

The Independent Chair and Steering Group
Best Practice Principles for Shareholder Voting Research
2017 Consultation

By email: consultation@bppgroup.info

15 December 2017

Dear Sirs

ICSA response to BPP Consultation 2017

We welcome the opportunity to comment on the 2017 consultation on the Best Practice Principles for Shareholder Voting Research (the Principles).

ICSA: The Governance Institute is the professional body for governance. We have members in all sectors and are required by our Royal Charter to lead 'effective governance and efficient administration of commerce, industry and public affairs'. With 125 years' experience, we work with regulators and policy makers to champion high standards of governance and provide qualifications, training and guidance. ICSA is the professional body that qualifies Chartered Secretaries, which includes company secretaries, many of whom work in listed companies. Company secretaries have a key role in advising companies and their boards and are, usually, the main point of engagement on governance issues between investors and their advisers, including voting research providers (VRPs) and the company. Our members are therefore well placed to understand the issues raised both in and by your consultation.

We have attempted below to follow the format of your online questionnaire.

Information on Respondent

1. Name of Organisation:

ICSA: The Governance Institute

2. Type of organisation [select one]:

Representative body

3. Main country / region of operation:

The United Kingdom, and globally through the international institute.

4. Are you currently a client of a voting research provider?

No



5. All responses will be posted on the Review website unless requested otherwise.

Noted

6. If you would like to be informed of the outcome of this consultation please provide a contact email:

pswabey@icsa.org.uk

General questions on the principles

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

Yes

8. If yes, how would you rate the positive impact of the Principles since they were introduced in 2014? [Scale of 0-5 where 0 is no impact, 5 is very positive]

- 0 no impact
- 1
- 2
- 3
- 4
- 5 very positive

Please give a reason for your rating

The Principles have helped in terms of raising awareness of some of the issues – for example the need for greater transparency and effective management of conflicts of interest. However, we believe that they have been limited in their effect by what we felt to be a lack of ambition in the original principles resulting from a failure to act on much of the feedback given when these were consulted upon. Codes are often less effective when their requirements are set by those who will be subject to them rather than by other market participants.

It should be added that some VRPs, especially Glass Lewis, have made significant strides in terms of their willingness to engage with companies since 2014, but communication across the market has generally improved during that time and it is difficult for us to assert with confidence whether the relation between this and the Principles is one of causation or simply correlation.

9. If you are a user of voting research services, do you, or will you in future check whether a service provider had signed up to the Principles before appointing them?

Not applicable.

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

Probably not. One of the challenges for VRPs working across multiple jurisdictions is the fact that there are a wide variety of differing market structures. Whilst some of the Principles are open to common application, for example those around conflict of interest, there will inevitably be some that need amendment to meet specific market conditions.

It is a little beyond the scope of the Principles, but we should mention that this will most often be the case where voting policies need to be flexible to meet market conditions – for example in the UK the concept of fourteen-day notice for general meetings other than the AGM is normal practice, but this caused some



concern from some VRPs when first put to general meetings. Similarly, we have anecdotal evidence from some company groups in other countries that VRP recommendations do not always reflect their local market issues, but we will leave them to make their own representations on these points. We mention this point only because we believe that it is very important that shareholder voting reflects local market practices rather than a global market prescription.

Scope and structure of the principles

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 [tick each that applies]

- Intermediary vote processing and confirmation
- ESG advisory services and indices
- Governance engagement services
- Other (please specify)

In so far as they do not already do so, it makes sense to us for the Principles to cover each item mentioned in Article 3j of the revised Shareholder Rights Directive (2007/36/EC) introduced by Article 1(3) of the latest Shareholder Rights Directive (2017/828/EC).

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?

Yes – although it should be noted that, as in other areas of the market, the quality of explanations is variable and signatories should be encouraged to improve these.

13. If no, how might it be improved?

Not applicable.

The Content of the Principles (1: Service quality)

14. If you are a client of one or more signatories, do you consider that this Principle deals adequately with the various service commitments that you expect?

Not applicable

15. If no, how might it be improved?

Not applicable

16. Depending on the wishes of their individual clients, those signatories that make voting recommendations will follow either bespoke or house voting policies. How satisfied are you with the process used by signatories to develop their house voting policies? [Scale 0 to 5, where 0 is dissatisfied and 5 is very satisfied]

- 0 dissatisfied
- 1
- 2
- 3
- 4
- 5 very satisfied



17. How might the process be improved?

We should begin by acknowledging that some VRPs are more transparent than others. For example, both ISS and Glass Lewis hold public consultations, although it is not always apparent whether, and if so how, feedback has been taken into account.

In our view, voting policies should be developed to relate specifically to each national market, giving due weight to local market practices, legislation, regulation and corporate governance norms. We understand that their clients will sometimes prefer a harmonised approach, but in our view the policy of the VRP should be specific, allowing their client to change them as they see fit. Where a VRP makes a voting recommendation, this should take carefully into account any 'explanation' that the company has offered for divergence from a corporate governance norm. The UK Corporate Governance Code applies on a 'comply or explain' basis and, whilst we accept that investors have the right not to accept an explanation, we believe that a VRP should make specific reference to the explanation in its recommendation.

