

The Best Practice Principles for Governance Research Providers Group

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20 December 2013

Dear Sirs,

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

***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of EuropeanIssuers, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Corporate Governance Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

***Response***

We welcome the opportunity to respond to this consultation. We are keen to help governance research providers carry out their services more effectively as this is good for the whole market and for our members, small and mid-size quoted companies.

As a general comment, we believe that there is a lack of transparency as to how the whole governance research and recommendation industry works, as well as a lack of understanding and trust between issuers and governance research providers.

In our QCA/BDO Small and Mid-Cap Sentiment Index carried out in May 2012, we found that almost half (47%) of small and mid-size quoted companies and advisory firms to those companies were unable to determine whether proxy voting agencies play a positive or negative role in corporate governance. We asked the same question in our Index carried out in September 2013 and found that 44% of small and mid-cap quoted companies believe they play a negative role, with 36% unable to determine whether they played a positive or negative role in corporate governance.

We greatly support the production of industry principles of best practice to govern the provision of services from governance research and recommendation providers to their fund manager clients and do not support efforts to regulate the provision of these services as yet. However, we believe that there are fundamental problems with the process through which these draft principles have been developed. Most importantly, issuers and other stakeholders were not actively involved in the production of the draft principles or consulted with on them at an early stage.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

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We believe there are many areas where these principles can be strengthened, as well as the need to address how they will be monitored and reviewed. It is of the utmost importance that any principles must be ‘fit-for-purpose’ and carry weight so as to build trust and transparency between investors, issuers and governance research and recommendation providers. Without greater trust and transparency, there is a real risk that, rather than being a positive influence, your industry may cloud the conversations and engagement between an issuer and its institutional investors. We make a number of suggestions in our responses to the questions below as to how to improve them.

Please note that we refer throughout the rest of our consultation response to ‘governance research providers’, as defined in paragraph 2.1 of the consultation paper.

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

We support the concept of principles to govern the provision of services from governance research providers. However, we believe that there are some fundamental problems with the process through which these principles have been developed.

We believe that there is a fundamental conflict of interest present by having the principles for governance research providers drawn up by a committee made up solely of governance research providers. We believe that it would have more authority and weight if there were other interested parties involved actively in the process, most importantly issuers and investors.

It is particularly important for issuers to be involved in this process – and specifically those that are small and mid-size – as the services provided by governance research providers greatly affect them. We note that in the consultation paper the committee explains that it had a discussion with potential signatories to go over the draft code. It would have been helpful for the committee to have actively engaged with issuers before the draft principles were published.

### **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 believe it is essential that there is independent review and monitoring of the principles and their adoption by governance research providers so as to build confidence in its effectiveness. This should be clearly outlined as to the frequency and who will be responsible for carrying out this process. This is a basic principle of good corporate governance, which is the ultimate objective of the research and recommendations provided by governance research providers.

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

We agree with the ‘comply or explain’ approach to the principles – so long as explanations are clear and full. We note that it would be particularly helpful for each governance research provider to issue an annual statement explaining how it applies these principles, as they all provide different services and have varying business models/approaches.

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

Yes, we believe the effectiveness of the principles will be further enhanced by engaging with other stakeholders, especially issuers, on these principles and by independent review and monitoring. Please see our response to Questions 1 and 12.

**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.**

We do not believe that the principles or supporting guidance conflict with obligation under legislation or other 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.**

We have no strong views on how this procedure takes place.

**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?**

We believe that these principles should cover signatories that provide services on issuers with securities admitted to markets in European Union Member States.

**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.**

We have no comments on this.

**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.**

We have no comments on this.

**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.**

Yes, we agree with the definition and that the scope is adequate.

Ahead of answering questions 11 and 12, we have some comments on the ‘Introduction to the Principles’. Firstly, we would query the wording used in paragraph five on page 10, which introduces the principles. This paragraph currently reads:

*Irrespective of the type of services used to support ownership and voting activities, the ultimate responsibility to monitor investments and make voting decisions lies with institutional*

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*investors; use of third-party services (such as those provided by signatories) does not shift this responsibility, unless the third party assumes additional authorities from the client.*

We believe that the phrase ‘unless the third party assumes additional authorities from the client’ goes against the overarching principles of the UK Stewardship Code. We object to the suggestion here that investors might abdicate their responsibility to monitor investments and make voting decisions. We understand that they are able to outsource the process of voting and research (extending to recommendations) to inform voting decisions – however, the ultimate responsibility for these processes remains with the investor as a steward.

Secondly, we note the use of ‘investor’ in paragraph 1 on page 10 and wonder whether it may be more appropriate to use the term ‘shareholder’. We understand that the meaning of these terms differs slightly between EU Member States – however, this highlights the importance of using and explaining terminology in the principles clearly. Furthermore, perhaps the word ‘institutional’ is not required.

**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.**

We would note that “engagement and governance overlay services” seems to refer to services similar to board evaluation. It may be helpful to include a reference to this in the definition or to clarify this further if it is not meant to refer board evaluation type services.

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

Yes, we agree that the Principles should not impose standard of conduct on investors.

**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.**

We believe that the first sentence of Principle One should be amended to read: “Signatories will deliver services in accordance with agreed client specifications”.

The phrasing ‘aim to offer services’ is not appropriate because if governance research providers do not offer services as agreed by their clients then they are in breach of contract (ie engagement terms).

