

2021 BPP Stakeholder Survey Qualitative Responses Analysis Report

By:

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EXECUTIVE SUMMARY

This Report presents the findings of the analysis of the qualitative responses that were provided in the context of the 2021 Stakeholder Survey. Stakeholders were asked to express their views on the quality of BPP Signatories reporting on the updated 2019 Best Practice Principles for Providers of Shareholder Voting Research & Analysis¹. The BPP Principles were implemented on an ‘Apply-and-Explain’ basis, in line with SRD II. This report summarizes qualitative responses of eleven stakeholders (five of whom were investors, three companies, two industry body representatives and one asset manager), starting with a brief overview of main findings, followed by summaries of respondents’ comments about BPP Signatories’ reporting on each of the three principles. The Report concludes with a summary of additional comments, provided by the survey respondents.

MAIN FINDINGS

It should be noted here that due to the small number of survey responses (11 in total) the findings of this Report should not be treated as scientific data but as means to highlight some of the ideas and overall impressions given by stakeholders in order to encourage better practices and dialogue. The analysis of the qualitative responses reveals both positive developments in Signatories reporting practices as well as some areas for further improvement.

On the positive side, Investors who were the majority of respondents, were broadly satisfied with the improvements of BPP and signatories reporting on their applying the principles. For example, one Investor noted that:

‘Generally speaking, we are very pleased with the quality of disclosure around issuer engagement and the impact this has had on recommendations’ (Investor).

¹ BPP Best Practice Principles for Shareholder Voting Research and Analysis (2019) <https://bppgrp.info/wp-content/uploads/2019/07/Report-of-the-Independent-Review-Chair-of-the-2019-Best-Practice-Principles-for-Providers-of-Shareholder-Voting-Research-Analysis.pdf>

Survey respondents also noted some examples of good reporting practice:

'ISS's section on conflicts of interest' (Asset Manager)

'Use of meaningful summaries; regular and timely updates to both summaries and statements; clearly linking the explanations to the principles; providing succinct but meaningful explanations; providing examples' (Company)

Furthermore, when it comes to stakeholders' expectations of the Oversight Committee's role, respondents seemed to have the overall willingness to recognise the role that the Committee plays in helping to improve service quality, integrity, and communication among proxy advisors and other stakeholders. Expectations ranged from 'wait and see' to 'high' and 'very high', indicating the importance of the Oversight Committee's role in facilitating and tracking the progress of best practices in shareholder voting research and analysis service provision.

However, there were also some areas for further improvement raised primarily by Company respondents, whose main concerns were relating to accuracy of the proxy reports, research and methodology and how the proxy providers communicated with companies. Overall, company respondents found that more improvement is still needed in reporting on all principles, whilst investors were more satisfied on reporting on all principles.

The following sections of this report will summarise in more detail the comments made about BPP Principles compliance, based on comments received for each of the three Principles. Report concludes by highlighting suggested ways forward and other relevant general comments.

Scope and structure of the Principles

At present the proxy advisory industry's voluntary Best Practice 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.

In response to the question of whether other issues or activities that should also be covered by the Principles, most respondents considered that the following should also be covered:

- Intermediary vote processing and confirmation
- ESG advisory services and indices
- Governance engagement services

Principle 1: Service quality

Although most respondents did not have much to comment on in respect of Signatories reporting on Principle 1, one Representative Body highlighted that the key problem in this area remains the lack of transparency on methodologies used by proxy advisors to inform their voting recommendations. More transparency is also needed when it comes to reporting on errors or misleading information on voting reports. There also needs to be more accounting of

national and legal context. The following vignette provides detailed commentary from this Representative Body on these matters:

Lack of transparency and Quality

'Lack of transparency of methodology used by proxy advisory firms to formulate their voting policy. While recent developments point to proxy advisory firms now essentially making their voting policy available ahead of the GM season, the methodology and procedures to formulate the voting policy underlying their voting recommendations still lack transparency. Not only is the elaboration of the voting policy lacking transparency, but also the procedures put into place to ensure that voting recommendations are of appropriate quality.

There is a need for clarity in two aspects: First, how voting recommendations and policies are being developed and reviewed? Has an investor/stakeholder consultation process been established? What are the main features of this process justifying revisions of the voting policy? Second, how do proxy advisors engage with issuers and other stakeholders? Which source of information do they use to ensure that the proxy advisory firms have complete information about the issuer and each particular matter? How do they take into account the issuer's views and comments in an efficient and timely manner?

