



European Securities and
Markets Authority

Report

**Follow-up on the development of the Best Practice Principles for
Providers of Shareholder Voting Research and Analysis**



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Acronyms and definitions used

| | |
|-------|--|
| AGM | Annual General Meeting |
| BPP | Best Practice Principles for Providers of Shareholder Voting Research and Analysis |
| BPPG | Best Practice Principles Group |
| ESMA | European Securities and Markets Authority |
| IOSCO | International Organization of Securities Commissions |

1 Executive Summary

Reasons for publication

In its 2013 Final Report on the role of the proxy advisory industry, ESMA recommended that the proxy advisory industry develops a code of conduct in order to foster greater understanding and assurance among stakeholders in terms of what these can rightfully expect from proxy advisors. In this report, ESMA also committed to undertaking a review of the development of such code.

In March 2014, a group of proxy advisors followed ESMA's recommendation and published the "Best Practice Principles for Providers of Shareholder Voting Research and Analysis". This report follows up on ESMA's 2013 Final Report and assesses the Best Practice Principles against the expectations presented in that report.

Structure

The report presents the background of the review exercise (Section 2) and elaborates on the purpose and methodology of the review (Section 3). The review itself is structured into three main parts. Firstly, the Best Practice Principles' impact is assessed from a *quantitative* point of view (i.e. the width of the impact) by way of an analysis of the number and characteristics of the signatories (Section 4.1). Secondly, the Best Practice Principles' impact is evaluated with a *qualitative* approach (i.e. the depth of the impact) by means of analysing how the Principles themselves (Section 4.2.1), the compliance statements published by signatories (Section 4.2.2) and the practice of signatories (Section 4.2.3) compare to the expectations set out by ESMA in its 2013 Final Report. Thirdly, the *governance* surrounding the Best Practice Principles is assessed (Section 4.3). Section 5 concludes.

Main findings

In terms of the width of the Best Practice Principles' impact, ESMA observes that the greatest part of the proxy advisory industry has signed up to the Principles. However, there are some further players in the industry which might fall within their scope. ESMA considers that a broader sign-up to the Principles would positively contribute to establishing the Principles as the prevailing standard in the industry.

Turning to the depth of the Principles' impact, ESMA considers that i) the Principles themselves are overall in line with the expectations set out in ESMA's Final Report, ii) while of varying length and detail, compliance statements contain the greater part of the minimum information which ESMA expected based on its Final Report, iii) the Principles have to date had a certain amount of impact on the market, mainly in terms of enhanced clarity for different stakeholders on how proxy advisors operate.

Lastly, as regards the governance approach of the industry group behind the Principles, while the process surrounding the drafting of the Principles met ESMA's governance

expectations, the governance to date regarding the on-going functioning of the Principles after their publication is viewed less positively and constitutes the main area in which ESMA encourages the industry group to take further steps.

Next steps

In line with its 2013 Final Report, ESMA will communicate this report to the European Commission.

2 Background

2.1 ESMA's previous work on proxy advisors

1. ESMA's work on proxy advisors commenced in the summer of 2011 with a targeted fact-finding exercise among representatives of a number of stakeholders to the industry, proxy advisors, institutional investors and corporate issuers along with several bilateral discussions with market participants and analysis of academic literature and public policy studies in the area.
2. Based on this data collection, ESMA published a Discussion Paper¹ in March 2012 asking for stakeholder input on the extent to which market failure related to the activities of proxy advisors existed and presenting four broad policy options which ESMA was considering; 1) no EU-level action at this stage, 2) encouraging Member States and/or the industry to develop standards, 3) quasi-binding EU-level regulatory instruments or 4) binding EU-level legislative instruments.
3. 63 responses to the Discussion Paper were received and based on these, as well as a round table conducted with market participants in June 2012, ESMA published its Final Report² in February 2013. The conclusion of the Final Report was the following:

*"[...] ESMA concludes that it 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 advisors industry would foster greater understanding and assurance among other stakeholders in terms of what these can rightfully expect from proxy advisors. [...] 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."*³

4. The Final Report contained a review clause, according to which:

"ESMA shall review the development of the Code of Conduct by two years after the publication of this Final Report. In order for ESMA to be able to conduct this review, the industry committee should provide ESMA with all relevant materials needed for such an assessment. If for any reason the application of the Code of Conduct has not

¹ ESMA (2012), "Discussion Paper – An overview of the proxy advisory industry. Considerations on possible policy options", available at: <https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-212.pdf>

² ESMA (2013), "Final Report – Feedback statement on the consultation regarding the role of the proxy advisory industry", available at: <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-84.pdf>

³ ESMA (2013), p. 3.

contributed to satisfactorily addressing the objectives underlying the principles by the time of this review, or if subsequent market developments cause concerns that a Code of Conduct cannot adequately address, ESMA may reconsider its current policy position may proceed with more formal measures. ESMA will communicate the findings of its review to the European Commission.”⁴

5. In February 2014, ESMA decided to change the deadline for the review to two years from the publication of the code of conduct (deadline March 2016) instead of two years from the publication of the Final Report (deadline February 2015). This decision was made to allow the BPP to be in place for a longer period of time before the review.

2.2 Development of an industry code of conduct

6. In the spring of 2013, six proxy advisors – Glass, Lewis & Co., ISS, IVOX, Manifest, PIRC and Proxinvest – established an industry group (hereinafter referred to as the ‘Best Practice Principles Group’ or ‘BPPG’) to draft a code of conduct as recommended in ESMA’s Final Report. Professor Dirk Zetzsche was elected chair of the BPPG. Over summer and autumn 2013, the BPPG drew up a first draft of the code of conduct, now referred to as Principles for Best Practice, which was presented to potential signatories in October 2013 and subsequently submitted to public consultation⁵.
7. Following the close of the consultation in December 2013, the BPPG analysed responses (46 in total) and amended the Principles which were published in their final version on 5 March 2014 under the name Best Practice Principles for Providers of Shareholder Voting Research and Analysis⁶ (hereinafter the ‘BPP’). As supporting documents, the chair published a report setting out the decisions made during the drafting process as well as a feedback statement analysing the consultation responses in detail⁷.

3 Purpose and methodology of ESMA’s review

3.1 Purpose of review

8. As the review clause in the Final Report is very high level and simply refers to an examination of the ‘development’ of the BPP, the first step towards developing a methodology is specifying the purpose of the review.

⁴ ESMA (2013), p. 11.

⁵ BPPG (2013), “Public Consultation on Best Practice Principles for Governance Research Providers”, available at: <http://bppgrp.info/wp-content/uploads/2013/11/BPP-Group-Principles-Consultation.pdf>

⁶ BPPG (2014), “Best Practice Principles for Providers of Shareholder Voting Research and Analysis”, available at: <http://bppgrp.info/wp-content/uploads/2014/03/BPP-ShareholderVoting-Research-2014.pdf>.

⁷ Dirk Zetzsche (2014), “Report of the Chairman of the Best Practice Principles Group developing the Best Practice Principles for Shareholder Voting Research & Analysis”, available at: <http://bppgrp.info/wp-content/uploads/2013/10/Report-of-Chairman.pdf>

9. ESMA's 2012 analysis led to the conclusion that improvements in the proxy advisory industry were necessary in a number of areas mainly related to transparency and disclosure. In the Final Report, ESMA presented a set of principles which explained how ESMA expected the necessary improvements to be brought about. The principles and expectations can be summarised as follows (the full text from the Final Report is set out in Annex II):

1. Identifying, disclosing and managing conflicts of interest: Proxy advisors should seek to avoid conflicts of interest and where this is not possible, they should manage conflicts to ensure the independence of their advice and disclose the conflict to their clients.

2. Fostering transparency to ensure the accuracy and reliability of the advice: Proxy advisors should provide investors with information on the process behind making general and specific recommendations and any limitations or conditions to be taken into account so investors can make appropriate use of the advice.

2.i Disclosing general voting policies and methodologies: Proxy advisors should, where appropriate in each context, disclose both publicly and to client investors the methodology and the nature of the specific information sources they use in making their voting recommendations and how their voting policies and guidelines are applied to produce voting recommendations.

2.ii Considering local market conditions: Proxy advisors should be aware of local market, legal and regulatory conditions to which issuers are subject and disclose whether/how these conditions are taken into account.

2.iii Providing information on engagement with issuers: Proxy advisors should inform investors about whether there is a dialogue with issuers and of the nature of any such dialogue.

10. ESMA's 2012 analysis also indicated some expectations on how the suggested code of conduct should be governed. The code should set clear expectations to signatories, be workable from an operational point of view and the industry committee behind the code should be transparent in its composition and selection of a chair and implement an appropriate and periodic monitoring process to evaluate the effectiveness of the code (please refer to Annex II for the full text).
11. These principles and expectations constitute the core elements of ESMA's analysis of the needed improvements in the proxy advisory industry. As such, the purpose of ESMA's review of the BPP is to assess the degree to which the creation of the BPP has so far contributed to addressing these expectations.

3.2 Scope of review

12. To be able to evaluate the extent to which the improvements described above have been produced in the proxy advisory industry, it is necessary to be clear about ESMA's understanding of the term 'proxy advisor'. A definition was not explicitly provided in

either ESMA's 2012 Discussion Paper or 2013 Final Report. However, the Discussion Paper contained the following statement regarding the understanding of the term:

“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.”⁸

13. Both the Discussion Paper and the Final Report further elaborated on this concept, as indicated in the following:

“The main focus of the Discussion Paper is on the operation of the proxy advisory industry in Europe and on the role or interaction of the relevant market participants such as proxy advisors, issuers and investors.”⁹

“ESMA has conducted analysis and consultation with regard to the role of the proxy advisory industry as service providers to institutional investors who invest in European listed companies.”¹⁰

“ESMA considers that the role of proxy advisors is to be understood as facilitators for institutional investors to help them to discharge a specific part of the investors' stewardship responsibilities more efficiently, namely where these responsibilities relate to the investors' ownership rights and voting activities.”¹¹

14. From these paragraphs, the following definition of proxy advisors can be distilled:

Firms that analyse the resolutions presented at the general meetings of European listed companies in order to submit voting advice or recommendations on these resolutions to clients, which are normally institutional investors.¹²

15. A different definition is provided for in the BPP, according to which *“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”¹³.*

16. There are three core aspects of the ESMA definition, namely: i) proxy advisors are firms that provide services, ii) proxy advisors' services are constituted by advice or recommendations on the exercise of voting rights at AGMs, and iii) proxy advisors' voting advice or recommendations are offered to shareholders, which are in most cases institutional investors. The BPP definition seems to be compatible with these elements, however, its scope is possibly broader as proxy advisors under the BPP

⁸ ESMA (2012), p. 7.

⁹ ESMA (2012), p. 8.

¹⁰ ESMA (2013), p. 3.

¹¹ ESMA (2013), p. 7.

