YALE SCHOOL OF MANAGEMENT

THE MILLSTEIN CENTER
FOR CORPORATE GOVERNANCE AND PERFORMANCE

POLICY BRIEFING NO. 3

Voting Integrity

Practices for Investors and the Global Proxy Advisory Industry

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Accountability of corporate boards to shareowners rests in large part on the integrity of the system by which investors vote their proxy ballots. Shareowners rely on the vote to affect the governance of a company; corporate directors see the vote as a barometer of investor confidence in board stewardship. Outcomes determine the fate of director tenure, mergers, acquisitions, capital raising, remuneration plans and other critical decisions with sometimes profound consequences for stakeholders and the marketplace.

However, this briefing finds that the proxy voting system in the US and other markets is chronically subject to criticism that it is short on integrity sufficient to ensure trust. Parties involved are institutional investors, agents such as proxy advisory services, and intermediaries charged with transmitting ballots. Threats include conflicts of interest, opacity, technical faults in the chain by which ballots are transmitted, and a shortage of resources devoted to informed decision-making.

Remedies proposed in this briefing include:

- Governance firms should endorse and comply with a first industry-wide code of professional ethics, including a general ban on a vote advisor performing consulting work for any company on which it provides voting recommendations or ratings. A proposed code is offered in Appendix A.
- Institutional investors should endorse and follow guidance on their own governance produced by the International Corporate Governance Network.
- Institutional investors should report to clients or beneficiaries at least annually on their voting policies and voting records. Further, such institutions should regularly review voting policies to ensure they are fit for purpose; identify, manage and disclose real or potential conflicts of interest on a regular basis; and determine the level and quality of resources necessary and appropriate to deliver vote recommendations and decisions that are in line with their voting policies.
- The US Securities and Exchange Commission should empanel a high-level independent review aimed at modernizing the US proxy voting system. Regulators should work with counterpart bodies in other markets to supervise the seamless integration of national systems to enable accurate and efficient cross-border voting.

ABOUT THE MILLSTEIN CENTER FOR CORPORATE GOVERNANCE AND PERFORMANCE

The mission of the Millstein Center for Corporate Governance and Performance (the "Center") is to serve as a vital contributor to the growing architecture of international corporate governance. The Center sponsors research, hosts conferences, generates global databases, designs training and publishes policy briefings on emerging corporate governance policy issues. Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry is an installment in a series of Policy Briefings designed to assist policymaking.

Center Policy Briefings are framed as think tank reports based in part on actual experience and observation rather than empirical research. They include original material and policy analysis in a concise format. Reports serve both as pointers to further detailed empirical research and as a resource for market practitioners.

This report is issued both as part of the Center's Policy Briefing program and as follow-up to a Voting Standards roundtable, convened in New York City on January 29, 2008 under the chairmanship of former US SEC chief accountant Lynn Turner. Material in it reflects research and input from the roundtable, as well as extensive comments received during a consultation period.

Voting Integrity was prepared under the supervision of Ira M. Millstein, Senior Associate Dean for Corporate Governance, Yale School of Management, and Stephen Davis, Center Senior Fellow. The principal author was Meagan Thompson-Mann, Center Visiting Research Fellow.

Contact meagan.thompson-mann@yale.edu or
stephen.m.davis@yale.edu.

ACKNOWLEDGEMENTS

The Center is grateful for contributions to this project from Lynn Turner, who chaired the Center's Voting Standards roundtable, as well as Prof. Jonathan Koppell of the Yale School of Management, Ira Millstein, senior associate dean at SOM, and Milica Boskovic, managing director of the Millstein Center. Thanks also go to the following bodies which provided assistance in the policy briefing project: American Federation of State, County and Municipal Employees (AFSCME); Broadridge Financial Solutions, Inc.; Florida State Board of Administration; Glass Lewis & Co., Governance for Owners; Hermes Equity Ownership Services; Inveshare; Marco Consulting Group; Morgan Stanley Investment Management; Norges Bank Investment Management; Office of the Connecticut State Treasurer; PROXY Governance, Inc.; Richson Consulting Group, LLC; RiskMetrics Group; The Society of Corporate Secretaries and Governance Professionals; TIAA-CREF; and Washington State Investment Board. However, the content of the policy briefing is solely the responsibility of the Center.

1. INTRODUCTION: WHY VOTING INTEGRITY MATTERS

At the heart of any discussion about proxy voting is the humble shareholder ballot. In its simplest interpretation, the ballot is arguably the principal method by which a company's shareholders can, while remaining investors in the company, affect its governance, communicate preferences and signal confidence or lack of confidence in its management and oversight. The ballot is the shareholder's voice at the boardroom table. Shareholders can elect directors (and, in several jurisdictions, have the right to remove them), register approval of transactions, supply advisory opinions and (increasingly) authorize executive pay packages, all through the medium of the ballot. It is one of the most basic and important tools in the shareholder's toolbox. Depending on the jurisdiction and the identity of the shareholder, it may even be obligatory for the investor to exercise this right.[1]

However, most institutional investors do not have the resources to make independent voting decisions on every resolution at every company in which they invest, nor to be present through a physical agent to cast a ballot. To remedy this, they employ others to supply analysis, make voting recommendations and even to vote shares in person or by proxy. It is here where the institution's own profile comes into play. The fund should be sufficiently structured and resourced to make informed judgments as an owner in ways that are aligned with the interests of ultimate beneficiaries.

The quality and integrity of other players– the proxy voting advisors, custodians, portfolio managers and vote execution services – also contribute to the voting process. With each stage that the ballot moves away from the hand of the effective owner, there may be a greater opportunity for the voice to lose its impact or even its intention. Without proper oversight by service provider and client, it can become like the children's game "Telephone" – the intended message gets slightly distorted with each transmission, to the point where its meaning has changed utterly. Safeguarding the intention of a voting instruction is of paramount importance to system integrity.

The issue of how investors make voting decisions is especially timely as proxy voting turnout rises worldwide, institutional investors address voting decisions with a more critical eye, and U.S. investors assess the impact of expanded voting rights, particularly the majority voting standard for directors. In this context, the Center believes it vital to shed light on how institutions go about making choices that can have profound consequences for the way corporate boards are composed and how they operate.

This policy briefing was designed to explore how various market institutions around the world develop, set, and maintain their standards for proxy voting; how potential conflicts of interest are identified and controlled; and what resources they have available in the standard setting process.

To probe how improvements might be made to the process, the Center convened a group of institutional investors and proxy voting advisors at the Yale Club in New York City on January 29, 2008. The "Voting Standards" roundtable was chaired by Lynn Turner, former chief accountant to the US Securities and Exchange Commission and former executive of Glass Lewis & Co. Participants from the US and Europe included state sector pension funds, mutual funds and fund managers. The session was held under Chatham House rules,[2] allowing for candid dialogue between parties and for sentiments expressed on the topics below to be explored freely, without attribution of any specific idea or quotation.
Roundtable participants focused on four major areas of concern:

- *How investors and their advisors set their voting policies;*
- *Recognizing and managing conflicts of interest in the proxy advisory industry;*
- *Impediments to efficient and accurate voting; and*
- *Providing adequate resources to the proxy voting function.*

Findings in this report are based largely on:

- The roundtable workshop with major institutional investors and proxy advisors;
- Independent research on voting-related topics;
- Correspondence with institutional investors, proxy advisors and other parties involved in the proxy voting process; and
- Comments received from roundtable participants and

1 For example, pension and mutual funds may have a fiduciary duty to vote; investment managers voting on behalf of clients may have a contractual duty to do so. The US 1974 ERISA legislation requires certain institutional investors to vote

2 Under Chatham House rules, content of the meeting may be cited but not attributed to any individual without their explicit agreement.

other interested parties after publication of the first draft of this paper.

