



The Steering Group
The Best Practice Principles Group

Sent by email: consultation@bppgrp.info

18 December 2017

Dear Sir/Madam,

GC100 Response to the Best Practice Principles Group Consultation 2017

GC100 is the association for the general counsel and company secretaries of companies in the UK FTSE 100. There are currently over 125 members of the group, representing some 85 companies. Please note that, as a matter of formality, the views expressed in this letter do not necessarily reflect that of each and every individual member of GC100 or their employing companies.

While the theme underpinning the GC100 is that the members' companies have a premium equity listing in the United Kingdom, many of those companies have additional listings on stock exchanges outside the UK. In addition, their share registers are very often global in nature, with a sizeable proportion of the equity being held by investors in other parts of the world, particularly North America, continental Europe, South Africa and Australia.

We are grateful to have the opportunity to participate in your consultation and hope that our observations will add value to your process. The structure of your online questionnaire did not lend itself to the points we want to make, hence this narrative response.

Overall approach

We welcomed the launch of the Best Practice Principles and Guidelines in 2014 (the '2014 BPP'), and feel that these have made a material difference since their introduction. In developing this response, we have borne in mind the statement from the 2013 ESMA Final Report, which we think captures perfectly our shared goal:

"...how investors and issuers can, from their respective roles, foster effective stewardship and robust corporate governance and ensure efficient markets"

The first paragraph of the introduction to the UK Stewardship Code expresses the same sentiment:

"Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole."

Recent trends in equity markets

We have observed a number of changes over recent years, which we sense to be accelerating and which are important context for this consultation:

- there has been a marked rise in the use of low-cost funds for the management of pension and other investments;
- as a result of this, we have seen growth in the use of index-tracking and other passive investment funds, where the management of sizeable investment portfolios at minimal cost is easiest to deliver;
- the decline of defined benefit (DB) pension funds has exacerbated these trends:
 - where the DB fund is closed, a move of future pension accrual into defined contribution (DC) schemes comprising investments in low-cost funds in order to maximise the potential growth of the investment 'pot'; and
 - where a DB fund remains open for future accrual, greater reliance is now being placed on property and fixed-return investments, with a decline in the amount allocated to equity investment (often accompanied by a move from active to passive asset management);
- at the same time, the body of corporate governance law and regulation is increasing, as are the expectations on shareholders and investors to scrutinise companies and hold them to account;
- in consequence, asset managers are being expected to do more in terms of their stewardship responsibilities, but at the same time are seeing a decrease in their income from investment fees. Accordingly, the time and cost to the asset manager of fulfilling this role of higher scrutiny and stewardship has become exceedingly burdensome and expensive;
- the natural response to this pressure, and a trend we see in practice, is for asset managers increasingly to outsource some or all aspects of their stewardship obligations to proxy advisory firms, including those who are signatories to the 2014 BPP. We are aware of cases where portfolio managers are not permitted to vote other than in line with the proxy advisors' recommendations, or are required to present an alternative case to an in-house committee who will decide whether to permit a deviation from the proxy advisors' recommendations; and
- the influence that the proxy advisory firms wield is therefore considerable and growing.

This situation is addressed in the UK Stewardship Code, which states (in the section titled 'Application of the Code'):

"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 advisors and investment consultants."

While our membership has experienced increasingly positive engagement and proactive dialogue with some signatories, others have not operated in a manner consistent with the Stewardship Code's aspiration.

GC100 Group

The Association of General Counsel and Company Secretaries of the FTSE 100

The GC100 Group is an unincorporated members' association administered by Thomson Reuters.

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Specific points we would like you to consider

We have structured this response in line with the 2014 BPP.

Principle One: Service Quality

1. In the section titled 'Voting Policies or Guidelines – Shareholder Policies', the BPP outlines two models: shareholders assessing how to cast votes based on their own policies, or based on those of their shareholder voting research and analysis services. As noted above, we experience a third model, whereby the asset manager (shareholder) outsources the decision-making on voting to one of the shareholder voting research and analysis services (signatories), either completely or in such a way that diverging from the signatories' policies becomes exceedingly difficult in practice.
2. In the section titled 'Signatory Policies', the BPP states that voting policies "typically consist of high-level corporate governance principles". While this remains true in certain cases, we also see a number of signatories who have implemented voting policies which consist of highly detailed and technical provisions over and beyond existing law and regulation (and in some cases guidance), which are frequently applied mechanistically or in a quasi-box ticking way, with no qualitative assessment.

In each of these cases, we would urge your Steering Group to reflect on whether these developments should be acknowledged in the revision of the BPP, and if so whether it has further implications for how signatories discharge their duties or creates new responsibilities.

Principle Two: Conflicts of Interest Management

3. We fully accept that signatory companies should form their own views on matters proposed by issuers or by 'shareholder proponents' for votes at general meetings. However, we have frequently experienced proxy advisory firms, including BPP signatories, who refuse to engage on substantive issues with issuers simply on the basis that this is (or could be) a conflict of interest. We do not regard this as an acceptable position, and it is not in keeping with the aspiration of the UK Stewardship Code or the interests of good corporate governance.

It would be helpful if the revision of the BPP could make clear that engagement with companies does not create a conflict of interest.

Principle Three: Communications Policy

As a preface to this section, we highlight that there are two distinct activities – engagement and voting. The UK Stewardship Code captures this well in paragraph 4 of the introduction:

"For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters, as well as on issues that are the immediate subject of votes at general meetings."