¹² Institutional investors are hereby defined according to the recitals of the European Commission's proposal for a revision of Directive 2007/36/EC ('Shareholder Rights Directive') (COM/2014/0213 final - 2014/0121 (COD)).

¹³ BPPG (2014), p. 9.

definition can also be entities: i) other than firms and/or ii) which do not offer explicit voting advice or recommendations but provide general recommendations/research, possibly as ancillary or free-of-charge services. The set of potential signatories to the BPP therefore possibly encompasses further entities than those envisioned by ESMA.

17. In order to provide for a clear basis of analysis, ESMA's review has focused on the BPPs' wider definition rather than the understanding of proxy advisors applied by ESMA in the Discussion Paper and Final Report. Given that the BPP definition is broader than ESMA's, by applying this definition the review ensures to also encompass all entities within ESMA's definition. Furthermore, ESMA highlights that while the relevant market is obviously important, the comply-or-explain principle which the BPP are based on allows for a flexible implementation based on signatories' characteristics; therefore entities only falling partially under the BPP definition should be able to apply the BPP to the appropriate extent. As a clarification, ESMA observes that its review focused on firms providing research, advice or recommendations to investors on voting in relation to European¹⁴ listed companies.

3.3 Timing of review

18. It should be acknowledged that the timing of ESMA's review only allowed for a preliminary assessment of the BPP's impact due to the date of publication of the BPP, on the one hand, and their state of implementation, on the other. No signatory signed up before May 2014 and the most recent signatory statement was published in July 2015. Therefore, the first and only proxy season which could be assessed within two years from the BPP's publication was 2015.

3.4 Levels of assessment

19. To assess the extent to which the BPP have addressed ESMA's considerations and thereby prompted the developments identified as necessary by ESMA, it was essential to take both a quantitative approach – looking at the width of the BPP's impact – and a qualitative approach – evaluating the depth of changes brought about by the BPP. Additionally, it was necessary to assess the extent to which the governance arrangements put in place to date meet the expectations presented in ESMA's Final Report.

Width of changes

20. The quantitative impact of the BPP was assessed by looking at the actual number of proxy advisors which have signed up to the BPP compared to the potential number of proxy advisors that fall within the BPP definition. The size and geographical coverage of signatories were also investigated in order to obtain a more complete indication.

¹⁴ Here and in the following, references to 'Europe' or 'European' cover both the EU and the EEA countries.

Depth of changes: Three steps of analysis

21. Three analytical steps were involved in the qualitative assessment of the BPP, ranging from the more theoretical to the more concrete.
22. Firstly, ESMA analysed how the BPP measure up against ESMA's Final Report. Since the Final Report, as described in paragraph 9, identified the areas within the proxy advisory industry in need of change, an examination of the extent to which the BPP address those areas was undertaken as a first step to understanding how far the BPP have met ESMA's expectations. This element of the review consisted of performing a comprehensive analysis of whether the BPP set out principles and guidance which in an adequate way cover the different elements described in paragraph 9.
23. The next step in the qualitative assessment consisted of analysing the extent to which the compliance statements which the various signatories have published address the expectations in ESMA's Final Report. In this step, the presentation and accessibility of the statements were also evaluated. As additional proxy advisors may sign up to the BPP at any given time, thereby adding compliance statements to be analysed, a cut-off point (end of October 2015) was defined by which no further signatories were included in ESMA's analysis.
24. The third step of the qualitative assessment was to compare signatories' compliance statements with their actual practice after they have become signatories to the BPP. This was both the most concrete and the most challenging step of the qualitative assessment. The most concrete because for the BPP and the compliance statements to have a real effect, signatories should have adjusted their practices if such were not in line with the BPP. The most challenging because it was not straightforward to evaluate whether signatories behave in accordance with their compliance statements, neither in terms of obtaining information nor of drawing general conclusions from such. Moreover, the BPP were published only in 2014 and changing practices takes time. On the other hand, it is possible that changes already undertaken by signatories are not yet perceived by stakeholders.

Governance approach

25. Lastly, ESMA undertook an assessment of whether a robust governance structure has been established for the BPP. This assessment focused on whether the governance expectations set out in ESMA's Final Report, and described in paragraph 10, have been met.

3.5 Collection of information

26. ESMA collected information for the review of the BPP through a number of sources. A public call for evidence was undertaken in the summer of 2015; ESMA received 31

responses from investors, issuers, proxy advisors and other stakeholders¹⁵. Furthermore, a round table with 25 industry stakeholders was conducted in July 2015 and bilateral meetings with signatories to the BPP were undertaken. ESMA supplemented the information collected through these measures with public sources.

4 Review of the Best Practice Principles

4.1 Width of impact

27. As a first step in the review of the BPP, this section provides an assessment of the extent to which providers of proxy advisory services related to European listed companies have signed up to the BPP¹⁶. For the purpose of this assessment, the current signatories were analysed from three different angles; i) number, ii) size and iii) geographical coverage.

Number of signatories

28. The number of signatories is relevant as it provides an indication of the level of momentum which the BPP have gained since their publication and the extent to which they have begun to establish themselves as an industry standard. In this regard, it is important once again to be conscious of the timing of the review and the fact that the BPP have only been in the market for a relatively short amount of time.

29. At the time ESMA's review started in February 2015, five entities had published compliance statements with the BPP: Glass, Lewis & Co., ISS, IVOX¹⁷, Manifest and PIRC. Furthermore, Proxinvest published its compliance statement in July 2015. The six signatories to the BPP thus correspond to the members of the drafting group behind the BPP, cf. paragraph 6.

30. In addition to these six, there are other firms which could possibly fall within the definition of a proxy advisor provided by the BPP. Some of these firms – the Institutional Voting Information Services (IVIS) and Eumedion – explicitly acknowledge in their responses to ESMA's call for evidence that they fall within the definition provided in the BPP but indicate that for different reasons they have chosen not to become a signatory. In addition to these, ESMA is aware of several firms or industry associations which possibly fall under the BPP definition but which are not at this stage signatories. Responses to the call for evidence mention the existence of more than 10 such, mostly local, firms. For example, one respondent indicates that some members of the Expert Corporate Governance Service (ECGS) fall within the scope of the BPP

¹⁵ The call for evidence, along with public responses, is available at: <http://www.esma.europa.eu/consultation/Call-evidence-Impact-Best-Practice-Principles-Providers-Shareholder-Voting-Research-and#responses>

¹⁶ For a more general description of the proxy industry in Europe, please refer to ESMA (2012).

¹⁷ On 11 June 2015, the acquisition of IVOX by Glass, Lewis & Co. was announced. While this caused IVOX to be removed from the BPPG website as an individual signatory in Q4 of 2015, ESMA's review takes IVOX into account as a separate BPP signatory as the review in large part focuses on the period of time from the publication of the BPP until the end of the 2015 proxy season.

but have not become signatories. In this regard, ESMA acknowledges that the BPP definition is broader than that applied by ESMA, cf. paragraphs 16-17, and that an evaluation of the number of signatories on the basis of the broader definition will therefore result in a seemingly lower degree of adherence than one based on ESMA's narrower definition.

Size of signatories

31. Looking at the size of signatories provides further relevant information in relation to the quantitative impact of the BPP. ESMA investigated the size of the current BPP signatories by means of specific questions on turnover and staff numbers included in its call for evidence. Regarding turnover, all respondents have asked that their responses be kept confidential. However, some respondents – both signatories and non-signatories – provide information about their number of staff and some signatories have furthermore made such information available through their signatory statements. This information is a realistic representation of their size and indicates a wide variation across the market. It furthermore points to ISS and Glass, Lewis & Co. being the two largest actors among signatories, though these two are themselves of different sizes (see Tables I and II).

Table I: Signatories' staff numbers

| Proxy advisor | Staff number | Of which seasonal/temporary employees |
|------------------------------------|--------------|---------------------------------------|
| Glass, Lewis & Co. (global number) | +360 | NA |
| ISS (global number) | 987 | 220 |
| IVOX ¹⁸ | 10 | 2 |
| Manifest ¹⁹ | 55 | NA |
| PIRC ²⁰ | 40 | NA |
| Proxinvest | 14 | 6 |

¹⁸ IVOX (2014), p. 1, available at: https://www.ivox-europe.com/tl_files/ivox/Dokumente/Ivox%20Statement%20of%20Conformity.pdf

¹⁹ Manifest (2014), p. 4, available at: <https://www.manifest.co.uk/wp-content/uploads/2014/05/Manifest-Statement.pdf>

²⁰ PIRC (2014), p. 8, available at: <http://pirc.co.uk/about-us-1/files/PIRC%20Best%20Practice%20Principles%202014.pdf>

Table II: Non-signatories' staff numbers provided through the call for evidence

| Proxy advisor | Staff number | Of which seasonal/temporary employees |
|---------------|--------------|---------------------------------------|
| Eumedion | 4 | NA |
| IVIS | 11 | 5 |

32. Academic research and US data²¹ confirm that ISS and Glass, Lewis & Co. are the two biggest global firms, holding cumulatively about 97% of the US market and both providing services also in Europe. While specific market shares of the different proxy advisors have not yet been calculated in a European context²², ESMA can hypothesise on the basis of the information collected through consultation that the situation in Europe is to some extent similar to the US, though less concentrated. This is consistent with the diversity in staff numbers observed above and the general information which ESMA has obtained.

Geographical coverage

33. To assess the quantitative impact of the BPP, it is lastly relevant to assess the geographical coverage of the BPP signatories within Europe. ESMA included specific questions in its call for evidence in this regard; however, most respondents ask that their country-by-country coverage be kept confidential. Coverage information in relation to ISS is set out in detail in its response, confirming the company's wide coverage of the European market²³. As regards non-signatories responding to the call for evidence, Eumedion informs that it covers 100% of companies listed in the Netherlands and IVIS that it covers 82% of UK listed companies.
34. Based on information collected through consultation, ESMA can confirm that ISS and Glass, Lewis & Co. both have a pan-European reach while the other signatories operate more at a local level, though not necessarily exclusively within their national market. Though there are a number of possible signatories which have not signed the BPP, cf. paragraph 30, the geographical coverage of the BPP seems rather broad

²¹ See, in particular: U.S. Chamber of Commerce, Center for Capital Markets Competitiveness (2013), "Best Practices and Core Principles for the Development, Dispensation, and Receipt of Proxy Advice", March, at p. 2, available at www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Best-Practices-and-Core-Principles-for-Proxy-Advisors.pdf. See also: U. S. Government Accountability Office (2007), "Corporate Shareholder Meetings. Issues Relating to Firms That Advise Institutional Investors on Proxy Voting", GAO-07-765, June, available at: <http://www.gao.gov/new.items/d07765.pdf> and Klöhn L. and P. Schwarz (2013), "The Regulation of Proxy Advisors", *Capital Markets Law Journal*, 8:1, 90-107, 7 June, pp. 2-3 as well as Katz, D. A. and McIntosh, L. A. (2014), "Corporate Governance Update: Important Proxy Advisor Developments", March, *New York Law Journal*.

