



22nd June 2012

Dear Sir/Madam

An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Options – European Securities and Markets Authority Discussion Paper

Thank you for the opportunity to take part in the above consultation. I am pleased to enclose The (UK) Investor Relations Society's response

The Investor Relations Society's mission is to promote best practice in investor relations; to support the professional development of its members; to represent their views to regulatory bodies, the investment community and government; and to act as a forum for issuers and the investment community. The Investor Relations Society represents members working for public companies and consultancies to assist them in the development of effective two way communication with the markets and to create a level playing field for all investors. It has over 600 members drawn both from the UK and overseas, including the majority of the FTSE 100 and much of the FTSE 250. As such, through our members, we have direct experience of working with proxy agents both in the EU and globally.

The development of the proxy advisory industry in Europe in recent years is a key issue for investor relations practitioners and listed companies more generally. This trend is growing sharply and we consider it is likely to continue to do so. We understand that nearly all institutional investors subscribe to one or more proxy advisory agencies ("PAAs") and that in the case of all but contentious resolutions, or in corporate actions, institutional investors will follow the advice of the PAAs. Therefore we support the analysis and scrutiny of the proxy industry that this consultation undertakes. We understand there is a role for proxy advisors in ensuring that diversified investors do not cite resourcing issues as a reason for implementing passive investment strategies, as outlined in ESMA/2012/SMSG/25, and that proxy advisors offer significant savings in cost and time to investors. However, on behalf of our members, we have a number of concerns regarding the industry. These can be summarised as follows:

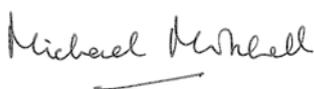
- **The lack of scrutiny from investment funds in habitually following proxy advisor recommendations.**
- **The de facto transfer of voting rights from investors to proxy advisors without a corresponding transfer of investor stewardship responsibilities.**
- **The potential conflicts of interest that can arise when proxy advisors have multiple roles both as administrators of the voting process and as advisors on voting issues.**
- **The lack of accountability and transparency over proxy advisory decisions with potentially major implications for issuers.**
- **Lack of understanding regarding the methodologies being employed by the proxy advisory agencies.**

We discuss these points amongst others in our response to consultation questions below in leading to our preferred policy option for ESMA to implement (Question 8).

It is important to draw a distinction between proxy advisory firms (the focus of this consultation) and proxy voting agencies that deliver executive voting services. Often, but not always proxy firms do both. We have restricted our answers to the proxy advisory question in almost all cases, as per the consultation, making it clear on the few occasions when we discuss the voting process itself. We understand that voting agency activity involves matters of company law and is therefore excluded from ESMA's remit.

If you have any questions regarding our consultation responses please contact us for further discussion.

Yours faithfully

A handwritten signature in black ink that reads "Michael Mitchell". The signature is written in a cursive style with a horizontal line underneath the name.

Michael Mitchell

General Manager, The Investor Relations Society

3 Bedford Street
London WC2E 9HD
020 7379 1763

michael.mitchell@irs.org.uk

A handwritten signature in black ink, appearing to read 'E Burdett', with a horizontal line underneath.

Emma Burdett
Chair of The Investor Relations Society's Policy Committee
020 7379 5151
eburdett@maitland.co.uk

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

The correlation between proxy advice and voting outcomes is clear. We see three main reasons for this trend. Firstly, this development in Europe has followed the pattern in the US where the proxy advisory industry is more established and investors habitually follow their proxy advisors' recommendation and where the proxy advisory industry is more established. Taking the UK, there has been increasing diversification of London listed companies' share registers in recent years (Non-UK investors owned 41.2 per cent of the value of the UK stock market at the end of 2010, up from 30.7 per cent in 1998 – Office of National Statistics Ownership of UK Shares 2010) with US investors in particular represented. In addition, with domestic investors also advised by US proxy advisory firms, the influence of major US advisory firms recommending votes against items of standard corporate housekeeping – for example, 14 days' notice for AGMs - is being felt.

