

# Report of the Chairman

of the Best Practice Principles Group  
developing the Best Practice Principles for  
Shareholder Voting Research & Analysis

**Dirk Zetsche**

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## 1 Introduction

In April 2013, I took on the chairmanship of the Best Practice Principles Group (the “Committee”). Almost a year later, on 5th March 2014, the Committee published the final version of the Best Practice Principles for Shareholder Voting Research & Analysis (the “Principles”).<sup>2</sup> The Committee has thus met the recommendation of the European Securities and Markets Authority (“ESMA”).

This report makes the Committee’s work and discussions transparent; it aims to facilitate an understanding among market participants – in particular clients and issuers – of the reasoning behind the adopted Principles and Guidance. Moreover, the report serves as a documentary function for the future application of the Principles. Finally, it aims to enhance the insight into the functioning of the industry, in general.

Given that not all market participants understand the Members’ working practices to the same level, I hope the report will assist in enhancing discussion and fostering an understanding of the challenges and opportunities of the industry.

## 2 Group Composition and Work Organisation

For the details of the Committee’s composition and work organisation, I refer to the consultation document from October 2013, which will continue to be available at the Committee’s website (<http://bppgrp.info>).

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<sup>2</sup> See Annex I and online *Best Practice Principles for Providers of Shareholder Voting Research & Analysis* (2014), available at <http://bppgrp.info/wp-content/uploads/2014/03/BPP-ShareholderVoting-Research-2014.pdf>.

The Committee conducted six in-person sessions in 2013, which took place in March (Milan), April (Paris), July (Frankfurt), August (London), September (Paris) and October (London), and held additional conference call sessions in September and October. In 2014, the Committee met in person in February (Frankfurt) and via conference call in March.

The Committee's work began with a comparative review of European as well as international stakeholders' expectations regarding the content of an industry code.

Particular attention was given to the *ESMA Final Report and Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry* ('ESMA Final Report') published 19 February 2013.<sup>3</sup> This was due to the fact that ESMA intends to review the development of the Principles by 2016.<sup>4</sup> The ESMA Final Report also included input from ESMA's Securities and Markets Stakeholder Group.<sup>5</sup>

After a set of draft provisions were outlined by the Chair based on these expectations, the Committee refined and improved this first draft in its meetings. Some provisions were subject to intense discussion within the Committee, which took account of stakeholders' expectations as well as the working practices and operational necessities of the industry.

In order to ensure the workability and practicability of the Principles and at the same time inform market participants and the public about the progress made, the Committee undertook a public consultation on the draft Principles (a summary of the feedback provided to this consultation is annexed to this report).<sup>6</sup>

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<sup>3</sup> See ESMA, *Final Report and Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry*, ESMA/2013/84 (2013), available at <http://www.esma.europa.eu/system/files/2013-84.pdf>.

<sup>4</sup> See ESMA, *Final Report*, *supra* note 3, p. 3 ("ESMA will review the development around the Code of Conduct by two years after the publication of this Final Report and may reconsider its position if no substantial progress has been made by that time").

<sup>5</sup> Securities and Markets Stakeholder Group ("SMSG"), *ESMA's Discussion Paper on Proxy Advisors – Opinion of the SMSG*, ESMA/2012/SMSG/25 (2012), available at <http://www.esma.europa.eu/system/files/2012-smsg-25.pdf>.

<sup>6</sup> For the Principles consultation paper, see Annex II. For the Feedback Report to the Principles consultation, see Annex III. For the non-confidential responses, see [http://bppgrp.info/?page\\_id=111](http://bppgrp.info/?page_id=111).

### 3 Discussion Items

This section provides an overview on the discussions surrounding the items that were most debated during the drafting of the Principles.

While the decisions on each of the items were taken by the Committee members, the independent Chair took care to ensure the transparency of the process and asked for a detailed reasoning for each decision taken by the Committee. This report makes these reasons available to the public.<sup>7</sup>

#### 3.1 Scope<sup>8</sup>

One of the most difficult questions discussed by the Committee was the scope of the Principles.

There is not a legal definition of ‘proxy advice’ on which the Committee could rely; official documents describe the function of ‘proxy advisers,’<sup>9</sup> but these definitions are unclear at the margin.

The lack of clarity is due to the diversity and complexity of the industry:

- The term ‘proxy advice’ used by ESMA, i.e. giving advice or making recommendations, does not apply to all members of the Committee.
- In particular, some Committee members do not provide advice that tells investors what to do, but instead issue reports on topics predetermined by clients.
- The variety of the industry renders it difficult to determine who is subject to the Principles and who is not. For example, some Committee members deliver raw data on governance issues to third-party service providers that add their own data to the former and thereby create new services. The Committee took the view that all links in the knowledge chain that intellectually contribute to the

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<sup>7</sup> Note that the following statements do not necessarily reflect the view of each of the Committee members.

<sup>8</sup> See the Principles, *supra* note 2, p. 9, *Scope & Definitions*.

<sup>9</sup> See ESMA, *Discussion Paper: An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Options*, ESMA/2012/212 (2012), available at <http://www.esma.europa.eu/system/files/2012-212.pdf>, p. 7 (“These are firms that analyse the resolutions presented at the general meetings of listed companies in order to submit voting advice or recommendations on these resolutions to their clients.”);

research report with the aim of helping investors make informed voting decisions should be subjected to the Principles.

- The format and presentation of the research process varies; some industry members issue company-specific reports, others provide the same content to clients in the form of newsletters, email alerts or corporate governance ratings. The Committee took the view that the form in which the research results are provided is irrelevant for the scope of the Principles.
- The ideology underlying the research varies, from shareholder-value orientation to social, environmental and governance (ESG), or from international to regional standards. The Committee decided that these considerations do not influence the scope of the Principles. To the contrary, the more diversity there is on the supply side, the more it can be ensured that investors' views are reflected in the voting decision.
- Investors can assign voting research and analysis to signatories to the Principles ('Signatories') that come closest to their own views, thus furthering efficiency in the market for voting research and analysis.
- The research methodology varies. Some industry members rely to a large extent on governance models and quantitative approaches, while others emphasize qualitative factors and personal judgement. Other industry members will use a blended approach.
- Some industry members work under specific direction provided by clients as to how to treat certain agenda items (custom voting policies), while others develop their own view on agenda items in so-called 'house' voting policies. Some will work under both frameworks.
- The regional scope of clients and services varies. Some industry members deliver services on stocks listed worldwide and serve clients from all jurisdictions, while other industry members focus on certain jurisdictions or cooperate with other industry members with regard to other jurisdictions.
- Clients use the services differently. Some clients primarily use the services as a research tool to form their own decisions. Other clients, in particular institutional clients with smaller holdings,<sup>10</sup> may rely on the industry's services

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<sup>10</sup> See Institutional Investor Committee ("IIC"), *Investors' Use of Proxy Advisory Research: The view of the UK Institutional Investor Committee* (2014), available at [http://www.iicomm.org/docs/Investors\\_Use\\_Of\\_Proxy\\_Advisory\\_Services\\_IIC.pdf](http://www.iicomm.org/docs/Investors_Use_Of_Proxy_Advisory_Services_IIC.pdf), p. 2.

to a greater extent and conduct reviews of the services provided. Moreover, some clients rely on the services provided by multiple industry members simultaneously<sup>11</sup> and make their own voting decisions based on a careful consideration of: (i) their own internal research and engagement with companies; (ii) the reports of all of these providers; and (iii) other data available to them.

- Some industry members provide a number of additional services together with their core service. These services include:
  - Vote agency (i.e., assisting the investor to transmit votes to the meeting, in particular in cross-border settings);<sup>12</sup>
  - Proxy voting services (i.e., voting as proxy on behalf of clients physically at the meeting);
  - Engagement services (i.e., communicating with issuers to ensure that the interests identified by investors or the industry members are adequately addressed by the issuers' management);<sup>13</sup> and,
  - Governance consultancy to issuers and investors, including, for example, the identification of governance-related risk factors.
- However, no industry member engages in 'proxy solicitation', be it on behalf of issuers or shareholder proponents. Furthermore, a permanent voting coalition with a particular group of shareholders or issuers would be deemed not in line with the Principles, as this would create an undue bias on the part the Signatory.
- The charging model varies. Some Signatories charge clients flat fees, while others charge per meeting or per report. In some cases, the flat fee includes other services provided to clients, such as vote agency and shareholder engagement. In other cases, Signatories generate income from other sources

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<sup>11</sup> E.g. 38% of institutional investors do that, see IIC, *Investors' Use of Proxy Advisory Research*, *supra* note 10, p. 2.

<sup>12</sup> See the Principles, *supra* note 2, p. 10, *Vote Agency*.

<sup>13</sup> See the Principles, *supra* note 2, p. 10, *Engagement & Governance Overlay Services*.

than the investors (such as voting platform providers, newsletter providers or securities brokers).

For these reasons, the Committee looked for an all-encompassing, neutral term or definition that covers all provided services. The Committee determined that the core function of their services is an intellectual contribution to investors' voting decisions at shareholder meetings. In its first draft, a wider set of concerns – all corporate governance issues – were considered and hence the first draft related to 'governance research'.

The consultation feedback, however, revealed that this all-compassing approach created confusion.<sup>14</sup> The Committee therefore reviewed its initial approach and excluded a number of services that some respondents had understood to be within the Principles' scope, when that had not been the Committee's intention.<sup>15</sup> In particular, it was clarified that credit rating agencies, as well as asset managers and asset owners conducting research for their own use, were not within the scope. Further, the Committee clarified that shareholder voting research and analysis may include services relating to ESG issues. 'Governance research' was therefore amended to 'shareholder voting research and analysis.'

With these amendments, the Committee ensured the scope of the Principles is more closely aligned with the scope initially set out in the *ESMA Final Report*.

Moreover, it was highlighted that in all cases of voting analysis, advice or recommendations, investor interests are paramount. A fair representation of investor interests is, therefore, the guiding rationale throughout the Principles.

### **3.2 General Approach**

The Committee decided in favour of a structure of the Principles that reflects the main concerns expressed in the *ESMA Final Report*, in particular the three areas that have been at the heart of the policy discussion surrounding the industry:

(i) Quality of service;

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<sup>14</sup> Accordingly, the Committee determined the Principles should apply to "Governance Research Providers".

<sup>15</sup> See the Principles, *supra* note 2, p. 9, *Scope & Definitions*.

(ii) Conflicts of interests; and,

(iii) Communication with issuers and the public.

Within this structure, the Committee ensured that each of the concerns was addressed with appropriate care.

Another main objective was to enhance transparency and understanding of the industry and its services. The Committee thus decided in favour of a 'Comply-or-Explain' disclosure approach. On each of the three main items – quality of service, conflicts of interest and communication with non-clients – Signatories must describe their own approach toward research methodologies, conflicts of interest and communication policy, and disclose related policies on their websites.

While some respondents to the consultation demanded non-discretionary rules of conduct, the Committee perceived such a uniform application of the Principles across the industry as undesirable, as it would interfere with a pro-competition approach to the provision of services. In contrast, a certain level of flexibility supports innovation and value creation.

However, certain key rationales of the Principles are not subject to Signatory discretion. This applies in particular to the Signatories' core commitments:

- Signatories assist investors in exercising their rights and, as such, investor interests must be paramount at all times;<sup>16</sup>
- Proxy solicitation for any specific industry grouping or shareholder proponent is not in line with industry best practice;<sup>17</sup> and,
- Signatories must have public policies regarding their research methodologies; disclosure and management of conflicts of interest; and communication with parties other than clients, in which they explain their approach to the Principles and Guidance provided in the Principles.<sup>18</sup>

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<sup>16</sup> See e.g. the Principles, *supra* note 2, p. 12, *Principle One: Service Quality*.

<sup>17</sup> See the Principles, *supra* note 2, p.9, *Shareholder Voting Research & Analysis*.

<sup>18</sup> See the Principles, *supra* note 2, p. 11, *The Best Practice Principles* ("Signatories provide services that are delivered in accordance with agreed client specifications").



### 3.3 Delineating Responsibilities<sup>19</sup>

Another concern aired in the policy discussion related to the perception of the alleged “undue” influence the industry has on voting outcomes.<sup>20</sup> After in-depth discussion, the Committee determined that it could not give a conclusive answer as to how much influence the industry as a whole or individual members have on voting outcomes, due to the different use of information by clients and how the wider market can report or comment on shareholder matters.<sup>21</sup>

For example: Investors may have their own custom policies; as such, it is not the Signatory who is influential. If investors make their own voting decisions by simultaneously using input from multiple industry members (on either a custom or house policy basis) and additional own research, as many investors do, should the voting outcome be deemed influenced by the industry? If raw data is provided to third-party service providers which then add their own data or opinions before issuing voting advice to their clients, should the influence be assigned to the provider of the raw data or the aggregating service provider? How should the fact that some clients exercise due care and cautious judgement before voting,<sup>22</sup> while others may, on an occasional basis, accept the voting advice after a brief review or without further scrutiny be factored in?<sup>23</sup>

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<sup>19</sup> See the Principles, *supra* note 2, p. 8 -9, *Introduction to the Principles*.

<sup>20</sup> See, for example, Cindy R. Alexander; Mark A. Chen; Duane J. Seppi & Chester S. Spatt, *Interim News and the Role of Proxy Voting Advice*, 23 *The Review of Financial Studies*, No. 12 (2010), or Tamara C. Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 *Stan. J.L. Bus. & Fin.* 384 (2009), Yonca Ertimur, Fabrizio Ferri & David Oesch, *Shareholder Votes and Proxy Advisors: Evidence from Say on Pay*, 51 *Journal of Accounting Research*, Nr. 5, 951–996 (2013).

<sup>21</sup> See, also, IIC, *Investors' Use of Proxy Advisory Research*, *supra* note 10, p. 2 (stating that “[n]ot a single respondent to the IMA’s 2013 survey indicated that they always follow the recommendations of their proxy advisory service.”); Ahern, Kenneth R. & Sosyura, Denis, *Rumor Has It: Sensationalism in Financial Media*, (2014), available at SSRN: <http://ssrn.com/abstract=2264468> or <http://dx.doi.org/10.2139/ssrn.2264468>.

<sup>22</sup> E.g., Ninety percent of Association of British Insurers (ABI) members state that their vote decision-making process involves active participation by portfolio managers or investment analysts, see IIC, *Investors' Use of Proxy Advisory Research*, *supra* note 10, p. 2.

<sup>23</sup> Signatories do not have complete information on the clients’ thought processes or internal procedures. Although some signatories can identify which research reports have been opened, they are unable to identify in which cases clients have voted in line with Signatories’ research without further analysis and in which cases the recommendations were subject to further review prior to confirming the vote intention.

The Committee concluded that, as correlation cannot be deemed to be causation, if investors exercise their own independent judgement, consistency between voting advice and voting outcome is, to a great extent, evidence that the research and analysis is in line with investor requirements and interests rather than evidence of undue influence on the part of Signatories. Accordingly, it is a core assumption of the Principles that investors comply with the standards of care as provided for in legislation and best-practice codes of conduct<sup>24</sup> for institutional investors.

It is not the function of the Principles to second-guess or correct the level of compliance exercised by institutional investors, nor has the Committee the power to impose additional duties and obligations upon their clients.<sup>25</sup> However, Signatories recognise that institutional investors may be subject to disclosure requirements of the use made, if any, of shareholder voting research and analysis services. Signatories should be willing to assist their clients with respect to their own disclosure requirements on the discharge of their stewardship responsibilities.

### 3.4 Local Standards<sup>26</sup>

The adherence to local standards has, in the eyes of the Committee, several dimensions.

First, there are the **mandatory laws and listing rules**. All Signatories recognise that they, as well as issuers, are subject to the minimum standards of conduct set forth by such laws and rules.<sup>27</sup>

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<sup>24</sup> See, for example, Financial Reporting Council (“FRC”), *The UK Stewardship Code (2012)*, available at <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf>.

<sup>25</sup> See the Principles, *supra* note 2, p. 8 -9, *Introduction to the Principles*.

<sup>26</sup> See the Principles, *supra* note 2, p. 11, *Principle One: Service Quality*.

<sup>27</sup> See the Principles, *supra* note 2, p. 9, “Nothing in these Principles is a substitute for adherence to relevant laws and market regulations”.

Second, there are the **recommended standards or best practice principles** set by local standard setters. These standards may or may not reflect investors' interests. If investors have determined how to deal with local standards and request custom-tailored explicit guidance from Signatories on how to treat local standards (as they usually do with custom-voting policies), it is not within the Signatories' discretion to decide in favour or against the clients' preferences (may they be in line with local standards or not). If shareholders intend to vote in line with local standards, they are free to do so and direct the Signatories accordingly.

