

RESPONSE TO PUBLIC CONSULTATION ON BEST PRACTICE PRINCIPLES FOR GOVERNANCE RESEARCH PROVIDERS

20 December 2013

Summary

We welcome the publication of the best practice principles. We have some comments and suggestions for clarification below, which we believe would help to improve the dialogue with issuers. Many companies find the current process and recommendations unclear and would like to see some more concrete disclosures to explain how and why the recommendations are reached, and to understand more about how the proxy advisers themselves operate, in order to be able to engage in dialogue and correct any misunderstandings.

We recognise that there will always be differences of opinion, but companies would like to have some more reassurance on the level of skills applied to the recommendations and any correction processes, and how these are translated into voting policy.

If issuers have a better understanding of this, they will be better able to engage with their shareholders (although we believe that institutional investors should be subject to their own, separate code).

Allowing sufficient time to prepare to engage is also important - proxy advisers should make their policy available sufficiently early, ideally no later than December preceding the AGM season beginning in March the following year.

We hope that increased transparency will improve the quality of engagement between companies and shareholders; in order to achieve this, it is important to enable issuers to understand the role played by proxy advisers in advising their clients.

Introduction and 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....particularly... how a representative feedback mechanism can be implemented.***

We welcome the work of the Drafting Committee in giving us the opportunity to comment on the draft best practice principles, which are intended to operate as a voluntary industry code of conduct.

We submit the comments below on behalf of our members, being companies quoted on the stock exchanges of Europe, who are thus the subject of the reports from the proxy advisory industry to their clients, the institutional investors.

We have previously commented on this subject in our [response to the EU Green Paper on corporate governance](#) in 2011 and in our [response to ESMA's consultation](#) in 2012.

We would be happy to provide further information to the Drafting Committee on any of the points below, if helpful.

Comply or Explain

The Principles are intended to operate on a “comply-or-explain” basis. This approach is inspired by other successful best practice codes and is considered to be the best option to ensure the effectiveness of the Principles.

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.

We are strong supporters of the “comply or explain” framework and we welcome the publication of the code and the provision of a central website for signatories to the Principles.

We would still like to be able to find the statement of compliance with Principles on the websites of the individual firms as well, together with contact details for companies.

We note that the Statement of Compliance with the Principles should:

- Describe in a meaningful way how signatories apply the Principles and related Guidance;
- Disclose any specific information suggested in the supporting Guidance and
- Where any of the Principles have not been applied or relevant information has not been disclosed, provide a reasoned explanation as to why.

We agree that meaningful and specific disclosures, together with reasoned explanations of the non-application of the Principles, will be important in order to promote a better understanding among companies of how the signatories operate, and thus to promote a better understanding among companies of when and how to engage with proxy advisers and when and how to engage with their clients. We agree that an annual review of the statement of compliance would be useful.

We believe that engagement by institutional investors in reviewing the Principles and their application will be critical to their effectiveness.

We also believe that the Principles should aim to attract all proxy advisors as signatories, in order to be effective.

Application of the Principles

The Principles are not intended as one-size-fits all approach. While global in scope, their implementation may vary depending upon proxy advisors' local circumstances and the manner in which they may carry out their duties.

We would like to underline importance of the quality of explanations (substance and form) to ensure the effectiveness of the comply-or-explain model (see also above). Apart from the Committee's independent website, we would also like to see publications of Statement of Compliance on signatories' own websites.

- 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.**
- 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.**
- 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?**
- 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.**

See answers under "Comply and Explain" above.

Scope and 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.**

We agree with the definition of "governance research services"; however, we believe that some of the terminology used could be more clearly defined. For example, does "policy guidance" refer to both country-specific guidance and to guidance tailored for individual clients? Or what does it mean? It would be helpful to provide some more concrete definitions and examples of the governance research services.

- 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.**

The definitions are not entirely clear since we are somewhat confused as to the extent to which the engagement and governance overlay services under the “additional services” may overlap with the ongoing engagement process described under Principle 3.

We agree that “vote agency services” are distinct and should be excluded.

We would like to see definitions provided for each of the categories cited in order to avoid potential misunderstandings; e.g. the definition for voting recommendations might include:

Voting recommendations are generally based on the application of predefined methodologies and on publicly available information. They usually implement the voting policy (or guidelines) released by the proxy advisory firm prior to the proxy season.

The matters for which proxy advisory firms make vote recommendations range from corporate governance matters to mergers and acquisition transactions.

Voting recommendations are based on whether the issuer complies with the governance practices recommended by the proxy advisory firm, or by its client (in the event of tailored services). Proxy advisors may provide **corporate governance ratings**, which are designed to help voting.

