inconsistent with our policies and procedures.*” CFA Institute believes such statements fail to give interested parties the underlying reasons for non-compliance and, therefore, fail to educate those parties as to the real reasons the firm did not comply. Ultimately it is up to the firms themselves to provide and their clients to demand adequate explanations of non-compliance.

### *4. Could the effectiveness of the Principles be further enhanced? Please elaborate and provide specific examples and/or suggestions.*

We are encouraged that the Committee plans to revisit the Principles periodically to ensure they remain current and relevant to both firms and clients.

### *5. Do you believe the Principles and/or supporting Guidance conflict with obligations under legislation or other best practice principles? If yes, please elaborate and provide specific examples and/or suggestions.*

No, to the best of our knowledge, the Principles do not conflict with obligations under any legislation or best practice principles.

### *6. Please share your views on the procedures for registering as a signatory, describing and disclosing how Principles and related Guidance are being applied, and for disclosing the Statement of Compliance.*

Not applicable.

*7. What should the regional scope of the Principles be, in terms of signatories and services provided? For example, do you think that the Principles should be global?*

As currently formulated, the principles can serve as global principles, as the needs for service quality and transparency around conflicts of interests and communications are universal and should not vary much from market to market. That said, even if a proxy adviser or governance research service provider operated in only one market, the Principles could still be applied to their operations.

*8. For additional potential signatories only: Are there factors that generally would keep you from becoming a signatory to the Principles? If yes, please elaborate and provide specific examples and/or suggestions.*

Not applicable.

*9. For additional potential signatories only: What are your views on the Guidance for subscription, adoption and ongoing compliance from an organisational point of view? Do you think the ongoing management of the Principles could be improved? If yes, please elaborate and provide specific examples and/or suggestions.*

Not applicable.

*10. Do you agree with the definition of “governance research services”? Is the scope of the definition adequate? If not, please elaborate and provide specific suggestions.*

The Committee defines governance research services as follows:

Governance research services comprise services provided on a regular basis as an intellectual contribution to the company-specific, proxy vote-decision and engagement activities of institutional investors.

Governance research services can be varied and may exhibit one or more of the following characteristics:

- Alerts, bulletins and newsletters
- Company-specific advice/opinions
- Data and analysis
- Policy guidance
- Ratings
- Voting recommendations

CFA Institute believes that the definition of governance research services is broad enough in scope to cover all manner of firms who provide governance data.

*11. Are the definitions of “vote agency services” and “engagement and governance overlay services” and their distinction from “governance research services” sufficiently clear and accurate? If not, please elaborate.*

“Vote agency” is defined as the provision of proxy vote execution services, whereby the voting agent is responsible for some or all of the logistical and operational activities associated with transmitting instructions from the institutional investor to the company meeting, as well as record-keeping and

reporting activities. Votes may be transmitted to the meeting directly (including personal attendance) or through a chain of operational intermediaries, depending on regulatory or market specificities in each relevant jurisdiction.

“Engagement and governance overlay services” are defined as undertaking contact and engagement with issuers on behalf of investors with a view to asking the company in question to amend aspects of its governance.

These definitions are distinct enough from governance research services to avoid confusion. Together, these three designated titles should cover all firms that would hold themselves out as proxy advisers or corporate governance service providers.

*12. Do you agree that the Principles should not impose standards of conduct on investors? If not, please explain why.*

The Principles should not seek to impose standards of conduct on investors. Such a standard is beyond the scope of these Principles, and should be initiated by an investor group if such a code were to come into being.

#### ***Principle One: Service Quality***

***Signatories aim to offer services that are delivered in accordance with agreed client specifications. Signatories should have and publicly disclose a research policy and, if applicable, “house” voting guidelines.***

*13. Do you think that Principle One will help the market to better understand the different kinds of services and approaches that participants operate? If not, please explain.*

Yes, though it is up to each firm to adequately put this principle into practice, as the principle – as currently stated – is fairly generic.

*14. Do you see any issues of service quality that are not addressed in this section? If so, please provide examples and specific information on the purpose and merits of any additional disclosures.*

More information concerning the policies and procedures a firm has in place to deal with errors and corrections would be helpful in this section, as this has been a main concern of issuers in the past.

*15. Do you think the disclosure of the research policy, voting guidelines and research methodologies will enable stakeholders to determine how signatories consider local market conditions? If not, please provide reasons.*

The disclosure of research policy, voting guidelines and research methodologies can only go so far to inform stakeholders as to how signatories consider local market conditions. It is up to clients and potential clients to communicate their expectations and concerns about local market coverage to signatories and subsequently ensure that such expectations and concerns are met and addressed or are otherwise accommodated in the clients voting practices. Signatories should work to facilitate such communications with clients and potential clients. Any way the Principles can accomplish this would be helpful.