Signatories have discretion on how to treat local standards only within their house voting policies, i.e. when clients do not provide specific directions as to how to treat certain agenda items. Some service providers have such a house voting policy, while others act on client specifications, i.e. custom voting policies. Some Signatories develop country-specific guidelines as soon as the number of stocks covered in any one country exceeds a minimum threshold, others always use country-specific guidelines. These country-specific guidelines then reflect the specific situation in each country.

Divergence between local standards and the country-specific guidelines of a Signatory does exist and, in the eyes of the Committee, should exist. The discretion to vote against local standards forms an integral part of the services Signatories offer to their clients because this is what investors request. The reasons for divergence may reflect the difference between local standards and international corporate governance standards, for example the ICGN guidelines<sup>28</sup> or OECD principles<sup>29</sup>, or may be necessary to protect or enhance investors' rights in that respective country.

Nevertheless, local standards have an impact on the research methodology. In particular, even if a Signatory's country-specific guidelines are not in line with the local standard, the local standard raises the standard of care to be applied by the Signatories.<sup>30</sup> Diverging from local standards without recognition or a contextual

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<sup>28</sup> E.g. International Corporate Governance Network ("ICGN"), *ICGN Global Corporate Governance Principles* (2009), available at [https://www.icgn.org/images/ICGN/files/icgn\\_main/Publications/best\\_practice/global\\_principles/ICGN\\_Global\\_Corporate\\_Governance\\_Principles\\_2009\\_July\\_2013\\_re-print.pdf](https://www.icgn.org/images/ICGN/files/icgn_main/Publications/best_practice/global_principles/ICGN_Global_Corporate_Governance_Principles_2009_July_2013_re-print.pdf).

<sup>29</sup> Organisation for Economic Co-operation and Development ("OECD"), *OECD Principles of Corporate Governance* (2004), available at <http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf>.

explanation is not considered best practice. However, if Signatories develop their own view on certain local standards based on a consistent methodology that reflect client interests, Signatories reserve the right to deviate from local standards.<sup>31</sup>

### 3.5 Conflicts of Interest<sup>32</sup>

One of the key concerns raised by respondents to the consultation is the problem of conflicts of interest and, in particular, the practice of some industry members to serve issuers and clients simultaneously.

The Committee discussed the option of banning this practice but could not identify a legal basis for such a prohibition. Under the comply-or-explain approach, Signatories could still deviate from such a requirement and consequently these practices would persist. Instead, the Committee decided to require particular scrutiny and care in identifying and mitigating the harmful effects of potential and actual conflicts of interest.

While some respondents said the Principles should require conflicts to be disclosed on Signatories' websites, such disclosures could exacerbate the conflicts-of-interest risk. This is because a Signatory's staff learning about business relations may cause the staff to adjust their behaviour to the detriment of the Signatory's research neutrality. Instead, the Committee opted in favour of an organisational and client-oriented approach.<sup>33</sup>

First, Signatories should organise their firms with special regard to potential conflicts and implement measures to mitigate such conflicts, such as information barriers.

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<sup>30</sup> It is the Committee's view that guidelines that do not take into account local standards are not in line with adequate research principles, if the industry member is *not aware of the local standards* due to a lack of expertise for this country or if the industry member cannot account for the deviation of the guidelines from the standards by reference to international standards or investors' interest. 'Blind' disregard of local standards is deemed not in line with these Principles.

<sup>31</sup> See the Principles, *supra* note 2, p. 13, *Research Methodology* ("Signatories should have and disclose a written research methodology that comprises the following essential features:[...] The extent to which local conditions and customs are taken into account").

<sup>32</sup> See the Principles, *supra* note 2, p. 16, *Principle Two: Conflicts-of-Interest Management*.

<sup>33</sup> See the Principles, *supra* note 2, p. 16, 17, *Conflicts-of-Interest Policy, Conflict Management & Mitigation*.

Second, the fact that a Signatory advises investors and issuers simultaneously should be publicly disclosed.<sup>34</sup>

Based on this disclosure, investor clients can make an informed decision to either rely on the research on issuers that are the subject of a Signatory's voting research and analysis or opt to refrain from taking research in cases where a potential conflict exists. With or without specific arrangements, such conflicts should be disclosed at the latest at the same time the research report is sent to investor clients.

#### **4 Communication with issuers**<sup>35</sup>

One of the most intensely discussed topics inside and outside the Committee relates to communication between Signatories and issuers. Communication practices differ widely within the industry.

##### **4.1 Issuer – Signatory Relations**

Issuer-Signatory relations take two primary forms:

- Mutual communication regarding Signatory policies and views on governance matters specific to a company. For example, Signatories discuss their policies and -- possibly -- specific concerns regarding governance matters at the issuer, while issuers explain their rationales for supporting directors, a specific remuneration policy, and other governance matters. This communication typically (and preferably) happens outside the 'convocation' period after the meeting agenda is released.
- Communication of alleged factual errors and omissions in a Signatory's research reports by an issuer or its advisors to a Signatory. This notification to the Signatory by the issuer/issuer advisor could result in a) a public follow-up disclosure by the issuer to clarify something that was not well communicated, b) a correction to the research by the Signatory; or c) nothing at all. This communication happens following the distribution of research reports and throughout the year following, whenever an alleged factual error is identified.

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<sup>34</sup> See the Principles, *supra* note 2, p. 16, *Conflicts-of-Interest Policy* ("Signatories should have and disclose a conflicts-of-interest policy that explains: The existence of potential material conflicts; ...").

<sup>35</sup> See the Principles, *supra* note 2, p. 18, *Dialogue with Issuers, Shareholder Proponents & Other Stakeholders*.

Both types of communication with issuers may, under certain circumstances, foster better understanding on the part of Signatories of the governance structures/activities of issuers and, on the part of the issuers, of the policies and relevant factors used by Signatories in evaluating those structures. In particular, the latter allows issuers to correct alleged factual errors in their agenda or provide required, expected or supplementary items in the corporate documentation. These benefits must be weighed against a number of downsides.

First, any obligation to communicate with issuers and/or shareholder proponents creates the risk of Signatories getting unduly influenced to the detriment of their clients. In particular, investors (the clients of the Signatories) expressed concerns during the consultation that issuers could unduly influence industry members, especially during the convocation period; this would reduce the value of the Signatories' services for investors and create additional costs on the side of investors.<sup>36</sup>

Second, during the proxy season, a number of legal concerns render communication between Signatories and issuers difficult. In particular, any additional information provided by the issuer to one or more Signatories must be scrutinised in light of laws against insider trading and market abuse while issuers must take into account company law provisions on equal treatment of shareholders.

Third, communication is not a purpose in itself but imposes costs on Signatories. In order to justify these additional costs, communication should enhance the quality of services provided to clients.<sup>37</sup> The Chair emphasizes that any obligation to communicate with issuers and/or shareholder proponents would impose fixed costs that are particularly severe for small service providers and may even force some of them to stop offering their services. Any additional fixed costs create a barrier to entry for new entrants and would inhibit competition in the market for shareholder voting

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<sup>36</sup> See Feedback Report, p. 24, 26.

<sup>37</sup> The Chair notes that from the service providers' point of view an issuer's improved understanding of the Signatories' approaches – which are closely aligned with and thus reflect the view of most investors – is a mere byproduct of their services provided to their clients, though a very valuable one for corporate governance. In essence, this creates a positive externality of the services provided to clients, as the social benefits generated by the Signatories' services in promoting better corporate governance may exceed the Signatories' private benefits (as measured by the Signatories' fees).

research and analysis. Both the risks and the costs are particularly significant in the convocation period.

While all Committee members agree that good relations between issuers and Signatories are desirable, the Committee's view was unanimous that the time between the convocation of the meeting and the general meeting of shareholders is typically not an appropriate time to discuss policies and governance matters with issuers.<sup>38</sup> As a general principle, it is best practice to communicate with issuers and shareholder proponents about policies and governance matters prior to the release of the meeting agenda. Communication should be ongoing throughout the year, with the exception of the 'proxy season.' This limitation does not extend to communication regarding alleged factual errors or omissions (which may happen on both sides – Signatories and issuers).

#### **4.2 Distribution of Reports**

The Committee is particularly concerned with demands to publish their research reports, or – which often comes to the same result – to forward their reports to other interested parties that do not license their services, including issuers and/or shareholder proponents and their advisors, such as lawyers, corporate governance consultants and proxy solicitors (hereafter collectively referred to as 'Interested Parties'). The Committee is unanimous in rejecting any obligation to provide Interested Parties with free access to research results before or at the same time as distribution to their clients. In addition to the arguments discussed above for and against communication, three reasons are particularly relevant when discussing the mandatory distribution of research reports.

First, as pointed out above, communication is justified if the benefits exceed the costs. According to the experience of those Signatories that communicate with issuers, a vast majority of the issuers' remarks and comments (estimated at more than 90 percent) concern the opinion derived from the facts, rather than the facts underlying the opinion. Thus, in those instances, providing an advance review of reports is an inappropriate device to enhance the "reliability" of reports or the quality

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<sup>38</sup> Some Committee members infer that there may be instances where dialogue is appropriate during the convocation period, for example when analysing a contested agenda item, or when a company released additional information during the convocation period that needs clarification.

of service in general, but again raises concerns with respect to the most important asset of the service provider: its commitment to represent investor interests.

Second, the reports contain intellectual property created by the Signatories that is derived from an extensive body of knowledge in the field of corporate governance collected over many years and over multiple countries and issuers. The Committee was informed about cases in which reports provided to issuers on a confidential basis were leaked to the press or the issuers' own paid corporate governance consultants. Such misconduct undermines the business models of Signatories that heavily invest in knowledge creation and information processing.

The Committee members emphasize that Signatories are private businesses – in contrast to public utilities – that write research reports and personal recommendations based on publicly-available information and provide them to their clients on a commercial basis. The delivery of this research and management of that delivery are cost-intensive activities. To the same extent as the expert opinions of lawyers, accountants, investment advisers and other consultants are not presented to parties that are not clients, mandatory access to Signatory research would infringe on Signatories' intellectual property and reduce the incentives to invest in knowledge creation. Consequently, mandatory access to research report would *reduce* the overall service quality of shareholder voting research and analysis.

Accordingly, while no Committee member allows for a preview by interested parties, the Committee deems all of the following procedures in line with best practice:

- Making reports, if based on a house voting policy, available to issuers at the same time they are available to investor clients, either for free or for a fee;
- Selling reports to advisors of interested parties, such as law firms, governance consultants and proxy solicitors;

Signatories that provide services exclusively on a custom voting-policy basis find little use in discussing whether their clients' preferences are in line with issuer expectations; indeed, such communication could be in violation of client



confidentiality agreements. Consequently, they refrain from distributing their reports to Interested Parties at all.<sup>39</sup>

### 4.3 Communication Policy

It is clear from the above that approaches to communication are highly provider-specific. Building on the principle of proportionality and adequacy, Signatories should be left to explain their own approach to communication. Signatories should set out in their communication policy how issuers may approach them to discuss their methodology, its application in specific cases, or report alleged factual errors. As the size and organization of Signatories varies, the Principles only require that such a communication policy should exist; it does not stipulate how such communication should take place. In particular, small Signatories can establish non-formal means of communication or provide a mere contact point for issuers and shareholder proponents for communication.

The requirement that Signatories should disclose their voting policy, if they have a house policy,<sup>40</sup> also furthers communication. As part of this, Signatories should set out their approach to reviewing their voting policies. Some Signatories may invite institutional investors, issuers, academics and other stakeholders to discuss their methodology at conferences, either virtual or in person, prior to the proxy season. Others, in particular smaller Signatories, may focus on feedback mechanisms and ensure the accuracy of their methodology by less costly means, such as relying on a literature survey on corporate governance and/or expert reviews.

Despite the requirement to have a communication policy, the Committee acknowledges that circumstances do exist in which Signatories' denying communication altogether is in line with best practice. In particular, if clients explicitly request that their service provider does not communicate with interested parties, doing so would violate contractual obligations. Moreover, if a research approach focuses on publicly accessible quantitative data,<sup>41</sup> communication with issuers that

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<sup>39</sup> "It is for signatories to choose whether or not to engage in dialogue and in what format" see the Principles, p. 18, *Dialogue with Issuers, Shareholder Proponents & Other Stakeholders*.

<sup>40</sup> The point in time when Signatories disclose their policies is strongly influenced by their clients' input.

<sup>41</sup> Note that director elections, advisory votes on remuneration (also called "say-on-pay" votes) and shareholder proposals, among other matters, also require the analysis of qualitative data.

leads to qualitative data only would be meritless. Nevertheless, the Committee is of the opinion that Signatories should have a communication policy that allows, at a minimum, the possibility to bring alleged factual errors and inconsistencies to the Signatory's attention (note that Signatories are open to discuss alleged inconsistencies with regard to their research methodology outside of the convocation period).

#### **4.4 Competition Considerations**

On several occasions, the Committee discussed the impact of the Principles on competition within the industry.<sup>42</sup> All industry participants are aware of the economies of scale that form part of the industry background; these are the same as the factors that create concentration in other information markets, such as for rating agencies or news agencies.

Other than ensuring these Principles do not impact on EU competition law, in particular, the Principles have not been drafted with a view to changing the competitive environment. Since ESMA did not address competition issues in the Final Report, the Committee decided not to cover such issues either.

### **5 Ensuring Compliance**

#### **5.1 Comply or Explain<sup>43</sup>**

As with many other industry codes, the Principles and accompanying Guidance operate on a comply-or-explain<sup>44</sup> basis. Consequently, Signatories should observe both the Principles and the related Guidance.

The Principles require Signatories to disclose their compliance statements and policies in one or more documents.

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<sup>42</sup> See the statement by the Securities and Markets Stakeholder Group (SMSG), in *Final Report*, *supra* note 3, Annex II, p. 32 ("To ensure a proper understanding of national law and the local environment and to ensure efficient competition, it is important to enable new and small local PAs to enter the market").

<sup>43</sup> See the Principles, *supra* note 2, p. 7, *Comply or Explain*.

<sup>44</sup> See the Principles, *supra* note 2, p. 7, *Comply or Explain*.

Signatories that intend to deviate from the Principles or Guidance are expected to explain their motives and reasons. Thus, albeit not providing a strict framework of “do’s and don’ts”, the Principles ask Signatories to inform market participants by way of disclosure that clearly articulates the reasons for non-compliance as well as any relevant alternative approaches.<sup>45</sup>

## 5.2 Compliance Review

Given that the Committee is not a standing organisation, such as those representing investors’ or issuers’ interests, the Committee discussed extensively how to ensure compliance with the Principles on an ongoing basis.

Two models of compliance were reviewed: the private enforcement model and the public enforcement model.

Under a private enforcement model, an industry-led organisation monitors the Signatories’ compliance and discloses statements of compliance to the industry body and/or market participants.

Under the public model, a government-sponsored organisation takes on the compliance review.

However, the Committee determined that the main disadvantage of the private model is that there is not a specific standing review body which covers the industry. Furthermore, its creation would prompt major discussions regarding representation of stakeholders, conflicts of interests of the review body’s members, the funding of the review body and the type of organisation that would be responsible for ensuring compliance.

In the search for a straightforward, efficient, transparent and reputable long-term solution, the Committee members preferred to adopt a public-accountability model. The public model, however, faces challenges.

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<sup>45</sup> See the Principles, *supra* note 2, p. 7, *Comply or Explain* (“Signatories that choose not to comply with one of the Principles, or not to follow the Guidance, should deliver meaningful, relevant and detailed explanations that enable the reader to understand their approach”).

Although the initial recommendation for the industry to self-regulate came from ESMA, the Committee believes that the Principles create value for worldwide market participants and the Principles' scope should not be limited to the EU/EEA.

Moreover, the Committee discussed requesting ESMA to monitor compliance with the Principles but a number of barriers came to mind, namely that, for a variety of legal reasons, ESMA does not have jurisdiction to supervise the compliance with the Principles and therefore would have no means of enforcement. A separate consideration was that linking the enforcement to one public institution could limit the Principles' geographic scope.

The Committee thus opted for a mixed model with four monitoring steps.

