



# ICGN

International Corporate Governance Network

**Attn. Chairman: Dr. Zetsche**  
The Best Practice Principles for Governance  
Research Providers Group

**Submitted by email to:** [consultation@bppgrp.info](mailto:consultation@bppgrp.info)

16<sup>th</sup> December 2013

Dear Sirs

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

The International Corporate Governance Network (ICGN) welcomes the opportunity to comment on The Best Practice Principles for Governance Research Providers ('Best Practice Principles').

As an investor-led organisation of governance professionals, ICGN's mission is to inspire and promote effective standards of corporate governance to advance efficient markets and economies world-wide. We achieve this through: influencing corporate governance policy; informing dialogue through guidance and education; and connecting peers at international conferences. ICGN members are based in over 50 jurisdictions and include investors responsible for assets under management in excess of US\$18 trillion. For more information on the ICGN, please visit [www.icgn.org](http://www.icgn.org)

**General remarks**

ICGN strongly believes that it is in the public interest to encourage and enable the owners of publicly listed corporations to exercise their shareholder rights and as such apply informed judgement to voting. This is emphasised in the ICGN Guidance on Institutional Investor Responsibilities (2013) as follows:

*"Institutional investors should make informed and independent voting decisions at investee companies, applying due care, intelligence and judgement.... Voting is a key investor right and an asset of the ultimate beneficiaries. Voting rights should therefore be exercised with due care and diligence, and institutional investors should ordinarily seek to exercise all voting rights." (Principle 2.4)*

We recognise that many ICGN members hold widely diversified portfolios so it is not always feasible to have regular face-to-face dialogue with all portfolio companies. The ability therefore to exercise voting rights electronically has helped to enable institutional investors and asset owners to play an important and effective corporate governance monitoring role in almost all corporations in which they are invested.

Proxy advisors also help investors in their monitoring role by providing a useful advisory service in analysing the ballots of all relevant shareholder meetings worldwide. This is especially important in cases where shareholders vote their shares cross-border as the research of proxy advisors provides useful information about the agenda items and how these relate to best practice.

In ICGN's response to ESMA's discussion paper 'An overview of the Proxy Advisory Industry: consideration on possible policy options', we voiced our support for increased transparency of proxy advisory firms, particularly around the need to be more transparent about their analytical methods, conflicts of interest and their policies for managing such conflicts.

The ICGN supports the introduction of Best Practice Principles or a Code of Conduct for the proxy advisory industry which will be helpful in applying a professional discipline to an emerging profession which has significant influence on European capital markets. Disclosure is a key element to understanding and governing the role of proxy advisors as intermediaries between investors and issuers. Therefore we were supportive of ESMA's recommendation to develop a pan European Code of Conduct for the proxy advisory industry. ICGN is also in agreement with the principles identified by ESMA that are intended to offer guidance for the development of the Code of Conduct for the proxy advisory industry as follows

1. Identifying, disclosing and managing conflicts of interest;
2. Fostering transparency to ensure the accuracy and reliability of the advice;
3. Disclosing general voting policies and methodologies;
4. Considering local market conditions;
5. Providing information on engagement with issuers.

We support ESMA recommendations that a Code of Conduct should be developed specifically for the proxy advisory industry, however we question the relevance of extending the scope of the newly proposed Best Practice Principles to governance research services in general. By extending the category to a broader scope firms providing services that are not related to proxy advisory services (e.g. alerts, newsletters, ratings) will be subject to the Best Practice Guidance which we do not think is particularly useful. Public criticism has been concerned with a perceived lack of transparency and potential conflicts of interest of proxy advisory firms specifically and in particular the potential influence their advice may have on the outcomes of shareholder meetings. The Best Practice Principles therefore offer a unique opportunity to make the activities of the proxy advisory firms more accessible and transparent, which would benefit general understanding and that of the clients of the advisory firms.

The Principles' Drafting Committee ('Committee') has proposed three Best Practice Principles that cover several of the topics that ESMA indicated should be taken into account when drafting the Code of Conduct. However, the Best Practice Principles are quite high level in nature with the resultant need for some guidance on each of them. While ICGN is generally supportive of a comply-or-explain approach, the success of such an approach depends on the code in question containing a clear set of benchmark standards against which market practitioners are asked to comply or explain. While there is somewhat more detailed guidance provided for each of the defined Best Practice Principles, it remains unclear to what elements of the guidance the comply-or-explain regime applies. ICGN recommends that most of the elements mentioned under guidance should become provisions that fall under the comply-or-explain regime.

## **Specific comments:**

### **1. Development process**

The Committee has been able to draft its first set of best practices in a relatively short period of time. This is encouraging as it demonstrates a strong commitment on the part of the participating firms to ESMA's recommendation to draft an industry Code of Conduct.

The Committee has extended the scope of the Best Practice Principles to governance research providers which is beyond the scope of the original ESMA Guidance. The category 'governance research services' is defined very broadly. The providers of the various services may have different challenges and therefore other best practices may need to be included.

In determining the extend the scope, we query whether representatives from 'governance research service firms' were consulted. In this regard we note that all six Committee members are representatives of proxy advisory firms and it does not appear that other types of governance research providers have been involved in the development process.

### **2. Review and monitoring**

The Best Practice Principles will benefit from establishing an independent body, under the auspices of ESMA, that monitors the principles on a regular basis and publicly reports about its findings. Best practices develop over time and therefore it is necessary to review the code and its relevance on at least an annual basis. An independent oversight body will ensure that proxy advisory firms report in a meaningful way about the implementation of the Best Practice Principles. Disclosure is an important element in understanding and governing the role of proxy advisors as intermediaries between investors and issuers.

