

The Drafting Committee
Best Practice Principles for Governance Research Providers Group

Submitted by email: consultation@bppgrp.info

20 December 2013

Dear Sirs

ICSA response to public consultation on Best Practice Principles for Governance Research Providers

We welcome the opportunity to comment on the proposals for Best Practice Principles for Governance Research Providers (GRPs). The Institute of Chartered Secretaries and Administrators (ICSA) is the international professional body that qualifies Chartered Secretaries and, as such, our members are well placed to understand the concerns of Issuers in their relationship with GRPs.

In preparing our response we have consulted, amongst others, with members of the ICSA Company Secretaries Forum, which includes company secretaries from more than 30 large UK listed companies from the FTSE100 and FTSE250. However, the views expressed in this response are not necessarily those of any individual members of the ICSA Company Secretaries Forum nor of the companies they represent.

We have made some general points under each of the issues where views are sought, together with our response to the specific questions set out in the consultation.

General comments

We very much support the proposals for a Code of Conduct for GRPs and consider this will be a positive step in improving relationships and understanding between providers and users of these services, and the issuers that are the subject of these services. We have noted the recommendations of the final ESMA report and the remit for this Code of Conduct, and we appreciate the draft Principles and Guidance have been developed within this remit. However, our view is that any problem lies not so much with the activities of GRPs themselves as with the way in which some (although by no means all) investors and other stakeholders use their services. Whilst we therefore welcome the additional transparency provided by subscribers to such a code of conduct, we are not convinced that it will totally address the perceived problems in this area.

A second concern is the issue of engagement with issuers to understand their governance arrangements. We think it is essential that there is engagement with companies at some stage, either by the governance research provider, the intermediary, or the investor. This is particularly important when a negative recommendation is being considered and we think it is essential that the Code of Conduct includes a requirement for transparency over the engagement with companies by GRPs in order that all participants in the market, whether

issuers, GRPs, their clients and others, are clear about the degree to which this engagement has taken place.

Responses to specific questions

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

We note that the Drafting Committee of the Principles comprised governance research industry members only. We have concerns that the views of those who use their services and of companies, who are the subject of their research, have not been taken into account in the drafting. Although we appreciate the opportunity to comment on the draft code, it might have been preferable if alternative views had been already considered in the drafting.

2. Expectations and suggestions regarding review, monitoring and feedback mechanism

We note that there is little detailed information on the monitoring and feedback mechanism and no indication of how enforcement might follow. We would suggest an annual compliance certificate given by each of the signatories to the Principles. We would also highlight the composition of the Committee and suggest that it would be useful for the feedback and monitoring process to include the collective views of those who use governance research services and of issuers. ICSA would be happy to be involved. We also think it would be helpful if the Committee undertook some form of public engagement from time to time as part of the periodic review process.

3. The practicality of a comply or explain approach to the Principles

We support the 'comply or explain' approach.

However, we are unclear as to whether the 'comply or explain' approach is intended to apply to the Principles only (as indicated by the question), or to both the Principles *and* related Guidance as set out in paragraph 1.1 of the consultation. If it is intended to apply to the Principles only we think it would be necessary to include some guidance on how potential signatories should exercise 'comply or explain' as this is difficult to accomplish in relation to Principles which, by their nature, are broad and imprecise. Our view is, very firmly, that it should be both Principles and Guidance to which the 'comply or explain' approach should apply. As drafted, the Principles are very high level, and should be significantly strengthened, in particular by removing language such as "reasonably", "reasonable efforts", "may" (instead of "should") etc. If non-compliance can be explained, there should be no reason for the Code not being more aspirational.

4. Could the effectiveness of the Principles be further enhanced?

We think the effectiveness of the Principles could be further enhanced by the inclusion of an explanation of how signatories should exercise 'comply or explain' and by providing clarity over whether 'comply or explain' applies to the Principles only or both the Principles and Guidance. We also think the Principles should cover *all* services provided by governance research providers. Please also see our detailed comments on the Principles and Guidance.