²² ESMA (2012), p. 11.

²³ At a global level, Manifest mentions in its compliance statement that it covered 75 countries in the 2013 proxy season while Glass, Lewis & Co. states that it covered 100 countries in the same season. See Manifest (2014), p.4, and Glass, Lewis & Co. (2014), p.5, available at: http://www.glasslewis.com/assets/uploads/2013/03/2014_22-August_Glass-Lewis-Statement.pdf,

seeing as the two largest signatories virtually cover the entirety of European countries, and other signatories additionally cover smaller constituencies.

Conclusion regarding quantitative impact

- From a general point of view, the size of signatories taken together with their geographical coverage indicates that the width of the BPP's impact has been satisfactory. Signatories to the BPP include the largest firms in the global proxy advisory market and the collective geographical coverage of signatories extends to all of Europe.

- The number of signatories, on the other hand, is more modest. While the six firms forming the BPPG have become signatories, no entities outside the original drafting group had signed up when ESMA's review closed in October 2015, despite the BPP's definition of proxy advisors allowing for a number of further firms to become signatories. This leaves room for additional entities signing up to the BPP in order to establish the BPP as the prevailing standard in the industry.

4.2 Depth of impact

35. The following sections present the assessment of the qualitative impact of the BPP. The assessment follows the three levels presented in Section 3.4 above, i.e. the BPP themselves, signatories' compliance statements and actual signatory practice.

36. For the two first levels of assessment, ESMA developed measurement indicators which are set out in Annex I. The purpose of applying such indicators to the assessment was two-fold. Firstly, to ensure that the assessment was based on clear and objective criteria, defined before the initiation of the review and closely aligned with the expectations communicated to the proxy advisory industry in ESMA's Final Report. Secondly, to provide the highest possible degree of transparency in ESMA's review, allowing stakeholders to understand how the review was undertaken and how each conclusion was reached.

37. When evaluating whether an indicator was met, ESMA applied a four-level scale based on IOSCO's categories for assessing implementation of the IOSCO objectives and principles of securities regulation²⁴:
 - Fully: An indicator was considered fully met when all elements of the indicator had been implemented without any significant deficiencies.

²⁴ IOSCO (2013), "Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation", p. 19, available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf>

- Broadly: An indicator was considered broadly met when shortcomings in implementation were identified, but such shortcomings were not deemed to substantially affect achievement of the intended outcome of the indicator.
 - Partly: An indicator was considered partly met when shortcomings in implementation were identified and such shortcomings were deemed to substantially affect achievement of the intended outcome of the indicator.
 - Not: An indicator was considered not met when the assessment demonstrated that no implementation of the indicator had taken place or when some implementation had taken place but such implementation was deemed clearly ineffective in achieving the intended outcome of the indicator.
38. At the end of each assessment of an indicator, ESMA has indicated whether it considers the indicator to be fully, broadly, partly or not met. The overall assessment of the BPP and of compliance statements is based on the collective of these rankings.
39. For the third level of assessment, i.e. actual signatory practice, the information providing the basis for the assessment was collected through ESMA's call for evidence and stakeholder round table. To allow for a reflection of the multifaceted input received, the assessment of the third level, while still covering the two principles and three subprinciples of ESMA's Final Report, will not be structured according to specific indicators but instead take a more narrative form.

4.2.1 Best Practice Principles

40. This first section of the assessment of the depth of the impact of the BPP analyses the extent to which the BPP address the principles identified in ESMA's Final Report. The indicators set out in the column 'Level 1: Best Practice Principles' in the table in Annex I form the basis for the analysis.

Identifying, disclosing and managing conflicts of interest

41. As a first principle which should be addressed, the Final Report set out 'Identifying, disclosing and managing conflicts of interest'. Principle 2 of the BPP concerns 'Conflicts-of-interest management' which would appear to address this topic. This principle and its accompanying guidance require signatories to draw up and publish a policy on conflicts of interest detailing which potential material conflicts exist, how and when potential material conflicts will be disclosed to clients, how the policy on conflicts is communicated, how staff is trained on the policy and how conflicts will be managed. The guidance to Principle 2 furthermore specifies a number of possible conflicts which

signatories should consider and establishes a list of approaches to conflict mitigation and management, of which signatories should apply one or more.²⁵

42. Turning to the specific assessment, according to the first of Annex I's compliance indicators, the BPP need to make clear that signatories should seek to avoid conflicts of interest with their clients (indicator 1.1.a). Principle 2 of the BPP does not explicitly make such a statement but instead takes the general approach that “[t]he possibility for conflicts-of-interest can arise in all businesses” and “[w]hile conflicts cannot always be eliminated, they can be managed and mitigated”²⁶. The BPP thus acknowledge the importance of managing conflicts of interest, and their approach to the possible existence of such conflicts broadly complies with the one proposed in ESMA's Final Report.
43. As regards managing and disclosing conflicts of interest, according to indicator 1.1.b of Annex I, the BPP need to require that, where a conflict effectively or potentially arises, signatories should adequately disclose this conflict and the steps which they have taken to mitigate it. Regarding the disclosure of conflicts, Principle 2 of the BPP requires signatories to “make full and timely disclosure of potential conflicts that could reasonably be expected to impact their independence or interfere with their duty to clients”²⁷. The principle furthermore requires that “[i]f 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”²⁸.
44. From these two extracts and from Principle 2 in general, it seems that the BPP make a distinction between potential and actual conflicts. Furthermore, Principle 2 distinguishes between conflicts that can and cannot be managed. While the principle requires signatories to disclose both types of conflicts, the requirements for disclosure of unmanageable conflicts seem more stringent, as these must be disclosed to clients without undue delay either before or at the latest at the same time as the signatory delivers its service to the client.
45. The distinction between potential and actual conflicts corresponds to the distinction made in ESMA's Final Report between conflicts that potentially or effectively arise. However, as regards the distinction between manageable and unmanageable conflicts, there is some ambiguity in Principle 2 of the BPP where it says that conflicts which cannot be effectively managed should be disclosed following which the signatory should “[m]anage the conflict as further detailed in the signatory's conflict-of-interest policy”²⁹. It is not entirely clear how a signatory would be able to manage a conflict which had to be disclosed to the client, because it could not be effectively managed in

²⁵ BPPG (2014), p. 16-17.

²⁶ BPPG (2014), p. 16.

²⁷ BPPG (2014), p. 16.

²⁸ BPPG (2014), p. 17.

²⁹ BPPG (2014), p. 17.

the first place. Additionally, ESMA suggests that the descriptions of potential vs. actual conflicts, manageable vs. unmanageable conflicts, mitigate vs. manage, as well as the relation between these concepts, could benefit from clarification.

46. This leads to the other part of indicator 1.1.b, namely that the BPP need to require steps to be taken to mitigate conflicts of interest that potentially or effectively arise. As already partly illustrated in the previous paragraphs, Principle 2 of the BPP contains several statements to this effect, including the aforementioned list of ways to address conflicts. In this connection, a small number of respondents to ESMA's call for evidence mention that the BPP's provisions on conflicts of interest in their opinion should be strengthened, and some of these respondents suggest that disclosure is not a sufficient means to handling conflicts. Overall, ESMA concludes that the BPP broadly address this indicator.

Fostering transparency to ensure the accuracy and reliability of the advice

47. As a second general principle which should be addressed by the BPP, ESMA's Final Report identified 'Fostering transparency to ensure the accuracy and reliability of the advice', which further contained three more detailed sub-principles. The consistency between these sub-principles and the BPP is analysed below. However, it is relevant to assess how the BPP correspond to the more general second principle.
48. According to the first indicator concerning this principle, the BPP need to require that signatories provide investors with information on the process they have used in making their general and specific recommendations (indicator 1.2.a). Principle 1 of the BPP, entitled 'Service quality', and its accompanying guidance address this topic by way of a number of requirements. Firstly, the principle itself states that "[s]ignatories should have and publicly disclose their research methodology and, if applicable, "house" voting policies."³⁰ Additionally, the guidance contains the following statements regarding providing information on the process applied:³¹
- *"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 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 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."*

³⁰ BPPG (2014), p. 12.

³¹ BPPG (2014), p. 12-15.

- *“Signatories should disclose their operational arrangements for the provision of services, including, for example, qualifications of staff, organisation of production processes, etc.”*
 - *“Signatories should have and disclose their policies for managing and responding to complaints, comments or feedback about their services.”*
49. Together, these different requirements seem to ensure that investors are provided with a certain amount of information about the general process which signatories have applied in developing their general and specific recommendations. Overall, the BPP are therefore deemed to fully implement ESMA’s expectations in this area.
50. According to the second indicator, the BPP need to specify that signatories should inform investors of any limitations or conditions to be taken into account regarding the advice provided so that investors can make appropriate use of the advice (indicator 1.2.b). Principle 1 of the BPP contains the following provisions in this regard:³²
- *“Signatories should describe what reasonable efforts they make to ensure their research and analysis are independent and free from inappropriate bias or undue influence.”*
 - *“Signatories should be transparent regarding the research information provided to clients, including, when applicable, dialogue with issuers or shareholder proponents [...]. 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.”*
 - *“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 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.”*
51. In addition to these provisions, Principle 1 comprises a list of possible limitations to signatory services, including data availability issues, reliance on third parties and inconsistencies and irregularities of information provided by intermediaries in the ownership chain.³³

³² BPPG (2014), p. 12-15.

³³ BPPG (2014), p. 15.

52. Taken together, the above requirements are concluded to fully ensure that investors receive information about any limitations or conditions to be taken into account, enabling them to make appropriate use of the advice provided by BPP signatories.

Disclosing general voting policies and methodologies

53. Following the above assessment of the second general principle from ESMA's Final Report, the first of the three sub-principles, 'Disclosing general voting policies and methodologies' is now assessed. This topic is also addressed in Principle 1 of the BPP.
54. The first indicator related to this sub-principle states that the BPP need to oblige signatories to disclose, where appropriate in each context, both publicly and to client investors the methodology and the nature of the specific information sources they use in making their voting recommendations (indicator 1.2i.a). In this regard, Principle 1 of the BPP requires signatories to *"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 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."*³⁴
55. The requirement for signatories to publish the research methodology described above fully meets ESMA's expectation as expressed in indicator 1.2i.a.
56. According to the second indicator, the BPP need to require signatories to disclose, where appropriate in each context, both publicly and to client investors how their voting policies and guidelines are applied to produce voting recommendations (indicator 1.2i.b). Principle 1, and the BPP in general, does not contain such a requirement. The only statement in the BPP which would appear to be relevant to this element of ESMA's recommendations is the obligation in Principle 1 for signatories to *"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."*³⁵ While this provision does not require signatories to explain how their voting guidelines or policies are applied to produce voting recommendations, it does oblige signatories to explain how issuer explanations are taken into account when producing specific recommendations.
57. On this basis, indicator 1.2i.b is only partly fulfilled by the BPP. While Principle 1 does comprise the requirement that signatories must have and publish a research methodology, this methodology relates to the way in which research is conducted and

³⁴ BPPG (2014), p. 13.

