

## RESPONSE TO ESMA'S CALL FOR EVIDENCE ON THE IMPACT OF THE BEST PRACTICE PRINCIPLES FOR PROVIDERS OF SHAREHOLDER VOTING RESEARCH AND ANALYSIS

27 JULY 2015

### SUMMARY & INTRODUCTION

- We welcome the opportunity to discuss the implementation of the BPP, despite its limited duration. It is really too soon for this review, as there has not been sufficient time for companies to judge the effect. Some of our members have reported limited progress in terms of enhanced clarity and transparency, while others reported no improvement.
- Some providers of research that companies would have expected to see as signatories have not yet signed up to the code.
- The shareholder rights directive will create new requirements for EU companies to engage with their shareholders which will result in an increased number of company resolutions. These will require additional analysis and it is not clear whether these shareholders currently have / will invest the necessary additional resources.
- Increased concentration of the proxy advisory market raises concerns, as reduced competition could potentially lead to lesser quality services provided in the long-term.
- Issuers would like to have the possibility to correct factual errors in the voting recommendations before they are passed on to investors. Some members have reported improvements in engagement and receipt of draft reports in advance; others have not.
- Companies would like the proxy advisors to forward to their clients the company's explanations in addition to their own recommendations, in order to ensure that the investor would have enough information to make an informed decision, where there is a difference of opinion. Business practices widely differ among the proxy advisory firms.
- Experiences of companies on whether the general business conduct of the proxy advisors, transparency and recognition of regional law and corporate governance have improved over the longer term vary. Further research may be needed to understand whether this is due to:
  - differences in shareholder structure;
  - corporate governance practices, who the main proxy advisory players are and how long they have been present on the relevant national market, etc.;
  - the amount of effort companies and/or national issuer associations invested in engaging and "educating" proxy advisers on national systems;
  - the level of engagement of companies and/or national issuer associations in a dialogue with investors;

- the efficiency and cost-effectiveness of different shareholder identification systems in a given country/jurisdiction and thus the ease of initiating a dialogue.

## GENERAL QUESTIONS

### 3.2.1 Background

**Q1: What is the nature of your involvement in the proxy advisory industry (proxy advisor, investor, issuer, proxy solicitor etc.)? To facilitate the comprehensibility of your response to this Call for Evidence, please describe your role in and your interaction with the industry.**

EuropeanIssuers is an organisation representing interests of the companies quoted on the European stock exchanges. Therefore, we answer to this call as a representative of issuers, who are the subject of analysis by proxy advisors, and issuer associations.

**Q2: Have you previously had concerns with the functioning of any areas of the proxy advisory industry? If yes, please specify.**

Yes, companies had voiced concerns over the following:

- Lack of clarity as to the roles of investors and proxy advisers;
- lack of or unsatisfactory engagement with issuers,
- the quality of recommendations and ability to correct factual errors,
- lack of adequate consideration of local corporate governance rules and market conditions, and
- insufficient disclosure of how policies and recommendations are developed and of any conflicts of interest;
- level of skills and resources of persons in charge of the analysis of the draft resolutions.

**Q3: Did you become aware of the BPP at the time of their publication, i.e. March 2014? If yes, how did you become aware of the BPP? If no, when did you become aware of the BPP and how?**

Yes, we participated in the consultation of the BPP Group (see [our response](#)). We have also commented in previous years (see our [response to ESMA consultation in 2012](#) and our [response to the EU Green Paper on corporate governance in 2011](#)).

### 3.2.2 The BPP on paper

**Q4: What is your view on the width and clarity of the scope of entities covered by the BPP (i.e. do you consider that the BPP cover the European proxy advisory market appropriately)? Please explain.**

We believe that the definition of proxy advisers as those providing shareholder voting research and analysis is clear. We comment separately in response to Q7 on whether all relevant entities

have yet signed up to the principles. We generally believe that these principles should cover signatories providing services on issuers whose securities are admitted to markets in the European Union.

