

2017 REVIEW OF THE BEST PRACTICE PRINCIPLES FOR GOVERNANCE RESEARCH PROVIDERS

About Frontis Governance and ECGS

Frontis Governance is a sole proprietorship firm founded and owned by Sergio Carbonara. It is the first Italian proxy advisory firm, focused on the domestic market, and it is a partner of the international network of proxy advisors ECGS (“Expert Corporate Governance Service”). Other European members of the ECGS network are: Proxinvest (France – managing partner), Corporance (Spain), DSW (Germany), Ethos (Switzerland), Manifest (United Kingdom) and VIRV Solutions (Netherlands).

ECGS and Frontis Governance, respectively for Europe and Italy, make publicly available their corporate governance principles, voting guidelines and voting recommendations per fiscal year. Frontis Governance has also adopted a dialogue policy with issuers and media. All documents are available on Frontis Governance website (www.frontisgovernance.com/en/resources). The dialogue policy, the Italian corporate governance principles and the voting guidelines are currently available in Italian only.

All researches published by Frontis Governance are written by senior analysts, and all ECGS researches are subject to the control of senior analysts of the network. A third level of control is performed by other ECGS partners and clients, who may directly contact the analysts for further clarifications or to express different views on specific items.

In our opinion, the best way to manage any conflicts of interest is to avoid them. The independence of all ECGS partners is guaranteed by the mandatory prohibition to provide advisory services to listed companies included in each partner’s research universe. However, some types of conflicts of interest are not avoidable, as generated by the ownership structure or activities performed by clients (i.e., the submission of resolutions). Any actual or potential conflicts of interest out of the control of Frontis Governance are duly disclosed in the first page of the relevant proxy voting research and in the analysis of the specific resolution.

Why Frontis Governance does not subscribe the Best Practice Principles

Although Frontis Governance complies with all the principles, we decided not to be signatories of the Best Practice Principles as long as there is no clear opposition to proxy advisory firms to provide consultancy services to listed companies that are under their universe of analysis.

Unlike other types of conflicts of interest (clients that are controlled by a listed company, or clients proposing resolutions), the possibility to offer advisory services to both shareholders and issuers is absolutely avoidable, and almost all proxy advisors have eliminated such conflict of interest by self-regulation. However, we strongly regret that the same principles are not adopted by all advisors, and no actions have been taken at a regulatory or self-regulatory level to prevent or minimize the effects of conflicts of interest.

In our opinion, “Chinese walls” are not an effective solution to distortions caused by conflicts of interest. Furthermore, we believe that “comply or explain” rules are not strong enough to solve all the problems generated by conflicts of interest. Despite any “Chinese walls”, analysts can easily identify those listed companies that hire the proxy advisor’s corporate services. On the other hand, listed companies may decide to purchase the corporate advisory services of the researcher to increase the possibilities of a favourable voting recommendation.

The possibility to offer advisory services to issuers may also represent a huge competitive advantage for a proxy advisor, which would be able to adopt aggressive commercial strategies significantly reducing the price of proxy researches thanks to higher revenues generated by the advisory services to issuers. Investors are surely interested in the quality of analysis, but the pricing of reports is still one of the main factors taken into account to choose the research providers, especially in markets where investors are forced by regulations or codes to vote at all general meetings, so that voting may be perceived as a mere matter of compliance.

In our opinion, allowing the possibility to provide advisory services to listed companies represents a clear distortion of competition, especially taking into account that almost all the competitors have voluntarily eliminated such possibility, renouncing to potentially significant revenues generated by providing advisory services to issuers.

Answers to the consultation questionnaire

Q.1 Name of Organization

Frontis Governance di Sergio Carbonara

Q.2 Type of organization

Governance advisory / voting research service (investor advisor)

Q.3 Main country / region of operation

Italy

Q.7 Were you previously aware of the Best Practice Principles?

Yes

Q.8 If yes, how would you rate the positive impact of the Principles since they were introduced in 2014? 2

Please give a reason for your rating:

In our opinion, the Principles contributed to improve transparency and further develop the debate on main issues concerning the proxy advisory industry. However, so far the Principles have had no real

impact on the behaviours of the main players in terms of both the quality of analysis and the management of conflicts of interest.

Q.10 Would it be beneficial to have a set of principles that are capable of being applied in all markets?

Yes

Q.11 At present the Principles address three areas: service quality (which includes duties to clients, research methodology and voting policy); managing conflicts of interest; and communications with issuers, the media and other stakeholders (see the BPPG website here). Are there other issues or activities that should also be covered by the Principles?

- ✓ Intermediary vote processing and confirmation.

Comment: In our opinion, poor attention has been given so far to the fairness and quality of the vote processing, and the possibility for investors to verify that their votes have been correctly cast and recorded. Best Practice Principles should be adopted by all the intermediaries involved in the proxy voting process, such as custodians, proxy agents, voting platforms and proxy solicitors. In some cases, the same actor plays several roles in the voting process, providing services to listed companies, investors and/or custodian banks, generating significant conflicts of interest.

Q.12 Each Principle is accompanied by guidance which sets out practices to be followed and information to be disclosed, on a “comply and explain” basis. Is this structure clear and appropriate?

No. The structure is very clear, but in our opinion, a “comply or explain” rule is not appropriate to actually prevent significant conflicts of interest, which may even affect the quality of analysis.

Q.18 In addition to national law and listing rules, which, if any of these considerations should signatories take into account when deciding whether to adjust their house policies for different markets?

Local policies should take into account all the aspects of a specific market, including codes, issuers’ practices, culture, etc. However, it should always be considered that financial markets are global, and researchers should be able to apply a local perspective to internationally recognised best practices, taking into account both the international investors’ view and the local culture (including laws, codes, practices, culture and history in general).

Q.21 The Principle does not attempt to eliminate potential conflicts, but to ensure that the signatories disclose the procedures by which they are managed. Is this an adequate approach?

No

Q.22 If no, how might it be strengthened?

There are some conflicts of interest that cannot be avoided (clients that are controlled by a listed company, or clients proposing resolutions), but others can and should be avoided, such as offering

advisory services to both shareholders and listed companies. In our opinion, the mere disclosure of the conflict of interest and/or a “comply or explain” rule are not enough, and we urge the adoption of a specific principle preventing research companies (or any other intermediary in the proxy voting process) from offering advisory services to both shareholders and listed companies that are included in their research universe.

23. The Principles include the following non-exhaustive list of potential sources of conflict. Are there any others that should be included in this list? Yes

24. If yes, please identify them:

An investor who is a client of the service provider and is controlled by a listed company that is in the provider’s research universe.

28. How might communication [between companies and signatories] be improved?

Organization of multilateral meetings by local authorities or associations of issuers or investors, such as the annual meetings organized by the Italian association of issuers Assonime in the 2013-2016 period.

36. As part of this review, the BPP Group intends to introduce an independent element into the monitoring arrangements. Which of the following features should be part of the arrangements for monitoring the implementation and impact of the Principles?

- ✓ Surveys of market participants

In our opinion, an oversight body including members independent of the sector is not possible, as any oversight body should include experts of the sector, who by their nature cannot be considered as fully independent. A third party certification may entail excessive costs for small local research providers, representing an additional sector entry barrier.

Yours sincerely,

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