The report recommends steps to improve global systems of voting and decision-making. Further, it makes two suggested additions to the canon of governance to assist in managing real and perceived conflicts of interest, promoting accountability, and refining stewardship:

- a code of best practice for investors; and
- a professional code of ethics for the proxy voting and governance advisory industry.

2. HOW INVESTORS AND THEIR ADVISORS SET THEIR VOTING POLICIES

Participants at the roundtable discussed the processes by which their institutions set proxy voting policies against which they make voting judgments, as well as how frequently such policies were reviewed, and by whom. Voting policies set out how the investor or advisor will normally vote on agenda proposals of company meetings if certain criteria (as determined by the policymaker) are met.[3] All participants had developed and continually refined their voting policies. Nevertheless, there were strikingly different patterns of design and review, both between, and amongst, the investors and advisors, and within each group.

Debate in this area centered on whether it is more appropriate, on the one hand, for investors and their advisors to develop general policies that are relatively flexible and then adjusted to fit the individual circumstances of the company under consideration; or on the other hand, to have far-reaching and detailed policies that generate consistent recommendations which allow possibly under-resourced proxy voting teams to vote without spending too much time considering the vote in the greater context of individual performance. When the proxy team is small, or governance resources sparse, this becomes a crucial issue.

Of the proxy advisors present, RiskMetrics Group, Glass Lewis & Co. and Proxy Governance Inc. ("PGI") develop policy through internal and external processes. Marco Consulting and Governance for Owners both keep policy creation and review primarily in-house, with some advice sought from their existing clients.

RiskMetrics, the global industry leader, has established a series of internal advisory sub-committees, each headed by a specialist who looks at an individual proxy subject area (e.g. audit, board, compensation). The lead specialists are part of a greater internal policy steering committee, which forms part of the Governance Services Global Policy Board. Other policy board members include the RiskMetrics CEO and outside governance experts. [4]RiskMetrics obtains and incorporates external sources of information in its policy-setting, mainly through surveying their clients annually and on a global basis as to what the clients feel works or does not work in the policy. More recently, RiskMetrics has taken the step of putting some elements of its draft proxy

3 For example, an investor may have a policy to vote against all shareholder resolutions unless an economic benefit will flow from approval

4 Further details at http://www.riskmetrics.com/issgovernance/policy/formulation.html; last accessed May 12, 2008.

voting policies on its website for public comment, much in the way the SEC puts its proposals out for public review, keeping them open for about a three-week time period before finalizing the policies. Both the client survey and public comment period are performed on a global basis. Final decisions on policy are made exclusively by RiskMetrics executives.

Glass Lewis also employs internal/external processes of policy development, with some differences compared to the methods employed by RiskMetrics. It too evaluates its policies on an annual basis, using topic–specific sub-committees, and reviewing local regulatory changes, market practices and notable events during the prior proxy season. There is also some ad hoc review occurring throughout the year depending on developments or changes to generally accepted best practices globally. Consideration is given to the ongoing conversation it has with existing clients. Glass Lewis has also established an independent external advisory board, called the Research Advisory Council, and is contemplating the introduction of an SEC-style comments period for certain aspects of its policy.

PGI performs an annual review of its policy, using both internal and external resources. The company has two managing directors for policy, who draft only after having met with active state and union pension funds, members of the socially responsible investment community, and potential shareholder resolution proponents. The draft policy then goes to its external policy council, which is composed of independent corporate governance and other business experts, for further commentary and review.

Governance for Owners, one of three members of a new sub-industry of global engagement specialists, uses market-specific policies as starting points in each jurisdiction for which it provides recommendations, but employs in-house resources for refining each policy further.[5] In comments made to the first version of this paper, Governance for Owners stressed that it is not a proxy advisory service in the same vein as the other services represented at the roundtable, as its emphasis is on engagement with companies rather than providing comprehensive voting recommendations.[6] Marco's policy is a synthesis of best practices based on the Council of Institutional Investors' governance principles and ideas that have come out of working with its own clients on bespoke policies. All five service providers were keen to point out the transparency of their policy-setting process.

Just as the advisors have similarities when developing voting policies, institutional investors have common themes in policy-setting while taking very different approaches to the task. A widespread practice, particularly amongst the state-sector funds, is the use of internal committees, usually reporting up to the investment committee, to vet the policy. This can be a fairly time-consuming process, depending on the layers of committees and the scrutiny involved. One of the roundtable participants, Connecticut Retirement Plans & Trust Funds, has its policy reviewed in public, open sessions. Another, TIAA-CREF, has its policy scrutinized by senior management, trustees and occasionally by the fund's overseers. At the other extreme, one of the other funds present reported that the governance staff has latitude in setting voting policies without the need for board approval.

All of the investors present described development processes that involved some degree of outside advice in conjunction with in-house expertise. One of the funds relies heavily on input from the Council of Institutional Investors to get further commentary on best practices, and another reaches out to its beneficiaries for their remarks. One of the funds stated that it is sensitive to the opinions of its beneficiaries: "[We] are publicly exposed and publicly responsible. And our participants care, actually, a lot about how we vote, particularly on social issues. So we have to be very careful about it. So our policy statement is directed in large part, well, 50% to the corporations whose stocks we own, but 50% to our participants, so that they can understand a voting decision that might superficially appear to them to be against their interests or their wishes."

TIAA-CREF takes a "glass house" approach to the policies it develops. The test applied is whether the fund company's own board would be able to adopt the policies it endorses. To this end, TIAA-CREF has itself embraced "say on pay" and majority voting principles for its own board, so that it can speak with conviction to companies where it is advocating improvements in these areas. This is the closest instance amongst the roundtable participants of a fund exposing its own governance policies to ratification by ultimate shareowners.

A notable development is the launch of the RiskMetrics Governance Policy Exchange.[7] The Exchange is a portal that provides

5 Others in the sub-industry include F&C and Hermes Equity Ownership Service (HEOS). The ventures offer institutional investor clients a range of engagement services in addition to voting. Note: Stephen Davis, director of the Center's voting integrity project, is the nonexecutive chairman of HEOS.

6 Email from Michelle Edkins, Managing Director, Governance for Owners; June 13, 2008.

7 Available at www.riskmetrics.com/policy_exchange/.

access to institutional investors'[8] governance policies and principles. It allows users to compare and contrast policies across various governance topics, and has audio commentary from investors taking part in the project on the policies and their governance philosophies. Exchange subscribers have the option to give feedback to the institutions on the policies, which brings more viewpoints to the table when the participating institutions mount a policy review. RiskMetrics has plans to include more institutions in this project, as well as to bring issuers into the project to get additional perspectives. Although it is currently US-centric, there are future plans to cover other jurisdictions.

8 At the time of writing, these investors were: TIAA-CREF, Morgan Stanley Investment Management, Domini Social Investments, the California Public Employee Retirement System (CalPERS), and the Connecticut Retirement Plans & Trust Funds.

3. CONFLICTS OF INTEREST

"And so to attempt to eradicate all conflict is really impossible and inconceivable. You practically have to not be in this business to eradicate all potential conflicts."
– Proxy advisor participant at the Voting Integrity Roundtable, January 29, 2009

Conflicts of interest are an issue with respect to institutional investors, and they are frequently mentioned in the context of proxy voting advisory services, particularly when those advisors provide services to issuing companies, as well as to the companies' shareowners.