1. Following completion of the drafting, consultation and finalisation of the Principles, the Signatories will, in a first instance, prepare their necessary disclosures. Signatories will be asked to support the Committee to facilitate compliance monitoring. In particular, each Signatory will provide their disclosures in a format to allow for a comparison that shows if and how each Signatory has implemented the Principles and its related Guidance. The comparison will be disclosed on the Committee's website so that other stakeholders can review the implementation.
2. A feedback mechanism regarding the application of the Principles will be provided on the Committee's website. If a stakeholder believes that a Signatory has insufficiently implemented one of the Principles or the related Guidance, it may inform the Committee using the feedback mechanism. While the Committee has not decided on the procedures regarding the feedback mechanism, the Chair is of the view that the Committee can decide to make a stakeholder's grievance public together with a statement of disapproval regarding the Signatory's non-compliance, while granting the respective Signatory the right to respond.<sup>46</sup>

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<sup>46</sup> The Chair emphasizes that a 'name and shame' mechanism (that enables a stakeholder to publish a public statement alleging non-compliance of the Principles by a Signatory) would be difficult to implement in the context of a voluntary-code framework, if that framework is not managed by a standing industry organization with the resources to address legal or liability issues that would arise. These issues include: the respective Signatory's right to appeal or respond to the publication of statement alleging non-compliance; an oversight body's or court's standing to intervene; the right of a Signatory to sue for damages in the case of unjustified statements of non-compliance; and insurance protection for Committee members in the latter case. Note that all of these

For competition reasons, the Committee members cannot comment on individual company research reports prepared by another Signatory. Complaints regarding the content of individual company research reports should therefore be directed to the relevant Signatory using their feedback mechanism.

3. In September 2014, the Committee will reconvene to address the ongoing governance of the Principles, including (but not limited to) monitoring, enforcement, complaints and periodic review by public consultation. The Committee has determined that it will consider all appropriate measures to address the good governance and integrity of the industry as a whole.
4. ESMA will perform a separate review of the implementation of the Principles, including their monitoring by the Committee, at the beginning of 2016.

## **6 Next Steps**

This first (2014) edition of the Principles marks an end and a beginning. The drafting period ends and the working period of the Principles begins. Industry codes such as the Principles should evolve over time. The Committee has scheduled a first review of the Principles for September 2014. During that meeting, the members of the Committee will discuss the implementation of the Principles as well as further improvements to the Principles in light of their own experience as well as their clients' or issuers' feedback on the impact of the Principles.

Two years from now – in spring 2016 – ESMA will review the effects of the Principles and assess whether they have adequately addressed its concerns. Should this not be the case, ESMA may proceed with more formal measures.

As agreed at the beginning of the drafting process, my assignment ends with the finalisation and publication of the Principles. I sincerely hope that the Principles will achieve their purpose in enhancing transparency and mitigating conflicts of interests. I thank all members of the Committee for their contributions, ESMA for its logistical

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particularities rest on jurisdictional and cost matters that do not lay in the hands of the Signatories alone. These matters could provide immovable barriers to a name-and-shame mechanism altogether.

support, Christina Preiner for her assistance during the consultation and reporting period, and all respondents to the consultations for their submissions.



Dirk Zetzsche

Düsseldorf (Germany) and Vaduz (Liechtenstein)

Annex I: Best Practice Principles for Shareholder Voting Research & Analysis

Annex II: Consultation Document and First Draft of Principles

Annex III: Feedback Summary on the Consultation

Report of the  
Chairman

# Annex I

Best Practice Principles for  
Shareholder Voting Research  
& Analysis

# Best Practice Principles

for Providers of Shareholder Voting Research & Analysis



Developed By:

The Best Practice Principles Group

Under the Chairmanship of Dr. Zetsche

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## Part One: Introduction

### ESMA's Call for Industry Self-Regulation

Over the course of 2011, the European Securities and Markets Authority ("ESMA") collected evidence from a variety of stakeholder groups with a view to understanding the state and structure of the market for shareholder voting research, suppliers' methodologies and on possible European policy options. In March 2012, ESMA published a consultation paper: 'An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Options'<sup>1</sup>, seeking further input from market participants.

In the 'ESMA Final Report and Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry' ("ESMA Final Report"), published 19 February 2013, ESMA concluded that:

*"(I)t has not been provided with clear evidence of market failure in relation to how proxy advisors interact with investors and issuers. On this basis, ESMA currently considers that the introduction of binding measures would not be justified. However, based on its analysis and the inputs from market participants, ESMA considers that there are several areas, in particular relating to transparency and disclosure, where a coordinated effort of the proxy advisory industry would foster greater understanding and assurance among other stakeholders in terms of what these can rightfully expect from proxy advisors. Such understanding and assurance will help to keep attention focused where it belongs, namely on how investors and issuers can, from their respective roles foster effective stewardship and robust corporate governance, and ensure efficient markets. Consequently, ESMA considers that the appropriate approach to be taken at this point in time is to encourage the proxy advisory industry to develop its own Code of Conduct."<sup>2</sup>*

Following publication of the ESMA Final Report, a number of industry members formed the Best Practice Principles Group ("BPPG") to develop a set of Best Practice Principles for Providers of Shareholder Voting Research & Analysis ("Principles"), which signatories to the Principles ("signatories") should adopt on a comply-or-explain basis.

The Principles are designed to help clients and stakeholders understand:

- The nature and character of shareholder voting research and analysis services;
- The standards of conduct that underpin those services; and,
- How signatories to the Principles interact with other market participants.

The Principles are intended to complement applicable legislation, regulation and other soft-law instruments.

The BPPG comprises the following members:

- [Glass, Lewis & Co.](#)
- [Institutional Shareholder Services Inc.](#)
- [IVOX GmbH](#)
- [Manifest Information Services Ltd](#)
- [PIRC Ltd](#)
- [Proxinvest](#)

<sup>1</sup> [ESMA 2012 Discussion Paper - An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Options.](#)

<sup>2</sup> ESMA recommends EU Code of Conduct for proxy advisor industry: ([Page 3 of the final report](#)).

The BPPG is led by an independent chairman, Prof. Dr. Dirk Andreas Zetzsche, LL.M. (Toronto), who is a professor of law and holds the Propter Homines Chair for Banking and Securities Law at the University of Liechtenstein. He is also one of the directors of the Center for Business and Corporate Law at Heinrich Heine University in Düsseldorf

Prof. Zetzsche was selected by the BPPG after a public call for interest in the post and is independent from both the BPPG and ESMA. Prof. Zetzsche has no industry affiliations but extensive practical and academic experience with both shareholder voting and institutional investments.

Whilst ESMA provided Prof. Zetzsche with logistical support, including granting him a daily allowance of 150 EUR per meeting attended and reimbursing his travel and accommodation costs in connection with meetings, ESMA was not involved in the drafting of the Principles. Prof. Zetzsche undertook the role of BPPG Chair because of his interest in shareholder stewardship and fostering transparency of the voting process. While the Chair fulfilled an advisory and coordinating function, he did not interfere with the fundamental decisions with regard to the Principles; these decisions were made exclusively by the industry members of the BPPG.

The BPPG operates an independent website (<http://bppgrp.info>) which is a central location for copies of the Principles together with any consultation-related materials.



## Public Consultation 2013

To refine the Principles and finalise the publication process, the BPPG sought feedback from potential signatories, institutional investors, issuers and other stakeholders during Q4 2013<sup>3</sup>.

The BPPG received 46 responses to its consultation.

The BPPG reflected upon the responses to a variety of topical questions, including:

- How the Principles could improve communication with stakeholders;
- How stakeholders could better understand the way signatories operate and the services they provide;
- Views on the proposed key Principles and related Guidance; and,
- Views on the governance of the Principles including, the transparency of the process and possible further development of the initiative.

Following a detailed review of the feedback, a number of amendments were made to the initial draft proposals.

## Ongoing Monitoring

The BPPG will perform on-going monitoring of the implementation of the Principles and will review the Principles and Guidance no later than two years following their launch.

ESMA will perform a separate review of the implementation of the Principles and their monitoring by the BPPG at the beginning of 2016.



The following pages reflect the results of the feedback and consultation process.

<sup>3</sup> [BPPGRP Consultation Responses](#)

## Part Two: The Best Practice Principles

### Background

The charter signatories (see [Appendix 1](#)) of the Best Practice Principles for Shareholder Voting Research & Analysis Providers (“Principles”) have prepared and adopted the following Principles in relation to their services associated with the provision of shareholder voting research and analysis.

In addition to promoting the integrity and efficiency of processes and controls related to the provision of such services, the Principles are intended to foster greater understanding of the role of service providers in the voting decisions made by institutional investors (i.e., asset owners and fund managers).

New signatories beyond members of the BPPG are encouraged to adopt the Principles.

In developing the Principles, the BPPG drew upon on a number of publicly available sources, including but not limited to:

### Regulatory Consultation

- ESMA Final Report and Feedback Statement on the [Consultation Regarding the Role of the Proxy Advisory Industry](#) (19 February 2013)



### Investor Codes

- AFG: Recommendations de l'Association Française de Gestion (FR)
- BVI: Bundesverband Investment and Asset Management Rules of Good Conduct (DE)
- Code for Responsible Investing in South Africa (“CRISA”) (ZA)
- EFAMA: European Fund and Asset Management Association Code for External Governance (EU)
- Eumedion: Eumedion Best Practices for Engaged Ownership (NL)
- FRC: The UK Stewardship Code (September 2012), published by the Financial Reporting Council (UK)
- ICGN: International Corporate Governance Network Statement of Principles on Institutional Shareholder Responsibilities (Global)
- Lignes Directrices pour les Investisseurs Institutionnels (Economiesuisse and other Swiss organisations) (CH)
- OECD: Organisation for Economic and Co-operation and Development Principles of Corporate Governance (Global)
- PRI: Principles for Responsible Investment (Global)

## Financial Markets Participants

- AMF : Recommendation No 2011-06 of 18 March 2011 in respect of proxy voting agencies issued by the Autorités des Marchés Financiers (FR)
- CFA: Code of Ethics and Standards of Professional Conduct and Research Objectivity Standards (Global)
- IIA: Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing (Standards) 1300 Series Regarding Quality Assurance and Improvement Programs (Global)

## Comply or Explain

Not all Signatories offer the same services in the same way. For this reason, the Principles operate on a “comply-or-explain” framework. This enables each signatory to explain how the Principles relate to their specific circumstances and business model.

The Principles are therefore not a rigid set of rules; rather they consist of three main Principles and accompanying Guidance.

The **Principles** are the core of this document and the way in which they are applied should be the central question for each signatory as it determines how to operate according to the Principles.

The **Guidance** recommends how the Principles are applied.

Signatories that choose not to comply with one of the Principles, or not to follow the Guidance, should deliver meaningful, relevant and detailed explanations that enable the reader to understand their approach. The explanations should be substantiated and adapted to the signatory's particular situation and should convincingly indicate why a specific aspect justifies an exemption. The explanations provided should state what alternative provisions have been made, if applicable. If a signatory intends to comply at a later stage with a measure from which it has provisionally deviated, it should state when this temporary situation will come to an end.

## Application of the Principles

Signatories to the Principles should publish a link to their Statement of Compliance with the Best Practice Principles (“Statement”), via the [BPPG’s independent website](#).

If they so choose, signatories may wish to issue their statements via other publicly accessible sources.

Furthermore, ESMA has agreed to display on its website a list of entities that have advised ESMA that they are signatories to the Principles together with a link to [the independent BPPG website](#).

The Statement should:

- Describe in a meaningful way how signatories apply the Principles and related Guidance;
- Disclose any specific information set out 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.

Signatories should review their Statement from time to time (at least annually) and update it as appropriate to reflect current practice and material changes.

## Introduction to the Principles

Investors have a number of important ownership rights, one of which is the right to vote at company meetings. Voting is a key right of investors, whose effective discharge may also be a fiduciary responsibility.

As with many other parts of the investment process, investors need access to information and administration tools that support them in the discharge of their responsibilities.

Signatories provide a range of professional services designed to assist investors in the discharge of their rights and responsibilities. In the spirit of the comply-or-explain framework, the Principles set forth here are designed to facilitate transparency and assist signatories’ conduct in discharging their responsibilities toward clients.

These Principles have been developed with the following considerations in mind:

- The services are an efficient way of managing the logistical complexities associated with analysing and interpreting company disclosures, as well as ensuring and managing the operational aspects of shareholder voting.
- Clients may use one or more services that support and complement their own in-house research activities;
- Clients may, themselves, be subject to a variety of rules and regulations in relation to asset ownership and oversight;

- Signatories' underlying clients are responsible for their own compliance procedures;
- Signatories operate within the framework provided by applicable law, including those governing company law, contract law and client confidentiality, as well as securities laws associated with market abuse and insider trading; and,
- Nothing in these Principles is a substitute for adherence to relevant laws and market regulations.

*Irrespective of the type of services used to support ownership and voting activities, the ultimate responsibility to monitor investments and make voting decisions lies with investors; use of third-party services such as those provided by signatories does not shift this responsibility.*

*Stakeholders wishing to understand how an institutional investor discharges its stewardship or ownership responsibilities should consult relevant disclosures of the investor to understand its approach.*

## Scope & Definitions

To better understand the relevance and application of the Principles, it is important to understand the different types of services the signatories provide.

- The key objective of the signatories is to support institutional investors in the exercise of their ownership rights and responsibilities through the provision of value-added services.
- Services may be provided on a commercial, not-for-profit or membership basis.

## Shareholder Voting Research & Analysis

Signatories analyse the corporate disclosures of listed companies with a view to informing investors' voting decisions. Services include the provision of research, advice or voting recommendations, that relate specifically to the exercise of voting rights.

The services may exhibit one or more of the following characteristics:

- Data and analysis
- Company-specific research, advice or opinions
- ESG Ratings<sup>4</sup>
- Policy guidance
- Voting recommendations
- Alerts, bulletins and newsletters

Depending on the services subscribed to, the services may yield different results for different clients. This is because governance and ownership policies and preferences will vary from organisation to organisation.

*Unless otherwise stated or disclosed signatories do not act on behalf of any particular shareholder or group of shareholders that is trying to influence how other shareholders vote. Similarly, signatories do not act on behalf of an issuer that is trying to secure votes from its shareholders.*

<sup>4</sup> Per para (20) Regulation (EC) No 1060/2009 "ESG Ratings" do not constitute Credit Ratings.



## Additional Services

In addition to shareholder voting research and analysis services, signatories may also provide other services, such as vote agency and/or engagement and governance overlay services.

### Vote Agency

A voting agent provides shareholder vote execution services, whereby the voting agent is responsible for some or all of the logistical and operational activities associated with transmitting instructions from the institutional investor to the company meeting, as well as record-keeping and reporting activities.

Votes may be transmitted to the meeting directly (including personal attendance) or through a chain of operational intermediaries, depending on regulatory or market specificities in each relevant jurisdiction.

*Unless otherwise stated or disclosed, signatories act under the direct instruction of their clients and do not cast votes without their authority.*

## Engagement & Governance Overlay Services

**Engagement services** are defined as undertaking contact and engagement with issuers on behalf of an investor or group of investors with a view to asking the company in question to amend aspects of its governance.

**Overlay services** are defined as the provision of fully outsourced governance engagement and voting services to institutional investors.

Vote agency, engagement and governance overlay service providers may provide shareholder voting research and analysis as part of their service. Where this is the case, the provisions of these Principles apply to the shareholder voting research and analysis services they offer, either on a standalone basis or in conjunction with other services.

The particularities of vote agency and engagement services are not addressed by these Principles.

## Part Two:

### The Best Practice Principles

#### **Principle One: Service Quality**

Signatories provide services that are delivered in accordance with agreed client specifications.

Signatories should have and publicly disclose their research methodology and, if applicable, “house” voting policies.

#### **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.

#### **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.

The Principles are supported by Guidance that explains the background, relevance and application of the Principles.

The comply-or-explain framework applies to both the Principles and the Guidance.

Unless otherwise stated, all policies should be disclosed on the signatory’s website or made available on request.

## Principle One: Service Quality

*Signatories provide services that are delivered in accordance with agreed client specifications.*

*Signatories should have and publicly disclose their research methodology and, if applicable, “house” voting policies.*

### Guidance

#### Introduction

- Signatories should explain how they organise their activities to ensure that research is developed in accordance with a stated research methodology and voting policies.
- Signatories should describe what reasonable efforts they make to ensure their research and analysis are independent and free from inappropriate bias or undue influence.

#### Responsibilities to Clients

A signatory’s primary responsibility is to provide services to clients in accordance with agreed specifications. Clients are the ultimate and legitimate judges of the quality of shareholder voting research and analysis and other services they subscribe to from signatories.

#### Quality of Research

- Shareholder voting research and analysis should be relevant, accurate and reviewed by appropriate personnel prior to publication.