The current pandemic situation has generally shown uncertainty about the voting policy and the adjustments made by proxy agencies regarding the measures taken by issuers to deal with this crisis. A number of them indicated that they would consider changes made by Issuers in their policies (dividends, remuneration...) "on a case-by-case basis".

One option could be to have a 'fast track' revision process in place to better react to market disruption events.

• Errors or misleading information in the voting reports

Many issuers periodically observe errors or sometimes more seriously misleading information appearing in the voting reports. These errors affect the quality of the reports and in some more serious cases this can lead to misleading information communicated to the investor client. Hence the importance (i) of a prior dialogue with the issuer, (ii) of them accessing the voting report ahead of its distribution to investors with a couple of days to comment and (iii) of an alert procedure intended for the investor client allowing the issuer to correct the errors observed and to present its point of view before the date of the votes casting.

• Insufficient accounting for local / national market, legal, regulatory and company-specific conditions

Despite some improvement, each European company's unique set of local and legal conditions (regarding notably corporate governance) are not always adequately taken into account and weighted by certain proxy advisory firms. Moreover, the same governance practice (e.g. the combination or separation of the Chairman and CEO offices) gives rise to a diverging voting policy in Europe and in the US. While merging both offices triggers in all instances a negative voting recommendation in Europe, it leads to a more nuanced and fine-tuned appreciation when it concerns US-based companies.

This is all the more difficult to understand since institutional investors operate on a global basis.

Generally, there is a strong trend by some proxy advisory firms to recommend sanctioning directors, when their office is up for renewal, who have assumed or approved a company-specific policy (e.g. on executive remuneration) differing from the proxy voting policy.

We therefore urge proxy advisory firms to better explain in their reports to investors how they consider local and legal regulatory conditions or circumstances in their voting recommendations and how the same subject may lead to diverging recommendations on both sides of the Atlantic' (Representative Body).

While recognising the need for signatories to protect their intellectual property, how might reporting on compliance with the principles in the statements be made more informative?

'Signatories describe their methodologies to some degree but that is not where the problem arises for issuers. Essentially, regardless of how robust a methodology is, misinterpretation of information is still possible. It is therefore difficult to ensure research is reliable if there is little input from the issuers who are subjects of the research. Another missing element for reporting/oversight is measures of how often companies are given the opportunity to comment on reports, how much time they are given, and the consequences of such engagement (e.g. voting recommendations changed or not, company comments incorporated or not)' (Representative Body).

How might the reporting process be improved?

Several respondents (an Investor and one industry Representative Body) suggested that more transparency is needed on quality of services as well as extensive and timely consultation of stakeholders, including insurers is needed.

Other comments specifically focused on highlighting the need to enhance reporting on particular skills and methodologies used to inform voting decisions. The following quotations highlight these key points:

'Enhance the reporting on specific skills and methodologies relating to voting items that are materially connected to disciplines other than governance. For example, investment knowhow needed to make recommendations on capital allocation items or M&As. Another example is voting items requiring sustainability knowledge such as the emerging categories of climate votes and non-financial information resolutions.' (Investor)

'The key issue with voting policies for issuers is that there appears to be very little external consultation for policies that end up being very influential. At the minimum issuers believe there should be some dialogue with regulators to ensure signatories voting policies are not in conflict with aims of government or

the regulators, do not have a negative impact on the health of our markets and are proportionally applied so that smaller issuers are not unintentionally and unfairly impeded' (Representative Body).

Principle 2: Conflicts of interest management

While this Principle have identified a number of potential conflicts of interest, Stakeholders were asked whether any other potential conflicts should be included in the list.

The following potential conflicts were identified by one Investor and a Representative Body:

- *'The potential conflicts of interest between different business lines of the Proxy Advisors' (Investor)*
- *'Ancillary services, including ESG consulting services provided both to investors and issuers;*
- *Platform voting services offered by ISS and Glass Lewis to their investor clients: these platforms automatically allow proxy advisors (unless a default option is disabled by their clients) to pre-tabulate the investors' votes in accordance with their own voting recommendations and policies. This de facto enables proxy advisors to exert substantial influence over corporate shareholder voting outcomes and may promote a box ticking behaviour by investors. Academic studies show that a negative ISS recommendation can lead up to a 25 percentage points decrease in voting support. Such platforms should remain neutral, which entails deactivating the default option' (Representative Body)*

When it comes to Respondents' satisfaction with the timeliness and appropriateness of the information they received on specific potential conflicts and how they are being managed, there were two comments from Investors relating to this issue:

'Signatories should disclose in detail where consulting services have been provided and how this has potentially driven or impacted on engagement with issuers and vote recommendation given' (Investor)

'Further detail on processes once a potential conflict of interest has been detected (rather than processes that seek to avoid it).' (Investor)

How might the procedures be improved?

