

An Overview of the Proxy Advisory Industry Considerations on Possible Policy Options

Discussion Paper of the European Securities and Market Authorities

Reply of the European Federation of Financial Services Users (EuroFinuse)

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The European Federation of Financial Services Users (“EuroFinuse”) (formerly European Federation of Investors, in short EuroInvestors) counts more than fifty national and international member and sub-member organizations. In turn those count about four million individual members. EuroFinuse acts as an independent financial expertise center to the direct benefit of the European financial services users (shareholders, other investors, savers, pension fund participants, life insurance policy holders, borrowers, etc.) and other stakeholders of the European financial services who are independent from the financial industry.

EuroFinuse has experts participating in the Securities & Markets, the Banking and the Pensions Stakeholder Groups of the European Supervisory Authorities, and the EC Financial Services User Group. Its national members also participate in the national financial regulators and supervisors bodies when allowed. For further details please see our website: www.eurofinuse.org.

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Executive Summary

Introduction and executive summary

EuroFinuse represents - among other financial services users - millions of individual shareholders who do not have access to the services of commercial – for profit – proxy advisers, because they cannot afford to pay for these services.

Also, it is even more challenging for EU’s individual shareholders – as compared to institutional shareholders - to analyse issuers’ proposed resolutions for their General Meetings, especially for cross-border voting, as resolutions proposed by management have become longer and more complex and as they are not always made available in the language of the shareholder.

Finally, EuroFinuse and Euroshareholders¹ experienced that the 2007 Shareholders’ Rights Directive’s main objective – to facilitate cross-border voting – is still faced with severe obstacles.

These are main reasons why they created the EuroVote web-based service to EU cross-border shareholders, a service that is free for individual shareholders and that is rendered by their representative not for profit organizations at national and European levels.²

EuroVote services include proxy advice if the shareholders wish so. The most important response we therefore want to communicate to ESMA is not to confuse this unique non-profit proxy adviser dedicated to offer free services to individual shareholders with the commercial -for profit- proxy advisers who cater to institutional shareholders only. In other words, this kind of not for profit and free proxy advice to individual shareholders, and supplied by their representative organizations should be exempt from all the additional regulations, constraints, burdens and fixed costs that ESMA or any other EU regulator are contemplating for commercial proxy advisers.

Besides these crucial requests, we would like to answer specifically to the following questions raised by ESMA:

¹ Euroshareholders is a founding member of EuroFinuse

² EuroFinuse and Euroshareholders cooperate together on the project EuroVote, a project facilitating cross-border proxy voting in Europe for shareholders. EuroVote also aims at testing implementation of Shareholders’ Rights Directive from 2007. For more information, visit <http://www.euroshareholders.eu/eurovote>

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

2) To what extent:

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

EuroFinuse represents small shareholders and it is aware that, although institutional investors are those who most commonly require the services of proxy advisors, certain individual shareholders may be directly affected by a change in the regulatory status-quo of proxy advisors. Individual shareholders face many barriers to make use of commercial proxy advisors (such as economic costs). This is why they commonly make use of non-profit proxy advisors to have voting recommendations. In this sense, according to the point 53 of the Consultation Paper, sometimes investors are eager to receive more than one voting recommendation in order to make their voting decision. This is the reason why proxy advisors may have an influence not only on institutional investors but also on individual shareholders' voting behaviour. So, we can consider that proxy advisors do have a significant influence on voting outcomes.

b) Would you consider this influence as appropriate?

We could assume that the influence of proxy advisors on voting behaviour is appropriate. However, the lack of information and transparency endangers this positive contribution of proxy advisors to investors' voting decisions. Finally, the existence of clear market failures leads to the consideration that the current situation is sub-optimal so appropriate legislation could make a positive contribution for improving corporate governance.

We must stress that the legislation should comply with certain requirements to be considered as efficiency-improving. From our behalf, we want to stress that any legislation that could be settled should not be primarily aimed at non-profit proxy advisors. Their nature as non-profit already solves most of the problems such as conflict of interest so imposing a regulatory burden on them would hinder retail investors getting expert voting advice and in consequence a loss of efficiency in the system.

