sodàli ALIGNING INTERESTS

103, Wigmore Street, Nations House, 9th floor, W1U 1QS London

Registered in England and Wales no. 5934595
VAT No.: GB906438618

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To: Dr. Dirk Andreas Zetsche, LL.M., Chairman
The Best Practice Principles
for Governance Research Providers Group
consultation@bppgrp

Re: Public Consultation on Best Practice Principles for Governance Research Providers

To the members of the Drafting Committee:

We applaud your initiative to establish a set of industry-wide best practice principles governing the conduct of proxy advisors. As stated in our comment letter to ESMA dated June 20, 2012, (**Sodali's comment letter to the ESMA Discussion Paper**) we support the development of ". . . a Code of Conduct governing the proxy advisory industry that (i) deals with the issues in the [ESMA] Discussion Paper and (ii) defines and enforces the role of [Proxy Advisory Firms] in fulfilling their . . . responsibilities . . . ."

We recognize the important role played by Proxy Advisory Firms (PAFs) in cross-border share voting and communication between issuers and shareholders. When used appropriately by institutional investors, PAFs' services can increase the efficiency of the proxy voting process and highlight extraordinary agenda items and director elections where the vote is of critical importance. Both shareholders and issuers can benefit when the proxy advisory process works effectively. These potential benefits have been overshadowed by criticisms about the PAF industry. Accordingly, the creation of an industry code of conduct and best practice principles is timely.

While we support the creation of a code and principles for proxy advisors, we have reservations about the proposal and we urge the Committee to address what we believe to be some of its shortcomings:

1. Coverage is too broad. The principles should deal specifically with PAFs rather than a broadly defined universe of "Governance Research Providers." The issues that need to be addressed arise from the activities of proxy advisory firms, not NGOs, think tanks, academics and other sources of governance research.
2. The three proposed principles are stated in terms that are overly generalized and therefore appear to lack substance and clarity. The principles themselves come across as a dilution rather than a distillation of the substantive "Guidance" sections in which best practices are amply described and explained.
3. The proposed principles do not directly address the specific concerns about PAFs that have been widely discussed by users, regulators and listed companies.
4. The proposed principles do not include an enforcement or accountability mechanism. Reliance on comply-or-explain is appropriate for principles adopted voluntarily by each PAF, but industry standards need some method of collective enforcement.

To address these concerns, we offer the following recommendations for the Committee's consideration:

1. Narrow the coverage of the principles to include only proxy advisory firms, i.e., the firms listed in Appendix 1.
2. Use the existing codes of conduct, best practice standards and policies on conflicts of interest that have been adopted by PAFs individually as models for the Committee to develop more meaningful and specific industry-wide standards. Proxy Advisors' websites include many clear and well articulated standards and principles. Examples include PIRC's "Best Practice Principles," Manifest's "Stewardship Code" disclosures, the "fundamental tenets" in ISS's "Business Practices & Principles," Glass Lewis's "Conflict of Interest Statement" and IVOX's "Code of Ethics." Industry-wide standards should be rooted in these provisions and should seek to achieve a comparable level of clarity.
3. Increase the number and content of the principles. Some important substantive issues appear to be overlooked in the proposal because it attempts to shoehorn guidance into three principles. This concern is reinforced by circular language stating that signatories should "have and disclose" policies without asserting what the substance of those policies should be. The effect of industry-wide principles is minimal if all they do is defer to existing policies.
4. Add accountability mechanisms to promote compliance. We are impressed by two mechanisms used by Glass-Lewis: (1) the Issuer Engagement Portal and (2) the Research Advisory Council. Both could easily be adapted, preferably in combination, as a means to give teeth to industry-wide principles. An industry-wide Research Advisory Council accessible electronically by users could serve an ombudsman function, as suggested in our letter to ESMA. The type of user group convened periodically by Broadridge Financial Solutions Inc. is another model for consideration by the Committee.

In addition, we would like to restate for the Committee's consideration a recommendation made in our ESMA comment letter: The PAF industry should consider adopting a "neutrality mandate" and require all proxy advisors to refrain from making voting recommendations in contested situations. As we said to ESMA: "We believe that a properly administered neutrality mandate – permitting PAFs to assemble data and conduct a detailed analysis of both sides in a bona fide contested solicitation, but prohibiting a vote recommendation – would benefit issuers, dissidents and PAFs by compelling shareholders to make their own voting decisions on the merits in cases where their votes have the greatest impact." This policy by itself would eliminate concerns about PAFs exerting undue influence in proxy contests and takeovers, or being perceived as "king-makers" while lacking expertise in the specific business issues of individual companies.

Respectfully submitted,

John C. Wilcox
Chairman

Andrea Di Segni
COO and Head of Corporate Advisory