VERBAND DER CHEMISCHEN INDUSTRIE e.V.
WIR GESTALTEN ZUKUNFT.

VCI

Public Consultation: "Best Practice Principles for Governance Research Providers"

VCI Position

18 December 2013

The VCI represents the politico-economic interests of some 1,650 German chemical companies and German subsidiaries of foreign businesses. The VCI stands for over 90 percent of the chemical industry in Germany. In 2012 the German chemical industry realised sales of around 186 billion euros and employed over 434,000 staff (EU-registration number: 15423437054-40).

I. Introduction

We welcome the taking up of a central aspect of the ongoing governance discussion: with the development of the Best Practice Principles for the proxy advisor industry. Proxy advisors have considerable influence on the voting behaviour of institutional investors, with direct consequences on the voting results at general meetings of publicly traded companies in Germany.

Where a concrete voting recommendation is flawed – because individual facts relating to a given company were not researched thoroughly (e.g. rejection of a capital increase for the purpose of an allegedly disadvantageous acquisition of another company) or because the specific elements of the local legal systems or conditions were not adequately taken into account (see the example below) – this has direct and adverse impacts on the company and the other shareholders.

Many – mostly foreign – institutional investors follow the recommendations of their proxy advisors without any further reflection which, obviously, strengthens the influence of the latter. This renders a dialogue with the investors about a forthcoming general meeting more difficult or even impossible. Moreover, the market for proxy advisors is highly concentrated so that imprecise or flawed voting recommendations can have much stronger impacts on the fate of the issuers than this would be the case in a more balanced proxy advisor market with many competitors.

II. Example

In particular, the limits for capital increases without preemptive rights – also in cases where no such exclusion is given from the economic perspective – make an excellent example of voting guidelines and concrete recommendations not necessarily reflecting the existing provisions under German law. For example, the ISS Proxy Voting Guidelines include a voting recommendation for issuance requests without preemptive rights only to a maximum of 20 percent of currently issued capital. Similarly, the Glass Lewis Guidelines include a general 20 percent limit in case of a general authorisation of the board. Other guidelines are even more restrictive, with limits as low as 10 or 5 percent.

It is worth noting that § 186(3) sentence 4 of the German Stock Corporation Act (Aktiengesetz/AktG) expressly permits an exclusion of subscription rights, in particular if the capital increase against cash contributions does not exceed 10 percent of the initial share capital and the issue price is not significantly below the stock exchange price (so-called “erleichterter Bezugsrechtsausschluss” / simplified way to issue new shares without preemptive rights). In this constellation, the existing shareholders have the possibility to counteract a potential dilution of their stakes by buying fresh shares through the stock exchange. From the economic perspective, the so-called “erleichterter Bezugsrechtsauschluss” needs to be seen like a capital increase with preemptive rights. But this specific element, which is of great importance in corporate practice, is not taken into account in the guidelines – with the consequence that any form of capital increase without preemptive rights is included in calculations regarding the above percent limits, with no differentiation whatsoever being made.

III. A legislator solution instead of voluntary agreements - Observations on questions 22, 23 and 26

Regarding the factual voting power of proxy advisors, the issuers need to be given a possibility for corrections – in order to ensure an adequate functioning of general meetings as an essential component of corporate governance.

For this purpose, the issuers should be given a possibility to examine and to comment both the general guidelines and the concrete voting recommendations by the proxy advisors as to their completeness and potential imprecisions. In particular, this presupposes that the issuers are informed about the planned concrete voting recommendations in due course before their publication. Such information to issuers can eliminate potential errors or misunderstandings as early as in the drafting stage of the voting recommendations. For this purpose, the issuers need to be granted an adequate right of examination and comments. Should the advisors not correct their

errors or where differences in views persist on individual agenda items, it must be ensured that the proxy advisors submit to their clients the relevant objections and counterstatements by the issuers – at the same time as the (deviating) voting recommendations. This would enable the clients to form their own picture of such agenda items.

The Principles put up for discussion by the Drafting Committee do not fulfil these requirements. In the Guidance ("*Communications Policy*") it says that signatories (proxy advisors) should have a policy to inform their clients, inter alia *"whether and how issuers are provided with a mechanism to review research reports or data used to develop research reports prior to publication to clients."* But it is solely up to the signatories to decide whether or not to engage in a dialogue with the issuers. Neither the Principles as such nor the Guidances or the equally non-binding Statement of Compliance ensure an adequate involvement of the issuers in the information processes between the proxy advisors and institutional investors.

All in all, both the Principles and the Guidances are lacking in concreteness; they leave so much scope to proxy advisors that a noticeable improvement in the existing communication situation is rather unlikely.

As proxy advisory services are of immense importance to corporate governance, the VCI sees the need for legislator action to introduce EU-wide applicable legislation for a formalised coordination process between professional proxy advisors and issuers throughout the European Union.
Should it not be possible to enforce such EU legislation at the present moment in time, national (German) regulation could be an acceptable alternative. Such regulation might build on the existing legal rules for proxies which apply to both banks and persons who professionally offer shareholders their services in exercising voting rights (§135(2) and (8) AktG).

signed Dr. Tobias Brouwer
Frankfurt am Main, 18 December 2013

Department Energy and Climate, Legal Affairs
and Taxes
Mainzer Landstrasse 55
60329 Frankfurt a. M., Germany
Phone: +49 (0)69/2556-1435
Fax: +49 (0)69/2556-1618
E-Mail: brouwer@vci.de
Internet: www.vci.de