

European Securities and Markets Authority  
Submitted online: [www.bppgrp.info](http://www.bppgrp.info) and [consultation@bppgrp.info](mailto:consultation@bppgrp.info)

Dear Sir,

We are pleased to have the opportunity to provide feedback on the ESMA Public Consultation on Best Practice Principles for Governance Research Providers.

By way of background, Hermes is a leading asset manager in the City of London. As part of its Equity Ownership Services (Hermes EOS), we also respond to consultations on behalf of a number of pension funds and institutional investors from the US, Australia and Canada, as well as across Europe, including PNO Media (Netherlands) VicSuper of Australia, Canada's Public Sector Pension Investment Board and the UK's Lothian Pension Fund, Mineworkers Pension Scheme and British Coal Staff Superannuation Scheme (only those clients which have expressly given their support to this response are listed here). We assist these clients to act as responsible owners of the assets in which they invest. In all, EOS advises clients with regard to assets worth a total of *over €150 billion (as of 30 September 2013)*.

As representative of a number of institutional investors, we are actively engaging with a number of companies on behalf of our clients, including our owner, the British Telecom Pension Scheme. Voting is part of our engagement programme. We vote at thousands of annual general meetings each year and we manage our voting via a partnership with proxy advisory firm ISS. While we see a lot of benefit in the vote processing service offered by our advisor, we retain complete authority over voting decisions.

## General Comments

In our response to ESMA's discussion paper "An overview of the Proxy Advisory Industry" we would like to stress the following points:



- The proxy voting industry answers a genuine demand among investors who in many cases have to cope with a significant workload concentrated in a comparatively short time period of time, as well as the complex technicalities of submitting a vote. Proxy advisors provide helpful information on agendas and how they relate to bespoke, general or local best practice, as well as effective shareholders' voting platforms. Employing a proxy advisor can be the only way of ensuring that all votes in all different markets are submitted validly and on time. In our view, it is important to recognise that a large part of proxy advisors' influence stems from this practical consideration.
- ESMA's Final Report and Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry raised concerns on what is perceived as an excessive influence of the proxy voting providers. In our view this influence may be over-stated. However we recognise that this influence is exacerbated by the comparatively high barriers to entry of the market for proxy services and a persistent and high first-mover advantage.<sup>1</sup> Therefore, it is necessary to introduce mechanisms of 1/ enhancing the accountability of proxy advisors, 2/ simplifying voting systems to lower entry barriers and 3/ incentivising investors towards continuous stewardship of their holdings and meaningful engagement with companies. We believe that the ESMA's Best Practice Principles for Governance Research providers should aim at responding to the first issue identified above.

We are supportive of the key principles identified by the Group in order to enhance the accountability of the proxy voting industry, primarily on the disclosure of proxy research methodology and on the disclosure and management of conflict of interests. Investors need reliable, systematic and unbiased material on which to base their own analysis and make their own judgement.

We would to raise the following concerns in relation to the approach suggested by the Group

The scope of the consultation seems very broad and poorly defined. It risks including a wide range of stakeholders, each with very different sets of issues. As a result, the Principles are likely lack focus and overlap with the other principles and guidance which these stakeholders should already follow. The Best Practice Principles drafted

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<sup>1</sup> Belinfanti, Tamara, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 *Stanford journal of Business and Finance*, 385 2008-2009, p. 408-413.

the group in response to ESMA's report should therefore focus on the proxy voting industry for which it was initially intended and which made up the expert committee of this draft.

Diluting the scope is also counterproductive, as it limits the ability to define clear practical guidance within the Principles. In order to fulfil its aim of providing reassurance in respect of the quality and reliability of the industry to issuers and shareowners alike, we would indeed expect a further and more specific actual best practice to the three Principles set out in this draft. The guidance should further detail the nature of best practice in the management of conflicts of interest, as well as in the definition and disclosure of a clear set of rules to ensure the reliability of the proxy voting research. This in turn would support the comply or explain principle, which as it stands, refers to too high principles and general practical elements to be meaningful.

