

ESMA Discussion Paper: Proxy Advisory Industry

Response by Russell Investments

1. Introduction

Russell Investments is pleased to respond to ESMA's Discussion Paper ESMA/2012/212 dated 22nd March 2012, entitled: *An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Options*.

1.1 Proxy Voting Decisions vs Recommendations

We would like to make one initial point which we believe would assist clarification around decision-making, and the recommendations which lead to the decision on a proxy resolution.

The Discussion Paper seeks to differentiate between decisions taken by the end-investor (who has appointed one or more proxy advisers) and recommendations delivered by the proxy adviser to their clients.

Russell believes it will often reflect good investor governance that such decisions are taken in one place, and in one place only. Our approach is, and has been for several years, to operate a global proxy policy. Implementation of Russell's policy is then delegated to Russell's proxy adviser, as implementer. Thus the proxy adviser may *implement* their recommendations (so, a decision) when these recommendations align with Russell's policy. Where the proxy adviser is unable to exercise the delegated authority on a particular vote without reference to Russell, the resolution in question becomes a "referred item". Russell then considers the matter, and directs the proxy adviser how to vote.

We believe this approach delivers two main benefits to our clients:

- Russell retains appropriate responsibility for all votes cast
- Russell benefits from the research and administration resource of the proxy adviser, which the proxy adviser leverages across all its clients, to deliver a cost-effective service.

2. Responses to Questions

Q1 How do you explain the high correlation between proxy advice and voting outcomes?

We believe institutional investors benefit from the economies of scale which proxy advisors offer. That enables some investors, such as Russell, to delegate the voting decisions to the proxy adviser provided the decision aligns with the investor's proxy policy.

Further, if an investor chooses to appoint a proxy advisor then the advantages of duplicate, overlapping research which could lead to a different voting outcome on some occasions would seem modest at best.

Q2 To what extent:

a) do you consider that proxy advisors have a significant influence on voting outcomes?

We consider proxy advisors have a significant influence on voting outcomes. Further, we believe this is reasonable and to be desired provided their research is adequate and other matters referenced in the Discussion Paper are viewed as satisfactory. We see the development of proxy advisors' services as a natural market response to investor needs.

b) would you consider this influence as appropriate?

Broadly, yes.

Q3 To what extent can the use of proxy advisors induce a risk of shifting the investor responsibility and weakening the owner's prerogatives?

We believe it is important for the investor to retain ownership responsibility for the investments in their portfolio. That should not preclude delegation of some activities, within an investor's policy, to a third party. The investor thereby retains oversight responsibility. Delegation is a stronger concept than, say, "outsourcing" which can suggest a lack of appropriate oversight.

Q4 To what extent do you consider proxy advisors:

a) to be subject to conflicts of interest in practice?

Any proxy adviser that receives revenue for services delivered to companies who are also researched by the proxy advisor for investor clients is clearly subject to a conflict of interest.

The issue then becomes one of whether the proxy adviser's clients determine that this conflict is managed satisfactorily.

b) have in place appropriate conflict mitigation measures?

We do not have a market view. For a proxy adviser appointed by Russell, we would ensure we are satisfied with the mitigation measures in place.

c) to be sufficiently transparent regarding the conflicts of interest they face?

See response to b) above.

Q5 If you consider there are conflicts of interest within proxy advisors which have not been appropriately mitigated:

a) which conflicts of interest are the most important?

b) do you consider that these conflicts lead to impaired advice?

No comments.

Q6 To what extent and how do you consider that there could be improvement:

a) for taking into account local market conditions in voting policies?

Russell believes it is important that local market conditions are taken into account when voting proxies. This belief is integral to Russell's policies. For proxy advisers, we believe that competition between (typically global or aspiring global) providers will drive proxy advisers to take these local market conditions into account in their research and recommendations. To the extent that they do not, we believe this may indicate a lack of resources committed to ownership practices by investors (and thus

potentially available to proxy advisers through fees), rather than necessarily a direct issue for proxy advisers.

b) on dialogue between proxy advisers and third parties (issuers and investors) on the development of voting policies and guidelines?

We see dialogue between proxy advisers and their clients (investors) as subject the normal client/supplier dynamics.

Whilst there may be opportunities to improve the dialogue between proxy advisers and issuers, it is reasonable to assume that issuers will on occasion be uncomfortable with the research outcome and recommendation of a proxy adviser. This is to be expected, and it is important that the independence of the proxy adviser is maintained.

Q7 To what extent do you consider that there could be improvement, also as regards to transparency, in:

a) the methodology applied by proxy advisers to provide reliable and independent voting recommendations?

Russell's view is that Proxy Advisors are transparent upon request and believe this is adequate. Too much transparency in terms of calculation methodology could lead to unintended consequence as investee companies make changes in order to achieve a certain threshold that would result in a favorable recommendation rather than making changes to improve governance or be better aligned with what shareholders view as valuable.

b) the dialogue with issuers when drafting voting recommendations?

No comments.

c) the standards of skill and experience among proxy advisor staff?

Russell's view is that this is simply a commercial matter. An investor should only appoint a proxy adviser where the investor is comfortable with the level of skill and experience of that provider's staff.

As stated in our response to Q6a, if this issue is viewed as a systemic problem then it may be driven by the lower-than-required resources that investors overall allocate to ownership activities.

Q8 Which policy option do you support, if any? Please explain your choice and your preferred way of pursuing a particular approach within that option, if any.

In this situation, Russell's perspective is: "competition where possible, regulation where not".

We therefore do not support policy option 4, and are minded to support policy option 1.

Because we see ownership rights and proxy voting in a global context, we would not support the Members States element of option 2. This would create significant additional cost with, in our view, little benefit.

It may be advisable to develop industry standards (option 2) which we believe should be framed by a global perspective.

9) Which other approaches do you deem useful to consider as an alternative to the presented policy options? Please explain your suggestion.

None.

10) If you support EU-level intervention, which key issues, both from section IV and V, but also other issues not reflected upon in this paper, should be covered? Please explain your answer.

Russell does not support EU-level intervention. This would create additional costs for firms operating globally. Many firms hold voting rights for shares held in multiple jurisdictions.

11) What would be the potential impact of policy intervention on proxy advisors, for example, as regards:

a) barriers to entry and competition;

b) inducing a risk of shifting the investor responsibility and weakening the owner's prerogatives; and/or

c) any other areas?

Please explain your answer on: (i) EU-level; (ii) national level.

No comments.

12) Do you have any other comments that we should take into account for the purposes of this Discussion Paper?

No. But we would be happy to discuss our responses if ESMA finds that helpful.