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? [Tick all that apply]

- Standards in national corporate governance codes and equivalent
- Views and practices of local companies
- Views of local and international investors
- Other (please specify)

19. How informative are signatories' descriptions of their research methodologies (see BPPG website here), including how they ensure that the research is reliable? [Scale 0 to 5, where 0 is uninformative and 5 is very informative]

- 0 uninformative
- 1
- 2
- 3
- 4
- 5 very informative

20. While recognising the need for signatories to protect their intellectual property, how might the statements be made more informative?

We are not clear why there should be issues of intellectual property surrounding a description of research methodologies. All that is required is a statement of how the research is done.

The Content of the Principles (2: Conflicts)

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

22. If no, how might it be strengthened?

Disclosure of the procedures by which potential conflicts are managed is an important safeguard, but we do not believe that it goes quite far enough.



For a variety of reasons, not least those on which we touch in our response to question 42 below, VRPs hold a uniquely powerful position in the market. Given this position, we believe that it is, unfortunately, necessary that they be held to a higher standard. We cover this in our response to question 24 below but, in brief, we believe that VRPs should not be permitted to offer consultancy services to companies on whom they may report.

- 23. The Principles include the following non-exhaustive list of potential sources of conflict:**
- **A signatory's ownership or shareholder base/structure, such as when a signatory is owned by an investor who owns shares in companies under coverage or when the investor is owned by an issuer under coverage;**
 - **A signatory's employee activities, such as board memberships, stock ownership, etc;**
 - **Investor-client influence on the signatories, such as when an investor, who is a client of the service provider, is a shareholder proponent or is a dissident shareholder in a proxy contest;**
 - **Issuer-client influence on the signatories, such as when signatories provide consulting services to companies under coverage for research; and**
 - **Influence of other investor clients.**

Are there any others that should be included in this list?

Yes.

24. If yes, please identify them.

We believe that in addition to the potential sources of conflict identified in the Principles, VRPs should also disclose relationships with the company or with shareholders, for example (again, on a non-exhaustive basis) where the VRP has, or recently has had, a commercial relationship with:

- The company subject of the voting research;
- Significant shareholders of the company subject of the voting research;
- The proponent(s) of any shareholder resolution; or
- Any person with significant control, either directly or indirectly of any of the above.

We believe that VRPs should not be permitted to offer consultancy services to companies on whom they may report – including the sale to companies of voting research reports. This creates a significant conflict of interest as, given the uniquely powerful position in the market held by VRPs, companies may be led to believe, rightly or wrongly, that the research or recommendation relating to their general meeting will be dependent to at least some extent on whether they choose to pay for consultancy services from that provider. We have heard, anecdotally, from one of our members who was told that buying a report would mean that they were more likely to get a positive recommendation for their remuneration resolution. We have no doubt that what was meant was that buying the report would mean that the company was better informed as to investor preferences and therefore in a better position to present a remuneration policy that would be unobjectionable, but the comment could be read otherwise and certainly another interpretation was placed on it by the company concerned.

Given such issues, we do not believe that disclosure of how conflicts are managed is sufficient in this case.

**25. If you are a client of a signatory, how satisfied are you with the information you receive on how potential conflicts are being managed?
[Scale 0 to 5, where 0 is dissatisfied and 5 is very satisfied]**

Not applicable



26. How might procedures be improved?

Not applicable

The Content of the Principles (3: Communications policy)

**27. How satisfied are companies with their communication with signatories?
[Scale 0 to 5, where 0 is completely dissatisfied, 5 is very satisfied]**

0 completely dissatisfied

1

2

3

4

5 very satisfied

28. How might communication be improved

We would begin by acknowledging that, as noted in our response to question 8 above, communication has improved in the last couple of years. This is especially the case with Glass Lewis who, our members tell us, have made significant strides in terms of their willingness to engage with companies.

However, there are still challenges.

There is a view amongst some companies that VRPs should submit their reports to the company before publication. Their argument is that voting research reports are different from analyst briefings, which they would not expect to see, in that the voting research market is much more restricted. Consequently, the report of one VRP can influence much more of the market than that of an individual analyst. There is, also, a perception about the quality of voting research – not helped by the advertisements for interns that we see each year – and that, consequently, it requires ‘checking’.

This is, of course, countered by VRPs who have, rightly in most cases, a pride in the quality of their work and bitterly resent the implication that companies should be ‘marking their homework’. They will add that they regularly come across situations where a company has made a mistake in its meeting documentation. They also believe, with some justification, that in a number of cases where a company is claiming that the VRP has made an error, what they mean is that the VRP has disagreed with the company on a matter of opinion.

We understand that some VRPs are in the habit of checking facts with the company outside the AGM season. Where this is done, it is much appreciated by companies.

We believe that, in the same way that the Stewardship Code recommends that investors inform the company in advance of their intention to abstain or vote against a resolution and the reasons why, a VRP should pro-actively engage with a company where they are recommending an abstention or a vote against the company or, where they do not offer recommendations, where their research contains significant criticism of the company’s position. This should be a requirement of the Principles, on a ‘comply or explain’ basis and should be done sufficiently far in advance of circulation of the report that the company has a meaningful opportunity to consider and respond to it – at least two business days.

