



# ESMA Call for Evidence

Impact of the Best Practice Principles for Providers of  
Shareholder Voting Research and Analysis

## ISS' Response

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Institutional Shareholder Services

**27 July 2015**

**ESMA**

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**Presented by**

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Brussels, 27 July 2015

Subject: Call for Evidence – Impact of the Best Practice Principles for providers of Shareholder Voting Research and Analysis

Dear Sir/Madam,

Institutional Shareholder Services Inc. (“ISS”) is a leading provider of corporate governance solutions for asset owners, investment managers, and asset service providers. ISS’ solutions include objective governance research and vote recommendations, end-to-end proxy voting and distribution solutions, turnkey securities class-action claims management, and reliable global governance data and modeling tools.

We have 30 years’ experience in this field and our team of more than 750 research, technology and client service professionals are located in financial centres worldwide, including across Europe, in London, Brussels and Paris. Investors, regulators and media regularly turn to ISS experts for insight and data on trends in corporate governance.

Our aspiration and goal is to serve our clients with their full trust and confidence. We earn and retain this by providing high quality services which are understood by our clients to rest upon high degrees of transparency, objectivity, and independence.

To this end, ISS welcomed ESMA’s Feedback Statement issued on 18 December 2012. The report concluded that ESMA had *“not been provided with clear evidence of market failure in relation to how proxy advisors interact with investors and issuers”*. At the same time, it also encouraged the proxy advisory industry to develop its own Code of Conduct, thereby providing a prominent platform for the industry to further improve its transparency and disclosure. The industry responded to ESMA’s invitation by publishing the Best Practice Principles (BPP) for Providers of Shareholder Voting Research and Analysis, which aim at fostering greater understanding and assurance among stakeholders in terms of what they can rightfully expect from proxy advisors.

On 10 June 2014, ISS published its Compliance Statement to the BPP<sup>1</sup>. This document aims to describe in a transparent way how ISS fully complies with all three Principles and all related Guidance in the provision of services.

We now welcome the opportunity to respond to the ESMA Call for Evidence. ISS is a member of the Best Practice Principle Group (“BPPG”) that prepared and adopted the BPP. Given our role and the fact that a number of these questions are directed to other market constituents, in some cases we will defer to others to provide the answers, where ISS does not believe it is appropriate to respond.

Finally, ISS welcomes ongoing dialogue regarding the content of the BPP and the way the signatories comply with its Principles. On 10 February 2015, the charter signatories to the BPP (BPP Group or BPPG) announced the launch of mechanisms for collecting feedback and monitoring the implementation of the Principles<sup>2</sup>. The BPP Group encourages all stakeholders to provide meaningful feedback and substantiated, fact-based comments as a way to consider updates and improvements to the Principles.

We hope that you will find our response useful. Please contact Jean-Nicolas Caprasse for any further information or questions regarding its content.

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<sup>1</sup> See ESMA’s website at <http://www.esma.europa.eu/page/Signatories-Best-Practice-Principles-Shareholder-Voting-Research-and-Analysis>, in industry website at [http://bppgrp.info/?page\\_id=208](http://bppgrp.info/?page_id=208); and ISS’s website at: <http://www.issgovernance.com/compliance/due-diligence-materials/>.

<sup>2</sup> See : [http://bppgrp.info/?page\\_id=385](http://bppgrp.info/?page_id=385).

### 3.2.1 Background<sup>3</sup>

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#### Q.1:

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

ISS is a leading provider of corporate governance solutions to the global financial community, including corporate governance analysis and voting recommendations for institutional investors (also referred to as proxy advisory services). More than 1,600 institutional clients rely on ISS' expertise to help them manage governance risk and make informed voting decisions.

As a global company, ISS has more than 750 employees in 15 offices in 10 countries. ISS covers approximately 39,000 companies in 115 countries, delivering proxy research and vote recommendations on nearly 28,000 companies each year. We work closely with clients to execute on their behalf nearly 7.5 million ballots representing more than 4 trillion shares annually. ISS analysts have extensive expertise and insight on the governance landscape, local market voting practices and regulatory requirements, along with expertise in varied fields such as law, M&A, compensation, and data analytics. In Europe, ISS operates from its three main offices, located in Brussels, London and Paris.

