

EFAMA's Reply to ESMA Call for Evidence on Impact of the Best Practice Principles 'BPP' for Providers of Shareholder Voting Research and Analysis

EFAMA appreciates the opportunity to submit comments to ESMA's Call for Evidence 'Impact of the Best Practice Principles ('BPP') for Providers of Shareholder Voting Research and Analysis'.

We would first like to raise a number of general remarks. To avoid overlap and respond in a targeted manner, EFAMA has chosen to respond to the questions on background (Q1, 2 and 3) and the questions for investors (Q27-Q33).

General remarks – Executive summary

- Proxy advisors facilitate the discharge of asset managers' stewardship responsibilities in the companies they invest in on behalf of their clients. While proxy advisor services allow investors enhance their efficiency, by no means do they substitute investors in exercising ownership rights and, in particular, voting rights. While some investors may appoint proxy agents to enable the execution of voting instructions, ultimately investors are responsible for their own compliance procedures and voting decisions. As the execution of voting instructions does not form part of the BPP, EFAMA's commentary focuses on the provision of proxy advisory services related to research, voting recommendations and reporting.
- EFAMA believes that transparency of proxy advisors should be driven by markets and investors' / clients' requirements, rather than by binding legislation. Self-regulation also allows flexibility to adapt more easily to the specificities of different markets.
- EFAMA members are, by and large, satisfied with the quality of the proxy advisors services. Our members exercise oversight and quality control through the service contracts which form part of the customer/client relationship between investor/proxy. Investors, like ESMA, do not see any market failure in terms of proxy advisors' activity.
- While EFAMA cannot establish a direct causal link between the BPP and better conduct of the proxy advisory industry with reference to the five principles from ESMA's 2013 Final Report, most of our members view the BPP very positively. The compliance statements drawn up by signatories of the BPP are public disclosure documents which provide greater transparency and can give investors a higher degree of comfort. EFAMA is also of the view that the compliance statements provide investors with a framework of consistent principles which

structures all the useful information in one easily accessible document and can be compared with other proxy advisors' statements.

- The debate regarding the proxy advisory industry seems to partly stem from the perceived misconception that investors are over-reliant on voting recommendations from proxy advisors. The suggestion that asset managers, as investors, could be unduly influenced by proxy advisors in the discharge of their fiduciary duty must be strongly refuted. Asset managers, big and small, act as fiduciaries to achieve the best long-term interests of their institutional and retail clients, and are required under UCITS¹ and AIFMD² to set up a voting policy and to report to their clients, including on the exercise of voting rights. The Revision of the Shareholder Rights Directive currently under discussion will further cement their duty of disclosing their corporate governance activities to their clients. Voting reports and policies are generally disclosed on EFAMA corporate members' websites. Some asset managers invest in public companies through passive/ indexed funds, however this does not make them 'passive shareholders' uninterested in investing in these public companies. As index-tracking investors, passive investors hold shares in listed companies for as long as the company is included in the index. They do not have the possibility to disinvest as other types of investors do. Therefore, active engagement is the only effective way for these long-term investors to influence the companies they invest in. Given their long-term ownership, passive investors have the ability to establish and maintain a constructive relationship with the company board and management and engage on issues requiring lengthier periods of engagement, such as environmental, social and governance issues.

¹ Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company, Article 21(1) states: *"Member States shall require management companies to develop adequate and effective strategies for determining when and how voting rights attached to instruments held in the managed portfolios are to be exercised, to the exclusive benefit of the UCITS concerned."* Article 21(3) states: *"A summary description of the strategies [of the exercise of voting rights] shall be made available to investors. Details of the actions taken on the basis of those strategies shall be made available to the unit-holders free of charge and on their request"*.

² Commission Delegated Regulation No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision, Article 37(1) states *"An AIFM shall develop adequate and effective strategies for determining when and how any voting rights held in the AIF portfolios it manages are to be exercised, to the exclusive benefit of the AIF concerned and its investors"*. Article 37(3) states *"A summary description of the strategies [of the exercise of voting rights] and details of the actions taken on the basis of those strategies shall be made available to the investors on their request"*.

3.2 Questions

3.2.1 Background

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

EFAMA is the representative association of the European investment management industry.

Asset managers, as agents for their clients, are bound by investment guidelines designed by their clients and will invest in companies on their clients' behalf. Given the extent of the portfolio holdings, managed by asset managers on behalf of their clients, which often spreads across 5 continents, the use of proxy advisors is extremely valuable from a logistical and resource efficient perspective for the investor's corporate engagement with companies. Proxy advisors condense the vast amount of publicly disclosed information regarding issuers into a readable format, flag key issues and provide research which will feed into the in-house decision making regarding voting policy. Some EFAMA members use the voting execution services of proxy advisors.

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

EFAMA members have previously had some concerns with parts of the functioning of the proxy advisory industry, namely in relation to:

- The accuracy and reliability of research
- The timing of research, which at times could be provided sooner
- Reporting after vote execution

It is fair to say, however, that given the large volumes of research provided, it may be difficult to wholly eradicate the small number of inaccuracies. Mistakes are generally shared and addressed with the issuer before a report is released. It also seems that the number of errors has dropped in recent years.

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

As an active stakeholder in the discussions on the proxy advisory industry since 2011, EFAMA has engaged in every initiative in this regard, through the questionnaire for investors on proxy activity (2011) and the discussion paper regarding different possible policy options (2012), both by ESMA, as well as the public consultation by the Best Practice Principles Group (2013). We therefore became aware of the BPP since its inception.