Secondly, the on-going trend towards investor stewardship (the UK Financial Reporting Council established 'The Stewardship Code' in June 2010), which we support, emphasises the need for asset managers to undertake more activism and provide strategic guidance in the companies they hold stocks in, in their own long term interests and that of the company. This is the theory and in many cases also the practice, with an improvement amongst smaller investment houses in particular. However, we are concerned about the trend for many funds to delegate in practice their stewardship responsibilities to third party proxy advisors; largely it would seem as a result of limited internal resourcing. We consider that the current focus on investor stewardship, combined with a desire to limit internal costs at investment funds, will continue driving this increase to use of third party resources in outsourcing voting to proxy agencies for time and resource reasons.

Thirdly, there is a natural reluctance for asset managers to go against the verdict of the proxy advisory firm they pay to issue advice. Given the time constraints on asset managers around the AGM season, it is often simpler and more cost effective to adhere to the proxy recommendation rather than engaging in further dialogue with the company. From discussions with our members it appears to be the case that funds more often than not act on these recommendations – hence the high correlation between advice and outcomes. As one member notes this is due to "the blind confidence the funds give to these companies", which reflects the payment they are making for that advice. It can also be the case that within the investment house, the fund managers are disassociated from the corporate governance specialists, so that even were there to be a good reason to go against the

proxy advice, that message may not easily get through to the voting process.

2) To what extent:

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

The vast majority of institutional investors use at least one proxy advisory firm in some capacity and this equates to around 60% of UK plc. We estimate that between 25-30% of votes in the UK are now directly following proxy advisory firms with little interaction with the underlying beneficiary.

b) would you consider this influence as appropriate?

In general we do not consider this influence to be appropriate. We consider that the lack of transparency and accountability amongst the proxy advisory firms should be the focus of concern. Our members (issuers and their advisors) and their investors view transparency as at the heart of best practice investor relations with a company's Board providing the lead and the IR team acting as a conduit to and from capital markets. We support the current disclosure and transparency regime and the principles of universal, proactive and prompt dissemination of information to shareholders and ensuring a fair investment market. As such, we are concerned when third party organisations exercise influence over essential governance issues affecting companies without demonstrating the level of transparency and accountability that issuers are mandated to do by the current regulatory regime.

There are a number of matters we feel need to be addressed by institutional investors and the proxy advisory agencies to satisfy issuers and market regulators that their influence is not inappropriate. Firstly, how are potential conflicts of interest managed internally by the proxy advisory firms? Secondly how transparent are their voting policies and records? And how can transparency be implemented as it is between issuer and investor? Thirdly, what are the methodologies used by proxy agents to prepare voting advice? Finally, and importantly, what dialogue exists presently with issuers, proxy agents and investors ahead of and following AGMs and any voting recommendations or decisions? At present this seems to be dangerously scant. We would also like to see transparency from investors on their choice and use of proxy advisor advice.

Our concern is that some asset managers appear to be subcontracting the narrow voting responsibility, but without the wider investor dialogue responsibility that provides the context and explanation that goes towards framing the former. We find it difficult to see how this

disassociation of the voting from the asset manager can be constructive. To quote one of our members: “The issue with the proxy firms is that they adhere in black and white to their own standards, and if something doesn’t tick a box then they vote against - any response should be on the basis that the advisory firms are forced to look beyond the box ticking exercise and understand the true motivations behind Board decisions and pay before they make a recommendation”. Another of our members states “the arbitrary nature of some of the decisions of these voting agencies is a cause for concern. It is very difficult to understand how they are going to make decisions in advance...we had no idea that (a particular issue) was something they looked at in advance of their decision”.

We also feel that in a number of cases third party bodies are using prescriptive methodology with little or no reference or understanding to the issuer’s particular circumstances in making their recommendations.

3) To what extent can the use of proxy advisors induce a risk of shifting the investor responsibility and weakening the owners’ prerogatives?