**Q5: In your view, are the BPP drafted in a way so that they address the following areas identified in ESMA's 2013 Final Report? Please provide examples to support your response.**

- (a) identifying, disclosing and managing conflict of interests;**
- (b) fostering transparency to ensure the accuracy and reliability of the advice;**
- (c) disclosing general voting policies and methodologies;**
- (d) considering local market conditions;**
- (e) providing information on engagement with issuers.**

Yes, although there may sometimes be discrepancies between what is in the code and in practice. We believe that the principles could still be further improved by allowing a greater participation of issuers and other stakeholders in the development process.

**Q6: What is your overall assessment of the quality of the signatory statements? Please provide examples referring to the areas identified under Q5.**

The quality of the signatory statement varies among different proxy advisors and may also differ on a case by case basis. Some are comprehensive and helpful in explaining internal processes and authority; others lack some explanations necessary to understand the business.

The statements are not always easily comparable. It would be useful for companies if they were published around the same time of the year and possibly on an annual basis, and possibly in a more comparable format. The BPP Group affirmed, on the website, that a framework to make the statement of compliance comparable will be adopted within the end of 2015 - this could be a useful tool for stakeholders.

### **3.2.3 The BPP in practice**

**Q7: In your view, are there proxy advisors which possibly fall within the scope of the BPP and have not signed the BPP? If yes, please:**

- a. identify such entities;**
- b. explain why you consider them to be within the scope of the BPP; and**
- c. indicate their size and the coverage of their operations within the European market.**

Our members see other research providers such as IVIS and Eumedion as providing similar services, but who are not yet signatories. In the longer-term, it would be helpful to encourage all such research providers to sign up, as it is sometimes confusing for companies to understand the market for those who provide advice to their shareholders.

***Q8: How would you describe the impact which the BPP have had on the proxy advisory industry in practice? Please provide examples to support your response.***

The feedback we have received from our members indicates that there has been only limited impact, although it may be too early to evaluate that as there has been only one AGM season since the introduction of the BPP at the beginning of 2014. However, some members report that we can observe a certain degree of enhanced transparency in the proxy advisors' activity, also resulting from the disclosure of the Statements of compliance.

Some of our members observe that the general business conduct of the most important proxy advisors have improved over the past five to ten years. This includes more openness to discuss general topics regarding the corporate governance of issuers and their general meetings. The same members report better recognition of national or regional specifics of both binding law and corporate governance issues in their voting guidelines and public consultation of the voting recommendations (or at least some unstructured feedback). Although they still underline that further improvement is needed, especially regarding the possibility for issuers to check voting recommendations against factual errors before they are passed on to investors. This might happen on an occasional basis but it is not a common standard across the whole industry. It could also be useful if all proxy advisors were able to publish error rates (as in the Manifest statement).

On the other hand, some other members say that there was very little improvement in proxy advisors behaviour over the years (e.g. they may answer calls more often, but are not open to discuss, or to accept arguments relating to national or regional corporate governance specificities). Some of these say that the quality of the recommendations and advice has deteriorated, given that proxy advisors have to cover ever more companies, while not sufficiently enlarging their resources (meaning qualified personnel).

The feedback can also vary within markets; with different views from companies as to whether there has been improvement over the years varying with the different advisers. Again, in some cases there is perceived to have been improvement, while in others the improvement is more limited or not noticeable.

For instance, some of our Dutch members report that while Glass Lewis does not engage at all, ISS now usually allows companies 48 hours to review their draft reports, rather than just an afternoon, which is helpful. According to the same source, ISS also tends to consult annually on their best practice guidelines in September, which is welcomed by companies. PIRC was perceived to have become more professional in its interactions with companies and to have improved at sharing drafts in advance.

Interestingly, the experience of some French and German companies is different. They report having more engagement issues with ISS, rather than Glass Lewis – co-operation with the latter was said to have improved.

From the Spanish companies, we hear that there is more effort both from the issuer side to better engage with the proxy advisors, and from the proxy advisors' side to better understand the Spanish companies and their corporate governance rules. Even though practice varies among proxy advisors with regard to sharing their reports with issuers, the meetings for which this is done (sometimes only for the AGM but not for other meetings), or the time allowed for comment (24 or 48 hours), the general feeling is that both issuers and proxy advisors are making more efforts to improve their engagement.