- Signatories should be able to demonstrate to their clients that their reports, analyses, guidance and/or recommendations are prepared to a standard that can be substantiated as reasonable and adequate.
- Signatories should have systems and controls in place so that they can reasonably ensure the reliability of the information used in the research process.
- Signatories cannot be responsible for disclosures published by issuers or shareholder resolution proponents that are the subject of their research.
- Signatories should maintain records of the sources of data used for the provision of services to clients (to the extent legally or contractually possible).
- Signatories should implement proportionate organisational features to achieve adequate verification or double-checking of the quality of research that is provided. These may include:
  - Issuer fact-checking
  - IT-based consistency check
  - Four-eyes principle (i.e. reports reviewed by an appropriate second person)
  - Review by senior analyst
  - Review by governance committee
  - Review by senior management and/or executives.
- Signatories should be transparent regarding the research information provided to clients, including, when applicable, dialogue with issuers or shareholder proponents

(see Principle 3). To that end, signatories should make reasonable efforts to ensure that use, inclusion or reproduction of external private information be duly referenced, so clients can assess to what degree third-party input plays a role in the services they use.

## Research Methodology

Signatories should have and disclose a written research methodology that comprises the following essential features:

- The general approach that leads to the generation of research;
- The information sources used;
- The extent to which local conditions and customs are taken into account;
- The extent to which custom or house voting policies or guidelines may be applied; and,
- The systems and controls deployed to reasonably ensure the reliability of the use of information in the research process, and the limitations thereof.

In making such disclosure, signatories do not need to provide information that could harm the signatory's legitimate business interests, including, but not limited to, intellectual property.

## Voting Policies or Guidelines

### Shareholder Policies

- Shareholders may assess investee companies' governance arrangements and make voting decisions based on their own view or "custom" voting policy. In this

case, they may contract with a signatory to receive services based on their own voting policies.

- Shareholders may subscribe to shareholder voting research and analysis services based on a signatory's proprietary or "house" voting policies and subsequently decide on the extent to which they incorporate that research and analysis into their own assessment and decision-making process.

*Whether shareholders use a signatory's "house" or "custom" voting policies, they are always responsible for and entitled to exercising their own judgement when determining their final voting decisions.*

## Signatory Policies

- Signatories may provide shareholder voting research and analysis services based on house voting policies or guidelines. These voting policies typically consist of high-level corporate governance principles against which the governance arrangements and general meeting resolutions of listed companies are assessed.
- Signatories should disclose whether they have developed house-voting policies. If so, they should disclose these policies, including, but not limited to, the extent to which local standards, guidelines and market practices are taken into account (if at all) and the extent to which issuer explanations on deviations from comply-or-explain corporate governance codes are taken into account. Signatories should

indicate whether the scope of their research includes corporate transactions and/or environmental and social matters (“ESG” or “Sustainability”).

- Each signatory will have its own approach to voting policy development and review, which may include one or more of the following approaches:
  - Client review
  - Public consultations
  - One-on-One/Face-to-Face discussions
  - Academic literature review
  - Guideline exposure drafts
  - Group discussions/webinars
  - Discussions at industry conferences
- Signatories should explain how their voting policies are developed and updated. They should explain whether and how they incorporate feedback into the development of voting policies. They should disclose the timing of their policy updates and policies.
- Signatories are not responsible for disclosing client corporate governance policies or voting guidelines and may have contractual obligations that preclude them from discussing any aspect of their client relationships, voting guidelines or intentions.
- A signatory’s voting guidelines do not need to include information that could harm the signatory’s legitimate business interests, including, but not limited to, intellectual property.

*Whether services are provided on a “custom” or “house” voting policy basis, clients expect signatories to exercise their independent professional judgement when delivering shareholder voting research and analysis.*

## Employee Qualification & Training

A signatory’s employees should have the education, skills, competence and experience that are appropriate for their positions. Signatories should make reasonable efforts to ensure their staffs are trained on the relevance and importance of their activities and on how they contribute to service delivery.

Where a signatory outsources any process that could affect service quality, the signatory should exercise control over such processes. The type and extent of control applied to these outsourced processes should be clearly explained.

Signatories should disclose their operational arrangements for the provision of services, including, for example, qualifications of staff, organisation of production processes, etc.

## Timeliness

Signatories have a responsibility to provide clients with adequate and timely services, subject to the availability of source information from issuers and shareholder resolution proponents, as well as intermediary constraints (for example, vote deadlines and intermediary cut-offs).

Signatories should make reasonable efforts to use the most up-to-date information available when delivering their services.

## Complaints & Feedback Management

Signatories should have and disclose their policies for managing and responding to complaints, comments or feedback about their services.

## Client & Supplier Understanding

The operational aspects of service delivery will generally form the basis of the service agreement between signatories and their clients.

Signatories should notify clients of the scope of the services provided, as well as any known or potential limitations or conditions that should be taken into account in the use of signatory services.

Limitations may include:

- Data availability issues, as not all markets require the same level of detail in disclosure;
- Missing, inaccurate or incomplete documents or disclosures, such as from issuers or shareholder proponents;
- Reliance on third parties that are beyond the control of the signatory; and,
- Inconsistencies and irregularities of information provided by intermediaries in the ownership chain, such as agenda information, vote deadlines, blocking procedures, etc.

Signatories should provide clients with a framework that enables them to fulfil their due-diligence requirements. The framework could include the following:

- 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.

## Client Disclosure Facilitation

Signatories recognise that institutional investors may be subject to disclosure requirements of the use made, if any, of shareholder voting research and analysis services.

Signatories should be willing to assist clients, upon their request, with disclosure relating to the clients' discharge of stewardship responsibilities. This disclosure could include information on how an institutional investor client uses a signatory's services; the public identification of a signatory; and information on the scope of services offered by a signatory, among other things.

## 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.*

### Guidance

#### Introduction

The possibility for conflicts-of-interest can arise in all businesses. While conflicts cannot always be eliminated, they can be managed and mitigated.

The overriding objective of this principle is to ensure, as far as reasonably possible, that research and business conduct are independent, fair, clear, not misleading and free from possible bias or undue influence.

With this in mind, signatories should make full and timely disclosure of potential conflicts that could reasonably be expected to impair their independence or interfere with their duty to clients.

#### Conflicts-of-Interest Policy

Signatories should have and disclose a conflicts-of-interest policy that explains:

- The existence of potential material conflicts;
- How and when potential material conflicts will be disclosed to clients (for example on a website, contained within research reports, email bulletins, etc.);

- How signatories communicate their conflicts-of-interest policy and train employees in the operation of that policy; and,
- How conflicts will be managed.

#### Possible Conflicts for Consideration

Signatories should consider how the following non-exhaustive list of potential conflicts may materially impact their operations and how these potential conflicts may be addressed:

- A signatory's ownership or shareholder base/structure, such as when a signatory is owned by an investor that owns shares in companies under coverage or when the investor is owned by an issuer under coverage;
- A signatory's employee activities, such as board memberships, stock ownership, etc.;
- Investor-client influence on the signatories, such as when an investor who is a client of the service provider is a shareholder proponent or is a dissident shareholder in a proxy contest;
- Issuer-client influence on the signatories, such as when signatories provide consulting services to companies under coverage for research; and,
- Influence of other investor clients.

## Conflict Management & Mitigation

Conflict management and mitigation procedures should include one or more of the following approaches:

- Transparent policies and procedures
- Code of ethics
- Division of labour
- Employee recusal
- Fire walls/IT systems and controls
- Information barriers and ring-fencing
- Independent oversight committees
- Physical employee separation
- Separate reporting streams



## Conflict Disclosure

If a signatory becomes aware of a material conflict of interest that cannot be effectively managed, the signatory should:

- Disclose the conflict to the relevant client(s) without undue delay before or at the same time the service is delivered, subject to contractual arrangements; and,
- Manage the conflict as further detailed in the signatory's conflicts-of-interest policy.



## 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.*

### Guidance

#### Introduction

Signatories should explain their approach to communication with issuers, shareholder proponents, other stakeholders, media and the public.

It is for signatories to choose whether or not to engage in dialogue and in what format.

If signatories choose to have such a dialogue, it is up to them to determine the objectives, timing, frequency and format of this dialogue.

Comments and statements in the press or public forums may have a significant impact and, as such, should be properly managed.

#### Dialogue with Issuers, Shareholder Proponents & Other Stakeholders

Signatories should have a policy (or policies) for dialogue with issuers, shareholder proponents, other stakeholders and their advisors.

To the extent dialogue has taken place, signatories should communicate to clients in their research reports the nature of the dialogue, which may also include informing clients of the outcome of that dialogue.

The policy should cover issues including, but not limited to:

- The circumstances under which such dialogue could occur;
- How signatories verify the information used in their analysis;
- Whether and how issuers are provided with a mechanism to review research reports or data used to develop research reports prior to publication to clients;
- Procedures for avoiding receipt of privileged, non-public information and, in cases where such information is received, procedures for managing such information;
- If/how signatories communicate during the voting period (defined as the period from release of the agenda until the general meeting);
- What steps are taken to protect signatories and their employees from undue pressure or retaliatory actions arising from the delivery of service

#### Dialogue with Media & the Public

Signatories reserve the right to respond to general media enquiries about the nature of their services and about the companies or issues they cover. However, signatories should have and disclose a policy (or policies) for communication with the media and the public. This policy should include, at minimum, the following considerations:

- Which of the signatory's employees are permitted to make comments to the media; and,

- The signatory's policy toward the publication of public recommendations (if made) on any particular resolution prior to the publication of their reports to clients. Exceptions to this policy should be explained.

It should be noted that signatories cannot be held responsible for the unauthorised use or re-use of their materials.

At all times, signatories should observe applicable laws or regulations regarding libel, slander, market abuse, insider trading, distribution of material non-public information, etc.

## Appendix I: Charter Signatories

The BPPG and Charter Signatories of the Best Practice Principles for Shareholder Voting Research & Analysis Providers are:

	<u>Glass, Lewis &amp; Co.</u>
	<u>Institutional Shareholder Services Inc.</u>
	<u>IvOX GmbH</u>
	<u>Manifest Information Services Ltd</u>
	<u>PIRC Ltd</u>
	<u>Proxinvest</u>

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The Best Practice Principles Group  
Under the Chairmanship of Dr. Zetsche

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Report of the  
Chairman

# Annex II

Consultation Document and  
First Draft of Principles

Public Consultation  
on  
Best Practice Principles  
for  
Governance Research Providers

Developed By:

The Best Practice Principles for  
Governance Research Providers Group

Under the Chairmanship of Dr. Zetsche

Web: [www.bppgrp.info](http://www.bppgrp.info)

Email: [consultation@bppgrp.info](mailto:consultation@bppgrp.info)

Consultation Start Date: 28<sup>th</sup> October 2013

Consultation Close Date: 20<sup>th</sup> December 2013

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## Part One: Executive Summary

### 1.1 Introduction

In February 2012, upon conclusion of the European Securities and Markets Authority (“ESMA”) consultation regarding the proxy advisory industry in Europe, an industry group formed to develop a set of Best Practice Principles for Governance Research Providers (“Principles”).

The Principles (which, in draft form, are the subject of this consultation) are designed to govern, on a comply-or-explain basis:

- The nature and character of governance research services;
- The standards of conduct that underpin those services; and
- How signatories to the Principles interact with other market participants.

They are intended to complement applicable legislation, regulation and other soft-law instruments.

The Drafting Committee of the Principles (“Committee”) invites comments on all matters contained in this Consultation Document and, in particular, on the questions raised (a full list of questions can be found on page 25.)

### 1.2 Background to the Principles

In March 2012, ESMA launched a consultation on the proxy advisory industry in Europe and the role of the industry in the shareholder voting process. In the *ESMA Final Report and Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry* (“ESMA Final Report”), published 19 February 2013, ESMA concluded that:

“(I)t has not been provided with clear evidence of market failure in relation to how proxy advisors interact with investors and issuers. On this basis, ESMA currently considers that the introduction of binding measures would not be justified. However, based on its analysis and the inputs from market participants, ESMA considers that there are several areas, in particular relating to transparency and disclosure, where a coordinated effort of the proxy advisory industry would foster greater understanding and assurance among other stakeholders in terms of what these can rightfully expect from proxy advisors. Such understanding and assurance will help to keep attention focused where it belongs, namely on how investors and issuers can, from their respective roles foster effective stewardship and robust corporate governance, and ensure efficient markets. Consequently, ESMA considers that the appropriate approach to be taken at this point in time is to encourage the proxy advisory industry to develop its own Code of Conduct.<sup>1</sup>”

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<sup>1</sup> ESMA recommends EU Code of Conduct for proxy advisor industry: <http://www.esma.europa.eu/content/ESMA-recommends-EU-Code-Conduct-proxy-advisor-industry> (page 3).



In February 2013, the Committee, made up of the following governance research industry members, was formed:

- [Glass, Lewis & Co.](#)
- [Institutional Shareholder Services Inc.](#)
- [IVOX GmbH](#)
- [Manifest Information Services Ltd](#)
- [PIRC Ltd](#)
- [Proxinvest](#)

The Committee is led by an independent chairman, Prof. Dr. Dirk Andreas Zetsche, LL.M. (Toronto), who is a professor of law and holds the Propter Homines Chair for Banking and Securities Law at the University of Liechtenstein. He is also one of the directors of the Center for Business and Corporate Law at Heinrich Heine University in Düsseldorf.

Prof. Zetsche was selected by the Committee after a public call for interest and is independent from both the Committee and ESMA. Prof. Zetsche has no industry affiliations but extensive practical and academic experience with both shareholder voting and institutional investments.

ESMA provides Prof. Zetsche with logistical support, including granting him a daily allowance of 150 EUR for meetings attended and reimbursing his travel and accommodation costs in connection with meetings. Prof. Zetsche undertook the role of Committee Chair because of his interest in shareholder stewardship and fostering transparency of the voting process. While the Chair fulfilled an advisory and coordinating function, he did not interfere with the fundamental decisions with regard to the Principles; these decisions were made exclusively by the industry members of the Committee.

Once finalised, the Committee will monitor the impact of the Principles and will review them periodically in order to respond to ongoing feedback from stakeholders and developments that are relevant to the industry. While the Committee has yet to finalise the specifics of the monitoring and review process, the first review will take place in autumn 2014, after which a statement regarding any further developments to the Principles will be issued. The Committee expects to publish the details of the monitoring and review process as part of the launch of the Principles, taking into account feedback by all relevant stakeholders in the course of this consultation.

A Committee member has volunteered to organise the creation and continued administration of an independent website that will serve as a central location for signatories to the Principles. (A copy of this consultation can be found at <http://bppgrp.info>.)

### **1.3 Aim & Scope of the Public Consultation**

In drawing up the Principles, the Committee took into account market feedback to the 2012 ESMA consultation regarding the role of the proxy advisory industry, as well as the analysis and views of ESMA and the ESMA Securities and Markets Stakeholder Group (“SMSG”) that were expressed in the ESMA Final Report.

To refine the Principles and finalise the process, the Committee is seeking feedback from potential signatories, institutional investors, issuers and other stakeholders on a variety of topics, including:

- Views on the way the Principles aim to improve communication with stakeholders and the public, and means to foster understanding about the way signatories operate and the services they provide;
- Views on the proposed key Principles and related Guidance; and
- Views on the governance of the Principles, the transparency of the process and possible further development of the initiative.

#### **1.4 How to Respond to the Consultation**

The following document features the Principles and related Guidance that were approved on a preliminary basis by Committee members on 18 October 2013.

The Consultation questions to which respondents are invited to answer are presented after each section.

Whenever possible, responses to this consultation should contain specific examples and/or describe possible alternatives the Committee should consider.

Responses should be sent via e-mail to [consultation@bppgrp.info](mailto:consultation@bppgrp.info) by noon (CET) 20 December 2013. It would greatly help the analysis of responses if you could send both PDF and word processor versions of your responses to the consultation.

When providing feedback, please also describe your organisation (e.g. issuer, asset owner, asset manager, etc.) and background.

If you do not wish your response to be made public, please let us know. All other responses will be made available at the Committee's independent website: <http://bppgrp.info>.

The Committee intends to issue the final Principles in March 2014. Please see Appendix II: Consultation Timetable on page 28 for details.

## Part Two: The Best Practice Principles

### 1 Background

The charter signatories (see Appendix 1) of the Best Practice Principles for Governance Research Providers (“Principles”) have prepared and adopted the following Principles in relation to activities associated with the provision of shareholder voting and analytical services.

In addition to promoting the integrity and efficiency of processes and controls related to the provision of such services, the Principles are intended to foster greater understanding of the role of governance research providers in the voting decisions made by institutional investors (i.e., asset owners and fund managers).

The Principles were developed by the Drafting Committee (“Committee”), which participated in a series of meetings under the guidance and independent chairmanship of Prof. Dr. Dirk Andreas Zetsche, LL.M. (Toronto), Propter Homines Chair for Banking and Securities Law, University of Liechtenstein (Principality of Liechtenstein), and Director of the Center for Business & Corporate Law, Faculty of Law, University of Duesseldorf (Germany).