We also believe the language of second sentence should be tightened up to require signatories to publicly disclose their research policy. This is to ensure that there is adequate transparency for all market participants. As such, we believe it should read: “Signatories will publicly disclose their research policy and, if applicable, ‘house’ voting guidelines”.

**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.**

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Yes, we believe that signatories should disclose their process for the identification and correction of any errors in relation to the services that they provide. Furthermore, we believe that signatories should publish statistics indicating the number of factual errors made each year.

Regularly, we receive feedback from our small and mid-size quoted company members that governance research providers had made a mistake on their research. While we understand that often times 'mistakes' may not be a matter of fact but instead a matter of judgement, we believe that it is essential for each governance research provider to have a clear and accessible process in place to identify true mistakes of fact and to swiftly remedy them within the tight voting timetable.

Many corporate members have expressed particular concern where they are asked to pay to receive information which they prudently consider it is necessary for them to review in order to guard against the risks of erroneous statements and research analysis being presented to shareholders.

**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.**

We have suggested some amendments in our response to Question 16 in order to enable this.

**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**

As noted above in our response to Question 14, we believe that there should be an additional bullet point added to require signatories to disclose their process for the identification and correction of any errors in relation to the services they provide, as well as the publication of statistics on the number of factual errors made each year.

**b. voting guidelines**

We believe that paragraph 2 under voting guidelines should also require signatories to disclose the extent to which explanations are taken into account, if the services being carried out by governance research providers are taking place in a market that has adopted a 'comply or explain' corporate governance approach.

**c. research methodologies**

We believe that signatories should specifically disclose whether they allow issuers to fact check their research and, if so, what time window the issuer is given. This will ensure that there is transparency as to the processes that each governance research provider undergoes to produce its research and also makes it clear to issuers what level of input they can expect when liaising with a governance research provider.

**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.**

We have no comments on this.

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**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.**

Yes, we believe that Principle Two addresses the relevant issues or considerations relating to potential conflicts of interest in the provision of governance research.

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

Yes, we agree with the proposed conflict management and mitigation procedures.

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

No. We do not understand the wording used in this section. If a conflict ‘cannot be effectively managed’, then the second bullet point (‘Manage the conflict as further detailed in the signatory’s conflicts of interest policy’) is contradictory and irrelevant. We believe that the second bullet point should be changed to read: “Cease acting for one or more clients”. This is best practice in other industries (i.e. legal and accountancy profession) and we believe it should be applicable in this circumstance as well. Many conflict situations cannot be managed.

**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?**

We have no comments on this.

**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**

With relation to both issuers and media and the public, we believe it is important for governance research providers to communicate how they deal with complaints and errors that may occur when carrying out their services. As noted in our responses to questions 14 and 16, we believe that disclosure and statistics on this point is essential.

**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.**

In relation to our suggestion in our responses to Questions 14, 16 and 22 that governance research providers should disclose how they deal with complaints and errors, we believe that it is particularly important to focus on engagement with issuers in this circumstance. Governance research providers should clearly explain their level of engagement with issuers on these matters.

**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.**

We have no comments on this.

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**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?**

We have no comments on this.

**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.**

We are keen to understand what, if any, are the sanctions of governance research providers not complying with the principles outlined in this document. Again, as mentioned in our response to Question 2, we believe that independent monitoring and review could help with this; but, we are not sure that it is clear what happens as a result of non-compliance.

Furthermore, we would like to understand what happens if there is a breach identified – for example, if a signatory publicly discloses something and then it is found that they do not actually adhere to that disclosure.

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

Yes, we believe the principles meet the policy principles set forth in ESMA's Final Report. However, there was not much detail included in ESMA's Final Report and we still believe that the principles could be improved.

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

We have no further comments. However, if you would like to discuss any of our response in more detail, we would be happy to attend a meeting. We do believe it would be useful for governance research providers to involve issuers in this process and in on-going effectiveness monitoring.

Yours faithfully,



Tim Ward

Chief Executive

**Quoted Companies Alliance Corporate Governance Expert Group**

Edward Craft (Chairman)	Wedlake Bell LLP
Colin Jones (Deputy Chairman)	UHY Hacker Young
Victoria Barron	Hermes Equity Ownership Services
Edward Beale	Western Selection Plc
Rob Burdett	FIT Remuneration Consultants
Anthony Carey	Mazars LLP
Richie Clark	Fox Williams LLP
Louis Cooper	Crowe Clark Whitehill LLP
Madeleine Cordes	TMF Corporate Secretarial Services Ltd
Kate Elsdon	PricewaterhouseCoopers LLP
David Firth	Penna Consulting PLC
Peter Fitzwilliam	Mission Marketing Group (The) PLC
David Fuller	CLS Holdings PLC
Clive Garston	DAC Beachcroft LLP
Nick Graves	Burges Salmon
Andrew Hobbs	EY
Alexandra Hockenhull	Xchanging plc
David Isherwood	BDO LLP
Nick Janmohamed	Speechly Bircham LLP
Dalia Joseph	Oriel Securities Limited
Claire Noyce	Hybridan LLP
Gabriella Olson-Welsh	McguireWoods
Anita Skipper	Aviva Investors
Julie Stanbrook	Hogan Lovells International LLP
Nicholas Stretch	CMS Cameron McKenna LLP
Peter Swabey	ICSA
Eugenia Unanyants-Jackson	F&C Investments
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