Investors' Use of Proxy Advisory Research

The view of the UK Institutional Investor Committee – March 2014

There has in recent times been a growing interest in how institutional investors exercise their voting responsibilities. There has been increasing focus, from issuers, regulators and others, on how institutional investors, within the UK, EU and internationally, utilise proxy advisory services in exercising their voting decisions. Some parties have suggested that institutional investors simply follow the recommendations of proxy advisers, derogating their own responsibilities and giving these actors undue influence.

This paper outlines how the members of the associations which together comprise the Institutional Investor Committee (IIC) - the institutional investor clients of the various proxy advisory firms - utilise these services and what is considered best practice.

The IIC is made up of representatives from the Association of British Insurers (ABI), the Investment Management Association (IMA) and the National Association of Pension Funds (NAPF). The ABI represents the UK's insurance, investment and long-term savings industry. The IMA represents the asset management industry operating in the UK. The NAPF is the voice of workplace pensions in the UK representing 1,300 pension schemes. The members of these associations together manage/own in excess of £4.5 trillion of assets invested in companies globally.

Overview

The ultimate responsibility for the voting decision on each resolution at a company meeting is with the institutional investor.

- The institutional investors represented by the IIC recognise that the *informed* use of votes is a responsibility of owners and the investment managers (together institutional investors) to whom they may delegate this function. Where practical, institutional investors seek to engage with companies to explore or resolve issues before voting against management.

- To fulfil their stewardship responsibilities, there is a clear need from institutional investors for quality voting and research services to support informed and effective proxy voting. The use of proxy advisory services facilitates investors in carrying out their responsibilities to engage and vote in an informed manner across highly diversified portfolios.

- The principles of good corporate governance, such as the UK Stewardship Code (alongside the Guides and Policies published by the IIC constituent members), which are utilised by proxy advisory firms are informed by industry consultation. As such, divergence from these principles is likely to concern investors and could result in votes against management unless appropriately justified. In such circumstances, correlation with proxy voting recommendations does not equate to causation.

Current practice

- It is established good practice amongst institutional investors that, in line with the expectations of the Stewardship Code, they have a clear policy on voting and disclosure of voting activity.

- In addition, as set out in the Code, institutional investors should disclose the use made, if any, of proxy advisory services. This should include a description as to the scope of such services and identify the providers utilised.

- The majority of institutional investors utilise at least one service provider with many utilising more. Some of these service providers offer voting recommendations whilst others offer research and analysis.

    - The IMA's 2013 survey of Adherence to the Stewardship Code (as at 30 September 2012) indicated that 78% of institutional investors use a service provider to supply research; 38% use more than one provider.

- Institutional investors themselves undertake rigorous analysis before reaching voting decisions. Research and voting recommendations are commonly utilised as just one of many inputs to this process and most generally as a form of screening process, highlighting issues worthy of further consideration and assessment by the firm's own in-house analysts.

    - Not a single respondent to the IMA's 2013 survey indicated that they always follow the recommendations of their proxy advisory service.

- The final voting decisions, whilst informed by, do not rely upon, the recommendations or research of advisory services. This is true for both the UK and overseas markets. It is also usual practice for the portfolio manager to either be involved in, or have final say over, the final voting decision.

    - Analysis by the ABI in 2013 of its members' use of proxy voting agencies found that 90% of its members' voting decision-making processes include active participation from portfolio managers and investment analysts.

- Where an institutional investor has a very small holding, then it is more common for votes to be exercised in accordance with the recommendations of their proxy advisory service. However, in such cases, it is likely that the recommendations have been based upon the investor's specific voting policy. Indeed, the majority of clients of the main proxy advisory firms have their own bespoke voting policies.

- Similarly, in overseas markets, especially in relation to smaller holdings, institutional investors may follow the recommendations of their proxy advisory service provider. Again these recommendations are based upon the investor's specific proxy voting policy.

The UK "comply of explain" regime confers dual responsibilities

- An effective "comply or explain" regime must be based on regular and open dialogue between companies and their shareholders/institutional investors. This dialogue should take place throughout the year, rather than be compressed into the period leading up to the shareholder meeting.

- It is important that companies wishing to understand the views of investors endeavour to engage directly with them. Institutional investors, in turn, should endeavour to be willing to meet companies and discuss the business, its strategy and governance practices such as how remuneration structures support the strategy.

- It is the company's duty to be suitably transparent, avoid "boiler-plate" explanations and provide clear, thoughtful and justifiable explanations for areas of non-compliance with best practice. Conversely, there is a responsibility on investors to evaluate these explanations, taking care not to adopt a mechanistic approach. Investors should make issuers aware of the reasoning behind their votes on contentious issues.

Best Practice Principles

1. **Institutional investors should have their own voting policy which should be publicly disclosed**
2. **Institutional investors should disclose how and when voting advisory services inform their voting decisions**
3. **Responsibility for the voting decision should remain with the institutional investor and should always be made in the context of a company's overall governance arrangements**
4. **Institutional investors should inform a company of the rationale for votes against management and for votes withheld**
5. **There should be ongoing constructive dialogue between investors and companies**

We would be pleased to engage further on this or any related subjects. Contacts are:

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