5. Do you think the Principles and/or supporting Guidance conflict with obligations under legislation or other best practice principles?

We think it is important that the Principles and Guidance for GRPs include support for best practice principles of engagement between investors and issuers. It is important that this engagement takes place and should be undertaken either by the GRP, the intermediary or the investor. Ideally GRPs should disclose whether or not they have engaged with the issuer

in order to understand the issuer's governance arrangements and verify their research information and, if they have, the degree to which issuer feedback is taken into account.

We would also highlight section 2 of the consultation (page 10), which emphasises the important ownership right of investors to vote at shareholder meetings. UK legislation provides that the registered shareholder holds the right to vote. However, the registered shareholder should vote in accordance with the wishes of the underlying investor, should the investor so direct. In circumstances where the voting wishes of the underlying investor differ from the recommendations of a GRP, it is appropriate for the registered shareholder to deviate from the recommendations and vote in accordance with the wishes of the underlying investor.

Finally, we are concerned about the comment in the penultimate paragraph of section 2 (Introduction to the Principles) that the use of "third-party services (such as those provided by the signatories) does not shift this responsibility to monitor investments and make voting decisions, **unless the third party assumes additional authorities from the client** (our emphasis)". The UK Stewardship Code is very clear 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. Accordingly, the Code also applies, by extension, to service providers, such as proxy advisers and investment consultants*" (Application of the Code, paragraph 2). We wholeheartedly endorse this position.

6. Views on procedures for registering as a signatory, disclosing how Principles and related Guidance are being applied, and disclosing the Statement of Compliance?

We do not feel able to answer this question and think additional potential signatories are best placed to respond.

7. The regional scope of the Principles in terms of signatories and services provided?

We think that the regional scope of the signatories to the Principles should be as wide as possible and, ideally, this would be a global scope as a number of the more influential GRPs are US based. We note that the UK Stewardship Code has a number of signatories from outside the UK.

With regard to services, we think that the Principles and standards of conduct should apply across the whole range of services provided by GRPs, including proxy advice and services. We appreciate the distinction made in the ESMA final report, and that the ESMA recommendation was that a Code of Conduct be developed for governance research services, but we think it is important that any Code of Conduct covers vote agency services where these are provided.

8/9 As we are not additional potential signatories, questions 8 and 9 are not applicable.

10. Do you agree with the definition of "governance research services" and is it adequate?

Yes. We agree with the definition of governance research services.

11. Are the definitions of "vote agency services" and "engagement and governance overlay services" and their distinction from research services, sufficiently clear and accurate?

Yes. We also agree with the definition of vote agency services and engagement and governance overlay services.

12. Do you agree that the Principles should not impose standards of conduct on investors?

Yes. We do not think the Principles should impose standard of conduct on investors. Investors are subject to their own codes, for example the UK Stewardship Code. However, as mentioned above, we have concerns about the *use* of governance research by investors, in particular where there has been no engagement with the company by either the GRP or the investor.

13. Do you think that Principle One will help the market to better understand the different kinds of service and approaches that participants operate?

Not really. Our concerns do not relate to the understanding of the different kinds of service provided, or to the research policy and ‘house’ voting guidelines, but rather to the approach of participants in relation to the accuracy of information. We think that the code should require a clear statement of how GRPs verify the accuracy of their information, and that they should carry out this verification without imposing a charge on companies.

14. Do you see any issues of service quality that are not addressed in this section?

One concern about service quality, not addressed in this section, is the issue of confidentiality. Engagement with companies is important but it is important that the discussions with companies remain confidential and we would like to see this reflected in the Principles and Guidance.

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?

Yes – provided this information is clearly disclosed.

16. Views on the scope and content of the proposed research-related disclosure under this principle with respect to:

a. research policy

In our view, this should take into account local *regulations*, conditions and customs, and should require “Their process for the identification and correction of errors”.