As part of its services providing governance research and voting recommendations, ISS provides and implements a variety of voting policies, providing choice and different options reflecting both regional and market differences, and the differing views and requirements of institutional investors.

ISS' clients include asset owners, investment managers, investment advisers (including investment advisers to investment companies, pension and profit-sharing plans), broker-dealers, banks or thrift institutions, hedge funds, trusts, estates, charitable organizations and other institutional investors, as well as law firms, universities and compensation consultants. Many clients use ISS' services to help fulfill their fiduciary obligations to their own clients.

#### Q.2:

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

As a primary service provider in the proxy advisory industry, we share the view that was ultimately reached by ESMA, which is that there is no market failure. We believe, however, that

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<sup>3</sup> Numbering matches that of the Call for Evidence (8 June 2015, ESMA/2015/920).

every company and industry should continue to grow and improve and that the BPP provides a robust and widely-accepted set of guiding principles for that growth. Overall, we believe that the industry is functioning well and is also well-positioned for the future with the BPP.

Q.3:

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

Yes, ISS is one of the chartered signatories of the BPP and is a member of the BPPG.

### 3.2.2 The BPP on paper

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Q.4:

*What is your view on the width and clarity of the scope<sup>5</sup> of entities covered by the BPP (i.e. do you consider that the BPP cover the European proxy advisory market appropriately)? Please explain.*

ISS refers to the definition of proxy advisors covered in the BPP:

*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*
- *Policy guidance*
- *Voting recommendations*
- *Alerts, bulletins and newsletters.*

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.

The Report of The Chairman of the BPPG provides a useful framework that guided the Drafting Committee regarding the scope of the industry<sup>4</sup>. As stated in the BPP, *new signatories beyond members of the BPPG are encouraged to adopt the Principles*<sup>5</sup>

**Q.5:**

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

Yes, we believe that the BPP was drafted in a way so that it addresses the areas identified in the ESMA 2013 Final Report. We direct you to the appropriate section(s) in the BPP as examples of the areas identified in ESMA's 2013 Final Report:

**a. Identifying, disclosing and managing conflicts of interest;**

Please see page 11 & 16-17 of the BPP

**b. Fostering transparency to ensure the accuracy and reliability of the advice;**

Please see page 11 & 12-15 of the BPP

**c. Disclosing general voting policies and methodologies;**

Please see page 11 & 13-14 of the BPP

**d. Considering local market conditions;**

Please see page 13 of the BPP (under Research Methodology and Signatory Policies)

**e. Providing information on engagement with issuers.**

Please see page 18-19 of the BPP.

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<sup>4</sup> See Report of the Chairman, Dr. Dirk Zetzsche, 12 May 2014, pp. 3-5: [http://bppgrp.info/?page\\_id=200](http://bppgrp.info/?page_id=200).

<sup>5</sup> See BPP, p. 6 ([http://bppgrp.info/?page\\_id=200](http://bppgrp.info/?page_id=200)).

Q.6:

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

We refer to our role as one of the chartered signatories of the BPP and respectfully defer to others to provide the answers to this question.

### 3.2.3 The BPP in practice

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Q.7:

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

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

We refer to our role as one of the chartered signatories of the BPP and respectfully defer to others to provide the answers to this question.

Q.8:

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

Since the release of the BPP each proxy advisor that is a signatory to the BPP has released its compliance statement. These statements are located in one central location on [www.bppgrp.info](http://www.bppgrp.info). As a result, we believe that the industry as a whole has increased the level of transparency towards the whole market, as was recommended by ESMA.

Q.9:

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

Please see our answer for Q.25.

**Q.10:**

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

We refer to our role as one of the chartered signatories of the BPP and respectfully defer to others to provide the answers to this question.

**Q.11:**

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

In our view, we believe that the BPP comprehensively addresses the primary goal of fostering greater understanding and confidence on how each proxy advisor operates, and therefore of the proxy advisory industry as a whole.

**Q.12:**

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

ISS welcomes ongoing dialogue regarding the content of the BPP and the way in which the signatories thereto comply with those Principles. On 10 February 2015, the charter signatories to the BPP (BPP Group or BPPG) announced the launch of mechanisms for collecting feedback and monitoring the implementation of the Principles. The BPP Group encourages all stakeholders to provide meaningful feedback and substantiated, fact-based comments as a way to consider updates and improvements to the Principles.