### **3. Practicality of a comply-or-explain approach**

The proxy advisory firms that fall under the scope of the Best Practice Principles should aspire to be transparent about the extent to which they comply with the principles. Many ICGN members utilize the services of one or more proxy advisory firms. Therefore we encourage our members to familiarize themselves with the policies underlying the proxy research. By introducing a comply-or-explain approach to the Best Practice Principles, institutional investors are better informed about issues such as potential conflicts of interest and the research methodologies that are applied. Therefore a comply-or-explain approach will initially provide institutional clients with an adequate tool to hold proxy research firms to account. In addition, the comply-or-explain approach offers proxy research firms the flexibility to explain any deviation from the principles if this can be adequately justified.

However, in order for a comply-or-explain approach to be effective we believe, as indicated above, that the benchmark standards with which firms are expected to comply, or to explain why they do not, should be clearly identified in the document. The three Principles as described in the Best Practice document are very high level. The parts of the document with which firms are expected to comply, or explain, should be more clearly identified. The reporting obligations that follow from the three Principles are to some extent captured in the guidance, but for a comply-or-explain approach to work properly the reporting obligations need to be more explicit.

### **4. Effectiveness of the Principles**

In order to enhance the effectiveness of the Best Practice Principles we believe that the scope should be narrowed to proxy advisory research services, instead of referring to the

broader category of governance research firms. As mentioned in our feedback to question 3, ICGN believes that it should be made more explicit what elements and requirements fall under the comply-or-explain obligation.

Also, we believe that it would be helpful if some essential terms that are used in the Principles are defined and better explained. In particular, Principle Two refers to the management of conflicts of interest and, while a non-exhaustive list of potential conflicts is provided, it would be helpful if a more thorough description of the concept is included. In addition, under the heading 'possible conflicts for consideration', it is mentioned that 'signatories should consider how the following non-exhaustive list of potential conflicts may materially impact their operations'. It would also be helpful if the concept 'material impact' is either defined or better explained.

In ICGN's response to ESMA's discussion paper (ESMA/2012/212), we indicated scepticism regarding the case for obliging proxy advisors to systematically share their research with issuers. This can potentially undermine the independence of proxy advisors and potentially put analysts under pressure to change an opinion. We also acknowledge, however, that some proxy advisors provide their research to issuers in draft form solely for fact-checking. To mitigate concerns about undue corporate influence on proxy advice, additional wording could be added under principle three to specify that proxy advisors should inform their clients about their approach to providing the research to issuers and should disclose any changes in their initial advice as a result of the dialogue or exchange of research.

## **7. Regional scope in terms of signatories and services**

The Best Practice Principles are developed in response to ESMA's recommendation to develop a code of conduct for the proxy advisory industry. Therefore the developed best practices should in first instance apply to all proxy advisory service providers with a European client base. That said, the high level nature of the Principles would seem to make them applicable in other markets, which would be beneficial, particularly given the global client base of many proxy advisory firms. Enhancing the transparency over time of the activities of all proxy advisory services worldwide is in the best interest of our members.

## **12. Standards of conduct on investors?**

The Principles are developed in response to ESMA's recommendation to develop a Code of Conduct for the proxy advisory industry. This is meant as a self-regulatory code for the proxy advisory industry and therefore the scope should not be broadened by also including standards for investors. Investors are already subject to compliance with a wide range of regulations (e.g. MiFID, UCITS, Transparency Directive, CRD IV). This is supplemented by a number of local stewardship / governance codes and industry wide codes for example, EFAMA Code for External Governance.

We attach the ICGN Statement and Principles of Institutional Investor Responsibilities for your reference which was adopted by ICGN members in June 2013. This guidance articulates 12 governing principles including the need for adopting and disclosing consistent policies with regards to investment, active monitoring of investee companies, proactive engagement and the delivery of informed voting decisions. We respectfully emphasize therefore that the global investment community does in fact have relevant, up-to-date and robust standards of conduct already in place. We will continue to encourage ICGN members to explain in their public disclosures, such as on their websites, how they implement their voting policies and what role proxy advisory firms play in their voting processes.

## 20. Disclosure of material conflicts

ICGN is supportive of the Best Practice Principle that calls for specific disclosure to clients of all potential and actual conflicts of interest, as well as disclosure of the specific measures taken to manage potential and / or actual conflicts. For clients of proxy advisory firms it is important to have an adequate insight into conflicts of interests as these can potentially impact the voting recommendations.

The disclosure of a written, publicly available conflicts-of-interest policy is also an important element of the proposed procedures. This provides corporates and other stakeholders with an interest in the activities of this industry, with a level of assurance that potential conflicts of interests are dealt with. This enhances the transparency of the activities of proxy advisory firms.

## 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.

For the clients of proxy advisory firms it is important to understand if and to what extent the information acquired during an issuer dialogue influences the proxy voting advice. Publicly available information, such as the annual report, can easily be verified whereas the information acquired during a dialogue may add a subjective element to the advice. The clients of proxy advisory firms should be able to also make a judgement about the information that was exchanged during the dialogue with the issuer. An example is a situation where the proxy advisor would normally advise to vote against the remuneration policy of a company, but based on input received during the dialogue decides to recommend voting in favour. Proxy advisory firms should also always inform clients about any changes in their initial advice as a result of the issuer's input.

We hope that these comments are helpful and should you wish to discuss any of the above points in more detail, please do not hesitate in contacting Kerrie Waring, ICGN Managing Director, by phone at 020 7612 7079 or by email at: [kerrie.waring@icgn.org](mailto:kerrie.waring@icgn.org).

Yours faithfully,



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ICGN Chairman



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