We believe this is already happening and this risks shifting investor responsibility and weakening the ultimate owners’ prerogative. We recognise there is the resourcing issue for investors. Fund managers will often have positions in a wide range of companies and geographies so employing proxy advisors to assume some of their duties is understandable when voting vast number of shares at annual meetings. Nevertheless, ultimately this weakens the asset managers’ ability to fulfil their stewardship responsibilities.

This issue is part of a wider one – that of short-termism in capital markets. The UK government is currently undertaking a series of reviews into this and the required steps to engender longer term perspectives. We feel that the proxy advisory industry risks exacerbating short-termism by recommending votes against Board policies that can at times be seen as penalising long term decision making. It is important that an inadvertent consequence of proxy recommendations is not to discourage attempts by issuers to focus on long term objectives.

We should state that there are a significant number of major and smaller investors who continue to liaise directly with investor relations teams on issues pertaining to votes and who take their responsibilities seriously in terms of interaction with the issuers. We feel this is ultimately more beneficial to them and their clients, the asset owners.

4) To what extent do you consider proxy advisors:

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

There is the potential for conflicts of interest in practice if a proxy advisory firm is providing advisory and voting services, while advising listed companies on corporate governance issues. We note that in the US, the Shareholder Communications Coalition recommended to the SEC that there should be a “complete and total separation of the proxy advisory business from all other business including consulting and research services”. It is certainly in the asset managers’ interest to ascertain that their own interests are not misaligned with those of their proxy advisors.

b) have in place appropriate conflict mitigation measures?

We can see little evidence that the proxy agencies have in place appropriate conflict mitigation measures, especially in the separation of their administrative and advisory roles in voting solicitation. US Securities and Exchange Chairman Mary Schapiro has previously called for proxy firms to provide “adequate disclosure of any conflicts of interest they may have in providing voting recommendations”. These need to be made clear to issuers and investors so that they might make rational judgements based upon fullness of information. Boilerplate templates by proxy advisory firms over potential conflicts of interests will not sufficiently assuage concerns that these conflicts are not arising with respect their particular company/fund. We feel that advisory firms should disclose specific relationships to the market, perhaps extending to the level of research carried out for either company or fund.

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

We do not consider proxy advisory firms are sufficiently transparent regarding potential conflicts of interest. We consider that citing client confidentiality to avoid transparency does not encourage best practice in assessing conflicts of interest.

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

a) which conflicts of interest are most important?

Conflicts of interest whereby the proxy advisory firm might have varying objectives vis-à-vis asset manager (and indeed asset owner) and/or issuer as a result of offering services to

both is the key conflict to be mitigated.

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

This might potentially occur, but is not a given. Impaired advice is more likely to derive from being too detached from the issues they are voting on.

6) To what extent and how do you consider there could be improvement:

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

To make improvements to the current process we would stress the importance of investment funds ensuring that when employing proxy advisors to issue voting recommendations then their investor engagement responsibilities also pass to the proxy advisory firm which must utilise these fully before making a recommendation. It is very important that the quality of analysis within the proxy advisor is sufficiently high for proper engagement to occur in these sorts of discussions. The investor relations team at the company should also be fully appraised regarding whom to approach for discussions within the advisory firm. Within the investment framework the IR team ultimately needs to know two key things: a) who is managing the investment in their company and; b) who to explain company strategy, performance, forecasts etc. to, while ascertaining market sentiment in reporting to management. It is crucial to the process of outsourced voting recommendations that there is high quality engagement between advisor and issuer. If, as is the case with proxy advisory firms a recommendation is being made on voting then there needs to be issuer-proxy advisor dialogue to ensure the asset manager and asset owner is not being compromised through lack of understanding on the part of the proxy. As it stands there is no guidance principle on this in UK or across the EU.

We must stress our view that a further administrative burden should not fall on issuers. The bulk of corporate regulation already centres on the companies and any steps taken to address concerns over the proxy advisory agency must not be redirected back to companies. It is, after all, issuers, that are the driving force of economies and we feel the regulatory burden on them is already very high.

