

## The Best Practice Principles for Governance Research Providers Group

### Public Consultation on Best Practice Principles for Governance Research Providers

#### NAPF response

##### Introduction

The National Association of Pension Funds (NAPF) is the UK's leading voice for workplace pensions. Our members have combined assets of around £900 billion, and operate some 1,300 pension schemes. NAPF membership also includes over 400 providers of essential advice and services to the pensions sector; these include accounting firms, solicitors, fund managers, consultants and actuaries.

We welcome the opportunity to respond to this consultation paper on Best Practice Principles for Governance Research Providers. We support the efforts by the industry to respond to the issues raised by ESMA and the criticisms voiced from some quarters. This is an important initiative. The use of governance research providers can positively facilitate investors in carrying out their stewardship responsibilities to engage with and vote in an informed manner across often highly diversified portfolios. It is imperative that the provider's primary obligation remains to their investor clients. As such it is important that the sector is transparent in how it undertakes its activities and how it manages its real and potential conflicts of interest. A failure to adequately respond to the challenges being presented to the industry could result in inappropriate regulation shifting the prioritisation of the interests from the investor clients towards issuers.

While we believe that this is a positive first draft we are concerned at the scope of the target constituency of the Principles. In our opinion the focus for these Principles should be on those who provide research and/or voting recommendations which relates specifically to the exercising of proxies.

In addition, we have concerns that at present too much of the substance is contained within the guidance and the Principles themselves are thus too high level and could be characterised as motherhood and apple pie. We would encourage the authors to consider including more elements within the Principles themselves with a presumption of compliance; the comply-or-explain mechanism then offers plenty of scope for signatories to explain their approach more fully.

In answering the consultation questions we have in many instances answered a group of questions rather than risk repeating messages in answer to multiple questions.

##### Consultation Questions - Background to the Principles

1. What are your views about the principles development process?
2. Respondents are welcome to express their expectations regarding the review and monitoring of the principles. As the on-going 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.

We have no detailed comments about the process undertaken. The development of the Principles is a matter a matter for the industry and is a process in which we would encourage all those in the sector to actively and constructively contribute to.

Governance research providers are accountable to their clients. Their clients are in turn responsible to the underlying beneficiaries – asset owners / trustees - for how they conduct their voting activities. Given this relationship we would like to stress that it is important that any review and monitoring of the application of these Principles by signatories should emanate from those to whom they are ultimately accountable.

### **Consultation Questions - Comply or Explain**

3. Please share your views on the practicality of a comply-or-explain approach to the principles.
4. Could the effectiveness of the principles be further enhanced? Please elaborate and provide specific examples and/or suggestions.

The NAPF is a supporter of the concept of a comply-or-explain approach. We believe that it is important that the approach taken to policy formation; provision of research (and voting recommendations); communication with issuers and clients and managing of actual and potential conflicts is suitably transparent.

Given the range of varying approaches and business models of the different firms in this space it is right to seek to set out Principles which signatories would be expected to comply with or to explain why they do not.

### **Consultation Questions - Application of the Principles**

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, the Principles appear to be very high level in nature and do not therefore appear to cut across obligations under other regulation or legislation. In addition, the Principles would likely complement the relevant Principles within other Codes such as the UK Stewardship Code.

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.

The suggested approach sounds perfectly sensible. It would be beneficial for there to be a central location where clients and other stakeholders can locate and subsequently compare and contrast the statements of the various signatories – the Best Practice Principles for Governance Research Group web site is a sensible home for this.

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?

The Principles should ideally be global. The majority of the clients of the signatories are likely to be global investors investing in companies who commonly have global operations and share registers.

In addition, the main instances where proxy advisors have an influence on voting outcomes is in relation to overseas investors – specifically those from the US market.

Given this, while it is hugely positive that the relevant firms in the EU, including the EU operation of US firms, are seeking to introduce a set of Best Practice Principles, it would be much more beneficial if these Principles were endorsed further afield, most relevantly within the US.