An alternative might be to require that in such cases the VRP should publish the negative report on its website.



29. If you are a company, have you used the procedures set up by one or more signatories to make a complaint or provide feedback on their research on, or engagement with, your company?

Not applicable

30. If yes, how satisfied were you with how your complaint was handled? [Scale 0-5 where 0 is not at all satisfied, 5 is very satisfied]

Not applicable

31. Many companies consider they should have the opportunity to comment on the analysis and recommendations in research reports before they are finalised. If you are an investor, which of these statements most closely reflects your view? [Tick one only]

Not applicable, although we would observe that we believe transparency to be a good thing, and so can see no reason why anyone should reasonably object to this practice.

Reporting on the Principles

32. At present, signatories are required to produce a public statement on how they have applied the Principles, which they update as necessary; some have chosen to update the statement every year. Signatories also produce a summary in a standard format for purposes of comparison (see BPPG website here).

Do the statements adequately cover all the matters that signatories are supposed to report on under the Principles?

Probably yes, but the quality of the explanations could, in some cases, be enhanced.

33. If no, please identify which matters are not adequately reported on

Not applicable

**34. How informative and useful are the statements?
[Scale 0-5 where 0 is uninformative, 5 is very informative]**

- 0 uninformative
- 1
- 2
- 3
- 4
- 5 very informative

35. How might the statements be made more useful?

By enhancing the quality of explanations where such are necessary.



Monitoring the Application of the Principles

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? [tick all that apply]

- X Oversight body including members independent of the sector
- X Surveys of market participants
- X Third party certification of how the Principles have been implemented by signatories
- Other (please specify)

Any third party certification should also include an assessment of the adequacy of explanations.

37. If you have specific suggestions for how the Principles should be monitored, please provide details

However the Principles are to be monitored, it would be helpful were there to be at least an annual public review of the monitoring process, identifying examples of good practice and cases where there is room for improvement and an analysis of complaints received, which might helpfully include examples of those that are valid and those which are not.

38. Have you ever used the complaints procedure to complain about a breach of the Principles (see BPPG website here)

Not applicable

39. If yes, how satisfied were you with how your complaint was handled? [Scale 0-5 where 0 is not at all satisfied, 5 is very satisfied]

Not applicable

Signing-Up Process

40. The process of signing up to the Principles is being looked at as part of this review. Other than a commitment to apply and report on the Principles and to be subject to the monitoring arrangements, are there other criteria that service providers should have to meet in order to be accepted as signatories?

No

41. If yes, please specify

Not applicable

Other comments

42. If there are any additional comments you would like to make as part of this consultation, please do so here:

Our major concern over the market role of VRPs is one for which they are not responsible, and one for which they are not to blame. It could, therefore, be seen as outwith the scope of this consultation. However, it is important that we mention it as it will colour many of the company responses that you receive, is the reason why the position of VRPs in the market is so powerful and, consequently, why we believe that their activities should be held to a higher standard than that of others. This is the perceived



propensity of some investors, particularly some overseas investors to blindly follow the recommendations that they receive from their chosen VRP.

We intend, by this comment, no disrespect to those investors who choose to use the services of a VRP and use that research as part of their assessment process in making voting decisions. That is what voting research is for. Equally, we understand the argument of some VRPs that the reason why voting follows VRP recommendations is that they have a commercial interest in making recommendations that meet the requirements of their clients and, quite simply, their clients agree with them.

However, against this we must set the anecdotal evidence from companies who have been told by an investor that they have voted against a resolution because “that is what [the VSP] told us to do” – in some cases, allegedly, after the investor has agreed to support the resolution in its engagement meeting with the company. We have also heard reports that some investors choose to follow VSP recommendations in order to avoid charges of conflict of interest where shareholdings are held both for clients and for the investors own account.

It is to address this issue, and to mitigate any potential for conflict of interest, that we believe that the Principles should require that:

- a VRP should pro-actively engage with an company where they are recommending an abstention or a vote against the company or, where they do not offer recommendations, where their research contains significant criticism of the company’s position, in the same way that the Stewardship Code recommends that investors inform the company in advance of their intention to abstain or vote against a resolution and the reasons why;
- such engagement should take place in good time to allow the company at least two business days to consider and respond to the VRP before circulation of the report;
- VRPs should not offer consultancy services to companies on whom they may report – including the sale to companies of voting research reports owing to the significant potential for conflict of interest that this creates.

Finally, all parties involved in the voting chain should do whatever they can to address the issue of blind voting by a minority of investors. As also noted above response to question 28), companies see VRPs as distinct from investment analysts in that the reports of the latter are presented to a relatively small pool of investors who have the opportunity to compare that report with those of other analysts and market consensus which will be in the public domain. The quality of the analyst report is, at least in the UK, assured by regulation and the oversight of the regulator. The same does not apply to the work of VRPs, and it might be worth considering whether it should.

We hope you find our comments helpful and would be happy to expand on any of these points should you wish to discuss them further.

Yours faithfully



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