



## BEST PRACTICE PRINCIPLES FOR SHAREHOLDER VOTING RESEARCH AND ANALYSIS

Issued 2 February 2018

ICAEW welcomes the opportunity to respond to the review of the Best Practice Principles for Shareholder Voting Research and Analysis which was published by the BPP Group on 11 October 2017. A copy of the review is available from this [link](#)

The EU Shareholder Rights Directive requires advisors to disclose prescribed information to the public and to disclose conflicts of interest to their clients. These themes are reflected in the existing Principles and Guidance, however there are discrepancies with the Directive which will need to be addressed as part of this review, eg, tighter controls on non-disclosure of information, publicly available information must be refreshed on an annual basis and the information must remain public for three years.

We recommend that the BPP Group takes this opportunity to address broader issues which are having a negative impact on the reputation of the advisory sector. For example, we suggest that advisors disclose the basis of their recommendations on executive pay, and that advisors are made subject to new duties towards the companies which are the subject of their research.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 149,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

This ICAEW response of 2 February 2018 reflects consultation with the Corporate Governance Committee whose members are drawn from the business and investment communities. The Committee informs our thought leadership and policy work on corporate governance issues and related submissions to regulators and other external bodies.

Copyright © ICAEW 2018

All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

For more information, please contact: [frfac@icaew.com](mailto:frfac@icaew.com)

## MAJOR POINTS

1. This review has been prompted by the EU Shareholder Rights Directive (the Directive) and we have made suggestions which are intended to ensure that the letter and the spirit of the Directive are reflected in the revised Principles and Guidance. The new quasi-legal status for the Principles and Guidance underlines the need for precision in the drafting and terminology, eg, the description of conflicts of interest must be consistent throughout the Principles and Guidance.
2. The Best Practice Principles Group (BPPG) should not feel constrained by the Directive. Existing Principles and Guidance which go further than the Directive but which do not contravene it should be retained, eg, the Guidance on Complaints & Feedback Management, Client & Supplier Understanding and Dialogue with the Media & the Public. The BPPG should also take this opportunity to go beyond the Directive in some new areas, eg, stronger controls on circumstances when advisors work for investors and the companies who are the subject of that research, and disclosure of potential and actual conflicts of interest to all affected parties.
3. The Principles and Guidance have an important role to play in generating consistency and preventing a two-tier system for advisors who operate in Member States and advisors who operate elsewhere.

## EU SHAREHOLDER RIGHTS DIRECTIVE

4. The Principles and Guidance must be restructured so that advisors must comply with the requirements of the Directive. We recommend the conventional structure of compulsory Principles with Guidance which operates on a comply or explain basis.
5. The Principles and Guidance are likely to be thought of as a Code of Conduct for the purposes of the Directive but, for the avoidance of doubt, we suggest that in future the Principles and Guidance are collectively referred to as a Code.

## Public disclosures

6. The public disclosure aspect of Principle One must be compulsory and other disclosures must be added, eg, quality control and main information sources used. Our interpretation is that the requirement to disclose the qualifications of staff is intended to cover the qualifications of all of those who do the work whether or not they are directly employed, ie, advisors cannot avoid disclosure of qualifications through outsourcing.
7. The existing Guidance includes a number of exceptions to public disclosure, eg, an exception for legitimate business interests, and an exception arising from intellectual property rights in research methodologies and voting guidelines. These wide exceptions must be reviewed with reference to Recital 45 of the Directive which seems a much narrower exemption, ie, information can only be withheld in cases of serious prejudice to a business position, and only if the non-disclosure will not undermine the objectivity of the disclosure requirements in the Directive. The BPPG may wish to take legal advice on their interpretation of Recital 45.

8. Effective public disclosure requires a reasonable prospect of the disclosed information being understood by non-specialists. Improving the ease of comprehension of the underlying Principles and Guidance would set a good example. If technical terms cannot be avoided then clear definitions are needed. Different terms must not be used interchangeably to describe the same thing, eg, charter signatories, signatories and service providers; investors and signatories' underlying clients; issuers, companies and investee companies.
9. The Directive requires advisors to update their information annually, and if it differs, the information for the previous three years needs to be publicly available. Although the Directive's objective in requiring historic information to be available is to allow institutional investors to choose the services of advisers taking into account their performance in the past, in fact this information may also be of interest to a broader audience.

## **Conflicts of interest**

### **Dual instructions: investors and investee companies**

10. The BPPG should consider a Principal which either prohibits or closely controls situations where advisers simultaneously advise investor clients and the companies (issuers) who are being researched on their behalf. The timing and sequencing of investors' and issuers' instructions could be relevant, eg, whether sufficient time has elapsed between an advisor finishing their work for an investor client and starting work for the issuer which was the subject of that research.
11. The Principles and Guidance should require advisors' conflicts of interest policies to outline the stringent risk mitigation measures they use when they advise both investors and the issuer(s) who they are researching on the investor's behalf, or who they have previously researched on an investor's behalf, eg information barriers and disclosure to all affected parties, including disclosure to other investors.