Conflicts of interest can have economic consequences for investors. Recent evidence, for instance, indicates that mutual funds tend to defy investment logic and overweight stock in companies for which they handle 401(k) retirement business—causing client investors to suffer worse returns than they would otherwise.[9] Confidence in the conflicted body may be affected, even when conflicts are not so explicit, or are mitigated to some degree by disclosure or control. Clients may choose to move to a less obviously conflicted advisor. The bona fides of an investor engaging with a company on transparency and accountability could be undermined if the investor has not handled its own conflicts adequately.

Almost all roundtable participants concluded that conflicts were manifold and not easy to eradicate given the nature of the capital markets, and that investors were just as likely to be conflicted as their advisors. Discussions focused on whether, having accepted the inherently conflicted nature of both advisor and client, it is enough to merely disclose the existence of a conflict, or if further steps must be taken to counteract the influence. As one roundtable participant said, "You know, it's not just the research, because if the data were so compelling.... [really] it's the conclusion. It's what influences the conclusion that's based on the data."

Proxy advisors have been the subject of scrutiny regarding conflicts of interest for some time. Concerns and service practices highlighted below are drawn from the public record. The most vocal criticisms have been reserved for advisors that provide both voting advice to institutional investor clients and structural governance advice to the companies on which they also

9 Cohen and Schmidt, "Attracting Flows by Attracting Big Clients: Conflicts of Interest and Mutual Fund Portfolio Choice." HBS Working Paper 08-054; January 2008.

produce voting recommendations. There is an argument that this model allows companies that purchase governance guidance to "game" the system, potentially tainting any voting recommendations to investors because the company in question might also be a client of the advisor.[10]

RiskMetrics (RMG), which provides both these services, is also the largest of the proxy voting advisory services and therefore the most obvious target of these criticisms; it has suffered some reputational damage due to the controversy.[11] RMG ranks over 8,000 companies using its Corporate Governance Quotient service, which assesses a company's governance systems and board of directors.[12] Although the companies do not pay to be ranked, RiskMetrics provides other advisory services aimed at helping deficient companies improve their governance standards. Simultaneously, RiskMetrics provides investors who use its voting advisory services with recommendations on these same companies. RiskMetrics has taken measures to keep the two advisory businesses separate, including maintaining separate premises for the two divisions, and openly discloses this conflict, and others. In a comment letter to the initial draft of this paper, RiskMetrics stressed that it actively reviews, manages and mitigates all potential conflicts and has taken pains to disclose all conflicts.[13]

However, uneasiness over hypothetical contamination remains in the market. Roundtable participants stated that they believe various corporations assume that signing up for RiskMetrics consulting provides an advantage in how the firm assesses their governance—despite the fact that RiskMetrics' own extensive safeguards make this highly unlikely. The company has also published on its website a report[14] validated by Sullivan & Cromwell LLP which states that RiskMetrics' "current protections effectively manage the potential for conflict, and perceived conflict, between ICS [the corporate consulting arm] and ISS [the proxy advisory service]."

Glass Lewis, RiskMetrics' nearest rival in terms of size, utilizes a model that seeks to minimize some of these conflicts. But it too has faced criticism for potential conflicts. Although Glass Lewis does not provide advice to the companies on which it supplies voting recommendations, it has gone through two recent changes of control that raised eyebrows. Xinhua Finance Media, a Chinese financial information provider, gained control of Glass Lewis in late 2006. It later emerged that Xinhua's chief financial officer had been under investigation by the SEC, and that the company itself would not have met Glass Lewis' governance standards.[15] Xinhua was also the parent company of businesses such as Taylor Rafferty that sold services to corporate managements. When the Ontario Teachers' Pension Plan (OTPP) acquired Glass Lewis from Xinhua in 2007, some expressed anxiety that the governance policies of OTPP might interfere or override Glass Lewis's own existing policies. Glass Lewis has endeavored in both circumstances to stress its independence from its owners, and from the governance philosophies of the parent organizations.

Although other voting advisory services represented at the Voting Standards roundtable are less frequently mentioned in discussions of conflicts of interest, each has faced potential tensions in this area. PGI's first subscription was from the Business Roundtable, which represents US chief executive officers and is commonly seen as promoting the interests of corporate America. The subscription was for over 160 Roundtable members, and came on the heels of a 2004 memo from the Roundtable's chairman, former Pfizer chief executive officer Hank McKinnell, urging members to buy PGI's services.[16] PGI has made it clear that the Business Roundtable has never made any effort to exert influence over policy setting. Indeed, the bulk subscription was terminated in 2005.

Governance for Owners (GO) and Marco Consulting face different but no less relevant conflict issues. GO's main conflict appears to be that it also runs a shareholder engagement fund. Ten to 15 times a year, depending on how many companies are in the portfolio, there will be occasions where GO will advise clients on how to vote at companies where GO will clearly have an interest of its own. Furthermore, at the time of writing this

10 Rose, "The Corporate Governance Industry". Journal of Corporation Law, Vol. 32, No. 4; p. 120.

11 There have been several recent, well-publicized incidents of large institutional investors, including the pension funds of the states of Colorado, Missouri and Ohio moving at least some of their proxy advisory contracts away from RiskMetrics to other providers,. Conflict management has been cited as one of the major reasons for terminating the contracts.

12 www.issproxy.com/issgovernance/esg/cgq.html; last accessed May 5, 2008.

13 Letter from Steven Friedman, General Counsel, RiskMetrics Group; October 13, 2008.

14 www.riskmetrics.com/sites/default/files/ISS_Corporate_Services_Conflict_Policy_Review_Project.pdf; last accessed November 28, 2008.

15 www.cpadaily.com/?p=323; last accessed May 5, 2008.

16 Gretchen Morgenson, "Pfizer and the Proxy Adviser," New York Times, April 21, 2006; www.nytimes.com/2006/04/21/business/21proxy.html?pagewanted=print; last accessed May 6, 2008.

report, GO's only stewardship client receiving vote recommendations is a pension fund which is sponsored by several publicly listed companies. It may become necessary for GO to engage with these companies on poor governance practice or recommend a proxy vote against management, and not to overlook bad governance practice at the companies which, after all, pay their fees. GO has commented that although there appears to be a potential conflict in such circumstances, UK pensions law requires corporate pension funds to be separate legal entities from their corporate sponsors. As such, GO's client is the fund trustee, not the corporate sponsor. GO would notify the trustee of engagement with the sponsoring corporate but it would not alter the intended engagement.

Many of Marco Consulting's clients are Taft-Hartley pension funds. Every year Marco's union clients sponsor a number of shareowner proposals. Most of these are in line with Marco's own proxy voting guidelines, but occasionally one is proposed that is contrary to its principles. Marco is then left in the potentially embarrassing position of recommending a vote against a proposal sponsored by own of its own clients. Marco seeks to limit the appearance of conflicts in such a situation by maintaining very comprehensive and specific proxy voting policies which make clear how the consultant would cast its vote under the circumstances. However, the possibility, though remote, that Marco could compromise its independence to satisfy clients causes concern to some.

It is not just the proxy voting advisors that are open to accusations of being inherently conflicted. Institutional investors also face pressure to acknowledge and manage their own conflicts as well, and their purported independence is less a matter of public record than that of their advisors.

A pension fund may feel it is impolitic to vote against a director of a public company for which it directly manages retirement funds, despite the recommendation of its proxy advisors. Investment managers face similar concerns, and could potentially have even greater numbers of conflicts simply because they provide other services to both institutional investors and the companies on which they have provided recommendations. Whereas the proxy advisory services make clear in their corporate information their recognized conflicts and what steps they are taking to mitigate them, there is some anecdotal evidence that disclosure of investor conflicts is harder to locate and, where it occurs, may take an anodyne or boilerplate approach.