³⁵ BPPG (2014), p. 13.

information collected rather than to how such research is applied and how the voting policy/guidelines, whether house, client or custom, are employed to produce specific voting recommendations or advice. It should be noted that the version of the BPP which the BPPG consulted upon in the autumn of 2013 contained a section that is more closely linked to these matters under the heading ‘Research methodologies’³⁶, but this section was not included in the final version of the BPP. While intellectual property rights necessarily limit the level of disclosure that can be provided to the public, ESMA considers that a more detailed approach could be taken in this area.

Considering local market conditions

58. The second sub-principle of ESMA’s Final Report concerns ‘Considering local market conditions’. This issue is also addressed in Principle 1 of the BPP within the requirements regarding research methodology and signatory policies.
59. The first indicator relating to this topic states that the BPP need to require signatories to be aware of the local market, legal and regulatory conditions to which issuers are subject (indicator 1.2ii.a). The BPP do not contain a corresponding statement, either in Principle 1 or elsewhere. However, Principle 1 comprises two more specific indications on the topic, firstly, requiring that signatories include in their research methodology “*the extent to which local conditions and customs are taken into account*” and, secondly, requiring that where signatories have house voting policies, they disclose “*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*”.³⁷ From these two extracts, it appears that the BPP do not oblige signatories to be aware of local conditions and customs, but simply that they publicly disclose the extent to which such conditions and customs are taken into account, if at all. This is only partly consistent with the approach recommended in ESMA’s Final Report.
60. The second indicator asserts that the BPP need to require signatories to disclose whether/how the local market, legal and regulatory conditions to which issuers are subject are taken into due account in their advice (indicator 1.2ii.b). As evidenced in the previous paragraph, Principle 1 of the BPP sets out such requirements both for the general research methodology and specifically for signatories who have house voting guidelines. The BPP therefore fully address this part of the second sub-principle.
61. A few respondents to ESMA’s call for evidence are of the opinion that the BPP should oblige signatories to explain when their voting policies deviate from local codes or to clarify, when using their own voting recommendations which are not in line with local codes, whether the issuer complies with the local code. These suggestions, however, fall outside the expectations which ESMA voiced in its Final Report in relation to proxy advisors’ conduct regarding local market conditions and as such go beyond the scope

³⁶ BPPG (2013), p. 14.

³⁷ BPPG (2014), p. 13.

of the review of the BPP. ESMA observes that there appears to be a gap between the expectations of some issuers and the provisions of the BPP in this area; it is up to the BPPG to consider whether this gap could be addressed in any future update of the BPP.

Providing information on engagement with issuers

62. The third sub-principle identified in the Final Report concerns 'Providing information on engagement with issuers'. Principle 3 of the BPP relates to signatories' 'Communications policy' and the principle includes a section on dialogue with issuers.
63. According to the indicator summarising this sub-principle, the BPP need to clarify that signatories should inform investors about their dialogue with issuers and the nature of the dialogue (indicator 1.2iii.a). Turning to the BPP, Principle 3 sets out that "[s]ignatories should have and publicly disclose their policy (or policies) for communication with issuers [...]". The accompanying guidance clarifies that "[s]ignatories should have a policy (or policies) for dialogue with issuers [...]" and further states that "[t]o 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".³⁸
64. The above extracts of the BPP's Principle 3 are in line with sub-principle 3 of ESMA's Final Report and the BPP's approach to providing information on engagement with issuers therefore fully meets ESMA's expectations. ESMA observes, however, that the outcome of a dialogue between a signatory and an issuer is an integral part of the nature of such dialogue and should as such be disclosed to investors on a systematic basis. One respondent to the call for evidence makes this same point by suggesting that the BPP should require signatories to disclose when they have changed a voting recommendation based on dialogue with the issuer.
65. In addition to this, a small number of respondents make other suggestions for changes to the BPP in the area of issuer communication, e.g. that signatories should be required to engage with issuers and these latter allowed to fact-check signatories' analyses for free. ESMA has taken note of these suggestions but observes that they go beyond the criteria set out in ESMA's Final Report and are as such outside the scope of the review.

Conclusion regarding Best Practice Principles

- From a general perspective, ESMA's evaluation of the extent to which the BPP address the principles and expectations presented in its Final Report is largely positive. There is a significant degree of either full or broad compliance between the BPP and the Final Report's two main principles regarding identifying, disclosing and managing conflicts of interest and fostering transparency to

³⁸ BPPG (2014), p. 18.

ensure the accuracy and reliability of the advice. However, there is an element of ambiguity in the taxonomies applied in the BPP principle regarding conflicts of interest.

- As regards the three sub-principles concerning disclosing general voting policies and methodologies, considering local market conditions and providing information on engagement with issuers, the general picture is positive albeit with room for improvement in certain areas. This would for example be the case regarding requiring signatories to disclose how voting policies are applied to produce advice or recommendations and requiring awareness – but not necessarily blind implementation – of local conditions.

- As a whole, the BPP constitute a good representation of the principles put forth in ESMA's Final Report and consequently an appropriate reference for compliance statements. This assessment is shared by a large number of respondents to ESMA's call for evidence.

4.2.2 Compliance statements

66. This second section of the assessment of the depth of the BPP's impact evaluates the degree to which the principles set out in ESMA's Final Report are reflected in signatories' compliance statements. As observed in Section 3.2, not only should the BPP adequately address the principles identified in the Final Report, but these principles should also be adequately reflected in signatories' compliance statements. The assessment relates to the six entities which had become signatories by the time ESMA's review closed, cf. paragraphs 23 and 29. The indicators contained in the column 'Level 2: Compliance statements' in the table in Annex I structured this assessment. ESMA clarifies that topics which are covered by signatories' compliance statements but which were not addressed in its Final Report, such as a policy for communicating with the press, are not part of the assessment.

General comments

- 67. As a general observation, ESMA considers that compliance statements show an important effort from signatories to clarify and, in some cases, formalise practices with the aim to reinsure their clients and other market participants in accordance with both the BPP and the requirements identified in ESMA's Final Report.

- 68. That being said, the length of compliance statements varies significantly, ranging from 4 to 29 pages. While ESMA acknowledges that quantity does not equal quality, it observes that it can be challenging to adequately account for comprehensive practices in a very short space. As such, the level of detail of descriptions differs considerably between the statements – and sometimes between sections within individual statements – and some accounts remain very abstract as opposed to providing concrete explanations of actual practices. At times, this makes it difficult to grasp the

nature of some signatory practices. Some signatories make more detailed information available in secondary documents which are, however, not in all cases easily obtained.

69. From a purely practical point of view, ESMA lastly observes that compliance statements are not always easy to find on signatory websites. While all statements are available on the website of the BPPG, it might increase accessibility for interested parties if they were also more easily available on signatory websites. A few respondents to ESMA's call for evidence observe that it would be helpful if compliance statements were updated/published at the same time each year in a standardised format and if they incorporated an executive summary allowing readers to quickly obtain an understanding of the level of compliance according to the comply-or-explain principle.
70. Furthermore, a number of respondents to the call for evidence comment on the general quality of the compliance statements. The majority of these respondents are of the view that compliance statements are good and have in general helped to provide better transparency about different firms' practices, though a few respondents observe that there is room for improvement in certain areas. A handful of other respondents consider the compliance statements to be of varying quality. Finally, one respondent remarks that the statements are too broad and resemble marketing materials and identifies a number of areas where some of them could be improved.

Identifying, disclosing and managing conflicts of interest

71. The first principle from ESMA's Final Report which the compliance statements have to be evaluated against is that of 'Identifying, disclosing and managing conflicts of interest'. All six statements contain sections on conflicts of interest as this is addressed by the second principle of the BPP. However, the level of detail varies significantly between statements, reflecting the general point made in paragraph 68.
72. Turning to the specific compliance indicators set out in Annex I, the first indicator asserts that signatories need to declare in their compliance statements that they will seek to avoid conflicts of interests with clients (indicator 2.1.a). The degree to which the compliance statements conform to this indicator varies. Two signatories explicitly declare that they will seek to avoid conflicts, whereas two other signatories implicitly seem to take the same approach but do not directly make such a declaration. Another statement has a stronger focus on managing conflicts while the last signatory states that it is not at risk of encountering conflicts due to its business model and the services it offers. ESMA therefore considers this indicator only partly met when looking at the compliance statements as a whole, all the while observing that this indicator has a more formal nature as it requires a formal declaration of intention without specifying details of action. ESMA observes that the fact that most signatories do not declare that they will seek to avoid conflicts is compliant with the BPP as these do not require such a statement, as described in Section 4.2.1 above.
73. Looking at the second compliance indicator for the first principle, this requires signatories to declare in their compliance statements that they will disclose potential

and actual conflicts of interest, and the steps taken to mitigate them, to clients (indicator 2.1.b). Despite variation in the granularity of descriptions, conformity with this indicator is high. All compliance statements contain declarations that conflicts will be drawn to the attention of clients and some statements also clarify the steps of the disclosure procedure. However, one statement sets itself apart as it states that clients will only be given a general indication that a conflict may exist and can then take initiative to obtain specific information. Also, most statements do not specify whether the steps taken to mitigate conflicts will be mentioned in the disclosure to clients. This indicator is therefore deemed to be broadly fulfilled. It would appear that the reason for uneven practices is not the BPP themselves as they require signatories to proactively disclose conflicts, actual as well as potential, and how such conflicts are managed (cf. paragraphs 43-46).

74. As regards managing conflicts, according to the last compliance indicator, compliance statements need to disclose details of signatories' methods or procedures for mitigating potential and actual conflicts of interest (indicator 2.1.c). While conformity to this indicator varies, all compliance statements address it in some way. Two statements set out detailed descriptions of conflict management procedures, including how potential conflicts identified as particularly pertinent to the signatory are managed in practice. The information about conflict management procedures in the remaining statements is of a less detailed nature. A few of these statements list activities which specific employees and board members, in order to avoid conflicts, cannot engage in. However, the way in which conflicts are handled if they do arise is not described. One signatory refers to internal procedures for conflict avoidance and management which are available to clients only. In general, it seems that the main approach signatories use to manage conflicts of interests is to disclose them in their respective reports while mitigation strategies rarely lead to different actions such as client refusal. As disclosure can be seen as a tool – albeit partial – to manage conflicts, ESMA views this second indicator as broadly fulfilled. The lack of detailed descriptions of conflict management procedures in most statements cannot be explained with reference to the BPP, as it is clearly set out in Principle 2 of the BPP that signatories should have and disclose a conflicts of interest policy explaining, among other, how conflicts are managed.