According to one Investor, they are:

'...satisfied with the current procedures. One suggestion however is that the prominence of disclosure of specific conflicts on the voting platforms (or otherwise alerts sent by the PAs) could be improved, as is more detailed noting on the type of conflict, for example along the categories proposed above' (Investor)

A more in-depth response on this question came from a Representative Body, highlighting the significance of identification potential conflicts of interest as well as offering their views on how such conflicts of interest be avoided and/or mitigated. The following vignette also

articulates their views on the conflicts of interests policy and individual reporting responsibilities in this area:

'Conflicts of interest within the terms of the shareholder rights directive need to be identified and disclosed to clients, together with the actions undertaken to eliminate, mitigate or manage them. The first stage is to properly identify potential conflict of interest.

- Identification of conflicts of interests

One of the major potential or existing conflict of interest may arise when a proxy advisory firm provides voting recommendations to investors on corporate governance matters for which the same firm offers consulting services to issuers. This is not even mentioned in the updated BPP and cannot be inferred from the description of the proposed services. It is simply not the case that proxy advisors may provide "engagement and governance overlay services" as described in the BPP to issuers based on a mandate given by investors. As termed by SEC itself, ISS's services create the need for issuers to be advised to obtain more favourable voting recommendations or improve their ESG ratings or their Pay for Performance evaluation. Particularly relevant in this respect, are the two services marketed by ICS, a subsidiary of ISS, who, despite claiming it has set up appropriate Chinese walls, is still systematically offering services to issuers aimed at improving their "QualityScore" or "Pay For Performance". A further case is the voting platform made available by ISS and Glass Lewis to their investor clients and mentioned above.

- Avoiding, managing and mitigating conflicts of interests

The next question is to determine whether such conflicts need to be eliminated or simply managed and mitigated. Ideally, proxy advisory should not offer consultancy services to issuers when being already mandated by investors to carry out research on the same companies, especially where services offered amount to compulsory sales (e.g. Quality score and PayforPerformance). Alternatively, where proxy advisors provide such services both to issuers and investors, the latter should at least be kept informed, which is presently not the case. where proxy advisors provide such services both to issuers and investors, Additionally, the proxy advisory firms should confirm the non-material character of the ancillary services offered to the relevant issuers from a revenue standpoint.

- Conflicts of interest policy

Proxy advisors should disclose a policy that describes their approach to addressing potential and existing conflicts of interests. The policy should explain which conflict exist or may arise, how and when these conflicts are disclosed to clients, how these conflicts are avoided, managed or mitigated and how their staff are trained on operating the policy.

However, measures of avoidance, including the separation of activities and the establishment of information barriers, proved insufficient to prevent subsidiaries of proxy advisors from generating significant conflicts of interests.

- Individual information about conflicts of interests

In addition to the obligation to publish a conflicts of interest policy, proxy advisors have to inform their clients individually about any actual or potential conflicts. This information needs to be provided before or at the same time as the voting recommendations are made available to them. In this respect, information already released in the conflicts of interest policy does not replace individual disclosure of conflicts that have appeared during the preparation of the voting recommendation.

In particular, the general reference to a relationship with issuers in the policy does not exempt from the obligation to indicate in the voting recommendation that the issuer covered in the report is also a client of the proxy advisor, which currently is far from being the case.’ (Representative Body)

Principle 3: Communications policy

‘Generally speaking, we are very pleased with the quality of disclosure around issuer engagement and the impact this has had on recommendations’ (Investor).

This view was shared among other investors. However, one Representative Body has highlighted a number of areas where progress is still needed. The following vignetter articulates their views and the areas where more improvement was proposed:

‘While making progress, there is still substantial room for improving dialogue with issuers. Proxy advisor engagement policy with issuer often lacks transparency. More specific BPP guidance should be made available along the following lines.

First, proxy advisors should disclose the main features of their engagement policy, which is currently not always the case.

Second, as recalled by ESMA, they need to inform investors about their dialogue with issuers and the nature of that dialogue. This dialogue and its extent should be mentioned in the voting report provided to the investor client. When they do not engage with issuers, they should explain why. However, opening up such a dialogue should become compulsory, if so, requested by the issuer, especially where contentious issues are at stake.

Third, engagement should be encouraged the whole year and not only during the proxy season.