See also our response to Q11.

***Q9: Have you observed any changes in signatories' practices in the areas mentioned under Q5 since the publication of the BPP in March 2014 and specifically during the 2015 proxy season? Please provide examples to support your view and specify whether these changes addressed the concerns you mentioned in response to Q2, if any.***

See our response to Q8.

Some members have reported greater clarity of roles between investors and proxy advisers, in terms of the presentations by the advisers.

***Q10: To what extent do you consider the conduct of BPP non-signatories in relation to the areas identified under Q5 to be different from that of BPP signatories? Please provide examples to support your view.***

To date the differences between the BPP signatories and non-signatories are seen as fairly limited, which could be related to the short period since the code was introduced.

***Q11: Do you consider other measures than the BPP necessary to increase understanding of and confidence in the proxy advisory industry? If yes, please explain why and specify the measures which would in your opinion be suitable.***

In order for companies to understand voting practices better, it would be important that the institutional investors also make their own disclosures under stewardship codes (as proposed in the draft shareholder rights directive).

We welcomed the creation of the Best Practice Principles and we support the “comply or explain” approach on which they are based. Some of our members believe that a monitoring process of

the application of the principles could be beneficial, although there is no agreement towards how such monitoring might work.

To start with, it would be useful to see feedback from the signatories of the BPP code of the ongoing monitoring of the implementation of the Principles to which they signed up (page 2 of the BPP). It would be useful to know if the members of the group met, how many times, if the independent chairman played a special role, etc. We note that the Group intends to conduct a biannual review of the Principles and Guidance, and to consult on any intended updates.

It would also be very useful to have an independent study, possibly commissioned by ESMA or the Commission, on the proxy advisory industry on the quality of their research, transparency regarding the formulation of their policies and recommendations, disclosure and management of conflicts of interest and engagement with issuers. This study should look at the evolution over a longer period of time (at least 5 years) and take into account various jurisdictions. This would allow for a better understanding of the situation.

On several issues, we have received diverging feedback from our members. Unfortunately we did not have sufficient time to inquire further to understand fully whether the differences may be stemming from:

- differences in shareholder structure (e.g. dispersed vs more concentrated ownership, proportion of retail vs institutional investors, proportion of domestic/national vs foreign investors [EU and international]);
- corporate governance practices, who the main proxy advisory players are and how long they have been present on the market, etc.;
- the amount of effort companies and/or national issuer associations invested in engaging and “educating” proxy advisers on national systems;
- the level of engagement of companies and/or national issuer associations in a dialogue with investors. This aspect is also connected to shareholder structure (probably easier to do in a more concentrated market and/or where large investors are dominant or well established investor associations that could an interlocutor).
- The feasibility of investor engagement linked to the efficiency and cost-effectiveness of different shareholder identification systems in a given country/jurisdiction – it is very difficult for companies to have a dialogue with investors when they don’t know who they are.

***Q12: Do you have any other general comments that ESMA should take into account for the purposes of its review?***

As mentioned in our previous positions, the use and behaviour of proxy advisors needs to be viewed as part of a bigger picture whereby the behaviour of all actors in the system is interconnected (companies, investors, proxy advisors, etc.) and whereby financial markets and their infrastructure often fail to deliver transparent outcomes for issuers as end users of those markets.

We believe that the use of proxy advisers should not shift investor responsibility. This means that the responsibilities in the investment chain should be clearer and the role of proxy advisers should not be viewed in isolation. Investors as clients of proxy advisers should hold them accountable for the quality of their work. Unfortunately we often hear that is not the case and that investors either do not care, or invest in too many companies in order to properly engage with companies and/or proxy advisers, or look for the cheapest solutions.