This is probably the most emotive point for issuers. In our recent FT-ICSA Boardroom Bellwether survey 62% of FTSE350 Company Secretaries consider the influence of proxy advisers to have a negative impact. Please be aware that ICSA are not suggesting that GRPs are more prone to errors than any other market participant, but it is a fact that, by the very nature of the services that GRPs provide, many issuers will have, or will have heard, some anecdote about a problem with a GRP. We are sure that GRPs could say the same about issuers, but believe that a clear and unambiguous statement of what a GRP would do were an error to come to light would go a long way towards addressing this concern.

b. voting guidelines

We believe that the second paragraph of this guidance should be amended to read: “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) and, in a market subject to a ‘comply or explain’ code of

corporate governance whether, and if so the degree to which, the issuer explanation (if any) is taken into account.

It is, of course, the decision of the GRP as to whether or not to have regard to any explanation published by the issuer, but a clear statement as to whether they do or not will put their client on notice.

c. research methodologies

We believe that signatories should specifically disclose whether they ask issuers to review their research prior to publication. This will improve the transparency of the processes that a GRP undertakes to produce its research and also makes it clear both to issuers what level of input they can expect when liaising with a governance research provider, and to investors that the research has not been seen by the issuer.

17. As we are not additional potential signatories, question 17 is not applicable.

18. Does Principle Two address the relevant issues or considerations relating to potential conflicts of interest?

Our main concern relating to potential conflicts of interest is the instances where governance research service providers are deriving income for providing services to both investors and to issuers. Ideally, GRPs should not be in the position of being 'paid by both sides', as the nature of the services they are providing results in a conflict of interest. In our view this problem is most likely to arise where a GRP advises issuers on how they might achieve a desired voting outcome, but will also arise where a GRP requires payment from issuers in order that an issuer can review, and can check the accuracy of, the information compiled by service providers.

19. Do you agree with the proposed conflict management and mitigation procedures?

We note that Principle Two does not appear to acknowledge that certain conflicts should be avoided, rather than just disclosed. In our view there are certain conflicts of interest, such as that discussed in 18 above that can, and should, be avoided. We do not think it is appropriate for GRPs to request payment from a company so that the company can check the accuracy of the information the service provider is intending to publish. We understand that it has been claimed that where such reports have been provided to the issuer, there have been cases where these reports have been shared with advisers and that this is a breach of copyright. We remain to be convinced that this is a major problem.

20. Do you agree with the proposed approach on disclosure of material conflicts?

We agree that signatories should have and publicly disclose a conflicts-of-interest policy, however we think that signatories should also disclose actual conflicts on all their published research. We note that disclosure to clients is envisaged in the preamble to the consultation questions on Principle Two, but believe that this should also be explicit in the guidance.

We did not fully understand the final section of the guidance on Conflict Disclosure, which appeared to us to say that "if a signatory becomes aware of a conflict of interest that cannot be effectively managed, the signatory should ...[disclose the conflict] and manage the conflict ..." In our view, if a signatory becomes aware of a conflict of interest that cannot be effectively managed, they should disassociate themselves from one or both client relationships.

21. As we are not additional potential signatories, question 21 is not applicable.

- 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**

Please see our comments below. In addition we would like to comment that if inaccurate information is released to the media this is potentially embarrassing to both the GPP and the Issuer and could be avoided if facts were verified with the Issuer in advance.

- 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.**

As noted above, we believe that this policy should include details of their process, if any, for dealing with any errors that are brought to their attention.

- 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.**

No.

- 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?**

As we are not additional potential signatories, question 25 is 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.**

See our general comments above.

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

Yes, although as noted above, we believe that any problem lies not so much with the activities of GRPs themselves as with the way in which some (although by no means all) investors and other stakeholders use their services.

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

No

Yours faithfully



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