4. BREAKDOWNS IN THE VOTING CHAIN

As shareowners gain greater rights, such as the ability to approve or dismiss executive pay packages, true majority voting for the election of directors, and the power to nominate candidates for election to the board, the ballot becomes even more valuable. Yet impediments can weaken or silence the shareowner's vote. Ballots may be lost or miscast in complex transit routes from an investor through intermediaries to the company. Securities lending and blocking of the stock for extended periods can derail voting rights. Onerous paperwork for non-resident shareowners can deter access to the ballot. Each amounts to a barrier to an investor being able to exercise the vote, and a step away from effective accountability.

One of the continuing problems facing investors is the complexity of an apparently simple process – casting a proxy vote. For many institutional investors, voting a proxy appears to be a straightforward practice. A ballot appears on their electronic voting platform stating the number of shares held, and in which voting accounts. The ballot may be pre-populated with a proxy voting advisor's recommendations or these may be shown on the ballot alongside blank voting boxes for the investor to register their voting preferences. Submitting the ballot merely requires clicking on boxes and buttons. But how can an investor be sure that voting instructions have been lodged with the company as intended?

In fact, the itinerary votes travel outbound from a publicly traded corporation and inbound from the voting investor seems almost pathologically complex. Devised for a different time, such systems have been streamlined and updated in certain markets, such as the UK. The US system is shown in the diagram supplied courtesy of Inveshare (formerly Swingvote), the Atlanta-based proxy delivery company. A criticism repeated at the Voting Standards roundtable was that there is currently no satisfactory method for an investor to confirm that every vote at a US company has been cast as directed. Three firms now comprise the proxy transmission industry in North America: Inveshare, Mediant Communications and Broadridge Financial Solutions, and each are working to meet that demand.

Broadridge is the leading provider of proxy voting technology to the financial services industry, and currently acts as the proxy agent for 97% of US banks and brokers.[17] ProxyEdge, Broadridge's proxy voting platform, is used by many institutions to vote their securities,[18] and it features a suite of reporting options which attempts to provide a verifiable proxy voting audit trail to the shareowner. However, what comes out in the report has not always reflected the reality of the voting circumstances.

In an October 2003 report by the Brandes Institute, entitled "Proxy Voting: Making Sure the Vote Counts",[19] Maryellen Andersen, then Vice President of Broadridge's predecessor company ADP, was quoted as saying: "We can confirm the votes as far as the company. What the company does with them is out of our hands." Essentially, although Broadridge has both internal and external audit processes in place to confirm that votes were transmitted to the issuer as instructed by the shareowner, there has been and continues to be no way of getting a true confirmation back from most issuers that the ballots were cast as instructed.

Broadridge has taken steps to improve voting integrity and transparency by implementing a program of end-to-end confirmation for ProxyEdge users where Broadridge provides services to the corporation for both beneficial and registered owners. End-to-end confirmation is currently available for approximately 1,500 meetings.[20] Broadridge has stated that it may be possible to expand this service further in the future. The service is at present free to all ProxyEdge users.[21]

One of the roundtable participants mentioned the now well-known incident in the UK, when Unilever plc mounted an investigation to understand why voting levels were so low at its May 2003 annual meeting. The company was particularly puzzled when three large institutional investors stated that they had voted their shares through an intermediary, but that the votes had not been executed as instructed. Further enquiries uncovered the problem. Although the investors had properly instructed Institutional Shareholders Services, the voting intermediary, ISS had improperly filled out a voting card. The card was then rejected by the registrar, Lloyds TSB. It is believed approximately 12.6 million votes were "lost" in this way.[22] ISS pointed the finger at the registrar, claiming that Lloyds TSB had not provided them notification of rejection – there was no legal requirement for Lloyds to do so.

Further complicating the process, depending on the market, there can be a dizzying array of intermediaries standing between the beneficial owner and the issuer, including custodian and sub-custodian banks, brokers, tabulators and registrars. Any break in this lengthy chain could lead to a discrepancy between the shareowner's stated voting intention and the outcome. There is no real incentive to remove or streamline these layers, as each link stands to benefit economically from being a part of the voting process. As one roundtable participant stated, "In fact, there's probably reason to resist change, because once you create standards that make it easier for issuers and investors, potentially, to communicate, then what happens to the guy in the middle, right?" Moreover, certain markets may cause further difficulties by requiring re-registration of shares (e.g. Switzerland), up-to-date powers of attorney (Brazil, Sweden, and Russia, amongst others), or personal attendance at the meeting.

Securities lending programs can create additional obstacles to efficient and verifiable voting. These were cited as particularly problematic at the Voting Standards roundtable. When shares are on loan from an investor, the voting rights that accrue to them are also, in essence, on loan. In order to exer-

17 www.broadridge.com/investor-communications/us/institutions/proxyedge.asp Last accessed May 1, 2008. Broadridge acts as an independent intermediary and contracts primarily with the banks and brokers to distribute proxy materials and tabulate the votes. For registered holdings, the practice is an 'issuer-pay' approach, where the corporation hires Broadridge. Other markets feature issuer-pay and investor-pay models.

18 Although there are other proxy voting platforms available, including proprietary systems provided by RiskMetrics Group and Inveshare amongst others, ProxyEdge is used here as an example.

19 www.brandes.com/NR/rdonlyres/57DE4F3E-9211-430B-8803-C0019553BA73/0/ BI_ProxyVoting.pdf; last accessed May 1, 2008

20 Email from Maryellen Andersen, Vice-President, Corporate and Institutional Relations, Broadridge Financial Solutions, Inc.; November 10, 2008.

21 Letter from Chuck Callan, Senior Vice-President of Regulatory Affairs, Broadridge Financial Solutions, Inc.; October 17, 2008.

22 Adam Jones, "Riddle of the missing Unilever votes solved," Financial Times, August 15, 2003. http://search.ft.com/ftArticle?queryText=unilever+proxy&y=0&aje=true&x=0&id=030815005114&ct=0 ; last accessed May 5, 2008.

cise the right to vote, the investor must recall the shares from the borrower. Policies that allow for the efficient termination of the loan contract – and subsequent return of securities – must also be in place. There are several potential snags facing the recalling borrower, not least of which are (1) lost income from having the shares out on loan; and (2) being apprised of a significant proxy issue with enough time to recall the shares. The securities lending team at an investor may be reluctant to forego the not-insignificant income possible from having shares out on loan, or may have a policy not to recall shares at all, in which case the investor's voice may not be heard. If an issuer delays getting the ballots to the custodians, the window of opportunity for recall may be lost.