Fostering transparency to ensure the accuracy and reliability of the advice

75. The second general principle from the Final Report against which the compliance statements must be assessed is 'Fostering transparency to ensure the accuracy and reliability of the advice'.
76. According to the first compliance indicator concerning this principle, signatories need to explain the process through which they ensure the accuracy and reliability of their advice. This might also include disclosing details on their staff's experience and qualifications (indicator 2.2.a). Generally, the six compliance statements show a quite high degree of conformity with this indicator by declaring that signatories' goal is to provide accurate and timely services and in many cases by providing some description of how this goal is attained, e.g. through application of a four-eyes principle or through

internal and external audit of working procedures. Again, the level of detail varies between statements with three statements being very specific and, at the other end of the spectrum one statement simply declaring that the signatory complies with the BPP in this area. A few signatories also provide information on their staff's academic backgrounds, language skills and seniority while others simply declare that their staff has the sufficient knowledge and experience to deliver high quality services, despite more detailed descriptions of obligations being included in the BPP. Even when a high level of detail is provided, the qualification and training level of junior and middle staff and the extent to which interim/temporary human resources are made use of are not always clear. This indicator is therefore concluded to be broadly fulfilled.

77. The second indicator of the second principle states that compliance statements need to provide details of signatories' methods of informing clients of limitations or conditions to be taken into account regarding the advice provided (indicator 2.2.b). Compliance statements only partly conform to this indicator. Three signatories describe in a rather generic manner how they inform their clients of shortcomings of data or conditions to be taken into account regarding signatory advice, one statement simply declares to comply with the section of the BPP which covers this topic and two statements do not address this aspect at all. This is despite the fact that the BPP themselves fully comply with this indicator as described in paragraphs 50-52 above.

Disclosing general voting policies and methodologies

78. Further to the above assessment of the six compliance statements' conformity with the second general principle, this section looks at compliance with the first of the three sub-principles, 'Disclosing general voting policies and methodologies'.
79. The first compliance indicator of this sub-principle requires signatories to provide details in their compliance statements about the methodology they use for making voting recommendations (indicator 2.2i.a). Five statements contain information on the methodology applied by signatories when undertaking research and providing voting advice. This is in line with the requirement of the BPP for signatories to disclose a written research methodology, as described in Section 4.2.1. The level of detail, however, varies significantly between these five statements, as some statements provide precise descriptions of all steps of the research and recommendation generation process while others remain at a quite general level. The last compliance statement indicates that clients will be provided with information about the methodology applied whereas stakeholders other than clients will be informed of such methodologies on a selective basis which would seem to indicate that all stakeholders may not be able to be fully informed. On this basis, ESMA considers this indicator to be broadly fulfilled.
80. The second compliance indicator states that signatories need to provide details of the information sources they utilise when developing their voting recommendations (indicator 2.2i.b). In accordance with the requirements of the BPP, all compliance statements address this point in some form, most statements by declaring that only publicly available information is utilised and several statements by furthermore providing a list of the types of information used. As such, most signatories provide

information to clients and the public about the information sources they use directly in their compliance statements. Three signatories furthermore indicate that they detail their specific data sources in each report. Therefore, ESMA considers this indicator fully met.

81. According to the last compliance indicator, signatories need to provide details of their methods of applying voting policies, whether house, client or custom, to produce recommendations (indicator 2.2i.c). Compliance statements are considered to partly conform to this indicator as they generally contain limited information on the way voting policies are applied to create voting recommendations on specific agenda items. Most statements provide short and general descriptions of the way information is entered into proprietary IT systems and the way voting recommendations are subsequently produced. A few statements provide a bit more detail regarding how specific policy areas are analysed. The general absence of details as regards how voting policies are applied to produce voting recommendations is not surprising, given that the BPP do not contain a requirement for signatories to provide their clients with such information (cf. paragraphs 56-57).

Considering local market conditions

82. Turning to compliance with the second sub-principle identified in the Final Report – ‘Considering local market conditions’ – the first indicator states that signatories need to declare that they are aware of local market, legal and regulatory conditions (indicator 2.2ii.a). Though such a requirement is not directly presented by the BPP (cf. paragraph 59), compliance statements exhibit a high level of conformity with this indicator as all signatories declare that they make sure to be aware of local conditions. Though different statements once again contain varying levels of detail in describing the local conditions which are considered, ESMA considers this indicator to be fully met.
83. The second indicator asserts that signatories need to provide details of the way in which they will inform clients³⁹ of whether/how they take local conditions into account (indicator 2.2ii.b). Conformity to this indicator is less strong. As reflected in the previous paragraph, all signatories live up to the obligation of informing clients of *whether* they take local conditions into account; it is confirmed directly in the compliance statements that this will always be the case. However, though it is required by the BPP, most statements do not make it clear if clients will be informed of *how* such conditions are taken into account, e.g. if clients are informed in cases where signatories choose to provide recommendations which are not in line with a local code of conduct, though some signatories do specify that their policies concerning different jurisdictions are available on their websites. On this basis, ESMA considers this indicator to be broadly fulfilled.

³⁹ In addition to clients, other stakeholders, particularly issuers, may also be interested to know whether/how local conditions are taken into account when signatories undertake research and/or provide voting advice or recommendations. However, as it was not specified in ESMA’s Final Report that the code of conduct would be expected to oblige signatories to provide such information both to clients and to other stakeholders, ESMA considers that it cannot retroactively impose such an expectation. Therefore, indicator 2.2ii.b refers only to providing such information to clients.

Providing information on engagement with issuers

84. The third and last sub-principle concerns 'Providing information on engagement with issuers'. This aspect is covered by the third principle of the BPP and all six compliance statements include sections on it.
85. According to the compliance indicator covering this sub-principle (indicator 2.2iii.a), signatories need to firstly declare that they will disclose their communication with issuers to clients. In line with what is required by the BPP, three compliance statements clearly conform with this indicator as they declare that, if and when dialogue with an issuer takes place, this will be communicated to clients, most often in the report submitted to clients. A fourth statement, while containing descriptions of the signatory's approach to communication with issuers, does not make it entirely clear if communication will in all cases be brought to the attention of clients. A fifth statement clarifies that the signatory offers such information to certain clients based on a geographical distinction while the sixth statement does not state that issuer communication will be disclosed to clients.
86. Secondly, the indicator requires signatories to declare that they will disclose the nature (e.g. frequency, format) of their communication with issuers to their clients. As described in Section 4.2.1, the BPP require signatories to disclose the nature of their communication with issuers. On that basis the compliance pattern from the previous paragraph is replicated as most signatories confirm that they will describe the nature of the dialogue with issuers when this is reported to clients, though the mechanics and timing of this communication are not always clear. The signatory that only informs clients in certain jurisdictions of communication with issuers, cf. paragraph 85, states that it will inform clients of the nature of such communication and the signatory that does not state that issuer communication will be disclosed also does not comply with this indicator as they are interlinked. On this basis, ESMA considers the indicator to be broadly met.

Conclusion regarding compliance statements

- ESMA considers that compliance statements show an important effort from signatories to clarify and, in some cases, formalise their practices. As a general assessment, ESMA observes that while the level of detail and clarity varies, statements are overall in line with the expectations indicated by ESMA in its Final Report. In the few areas where ESMA's expectations are only partly fulfilled, this is either due to the way the BPP are drafted or to the compliance statements being drawn up in a way that is not fully in line with the BPP. For example, the fact that most signatories do not declare that they will seek to avoid conflicts may be explained by the BPP not requiring such a statement. The same conclusion applies to the lack of information regarding the way in which voting policies are applied to produce specific voting recommendations as such disclosure of information is also not required by the BPP. On the other hand, statements generally do not provide sufficient details of signatories' methods of informing

clients of limitations or conditions to be taken into account regarding the advice provided, despite the BPP clearly requiring this practice.

- While ESMA considers that there is still room for improvement in certain areas, the significant diversity in terms of level of detail in the description across different players seems at least in part correlated with signatories' different size and level of resources. This correlation is particularly evident in some statements.

- ESMA also recalls that the BPP operate within a comply-or-explain framework. This means that if signatories opt not to comply with one or more elements of the BPP, they are "*supposed to deliver meaningful, relevant and detailed explanations*". This should be substantiated, accompanied by an indication of any alternative provision applied, and "*[i]f 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*".⁴⁰ ESMA observes that, while different signatories show a varying degree of compliance with the BPP, no signatories indicate non-compliance with any of the Principles or accompanying guidance.

4.2.3 Signatory practice

87. Following the above analysis of the extent to which the BPP as well as the compliance statements reflect the expectations presented in ESMA's Final Report, this section contains the third and last element of the assessment of the depth of the BPP's impact: the extent to which signatories' actual practices reflect their compliance statements and as such the extent to which such practices have changed, if necessary, following signatories signing up to the BPP. As ESMA has no power to require information in this area, the assessment is based on the information that was voluntarily provided by proxy advisors and other stakeholders in the context of ESMA's call for evidence as well as its stakeholder roundtable. As such, this section also provides feedback to the market on these information collections.

88. While this third element of the qualitative assessment is important, it is also necessarily of a preliminary nature due to the timing of ESMA's review. As the BPP were published in March 2014 and most of the current compliance statements were published in the course of 2014, the only proxy season in which current signatories' practice can be fully analysed is the 2015 season, meaning that the analysis of practices covers only one season. As such, it is possible that signatories will undertake further changes over the coming proxy seasons, that changes which have already been made have not yet been identified by stakeholders or that the impact of changes that have been made has not yet become fully apparent. A further caveat which must be highlighted is the difficulty connected with verifying causality in the relationship between the BPP and any

⁴⁰ BPPG (2014), p. 7.

changes in signatory practices. These considerations will be taken into account in the conclusions drawn throughout this section.

General comments

89. A number of general reflections regarding the impact of the BPP in practice can be discerned in the input ESMA received, both through its stakeholder round table and its call for evidence. Firstly, it is highlighted by a number of respondents that it is still early to evaluate fully and accurately the impact of the BPP due to the short time which has passed since their publication. On this basis, it is pointed out that the impact of the BPP may be stronger after a few successive proxy seasons following their publication.
90. With this caveat, a large part of respondents to the call for evidence consider that the BPP have brought about improvements in the industry with many pointing out that particularly the transparency of proxy advisors' activity has improved whereas the actual way they run their business has not yet seen significant change. These respondents mainly consist of users of proxy advice but also contain some issuer associations. One issuer association, for example, explains that clarification from proxy advisors that advice and recommendations are solely based on publicly available information has been helpful to issuers. Other respondents mention that the publication of compliance statements creates transparency by facilitating comparison.
91. Additionally, a few respondents consider that there has been a general improvement in the actual business practices of proxy advisors in the last 5-10 years though these are not necessarily linked to the BPP. Finally, a different group of respondents, primarily issuer associations, advise that they have not seen significant signs of changes in the practices of proxy advisors as a result of the BPP.