### **Conflicts of interest policies**

12. The Directive requires an advisor to publicly disclose their conflicts policy. It will not be sufficient for conflicts policies to be available on request. We recommend that advisors continue to be obliged to train their employees on their policy.
13. There is a discrepancy between the Directive and Principle Two in respect of the description of which conflicts of interest must be covered in advisors' policies, ie, whether actual conflicts need to be covered in policies. We suggest that potential and actual conflicts are covered in policies as this will support the Directive's requirement to disclose both types of conflict, see paragraphs 15 and 16.
14. The Principles and Guidance should require policies to outline when advisors will terminate their instructions, eg, termination may be necessary when a conflicts policy fails and an advisor accepts instructions from a new client despite creating a conflict of interest with an existing client. Mitigation will not be sufficient in all cases.

### **Disclosure of conflicts of interest**

15. The Directive refers to the disclosure to clients of business relationships that may influence the preparation of research, advice and voting recommendations and the action [advisors] have undertaken to eliminate, mitigate or manage the actual or potential conflict of interest. The BPPG's existing Guidance includes a helpful list of such high-risk business relationships and this should be retained.

16. We suggest that the BPPG goes further than the Directive and requires advisors to disclose actual or potential conflicts (including business relationships) to all affected parties, including to issuers. This would be a demonstration of advisors' extended duty of care, see paragraphs 20-24.

## **EXECUTIVE REMUNERATION**

17. The BPPG may wish to consider a new Principle and Guidance to cover say-on-pay. For example, if advisors' recommendations on remuneration policies are based on a comparison of other companies' policies then this should be made clear, and there should be Guidance on appropriate samples, eg, number of policies to be included in samples, and sectorial and jurisdictional considerations for the choice of company policies included in samples.

## **OTHER CHANGES**

### **Advisors and their investor clients**

18. The BPPG should use this opportunity to re-emphasise that advisors have a responsibility to do all they can to avoid their investor clients solely placing reliance on them. For example, advisors should use a contractual term which makes their responsibilities and the responsibilities of their investor clients absolutely clear. The Principles and Guidance should require additional communication on this point when advisors provide voting execution services, eg, pre-population of voting platforms on behalf of investor clients.
19. There appears to be a tension between advisors exercising their independent professional judgement but at the same time being constrained by their client's house-style. We recommend that the revisions cover what could be an unacceptable house-style, and that advisors' reports are transparent about the restrictions they have worked under.

### **Advisors' duties to issuers**

20. The Principles and Guidance must make it clear that advisors owe a duty of care to the issuers who are the subject of their research, ie, a duty to non-clients. Investors and issuers face the difficult task of balancing the competing priorities of a range of stakeholders. Giving advisors a duty to consider their treatment of issuers would help address this anomaly. Issuers as well as investor clients need to be satisfied that advisors' reports, analyses, guidance and/or recommendations are prepared, as a minimum, to a standard that can be substantiated as reasonable and adequate.
21. We agree that advisors should be transparent regarding the research information provided to investor clients. This includes transparency with issuers. The BPPG should consider introducing a duty on advisors to either inform issuers about the research information that has been used, or to provide issuers with this information on request.
22. The Guidance on Client & Supplier Understanding includes a framework for investor clients to fulfil their due-diligence requirements. The framework includes: site visits; interaction with research teams; information on quality controls that govern the research development process; information on the qualifications and experience of the signatory's staff; and information on how the research framework has been or will be applied and on which assumptions the research output has been based. The Directive's public disclosure requirement will put issuers in the same place as investor clients in relation to parts of this framework. We have suggested better communications between advisors and issuers which will apply some of the other aspects of the framework to issuers, see paragraphs 25-28. In fact we suggest that the BPPG applies the whole framework to issuers.

23. Issuer fact-checking needs to be compulsory, and issuers need to be allowed adequate time to respond to advisors' enquiries. Advisors and issuers will want flexibility about how this operates in practice, but the Guidance could recommend that advisors give issuers their draft reports to comment upon and outline circumstances when issuers' views should be included in advisors' finalised reports. Having said this, we do not object to the BPPG retaining the concepts of proportionality and adequacy.
24. Our suggestions pertaining to advisors' duties to issuers may need to be balanced with stronger steps to avoid undue pressure or retaliatory actions.

### **Advisors' communications**

25. We recommend that advisors continue to be required to disclose a communications policy even though this goes beyond what is required by the Directive.
26. Strengthening communications between advisors and issuers should be high-priority. Comply or explain is intended to allow flexibility and to encourage proportionality. However, advisers are in a position to erode the option to explain if they routinely reject issuers' explanations. The revised Principles and Guidance should make clear that advisors must always give explanations due consideration.
27. Better engagement would benefit advisors as well as issuers and others. Advisors need a platform to explain why they may make different voting recommendations to different investor clients in respect of the same issuer, and to explain when and why they recommend a negative shareholder vote. Similarly issuers need an opportunity to give their perspective, eg, the impact that negative votes can have on their business operations.
28. These communications should be routine and not subject to the time pressure of AGMs. We suggest that advisors are required to tell issuers when and how they will consult on their voting policies. Advisors should make it clear that as this is general consultation they cannot discuss specific circumstances.

### **SCOPE**

29. Member States are likely to implement the Directive through national legislation. The BPPG will need to think about how to prevent any inconsistencies with the revised Principles and Guidance which may arise.
30. The BPPG may be able to provide information about the identity of Competent Authorities and the role they play in relation to advisors. Dependent on timing, this information may either be included in the revised Principles and Guidance or published separately.

### **FUTURE REVIEWS**

31. The European Commission must report on the implementation, appropriateness and effectiveness of the Directive by June 2023. The BPPG should undertake a review immediately after this report has been published.