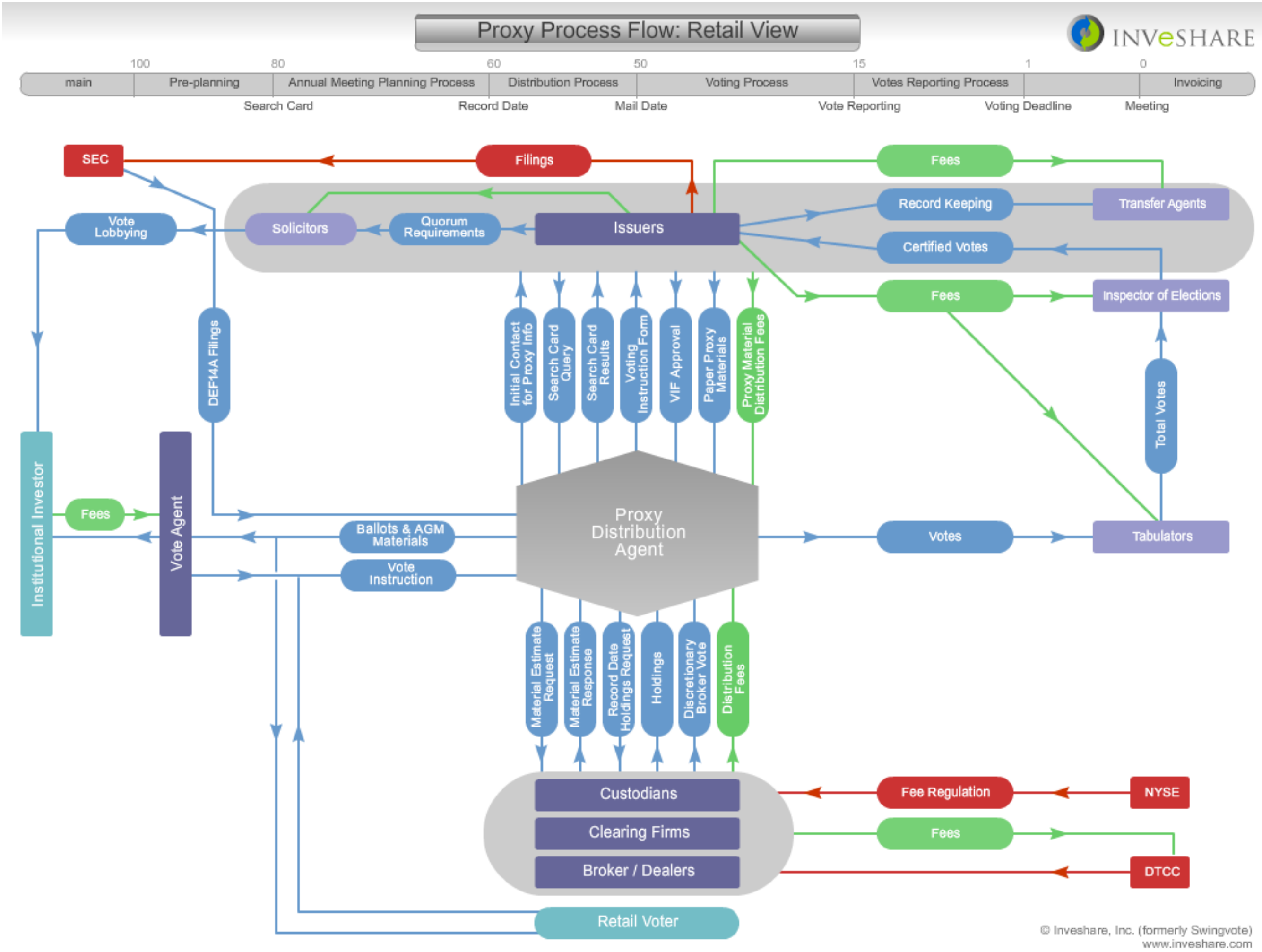
Several roundtable participants complained that the reporting available from the intermediaries, in particular from the client-facing voting platforms, was not sufficiently robust to guarantee that the information genuinely reflected their voting intentions. In particular, one participant mentioned running a report on the vote at the Walt Disney Company. The platform showed that the institution had a split vote on the ProxyEdge system, with 92% of shares voted for, and 8% against. However, this participant's fund has a house policy never to split the vote, and was perplexed as to how this might have occurred. The investor called Broadridge to investigate further, and was initially told there was no way of telling how the vote had been split. Further inquiry by Broadridge demonstrated that some of the investor's accounts were voted in such a way as to appear to have been split because an outside money manager voted in error against the investor's policy.[23] The fund originally speculated that there may have been an error in recalling shares, or in loan tracking, and that occasionally shares that are on loan might appear on the voting platform that reflect the way the borrower has voted, even though the voting rights are not currently accrued to the originating fund.

Other investors at the Voting Standards roundtable criticized the appearance of lines of stock on the voting platforms when shares have no voting rights, which could lead to confusion. Broadridge has since confirmed that these shares can only be voted if the client requests to do so, and if the client has recalled the shares before the record date. Further complications may arise when the platform gives a direct feed into a public report on the investor's website which shows voting outcomes.

The consequences of a miscast or missed vote can be both economic and reputational. If a report of how the votes were cast does not reflect the true intention of the investor, there is the danger both of embarrassment to the investor and a putative claim of breach of fiduciary duty to vote in line with the agreed voting policy. In mergers and acquisitions activity, particularly in very tight contested takeover situations, a miscast or missed vote could lead to monetary losses for an investor. For other parties, like custodians and vote execution providers, improperly cast ballots could lead to the eventual loss of clients if lapses regularly occur or a particularly sensitive matter was involved.

Even occasional missed votes raise questions about disenfranchisement when those votes are accumulated. As mentioned above, where there is a particularly contentious resolution on the ballot, the matter of a few tenths of a percentage can make the difference as to whether a measure will pass. If even one large shareholder's votes are not cast correctly, a resolution which should not have passed can gain approval. As majority voting for director elections gains ground in the US, it can be argued this becomes even more pertinent. A director who might have the support of a significant shareholder could be voted off the board if that shareholder's vote is lost.

23 Email from Maryellen Andersen, op cit; November 10, 2008.



Proxy Process Flow: Retail View
INVeSHARE
100
80
60
50
15
1
0
main
Pre-planning
Annual Meeting Planning Process
Distribution Process
Voting Process
Votes Reporting Process
Invoicing
Search Card
Record Date
Mail Date
Vote Reporting
Voting Deadline
Meeting
SEC
Filings
Fees
Vote Lobbying
Solicitors
Quorum Requirements
Issuers
Record Keeping
Transfer Agents
Certified Votes
Fees
Inspector of Elections
DEF14A Filings
Initial Contact for Proxy Info
Search Card Query
Search Card Results
Voting Instruction Form
VIF Approval
Paper Proxy Materials
Proxy Material Distribution Fees
Total Votes
Institutional Investor
Fees
Vote Agent
Ballots & AGM Materials
Vote Instruction
Proxy Distribution Agent
Votes
Tabulators
Material Estimate Request
Material Estimate Response
Record Date Holdings Request
Holdings
Discretionary Broker Vote
Distribution Fees
Custodians
Clearing Firms
Broker / Dealers
Fee Regulation
NYSE
Fees
DTCC
Retail Voter
© Inveshare, Inc. (formerly Swingvote)
www.inveshare.com

5. PROVIDING ADEQUATE RESOURCES TO PROXY VOTING

"Who is going to pay for it? It all comes down to money. Money is one, two, and three. Either people pay for it and it can be done properly, or people don't pay for it, and we get less than best practice."
– Institutional investor participant at the Voting Integrity roundtable, January 29, 2008. February 26, 2008 Attendees

Share voting has become both more important and more complex. So do investors or their agents make sufficient resources available for informed decision-making? Even large investors, which may be able to assign dedicated staff members to assess individual proxies based on a variety of resources, may find that their efforts at effecting real change through their votes at the companies in which they invest are hindered when their resources do not meet their ambitions. Smaller investors may not have any committed full-time proxy voting staff. Instead, they outsource their voting decision-making to one of the proxy advisory services to discharge their duty to underlying beneficiaries to vote their proxies. But at the services themselves, staff making recommendations may be inexperienced or temporary, which prompted some roundtable participants to question the validity of the advice. This concern is obviously exacerbated when the investor-client has fully outsourced voting decisions.

Lack of support, whether in monetary terms or staffing levels, can hinder voting capabilities and limit potential improvements in service. Smaller funds appear to be particularly prone to having fewer staff members committed principally to voting. Historically, the seasonality of proxy voting, wherein the lion's share of annual meetings worldwide takes place in a 4-5 month period, has required the voting advisory services to take on temporary staff, leading to concerns about the expertise and supervision behind the recommendations. "How do you make sure," asked one roundtable participant, "that, with these very temporary [staff], that you're getting things identified, and then votes are being made according to whoever's guidelines you're using on those, such that the institutional investors can rest assured that that's the way the votes are being done and there's really this input going into these things?" At the institutional level, with a few notable and well-known exceptions, frequently only a few staff members are dedicated to proxy voting and corporate governance, and sometimes these staff members have other duties as well.