Identifying, disclosing and managing conflicts of interest

92. Looking at the first principle from ESMA's Final Report, a small number of respondents consider that proxy advisors' disclosure in the area of conflicts of interest has improved following the publication of the BPP. For example, one investor respondent observes that, while disclosure of conflicts of interest and procedures for managing them existed also before the BPP, such disclosure has become more accessible following their publication. Examples are given of signatories either actively highlighting a relationship with the issuer in their reports or on their voting platform. This last change is also mentioned by other respondents as a positive development.
93. Other respondents do not consider that change has taken place and concerns are voiced regarding possible conflicts. Some respondents, for instance, repeat previously expressed concerns that some proxy advisors' practice of selling their reports to issuers could have the double disadvantage of drawing the independence of proxy advisors into question and making issuers feel forced to buy reports. Other respondents are critical towards the practice of one signatory offering advice to issuers regarding how they may align their governance with the signatory's house voting policy, and these respondents state that a clear distinction should be made between data

provision as a standalone service and provision of data and advice which could be problematic. One investor respondent observes that there is still progress to be made also in terms of timely disclosure. In particular, the respondent mentions that it normally only becomes aware of conflicts of interest shortly before the AGM when it does not receive input from its proxy advisor; a practice that creates timing problems.

94. Another respondent observes that many capital markets participants have to manage conflicts of interests and succeed in doing so without difficulty and as such there is no reason why this would be a problem for proxy advisors. Two BPP signatories explain that they have enhanced their conflict disclosure as a result of becoming signatories which is in line with the feedback received from a number of investors and issuers, as described above.

Fostering transparency to ensure the accuracy and reliability of the advice

95. As regards the second general principle from ESMA's Final Report, namely fostering transparency to ensure accuracy and reliability, one respondent comments that the BPP are likely to have led to an improvement in the accuracy, reliability and timing of reports whereas another respondent comments that the qualifications of proxy advisors' staff are not always sufficient. More extensive input is provided in relation to the three sub-principles, as reflected below.

Disclosing general voting policies and methodologies

96. Looking at the sub-principle regarding disclosing general voting policies and methodologies, respondents to the call for evidence express divergent views when it comes to signatories' disclosure of their methodologies. Several, both from the investor and the issuer side, consider that transparency relating to methodologies has improved. One issuer association, for example, mentions that signatories as well as non-signatories appear to be making greater efforts to explain their methodology and the origin of their research. Some respondents in this group observe that there is still room for further improvement and one respondent considers that transparency was already good before the BPP. On the other hand, several other respondents, all issuer representatives, consider that there has been no change following the BPP or that proxy advisors' methodology disclosure still needs to improve. For instance, one respondent comments that the criteria applied by proxy advisors when assessing issuers should be more clearly explained, in particular when standard formula are utilised.
97. Concerning voting policies, a few respondents observe that such should be made in due time and that issuers should be allowed to comment on the policies before they are finalised. One respondent states that some proxy advisors charge issuers to see their voting policies while another respondent comments that disclosure of voting policies has improved, but that it would be helpful to have an annual consolidated version of each house voting policy instead of only a document containing changes compared to the previous season. A BPP signatory observes that they have started disclosing their

specific voting policy and are also disclosing all voting recommendations two days before each general meeting.

Considering local market conditions

98. In relation to the second sub-principle on signatories' consideration of local market conditions, several respondents – all issuer representatives – believe that proxy advisors should ensure that their voting policies are better suited to take local specificities into account and that advice and recommendations need to be better tailored to the particularities of individual issuers. Examples are given of agenda items in relation to remuneration, director independence and the separation of chair and CEO on which proxy advisors did not take into account issuer explanations of jurisdiction or company specificities. One of these respondents notes, however, that some issuers have seen improvements in this area over the last 5-10 years.
99. Another group of respondents, a mix of issuers and investors, is more positive, observing that they have seen improvements in signatory practice, that quality in this area is continuously improving or that proxy advisors' knowledge of local conditions was already good before the BPP. An example regarding the functioning of the 'Voto di Lista' system at the 2015 Telecom Italia AGM is used to demonstrate the increasing quality of research in relation to local standards⁴¹. Additionally, some investors underline that while the proxy advisors they use consider local market conditions, some local market codes do not promote shareholder interests. Therefore, proxy advisors will assess which local codes to follow and which to disregard based on alignment with client interests, thereby creating pressure to bring about improvements in local governance arrangements.

Providing information on engagement with issuers

100. Regarding the last sub-principle on signatories' disclosure to clients of their communication with issuers in relation to the services provided to clients, some investors indicate that they have seen improvements. One respondent highlights that especially disclosure regarding changes to voting recommendations following engagement with an issuer has improved. Other investors comment that the information they received regarding their proxy advisors' communication with issuers was good even before the BPP came into place.
101. In addition to these comments, ESMA also received a large amount of input from issuer representatives regarding communication with proxy advisors. Such input, however, does not relate directly to the question of whether signatories to the BPP are informing their clients of communication with issuers. Instead, it relates to communication

⁴¹ It is indicated that on that occasion, a proxy advisor "provided investors with a non-routine recommendation to vote against the minority investor slate. A different recommendation by [the proxy advisor] 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 [the proxy advisor] as well as an awareness by investors of the implications of their vote".

between proxy advisors and issuers more generally and to the expectations issuers have in this regard. In general, issuers comment that they wish to have the opportunity to review proxy advisors' reports before they are circulated to investors so that any factual errors can be corrected. It is furthermore remarked that proxy advisors should give issuers sufficient time for such review, for example a minimum of two days, and should not charge them for it. In this regard, two signatories state that they have enhanced issuers' possibility for verifying data in their reports following the BPP, one in particular by initiating the practice of making a 'data-only' report available to issuers for fact-checking prior to releasing the entire report to investor clients. These changes are also acknowledged by other respondents to ESMA's call for evidence.

102. A number of issuers additionally suggest that when proxy advisors recommend their clients to vote against an issuer proposal, the issuer's explanation for the proposal – provided in the process of commenting on the report – should be included when the voting recommendation is sent to investors. As regards these suggestions, a handful of issuers state that they have seen improvements in signatories' willingness to engage and listen to issuers following the BPP or that such change is likely to follow from the BPP in the future while a few others indicate that they have seen no change.

Conclusion regarding signatory practice

- Within the general context that the BPP, and consequently compliance statements, have been established only for a relatively short period of time, and that it is therefore too early to fully evaluate their impact, ESMA's overall conclusion is that there have been some positive changes in signatory practices but that these have been more significant in some specific areas and more variable in others. In particular, a significant proportion of respondents have noted an improvement in transparency, in line with expectations set out in ESMA's Final Report. Specifically, as reported above, improvements in signatories' practices have been observed by a number of respondents with regards to disclosure of conflicts of interest and disclosure of communication with issuers and also, to a lesser degree, with regards to disclosure of methodologies. However, a number of stakeholders still raise concerns about signatories' ability to manage or to avoid conflicts of interest and – to some extent - about signatories' consideration of local conditions. Finally, a few investors indicate that they would look at whether a proxy advisor is a signatory when selecting new service providers, thereby confirming that the BPP are starting to play a role in the market.
- As for the specific concerns voiced by issuers in relation to how signatories operate regarding engagement with issuers and – to a certain extent – voting policies (cf. paragraphs 101-102 and 97), ESMA takes note of these. However, the expectations set out in ESMA's Final Report in relation to these two topics

relate to changes in disclosure and not to changes in proxy advisors' business operations. As such, the aforementioned concerns fall outside ESMA's review of the BPP⁴². Notwithstanding this, ESMA acknowledges that there seems to be a mismatch between many issuers' expectations regarding the changes in terms of engagement and dialogue on voting policies they would like to see as a result of the BPP and actual changes. It is up to the BPPG to consider whether this issue could possibly be addressed in future updates of the BPP.

- Overall, while it is still early to draw any definitive conclusion, evidence suggests that the impact of the BPP on the market has so far mainly been on the transparency side. In this connection, ESMA recalls that its expectations in the 2013 Final Report mainly related to transparency while expectations in relation to changes in actual business operations were limited to conflicts of interest management and awareness of local market conditions.

4.3 Governance approach

103. In this last part of the review of the BPP, the governance approach of the BPPG is assessed. This covers the transparency of the BPPG and its internal structure, the degree to which the BPP would appear to be workable from a practical point of view and the framework for monitoring the application of the BPP. ESMA's expectations in this area were firstly set out in its Final Report and are reiterated in Annex II under the heading 'Governance expectations regarding the Code of Conduct'.

Transparent committee with clear structure

104. ESMA's Final Report mentioned that the industry committee undertaking the drafting of a code of conduct should work independently from ESMA and that it should adopt all necessary measures to allow it to carry out its work, including those relating to governance, membership and decision-making. The committee should furthermore be transparent regarding its composition as well as its selection of an independent chair – who should “*possess relevant skills and experience*” – and could decide to include independent members or other stakeholder representatives than proxy advisors.
105. The BPPG made the decision to formally appoint a chair to lead the group in its drafting work and launched a public call for interest in this position via the website of the International Corporate Governance Network (ICGN) in March 2013. The call led to the selection of Professor Dirk Zetsche, an academic independent from the BPPG and with no affiliations to the proxy advisory industry⁴³. The BPPG furthermore established a

⁴² The Final Report set out ESMA's view that “[i]ssuers may legitimately fact-check the opinions of proxy advisors as regards to their resolutions (where proxy advisors choose to be in dialogue with issuers on these matters)” and “[p]roxy advisors can choose whether or not to have a dialogue with issuers. If they do choose to have such a dialogue, it is up to the proxy advisor what should be the timing, frequency, intensity and format for this dialogue.” ESMA (2013), p. 8-10.

⁴³ BPPG (2014), p. 4.

website containing information about the BPP project and the participants of the BPPG⁴⁴.

106. Looking at the period following the publication of the BPP, ESMA observes that there is no public information on rules or other measures having been adopted to ensure that the BPPG can continue to function in an efficient and transparent manner and that the group is composed only of the original drafting members. Furthermore, the BPPG has since the publication of the BPP operated without a chair. Respondents to ESMA's call for evidence also highlighted these points and indicated that clearer and sounder governance would provide more comfort to stakeholders, and in particular potential additional signatories, thereby possibly also facilitating further diffusion of the BPP.
107. ESMA acknowledges that it is the prerogative of the BPPG to adopt all necessary measures to ensure that it can appropriately carry out its work and that there are a number of challenges connected to the set-up of a governing body⁴⁵. However, on the basis of its Final Report, ESMA expects the BPPG to adopt measures to ensure a robust governance structure which is clearly communicated to the public. ESMA recalls that the appointment of a chair could be a tool to facilitate increased clarity as regards the operation of the group as well as contribute to its efficient functioning. A rotating chairmanship among the BPPG members themselves could serve this purpose, while an independent chair would have the further advantage of affording the BPPG a certain degree of independence from the original drafting entities and thereby additional comfort to stakeholders. Additionally, other arrangements could contribute to these goals, e.g. in terms of a broader composition of the BPPG.

