

Eurosif Response to ESMA Discussion Paper on the Proxy Advisory Industry (ESMA/2012/212)

June 25, 2012

Eurosif, the European Sustainable Investment Forum, welcomes the work of the European Securities and Markets Authority (ESMA) in highlighting the need for transparency and clarity around the share voting process and asset owners' and managers' use of third-party services such as proxy advisors.

This response has been developed as a part of Eurosif's aims to encourage disclosure, transparency and responsible ownership, and to promote the integration of environmental, social and governance issues into financial services. It does not necessarily reflect the views of all its Members and Member Affiliates.

Eurosif, through its work and initiatives such as the European SRI Transparency Code¹, encourages investor and asset manager transparency in the voting and engagement process, including use of third-party services such as proxy advisors. Exercising shareholder rights in an informed manner is an important part of managing the principal-agent relationship of share ownership, and can contribute to sustainability by guiding company management to think long-term and in the best interests of owners and other stakeholders.

In the discussion paper, ESMA notes (section IV.II) that a number of studies have shown a high degree of correlation between proxy advisors' voting recommendations and voting behaviour. This is not surprising, considering that proxy advisors base their recommendations on established corporate governance best practices and the preferences of their institutional investor clients. The indication that investors agree with the advice given by proxy advisors is a reflection of the value of the advice and the benefit of the services provided.

However, Eurosif does not consider it appropriate for proxy advisors' influence on the decisions made by investors to be regulated, because the use of third-party advice does not remove or weaken the fiduciary responsibility of investors to make informed decisions. Investors must ensure that the analysis process, advice and voting is in line with their voting policy, and that the information and analysis they receive is used in an appropriate and responsible manner. At the same time, proxy advisors should be transparent about their processes and any potential conflicts of interest. As an advocate of self-regulation in the first instance, Eurosif would encourage the creation of industry

¹ <http://www.eurosif.org/sri-resources/sri-transparency-code>



transparency guidelines or best-practice disclosure standards to facilitate the proxy advisors' transparency initiatives.

Eurosif, as mentioned in our response to the EC consultation on Corporate Governance², encourages enhanced proxy advisor transparency by the following measures:

- Voting advisors should disclose all conflicts of interest;
- Voting advisors should disclose their policies and guidelines and how these are integrated in their methodologies to produce recommendations;
- Voting advisors should disclose whether they make generic voting recommendations ("in-house voting advice") for each meeting. If they do, then they should indicate what proportion of the voting instructions they send on behalf of their customers is voted automatically in line with in-house voting advice (i.e. determined, confirmed and instructed by the voting advisor without the need for confirmation by the investor).

The importance of shareholder responsibility is becoming more widely accepted, expanding the concept of fiduciary duty from merely delivering financial returns to also incorporating ownership duties and focus on environmental, social and governance issues. As part of this process, shareholders are increasingly making use of third-party expertise to aid them in decision making. This is an evolution to be encouraged. As mentioned in the ESMA paper, proxy advisors can enhance shareholder democracy through lowering the cost of monitoring, especially on a cross-border basis where each fund or asset manager may not have the specialist knowledge to make an informed decision on a voting item.

However, the use of third-party services does not absolve the ultimate owner of its responsibility. Therefore, while it is important for proxy advisors to be transparent about their conflicts of interests and processes, it is equally important for investors to be transparent about their use of such services, and to use their shareholder rights as part of a holistic engagement process designed to improve company practices. This is the case, not only for asset owners, but also for asset managers managing investment funds or assets whose unit holders are de facto the ultimate owners of the holdings in the fund portfolio.

Eurosif therefore advocates the disclosure of whether the asset manager or fund manager exercises their voting rights; the voting policy and principles used; the resources available for this process; and whether any part of this is outsourced to third parties. Funds should also regularly disclose their voting habits, and explain any deviation from their adopted voting policy.

In attempting to identify market failure in the voting process, Eurosif would argue that ESMA can better serve the aim of improving the functioning of the relationship between issuers and owners by focusing on impediments to voting, especially on a cross-border basis, and investor disclosure, rather than on regulating the proxy advisor industry.

² http://www.eurosif.org/images/stories/pdf/Lobbying_Papers/Eurosif_Response_Corp_Gov_2011_FINAL.pdf



About Eurosif

EUROSIF, the European Sustainable Investment Forum, is the leading European sustainable investment membership association whose mission is to develop sustainability through European financial markets. Being a multi-stakeholder organisation, Eurosif works as a partnership of national Sustainable Investment Forums (SIFs) with the support and involvement of around 80 Member Affiliates from the industry and related services. These include asset managers, ESG rating agencies, research and investment service providers, academic institutions, trade unions and NGO's, together representing assets exceeding €1 trillion and richly diverse standpoints. Informed by the expertise of its member affiliates, Eurosif speaks authoritatively and broadly on SRI (sustainable and responsible investment) issues. The main activities of Eurosif are public policy, research and supporting platforms for nurturing best practices regarding SRI.

For the full list of Eurosif Member Affiliates and Reports, please see www.eurosif.org

Eurosif has two main roles: (1) to provide an international forum that allows members and member affiliates to work together on issues pertaining to Sustainable & Responsible Investment (SRI, see below for definition of SRI and its market size in Europe) and Corporate Governance in the EU financial services sector, and (2) to collect input from members and member affiliates and then communicate their ideas and initiatives to European policy makers, including the European Commission as well as the European Parliament. Therefore, this note is mainly driven from and by the interest and expertise of our membership.

Sustainable and Responsible Investment Definition

Eurosif continues to use the term "SRI" as the most readily acknowledged expression for this field and defines SRI as follows:

Sustainable and Responsible Investing (SRI) is a generic term covering any type of investment process that combines investors' financial objectives with their concerns about Environmental, Social and Governance (ESG) issues.

Market Size

Eurosif's latest SRI market study, the European SRI Study 2010, indicated that total SRI assets under management (AuMs) had reached €5 trillion as of December 31, 2009. The SRI market experienced compound annual growth-rate (CAGR) of 37% since the previous study was published in 2008, which is significant, especially in view of the financial crisis. This biannual study is based on a survey of asset managers and self-managed asset owners in nineteen European countries.