## Questions for Proxy Advisors

### 4.2.1 Background

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Q.13:

Where are your company's headquarters?

ISS is a global company. ISS' U.S. headquarters are located in Rockville, Maryland, U.S. We operate our services from 15 offices in 10 countries<sup>6</sup>. In Europe, our main offices are located in Brussels, London and Paris.

Q.14:

Does your proxy advisory business cover the global market or are you specialised in particular countries, regions and/or markets?

ISS' services cover the global market, and we are a global company with 15 offices in 10 countries. We cover approximately 39,000 companies in 115 countries, delivering proxy research and vote recommendations on nearly 28,000 companies each year. ISS analysts have expertise and insight on the global, regional and local governance landscapes, local market voting, practices and regulatory requirements, along with expertise in varied fields such as law, M&A, compensation, and data analytics.

Q.15:

For each European country in which you conduct your proxy advisory business, what is the percentage of listed companies that you cover? Please fill in the table below.

The table below presents the number of companies listed in countries of the European Economic Area (28 EU Member States + Iceland, Liechtenstein and Norway) for which ISS provided research coverage in the course of 2014<sup>7</sup>.

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<sup>6</sup> A complete list of ISS office locations can be found at <http://www.issgovernance.com/contact/contact-us/>.

ISS' coverage is determined by our clients' portfolios, meaning that ISS will generally cover all public companies held by our clients.

The last column in the table below provides an estimate of the percentage of listed companies in the national stock market covered<sup>8</sup>.

Country	Number of listed companies covered by ISS during 2014	Percentage of listed companies in national stock market covered by ISS in 2014
Austria	53	67.1%
Belgium	91	66.4%
Bulgaria	17	11.9%
Croatia	22	18.0%
Cyprus	23	37.7%
Czech Republic	8	66.7%
Denmark	91	58.3%
Estonia	9	56.3%
Finland	100	76.9%
France	447	59.0%
Germany	346	43.4%
Greece	66	32.8%
Hungary	11	28.2%
Iceland	4	23.5%
Ireland	63	100.0%
Italy	233	80.1%
Latvia	5	18.6%

<sup>7</sup> Coverage referred to in the table is limited to publicly-traded companies. It includes all companies domiciled in a country and which are traded in that country and/or on a foreign exchange. It excludes private issuers. It also excludes European mutual funds, which may or may not be traded on exchanges.

<sup>8</sup> We used S&P Compustat data for the number of listed companies in a country.

<b>Liechtenstein</b>	<b>2</b>	<b>-</b>
<b>Lithuania</b>	<b>14</b>	<b>46.7%</b>
<b>Luxembourg</b>	<b>62</b>	<b>38.0%</b>
<b>Malta</b>	<b>5</b>	<b>31.3%</b>
<b>Netherlands</b>	<b>109</b>	<b>100.0%</b>
<b>Norway</b>	<b>142</b>	<b>70.7%</b>
<b>Poland</b>	<b>152</b>	<b>28.1%</b>
<b>Portugal</b>	<b>29</b>	<b>54.7%</b>
<b>Romania</b>	<b>34</b>	<b>22.4%</b>
<b>Slovakia</b>	<b>0</b>	<b>0.0%</b>
<b>Slovenia</b>	<b>12</b>	<b>30.0%</b>
<b>Spain</b>	<b>106</b>	<b>52.7%</b>
<b>Sweden</b>	<b>248</b>	<b>50.4%</b>
<b>United Kingdom</b>	<b>1189</b>	<b>77.6%</b>

**Q.16:**

For each of the countries you have listed under Q15, can you provide the number of listed companies you had a dialogue with during or in relation to the 2015 proxy season?

The table below presents the number of European companies with whom ISS analysts held a purposeful engagement during or in relation to the 2015 proxy season. The numbers do not reflect interactions with companies that are limited to requests for information, availability of information in specific languages or other “ordinary” communications that are not included in ISS’ engagement statistics. It should also be stressed that the statistics reflect engagement undertaken during the first half of the year only, whereas a significant amount of dialogue with companies is undertaken outside of the first half of the year and many general meetings also occur outside of the main “proxy season”.