New signatories beyond the Committee are encouraged to adopt the Principles.

In developing the Principles, signatories have drawn on a number of publicly available sources, including but not limited to:

- **ESMA Final Report** and Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry (19 February 2013)
- **Investor Codes**
  - AFG: Recommendations de l’Association Française de Gestion (FR)
  - BVI: Bundesverband Investment and Asset Management Rules of Good Conduct (DE)
  - Code for Responsible Investing in South Africa (“CRISA”) (ZA)
  - EFAMA: European Fund and Asset Management Association Code for External Governance (EU)
  - Eumedion: Eumedion Best Practices for Engaged Ownership (NL)
  - FRC: The UK Stewardship Code (September 2012), published by the Financial Reporting Council (UK)
  - ICGN: International Corporate Governance Network Statement of Principles on Institutional Shareholder Responsibilities (Global)
  - Lignes Directrices pour les Investisseurs Institutionnels (Economiesuisse and other Swiss organizations) (CH)
  - OECD: Organisation for Economic and Co-operation and Development Principles of Corporate Governance (Global)
  - PRI: Principles for Responsible Investment (Global)

- **Financial Markets Participants**

- AMF : Recommendation No 2011-06 of 18 March 2011 in respect of proxy voting agencies issued by the Autorités des Marchés Financiers (FR)
- CFA: Code of Ethics and Standards of Professional Conduct and Research Objectivity Standards (Global)
- IIA: Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing (Standards) 1300 Series Regarding Quality Assurance and Improvement Programs (Global)

### **1.1 Comply or Explain**

Not all governance research providers offer the same services in the same way. For this reason, the Principles are constructed on a “comply-or-explain” framework. This will enable each signatory to explain how the Principles relate to their specific circumstances and business model.

Regardless of a signatory’s business model, it is expected that explanations for deviation from the Principles and the related Guidance should be comprehensible, relevant and detailed. They should be substantiated and adapted to the signatory’s particular situation and should convincingly indicate why a specific aspect justifies an exemption. The explanations provided should state alternative measures that have been taken, if applicable. If a signatory intends to comply at a later stage with a measure from which it has provisionally deviated, it should state when this temporary situation will come to an end.

### **1.2 Application of the Principles**

In the first instance, signatories to the Principles should publish a link to their Statement of Compliance with the Governance Research Principles (“Statement of Compliance”), via the Committee’s independent website <http://bppgrp.info>.

If they so choose, signatories may wish to issue their statements via other publicly accessible sources. For example, ESMA has agreed to maintain a voluntary list of signatories to the Principles on its website together with a link to the independent Best Practice Principles Group website.

The Statement of Compliance 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.

Signatories are encouraged to review their Statement of Compliance from time to time (at least annually) and update it as appropriate to reflect current practice or material changes.

## Consultation Questions - Background to The Principles

In February 2013, the members of the Committee announced their support of ESMA's recommendation to develop a set of best practice principles for the industry and launched a process for collaborating on the development of the Principles, with the administrative support of ESMA.

Since announcing the initiative, the Committee met in March (Milan), April (Paris), July (Frankfurt), August (London), September (via conference calls and in person in Paris) and in October (via conference calls and in person in London) and has scheduled a February session in Frankfurt to finalise the Principles in advance of the official launch scheduled for March in Brussels.

In drafting the Principles, the Committee considered each of ESMA's and the SMSG's conclusions and suggestions in terms of content and practicability. Where conclusions and suggestions were inconsistent with actual industry practice, the Committee carefully reviewed alternatives in light of the two key rationales of the ESMA Final Report: enhance transparency and reduce the impact of conflicts of interest on stakeholders.

In October, the Committee invited a number of additional potential signatories to a meeting in London for a discussion of a draft version of the Principles. The Consultation Document reflects feedback and suggestions made at the October meeting, if they were widely supported by the expanded group. (Feedback from the October meeting is not reflected in this version of the Principles and will be considered as part of the wider Consultation review.) The Committee acknowledges that certain provisions of the Principles were hotly debated among the Committee members and/or potential signatories.

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. As the ongoing governance of the Principles has yet to be determined, the Committee particularly welcomes suggestions by stakeholders as to how a representative feedback mechanism can be implemented.

## Consultation Questions - 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.

## Consultation Questions - Application of the Principles

The Committee recognises that potential signatories have different business models and approaches to service provision, i.e. they are not “One Size Fits All”. The comply-or-explain approach is therefore viewed as the most appropriate tool to enable the industry to enhance transparency and understanding of their individual approaches without imposing standards that may not be relevant to their given model.

The form and substance of disclosures are fundamental to the effectiveness of the comply-or-explain model and will enhance the visibility of the initiative. To that end, signatories should publish their Statement of Compliance on the Committee’s independent website.

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.

## 2 Introduction to the Principles

Investors have a number of important ownership rights, one of which is the right to vote at shareholder meetings. Voting is a key right of asset owners, whose effective discharge is a fiduciary responsibility.

As with many other parts of the investment process, investors need access to information and administration tools that support them in the discharge of their responsibilities.

Signatories provide a range of professional services designed to assist institutional investors in the discharge of their rights and responsibilities. The Principles set forth here govern signatories' conduct in discharging their responsibilities toward clients.

These Principles have been developed with the following considerations in mind:

- The services are an efficient way of managing the logistical complexities associated with analysing and interpreting corporate disclosures, as well as ensuring and managing the operational aspects of shareholder voting;
- Clients may use one or more services that support and complement their own in-house research activities;
- Clients may, themselves, be subject to a variety of rules and regulations in relation to asset ownership and oversight;
- Signatories' underlying clients are responsible for their own compliance procedures;
- Signatories operate within the framework provided by applicable law, including those governing company law, contract law and client confidentiality, as well as securities laws associated with market abuse and insider trading; and,
- Nothing in these Principles is a substitute for adherence to relevant laws and market regulations.

Irrespective of the type of services used to support ownership and voting activities, the ultimate responsibility to monitor investments and make voting decisions lies with institutional investors; use of third-party services (such as those provided by signatories) does not shift this responsibility, unless the third party assumes additional authorities from the client.

Stakeholders wishing to understand how an institutional investor discharges its stewardship or ownership responsibilities should consult relevant disclosures of the organisation to understand its approach.

### 2.1 Scope & Definitions

To better understand the relevance and application of the Principles, it is important to understand the different types of services the signatories provide.

The key objective of the signatories is to support institutional investors in the exercise of their ownership rights and responsibilities through the provision of value-added services. These services may include one or more of the following, which may or may not be provided on a commercial basis:

### 2.1.1 Governance Research Services

Governance research services comprise services provided on a regular basis as an intellectual contribution to the company-specific, proxy vote-decision and engagement activities of institutional investors.

Governance research services can be varied and may exhibit one or more of the following characteristics:

- Alerts, bulletins and newsletters
- Company-specific advice/opinions
- Data and analysis
- Policy guidance
- Ratings
- Voting recommendations

Depending on the services subscribed to, the services may yield different results for different clients. This is because governance and ownership policies and preferences will vary from organisation to organisation.

Unless otherwise stated or disclosed, in developing governance research services, signatories are not acting on behalf of a particular shareholder or group of shareholders that is trying to influence how other shareholders vote, nor are they acting on behalf of an issuer that is trying to secure votes from its shareholders.

### 2.1.2 Additional Services

In addition to governance research services, signatories may provide additional services, such as vote agency and/or engagement and governance overlay services.

“Vote agency” is defined as the provision of proxy vote execution services, whereby the voting agent is responsible for some or all of the logistical and operational activities associated with transmitting instructions from the institutional investor to the company meeting, as well as record-keeping and reporting activities. Votes may be transmitted to the meeting directly (including personal attendance) or through a chain of operational intermediaries, depending on regulatory or market specificities in each relevant jurisdiction.

“Engagement and governance overlay services” are defined as undertaking contact and engagement with issuers on behalf of investors with a view to asking the company in question to amend aspects of its governance.

Vote agency, engagement and governance overlay services providers often provide governance research services. Where this is the case, the provision of these Principles apply to the governance research services they offer, either on a standalone basis or in conjunction with other services.

The particularities of vote agency and engagement services are not addressed by these Principles.



## Consultation Questions – Scope & Definitions

The scope of the governance research industry, and hence the list of potential signatories, can only be determined by a clear definition of the services provided to investors. In its feedback statement, ESMA does not provide such a definition. According to the SMSG, the Principles should apply to “all parties that engage on a professional basis in proxy advice”<sup>2</sup>

A review of the services provided by different members of the industry revealed a wide variety of types of services. In fact, some industry members do not provide “advice”<sup>3</sup> on how to exercise voting rights but rather provide governance research and guidance to help investors form their own voting decisions.

The Committee believes the distinction between the defining activities of “governance research” and other related governance services best reflects what (potential) signatories offer on a regular basis. This approach was taken in light of the SMSG’s clear distinction between agency services and “proxy advice”<sup>4</sup>.

The Principles relate only to the development and provision of “governance research services,” as defined in 2.1 on page 10. It is up to the individual service provider to determine if what it does qualifies as governance research and, as such, should be subject to the Principles.

In addition to governance research services, signatories may provide additional services, such as vote agency services and/or engagement and governance overlay services. Those services are likely to be governed by additional legal requirements imposed by the company and securities laws of relevant markets, most of which are not fully harmonised. Since the Principles do not seek to override existing legislation, neither at the EU Member States’ or global markets’ level, the Principles are silent on these matters. The Committee and the Principles may evolve over time to encompass other such activities related to governance research.

Given that the responsibility for the vote decision lies with the shareholder or its investment manager, the Committee has not included any Principles or Guidance that would impose standards of conduct on investors, for example any obligation on the part of investors to review governance research before voting. These requirements concern the investor’s duty of care or conduct of business as established by legislation governing institutional investors and as such are beyond the scope of these Principles.

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.

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.

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

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<sup>2</sup> See [ESMA Final Report](#), p. 34.

<sup>3</sup> The legal definition of “Advice” varies from market to market. Advice may be regarded by some as “telling” or directing clients what to do, others consider advice as “informing”. A Tilba and T McNulty, “Engaged versus disengaged ownership: the case of pension funds in the UK” (2013) 21(2) *Corporate Governance: An International Review* 165 at 173.

<sup>4</sup> See [ESMA Final Report](#), p. 30.

### 3 The Best Practice Principles

#### Principle One: Service Quality

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

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

#### 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 provisions of services.

#### 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.

The Principles are, in turn, supported by Guidance that explains the background and relevance of the Principles.

Unless otherwise stated, all policies should be disclosed on the signatory’s website or made available on request.

## Principle One: Service Quality

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

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

### Guidance

Governance research and analysis should be relevant, accurate and reviewed by appropriate personnel prior to publication. Signatories should be able to demonstrate that their reports, analyses, guidance and/or recommendations are prepared to a standard that can be substantiated as reasonable and adequate.

Signatories should explain how they organise activities to ensure their research is developed in accordance with stated research policy, methodologies and, if applicable, voting guidelines; in addition, they should describe what reasonable efforts they make to ensure their research is independent and free from inappropriate bias or undue influence.

Institutional investors may assess investee companies’ governance arrangements and make voting decisions based on their own view or “custom” voting policy. In this case, they may contract with a signatory to receive governance research based on their own voting guidelines. Alternatively, investors may subscribe to governance research services developed based on a signatory’s proprietary or “house” voting guidelines and subsequently decide on the extent to which they incorporate that research in their own assessment and decisions.

### Responsibilities to Clients

A signatory’s primary responsibility is to provide services to clients in accordance with agreed specifications.

### Research Policy

Signatories should have and disclose a written research policy that outlines:

- The general approach that leads to the generation of research;
- The extent to which local conditions and customs are taken into account;
- The extent to which custom or house voting guidelines may be applied; and
- The systems and controls they deploy to reasonably ensure the reliability of the use of information in the research process, and the limitations thereof.

A signatory’s research policy does not need to disclose any information which could harm the signatory’s legitimate business interests, including, but not limited to, intellectual property.

## Voting Guidelines

Signatories may elect to provide governance research services that are developed based on a set of house voting guidelines. The voting guidelines typically provide a reference framework against which to assess governance arrangements and general meeting resolutions.

Signatories should disclose whether they have developed house voting guidelines. If so, they should disclose the guidelines, including, but not limited to, the extent to which local guidelines and standards are used (if at all).

Each signatory will have its own approach to house voting guideline development and review, which may include one or more of the following approaches:

- Client review
- Public consultations
- One-on-one/face-to-face discussions
- Expert/regulatory body reports
- Academic literature review
- Guideline exposure drafts
- Group discussions/webinars
- Discussion at industry conferences

Signatories should explain how their voting guidelines are developed and whether and how they incorporate feedback into the voting guidelines development process.

Signatories are not responsible for disclosing client research policies or voting guidelines and may have contractual obligations that preclude them from discussing any aspect of their client relationships, voting guidelines or intentions.

## Research Methodologies

In addition to a research policy and house voting guidelines, signatories may also develop research methodologies. Research methodologies provide a detailed framework on how to assess governance arrangements and general meeting resolutions in each specific instance.

Signatories should make their research methodologies available to clients. In making such disclosure, research methodologies do not need to contain information which could harm the signatory's legitimate business interests, including, but not limited to, intellectual property.

## Quality of Research

Signatories should have systems and controls in place to reasonably ensure the reliability of the information used in the research process to the extent possible, bearing in mind they cannot be responsible for disclosures published by issuers or shareholder resolution proponents that are the subject of their research.

Signatories should maintain records of the sources of data used for the provision of services to clients (to the extent legally or contractually possible).

Signatories should, where this is proportionate to their size, implement organisational features to achieve adequate verification or double-checking of the quality of research that is provided. These may include:

- Four-eyes principle (i.e. reports must be checked by a person independent of the research process itself)
- Issuer fact-checking
- IT-based consistency check
- Review by governance committee
- Review by senior analyst
- Review by senior management and/or executives

Signatories should be transparent regarding the research information provided to clients, including, when applicable, dialogue with issuers or shareholder proponents (see Principle 3). To that end, signatories should make reasonable efforts to ensure that use, inclusion or reproduction of external private, copyright-protected information be duly referenced, so clients can assess to what degree third-party input plays a role in the services they use.

### **Employee Qualification & Training**

Employee qualifications include desired requirements for education, skills, competence and experience. Signatories should make reasonable efforts to ensure staff are trained on the relevance and importance of their activities and on how they contribute to service delivery.

Where a signatory outsources any process that could affect service quality, the signatory should exercise control over such processes. The type and extent of control applied to these outsourced processes should be clearly explained.

### **Timeliness**

Signatories have a responsibility to provide clients with adequate and timely services, subject to the timely availability of source information from issuers and shareholder resolution proponents, as well as intermediary constraints (for example, vote deadlines and intermediary cut-offs). Signatories should make reasonable efforts to use the most up-to-date information available when developing research and vote guidance.

### **Complaints & Feedback Management**

Signatories should have and disclose their policies for managing and responding to complaints, comments or feedback about their services.

### **Client & Supplier Understanding**

The operational aspects of service delivery will generally form the basis of the service agreement between signatories and their clients.

Signatories should notify clients of the scope of the services provided, as well as any known or potential limitations or conditions that should be taken into account in the use of signatory services.

Limitations may include:

- Data availability issues, as not all markets require the same level of detail in disclosure;
- Missing, inaccurate or incomplete documents or disclosures, such as from issuers or shareholder proponents;
- Reliance on third parties that are beyond the control of the signatory; and,
- Inconsistencies and irregularities of information provided by intermediaries in the ownership chain, such as agenda information, vote deadlines, blocking procedures, etc.

Signatories should provide clients with a framework that enables them to fulfil their due-diligence requirements. The framework could include the following:

- 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 policy has been or will be applied and on which assumptions the research output has been based.

## Consultation Questions - Principle One

Principle One aims to explain the quality of services provided by signatories. It underlines the primary importance of loyalty and transparency toward clients. In compliance with this principle, signatories will prepare and disclose a written policy that outlines their general approach to their research.

Principle One also calls for the disclosure of research policies, voting guidelines and research methodologies, which will enable stakeholders to understand how signatories develop the services they offer. In drafting Principle One, a balance was sought between ensuring transparency on the research policy, voting guidelines and research methodologies and protecting the legitimate business interests of signatories and their clients.

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.
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.
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.
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
17. For additional potential signatories only: Does the Guidance provide you with the information necessary to properly apply Principle One? If not, would you prefer further Guidance? Please explain.

