

**Issuers should be allowed to react
to Proxy Advisors' Voting
Recommendations**

Incomplete Best Practice Principles for Governance
Research Providers

Introduction

Deutsches Aktieninstitut appreciates the opportunity to respond to the public consultation on the Best Practice Principles for Governance Research Providers (BPPGRP).

Proxy advisors (PAs) play a central role for general meetings of listed companies, because the PAs' advices certainly influence the voting behaviour of institutional investors.

It is therefore of utmost importance that PAs adhere to minimum standards ensuring that PAs use their influence on the voting decisions of institutional investors in a responsible manner and that the perspective of the individual listed company is properly analysed before voting recommendations are issued to investors. Although there has been improvement in the transparency and the general business conduct of PAs over the past years, the business of PAs is often still a "black box" for issuers.

Against this background Deutsches Aktieninstitut welcomes the BPPGRP as step forward into the right direction. The BPPGRP show that PAs are taking seriously concerns about their own governance, their de facto influence on issuers and negative effects of errors in their analysis.

From Deutsche Aktieninstitut's point of view the set of minimum standards for the PAs should include the following elements at least:

- A duty to publish the voting policy in due time. Furthermore, these guidelines should be open for comments also for issuers before they are issued and the process of amendment should be transparent in terms of decisions taken.
- A duty to give issuers the opportunity to check the draft of the voting recommendation on its completeness and accuracy in a certain (short) period of time before its finalisation. Factual errors then should be corrected by the proxy advisor. In case of dissent on a particular voting recommendation the proxy advisor should ideally also pass the dissenting opinion of the issuer together with the PA's voting recommendations to the investors.

- A duty to take into consideration local market conditions when establishing voting policies by at least giving the issuers the option to comment on voting policies.
- A duty to publish possible conflicts of interest or at least to inform the client / investor about them when providing the voting recommendations.

Unfortunately, the BPPGRP reflect fully only the last of Deutsches Aktieninstitut's own recommendations. In sum, the BPPGRP will not ensure that issuers' opinions on sensitive governance issues, general meeting topics and business decisions are appropriately taken into account and factual mistakes in the analysis of PAs can be uncovered before voting recommendations are sent out to the investors.

From the issuers' perspective the interaction with PAs' is therefore crucial for the improvement and the reliability and efficiency of the whole process. The remainder of this position paper lays down in more detail where the BPPGRP should be improved from the Deutsches Aktieninstitut's point of view.

1 Comply or Explain (Questions 1 and 2)

The “comply or explain” principle is highly accepted with regard to the governance of listed companies.

Thus, to apply the same regulatory principle to the governance of the voting process in general and PAs in particular appears to be basically appropriate – at least as a first step. Deutsches Aktieninstitut also agrees that explanations of deviations should be comprehensible, relevant and detailed.

However, the effect of “comply or explain”-principle in the BPPGRP will be different to the effect of the codes of best practices for listed companies. Basically, proxy advisors will comply with the code if they improve the *transparency on their behaviour*. But they often do *not* need to change the *behaviour itself*. This holds particularly true with regard to the dialogue with issuers. In addition, there are only three very broad principles so that there is little guidance with regard to the question what will constitute a desirable behaviour on the level of the principles. At least parts of the guidance/explaining text to the principles should therefore be included directly into the code of best practices as own recommendations/principles.

Overall, the BPPGRP are less restrictive and less demanding than the existing codes of best practices for listed companies.



2 Principle 1: Service Quality (Questions 13 to 17)

Deutsches Aktieninstitut regards the principle 1 as a step forward into the right direction as PAs basically accept that own voting policies and the way they are developed need to be transparent for the general public in order to better understand the PAs' general attitude and thinking on sensitive issues. Many issuers would, however, prefer that voting recommendations better reflect local legal conditions so that issuers from different countries are treated equally. In addition and as explained above the BPPGRP are less demanding with respect issuers' involvement.

Consequently the BPPGRP should be amended by the following principles to ensure high service quality.

- The BPPGRP should demand that local market conditions are considered when general voting guidelines are drafted as it is already the case for some PAs. This should include the recommendation that voting guidelines provide for a fair treatment of corporate governance issues across markets. For example, a voting policy appears to somewhat unbalanced if it recommends to vote against the appointment of a supervisory board member of a European company, unless there has been a "cooling off" for five years, but at the same time do mind the identity of the CEO and the chairman of the board of an US company. The latter appears to be basically a greater corporate governance issue as managing and supervisory power is concentrated in one person.
- Though we agree that signatories' legitimate business interests should be protected, we suggest to make the research methodologies transparent also to issuers. This would improve issuers' understanding of the development of proxy advices and could help to bridge misunderstandings on both sides.
- A high quality of research is crucial from the issuers' perspective. It needs to be avoided in any case that voting recommendations are based on wrong facts and a wrong understanding of the issuers' perspective on agenda items and the economic rationale behind it. We therefore strongly recommend that "issuer fact checking" of the draft of voting recommendations should be mandatory before the final recommendations are passed on to the end investors.
- In the same way we suggest that PAs should not only disclose their policies for managing and responding to complaints, comments and feedback

about their services but also that an option for feedback from both investors and issuers should be included in the BPPGRP.

- At last, we agree that staff should be trained well so that they have a solid knowledge of the market practice and the legislative framework of the respective markets. In addition it needs be ensured that there is a sufficient number of staff in order to allow for detailed and balanced analysis.



3 Principle 3: Communication Policy (Questions 22 to 28)

As frequently pointed out by Deutsches Aktieninstitut the issuers' main request with regard to the role of PAs is to make sure that the dialogue between the parties involved works as smoothly as possible. For listed companies it is a key factor that there is a fair and transparent dialogue with PAs including a fair chance that the issuers' point of view is properly understood and reflected in the voting guidelines and recommendations.

Deutsches Aktieninstitut therefore believes that the BPPGRP should require PAs to be open for such a dialogue with issuers in order to avoid misunderstandings or factual errors. Instead, principle 3 only demands that signatories have a communication policy which is published on the website. The guidance to this principle underlines that PAs will not be expected to seek or enter into dialogue with issuers ("It is for the signatories to choose whether or not to engage in the dialogue and in what format", page 22).

Deutsches Aktieninstitut, thus, believes that the BPPGRP will not raise the standards for PAs in this important respect. Consequently the BPPGRP should be amended by the following two principles:

- PAs should give the issuers the opportunity to check the draft of the voting recommendation on its completeness and accuracy in a certain (short) period of time before its finalisation. Factual errors then should be corrected by the PA after this issuer fact checking. In case of dissent on a particular voting recommendation the PA should ideally also pass the dissenting opinion of the issuer together with the PA's voting recommendations to the investors.
- Issuers should also be involved in the development of general voting policies as long as these policies are not client research policies in order to get a full picture of the written and unwritten local governance traditions. This would help to better adjust voting policies to local market conditions and provide for a fair treatment of governance issues across markets. In addition to that we suggest that a clear guidance is included in the BPPGR until when the general voting policies should be reviewed and made public before the general meetings' season.

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