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.*
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. 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.*

### **Consultation Questions – Scope & Definitions**

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.

No we do not.

As already alluded to above, we are conscious that there are different approaches undertaken by different providers in this space, and therefore it is not a simple task to define the characteristics of the constituency of firms towards which these Principles are directed. However, we are concerned that the definition of ‘governance research services’ is much too wide.

We would like to see a distinction made between ‘proxy advisory or research providers’ and wider ‘governance research services’.

It is our view that these Principles should be directed solely at those firms who provide research, advice or voting recommendations which relate specifically to the exercising of proxies. More general corporate governance research, analysis or policy guidance should not be the focus of these Principles. In addition, as already suggested, vote agency and engagement and governance overlay service providers should also be considered separate to these Principles.

It is the result of the exercising of proxies – ultimately a responsibility of the investor - which can have a significant impact upon an issuer. For example, in the UK the results of such votes could result in the de-selection of a company director or external auditor or the rejection of a company’s remuneration policy. It is understandable therefore that issuers have an interest in the quality of the research being used by investors in reaching their voting decisions.

It would be inappropriate however, to seek to bring more general corporate governance research or other related activities within the remit of these Principles. To bring more general corporate governance research within the remit of these Principles would be seeking to address a wider issue, namely the broad quality of all research which investors utilise in reaching investment decisions. Indeed, broker research is undoubtedly much more market sensitive and it would therefore be paradoxical for general corporate governance research to be the focus of soft-regulation ahead of this larger and more influential area of company research.

**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.

Yes.

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

Yes we agree. The ultimate voting decision for each resolution at a company meeting is ultimately the responsibility of the investor, not the advisory service. In turn it is important that investors do utilise the research or advice provided appropriately. In the UK mechanisms are already in place to bring transparency to this process and discussions around vote transparency also have merit. It is important that investors are transparent and accountable to their clients for how they exercise their rights on their behalf.

Currently, investors commonly utilise a range of research information in assessing the resolutions at a company’s AGM, including that conducted by advisory and research services. We would expect that such a service would be used in the fashion for which it is intended – advisory. In practice many investors use these services as a form of screening process, highlighting issues worthy of further consideration and assessment by themselves.

In the UK, the Stewardship Code sets out the principles of effective stewardship by investors. The Code, directed in the main towards institutional investors, is very clear that institutional investors may choose to outsource to external service providers some of the activities associated with stewardship – such as voting - however, they cannot delegate their responsibility for stewardship. Accordingly, the Code also applies, by extension, to service providers, such as proxy advisors. The Code specifically states under Principles 6 that:

“Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.”

The NAPF believes that the informed use of votes, while not a legal duty, is a responsibility of owners and an implicit fiduciary duty of pension fund trustees and asset managers to whom they may delegate this function.

As set out within the NAPF’s Corporate Governance Policy and Voting Guidelines, voting decisions should always be made in the context of a company’s overall governance arrangements and any trends towards (or away from) improved standards. Indeed, the NAPF’s Voting Guidelines assume that investors have evaluated explanations for non-compliance with the NAPF’s Policy (which is based upon the UK Corporate Governance Code) and, taken account of a company’s individual circumstances and engaged as appropriate.

Furthermore, the Stewardship Disclosure Framework published by the NAPF in October this year seeks to further enable pension funds, and other stakeholders, to better compare and contrast the stewardship approaches of different asset managers. One category within this Framework specifically asks firms to signify whether they: “demonstrably vote all shares on a considered basis with fund manager involvement.” Or whether their “votes cast always follow recommendations of an external voting advisory service.”

We believe that it is the responsibility of investors to clearly and transparently articulate how they fulfil their shareholder responsibilities, including the exercising of their voting rights. It would be wholly inappropriate for either the service providers, or other stakeholders, to set out standards of conduct for investors in this area.

These Best Practice Principles should instead seek to complement the existing Codes of best practice for investors.