For investors, low staff numbers can lead to concerns about how much information, expertise and time may be devoted to making voting decisions. According to the proxy advisors present at the roundtable, there has been a marked rise in the number of investors developing, with advisor input, customized voting policies and templates to produce recommendations in line with the investor's philosophy, as opposed to the "plain vanilla" off-the-shelf policies available. There appeared little doubt that a custom policy can produce more tailored voting recommendations and screen out recommendations that contradict the investor's internal governance philosophy. However, there was concern that this might lead to a robotic "set it and forget it" mentality. With the vast number of proxies to consider, any investor who has moved even some of the voting function in-house may, when a recommendation comes through to vote in favor of what appears to be a non-controversial agenda item, vote as recommended without performing further research. Investors may wonder what they are paying for if they can't rely on the voting recommendations derived from a custom policy. One investor present at the roundtable stated that of the more than 2,000 lines of U.S. stock his team voted in 2007, perhaps only fifty merited in-depth analysis beyond review of the advisor's recommendations. In addition, depending on where the voting function is housed within an organization, there may be some pushback on truly informed voting. One participant recalled a situation at a large organization where there "was a group of portfolio managers who were also voting, doing the actual proxy voting, who were more interested in making sure they maintained the open line of communication with the management team, and that they could care less about the vote. And this is why we get these yes votes on companies that are not performing. They are petrified that they're going to get cut off."

Roundtable participants asserted that this dependence on the advisory services stems from the lack of investment in staffing numbers and the cyclical nature of the proxy calendar. The voting process is considered a cost rather than revenue center. And for much of the year, when the annual meeting calendar is fallow, it makes little economic sense to maintain a large team of professionals, unless there are other tasks for them to pursue in the off-season. During the off-season, more time can be devoted (if an investor chooses) to putting each resolution into its greater context at the company in question, with detailed in-house analysis of the issues at hand. It is only during the voting season, generally considered to be March through July for northern hemisphere-based funds and September through November for those in the southern hemisphere, that problems related to low staffing numbers are thrown into sharp relief.

If a fund's custom policy is well-drafted, it can act in effect as a surrogate staff member at all times of the year by scrutinizing the financials, raising red flags, and performing the more mundane aspects of proxy analysis. The danger can come when, during the busy periods, the red flags are heeded, but not the more subtle aspects on the agenda. In one incident related by an investor present at the roundtable, a proxy advisor recommended a vote against a director for serving on multiple audit committees, against the advisor's best practice guidelines. This red flag caught the attention of a portfolio manager, who duly voted against the director, citing concerns about overstretching. When the director came on to yet another board, this time at a troubled company, the recommendation came through to oppose once again. The investor's in-house team judged, however, that the director's presence was part of the company's reconstruction, and that opposing election might cause more harm than good. In the busy times, when there is greater appeal to rely more automatically on service recommendations, it is conceivable that this level of in-depth, company-specific analysis could be missed by the investor's in-house staff.

Lack of resources is not only an issue for investors. The voting advisory services are also affected by the proxy calendar, and the issues relating to having appropriate staffing levels during the busy season. Temporary staffers are frequently employed by the advisors in order to generate the significantly greater number of recommendations during this time. However, some providers are moving away from this model towards permanent staffing. All the proxy advisors present at the roundtable appeared to have robust supervision and detailed training in place for these temporary hires, ranging from several weeks to several months. Nevertheless, there is concern whether someone who may have limited, or no, business or proxy experience can make informed and appropriate voting recommendations. More than one investor present was uneasy about whether relying on the advice of inadequately resourced providers meant that they were not properly discharging their duties. This appeared to be of particular concern in markets where company information has been difficult to obtain or is only available in the market's domestic language.

All the advisors present at the roundtable claimed that any voting recommendation that eventually would be distributed to a client was vetted by a more experienced, permanent member of staff. Despite these safeguards, which the advisors explained were just as strong as those used to control conflicts of interest, skepticism remains amongst consumers whether reliance on less-skilled staff can produce uniformly accurate recommendations. As long as it is as uneconomic for the advisors to maintain large stables of analysts year-round as it is for their investor clients, it remains unlikely that the use of temps will ever disappear.

Complicating matters is the legitimate argument that it may not be economic for investors to devote more resources to the voting function, given that the effect of voting on portfolio value is arguable.[24] Devoting resources to a function that yields little immediate obvious economic gain moves resources away from more demonstrably profitable areas. There will always be prominent institutional investors such as CalPERS and TIAA-CREF who disregard the economic disincentive to devote more staff and money to proxy voting. For most investors, the benefits of doing so are uncertain unless there is some clear justification for the investment.

---

24 Considerable research ties better corporate governance at companies to better financial returns, but the role of proxy voting is less clear. See Gavin Grant, "Beyond the Numbers: Corporate Governance: Implications for Investors" (Deutsche Bank AG, April 1, 2004).

6. RECOMMENDATIONS

One aim of the Millstein Center's Voting Integrity project is to suggest possible solutions to challenges. Below are recommendations for improvements in the four areas highlighted at the New York roundtable. This is not an exhaustive list, but a starting point for further dialogue in these areas.

Setting voting policies

- Both proxy advisors and investors should regularly review their voting policies and determine whether any change is needed based on market developments and movements in consensus over best practice.

  From our discussions, it appears that advisors already conduct such reappraisals at least annually, and often more frequently as needed. Investors of all sizes should be encouraged to follow this lead. The appraisal need not be a root-and-branch assessment of all the policy positions, but should be done with reference to any changes in the fund's statement of investment principles; international generally accepted best practices promoted by groups such as the International Corporate Governance Network (ICGN); and local market standards and events. Investors may also wish to benchmark their policies against other leading funds. RiskMetrics' Governance Policy Exchange or the online ProxyDemocracy.org service could assist to this end. Investors and advisors could also consider sharing their policies with each other. Smaller or less well-resourced funds should consider either working closely with a service provider or with a like-minded fellow fund.

- Proxy advisors should draft their guidelines in a manner that provides transparency and detailed information about the decision-making process to their clients. Those parties which provided feedback to the first draft of this report were unanimous in their support for robust voting policies that are regularly reviewed and adjusted to make sure they remain fit for purpose. As one proxy advisor stated at the roundtable, "because of just the nature of what we do and how fast and furious we're all moving…, it's not enough just to sort of post [our voting policy] out there. You've got to really make people see it, be aware of it." In turn, investors should be more active in helping their advisors develop, review and revise voting policies so that they truly are fit for purpose. Investors should feel free to contact their advisory service(s) to adjust their policy if it does not produce recommendations in line with expectations.

This paper does not take a position on whether voting policies should be general and flexible or highly specific and consistent (or even a hybrid of the two approaches). Proxy Governance, which favors the former of these two approaches, has commented that prospective clients have said it is essential that they are consistent in voting lest they need to explain inconsistencies to trustees, the SEC or the Department of Labor. PGI asserts, however, that such a hands-off approach is "tantamount to turning the concept of fiduciary duty on its head" since little attention is then paid to the underlying issues at each company. [25] Still, we believe that the appropriate model is the one that fits the needs of the client best, whether that be one that requires extensive client consideration on nearly every meeting or one that allows the client to let the advisor take the strain.

That said, proxy advisors should ensure that policies are applied consistently, even if that policy is to assess each company and company meeting in an individual context. Deviation from expected norms of recommendation should be explained to clients. Additionally, advisors should ensure that their clients understand the process of making recommendations.