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

As regards the Code’s *ratione personae* scope, we agree that it should not be extended to investors. We believe that institutional investors should be subject to their own, separate stewardship codes. In this respect, the introduction to the Principles is helpful, particularly the statement: “the ultimate responsibility to monitor investments and make voting decisions lies with investors... stakeholders wishing to understanding how an institutional investor discharges its stewardship or ownership responsibilities should consult relevant disclosures of the organization to understand its approach”.

We understand that this is not within the mandate of the Drafting Committee, but we would point out that not all institutional investors are yet subject to such stewardship codes, and also that companies do not always have access to effective shareholder identification regimes, so it is not always easy for them to know who their shareholders are and thus to find the relevant disclosures.

For more detail, please see our previous comments:

[Response to question 22 in our response to the Green Paper on Long-Term Financing of the EU Economy](#) and [Response to question 20 in our response to the Green Paper on corporate governance](#)

Principle one: Service Quality

“Signatories aim to offer services that are delivered in accordance with client specifications.

“Signatories should have and publicly disclose a research policy and, if applicable, “house” voting guidelines.”

The Guidance covers the need to explain how research is developed, responsibilities to clients, the need for a written research policy including any systems and controls, explanation of voting guidelines including development via public consultation and discussions, research methodologies to be available to clients, quality of research including data and personnel, timeliness, complaints, and any other operational aspects.

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, we believe that Principle One when taken together with the guidance in the consultation document will help to promote better understanding.

Increased disclosure of information about how proxy advisors arrived at their recommendations will help issuers and investors assess the quality and the credibility of the analysis that forms the recommendation.

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.

See our comments below.

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 welcome the guidance whereby methodologies and assumptions supporting vote recommendations should be disclosed, as this would allow the market to evaluate the rationale for these 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.

In determining what information should be disclosed, we are well aware that some information is proprietary or should remain confidential for legitimate business purposes. We do not consider, however, that this should apply to the process undertaken by proxy advisory firms to generate their vote recommendations.

That being said, the proposed guidance remains too vague and should go beyond a mere statement of principles and specify what exactly should be disclosed.

We would like to see the following standards of practice, some of which we recognise are mentioned in the consultation document, incorporated into the guidelines.

First, it should be recalled that proxy advisers must dispose of the appropriate skills and resources to provide the relevant services and to analyse draft resolutions. The persons in charge of examining draft resolutions must have a solid knowledge of the market practice and legislative framework of the relevant market to conduct this type of analysis.

Second, voting policies developed by proxy advisors should be formulated in a clear and concise manner and be tailored for each market, which is far from being the case now: typically, proxy advisors do not provide detail on how corporate governance standards are translated into voting policy;

To avoid misleading descriptions or errors, the policy should contain definitions of concepts being used and any other relevant information.

Third, proxy advisors should not only make their voting policy transparent to the public and to issuers but also any update thereof.

Proxy advisers should make their policy available sufficiently early, no later than December preceding the AGM season beginning in March the following year.

Fourth, proxy advisors should ensure that the way their policies are implemented is accurate. In practice, however, the conditions under which a voting recommendation is made are often too vague and the way voting policies are implemented remains often unclear.

Fifth, in their reports to clients, proxy advisors should explain the reasons supporting their voting recommendations to each draft resolution, particularly with regard to its established general voting policy. They should also disclose the process of identifying and correcting errors and indicate in their report to clients whether they have taken issuers' comments into account.

Finally, we believe that it is important that companies can see the whole picture and that institutional investors should ideally then disclose their own use of vote recommendations (see our earlier comments in response to question 12).

Companies would like to know that the votes being cast for or against their resolutions are in line with the wishes of the ultimate owners and so are interested to know whether and how the policies being recommended by the proxy voting agencies are designed in accordance with client wishes.

Principle two: Conflicts of Interest Management

“Signatories should have and publicly disclose a conflicts-of-interest policy that details their procedures for addressing potential or actual conflicts of interest that may arise in connection with the provision of services”

The Guidance provides a non-exhaustive list of potential conflicts. Where a conflict is unavoidable, signatories maintain policies and procedures for their proper management.

The Committee considers that a written, publicly available conflicts-of-interest policy is the right instrument to ensure the independence and integrity of the service. The Guidance for this principle provides examples of conflicts, conflict-management and mitigation procedures, and conflict-disclosure procedures. (The list of examples provided is not considered exhaustive.)

Although the policy should be made public, it does not require public disclosure of specific conflicts, as such disclosures could conflict with information barriers put in place by a signatory to prevent a potential conflict from becoming an actual conflict. For example, some signatories may have established information barriers to prevent their research staff from being influenced by the provider's relationships or potential relationships with an issuer subject to their analysis and to guarantee an unimpaired judgment by the research staff. Therefore, each signatory may decide on a case-by-case basis whether disclosure of the conflict to the public is appropriate. Signatories should, however, disclose all potential and actual conflicts to their clients.