## 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 provisions of services.

### Guidance

The possibility for conflicts of interest can arise in all businesses. While conflicts cannot always be eliminated, they can be managed and mitigated. The overriding objective of this principle is to reasonably ensure that research and business conduct are independent, fair, clear, not misleading and free from possible bias or undue influence. With this in mind, signatories should make full and timely disclosure of potential conflicts that could reasonably be expected to impair their independence or interfere with their duty to clients.

### Possible Conflicts for Consideration

Signatories should consider how the following non-exhaustive list of potential conflicts may materially impact their operations and how these potential conflicts may be addressed:

- A signatory's ownership or shareholder base/structure, such as when a signatory is owned by an investor that owns shares in companies under coverage or when the investor is owned by an issuer under coverage;
- A signatory's employee activities, such as board memberships, stock ownership, etc.;
- Investor-Client influence on the signatories, such as when an investor who is a client of the service provider is a shareholder proposal proponent or is a dissident shareholder in a proxy contest; and,
- Issuer-Client influence on the signatories, such as when signatories provide consulting services to companies under coverage for research.

### Conflicts of Interest Policy

Signatories should have and disclose a conflicts-of-interest policy that explains:

- How and when potential material conflicts will be disclosed to clients (for example on a website, contained within research reports, email bulletins, etc.);
- How signatories communicate their conflicts-of-interest policy and train employees in the operation of that policy; and,
- How conflicts will be managed.



## **Conflict Management & Mitigation**

Conflict management and mitigation procedures may include one or more of the following approaches:

- Code of ethics
- Division of labour
- Employee recusal
- Fire walls/IT systems and controls
- Independent oversight committees
- Information barriers and ring-fencing
- Physical employee separation
- Separate reporting streams
- Transparent policies and procedures

## **Conflict Disclosure**

If a signatory becomes aware of a conflict of interest that cannot be effectively managed, the signatory should:

- Disclose the conflict to the relevant client(s) without undue delay before or at the same time the service is delivered; and,
- Manage the conflict as further detailed in the signatory's conflicts of interest policy.

## Consultation Questions - Principle Two

Principle Two 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. 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.
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.
21. For potential additional signatories only: Does the Guidance provide you the information necessary to properly apply Principle Two? If not, what additional Guidance do you need?

## 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.

### Guidance

Signatories should explain their approach to communications with issuers, shareholder proponents, other stakeholders, media and the public.

It is for signatories to choose whether or not to engage in dialogue and in what format. If signatories choose to have such a dialogue, it is up to them to determine the objectives, timing, frequency and format of this dialogue.

Comments and statements in the press or public forums may have a significant impact and, as such, should be properly managed.

### Dialogue with Issuers, Shareholder Proponents & Other Stakeholders

Signatories should have a policy (or policies) for dialogue with issuers, shareholder proponents, other stakeholders and their advisors.

The policy should cover issues including, but not limited to:

- The circumstances under which such dialogue could occur;
- How signatories verify the information used in their analysis;
- Whether and how issuers are provided with a mechanism to review research reports or data used to develop research reports prior to publication to clients;
- Procedures for avoiding receipt of privileged, non-public information and, in cases where such information is received, procedures for managing such information;
- If/how signatories communicate during the voting period (defined as the period from release of the agenda until the general meeting);
- When and how signatories communicate to clients the nature of any dialogue with issuers, shareholder proponents or other stakeholders regarding voting issues under review; and,
- What steps are taken to protect signatories and their employees from undue pressure or retaliatory actions arising from the delivery of their services.

### Dialogue with Media & the Public

Signatories reserve the right to respond to general media enquiries about the nature of their services and about the companies or issues they cover. However, signatories should have and disclose a policy (or policies) for communication with the media and the public. This policy should include, at minimum, the following considerations:

- Which of the signatory's employees are permitted to make comments to the media and/or make public appearances; and,
- The signatory's policy toward the publication of public recommendations (if made) on any particular resolution prior to the publication of their reports to clients. Exceptions to this policy should be explained.

It should be noted that signatories cannot be held responsible for the unauthorised use or re-use of their materials.

At all times, signatories observe applicable laws or regulations regarding libel, slander, market abuse, insider trading, distribution of material non-public information, etc.

### Consultation Questions - Principle Three

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
  - b. Media and the public
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.
24. Are there any other aspects of **media and the public** dialogue that should take into account? If yes, please elaborate and provide specific examples and/or suggestions.
25. For additional potential signatories only: Does the Guidance provide you with the information you need to properly apply Principle Three? If not, where would you prefer further Guidance?

### Consultation Questions - General Features of The Principles

26. In addition to comments on the specific questions addressed in the remainder of this Consultation Document, views are invited on the general approach taken by the Committee and the general features of the Principles.
27. Do you feel that the Principles meet the policy principles set forth in ESMA's Final Report? If not please explain.
28. Do you have any other comments that the Committee should take into account when finalising the Principles?

## 4 Summary of Consultation Questions

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. As the on-going governance of the principles has yet to be determined, the committee particularly welcomes suggestions by stakeholders as to how a representative feedback mechanism can be implemented.
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.
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. 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.
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.
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.
12.	Do you agree that the Principles should not impose standards of conduct on investors? If not, please explain why.
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.
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.
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.
16.	Please express your views on the scope and content of the proposed research-related disclosure under this principle with respect, to: <ol style="list-style-type: none"> <li>a. research policy</li> <li>b. voting guidelines</li> <li>c. research methodologies</li> </ol>

17.	For additional potential signatories only: Does the Guidance provide you with the information necessary to properly apply Principle One? If not, would you prefer further Guidance? Please explain.
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.
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.
21.	For potential additional signatories only: Does the Guidance provide you the information necessary to properly apply Principle Two? If not, what additional Guidance do you need?
22.	Please express your views on the scope and content of the proposed policy disclosure under this principle with respect to: <ul style="list-style-type: none"> <li>a. Issuers; and</li> <li>b. Media and the public</li> </ul>
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.
24.	Are there any other aspects of media and the public dialogue that should take into account? If yes, please elaborate and provide specific examples and/or suggestions.
25.	For additional potential signatories only: Does the Guidance provide you with the information you need to properly apply Principle Three? If not, where would you prefer further Guidance?
26.	In addition to comments on the specific questions addressed in the remainder of this Consultation Document, views are invited on the general approach taken by the Committee and the general features of the Principles.
27.	Do you feel that the Principles meet the policy principles set forth in ESMA's Final Report? If not please explain.
28.	Do you have any other comments that the Committee should take into account when finalising the Principles?

## **Appendix I: Charter Signatories**

Charter Signatories of the Drafting Committee of the Best Practice Principles for Governance Research Providers

- [Glass, Lewis & Co.](#)
- [Institutional Shareholder Services Inc.](#)
- [IVOX GmbH](#)
- [Manifest Information Services Ltd](#)
- [PIRC Ltd](#)
- [Proxinvest](#)



## Appendix II: Consultation Timetable

Monday 28 October 2013	Launch of public consultation
Friday 20 December 2013	Close of public consultation at 12.00 CET
Thursday-Friday 6-7 February 2014	Review of draft Principles in light of consultation responses.
28 February/early March 2014	Ratification and Adoption of final Principles by Drafting Committee Publication of Principles
September/October 2014	Committee meets for first review of Principles

Report of the  
Chairman

# Annex III

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Feedback Summary on the  
Consultation

# Feedback Summary

## Results of Public Consultation on Best Practice Principles for Governance Research Providers<sup>1</sup>

30 April 2014

### I. Introduction

Forty-six entities responded to the Principles 28 October 2013 consultation<sup>2</sup>, including:

- 17 institutional investors and investor associations;
- 17 issuer associations;
- Nine service providers; and,
- Three other stakeholders (such as corporate interest groups, investor relation associations, investment services and private individuals).

The respondent group included 20 respondents from the UK; four each from the United States, Germany and the Netherlands; three each from France and Belgium; and further responses from other European and global entities.

### II. Background to The Principles

#### 1. Development Process

##### ***Question 1 What are your views about the Principles development process?***

One investor association remarked that the development of the Principles is a task for the industry. Correspondingly, one service provider and one other stakeholder agreed with the Drafting Committee's composition (six industry members and an independent chairman), as it reflects the industry and thus ensures a balanced approach.

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<sup>1</sup> Now „Best Practice Principles for Shareholder Voting Research & Analysis“

<sup>2</sup> The consultation document is available at <http://bppgrp.info/wp-content/uploads/2013/11/BPP-Group-Principles-Consultation.pdf>.

Two investor associations and one issuer association questioned whether the Drafting Committee's current composition represents all relevant stakeholders or whether other perspectives should have been taken into account. One respondent said they would welcome further information on the formation of the Drafting Committee and selection of its members.

Four investor associations and four issuer associations said they thought a wider stakeholder group should have been included in the drafting process or consulted at an earlier stage. One issuer association said that having governance research providers ("GRPs") draft their own Principles presents a conflict of interest. Respondents from both investor and issuer groups recommended that a wider stakeholder group -- including shareholders, regulators, issuers and governance advisory services -- should be included in future refinement of the Principles. While most of those calling for the involvement of a wider stakeholder group were referring to the review and monitoring process of the Principles following their launch (see below), one investor association proposed that the inaugural Principles should be finalised by an independent committee.

## **2. Review and Monitoring**

***Question 2 Respondents are welcome to express their expectations regarding the review and monitoring of the Principles. As the on-going governance of the Principles has yet to be determined, the committee particularly welcomes suggestions by stakeholders as to how a representative feedback mechanism can be implemented.***

### **1.1. Review of the Principles**

#### **1.1.1. Review body**

Nine investor group respondents and three issuer associations recommended the creation of a review body with independent members or stakeholder representatives. One service provider expressed the same view, citing as examples the UK Financial Reporting Council, which monitors the UK Stewardship Code, and the Dutch Corporate Governance Code Monitoring Committee that reviews whether Dutch

listed companies and institutional investors comply with the Dutch Corporate Governance Code.

### 1.1.2. Involvement of Stakeholders

Eight investor group respondents, six issuer associations, four service providers and one other respondent recommended a review process that takes into account stakeholder feedback. While some respondents would include all relevant stakeholders, others emphasised the involvement of signatories and investor clients. With respect to feedback mechanisms, respondents suggested the use of consultations and ongoing feedback instruments, such as a comment system on the Best Practice Principles Group (the “Committee”) website or meetings with stakeholders.

### 1.1.3. Timetable

Most respondents did not comment on the proposed review timetable. While some prefer an ongoing review, other respondents said there should be periodic reviews. The proposed timing of the periodic reviews ranged from annually to every five years. One institutional investor said the initial review should occur after the first round of disclosures. One issuer association said the first review should occur sooner.

## 1.2. Monitoring of the implementation by Signatories

Respondents generally highlighted the importance of properly monitoring the effectiveness of the Principles’ implementation. Two institutional investors and one issuer association said they would like more information regarding the monitoring process and its results, in particular the consequences of non-compliance with the Principles or disclosed policies.

### 1.2.1. Oversight Body

Six investor group respondents, one service provider and five issuer associations advocated for an independent oversight body to monitor the implementation of the Principles. Other respondents highlighted the importance of a transparent monitoring process and said the process should be conducted by signatories’ investor clients,

the signatories themselves and other stakeholders (see below). One investor association and one issuer association said the monitoring body could also be an independent organisation, such as ESMA, or could work under the auspices of ESMA.

One service provider recommended the creation of a feedback mechanism on the Committee website (where signatories will post their Statements of Compliance) that would facilitate commenting on the implementation of the Principles. Other respondents recommended that the monitoring board should have a global remit and not focus solely on compliance as it relates to activities in the European market. In addition, they said the monitoring body should also be responsible for making recommendations to improve the quality of the Principles.

### 1.2.2. Involvement of Stakeholders

Four investor associations and one issuer association referred, in particular, to the relationship between GRPs and their investor clients. These respondents said GRP investor clients should monitor the implementation of the Principles by signatories, consider explanations and engage with GRPs, in particular with regard to explanations for non-compliance with the Principles or related Guidance. However, respondents also emphasized that other stakeholders should be able to contribute to the monitoring process. This was recommended by four investor group respondents, one service provider and one issuer association. Respondents suggested a comment system or forum for stakeholders (GRP investor clients, investors and issuers) that enable them to provide ongoing feedback on their experience with compliance with the Principles.

### 1.2.3. Report on the monitoring process

Respondents generally favour a transparent monitoring process. Correspondingly three investor associations, two service providers and two issuer associations recommended a public report on the monitoring process.

One investor association said the monitoring report could feature a list of the signatories and the extent to which the services they provide are in line with their Statements of Compliance. One issuer association said signatories that deviate from

best practice without giving sufficient explanation should be identified (“name-and-shame principle”).

### **III. Comply or Explain**

#### **2. Comply or Explain**

***Question 3 Please share your views on the practicality of a comply-or-explain approach to the Principles.***

Twelve investor group respondents, 12 issuer associations, six service providers and one other stakeholder expressed their general support for the comply-or-explain approach. Reasons provided for support of the comply-or-explain model include:

- GRP investor clients have the primary responsibility for holding GRPs accountable;
- The comply-or-explain approach provides more flexibility;
- The variety of contrasting business models of GRPs; and,
- Comply or explain provides more transparency for clients.

Issuers that generally objected to this approach (three respondents) said:

- The comply-or-explain approach is not appropriate because, in this specific area, a level of flexibility comparable to corporate governance codes is not necessary, as the aim is to implement a basic standard for the industry; and,
- Because of the current high-level design of the Principles, the comply-or-explain model would not yield meaningful results, as GRPs can easily deviate from the intention of the very general Principles without having to explain.

#### **3. Effectiveness of the Principles**

***Question 4 Could the effectiveness of the Principles be further enhanced? Please elaborate and provide specific examples and/or suggestions***

Two issuers that generally agree with the approach set forth by the Principles said registration as a signatory and/or the submission of a Statement of Compliance should be mandatory for all qualified firms.

Three investor group respondents and three issuer associations expressed confusion regarding the implementation of the comply-or-explain regime, in particular whether it would apply to both the Principles and the Guidance or just the Principles.

While one investor association said it supported the broad, high-level Principles and the plan for signatories to give substance to those Principles, other respondents criticized the Principles for not being directive enough.

- Five investor group respondents said the Principles are too high level. Six issuer associations and two service providers also expressed this view.
- Six investor group respondents said they would like more clear -- and specific -- best-practice standards for GRPs to which GRPs should comply with or explain why they don't. Similar criticism was voiced by eight issuer associations and two service providers.

Some respondents repeatedly said that some or all of the Guidance should become Principles, and thus be subject to the comply-or-explain regime. Also, they said the Principles should set a higher standard than what is contained in the draft version and that signatories should not be allowed to deviate from very general Principles.

Two issuer associations said that improving transparency of GRP behaviour is not sufficient. They said the Principles should include best-practice provisions that promote dialogue with issuers and “the adoption of policies and organizational structures that mitigate conflicts.”

## **IV. Application of the Principles<sup>3</sup>**

### **4. Conflict With Legislation or Soft Law Instruments**

***Question 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.***

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<sup>3</sup> There were little or no responses to Question 9, provided feedback has been implemented in other report sections.



A majority of those who provided feedback on this question – both investor group respondents (eight) and issuer group respondents (three) – said they do not think the Principles and Guidance contain direction that conflicts with obligations under other best practice principles or existing legislation. One service provider concurred.

#### **4.1. Shareholders’ Right Directive**

However, three respondents recommended that the 2014 Shareholders’ Right Directive revision be taken into account, as “proxy advisors” have been named as one area of possible future regulation.

#### **4.2. UK Stewardship Code**

Respondents said sections that address the responsibility of shareholders should not deviate from the UK Stewardship Code<sup>4</sup> and expressed particular concern regarding the statement that “use of third-party services (such as those provided by signatories) does not shift this responsibility, unless the third party assumes additional authorities from the client.”

Two issuer associations said the term “investor” was not appropriate to describe the users of GRP services. They said the term “shareholder” is more appropriate because “registered shareholders” have the right to vote proxies under UK law.

One investor association and one service provider said compliance with the Principles will result in a replication of requirements if, due to the alleged broad scope of the Principles, signatories also are subject to the UK Stewardship Code. Another stakeholder said that if GRPs are also signatories to the UK Stewardship Code, reporting against the Principles wouldn’t alone be sufficient to demonstrate compliance with the UK Stewardship Code.

### **5. Procedural Aspects**

***Question 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.***

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<sup>4</sup> One respondent named the relevant section of the UK Stewardship Code: “Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their responsibility for stewardship,” see <https://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx>, on p. 2.