*16. Please express your views on the scope and content of the proposed research-related disclosure under this principle with respect, to:*

a. research policy

b. voting guidelines

c. research methodologies

a. research policy

According to the Principles; *Signatories should have and disclose a written research policy that outlines:*

- *The general approach that leads to the generation of research;*
- *The extent to which local conditions and customs are taken into account;*
- *The extent to which custom or house voting guidelines may be applied; and*
- *The systems and controls they deploy to reasonably ensure the reliability of the use of information in the research process, and the limitations thereof.*
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This basic framework should be adequate to communicate the general concepts behind research policy. A signatory should make clear that clients and prospective clients can inquire concerning any (non-proprietary) specifics of research policy that may need clarification.

b. voting guidelines

According to the Principles; *Signatories should disclose whether they have developed house voting guidelines. If so, they should disclose the guidelines, including, but not limited to, the extent to which local guidelines and standards are used (if at all).*

*Each signatory will have its own approach to house voting guideline development and review, which may include one or more of the following approaches:*

- *Client review*
- *Academic literature review*
- *Public consultations*
- *Guideline exposure drafts*
- *One-on-one/face-to-face discussions*
- *Group discussions/webinars*
- *Expert/regulatory body reports*
- *Discussion at industry conferences*

*Signatories should explain how their voting guidelines are developed and whether and how they incorporate feedback into the voting guidelines development process.*

These guidelines should be adequate to effectively communicate a firm's general voting guidelines. It is up to clients and prospective clients to inquire about any concerns not addressed here

c. research methodologies

According to the Principles; *Signatories should have systems and controls in place to reasonably ensure the reliability of the information used in the research process to the extent possible, bearing in mind they cannot be responsible for disclosures published by issuers or shareholder resolution proponents that are the subject of their research.*

*Signatories should maintain records of the sources of data used for the provision of services to clients (to the extent legally or contractually possible).*

*Signatories should, where this is proportionate to their size, implement organisational features to achieve adequate verification or double-checking of the quality of research that is provided. These may include:*

- *Four-eyes principle (i.e. reports must be checked by a person independent of the research process itself)*
- *Issuer fact-checking*
- *IT-based consistency check*
- *Review by governance committee*
- *Review by senior analyst*
- *Review by senior management and/or executives*
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These guidelines should be adequate to give clients and prospective clients a general understanding of a firm's research methodologies. CFA Institute would like to inquire whether the Committee considered a period of time that would be reasonable to keep records? Is this something that the Committee wanted to leave up to the individual firms? If a firm does have a formal recordkeeping policy, this should be communicated to clients and prospective clients.

*17. For additional potential signatories only: Does the Guidance provide you with the information necessary to properly apply Principle One? If not, would you prefer further Guidance? Please explain.*

Not applicable

**Principle Two: Conflicts of Interest Management**

***Signatories should have and publicly disclose a conflicts-of-interest policy that details their procedures for addressing potential or actual conflicts of interest that may arise in connection with the provisions of services.***

*18. Does Principle Two address the relevant issues or considerations relating to potential conflicts of interest in the provision of governance research? If not, please explain.*

Principle two goes a long way to providing transparency concerning conflicts of interests. However, signatories should have to actually provide clients and prospective clients with descriptions of actual material conflicts that signatories have identified and how they have addressed them. It is not adequate to simply list a number of conflicts and tell clients that one or more of these conflicts may be present at the firm.

*19. Do you agree with the proposed conflict management and mitigation procedures? If not, please explain why and what additional measures you would propose.*

The conflict management and mitigation procedures listed in the Principles is short on detail, consisting simply of a list of possible mitigation procedures, such as:

- *Code of ethics*
- *Division of labour*
- *Employee recusal*
- *Fire walls/IT systems and controls*
- *Independent oversight committees*
- *Information barriers and ring-fencing*
- *Physical employee separation*
- *Separate reporting streams*
- *Transparent policies and procedures*

The list is however rather self-explanatory, if not exhaustive. Signatories should be required to state which of these procedures they have in place, and the details behind such procedures. It is not enough to simply provide a list such as this and tell clients and prospective clients that one or more of the following procedures are in place to mitigate conflicts.