This could be possibly improved with the introduction of stewardship codes via the shareholder rights directive. We hear that the FRC Stewardship Code helped to improve transparency of methodology for UK issuers. As a result, in 2012, companies could see that e.g. 60% of ISS clients use their own voting policies and only 40% use ISS's own version. This helped to improve transparency, as often companies are not aware how investors' voting decisions are made and to what extent the end investors rely on the policies of the proxy advisers, or on their own policies. Nevertheless, it remains unclear how these investors' policies are formulated and their relationship to the policies of the proxy advisers, and in themselves, do not necessarily imply a direct dialogue between the investor and the issuer. It is therefore important to have disclosure not just by the advisers, but also by investors. This is the information that the company's investor relations or company secretarial department needs in order to communicate with the right person at the right time.

There is some confusion among companies as to the tendency of investors to vote against certain general resolutions common in local markets, rather than tabling a specific resolution to deal with the issue of concern.

Some of our members underline that they would welcome agreement on a minimum time period among the proxy advisers, in order to grant issuers sufficient time to check voting recommendations and respond in the event of any factual errors.

We note that some proxy advisers have commented on problems in the investment chain: we do not see these as directly part of the BPP Principles, but we would note that this is an area that we have worked on via the General Meeting standards and in co-operation with the ICGN for their Viewpoint on vote execution. We have commented in more depth on several of these issues in our responses to the shareholder rights directive and to the earlier consultations on securities law and would be happy to provide further details.

## **6 Questions for issuers**

### **6.1 Introduction**

***22. The questions in the following section are directed at issuers, i.e. European listed companies. ESMA's Final Report highlighted in particular: i) that proxy advisers should, in principle, not be understood to be engaging with issuers on behalf of their investor clients on general matters of stewardship, and ii) that direct contacts between proxy advisers and issuers***

*should be focused on helping the other to better understand the basis for their positions in the voting process.*

**23. With the following questions, ESMA would like to obtain issuers' view on the effectiveness and impact of the BPP thus far, in particular referring to the 2015 proxy season.**

## 6.2 Questions

**Q34: As regards your experience with proxy advisors before and after the publication of the BPP, please describe:**

**a. whether proxy advisors have provided research, advice and/or recommendations on your company;**

Being an association representing interest of the companies quoted on the European stock exchanges, our corporate members and members of our member associations are subject of research, advice and/or recommendations by proxy advisors.

**b. whether you have used services from proxy advisors (please specify which services, e.g. research, consultancy).**

See above.

**Q35: In your experience, to what extent have the BPP enhanced clarity as regards the expectations issuers can have towards communication with proxy advisors? Please provide examples to support your response.**

See our replies to Q 8, 11 and 12.

**Q36: Has your approach to seeking or maintaining dialogue with proxy advisors within or outside the proxy season changed in any way as a result of the publication of the BPP (e.g. in terms of frequency, nature, circumstances)? If yes, please provide examples and quantitative evidence.**

The feedback we have received from our members indicates that the approach to seeking and maintaining dialogue with proxy advisors has either been subject to limited improvement or has not changed after the BPP have been published, although that it may be too early to judge.

While some issuers have seen an improvement of the dialogue with the proxy advisors over the last 5-10 years, others are less satisfied. In any case, there is general agreement that the dialogue could still be further improved.

For more details, see our replies to Q 8, 11 and 12.

**Q37: In your experience, to what extent have the BPP improved proxy advisors' procedures for managing and disclosing conflicts of interest, and specifically the following two types?**

**a. The proxy advisor provides services to both the investor and the issuer;**

**b. The proxy advisor is owned by an institutional investor or by a listed company to whom, or about whom, the proxy advisor is providing research, advice and/or recommendations. Please provide examples to support your response.**

It is really too soon for this review as there has not been sufficient time for companies to judge the effect.

Among the areas highlighted for concern by companies are: the use of Quick Score service, offering corporate governance advice and the sale of the report to the issuer.

For example, one of our members mentioned that they were offered such a service by one of the US proxy agencies for a price of 60 000 euro with the idea of "improving the corporate governance" of the company in order to bring it more into line with the proxy advisor's guidelines. Incidentally, after the company rejected the offer, and pointed out several misstatements of facts in the "corporate governance analysis", not all factual statements were corrected and the next year the proxy advisor reduced the "corporate governance score" by 1 point, without any changes in corporate governance at the company. Of course, one may argue that there were separate substantive reasons for that, although it was not clear to this company.