Code that sets clear expectations and is workable

108. According to the Final Report, the BPP should set clear expectations in terms of principles, guidance and examples of good practices so that high level principles are supported by descriptions of how they should be applied. As mentioned on page 11 of the BPP, the principles in the BPP are accompanied by guidance which clarifies the background, relevance and application of the principles. This structure is maintained for all three principles of the BPP; the principles being very general and the accompanying guidance providing details on the way in which the principles should be implemented. The guidance includes examples, often in the form of non-exhaustive lists of measures which signatories may consider in their effort to comply with a given element of a principle. On this basis, ESMA finds that the BPP fully live up to the aim of setting clear expectations presented in the Final Report; this assessment is echoed by several respondents to the call for evidence.
109. The Final Report additionally set out that the BPP should be workable from an operational point of view for those who subscribe to them; if this were to imply a comply-or-explain approach, explanations given should be sufficiently precise, specific

⁴⁴ <http://bppgrp.info/>

⁴⁵ A similar point is raised by the BPPG chair in his report (Zetzsche, 2014, p.18).

and comprehensive. The BPP declare to function according to a comply-or-explain logic according to which signatories should comply with the principles as well as the related guidance or otherwise provide meaningful, relevant and detailed explanations for not complying. Furthermore, the BPP state that explanations for temporary non-compliance should be accompanied by a date by which the non-compliance will come to an end.⁴⁶

110. The descriptions of how the comply-or-explain principle should be applied would appear to meet the condition of the BPP being workable. The descriptions specify to signatories that all elements of the BPP are covered by comply-or-explain and clarify how situations of non-compliance should be handled. However, in connection with the condition that explanations for non-compliance should be sufficiently precise, specific and comprehensive, ESMA observes that no signatories have as of yet declared that they do not comply with elements of the BPP. While this from an initial point of view seems positive, there nonetheless appears to be elements of the BPP which are not applied by all signatories, when considering their compliance statements, cf. Section 4.2.2. In this regard, ESMA observes that an appropriate application of the comply-or-explain principle would normally entail clear identification and explanation of the cases in which signatories are not complying with the BPP or the associated guidance. On this basis, while the application of a comply-or-explain framework to the BPP allows different signatories to adapt their compliance to their specific business models, ESMA considers that not all the current signatories are employing the framework accurately throughout their statements.

Monitoring framework

111. Turning lastly to the framework for monitoring the application of the BPP, the Final Report firstly set out that the BPPG should implement an appropriate and periodic monitoring process to evaluate the effectiveness of the BPP. In line with this expectation, the BPP indicated that “*the BPPG will perform on-going monitoring of the implementation of the Principles*”⁴⁷. On 10 February 2015 the BPPG in a press release announced the launch of formal mechanisms for collecting feedback and monitoring the implementation of the BPP⁴⁸. The BPPG invited on-going comments and feedback from stakeholders and advised that such will be considered on an ad hoc basis. The BPPG’s press release furthermore mentioned that the BPPG planned to develop a comparative framework to facilitate assessment of how signatories have complied with the BPP. The template of the comparative framework was published on the BPPG website in early Q4 2015 with signatories expected to fill in the template soon thereafter.

⁴⁶ BPPG (2014), p. 7.

⁴⁷ BPPG (2014), p. 5.

⁴⁸ BPPG (2015), available at: <http://bppgrp.info/wp-content/uploads/2014/03/150210-BPP-Group-Consultation-Press-Release-Monitoring.pdf>

112. On the basis of the above, it appears that the BPPG has taken steps toward establishing a monitoring procedure regarding the application of the BPP. While a few respondents to ESMA's call for evidence welcome the feedback mechanism established by the BPPG, some of the BPP signatories mention that no feedback had been received through the mechanism at the time of their responses to the call for evidence. One signatory suggests that this could be due to stakeholders not actually wishing to engage. Regarding the comparative framework, some respondents to the call for evidence, both from the investor and the issuer side, comment that a comparative framework as mentioned in the press release is likely to be useful. In ESMA's view, the recently published comparative framework is a positive step in the direction of developing a sound monitoring regime around the BPP. Furthermore, it is possible that it will help address the problem of signatories not always applying the comply-or-explain principle in an accurate manner. However, it is early to draw conclusions as the framework had not yet been filled in by signatories at the close of ESMA's review in October 2015.
113. The Final Report secondly set out that the BPPG should publicly communicate the parameters by which the effectiveness of the BPP will be assessed and that it should publish the results of the monitoring process. As regards publication of the results of the monitoring, ESMA expects the comparative framework to remain in the public domain also when filled in by signatories which would go some way towards fulfilling this expectation. The communication of parameters itself is to some extent met by the comparative framework. However, it is ESMA's view that other elements besides the written statements of signatories would need to be monitored to have a full understanding of the effectiveness the BPP. This could for example include whether declarations made in the compliance statements are implemented in practice, possibly by using any input received through the feedback mechanism. Also, it is not yet clear whether the exercise of assessing the effectiveness of the BPP will be undertaken by the BPPG itself or by a third party.
114. To sum up, while the publication of the comparative framework is also positive in the sense of clarifying the parameters by which the effectiveness of the BPP will be assessed, until the BPPG has published the results of its monitoring of the BPP and clarified which role the comparative framework and potential other elements will play in this monitoring process, it is too early to assess its overall effectiveness. It is worth mentioning that in order to improve clarity on the activities carried out by the group, ESMA's Securities and Markets Stakeholder Group suggests in its respond to the call for evidence that "*[i]t would be useful if the [BPPG] were to publish a (annual) report on its activity and express its view on the application of the Principles and the room for improvements, and any other relevant comment*"⁴⁹. This is one

⁴⁹ SMSG (2015), p. 5, available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-smsg-026-advice_on_proxy_advisors.pdf

potential tool that the BPPG might consider to facilitate transparency on the results of its on-going monitoring process.

115. Finally, ESMA observed in its Final Report that where results of the monitoring process or new market developments necessitate changes to the BPP, the BPPG should appropriately implement such changes, subject to a process of robust and public consultation. ESMA observes that no changes have been made to the BPP so far, which does not give reason for concern considering the relatively recent launch. Furthermore, the BPP explicitly indicate that “*the BPPG will review the Principles and Guidance no later than two years following their launch*”⁵⁰. The BPPG confirmed in its February 2014 press release that it will undertake a formal biannual review of the BPP. While the press release indicates that the BPPG will subject any changes to the BPP to a stakeholder consultation, no details can be found on the BPPG website, neither in terms of concrete steps envisaged nor in terms of who would perform the review. Therefore, it is not at this stage possible to draw any conclusion in this area.

Conclusion regarding governance approach

- To summarise, ESMA’s expectations in relation to the governance of the BPP are to date partly fulfilled. While the drafting phase met ESMA’s expectations, both in terms of structure and process, there is room for improvement and open issues to be resolved in a number of other areas related to the on-going work which needs to be carried out to ensure the successful evolution of the BPP.
- As for the BPPG’s structure and independence, it can be recalled that in its Final Report ESMA indicated that the industry committee was expected to be transparent about its composition and status, including the selection of its chair. While ESMA considers that the BPPG fulfilled these expectations regarding the drafting process, it highlights that the on-going monitoring work should also be based on a clear and sound governance structure.
- Regarding the BPP being workable, the principles and guidance provided by the BPP are clear and the comply-or-explain system is widely understood as the most effective means to signal compliance with self-regulatory codes. However, signatories’ compliance statements do not always clearly point out when elements of the BPP framework are not complied with nor do they highlight the reasons for non-compliance or alternative practices applied.
- As for the monitoring framework, ESMA considers that it is not at this stage possible to draw a final conclusion as some developments are not yet completed. A feedback mechanism has been set up and the structure of a comparative framework established, although neither had been used at the closing of ESMA’s

⁵⁰ BPPG (2014), p. 5.

review in October 2015. The BPPG has announced that it will undertake a biannual review; however, there are no details available on this to date. ESMA encourages the BPPG to provide more information on these initiatives and to take them forward as substantively as possible in order for stakeholders to have confidence in the role of the BPP in addressing the areas identified in ESMA's Final Report.

5 Conclusion

Main conclusions drawn from the review

116. In terms of the width of the BPP's impact, ESMA observes that the greatest part of the proxy advisory industry has signed up to the BPP. There are some further small players in the industry which – while they mostly do not fall within the narrower understanding of the industry used by ESMA in its Final Report – might be captured by the wider definition used in the BPP. ESMA therefore considers that a broader sign-up to the BPP would positively contribute to establishing the BPP as the prevailing standard in the industry.
117. Turning to the depth of the BPP's impact, ESMA considers that:
- The BPP themselves are overall in line with the expectations set out in ESMA's Final Report. There is a significant degree of either full or broad compliance between the BPP and the Final Report's two main principles regarding identifying, disclosing and managing conflicts of interest and fostering transparency to ensure the accuracy and reliability of the advice. As regards the three sub-principles, the general picture is positive albeit with room for improvement in certain areas, e.g. requiring signatories to disclose how voting policies are applied to provide advice. Feedback received through the call for evidence confirms this largely positive assessment.
 - As regards compliance statements, while such are of varying length and detail, they all contain the greater part of the minimum information which ESMA expected based on its Final Report. In the few areas where ESMA's expectations are only partly fulfilled, this is either due to the way the BPP are drafted or to the compliance statements being drawn up in a way that is not completely in line with the BPP. The significant diversity between compliance statements in terms of level of detail in the description of practices seems partly correlated with signatories' different size and amount of resources. ESMA considers that, while there is still room for improvement as regards disclosure in certain areas, the compliance statements show an important effort from signatories to clarify, and in some cases formalise, their practices. The added value of compliance statements in terms of increased transparency is confirmed by several respondents to ESMA's call for evidence.

- Thirdly, while it is still early to draw any definitive conclusion, on the basis of the input it has collected from responses to its call for evidence and roundtable ESMA concludes that the BPP have to date had a certain amount of impact on the market, especially in terms of enhanced clarity for different stakeholders on how proxy advisors operate. As such, respondents comment that the practices of signatories have changed mainly in the area of transparency while they indicate that comparable changes have not yet taken place in relation to the way signatories actually operate in the two areas where ESMA formulated such expectations, namely managing potential conflicts of interests and taking local conditions into account.
118. Lastly, as regards the governance approach of the BPPG, while the process surrounding the drafting of the BPP met ESMA's governance expectations, the governance to date regarding the on-going functioning of the BPP after their publication is viewed less positively and constitutes the main area for improvement found in ESMA's review. The BPPG would benefit from a clearer and more robust structure; a number of arrangements could contribute to these goals, e.g. the appointment of a chair or a broader composition of the BPPG. It is possible that the comparative framework recently published by the BPPG will help address the challenge of signatories not applying the comply-or-explain principle in a consistent manner, however, it is early to draw conclusions as the framework had not yet been applied by signatories at the end of ESMA's review. Furthermore, ESMA would welcome a clearer structure for the monitoring of the BPP.
119. ESMA encourages the BPPG to consider all the above mentioned points. Particular attention should be given to the comments regarding governance as this element is fundamental in ensuring that the BPP are fully effective and that stakeholders have confidence in the role of the BPP in addressing the areas identified in ESMA's Final Report.