## 5.1. Registering

One investor association and one service provider said they agree with the registration and disclosure procedures outlined in the Principles. One institutional investor, however, recommended a separate process for registering as a signatory prior to the signatory publishing its Statement of Compliance. One issuer association said the list of signatories should be operated by ESMA and accessible to stakeholders.

## 5.2. Statement of Compliance

Both investor and issuer group respondents highlighted the importance of meaningful disclosures and reasoned explanations in case of non-compliance with the Principles. One investor association and two issuer associations said Statements of Compliance should feature – either within the Statement or as an addendum – the content that, according to the Guidance, should be disclosed by signatories, in particular signatories' research policies.

Other respondents called for:

- More explicit reporting obligations;
- More detail in the Guidance regarding what constitutes an appropriate explanation for non-compliance; and,
- The inclusion in the Statement of Compliance of a statement regarding the compliance with applicable national instruments, such as the recommendation regarding proxy advisor activities issued in 2011 by French regulator Autorité des Marchés Financiers (AMF).

## 5.3. Disclosure

Respondents of all groups endorsed the issuance by signatories of a Statement of Compliance. Suggestions regarding the means of disclosure fell into two groups:

- Four investor group respondents, one service provider and one issuer association said they would like signatories to publish their Statements of Compliance and any related documents in a central location, such as the

Committee and ESMA websites, in order to simplify access and review by stakeholders.

- One institutional investor and three issuer associations said signatories should (also) make the information available via their own public websites.

One institutional investor and one issuer association recommended that signatories be expected to proactively deliver their statements to existing clients.

#### 5.4. Update

One institutional investor recommended that signatories update and disclose Statements of Compliance annually or more frequently in the event of material changes, such as a change of ownership or changes related to conflicts of interest. Similarly three issuer associations recommended annual disclosure and review.

### 6. Regional Scope

***Question 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?***

Thirteen investor group respondents said the Principles should be applied globally. However, five of the 13 said the Principles should be developed and tested on the European level before extending the scope. Another stakeholder said the Principles should be harmonised with upcoming non-EU Principles or provisions (United States, Canada and Australia) once they are in place, rather than extending the scope now.

One service provider expressed explicit support for a global scope of the Principles. Two other service providers endorsed a global scope in general but expressed reservations. One said that extending the scope at this stage could delay the implementation process, while the other said that expanding the scope globally could result in homogenization of guidelines, which the respondent said should be country specific. Another service provider said the Principles should be designed for the EU but said Guidance should encourage signatories to explain how the Principles apply – or not, due to “potential geographical challenges” – to other regions.

Four issuer associations endorsed applying the Principles globally. Two issuer associations said the Principles should only be applied to GRPs that provide services on Europe-listed companies. Three issuer associations said the Principles should ensure international consistency while remaining flexible enough to allow for national differences.

The reasons provided in support of a global application of the Principles include:

- The global nature of the services provided, companies covered and the client base;
- The need for a level playing field for GRPs and equivalent client protection;
- Concern that multiple codes would be counterproductive and would lead to confusion for clients and difficulties for signatories;
- The similarity between the concerns being addressed by the Principles and those raised in other jurisdictions (United States and Canada); and,
- The ability to apply the Principles to other jurisdictions because of their high-level nature and non-binding character.

## 7. Possible Barriers for Signatories

***Question 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.***

One possible barrier cited by a service provider is the limited resources, infrastructure and coverage of some signatories, which could inhibit their ability to employ sophisticated checking procedures, IT platforms and third-party experts. This respondent said the Principles should “foster the development of locally-based expert providers that guarantee the highest level of knowledge of local practices, a quick engagement with all involved parties and a direct involvement in all specific market-related issues.”

## V. Scope & Definitions

### 8. General Remarks on the Scope

Three investor group respondents expressed agreement with the scope of the Principles. However, one of them said the wide scope could cause confusion and suggested that signatories should separate each provided service into the relevant components and explain compliance with the Principles with respect to each component.

One service provider expressed agreement with the broad definition of firms to which the Principles should be applied and emphasized that the Principles should reflect the variety of GRP business models and should not be focused solely on the business practices of major market players.

However, eight investor group respondents and three service providers criticised the extension of the scope beyond firms that provide vote recommendations and proxy research. The main criticism voiced by those respondents is that the broader scope could encompass other market participants that are part of the active investment process or are acting as engaged owners on the basis of their own governance analyses, such as asset managers.

Some respondents raised concern that the scope encompasses ESG rating agencies, not-for-profit investor organizations and information providers that only issue bulletins and newsletters (and not proxy recommendations or research specifically related to the proxy voting decision-making process). The respondents argued that these types of firms or market participants have different issues and positions in the governance framework and are already subject to other codes.<sup>5</sup> They said the Principles should focus on third-party services, whereas investors that act as engaged owners and conduct their own governance analysis and research (also via collective vehicles) should be excluded from the scope.

Further arguments raised by two or more respondents include:

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<sup>5</sup> E.g. UK Stewardship Code, ICGN Modern Mandate, EFAMA Code for External Governance for asset managers, ARISTA 3.0 for ESG rating agencies.

- Providers of services other than proxy advice have different issues;
- Representatives from some of the industries encompassed in the scope were not involved in or consulted about the development of the Principles;
- A broad scope could hinder the effectiveness of the Principles; and
- A broad scope could result in overlap with other codes.<sup>6</sup>

Issuer group respondents did not comment on the scope of the Principles as often as other respondent types. However, one issuer association suggested that smaller organizations and those that provide services on a limited basis should be exempted from the Principles, unless those firms provide voting recommendations or advice. Another issuer association respondent said the focus of the Principles should be on firms that influence the voting process and recommended that governance research services should only be subject to the Principles if they are provided by “proxy advisors” that issue recommendations.

## 9. Definition of “governance research services”

***Question 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.***

In addition to the above-mentioned general remarks regarding the scope of the Principles, some respondents provided feedback on the definition of “governance research services.” Four investor group respondents, one issuer association and two service providers approved the definitions.

One institutional investor said the governance research services were not properly defined, an opinion shared by two issuer associations. In particular, it was unclear to some respondents whether “policy guidance” captures the implementation of custom voting guidelines and whether “data and analysis” refers to company-specific data or more general data.

Three investor associations criticised the inclusion of ratings in the scope and said they were not aware that GRPs provided rating services. These respondents

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<sup>6</sup> E.g. stewardship codes, EFAMA Code for External Governance or the ICGN model mandate.

highlighted the “potential dangers of relying on sole ratings, especially in a field such as governance.”

## **10. “Vote Agency Services” and “Engagement and Governance Overlay Services”**

***Question 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***

Two investor associations and one service provider criticised both definitions. They described the definitions as “artificial” and hard to understand. According to one of these respondents, “companies may not fully understand how [vote agency services and engagement and governance overlay services] fit into the way investors approach their responsibilities.” Respondents said the definitions should be replaced with one clear definition or a more intuitive definition that features a description of how the services are used by investors.

### **10.1. Engagement and Governance Overlay Services**

Five investor group respondents agreed with the definitions of “engagement” and “governance overlay services.” This opinion was shared by two issuer associations, one service provider and one other stakeholder. Another stakeholder said that “engagement and governance overlay services” should be listed as a key service rather than as an additional service.

Three service providers and two investor group respondents said the definition of “governance research services” is confusing. They said that while “engagement and governance overlay services” are excluded from the scope, some of the services offered by engagement and governance overlay firms are not.<sup>7</sup> These respondents emphasized that the responsibility for engagement with issuers lies directly with other stakeholders (investors and regulators) and said that GRPs should not -- unless they have explicit assent from clients – engage themselves. They also said the influence on companies and the risk for conflicts of interest could arise from engagement.

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<sup>7</sup> The reference to “providing regular and intellectual contributions to company-specific engagement services.”

Similarly, two issuer associations expressed confusion about the correlation between the excluded and included engagement services and recommended better definitions for each of the categories. One issuer association said the definitions should clarify whether “engagement and governance overlay services” refers to services similar to board evaluation.

## **10.2. Vote agency services**

One investor association, two service providers and three issuer associations expressed disappointment that the Committee excluded “vote agency services” from the scope of the Principles. They said the Principles should address the particularities of vote agency services because:

- There is a conflict-of-interest risk for service providers when they act as a voting agent;
- ESMA's work focused mainly on the voting services; and,
- The influence on voting outcomes, as criticised by the issuer community, derives also from the use of voting platforms and quick-vote options.

However, seven investor group respondents and one other stakeholder said they agreed with the definition of “vote agency services.” One issuer association explicitly agreed that “vote agency services” should be excluded from the scope because of the “distinct” nature of these services.

## **11. Standards of Conduct for Investors**

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

Many respondents took the opportunity to express their views on investor stewardship responsibilities and the use of GRP services in general. They stated that investors remain responsible for the discharge of their stewardship responsibilities.

Respondents of all types made the point that GRPs provide important support to asset managers in helping them to exercise their ownership rights and responsibilities in an informed manner. Nevertheless, investor group and service provider respondents also said the influence of GRPs should not be overstated.



Service provider respondents said it was important to distinguish between the responsibilities of investors and those of GRPs and endorsed the clarification that research providers are solely responsible to their clients.

Investor group respondents view GRPs as an important source of information and objective analysis. According to one investor association, “the proxy advisory industry plays a crucial, although indirect, role in enabling long-termism and restoring trust in the financial markets, thereby contributing to the public interest.” Eight investor group respondents said it was important for all GRP investor clients to have the ability to monitor the services provided to them and some stated that they actively do so. Two recommended the inclusion of a reference to investment managers’ duties with respect to the responsible use of GRP services and a requirement for more transparency on the resources investors devote to voting and stewardship.

Nine investor group respondents agreed that the Principles should not impose standards of conduct on investors. In answering Question 12, these respondents said that:

- Investors already are subject to regulation and codes of conduct;
- The Principles should not try to address entities with different sets of issues; and,
- The conduct of investors should be addressed within an investor-focused initiative.

Similarly, five service providers and one other stakeholder agreed that the Principles should not impose standards of conduct on investors, as they are already subject to regulation and abide to codes of conduct. Three service providers said clients are responsible for using and assessing GRP services with care and due diligence. One other stakeholder said investors should ensure that “they are delegating activities to (GRPs) that will carry out those activities in a manner consistent with their own approach to engagement and decision-making.”

Among issuer respondents, six said the Principles should not regulate investors. Two of them suggested the development of a EU stewardship code. Two issuer associations disagreed and said the Principles should require investor clients of

GRPs to monitor their service providers. One issuer association said GRPs should disclose their procedures to facilitate monitoring efforts by clients.

## **VI. Principle One: Service Quality (Questions 13-16)<sup>8</sup>**

### **12. Understanding among Stakeholders**

***Question 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.***

Seven investor group respondents said Principle One will provide a better understanding among stakeholders. However, two of them criticised the wording of Principle One as being too weak (“aim to offer...”) and recommended the language should be based “more on a presumption of compliance.” One investor association said the Guidance provided is comprehensive, but more of the Guidance should be shifted to the Principle itself.

Three service providers and one other stakeholder agreed with Principle One. One service provider said the Principles should not introduce procedures on quality and independence that are too strict, as this approach could lead to an unwanted standardisation of GRP procedures instead of addressing respective criticism (“tick-the-box approach”). Two service providers emphasized that the Principles should reflect different business models and sizes of signatories. As smaller GRPs might not be able to implement large structures to comply with strict procedures, they said the comply-or-explain framework is most appropriate.

Four issuer associations said they believed Principle One will foster a better understanding in the market of the different services and approaches that signatories operate, while four others said the Principles are too generic and should contain more specific best-practice provisions or Guidance for the contents of the policy.

Similar to some of the investor group respondents, issuer group respondents criticised the wording of Principle One. They said the Principles should be more

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<sup>8</sup> There were little or no responses to Question 17, provided feedback has been implemented in other report sections.

tightly drafted and that vague wording should be rephrased, highlighting “signatories aim...” or “signatories should make reasonable efforts.”

### **13. Issues of Service Quality**

***Question 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.***

Investor group respondents suggested that the following additional issues should be addressed by the Principles:

- Confidentiality of client information, such as holdings information and voting decisions;
- Resolution of disagreements between GRPs and their clients;
- Liability insurance of the GRP relating to the services they provide; and,
- How GRPs could assist clients in thinking about their own voting policy.

Two issuer associations suggested the inclusion of a Principle that would ensure adherence to a GRP’s own voting guidelines and policies.

#### **13.1. Staff**

One investor association and one service provider said the Principles should include best-practice provisions regarding the qualifications of the resources that develop and oversee the research services provided. Two investor associations said they would like more transparency on GRP resources, including size, experience, qualifications and geographical spread of the team.

Seven issuer associations said the Principles should call for GRPs to ensure they have sufficient staff resources with appropriate qualifications. They called for more transparency on whether a GRP outsources any part of the research process and how much time is spent analysing each company, among other issues. Two issuer associations said that GRP reports should be reviewed and approved by experienced staff members and that reports should include the name(s) of the senior analyst(s) responsible for the content.

### **13.2. Accuracy of Services**

One investor association and one service provider called for the addition of best-practice provisions designed to safeguard the accuracy of research. Similarly, seven issuer associations proposed provisions for systems and controls that would ensure the reliability, accuracy and timeliness of information such as verification of data and double checking.

One institutional investor said the research policy should outline procedures for identification and correction of errors with respect to provided services. Similar suggestions were made by six issuer associations. Two issuer associations said GRPs should be required to produce annual statistical reporting of complaints and factual errors.

### **13.3. Stakeholder Feedback**

Two issuer associations said the Principles should not only require disclosure of the mechanisms employed by GRPs for receiving and incorporating feedback but should be prescriptive regarding appropriate mechanisms. Correspondingly one investor association and one service provider recommended best-practice provisions on dealing with client views.

### **13.4. Additional Transparency**

Two or more investor group respondents said the Principles should call for enhanced transparency to clients on the following issues:

- Ownership structure and types of provided services to assess potential conflicts of interest;
- Information that allows an assessment of the continuing capacity of the GRP (e.g., ownership, staffing and financial position);
- Compliance with client instructions;
- Whether the vote was cast correctly in accordance with client instructions (for both house policy and custom policy clients) and in proportion to the different instructions from different clients; and,

- Whether or not the GRP evaluates financial transactions and, if that is the case, the relevant experience and expertise of the analysts responsible for such research.

Two service providers would like GRPs to disclose the percentage of clients that vote according to house voting guidelines. They argue that a GRP's guidelines influences best-practice standards if a large proportion of owners follow this policy.

#### **14. Transparency on consideration of local-market conditions**

***Question 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.***

One issuer association, one other stakeholder and seven investor group respondents said the disclosure of research policies, guidelines and methodologies will enable stakeholders to understand the degree to which GRPs consider local-market conditions in the development of their research reports. However, three of them added that the value of this disclosure depends on the practical implementation of the Principles and “how detailed and contextual” the disclosures are. Consequently, two investor associations recommended that GRPs disclose not only the extent to which local conditions are taken into account but also how this is reflected in their policies and methodologies. Other investor group respondents called for monitoring of disclosures by an independent committee to ensure they are meaningful.

One investor respondent and four issuer associations said some of the language in the Guidance – specifically “signatories should take into account local-market conditions” – could better serve as a Principle, while the related Guidance should feature examples of how this might be implemented. One issuer association also said the wording of the Principles and Guidance is not “explicit” enough. As written, this respondent said the wording would not compel signatories to provide meaningful information regarding how they consider local-market conditions.

Other suggestions include:

- GRPs should draft specific guidelines (that are publicly disclosed or available to clients) to ensure the consideration of local-market conditions;
- The Principles should explicitly state that GRPs make recommendations on the basis of individual analysis and should not encourage a “check-the-box” approach; and,
- Issuers should be engaged in the development of house voting guidelines to provide a full picture of the written and unwritten local governance traditions.

## 15. Scope and Content of the Proposed Research-Related Disclosure

***Question 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***

Five investor group respondents said they agree with the proposed research-related disclosure. One institutional investor said GRPs should disclose analytical methods and the rationale for the vote recommendations in their reports (and not to the public). One institutional investor and two issuer associations said GRP voting guidelines should explain to what extent issuer explanations on deviation from comply-or-explain corporate governance codes are taken into account.

One service provider said GRPs should not provide voting recommendations based on a house policy, as it believes this dissuades investors from exercising their responsibilities. One investor association said investor clients should “take active responsibility for ensuring that the approach of their providers, especially in regards to the recommendation and execution of votes, is congruent with their wider communication with investee companies and in both the investors’ and the company’s long-term interest.” Six issuer associations and three investor group respondents said the Principles should require disclosure of GRP research methodologies.

