Comply or explain

Shareholders shouldn't outsource decision-making to third-party voting agencies.

Bernadette Young FCG

The requirement for boards to act in the collective interests of members is a long-entrenched tenet of company law. But, despite the primacy of shareholder interests and the fact that directors act only with the authority and as agents of a company's members, engagement with shareholders has not always been a board priority.

In fairness, institutional investors have also been guilty of taking a somewhat relaxed attitude to even the basics, such as **AGM** voting. In his 2004 report, Review of the Impediments to Voting UK Shares, Paul Myners noted that 2003 voting levels at company meetings were only around 50%.

Attitudes to the value of shareholder engagement have improved considerably since then, but the system remains far from perfect as reflected in a recent review published by Tulchan Communications, The State of Stewardship Report.

One of the key complaints made against major shareholders is that some fail to engage with the significant and strategic issues facing their companies. Instead, they effectively outsource decision-making to third-party voting agencies. Such an approach is contrary to the Stewardship Code which asserts that 'asset owners and asset managers cannot delegate their responsibility and are accountable for effective stewardship'. In other words, while use of a proxy advisor is a practical solution, the advice of the proxy agency should only be a guide; it should not be followed blindly without thought or care.

For governance professionals, the practical issues in relation to proxy votes cast in the lead up to an **AGM** can create quite a headache.

Draft proxy agency reports – if they are sent in advance for comment – generally need to be turned around with lightning speed. There is little opportunity for the contents to be reviewed internally, to identify published information that can be used to rebut any inaccuracies or for conversation with proxy voting advisors to result in substantial change. While commentary from the company will often be added to the narrative accompanying the voting recommendations, the recommendations themselves tend exclusively to reflect compliance – or otherwise – with the strict letter of the UK Corporate Governance Code, rather than allowing for an alternative recommendation based on the 'explain' option which underpins the Code's operation and success.

The Tulchan report calls for tighter regulation of proxy voting agencies. From a practical perspective, it would be helpful for the Best Practice Principles for Providers of Shareholder Voting Research & Analysis – the code to which such agencies commonly adhere – to be expanded beyond its existing myriad, loosely worded disclosure and policy requirements. Providing issuers with early voting recommendation review opportunities is currently neither mandatory nor subject to thresholds of acceptable practice – an agency's policies must only cover 'whether and how issuers are provided with a mechanism to review research reports'.

There is a disconnect between the intention and desire on both sides to create meaningful investor dialogue and how it operates in practice. Boards can do more to improve communication with shareholders through earlier and more regular conversations about strategic direction and priorities, executive remuneration and other governance issues. But shareholders and proxy voting agencies should also reflect on whether they are more concerned with ticking the 'proxy-card box' or actually focusing on engagement with the significant issues facing their portfolio companies and, in doing so, accepting that the principle of 'comply or explain' needs to leave as much room for the 'explain' as the 'comply'.

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