Fourth, proxy advisors should promptly provide issuers with the draft voting recommendations (at least two weeks ahead of the GM and before the draft is circulated to Investor clients) and give them sufficient time to comment (minimum two days, preferably three).

Fifth, proxies should formally acknowledge issuers right to have factual errors rectified which requires proxy advisors to correct them in due course and at the latest before releasing their voting recommendations to their clients. In cases where proxies disagree with the issuer, they will pass on the issuer's comments to their clients.

Sixth, where GM draft resolutions are being tabled closer to the meeting date, for instance, at the behest of shareholders and according to deadline and conditions set forth by national company law, it often happens that proxy advisors recommend voting against or abstain to any new items on the agenda, because of lack of information. This happens, for instance, where the board of directors is to be integrated and shareholders are expected to propose a candidate, and they do it after the publication of voting report by proxy advisors. A possible solution could be to recommend proxy advisors to update their voting recommendation with reference to such new items and proposals.

Seventh, the role proxy advisors play in mergers & acquisitions, proxy contests and other litigious matters appears problematic in several respects. First, even in cases where proxy advisors accept to provide issuers with an advance copy of their draft report for verification purposes, we note they don't make it available if it concerns M & A or any other issue, they deem contentious.

Second, the draft voting recommendations prepared in such a context should be communicated to the issuer ahead of their disclosure to investors, so that issuers can make their position

known to investors, and the issuers' position which may influence the vote's outcome should even be made public.

Third, whenever proxy advisors get involved in takeover situations, they are recommending in effect that their institutional clients sell, or not sell, their shares to a would-be acquirer.

In those circumstances, proxy advisors should subject themselves voluntarily to rules and regulations for financial advisers and investment bankers giving an “opinion” about a merger or acquisition transaction. In addition, proxy advisors should inform all parties concerned as to whether they have acted as consultant in any way for any of the parties involved in the transaction. It should be noted that many of the largest hedge funds are clients of ISS’ (Representative Body).

There were six recommendations from various types of respondents **on how might the procedures on reporting on these principles be improved**. These are the following:

- ‘Statements of different services providers lack consistency in the level of detail. It would be beneficial for all to see numeric evidence supporting the approach to engagement with issuers (how many companies were given an opportunity to speak to proxy advisers, what is the minimum time for the Co to respond). Advisers should not make it a prohibitive expense for companies to provide their feedback’ (Investor)
- ‘Including more information or statistics on prior year proxy advisor - company engagement activity and possibly tracking outcomes’ (Asset Manager).
- ‘We would prefer to have sufficient chance to review the draft report ahead of publication for all proxy advisors’ (Company)
- ‘Reporting is generally fine. There may be a benefit from including more specifics/examples of how the principle has been applied to provide greater context’ (Company)
- ‘It would be beneficial to see a general approach to engagement and a minimum amount of time given to companies to feed back on the draft research and to detail within the reports, where companies made corrections’ (Investor)
- ‘There is a need for more meaningful communication. Companies and investors are under governance obligations to engage in a meaningful manner. It is therefore logical that the proxy advisors are also subject to the same obligation, as they play a key role in the functioning of the markets. It is often that the company does not see a copy of the report, so cannot attempt to clarify circumstances or correct inaccuracies directly with its shareholders. Usually, the company is not given an opportunity to comment on a draft report before the final report is published, nor is it given insufficient time to comment, so at no stage do they have a window for meaningful communication. Finally it is the norm for the company to not know which shareholders will be receiving the report. It therefore cannot approach those shareholders directly to clarify circumstances or correct inaccuracies. This impacts the obligation for companies and investors to communicate meaningfully also. To remedy this more time is needed. The company should be provided with a draft report before the proxy advisers circulation date and given the opportunity to comment on the draft and share their comments with shareholders. The ideal time period for issuers would be 5 days but at least a full

working day (24hrs) would be an improvement. If the company does not receive a draft report before the circulation date, they should receive a copy of the final report and a list of shareholders being provided with this report, so that they can then approach those shareholders directly to clarify circumstances or correct inaccuracies. Finally it is important to ensure that all issuers, regardless of market, are capable of receiving their report, for free. Signatories should be obligated to provide the reports to the respective upon request immediately. Effective dialogue between issuers and shareholders may be impaired by an information asymmetry if the shareholder has access to a report that the issuer is unable to see'. (Representative Body)

With regards to compliance statements some respondents considered that:

'It appears signatories explain their complaints procedures fairly clearly without describing the outcomes at all. There is no quantitative measure of the number of complaints, the results of a complaint or satisfaction with the outcome from complainants. This seems to be a glaring missing element of the reporting' (Representative Body)

'Generally speaking, complaints made by issuers are not seriously considered and examined in depth by proxy advisory firms. Moreover, the complaint procedures and the follow-up given therein are unknown and this situation very often discourage issuers from launching such a complaint. In terms of efficiency, issuers are of the opinion that the shortcomings observed should rather be subject to a procedure which could be initiated with a national regulator.' (Representative Body).