- Several of the advisors present at the roundtable either currently expose at least part of their policy for public comment, or are considering doing so. Such outreach can help produce amendments that had not yet been considered through existing forms of review, and could broaden market credibility for voting standards. All advisory services should consider emulating this approach or explain why they prefer a different process in relation to the best interests of their clients. Glass Lewis, which already makes public summaries of its pay-for-performance evaluation guidelines, has indicated that it would be open to the idea of making its full guidelines more widely available as long as its intellectual capital can be safeguarded. RiskMetrics, in its comment letter to the first draft of this paper, stated: "We think …[disclosure] is helpful in terms of allowing investors to share ideas/best practices as well as providing issuers with insight into what inves-

---

25 Letter from Michael J. Ryan, Jr., President and Chief Operating Officer, Proxy Governance, Inc.; June 23, 2008.

tors care about from a proxy voting standpoint."[26]

- Institutional investors should expose their voting and governance standards to comment and feedback from their members. This could be accomplished through a public process or, for instance, through a secure, members-only website. Such a process might forge links between beneficiaries and the governance staff, and enhance transparency of the policy-setting process.
- Investors and proxy advisors who do not already do so might consider appointing an external policy advisory board. As with soliciting public opinion, this could provide an additional source of information and accountability. Proxy advisors facing pressure over conflicts and accountability could, for instance, assign ultimate decision making power over general policies to a credible outside, independent board of clients and/or experts. The board should be independent of both the management and board of the advisor, and should have experienced and committed members representing more than just one jurisdiction to avoid a blanket approach for all countries. The board should not act as a rubber stamp for policies but give considered thought to the policies presented. Institutional investors could create a body that includes beneficiaries to provide policy input.
- Investors and advisors should consider who has a right to a seat at the table when revisiting their policies. Investors might consider more than just their beneficiaries, shareholders, and the views of their main proxy voting advisor. The views of management and the board are obvious potential participants in the review process. But other stakeholders who should be involved may exist. Input from less orthodox sources may bring some new ideas, but might also distract from the process at hand.

Glass Lewis has indicated that it may be open to a more public form of solicitation of input on its guidelines than it currently employs. At the moment, it seeks comments from its existing clients, but has not sought remarks from other parties. In a letter to the Center commenting on the first draft of this paper, Glass Lewis stated that it may accept input from non-clients "if the method of soliciting feedback does not compromise [Glass Lewis'] independence or insinuate agenda-driven parties into the process."[27]

Handling conflicts of interest

Judging by roundtable comments, it is not enough to recognize and disclose conflicts of interest. Parties must also make an effort to be seen to manage conflicts effectively and, more problematically, be believed that they are doing so. When investors and advisors try to improve corporate accountability and transparency, it is harmful if they do not practice what they preach.

- Investors present at the roundtable seemed, for the most part, relatively at ease with the current state of their own disclosures as a means to manage conflicts when they arise. However, investors are not conflict-free. Business relationships with companies may influence the decision on casting a proxy vote. The proxy voting team may be pressured by management to vote one way or another, or the investor may handle money for the pension fund of a company holding an annual meeting. Few institutions so far meet extensive disclosure standards addressing how they manage those risks. The Center therefore recommends that investors adopt a Code of Conduct for recognizing, managing and disclosing conflicts. The ICGN and the Stanford Institutional Investors' Forum already have macro texts for such a document. A draft Code follows in Appendix B.
- For proxy advisors, the Center recommends one approach to fortifying safeguards: a code of professional ethics for the governance industry modeled on similar codes for other industries. A sample code is below in Appendix A.

Several comments received on the initial draft of this paper indicated that conflicts should not only be disclosed, but should be done so robustly, specifically and in a way that end-users can understand them. In its comment letter, Glass Lewis stated: "Analyzing and voting thousands of proxies is challenge enough for investors without the added burden of having to investigate and evaluate the potential for conflicts of advisors. The better approach is to have both explicit disclosure and robust conflict management policies and procedures."[28]

Since the initial publication of this paper, several organizations have voiced their support for the adoption of a code of professional conduct for advisory services. Glass Lewis and PGI have both endorsed the code appended to this paper (with technical amendments). PGI adopted its own code of

26 RiskMetrics comment letter, op cit; October 13, 2008.

27 Letter from KT Rabin, Chief Executive Officer, and Robert McCormick, Chief Policy Officer, Glass Lewis & Co.; October 10, 2008.

28 Letter from Glass Lewis, op cit; October 10, 2008.

conduct recently in response to this paper's suggestion. [29] The Society of Corporate Secretaries and Governance Professionals agrees that the introduction of a uniform code would be useful in "improving the quality and reliability of the advice and analysis provided by the proxy advisory firms".[30] RiskMetrics, while supporting the introduction of a code of ethics, disagreed that a single standard code would be applicable to all advisors and inferred that insofar as an advisor had adopted its own code (as indeed RiskMetrics has) it would have fulfilled this requirement. Nevertheless, the Center continues to suggest that a single code of conduct for the industry is the preferred model, as a uniform code would allow current and prospective users to compare the conflict management and other provisions of the advisors more easily and clearly.

An important aspect of the Center's draft code is the principle that a proxy service should refrain from supplying consulting services to the same corporations for which it is recommending votes. This approach follows other conflict-management stances prevalent in the market. Audit firms, for instance, are discouraged from supplying consulting services to corporations they audit. In the context of the 2008-09 economic crisis, and where proxy services play an increasingly critical role in capital markets, it is all the more critical that intermediaries hew to behavior standards that draw trust rather than concern. The Center takes this view in the knowledge that corporate advisory services may be a force for good in helping companies amend poor internal governance. But if such services are combined with vote advisory or governance ratings, they invite the perception, if not the reality, of conflicts of interest.

Mending breaks in the voting chain

- In the opinion of the roundtable participants, the current US system of casting proxy votes is over-complicated, time-consuming and involves too many parties. It was developed ad hoc for an era in which proxy ballots were seen principally as a compliance exercise rather than a contributor to value. It now falls short of investor needs. Investors and their advisors have need of channels to air faults in the system and to identify and advocate improvements. As one advisor expressed in a comment letter, "What's the point of putting time, energy and resources into making voting decisions and casting the votes if the votes might not be counted?" Another stated: "We believe that every ballot is important and should make its way to the meeting and have the intent of the ballot holder carried out."

There have been many solutions suggested. In 2004, the Business Roundtable proposed a model that removed brokers and banks from the equation and shifted responsibility for proxy voting to the shareholder; as a sideline, it also eliminated the issue of broker votes.[31] The proposal promised efficiency, but would have shifted costs for voting onto investors, reduced options for shareowner anonymity, and replaced an independent third party (usually Broadridge, in the US) with more corporate influence over the voting system.

Obviously, such radical changes to the architecture of voting would face fierce opposition from parties – custodians, brokers and voting execution platforms – who stand to lose the most revenue. As one roundtable participant said, "It's the people in the middle, particularly the brokers, who claim 'Ah, the privacy of our clients!' It's really their vested interest. They make a lot of money out of the inefficiencies of the system. It's a revenue source for them." Such changes might also trigger opposition from those who strongly favor third party control over the proxy process. Furthermore, the proposal has not received extensive support from institutional investors, who have expressed concerns over the confidentiality of shareholder voting decisions if the issuers had responsibility for the ballot system.[32] Broadridge has commented that "no details have been offered by any parties on how such a process would work on the ground."[33]

- The Center proposes that the US SEC convene a blue ribbon panel of investor, corporate and third party representatives charged with finding common ground on modernization of the US proxy voting system. A similar group, spurred by the UK's Department of Trade and In-

29 Letter from PGI, op cit; June 23, 2008.

30 Letter from Donald R. Rawlins, Securities Law Committee, The Society of Corporate Secretaries and Governance Professionals; November 14, 2008.