In addition, ISS also regularly engages with European-wide and country-wide trade bodies representing corporate issuers, thereby providing another meaningful platform for dialogue with listed companies.

Country	Companies Engaged by ISS in the course of 2015
Austria	2
Belgium	16
Denmark	4
Finland	2
France	72
Germany	6
Greece	4
Ireland	4
Italy	21
Luxembourg	10
Netherlands	40
Norway	4
Portugal	2
Spain	27
Sweden	21
United Kingdom	436

**Q.17:**

Are you providing proxy advisory services only or do you also offer other services? If you offer other services, please briefly describe the role proxy advisory services play relative to the share of total business.

ISS' primary business is providing corporate governance and voting-related products and services. ISS' suite of products includes objective governance research and voting recommendations, end-to-end proxy voting and distribution solutions, and reliable global governance data and modeling tools. Our services help institutional investors act as informed fiduciaries, fulfill their regulatory requirements, and to meet the needs of their clients and stakeholders. Subsidiary companies of ISS provide securities class action services and a number of services for corporate issuers.

ISS' main services can be categorized as follows:

## **Shareholder Voting Research and Analysis**

ISS aims to provide timely, accurate and insightful shareholder voting research and analysis for investors on all publicly-traded companies held in our clients' portfolios, regardless of size or location, taking into account local market regulations and practices, as well as internationally accepted principles of good governance.

ISS offers an extensive array of voting policies to meet the varied needs of institutional investors and their clients. Institutions can choose from ISS' selection of global benchmark policies, or ISS specialty policies that evaluate governance issues from the perspective of socially-responsible investors, public funds, labour unions, mission and faith-based investors, and sustainability issues. ISS also manages full custom voting policies and implements voting recommendations for more than 400 institutional clients according to their own specific guidelines and philosophies.

## **Proxy Voting services**

ISS' proxy voting solutions offer clients complete or partial outsourcing of the processing portions of the voting process, while leaving investors with the final vote decisions. ISS receives proxy ballots from clients, works with their custodian banks, executes votes based on clients' instructions, maintains vote records and provides comprehensive reporting tools on votes cast.

## **Investment Tools and Data**

Institutional investors use ISS' robust data to enhance reporting and to inform investment decisions. ISS tools and data assist clients in their investment decision-making and engagement within portfolio companies, including the following services:

- ISS Governance QuickScore
- Company Profile Reports
- ExecComp Analytics
- Governance Datafeeds
- FactSet integration.

## **Securities Class Action Services**

ISS, through its wholly owned subsidiary, Securities Class Action Services, LLC

("SCAS"), provides a complete, end-to-end litigation research and claims filing solution. With more than 20 years of experience, SCAS helps clients manage and maximize asset recoveries while fulfilling their fiduciary responsibility. SCAS helps clients manage and maximize securities class action recoveries, utilize litigation data as a tool for engagement, and meet fiduciary responsibilities. Our RecoverMax platform and proprietary technology identifies global cases, recovery opportunities and client eligibility, files on behalf of clients, tracks claims, addresses issues, and provides a detailed audit trail of funds recovered.

### **Services for Corporate Issuers**

ISS' wholly owned subsidiary, ISS Corporate Solutions, Inc. ("ICS"), provides a variety of solutions, including web-based governance tools and advisory services that can assist corporate issuers with executive and director compensation modeling, capital structure planning, and visibility into how their governance practices compare with peers.

#### **Q.18:**

For each European country in which you conduct business, what was your turnover in 2014? Please fill in the table below.

As a private company registered in the U.S., ISS does not publicly disclose its financial information. ISS will, however, provide high level financial information regarding its European business directly to ESMA, on a confidential basis.

#### **Q.19:**

What is your total number of clients investing in European listed companies and their approximate total assets invested in such companies?

As of 15 June 2015, approximately 750 to 800 clients had voting authority with respect to European securities from EEA countries. This estimate includes only clients who subscribe to ISS proxy voting services (see Q. 17), and ISS does not track total assets held by its clients.

#### **Q.20:**

Please estimate the percentage of clients using your proxy advisory services which request a custom policy. Have you noticed any trend in the services requested in recent years? Please differentiate across classes of investors (e.g. investment funds, pension funds, insurance companies etc.).