We answer specific questions below.

Yours sincerely,

Natacha Dimitrijevic  
Associate Director

## **Questions**

### **Consultation questions: Background to the Principles**

#### **Question 1**

We welcome the drive of the proxy voting industry with the elaboration of a set of relevant principles to respond to concerns raised in ESMA's Final Report and Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry.

However, these principles are lacking in the definition of specific best practice to the industry. Should the current wider scope be maintained, we would encourage ESMA to further consider existing principles and codes it listed in this consultation, and expand it to others such as the ICGN model mandate, the UK Stewardship code or other codes of conduct for news and wider research providers. ESMA may also want to seek the expertise of relevant representing bodies for their respective industries. However, we believe ESMA should focus its stance on the proxy voting industry and clearly define best practice relevant for the specific challenges it faces.

### **Consultation questions: Comply or explain**

#### **Questions 3 and 4**

We are fully supportive of a comply or explain approach, which would provide flexibility as well as enhance disclosure on the practice of the industry. However, in order to be meaningful clear standards should be defined. We would particularly welcome specific guidance on the nature and management of conflict of interests, as well as on the dialogue with issuers and its impact on the research provided.

### **Consultation questions: Application of the principles**

#### **Question 7**

We welcome common EU Principles. Practical guidance could encourage the proxy voting industry to explain how these Principles sit with other relevant legal requirements when they apply, such as in the United States, or potential specific geographical challenges, in emerging markets for instance.

### **Consultation questions: Scope and Definitions**

#### **Question 10**

The wide scope of the consultation risks encompassing very different stakeholders with as many sets of differing issues. As a result, the Principles would lack focus and overlap with the other principles and guidance which these stakeholders should already abide by. In addition to extensive legal frameworks, at both European and local levels, responsible asset owners and asset managers seek to be active owners respectively under the helm of a number of principles or codes such as stewardship codes, EFAMA Code for External Governance or the ICGN model mandate. The Best Practice Principles drafted by ESMA should therefore focus on the proxy voting industry for which it was initially intended and which made up the expert committee of this draft.

#### **Question 11**

We believe that the current definition of “governance research services” is confusing. Engagement is the cornerstone of active responsible ownership. It requires both research and analysis in order to have a meaningful dialogue with companies and an informed exercise of voting rights. In the draft Principles as they stand, engagement is excluded from the scope, while a significant part of its substance seems to be included. We therefore suggest to stick with proxy voting research providers.

#### **Question 12**

We agree that the Principles should not impose standards of conduct on investors, who should already abide by codes and regulations specifically designed to tackle the numerous specific challenges of this industry (see question 10). As they stand, the Principles risk encompassing part of the active and responsible investment processes.

#### **Consultation questions: Principle two : Conflicts of interest**

##### **Question 18**

More specific disclosure requirements are needed. In particular, the advisor should disclose the clients to whom it provides both corporate governance advice and voting recommendations, as well as instances where it provides a voting recommendation in respect of a company that is a client for corporate governance advice. Furthermore, disclosure regarding the percentage of clients who vote according to a “follow the advisor” policy should also be required.

The bargaining power resulting from providing voting research and recommendation to a large proportion of owners in a certain market could potentially limit the possibilities of influencing the company through other channels, such as direct

engagement with the owner. In an extreme situation, best practice standards would not be established by the owner through the proxy advisor, but would stem from the proxy advisor's own guidelines.

**Consultation questions: Principle Three: communication Policy**

**Question 23**

Proxy providers should systematically flag instances where voting recommendations were changed after the company has reviewed them if the review went beyond mere fact-checking.

Furthermore, conflicts of interest may lead to advice of diminished quality. A symbiotic relationship between issuer and advisor, or instances of "buy the test" behaviour may lead to recommendations that are not in the best interest of shareholders.