*20. Do you agree with the proposed approach on disclosure of material conflicts? If not, please explain.*

The approach the Principles take towards disclosure of material conflicts appears sound. CFA Institute believes that signatories should inform clients and potential clients about potential conflicts of interest. These disclosures enable interested parties to understand and interpret whether the information that firms provide to them has the potential for manipulation as a result of any conflicting interests of the reporting parties. Ultimately, these disclosures will allow clients and potential clients to make informed decisions.

*21. For potential additional signatories only: Does the Guidance provide you the information necessary to properly apply Principle Two? If not, what additional Guidance do you need?*

Not Applicable

### ***Principle Three: Communications Policy***

***Signatories should have and publicly disclose their policy (or policies) for communication with issuers, shareholder proponents, other stakeholders, media and the public.***

*22. Please express your views on the scope and content of the proposed policy disclosure under this principle with respect to:*

*a. Issuers*

*b. Media and the public*

According to the Principles; *Signatories should have a policy (or policies) for dialogue with issuers, shareholder proponents, other stakeholders and their advisers.*

*The policy should cover issues including, but not limited to:*

- *The circumstances under which such dialogue could occur;*
- *How signatories verify the information used in their analysis;*

- *Whether and how issuers are provided with a mechanism to review research reports or data used to develop research reports prior to publication to clients;*
- *Procedures for avoiding receipt of privileged, non-public information and, in cases where such information is received, procedures for managing such information;*
- *If/how signatories communicate during the voting period (defined as the period from release of the agenda until the general meeting);*
- *When and how signatories communicate to clients the nature of any dialogue with issuers, shareholder proponents or other stakeholders regarding voting issues under review; and,*
- *What steps are taken to protect signatories and their employees from undue pressure or retaliatory actions arising from the delivery of their services.*

CFA Institute is concerned about the third item on this list. This seems an issue of independent research and we do not wish to see inappropriate interference or influence in the research process from outside sources. We would suggest a modification to this bullet point to consider “a mechanism to review research reports or data used to develop research reports for purposes of ensuring the accuracy of facts prior to publication to clients. “

Otherwise, this list of policies is a good start for providing issuers and other stakeholders with the avenues for dialogue with signatories. As stated above, these policies should include a way for issuers and stakeholders to communicate errors or inaccuracies in reports and the procedures signatories follow for dealing with such errors.

#### Dialogue with Media & the Public

The Principles state that: *Signatories reserve the right to respond to general media enquiries about the nature of their services and about the companies or issues they cover. However, signatories should have and disclose a policy (or policies) for communication with the media and the public. This policy should include, at minimum, the following considerations:*

- *Which of the signatory’s employees are permitted to make comments to the media and/or make public appearances; and,*
- *The signatory’s policy toward the publication of public recommendations (if made) on any particular resolution prior to the publication of their reports to clients. Exceptions to this policy should be explained.*

These policies appear adequate to address dealings with the media and public. We encourage signatories to go beyond this minimum requirement however if their contact with the media or public is expected to be extensive. We encourage the Committee to consider language that would call on signatories to reach out to issuers, investors and other stakeholders on an annual basis for comment on the signatories voting recommendation or research policies where applicable.

*23. Are there any other aspects of issuer-related dialogue that should be taken into account? If yes, please elaborate and provide specific examples and/or suggestions.*

We suggest that they include a policy for the recognition and correction of errors.

*24. Are there any other aspects of media and the public dialogue that should take into account? If yes, please elaborate and provide specific examples and/or suggestions.*

None at this time

*25. For additional potential signatories only: Does the Guidance provide you with the information you need to properly apply Principle Three? If not, where would you prefer further Guidance?*

Not applicable.

*26. In addition to comments on the specific questions addressed in the remainder of this Consultation Document, views are invited on the general approach taken by the Committee and the general features of the Principles.*

None at this time

*27. Do you feel that the Principles meet the policy principles set forth in ESMA's Final Report? If not please explain.*

Yes. We agree with ESMA and the Committee that these principles should be revisited and updated periodically.

*28. Do you have any other comments that the Committee should take into account when finalising the Principles?*

None at this time

### **Concluding Remarks**

CFA Institute appreciates the opportunity to review the Best Practice Principles for Governance Research Providers. We are happy to talk to the Committee further about any of the issues raised in this letter. Should you have any questions about our positions, please do not hesitate to contact, Robert Dannhauser at [bob.dannhauser@cfainstitute.org](mailto:bob.dannhauser@cfainstitute.org) or 212.05.1723 or Matthew Orsagh at [matt.orsagh@cfainstitute.org](mailto:matt.orsagh@cfainstitute.org) or 212.756.7108.

Sincerely,

/s/ Robert W. Dannhauser, CFA, FRM, CAIA

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