### 15.1. Disclosure of the voting guidelines

With respect to voting guidelines, two issuer associations said the Guidance does not sufficiently clarify exactly what should be disclosed (and what could remain

confidential). Issuer associations said they support the public disclosure of voting guidelines. Four issuer associations said the Principles should require disclosure of voting guidelines (and respective updates) sufficiently ahead of general meetings. One issuer association said voting guidelines should be provided to the national regulator.

Four issuer associations and one other stakeholder said GRPs should consult or engage with stakeholders and/or provide a public feedback mechanism as part of their voting guidelines development process.

## **15.2. Amendments to the policies**

Regarding voting guidelines and research policies, respondents said:

- They should be tailored for each market and consider local-market conditions;
- They should contain definitions of concepts that are used; and,
- They should include a statement for fair treatment of corporate governance issues across markets.

## **VII. Principle Two: Conflicts of Interest (Questions 18-20)<sup>9</sup>**

Two investor associations and one service provider said that some concepts and terms included in Principle Two should be more clearly defined or explained, such as “conflict of interest,” “material impact,” “material conflicts” and “investor-client influence.” Also one issuer association said they would like clarification on the concept of “conflict of interest.”

### **16. Conflicts of Interest - Relevant Issues**

***Question 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.***

Six investor group respondents, five issuer associations and one other stakeholder agree that Principle Two addresses the relevant issues relating to conflicts of interest.

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<sup>9</sup> There were little or no responses to Question 21, provided feedback has been implemented in other report sections.

However, three issuer associations criticized the disclosure-oriented approach of the Principle and recommended specific measures to avoid conflicts

Respondents frequently mentioned the provision of consulting services to investee companies as a potential source of conflicts of interest. Three investor associations, three service providers and nine issuer associations discussed this type of potential conflict.

- Two service providers and two issuer associations said the Principles should contain requirements for always explicitly disclosing to clients material conflicts and/or for disclosing such conflicts in the relevant research reports;
- Two investor associations and two service providers recommended that the Statement of Compliance should contain descriptions of the ownership structure of the signatory, the services it provides and the types of clients it services, thereby enabling clients to determine what potential conflicts using this GRP presents;
- Four issuer associations said GRPs that provide governance research services to institutional investors and consulting services to issuers should establish Chinese walls between the businesses; and,
- One issuer association recommended that GRPs providing both research services to investors and consulting services to issuers should separate those businesses, while two other issuer associations said GRPs should be prohibited from issuing voting recommendations on issuers to which they currently or previously provided consulting services. Similarly, two service providers said GRPs should be restricted from providing services to investee companies under certain circumstances.<sup>10</sup> One investor association said it would support such restrictions.

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<sup>10</sup> “We suggest that research providers commit themselves not to directly provide any advisory services to listed companies under coverage for research, unless the potential buyers of researches and/or papers are not known (i.e., through a sale “over-the-counter” or through intermediaries).”



## 17. Conflict Management and Mitigation Procedures

***Question 19 Do you agree with the proposed conflict management and mitigation procedures? If not, please explain why and what additional measures you would propose.***

With respect to the mitigation procedures, six investor group respondents, three service providers, one issuer association and one other stakeholder approved the conflict management and mitigation procedures outlined in the Principles.

However, two investor associations requested more specific best-practice provisions and one service provider said the Guidance should contain more direction on conflict-of-interest management. Another issuer association recommended more Guidance on the contents of the policy.

Two issuer associations said the Guidance on conflicts of interest should not only address disclosure requirements but should feature provisions on the establishment of specific policies, procedures and organizational structures that mitigate conflicts. Similarly, three investor group respondents said the Principles focus too much on the publication of a conflict-of-interest policy but lack precision with respect to the disclosure of conflicts of interest to clients. They, as well as two service providers and one issuer association, expressed interest in seeing more specific disclosure on actual conflicts of interest. Respondents said GRPs should make their conflicts-of-interest policy publicly available, as this would enhance transparency and, according to one investor association, would provide “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.” Two issuer associations recommended disclosure of the conflicts-of-interest policy within or as an addendum to the Statement of Compliance.

One investor association said the conflict-of-interest policy of GRPs should be at a higher level compared to their research policies and “house” voting guidelines and should govern the provided services.

## 18. Disclosure of Material Conflicts

***Question 20 Do you agree with the proposed approach on disclosure of material conflicts? If not, please explain.***

Several respondents expressed confusion regarding what types of conflicts of interest signatories would be expected to disclose in order to comply with the Principles. The respondents highlighted discrepancies among the policy and disclosure sections of Principle 2 with respect to “potential conflicts,” “potential material conflicts,” and “conflict of interest that cannot be effectively managed.”

### 18.1. Disclosure to clients

One service provider and one stakeholder said the approach outlined in the Principles for disclosure of material conflicts is appropriate.

Six investor group respondents said all conflicts of interest should be disclosed to clients, irrespective of whether they are material or they can be managed effectively. Proponents of this argument argued that GRP investor clients should be sufficiently informed to be able to make their own assessment of whether a conflict is material to the services provided or if the management of the conflict is appropriate.

However, four issuer associations and one investor association said if a conflict cannot be effectively managed, the affected signatory “should remove the conflict by ceasing to act for a particular client,” as disclosure would not be sufficient to resolve the issue. In this context, two issuer associations said the bullet point “manage the conflict as further detailed” is contradictory or confusing.

### 18.2. Form and Timing of the Disclosure

Due to the high volumes and compressed timeframes associated with proxy voting, one respondent said it should be made as easy as possible for clients to assess any potential or real conflicts of interest. Three investor associations and two issuer associations said they would like the disclosure to also contain a description of the applied conflict-mitigation measures. Another issuer association said that a blanket

disclosure about potential conflicts or a list of issuers that may receive consulting services is not satisfactory.

Two investor associations said material conflicts should be disclosed as soon as possible and before the service is provided rather than only at the time of the delivery of the service. Three issuer associations and one institutional investor recommended that if a potential conflict impacts a specific research product, the conflict should be disclosed within that product.

### **18.3. Disclosure to non-clients**

One service provider said it does not think GRPs should disclose specific conflicts to the public. One investor association recommended that the issue of disclosing conflicts of interest to non-clients should be considered in the signatories' policy for communicating with the public. Another investor association said that any conflict of interest should be disclosed on the website of the service provider, together with the mitigation procedures.

Disclosure to non-clients received more support from issuer associations than other respondent types. They recommended:

- The disclosure of potential conflicts to the public in addition to the disclosure to clients (two respondents);
- The disclosure of conflicts of interest to ESMA or a monitoring board (one respondent); and,
- The disclosure of all conflicts concerning the issuance of voting recommendations to the public (one respondent).

## **VIII. Principle Three: Communication (Question 22-25)**

### **19. Policy Disclosure**

***Question 22 Please express your views on the scope and content of the proposed policy disclosure under this principle with respect to: a. Issuers, b. Media and c. the Public.***

## 19.1. Policy Approach

One investor association respondent said Principle Three, as developed, is less prescriptive than ESMA's recommendations. Similarly, one investor association and one service provider said the Principle lacks best-practice provisions on the dialogue with issuers.

Service providers and investor group respondents highlighted the importance of independent research. In general, they promoted dialogue on corporate governance issues among relevant stakeholders and said they don't think the Principles should prescribe a particular communication approach for signatories.

Issuer associations emphasised the importance of dialogue between issuers and GRPs, which they believe can enhance understanding of issuers' particularities, provide a better understanding of issuers' explanations for any deviation from comply-or-explain corporate governance codes and improve the quality of GRP advice.

Still, opinions are divided: Six issuer associations said the Principles should require dialogue between issuers and GRPs. Indeed, they expressed criticism of the Principles for leaving it up to the signatory to decide whether or not to have dialogue with issuers. Four other issuer associations expressed no objection to the policy approach. One issuer association said they would like to see more Guidance for the contents of the policy.

One other stakeholder said it supports the policy approach for communications with media, issuers and the public. It said GRPs should not be forced to engage with issuers. Another stakeholder, who also does not object to the policy approach, said the policy should contain minimum standards.

## 19.2. Transparency

Eight investor group respondents expressed strong support for disclosure of matters relating to communication between GRPs and issuers. While some investor group respondents said GRPs should inform clients of their general approach to communication with issuers, others said they would like to see additional disclosure

on the nature, content and context of the dialogue, including whether full reports or no recommendations or opinions are provided to issuers to review. Six respondents called for disclosure on the outcome of the dialogue, in particular whether and how the research and subsequent recommendations have been influenced by the dialogue. One investor association said that when and how dialogue with issuers is disclosed to clients should not be subject to GRP discretion.

Five service providers also stressed the importance of transparency regarding dialogue with issuers, including whether dialogue has taken place, the contents of the dialogue and whether the dialogue had an impact on a signatory's research, recommendations or advice.

One issuer association called for more ex-post transparency on the engagement with market participants, in particular whether there has been dialogue, if and how feedback was taken into account and whether issuers were given the opportunity to review and/or fact-check the research. However, one issuer association said discussions with companies should remain confidential.<sup>11</sup>

## 20. Issuer Related Dialogue

***Question 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.***

### 20.1. Initial Check by Issuers

One investor association said that a best-practice provision should be included in the Principles to address the provision of voting analyses to issuers before publication. However, opinions on this topic vary among investor group respondents: While three respondents have no reservations about providing issuers a with preview of the report (including one who said they would prefer that the Principles compel signatories to make their reports available for review to issuers in advance of finalizing and publishing them), seven others said they do not fully endorse this practice. These respondents said providing issuers with a preview of the report could

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<sup>11</sup> The respondent apparently means the content of the discussion, as it later suggests that "GRPs should disclose whether or not they have engaged with the issuer".

impact the independence of GRP advice. Two investor associations said GRPs should ensure that the contact person of the relevant company is duly authorised to speak with them and that the information provided to GRPs is not privileged or confidential.

Fourteen issuer associations said GRPs should provide issuers with draft reports (or parts thereof) prior to publication to clients and should give issuers a reasonable amount of time to verify and respond to the information. Seven issuer associations said the Principles should require publication or release of dissenting issuer opinions in, or in conjunction with, the final report that is sent to clients. Some issuer association respondents said GRPs should provide their reports free of charge to the subject issuers. Four issuer associations said they would like transparency on whether GRPs allow validation of reports by issuers.

## **20.2. Feedback and Corrections**

One investor association said the Principles should include a best-practice provision on the management of report feedback from issuers and GRP investor clients, in order to ensure accuracy. This respondent also said the Principles should include a provision regarding the disclosure of corrections made based on issuer feedback. On the other hand, one institutional investor said that research outputs should “by their nature not be subject to review and/or change as a result of company input or opinion.”

One issuer association said issuers would like information on the research process and on what influences voting decisions. Another issuer association said reports should be made public after the shareholder meeting for academic purposes or ex-post analysis by issuers.

## **21. Dialogue with Media and Public**

***Question 24 Are there any other aspects of media and the public dialogue that should take into account? If yes, please elaborate and provide specific examples and/or suggestions.***

Respondents from all groups -- four investor group respondents, two service providers, five issuer associations and one other stakeholder -- expressed concern regarding dialogue between GRPs and the media and public. Two investor group respondents expressed support for the development and disclosure by signatories of a policy for communication with the media and public, saying public communication “is a major reputational issue” and that they have “concerns if proxy advisors comment publicly on proxy battles, indicating what their vote recommendation will be.” One other stakeholder was critical of the Principle, saying it does not set minimum standards for the policy.

Three investor group respondents raised concerns about the risks inherent in communication with the media and public, including liability risks for GRPs and improper disclosure of confidential client information. Two investor associations emphasized that such dialogue should not happen without the agreement of clients on the approach. One service provider said GRPs should not publicly disclose their voting recommendations because doing so could inhibit a fair voting process. According to the respondent, “issuers or dissident shareholders may take advantage of the disclosure to foresee the final outcome of the meeting or to put pressure on some institutional investors to change their voting position.”

Four issuer associations highlighted the importance of factual accuracy when communicating with the media, as well as the negative consequences for both issuers and GRPs when errors occur. One respondent said the Principles should contain more “cautionary notes” on providing unchecked information to the press or public. Three of them recommended that there should be a verification of facts with issuers before making public disclosures or comments. Two issuer associations said the policy should also contain procedures for dealing with errors.

## **22. Further Guidance for Potential Signatories**

***Question 25 For additional potential signatories only: Does the Guidance provide you with the information you need to properly apply Principle Three? If not, where would you prefer further Guidance?***

One service provider said it agreed with Principle Three, while two others requested further specific Guidance and best-practice provisions on transparency regarding the dialogue with issuers and its impact on GRP research.

## **IX. General Features of The Principles**

### **23. Additional Comments**

***Question 26 In addition to comments on the specific questions addressed in the remainder of this Consultation Document, views are invited on the general approach taken by the Committee and the general features of the Principles.***

***Question 28 Do you have any other comments that the Committee should take into account when finalising the Principles?***

One investor association said competition and concentration issues remain a problem, while another said the Principles failed to address the operational barriers that can impact the exercising of voting rights. One Investor association and one issuer association said stakeholders should join the committee.

Other respondents suggested the Principles:

- Should require disclosure on specific topics that a GRP covers, such as environmental and social issues.
- Should state that signatories should not be allowed to act on behalf of particular shareholders or issuers in attempting to influence voting, even if that activity is disclosed.
- Should address the consequences of non-compliance with the Principles or the statement of compliance.
- Should require more transparency on compliance with client instructions.

### **24. ESMA Policy Principles**

***Question 27 Do you feel that the Principles meet the policy Principles set forth in ESMA's Final Report? If not, please explain.***



Four investor group respondents, one service provider, one other stakeholder and one issuer association said the proposed Principles are in line with the Principles ESMA set forth in its Final Report and said they encompass the relevant issues.

Two issuer associations said the focus of the Principles on service quality, conflicts of interest management and communication policies is appropriate, as these are “the key areas in which best practice principles need to be established.”

In answering this question, some respondents cited concerns about the broad scope of the Principles. One investor association said “the Principles need to be much more focused on a specific constituency – i.e. those whose research or advice directly relates to the informed voting of proxies” in order to fulfil the remit detailed in the ESMA Final Report. Two investor associations and two issuer associations also criticised the high-level nature and the wording of the Principles.

One issuer association said that while the development of the Principles for GRPs fulfils the remit of ESMA outlined in the ESMA Final Report, “any problem[s] lie not so much with the activities of GRPs as with the way in which some (although by no means all) investors and other stakeholders use their services.”

## List of Respondents

Amundi (FR)  
Association of British Insurers/ABI (UK)  
Assonime (IT)  
Aviva Investors (UK)  
Belgian Asset Managers  
Association/BEAMA (BE)  
Blackrock (Global)  
Capita Asset Services (UK)  
Center On Executive  
Compensation/COEC (USA)  
CFA Institute (USA)  
Church Investors Group/CIG (UK)  
Confederation of British Industry's/CBI  
(UK)  
Deutsches Aktieninstitut e.V./DAI (GER)  
Dutch Association of Listed  
Companies/VEUO (NL)  
Egan-Jones Proxy Services (UK)  
Emiliano Torracca (UK)  
Eumedion (NL)  
European Fund and Asset Management  
Association/EFAMA (EU)  
European Issuers/EI (BE)  
European Sustainable Investment  
Forum/Eurosif (BE)  
F&C Management Limited (UK)  
Federation of German Industries/BDI  
(GER)  
Financial Reporting Council/FRC (UK)  
Frontis Governance (IT)  
GC100 (UK)  
German Commission for the German  
Corporate Governance Code (GER)  
Global Network of Director Institutes/GNDI  
(AUS)  
Hermes Equity Ownership Services/EOS  
(UK),  
ICMA Asset Management and Investors  
Council/AMIC (UK)  
International Corporate Governance  
Network/ICGN (UK)  
IR Society (UK)  
MIROVA (FR)  
National Association of Pension  
Funds/NAPF (UK)  
NEI Investments (CA)  
Nordic Investor Services/NIS (SE)  
Quoted Companies Alliance/QCA (UK)  
RPMI Railpen(UK)  
Shareholder Communications  
Coalition/SCC (USA)  
SNS Asset Management (NL)  
Sodali (Global)  
The Association of Investment  
Companies/AIC (UK)  
The French Association of Large  
Companies/AFEP (FR)  
The Institute of Chartered Secretaries and  
Administrators/ICSA (UK)  
The Investment Management  
Association/IMA(UK)  
U.S. Chamber of Commerce (USA)  
Verband der Chemischen Industrie/VCI  
(GER)  
Vereniging VEB NCVB (NL)

Responses received can be found at [http://bppgrp.info/?page\\_id=111](http://bppgrp.info/?page_id=111).