Other considerations which surfaced through the review

120. A number of respondents to ESMA's call for evidence raise concerns regarding topics which fall outside the scope of the review of the BPP.
121. These relate firstly to the structure of the proxy market, more specifically the concentration which characterises the industry and the effects this has or could have on competition⁵¹. ESMA recognises that it is important to have an understanding of the market's functionality as healthy competition can promote the provision of consistent, accurate and independent services and thereby increase the services available to investors. In the past, ESMA also acknowledged that binding legislative measures could have a significant impact on competition by potentially changing the dynamics of the proxy industry⁵². In general, however, ESMA recalls that competition matters on a

⁵¹ See also ESMA (2012), p. 33.

⁵² ESMA (2012), p. 37.

European scale fall within the remit of the European Commission and that ESMA does not have specific enforcement powers in this area.

122. Secondly, a number of respondents bring up the investment chain more generally. Whereas ESMA's review focuses on the BPP and the provision of proxy advice in relation to European listed companies as such, ESMA is aware that this is only one of several critical elements in the broader investment chain. While enhanced clarity regarding the business operations of proxy advisors can facilitate confidence across the industry's stakeholders and a smoother interaction between them, it is equally important to reiterate that the ultimate responsibility for voting decisions lies with investors⁵³.
123. As also emphasised by a number of market participants responding to the call for evidence, (institutional) investors should have and publish their own voting policy and should publicly clarify how proxy advisors' input informs their voting choices. When companies are unsure of the rationale behind a certain shareholder's voting decision, they should seek dialogue with the shareholder rather than with the proxy advisors. Respondents confirmed that there have recently been a number of discussions on these issues within the institutional investors' community, and such issues were also being addressed in a legislative context at the time of ESMA's review.

⁵³ See also ESMA (2013), p. 3: "*The attention [should be] focused where it belongs, namely on how investors and issuers can, from their respective roles (in terms of fostering effective stewardship and robust corporate governance, can ensure efficient markets.*"

Annex I: Indicators used in the assessment of the depth of the BPP's impact

| <i>Level 1: Best Practice Principles</i> | | | <i>Level 2: Compliance statements</i> | |
|--|---|-------------------|--|-------------------|
| <i>Dimensions</i> | <i>Indicator</i> | <i>Assessment</i> | <i>Indicator</i> | <i>Assessment</i> |
| 1. Identifying, disclosing and managing conflicts of interest | 1.1.a PAs should seek to avoid conflicts of interest with their clients | Broadly fulfilled | 2.1.a Signatory declares that it will seek to avoid conflicts of interest with clients | Partly fulfilled |
| | 1.1.b Where a conflict effectively or potentially arises, PAs should adequately disclose this conflict and the steps which they have taken to mitigate the conflict | Broadly fulfilled | 2.1.b Signatory declares that it will disclose potential and actual conflicts of interest and steps taken to mitigate them to clients | Broadly fulfilled |
| | | | 2.1.c Signatory publicly discloses details of its procedures of mitigating potential and actual conflicts of interest | Broadly fulfilled |
| 2. Fostering transparency to ensure the accuracy and reliability of the advice | 1.2.a PAs should provide investors with information on the process they have used in making their general and specific recommendations | Fully fulfilled | 2.2.a Signatory provides details of its process of ensuring the accuracy and reliability of its advice, e.g. by disclosing details on its procedures and staff's experience and qualifications | Broadly fulfilled |
| | 1.2.b PAs should provide investors with information on any limitations or conditions to be taken into account on the advice provided so that investors can make appropriate use of the proxy advice | Fully fulfilled | 2.2.b Signatory provides details of its method of informing clients of limitations or conditions to be taken into account regarding the advice provided | Partly fulfilled |
| 2.i Disclosing general voting policies and | 1.2i.a PAs should, where appropriate in each context, disclose both publicly and to client investors the methodology and the nature of the | Fully fulfilled | 2.2i.a Signatory provides details of its methodology for making voting recommendations | Broadly fulfilled |

| | | | | |
|--|---|------------------|---|-------------------|
| methodologies | specific information sources they use in making their voting recommendations | | | |
| | 1.2i.b PAs should, where appropriate in each context, disclose both publicly and to client investors how their voting policies and guidelines are applied to produce voting recommendations | Partly fulfilled | 2.2i.b Signatory provides details of the information sources utilised in developing voting recommendations | Fully fulfilled |
| | | | 2.2i.c Signatory provides details of how voting policies, [whether house, client or custom,] are applied to produce voting recommendations | Partly fulfilled |
| 2.ii Considering local market conditions | 1.2ii.a PAs should be aware of the local market, legal and regulatory conditions to which issuers are subject | Partly fulfilled | 2.2ii.a Signatory declares that it is aware of local market, legal and regulatory conditions | Fully fulfilled |
| | 1.2ii.b PAs should disclose whether/how these conditions are taken into due account in their advice | Fully fulfilled | 2.2ii.b Signatory provides details of its method of informing clients of whether/how it takes local conditions into account | Broadly fulfilled |
| 2.iii Providing information on engagement with issuers | 1.2iii.a PAs should inform investors about their dialogue with issuers and of the nature of that dialogue | Fully fulfilled | 2.2iii.a Signatory declares that it will disclose communication with issuers, including nature of such communication (e.g. frequency, format), to clients | Broadly fulfilled |

Annex II: Extracts from ESMA's Final Report (page 8-9) – Expectations regarding the proxy advisory industry

“1. Identifying, disclosing and managing conflicts of interest

Principle: Proxy advisors should seek to avoid conflicts of interest with their clients. Where a conflict effectively or potentially arises the proxy advisor should adequately disclose this conflict and the steps which it has taken to mitigate the conflict, in order that the client can make a properly informed assessment of the proxy advisor's advice.

Rationale: Considering their important role in the voting process, proxy advisors can, like many intermediaries, be subject to conflicts of interest. They should therefore identify, disclose and manage these conflicts to ensure the independence of their advice. ESMA learned from the market consultation that market participants are concerned regarding potential conflicts of interests, in particular about circumstances where: (i) the proxy advisor provides services both to the investor and to the issuer; and (ii) where the proxy advisor is owned by an institutional investor or by a listed company to whom, or about whom, the proxy advisor may be providing advice.

2. Fostering transparency to ensure the accuracy and reliability of the advice

Principle: Proxy advisors should provide investors with information on the process they have used in making their general and specific recommendations and any limitations or conditions to be taken into account on the advice provided so that investors can make appropriate use of the proxy advice.

Rationale: Proxy advisors may have systems and controls in place that guarantee proper and sound advice. These systems and controls may increase the reliability of the advice and enlarge accuracy. ESMA learned from the market consultation that the market would specifically favour greater transparency of these systems and controls, including, but not limited to (i) disclosure of general voting policies and methodologies, (ii) consideration of local market conditions and (iii) providing information on engagement with issuers.

2.i. Disclosing general voting policies and methodologies

Principle: Proxy advisors should, where appropriate in each context, disclose both publicly and to client investors the methodology and the nature of the specific information sources they use in making their voting recommendations, and how their voting policies and guidelines are applied to produce voting recommendations.

Rationale: To allow all stakeholders, especially investors and issuers, to better assess the accuracy and reliability of the proxy advisor's services, proxy advisors are expected to be transparent on their voting policy and on the main characteristics of the methodology they apply, which form the rationale of their recommendations. This is also in line with the overall

message that ESMA received from the market consultation for greater transparency, where appropriate, by proxy advisors about their activities and processes.

2.ii. Considering local market conditions

Principle: Proxy advisors should be aware of the local market, legal and regulatory conditions to which issuers are subject, and disclose whether/how these conditions are taken into due account in the proxy advisor's advice.

Rationale: Proxy advice generally is a cross-border activity which requires the awareness of different laws, rules and regulations governing issuers' activities in each relevant jurisdiction. Therefore proxy advisors, as ESMA also learned from the market consultation, are expected to have a proper knowledge of the national and regional context, irrespective of whether proxy advisors choose to apply an international benchmark, or their client's own preferences/policies, in forming their opinion of individual meeting resolutions. Such knowledge of local/regional conditions is needed in order to develop an accurate voting policy, and, as a result, an appropriate advice.

2.iii. Providing information on engagement with issuers

Principle: Proxy advisors should inform investors about their dialogue with issuers, and of the nature of that dialogue.

Rationale: Proxy advisors can choose whether or not to have a dialogue with issuers. If they do choose to have such a dialogue, it is up to the proxy advisor what should be the timing, frequency, intensity and format for this dialogue. A proxy advisor should disclose to investors whether there is a dialogue between the proxy advisor and an issuer. Where such a dialogue takes place, it should inform investors about the nature of the dialogue, which may also include informing his clients of the outcome of that dialogue. ESMA learned from the market consultation that some proxy advisors do not conduct dialogue with issuers. When there is dialogue, the nature and degree of that dialogue differs significantly among proxy advisors, as well as the level of transparency on the fact that dialogue is taking place."

Governance expectations regarding the Code of Conduct (page 10-11)

"The Committee should adopt all necessary measures (including those relating to governance, membership, and decision making) that ensure that it can appropriately carry out its work. The Committee is expected to be transparent about its composition and status, including the selection of its Chair, who should be independent and possess relevant skills and experience. While it is expected that the Committee will contain a broad representation of proxy advisors, independent members or members representing other stakeholder groups could also be part of the Committee, if desired.

While ESMA would expect to be periodically updated on the progress of the work relating to the development and operation of the Code of Conduct, it should be understood that the Committee will be working independently from ESMA, and assumes full responsibility for the

outcome of its work. During the elaboration phase of the Code of Conduct, ESMA may engage with the Committee to discuss the further development of the Code of Conduct and the progress achieved.

The Committee is expected to develop a Code of Conduct that sets clear expectations (in terms of principles, guidance, and examples of good practices) and that is workable (from an operational point of view) for those who subscribe to it (which may imply a comply or explain approach, provided that the given explanation is sufficiently precise, specific and comprehensive).

The principles contained in this report offer guidance for the detailed elaboration of the Code of Conduct. In addition, the industry may also consider additional or alternative elements that it deems appropriate to ensure that the objectives for the Code of Conduct are met.

The Code of Conduct should adequately address the needs and concerns of all relevant stakeholders (including proxy advisors themselves, institutional investors, and issuers). To this end, the Committee is expected to carry out a robust and public consultation of stakeholders in developing or reviewing the Code of Conduct.

The Committee is expected to implement an appropriate and periodic monitoring process to evaluate the effectiveness of the Code of Conduct, and it is expected to publicly communicate the parameters by which the effectiveness of the Code will be assessed. The results of this monitoring process should be made public. Where these results, or new market developments, necessitate changes to the Code of Conduct, these should be appropriately implemented, subject to a process of robust and public consultation.”