7) To what extent do you consider that there could be improvement, also as regards

to transparency, in:

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

An explanation from each firm of how their methodology, if at all, deviates from one-size-fits-all policy guidelines would be advantageous. It is very important that sufficient time is allowed for IR departments to respond to proxy advisors communications and that in general, issuers have the right to reply to the reports produced by proxy advisors. In addition proxy firms should bear in mind that IROs are typically in meetings or on calls, when they are not travelling on roadshows. To give a timeframe of twenty-four hours for responding to challenges, as frequently happens, is clearly not sufficient and does not allow IROs a sufficient opportunity to respond. It should be remembered that IR within companies from mid-ranking FTSE250 downwards (or sometimes even upwards) is often carried out by sole individuals who have a wide range of pressing work.

b) the dialogue with issuers when drafting voting recommendations?

We have said this needs to improve. Scheduled meetings with issuers' IR teams, regular communication between proxy adviser and issuer IR teams, indications of voting recommendations well in advance of meetings together with detailed explanations if votes go against the company, and explanations of methodology are all improvements to be made. We realise this is a complicated process whereby investors may subscribe to more than one proxy advisor, are very likely not the asset owner and that operations take place within a long chain. However, we argue strongly that the current situation cannot be allowed to continue unchecked and that the increasingly adversarial engagement process is detrimental to open investment dialogue.

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

The more experience proxy advisory staff have in working in a corporate communications environment, either for in-house listed company or a listed company's advisors (eg Financial PR), the better. In the case of proxy **voting** it is not unknown for careless mistakes to be made during the voting process itself and if a proxy advisory firm also carries executive voting rights then this needs to be addressed.

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

Having canvassed our members' views, we feel the most effective and realistic programme for success in the first instance is **Option 2: ESMA to encourage member states and/or industry to develop standards**. If this fails to deliver results within an agreed timeframe then we feel it would become necessary to consider implementing Option 3: quasi-binding EU-level regulatory instruments - with the burden of compliance to fall on proxy advisory agencies - not issuers!

Our members are reluctant to see additional EU wide regulation implemented and as stated we have concerns that regulation focused on the proxy industry might be passed onto issuers. However, we feel strongly that some action does need to be taken and have genuine concerns over the growth and reach of the proxy advisory industry, as we have outlined in this consultation. We note that the French Autorité des Marchés Financiers (AMF) issues practice recommendations for proxy advisory firms and we would envisage something similar being developed in the UK and other EU member states. We consider it unbalanced that issuers face a great regular burden and that currently the proxy advisory industry is not required even to operate under a system of best practice guidance. Option 2 also fits in with the UK's general adherence to the principle of 'Comply or Explain', to which The Investor Relations Society adheres. We feel that applying Comply or Explain through the implementation of proxy advisory industry standards would be beneficial for both issuer and investor.

We would suggest that a timeframe (to be agreed) is set to ensure steps are taken. If this timeframe is exceeded without the new standards being adopted to a sufficient degree then quasi-binding regulatory instruments will need to be considered. We hope that this will not be the case and that the proxy advisory industry will recognise a general code of standards will help to alleviate some of the concerns raised.

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

N/A

10) If you support EU-level intervention, which key issues, both from section IV and V,

but also other issues not reflected upon in this paper, should be covered? Please explain your answer

For now we prefer member states to develop their own codes of practice/industry standards.

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

a) barriers to entry and competition;

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

c) any other areas?

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

The role of the US proxy advisory industry and potential regulation thereof needs to be considered carefully. If cross-EU guidelines are adopted then it must be ensured that European competitiveness against the US does not suffer adversely. As we have outlined we already think investor voting responsibilities have shifted to proxy advisors in the UK. We think Option 2 gives the flexibility required for each member state to adopt guidelines as it sees fit.

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

No further comments.