31 The letter is available at http://www.sec.gov/rules/petitions/4-493/georgeson050304.pdf.

32 Letter from Broadridge, op cit; October 17, 2008. Also letter from John Endean, President, American Business Conference, to Jonathan G. Katz, Secretary, Securities Exchange Commission of July 19, 2004 regarding the BRT proposal; available at: http://www.americanbusinessconference.org/rulemaking.html.

33 Letter from Broadridge, op cit; October 17, 2008.

dustry, brought reform to the British proxy voting system. Given the likelihood of resistance to changes in this area, interested parties should initiate a project towards this end as a matter of urgency.

Support for a blue ribbon commission has been expressed by the Society of Corporate Secretaries & Governance Professionals. In their letter of November 14, 2008 commenting on the first draft of this report, the Society stated that securities issuers are also concerned with the efficiency of the proxy voting process as it is currently constituted and how errors can affect all shareholders – whether institutional or retail. "The Society believes that the pervasiveness of the impediments to the proxy voting process and the seriousness of the attendant dangers, namely disenfranchisement of the corporate owners, require an immediate overhaul of the entire proxy voting system. The current issues with the system cannot be addressed in a piecemeal fashion, or by any one actor in the system, be it the issuers, the vote tabulators, or the regulators."[34] The Society gives its explicit support for a blue ribbon commission, and suggests that panel members be drawn from issuers, investors, advisory agencies, Broadridge, brokers, transfer agents and other interested parties. PGI also supports establishing a blue ribbon commission and has expressed interest in participating to share its experience.

Broadridge has stated that there have been blue ribbon panels in the past charged with exploring proxy voting issues and vote processing. It cited, most notably, the Proxy Voting Review Committee (PVRC) in 2001-02, organized by the SEC, as well as the Proxy Working Group (PWG), convened by the New York Stock Exchange in 2005 and still in place. Neither group has supported the BRT proposals nor concluded that there is any reason to believe that the current proxy voting system in the US is not fit for purpose. Indeed, the PWG's report to the NYSE of June 5, 2006 states that the process "is viewed by the institutional community as impartial, reliable and efficiently administered," and the PVRC's report of March 1, 2002 concludes that the US system is the "finest proxy system in the world."[35] This project found that nearly all roundtable participants disagreed with such characterizations.

- Investors should urge the SEC and other national regulatory bodies to initiate global talks on seamless coordination of proxy systems so as to remove barriers to cross-border voting worldwide. Shareowners can also foster joint projects through collective organizations such as the ICGN or Global Institutional Governance Network (GIGN) to tackle impediments to effective proxy voting both in the US and across borders. These include re-registration, requirements for personal attendance at annual meetings, shareblocking and overly conservative cut-off dates for casting a ballot. Powers of attorney are necessary to vote in certain markets; investors should take careful note of how long each power is valid and have in place a reminder system to renew these documents. They should also bear in mind that when changing custodians or employing new outside investment managers, there may be a need to execute new powers of attorney. Advisors have an abundance of information on these matters, and investors should feel free to ask questions. The recent global financial turmoil has stressed how interconnected capital markets are. Ignoring "difficult" non-domestic markets is no longer an option.

- Reporting by voting intermediaries needs to be made more meaningful and accessible to shareowners. Discussions at the roundtable indicate that while there is an abundance of information available from the voting advisors and the execution providers, it is not always presented in ways that are useful or easily understood by the end users. Organizations providing the data should consider holding discussions with their clients, either on a one-to-one basis or in a roundtable summit, to discover what information is actually being used and how this should be presented in a more user-friendly format.

In addition, end-to-end confirmation of voting decisions from issuers and tabulators and closer work between issuers and ballot distributors to achieve confirmation needs to be encouraged. Although parties like Broadridge have instituted a program for end-to-end confirmation for approximately 1,500 companies, this does not nearly begin to cover all or even most companies across international markets. Participants in the proxy voting process – investors, issuers, intermediaries and others – should press to increase this number to cover as many companies as possible. This will almost certainly involve substantial technological investment, and those who would like to see end-to-end confirmation rolled out to a greater number of meetings should be prepared to pay for it.

- The proxy voting function is often an afterthought when

34 Letter from the Society of Corporate Secretaries and Governance Professionals, op cit; November 14, 2008

35 Letter from Broadridge, op cit; October 17, 2008.

funds are framing contracts or performing periodic reviews of their relationships with custodians. Generally speaking, governance staff take no part in such discussions and must employ whatever voting platform is used by the chosen custodian, regardless of quality of service. Roundtable participants remarked on missed or improperly executed votes caused by the platform. The Center recommends that institutions, when reviewing custodians, take into account the quality of proxy voting platforms. For instance, investors, as a matter of best practice, may be able to insert a clause into a request for proposal that introduces penalties when a vote is missed or information has been transmitted incorrectly. Other investors have already done so; one major UK fund introduced a €100 fine for exceptions. The penalty stresses to the custodian that their client is monitoring their work in this area, even if the financial consequences are relatively minimal.

Providing adequate and appropriate resources

- Investors need to undertake regular internal reviews to test whether management of stewardship through proxy voting and engagement at portfolio companies is best treated in a fashion that maximizes ability to affect fund value. There is ample anecdotal evidence[36] that institutional investors often fail to consider the proxy voting and governance unit as a contributor to value creation. It may be marginalized, in part, by insufficient resources. Or the stewardship function could be assigned to a compliance or legal silo distant from fund management.
- Amongst issues that could be addressed in a regular review would be the skills and numbers of permanent staff and their position within the hierarchy; skills and numbers of temporary staff hired during the peak season and whether their training matches responsibilities;[37] and the extent and quality of outside information or engagement resources hired. Institutions could assess whether they need individuals on the stewardship team with experience running corporations, as some believe these individuals could interact more effectively with corporate board members.[38]
- Empirical findings are still mixed on what economic effects proxy voting has on investment return. That both investors and advisors should devote more resources to proxy voting is practically an article of faith in the governance community, despite little empirical evidence that a greater voting resource improves the quality of voting decisions or that it increases returns. Until a causal link has been proven, it will be difficult to convince skeptics that the investment is worthwhile.

Interested parties should consider sponsoring or undertaking research to prove that more active and engaged proxy voting does result in greater returns for investors. This would not only help the case of those agitating for more and better resources, but could help consumers differentiate institutional investors on the basis that more engaged investors create better returns.

- Proxy services, for their part, face equivalent duties regularly to review their internal research skill base to determine if it matches market needs. For instance, they may have to add experts in compensation if management 'say on pay' resolutions become commonplace in the US. They also need routinely to check the adequacy of training of permanent or temporary employees, and the quality of internal research controls. Questions for advisors to ask include whether the ratio of analysts to covered companies is optimal, and if temps are familiar enough with the world of business to gain real insights from reading an annual report. An option might be to disclose to clients and/or potential clients whether and how these regular reviews take place.

---

36 This evidence comes not only from discussions at the Voting Standards roundtable, but also from the author's own informal conversations with corporate governance and investment staff at major UK and US institutional investors while she served as the corporate governance counsel at a large UK pension fund from 2003-2007.

37 Temporary employees could be there simply to press the buttons and compile post-season reports, thus needing less in-depth, issues-based training, or they could be more seasoned proxy specialists who could provide deeper analysis into recommendations.

38 TIAA-CREF, for instance, hired ex-CEO Kenneth West for this purpose. