

**REPLY TO THE ESMA CALL FOR EVIDENCE ON THE IMPACT OF THE BEST PRACTICE  
PRINCIPLES FOR PROVIDERS OF SHAREHOLDER VOTING RESEARCH AND ANALYSIS  
(ESMA/2015/920)**

In February 2013, ESMA published a Final Report on the role of proxy advisory industry following a public consultation run in 2012 on a Discussion Paper, seeking input of stakeholders on several key issues relating to the proxy advisory industry and asking whether market participants saw any need for policy action. In its Report, ESMA encouraged the industry to develop its own code of conduct and drafted a set of high-level principles to serve as guidance for the industry. ESMA also committed in undertaking a review of the code of conduct after two years of the publication of its Report.

Following the publication of ESMA's Final Report, a number of proxy advisors established an industry group (the Best Practice Principles Group (BPPG)) to draft a code of conduct. In March 2014, after a consultation run in the second half of 2013, the BPPG published the Best Practice Principles for Governance Research Providers, consisting of three main Principles (Service Quality, Conflict of Interest Management, Communications Policy) and accompanying Guidance, which have to be applied on a comply or explain basis. Signatories to the Principles should publish a Statement of Compliance describing how they apply the Principles and, where any of the Principles have not been applied, provide a reasoned explanation as to why.

The current Call for Evidence has the purpose to gather information on how stakeholders perceive the most recent proxy seasons after the adoption of the Best Practice Principles and to assess new trends or changes in proxy advisors' approaches, in order to allow ESMA to proceed with the said review.

Assonime was actively engaged in the consultation process run by ESMA and the BPP Group and welcomes the opportunity of the ESMA Call for Evidence to express its view on how the activity of proxy advisors evolved and on their impact in the voting process of Italian listed companies. The issue is extremely relevant since proxy advisors have an important influence on institutional investors voting. Evidence of this influence can be found by comparing proxy advisors voting recommendations and the voting results published by companies after the general meeting; this is also confirmed by the comments we received by the largest listed companies.

However, we would like to stress the fact that the responsibility for the votes cast is retained by institutional investors, even if they follow the recommendation of a proxy advisors.

As clearly pointed out by ESMA in its Final Report, the responsibility for the final decision on how to exercise the voting rights always lies with the institutional investor (being a steward of its final client); the role of proxy advisors is to be understood as facilitators for institutional investors to help them to discharge a specific part of the their stewardship responsibilities more efficiently, namely where these responsibilities relate to the investors' ownership rights and voting activities. Thus, the services offered by proxy advisors are to be understood as a signalling tool in addition to the investors' own analysis and, therefore, are not meant to be mechanistically relied upon.

The distinction of the role of (institutional) investors, as engaged shareholders, and proxy advisors, as facilitator for investors, is clearly reflected in the proposed revision of the SHRD, in the text approved by the EU Parliament on July 8<sup>th</sup>, 2015, which provides for separate requirements for policy adoption and disclosure.

## GENERAL QUESTIONS

### 3.2.1 Background

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

Assonime is the Association of the Italian joint stock companies. Its membership is composed of around 500 companies from all sectors (industry, finance, services and public utilities) including around 110 listed companies. This represents 90% of the market capitalization of the Italian stock exchange.

Assonime has regular contacts with the main proxy advisors operating in the Italian market (ISS, GlassLewis, Frontis Governance). In the past years, Assonime organized collective meetings between its members and proxy advisors, well before the AGM season, in order to facilitate a constructive dialogue and enhance proxy advisors' knowledge of the specificity of the national legal system and corporate governance practices, with good results in terms of debate and reciprocal understanding.

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

Yes. As already pointed out in our response to ESMA discussion paper of March 2012<sup>1</sup>, there was clear evidence of the influence of proxy advisors on the vote of institutional investors and we expected this influence to grow in the Italian market due to increased participation of institutional investors in the general meetings of Italian listed companies. Until a few years ago, our most serious concerns were the lack of adequate consideration of local market conditions by proxy advisors and the quality of their voting recommendations. Therefore, the focus of our requests were on: the accuracy in drafting policy guidelines; the transparency on conflict of interest and of methodology of proxy advisors; the modality of the direct engagement with issuers. Meantime, a constructive dialogue with proxy advisors has been started and improvements on the reciprocal understanding have been reached. Still, there are a few areas for improvements, as indicated in our answer to Questions 37, 38 and 39.

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

Yes, we participated to the consultation of the BPP Group. In our response<sup>2</sup> we fully supported the position taken in the Consultation Document, according to which "the ultimate responsibility to monitor investments and make voting decisions lies with institutional investors"; we welcomed the consultation process and the opportunity to comment on the draft best practice principles and wished that the same approach would be followed in the future for the review of the Principles; we fully supported the comply or explain approach followed by the Drafting Committee and wished it would be complemented by an adequate monitoring activity on the application of the Principles.

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<sup>1</sup> [Assonime response to the ESMA Discussion Paper "An overview of the proxy advisory industry. Consideration on possible policy options"](#).

<sup>2</sup> [Assonime response to the Public Consultation on Best Practice Principles for Governance Research Providers](#)

### 3.2.2 The BPP on paper

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

The approaches to the definition of the proxy advisors' activity are diverse.

The definition of proxy advisor adopted in the proposed revision of the SHRD, in the text approved by the EU Parliament on July 8th, 2015, is limited, since it makes reference to a legal person that provides on a professional basis recommendations to shareholders on the exercise of their voting right.

The Principles distinguish between shareholder voting research and analysis (including data and analysis, company-specific research, advice or opinion, ESG ratings, policy guidance, voting recommendations, alerts, bulletins and newsletters), which are the key activities of the Signatories, and other additional services (such as vote agency, engagement and governance overlay services).

We generally agree with this approach which also reflects the distinction adopted in the Opinion of the ESMA Stakeholder Group of April 2012<sup>3</sup>, distinguishing the advisory activity, that is the advice on how to exercise the voting rights attached to securities, from the agency activity, that is the assistance in the exercise of voting rights attached to securities.

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

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

Yes, the Principles cover the main issues addressed by the ESMA Final Report. The point is to monitor how the Principles are applied and their ability to cover all the subjects giving advice on voting rights.

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

The quality of the Signatories' Statements varies among different proxy advisors and they are not always easily comparable. The Principles require that "Signatories should review their Statement of Compliance from time to time (at least annually) and update it as appropriate to reflect current practice and material changes". It would be useful if they were published on the same time of the year and possibly *ex-novo* on an annual basis or, as an alternative, highlighting the changes.

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<sup>3</sup> [ESMA Discussion Paper on Proxy Advisors – Opinion of the MSG](#)

The BPP Group affirmed, in the website, that a framework to make the Statements of Compliance comparable will be adopted within the end of 2015; we believe this could be a useful tool for stakeholders to compare different Statements of Compliance.

As to the content, the Principles provide that 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.

At this regard, special consideration should be given to the quality of the explanation from deviation, considering that information on the compliance to principles of best practice and on deviations from its recommendations is the core of the comply or explain approach. We believe that meaningful and specific disclosures, together with reasoned explanations of the non-application of the Principles, will be important in order to promote a better understanding among companies of how the Signatories operate, and thus to promote a better understanding among companies of when and how to engage with proxy advisers and when and how to engage with their clients.

Useful inputs may be found in the European Commission Recommendation of 9 April 2014 on the quality of corporate governance report.

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

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

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

In general, the main proxy advisors operating in the Italian market are covered by the Principles.

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

We have not observed any significant impact yet, probably due to the early stage of the process of implementation of the Principles which were published at the beginning of 2014.

However, we can observe a certain degree of enhanced transparency on proxy advisors activity, also resulting from the disclosure of the Statements of Compliance. This is especially true with reference to the risk of disclosure of inside information during the dialogue with proxy advisors, which was an important concern for issuers. This was a sensible topic for proxy advisors as well; the fact that, thanks to the BPP, proxy advisors normally clarify in their policies and Statements of Compliance that their recommendations are only based on publicly-disclosed information is a positive outcome and helps issuers to understand that this kind of engagement is proper and legitimate.

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

No comment

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

No comment

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

We generally see with favour the Best Practice Principles and we fully support the comply or explain approach they are based on, but we believe that closer attention should be given to the monitoring process.

According to the BPP, the Group will perform an ongoing monitoring of the implementation of the Principles (p. 2) and will review the Principles and the Guidance no later than two years following the launch. At present, there is no feedback on the activity carried out and it would be useful to know if the members of the group have met, how many times, if the independent chairman played a special role, etc.. At this regard, it could be useful if the Group publishes a (annual) report on its activity where it expresses its view on the application of the Principles and the room for improvements, etc.

Another issue to be addressed is the composition of the Group carrying out the monitoring. An appropriate monitoring process carried out by an independent body on an annual basis and full disclosure of the outcome of the monitoring will contribute to the effectiveness of the Principles. We therefore suggest that the monitoring should be carried out by an independent committee, appointed by the BPPG.

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

The market of proxy advisory firms is highly concentrated. From a policy perspective, it is important not to run the risk that the adoption of any binding regulation reinforces such a concentration (for example by introducing too many fixed costs on PAs that would disadvantage new entrants and thus impede competition) or encourage an overreliance on the activity of proxy advisors. We therefore fully support the disclosure requirements and comply or explain approach adopted by the revision of the SHRD as approved by the EP Parliament. This approach appears to be suitable for an industry which relies on reputation and which operates cross-border.

## **6 QUESTIONS FOR ISSUERS**

### **6.1 Introduction**

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



*stewardship, and ii) that direct contacts between proxy advisors and issuers should be focused on helping the other to better understand the basis for their positions in the voting process.*

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

## **6.2 Questions**

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

- a. whether proxy advisors have provided research, advice and/or recommendations on your company;*
- b. whether you have used services from proxy advisors (please specify which services, e.g. research, consultancy).*

Normally issuers don't use the service of proxy advisors but are the object of their recommendations. What may happen is that issuers buy from proxy advisors their reports in order to know how they are rated. The same happens with the quick score service offered by some proxy advisors.

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

No comment

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

We would like to stress again the fact that, while engagement and dialogue with proxy advisors may play an important role in the voting process, the main focus for issuers is direct engagement and dialogue with their investors.

As pointed out by ESMA in its Final Report, given the role of proxy advisors and given the fact that the responsibility for stewardship should always lie with the investor, proxy advisors should, in principle, not be understood to be engaging with issuers on behalf of their clients (the investors) on general matters of stewardship. Where issuers wish to discuss issues related to voting, engaging in direct dialogue with investors, and discussing the investors' voting policy with them, offers the most effective and preferred route. This approach is in line with generally accepted standards of good corporate governance, which recognise that there should be a dialogue between issuers and investors based on the mutual understanding of objectives.

According to the Principles, 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. In any case, they should disclose and explain their approach to communication with issuers. At this regard, it is very important that there is full transparency on the formalities of such an engagement.

As to direct dialogue with issuers proxy advisors have different practices. Some of them send the draft recommendation before publishing them. This is a practice generally welcome by companies,

although it does not substitute issuers' direct engagement with investors. Some proxy advisors adopt a different policy and do not meet with companies during the solicitation period, that goes from the date a notice meeting is released to the meeting itself, although when a clarification on a specific issue is needed they will reach the company. However, it is exactly during the solicitation period that all the documents relating to the items on the agenda of the general meeting are made public (according to the law) and a dialogue on these topics and documents might be useful.

We believe that the quality of dialogue could be improved from several perspectives. First of all, a less standardized and more open approach, able to take in due consideration local conditions and specific circumstances referred to the issuer, would be appreciated in the perspective of a constructive dialogue (see examples in the answer to Q39).

Second, where a proxy advisor decides to have a direct dialogue with issuers, the same policy should be applied, as far as possible, to all the issuers covered by their recommendations.

Third, it is important for issuers to know the reasoning behind the voting recommendations, in order to engage constructively with their shareholder base. This is especially important where the recommendation is not expressed in terms of "vote against" or "vote for" a resolution, but it is a choice between alternatives, as it is the case in Italy with the slate voting, where the recommendation of proxy advisors is to vote for one of the slates submitted for the appointment of members of the board of directors or of the board of statutory auditor. This may be even more important in case of a recommendation for voting against a resolution proposed in the agenda. This kind of discussion may happen before the general meeting, both before the formulation of the recommendation by the proxy advisors and after that, to check for factual errors with issuers (where the policy of engagement provides so). But it would also be useful to have an ex -post evaluation and dialogue, after the general meeting, where the issuer has the opportunity to know the report and the concrete reasons behind the recommendation.

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

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

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

Among the areas of conflict of interest that should be taken into consideration there is the sale of report by proxy advisors to issuers. One hand the issuer may feel compelled to buy the report and on the other the independence of proxy advisor may be questioned.

These kind of problems may arise where proxy advisors also offer consulting services, even if through a branch different from that giving voting advice, to issuers while also providing for voting recommendations on their general meetings (for example, ISS quick score service). We believe that a clear distinction should be made and disclosed between the provision of data (which could be neutral) from the provision of data and advice (which may generate a conflict of interest).

In addition, the voting recommendation should mention the other consultancy services rendered by the proxy advisor or its group to the issuer.

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

Disclosure of methodology should be improved and the criteria followed to assess the governance solutions should be better explained, especially when standardized formula are used (i.e. in the case of Quick Score service, which uses a numeric score that indicates a company's governance risk relative to their index or region; companies are assessed across four pillars: board structure, compensation/remuneration, shareholder rights, audit and risk oversight).

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

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

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

Awareness of local market could be improved. A general issue for Italian companies is the slate voting. Since slate voting system does not allow to express the vote regarding any single candidate, proxy advisors generally recommend to vote against a list in case one or more of the candidates do not meet their full approval. At this regard, it may be difficult to understand the specific reasons and the relevance of the criticism towards certain candidates. In addition, it may happen, as it was the case this year, that the slate containing a minority number of candidates (the so called "minority list") submitted by several funds got the majority of votes cast, and the so called "majority list" (which had the majority number of candidates) was the second most voted. Since the "minority list" only provided for one candidate, it happened that the majority of the board was appointed by a "minority" of votes cast in the GM. Another general issue concerns remuneration policy. Proxy advisors normally requires the nominative disclosure of the peers used as a comparison by companies; however, Italian legislation requires to companies to disclose whether they compare with any peer when adopting their remuneration policy, without requesting to disclose who these peers are in order to be compliant.

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

We have also been reported of different evaluation given to the same remuneration policy adopted within a group of companies and applied by subsidiaries located in different continental countries.

Roma, July 27<sup>th</sup>, 2015