**Q38: In your experience, to what extent have the BPP enhanced clarity as regards proxy advisors' methodologies and the nature of their information sources, thereby allowing you to better assess the accuracy and reliability of the proxy advisors' research, advice and/or recommendations as regards your company? Please provide examples to support your response.**

Some of our members mention that the signatory statements on the BPP website allow for a better understanding of the processes within the proxy advisors for all stakeholders and thus have improved access to information to some extent. Nevertheless, there could be further improvements to the disclosure of methodology, and the criteria followed to assess the governance solutions should be better explained, especially when standardized formulae, like the Quick Score service, are used.

**Q39: In your experience, have the BPP enhanced:**

**a. proxy advisors' level of awareness of local market, legal and regulatory conditions which your company is subject to?**

***b. proxy advisors' disclosure of the extent to which they take the above conditions into account?***

***Please provide examples to support your response***

Once again, it is probably too early to judge the influence of the BPP. Some of our members have seen improvements in the awareness of local market conditions by the proxy advisors, as well as of the extent to which they are taken into account over the last 5-10 years, while others complain that, despite their efforts and engagement with proxy advisors, there has not been much progress. Nevertheless, there is agreement that awareness of local market and consideration of specific circumstances could be further improved.

**Italian example**

An Italian company adopted a remuneration policy where the long term incentive plans referred to two years instead of three years normally recommended by proxy advisors. The reason for the shorter period, clearly motivated in the policy itself and explained to proxy advisors, was due to a forthcoming change in the regulatory environment, likely to impact directly on the profitability of the business. Notwithstanding the sound business reason behind the policy remuneration formulation, proxy advisors gave a recommendation to vote against the policy; while investors, directly addressed by the issuer on the specific point, voted for the resolution.

**Belgian example**

One of our Belgian members reported that they reach out to proxy advisors ahead of shareholders' meetings, and that the advisers usually send a draft of their voting recommendation a few days before the meeting. However, if the advisers accept to have a call or discussion, it is almost impossible to have them change their recommendation, which the company sees as based on a "one size fits all" policy, which does not take the specificities of the company into consideration. This year, for example, the company had a temporary exception to a "comply or explain" rule in the context of a change of CEO. The company's concern was to ensure the continuity of the chairmanship of the Board during the transition. They therefore had to accommodate some temporary situations within Board committees for a transition period of 1 year. However, the company felt that this situation was ignored in the adviser's recommendation.

**German example**

One German company reported that ISS believes that the independence of directors is jeopardized after 12 years. When discussing it with them, they mentioned that 12 years in the US means three terms as the overall tenure in the board. When the company in question pointed out that, in Germany, the normal mandate runs for five years and that three periods would therefore translate into 15 years, they said that they comply with their US based assessment and stay with 12 years. This means that they would recommend to vote against someone after 10 years and up for re-election for third term, because it is foreseeable that this person would stay for more than 12 years.

### **French example**

In most proxy advisors' view, separation of the offices of Chairman of the Board and CEO is the only acceptable arrangement for the governance of Boards of directors. This contrasts with the French commercial code, which offers the possibility to choose between 3 different formulae:

- in the unitary system, there are two options:
  - possibility either to combine or
  - to split the function of chairman and CEO or,
- the two tier system, comprising a management board and a supervisory board, with separate chairmen of each.

The specific context of each company should be taken into account as the company's success depend more on the skills of executive directors at the top of the company than on the governance structure.

### **Spanish example**

Similar to the situation in the Italian market, in Spain there are many initiatives aiming at enhancing the engagement of companies and proxy advisors. Amongst others, this is done through the organisation of roadshows and meetings, allowing proxy advisors to gain a better understanding of Spanish companies and the local corporate governance rules. A good example of these developments has been a discussion around the need to split the figure of the President of a company and its CEO, with the outcome reflected in the New Corporate Governance Code published by the CNMV in February 2015.

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