Because ISS clients may use multiple custom and/or specialty policies (as described below), it is not possible to provide a percentage of total clients who request a customised policy.

However, ISS currently manages and applies over 400 custom policies on behalf of its clients. These custom voting policies reflect each investor's specific corporate governance and voting philosophies and approaches. As a result, the vote recommendations issued under these policies may well differ from those issued under ISS benchmark policies. Over 75% of our top 200 clients subscribe to at least one custom research policy service from ISS. For the last couple of years, client custom policies have been the fastest growing segment of ISS' research services.

In addition, ISS also offers "specialty policies", which evaluate governance and other issues from the perspective of sustainability, socially-responsible investing, public funds, labour unions or mission and faith-based investing.

**Q.21:**

Please indicate your number of employees during the 2015 proxy season and the percentage of seasonal employees.

To be representative of the situation during proxy season, we present total headcount as of 1 May 2015:

- Full time employees: 767 (77.7%)
- Seasonal employees: 220 (22.3%).

## 4.2.2 Questions for non-signatories to the BPP

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ISS is one of the chartered signatories of the BPP, so this section is not applicable.

## 4.2.2 Questions for signatories to the BPP

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**Q.24:**

What made you decide to become a signatory to the BPP?

While ESMA found *"no clear evidence of market failure in relation to how proxy*

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*advisors interact with investors and issuers”, it determined that the industry would benefit from increased disclosure and transparency into how it operates. ISS fully agreed with this important conclusion and subscribed to ESMA’s recommendations. We believe that the BPP comprehensively addresses the areas highlighted in ESMA’s 2012 Final Report. In addition, we believe the BPP will achieve its main goal to enhance transparency and help to foster a better understanding and assurance among other stakeholders in terms of what these can rightfully expect from proxy advisors.*

**Q.25:**

*Has your practice in the areas mentioned under Q23 changed since you signed the BPP? If yes, how did it change? Please provide examples, especially related to the 2015 proxy season, to support your response.*

ISS continuously monitors its business practices and takes into account regulatory, client and other market feedback to monitor and further improve its business practices.

As part of the process of becoming a signatory to the BPP, ISS conducted an internal assessment of policies and procedures and strengthened them, including in the three following areas.

**Dialogue with Media and the Public**

We have formalized a communication policy with Media and the Public. The policy is summarized in ISS’ Compliance Statement to the BPP<sup>9</sup>.

**Enhanced client disclosure regarding significant relationships**

Under a policy issued in November 2014, ISS undertook to assess the significance of certain relationships that it might have with any subjects of its proxy research reports. Under that policy we determined to deem as significant all corporate issuers that are clients of ICS. In addition, under the policy, we assessed our relationships with publicly traded institutional investors, as well as clients that act as shareholder proponents, and have determined to deem as significant any such relationship where the client represents 5% or more of ISS’ revenues. In conjunction with adopting the policy, ISS made enhancements to its client-facing

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<sup>9</sup> See ISS Compliance Statement to the Best Practice Principles for Providers of Shareholder Voting Research and Analysis, p. 28 (<http://www.issgovernance.com/compliance/due-diligence-materials/>).



ProxyExchange platform to provide for the disclosure to our clients of significant relationships through the platform.

#### **Enhanced issuer verification process for QuickScore**

ISS' Governance QuickScore is a scoring and screening solution designed to help identify governance risk within companies by providing a score for each company in its coverage universe that measures the company's level of corporate governance risk both overall and based on four broad pillars: board structure, compensation/remuneration, shareholder rights, and audit & risk oversight. ISS developed a complementary Data Verification tool enabling covered companies to review, verify and provide feedback on the data used to determine their scores.

#### **Q.26:**

*Have you taken any other practical initiatives in direct response to, or generally reflecting, the introduction of the BPP which are still in the process of being implemented? If yes, please specify what these are and the time frame you are envisaging for their implementation.*

In June 2014, ISS issued a Statement of full compliance to all three Principles and related Guidance included in the BPP. However, as compliance, disclosure and transparency are always evolving, we regularly review the situation with a view to respond to regulatory, client and other market feedback. To that end, we encourage all stakeholders to provide meaningful feedback and substantiated, fact-based comments as a way to consider updates and improvements to the Principles and to our own practices.