Many companies consider they should have the opportunity to comment on the analysis and recommendations in research reports before they are finalised. When asked about statements that are most relevant to the respondents, the following three statements were highlighted:

- *'I find it helpful to know the company's views on the research report before deciding how to vote'*
- *'I have no objection in principle to this practice, as long as it does not reduce the amount of time I have to make voting decisions or impact on costs'*
- *'Companies already have opportunities to explain their case in their annual and compliance reports, the papers for the general meeting and direct engagement with their shareholders. They do not need another one.'*

Areas of Concern: it took months for some respondents to receive reports on compliance statements.

'ISS example: state structures and stats, but none on employee training or processes to improve' (Investor).

When regards to Reporting on Principle, there were several comments from different types of respondents on **how might the statements be made more useful:**

- *'Including more information or statistics on prior year proxy advisor - company engagement activity and possibly tracking outcomes' (Asset Manager).*

- *‘Signatories should be encouraged to embed relevant case studies in their statements’ (Investor).*
- *‘Greater detail regarding complaints and how policies are developed should be included in future reports’ (Representative Body)*
- *‘Training and processes that further develop the status quo’ (Investor)*
- *‘The Glass Lewis statement provides a good level of detail, which gives a full picture of their activities during the year. If reports of other service providers would be consistent, this will be very informative for their existing and potential clients. It could be potentially considered to provide a questionnaire (like the PRI questionnaire for signatories), where service providers would demonstrate exact data, this would let their clients to more efficiently search for the information they need and make the compliance statements more consistent’ (Investor)*
- *‘Including statistics within statements is useful to see how the principles have been applied and understand both reach and potential impact. Not all signatories provide this level of information. Signatories should be required to review their statements annually so that the information contained within them remains relevant and up-to-date. The statements should clearly identify any changes made and include an explanation for those changes, e.g. when they have been made in light of stakeholder feedback, for ease of reference and to give relevance to the “apply or explain” approach.*

It may be useful for signatories to provide some real life examples of how the principles have been applied and any changes that have been made to improve application.

The use of summaries is helpful and these should be encouraged – including an indication of whether or not they have complied, as opposed to a reference to the relevant page within the statements. Key changes could also be flagged. The statements themselves are often fairly lengthy documents and this would make the information more accessible’ (Company).

Time expectations for company feedback ranged from 48 h to 5 days with 3-day mark more requested by the survey respondents.

Additional Comments:

- *‘On the whole, we believe that proxy advisors perform a valuable role in the voting chain. In our view, this is largely a perception problem, which needs to be addressed by better dialogue and better education for all parties’ (Investor)*
- *‘Although there has been marked improvement, there is inconsistency in approach taken by signatories, including their willingness to engage. Given the impact of reports on voting outcomes, firms should continue to be encouraged to enhance communication with, and feedback to, companies. If there is a level of comfort with proposals, simple confirmation prior to publication would be useful with no engagement required’ (Company)*
- *‘It would be also good for us to see if service providers could reference in their research when votes change because of changes in their methodology (for example, an against*

vote in 2021 would be actually a favourable vote under the 2020 policy). It would be good for us to develop some kind of reporting on this' (Investor)

- *'Of the signatories to these principles, there is a range in the quality of the reporting that is produced. Often voting recommendation reports are littered with inaccuracies and even where issuers are given an opportunity to comment and correct factual errors, this feedback is not taken into account. Some such inaccuracies can be minor details but others can be far more significant including reporting on an outdated strategy of a company or recording the name of board members who have left the company over 12 months earlier. A longer review period and appropriate resourcing within the proxy advisor firms would support a more meaningful dialogue with the opportunity for higher quality reports to be issued' (Public Company).*
- *'Greater consideration of communication and interaction with issuers should be included in the principles. Ultimately this will foster a more accurate service for investors but will also create a healthier ecosystem for businesses to access growth capital' (Representative Body).*
- *'Signatories statements of compliance should continue to remain publicly available in order to maintain transparency and accountability of reporting and foster more academic research, which has been lacking in this area' (Comment from the author of this report)*

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