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

4) To what extent do you consider proxy advisors:

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

b) have in place appropriate conflict mitigation measures?

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

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?

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

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

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

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

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?

b) the dialogue with issuers when drafting voting recommendations?

Regarding the recommendation from AMF to promote dialogue between issuers and proxy advisors stated in point 80 of the Consultation Paper, EuroFinuse is against that possibility. At the very least, it should not apply to proxy advisers dedicated for free to individual shareholders, who – in addition – do not have the resources to comply with such a requirement.

The CFA Institute already made a stand against such a practice, as mentioned in point 81 of the Consultation Paper. In our view, such an obligation would have a negative effect on the reliability of voting recommendations from proxy advisers as there could appear conflicts of interest. It should be noted that the interaction between evaluated and evaluator parties entails high risks of conflicts of interest.

This view is justified by the Report from the Senate of the USA “Wall Street and the Financial Crisis: Anatomy of a Financial Collapse”. This report from 2011 pointed that the interactions (through meetings and other communications) between investment banks and Credit Rating Agencies CEOs resulted on biased ratings of financial products linked to the existence of side payments or other kinds of rewards or compensations between the parties. It is true that this comparison is somehow limited as proxy advisers just have an impact on a

limited part of the market (institutional investment), as said in point 106 of the Consultation Paper. However, institutional investment has a continuously growing importance that makes its regulation very important for the overall system.

For all the aforementioned reasons, EuroFinuse advocates for the strict independence of proxy advisors and considers an increased importance of the role of non-profit institutions in voting recommendations would be generally beneficial.

In the case that ESMA still considered that there has to be dialogue between issuers and proxy advisers, transparency of communications (point 80 in the Consultation Paper) should have a capital role. Either ESMA or the EU national securities regulators should be legally entitled to ask for disclosure of these private conversations. At the same time, “whistle-blowing” policies should be set up to promote denouncing of inappropriate relations between issuers and proxy advisers by employees. However, there are big chances that supervision can’t be properly exerted so in our view it is better not to allow that kind of mandatory communications.

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.

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

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

Regarding the policy options taken into consideration by ESMA we believe that it is necessary to establish a light but binding EU-level legislative instrument, but only with regard to commercial proxy advisers who supply services to institutional shareholders. There are market failures in the market of institutional investment advising that need not only standards on business conduct and transparency related issues but also supervision from national authorities or ESMA.

The reason why it would be necessary to have not only a member state level policy response, but an EU-wide policy response is because if different regulatory possibilities were left for the Member States to decide it would endanger the Internal Market. That would happen because proxy advisers would just register in the member states with a more favourable approach to their business to circumvent any possible legislative responses in other EU

Member States. Auto regulation of the sector would not insure a resolution of these market failures

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

a) barriers to entry and competition;

Any Public intervention should be careful to protect and nurture diversity and choice in the proxy advice area, and not to overly favour bigger providers by imposing fixed cost-generating rules and procedures.

The potential role on non-profit proxy advisors should be especially considered. EuroFinuse and Euroshareholders have already implemented the EuroVote web-based Platform. Although it has been mainly aimed at small shareholders, we can consider it is a future potential competitor for proxy advisors, in the sense that institutional investors could also use those voting recommendations.

This is why a differentiated regime for non-profit proxy advisors and the promotion of its role on the decision-making of these institutional investors that have a clear “public” nature are two basic strategies that could increase competition in the market for advice to institutional investment, avoiding the existence of oligopolies like in the case of credit rating agencies (which, as commonly accepted, had a major role on the formation of the financial crisis as they did not do their job properly because of such lack of competition in the market, and because they are paid the rated entities or their sponsors).

The non-profit nature of some proxy advisors could be considered as an additional barrier to entry in the market, in addition of these other factors detailed in point 115 of the Consultation Paper. This would be negative for the competition in the market so the ESMA should impose minimal requirements to non-profit institutions issuing voting recommendations, which may be used by institutional investors.

To conclude, we would like to add that this whole paper seems to unfortunately forget individual shareholders’ needs and how to best fulfil them.

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.

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