Our experience has been that some proxy advisors, including BPP signatories, are increasingly unwilling to engage with issuers. Without this purposeful dialogue (which would facilitate an exchange of facts and ideas, even if there is no agreement on the specific issue being discussed), it is exceedingly difficult, if not impossible, for investors or their proxy voting advisors to reach an informed decision on how to cast (or withhold) their votes on more complex or contentious issues.

4. In the section titled 'Introduction', the BPP states that "it is for signatories to choose whether or not to engage in dialogue" and expands this further, stating that where signatories choose to have dialogue "it is up to them to determine the objectives, timing, frequency and format". As explained above, we increasingly experience proxy advisory firms, who are BPP signatories, effectively standing

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in the shoes of their clients (the asset managers and owners) but we do not always see the proxy advisory firms acting in accordance with the UK Stewardship Code by engaging with the issuer.

We recommend that the revision of the BPP explicitly acknowledges the relevant recommendation of the Stewardship Code explained above which ‘applies, by extension, to service providers, such as proxy advisors’. While this is a UK-specific requirement, we think that the underpinning logic means that the principle should apply internationally.

5. In the section titled ‘Dialogue with Issuers ...’, the BPP states that “signatories should have a policy for dialogue with issuers, shareholder proponents [and] other stakeholders”. In our experience, engagement can take one of two broad forms:

- Pro-active engagement, usually in advance – we experience a very wide range of reactions to requests to meet in advance. Some proxy advisors will engage with issuers, while others seem very unwilling to do so. Unhelpfully, one major signatory will engage with issuers on amendments to directors’ remuneration policies but then declines to offer a house view, reserving its position until after publication;
- Reactive engagement, usually after publication of a general meeting circular – we have widespread experience of seeing factual errors in proxy advisors’ reports. This is echoed by a recent report from the Australasian Investor Relations Association (AIRA), where one-third of ASX200 respondent reported one or more significant mistakes in reports written on them by proxy advisors. Helpfully, 94% of respondents to the AIRA survey would like to correct factual errors. Some proxy advisors will not share draft reports with issuers, while others will only issue data sheets (which are sometimes incomplete) for checking, or provide only very limited time for review of draft report. To be clear, we are not looking for an opportunity to intervene in the formulation of voting recommendations, but where voting recommendations are based on erroneous data, they are clearly flawed. Having an appropriate opportunity to review the draft report for factual accuracy would greatly assist issuers, investors, and the development of an efficient market.

The UK Stewardship Code sets out some clear recommendations. Principle 4 states that “Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities”, including participation in collective engagement. More pertinently, the guidance on Principle 6 states that for investors (and by extension proxy advisors, in accordance with the Code):

“If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.”

This is very clear, but it would be more constructive if the logic of the first sentence was reversed – investors (and therefore proxy advisors) should engage in dialogue with issuers and only if that fails to reach a satisfactory outcome should they register (or recommend) an abstention or a vote against the resolution. We also see varied practice in informing the company in advance of voting intentions, and the underlying rationale for recommendations.

We would like to see an explicit acknowledgement in the revised BPP that engagement in pro-active dialogue with issuers is a necessary and expected precursor to any recommendation to abstain or vote against a resolution on any material item of business.

In addition, BPP signatories should be expected to provide a copy of their report in draft, at least two business days prior to publication, and at no cost to the issuer, for fact-checking by the issuer in

question. This would also enable proxy advisors to fulfil the second leg of the Stewardship Code’s recommendation.

6. In the section titled ‘Dialogue with Media’ we think there would be a benefit if signatories explained the circumstances in which they would initiate (as opposed to respond to) media contacts – the 2014 BPP is currently silent on this point. Our experience is that we have occasionally seen proxy advisors, sometimes including BPP signatories, quoted in the media in relation to sensitive or contentious general meeting proposals, commenting on matters which they have not previously raised with the issuer.

We would welcome an explicit requirement in the revised BPP for signatories to explain the circumstances in which they would initiate contact with the media and to justify why this might be appropriate, especially where relevant issues have not first been raised with the issuer.

Closing thoughts

Of relevance to this response and the BPP is the UK Financial Reporting Council’s recently published consultation on the UK Corporate Governance Code which also sets out a number of initial, high-level questions about the future direction of the UK Stewardship Code. The full consultation, expected in mid-2018, will introduce revisions to increase the quantity and quality of investor engagement. The implementation of the Shareholder Rights Directive in the UK will also introduce a requirement to publicly disclose, on an annual basis, information relating to the preparation of the research, advice and voting recommendations.

Our members’ companies seek to work closely with their investors to promote the success of the company over the long term for the benefit of their members as a whole. Given the changes to the investment landscape we have observed and outlined in this response, we feel that the signatories to the BPP need to acknowledge that the valuable role they perform for their clients has also changed and carries additional responsibilities.

In any revision of the BPP, we would like to see an acceptance that, where the investor has for all practical purposes delegated the management of engagement and voting to a signatory company, BPP signatories will adhere to the same obligations and responsibilities (as set out for example in the case of the UK, in the FRC’s UK Stewardship Code) that would attach to the underlying investor. To return to ESMA’s words, we believe that acceptance of this would “*foster effective stewardship and robust corporate governance and ensure efficient markets*” for the benefit of all.

We would be happy to discuss any of these points with you further.

Yours faithfully,



Mary Mullally
Secretary, GC100