The Guidance to Principle Two follows established regulatory or professional models, i.e. a standard of integrity that is comparable to what any regulation would achieve notwithstanding the fact that signatories serve institutional investor clients on a confidential basis.

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.

We agree that the list of examples provided includes the most relevant types of conflicts, e.g. conflicts between consulting services and proxy advisory services provided by the same firm, conflicts in ownership structures, etc. Nevertheless, we believe that it would be helpful to include a definition of conflict of interest here.

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.

We believe that conflicts of interest should not only be addressed by way of disclosure requirements but also through adoption of policies and organisational structures that mitigate the conflicts.

A first response would be to require proxy advisors to have Chinese walls to separate their proxy voting services from advisory or consulting services.

Second, proxy advisers should establish and maintain policies and procedures designed to identify and manage any conflicts of interest that arise in connection with a vote recommendation. These policies should also deal with employee and ownership conflicts.

Third, proxy advisers should disclose the procedures to address conflicts.

Fourth, proxy advisers should also identify and disclose potential conflicts of interest to the public and in the report to their clients. These disclosures should be part of the Statement of Compliance with these Principles.

Fifth, they should review the effectiveness of these policies and procedures on a regular basis.

Principle three: Communications Policy

“Signatories should have and publicly disclose their policy (or policies) for communication with issuers, shareholder proponents, other stakeholders, media and the public.”

Principle Three does not dictate whether or not signatories should engage in dialogue with issuers and/or shareholder proponents. This approach was taken because some founding signatories engage on a routine basis, while others enter into dialogue only on a case-by-case basis or for further information gathering as part of their research process. In order to safeguard proper management of these interactions, signatories should disclose and explain their approach in a communications policy that is publicly accessible and can be reviewed by clients, issuers, shareholder proponents and other stakeholders.

The Committee also seeks to achieve greater transparency with regard to signatories’ media relations and to foster greater understanding and assurance among other stakeholders in terms of what they can rightfully expect from governance research providers. In order to achieve a balance between the stakeholders’ interest in transparency and the legitimate interests of signatories and their clients, a written policy that is publicly accessible should set forth the framework for interaction with media and the public.

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

a. Issuers

What companies are interested to understand is the process by which research and advice are provided to institutional investors, which may influence their voting decisions; both by way of country-specific guidance regarding a market practice specific to that country, and also company-specific voting recommendations, where a company may have chosen not to comply with a recommendation of the corporate governance code but instead to explain its decision not to follow the recommendation.

What is essential for issuers is to understand who is casting the vote in terms of who is actually taking the decision (individual fund manager, group policy, etc). In some cases, this is not always clear.

We firmly believe that proxy advisors should be open to dialogue with issuers on an ongoing basis, including but not limited to the AGM season, in order to avoid misunderstandings or factual errors and to enable issuers to react in due course.

A particular concern for issuers is the potential for inaccuracies in proxy advisors’ reports, which may lead to misinformed decision-making, especially in the context of complex or sensitive matters.

Another concern is the adoption of a “one-size-fits-all” approach and do not always take into account the company’s specific, local circumstances.

We understand that there is a difference between factual errors and differences of opinion and that the advisers’ clients are usually the institutional investors, not the issuers. Differences of opinion will remain just that, although an early dialogue with issuers can help to resolve the

potential for miscommunication as opposed to genuine differences. Nonetheless, issuers would like some reassurance that factual errors, e.g. length of service of an individual director, should be corrected.

Hence, we would like to see proxy advisors distribute their voting recommendations to issuers and to allow issuers sufficient time to review their drafts and make comments - before they are released to their clients, the investors. Business practices widely differ among the proxy advisory firms and clearer guidance is needed in this respect.

Furthermore, proxy advisors should have a policy in place to address issuers' comments on voting recommendations (companies' quotes). In particular, proxy advisors should indicate in the report they submit to investors whether these comments have been addressed and to what extent taken into account.

Signatories' policy for dialogue with issuers should also be made available to the issuers, in order to facilitate engagement. We note that some proxy advisers have engaged *ex ante* with national issuer representative associations on the revision of their policies, and we would encourage others to do the same and we would be prepared to facilitate such a dialogue among our own [members](#) at national and European level.

b. Media and the public

It would be helpful to know if the proxy adviser has a policy of speaking to the media on particular issues, or if their policy is not to speak to the media.

EuropeanIssuers represents the interests of quoted companies across Europe. Our members include both national associations and companies from all sectors in 14 European countries.

We aim to ensure that EU policy creates an environment in which companies can raise capital through the public markets and can deliver growth over the longer-term. We seek capital markets that serve the interests of their end users, including issuers.

More information can be found at www.europeanissuers.eu.