### Consultation Questions - Principle One

**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, but we would prefer to see the scope of these Principles restricted to those whose research or voting recommendations are directed specifically towards informing the exercising of proxies. This tighter focus would be beneficial in allowing investors to compare and contrast the different firms and will also enable issuers and others to understand the how the relevant research is being undertaken.

**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.

The guidance is fairly comprehensive; however, we would like to see more of the expected undertakings communicated within the Principles and for the tone of wording to be based more on a presumption of compliance.

It would also be good to see inclusion within the guidance for Principle one encouragement for signatories to assist clients in thinking about and devising their own bespoke voting policies in order to promote a more informed and involved engagement by clients with the proxy voting process.

Additionally, and importantly, it would be beneficial if signatories were to disclose the issues which they provide research or voting recommendations upon. Crucially, it is important to understand whether research or advice is provided in relation to transaction activity or whether it is restricted to purer governance issues. If the firm does provide recommendations in relation to transactions, the firm should communicate on what areas it deems it has the expertise to advise upon.

**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.

Yes. We believe that proxy research providers and advisors should be transparent about the methodology and guidelines they are utilising to determine their recommendations.

**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

As per above, we would like to see it clearly articulated whether advice or recommendations are issued in relation to corporate transactions. It is these resolutions which are most important from an issuer perspective and which may a negative vote may have the most financial impact. Indeed, voting on these resolutions, possibly more than any other, requires much more considered analysis and there would be understandable

concern if voting was undertaken or influenced by a narrow analysis of just governance matters or via a tick-box approach.

Additionally, clients would welcome greater transparency around the level of resources available for analysis at signatory firms. This disclosure should include the size of the team, the experience and qualifications in the team and the geographical spread of the team. We should however, make clear that we do not feel that there are any issues of concern with regards to the standards or skills and experience among signatory staff. This is a commercial issue for which the market for such services should drive and greater transparency around current resource levels would help this.

*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.*

### **Consultation Questions - Principle Two**

**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.

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

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

*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?*

Yes the proposed approach to conflicts of interest appears sensible.

There is clearly the potential for conflicts of interest to occur with regards to proxy voting firms – as there is along the entire investment chain. To counter this, we believe that proxy advisors should explicitly disclose any conflicts along with their procedures for managing them on their website.

Importantly, we would welcome more specific disclosure around conflicts, rather than general disclosure that conflicts exist. But we would suggest that this should be done on a case-by-case basis, rather than formulaically, in order to avoid boilerplate disclosures.

In relation to the list of possible conflicts for consideration, we would suggest that the ‘Issuer-Client’ influence on signatories’ should perhaps be promoted higher. In addition, we would suggest that potential conflicts arising from a parent company should also be included.

### **Consultation Questions - Principle Three**

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

- a. Issuers; and
- b. Media and the public

We would expect signatories to clearly disclose their approach to engagement with issuers. Such disclosure should make clear *who* would undertake any engagement, *when* any engagement would take place and *on* what issues any communication would take place and in what *form*. All stakeholders should be able to easily understand how each signatory approaches engagement and communication with issuers and their rationale for this.

We believe that it makes sense for companies to be given a window to respond and correct any factual errors or provide a concise explanation which can be included within any report to investors. However, this should not be seen as an opportunity to negotiate a favourable voting recommendation – that must be a judgement call by the signatory. It is imperative that the signatory's primary obligation remains to their investor clients.

It is to clients that signatories owe their first duty; ensuring information is provided in sufficient time for votes to be informed and thus executed in an appropriate manner.

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.
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.
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?*

#### Consultation Questions - General Features of The Principles

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

We believe that in order to meet the principles set out within ESMA's report and the wider expectations of the industry's response the Principles need to be much more focused on a specific constituency – i.e. those whose research or advice directly relates to the informed voting of proxies.

In addition, it would be in the signatories interest to look at the tone of the Principles and assess whether a) they can be articulated in a presumption of compliance manner, and b) whether the Principles can more clearly articulate some of the underlying points currently contained with the Guidance in order that it is clearer at a glance that the Principles are more than simply motherhood and apple pie.

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

To discuss further please contact:

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