5. Questions for investors

5.2 Questions

Q. 27: Please describe the way your institution currently uses services from proxy advisors, in particular as regards:

A- Type of services

EFAMA members use different services provided by proxy advisors. The first type of services availed of by the investor is generally analysis related: sectorial analysis, company analysis, general meeting proposals analysis, voting recommendations, and detailed reporting after vote. The second type of service used by members relates to the transmission of voting instructions to the issuer.

B- Number of proxy advisors contracted and, if applicable, reasons for choosing several rather than one provider

Most EFAMA members contract two or three proxy advisors globally, while some will also contract a proxy advisor for a specific market. Members tend to use one provider as their main source of research, and contract the second provider for cross-referencing research and in the event new and different issues are flagged.

Q28: When using services from proxy advisors, how often do you deviate from their research/advice/recommendations in your voting choices. Please differentiate your answer across agenda items (e.g say on pay, balance sheet approval, appointment of directors)

Many EFAMA members use custom voting policies whereby the proxy advisor implements the voting recommendations according to the investor's specific guidelines and philosophies. These are subject to strict internal controls on the part of the investor which allows them to easily override the custom policy in the event of a contentious or high profile vote.

More generally, EFAMA members use research and advice from proxy advisors as a source of information, which supplements their own in-house research. Some members will only use proxy advisory services for screening purposes, as a means of filtering important information. Other members will receive voting recommendations, however we would emphasize that the ultimate responsibility for the voting decision remains with the investor. We stated in previous ESMA consultations that a high correlation between proxy advice and the investor's voting decisions is a sign of a well-functioning advisor-client relationship and not one of a malfunctioning of the market or an overreliance on advice by investors.

Q29: When selecting a proxy advisor from whom to purchase services and/or in the course of your contractual relationship with a proxy advisor, do you place any importance on whether the entity is a signatory of the BPP? If no, please explain why. If yes, have you been in dialogue with the proxy advisor(s) you are making use of as regards its (their) application of the BPP?

Most EFAMA members have long-standing contractual relationships with proxy advisors who are signatories of the BPP. It is therefore too difficult to factually determine whether investors are influenced in their choice of proxy advisor based on the proxy's adherence to the BPP. However, in a hypothetical situation, some members confirmed that if they were negotiating a new contract with a proxy advisor who was not a signatory of the BPP, they would certainly raise this matter with their potential new provider and ask them why they were not signatories.

The vast majority of EFAMA members have not been in dialogue with the proxy advisor they make use of with regards to its application of the BPP simply because they are satisfied with the quality of the service and research, which they believe effectively supports their informed engagement and use of votes across highly diversified portfolios.

Q30: In your experience, to what extent have the BPP improved proxy advisors' procedures for managing and disclosing conflicts of interest, and specifically the following two types?

A – The proxy advisor provides services to both the investor and the issuer

B – The proxy advisor is owned by an institutional investor or by a listed company to whom, or about whom, the proxy advisor is providing research, advice and/or recommendations

Please provide examples to support your response.

Potential conflicts of interest of proxy advisors have long been known in the industry. However, most EFAMA members consider that the procedures put in place by proxy advisors for managing and disclosing such conflicts of interest are generally satisfactory.

EFAMA members cannot conclusively state that the BPP have improved proxy advisors' procedures managing and disclosing these conflicts of interests. However, it is important to note that the BPP has encouraged more transparency as it provides a framework whereby investors can compare how each of the main players address and disclose potential conflicts in their respective compliance statements. Some members have commented that since the BPP has come into play, some providers' voting platform states whether an issuer is also one of their corporate clients. Extensive disclosure regarding this relationship is available on the voting platform.

Q31: In your experience, to what extent have the BPP enhanced clarity as regards proxy advisors' methodologies and the nature of their information sources, thereby making it easier for you as an investor to better assess the accuracy and reliability of their research, advice and/or recommendations? Please provide examples to support your response.

As stated in the previous answer, most EFAMA members cannot correlate better accuracy and reliability of proxy advisors' research to the BPP. However, members have noted that the BPP offers a framework for proxy advisors, whereby consistent principles in the form of a compliance statement enables investors' to better assess proxy investors' methodology and nature of information sources.

Q32: In your experience, have the BPP enhanced:

A- Proxy advisors' level of awareness of local market, legal and regulatory conditions which the companies you invest in are subject to?

B- Proxy advisors' disclosure to the extent to which they take the above conditions into account?

Please provide examples to support your response

EFAMA members agree that proxy advisors' knowledge of local market, legal and regulatory conditions adds value to the services they provide. For example the proxy advisor will gather the information regarding this market in a "digestible" format for the investor, will translate from a market's official language to English or will do the initial issuer engagement in that market. Some members have argued that the quality of the research in relation to local, legal and regulatory conditions is continuously improving, which could be reflective of proxy advisors compliance with the BPP.

The 2015 Telecom Italia AGM provides a good example. By delving deeper beyond the standard functioning of the Italian 'Voto di Lista' system, ISS provided investors with a non-routine recommendation to vote against the minority investor slate. A different recommendation by ISS could have steered international investors to vote for the minority slate, which would have likely made institutional investors a majority at the AGM. In turn, this would have lost investors the right to appoint the president of the Board of Statutory Auditors. Investors as a whole voted differently as the domestic investors who put down the slate, voted in favour. This showed both a conscious analysis of the Italian market's regulatory environment by ISS as well as an awareness by investors of the implications of their vote.

Q33: In your experience, to what extent have the BPP enhanced clarity as regards the manner in which proxy advisors will disclose their communication with issuers to clients? If you consider there has been a change, has this affected the way you make use of their research, advice and/or recommendations? Please provide examples to support your response.

EFAMA members do not have any specific comment to make on this question.

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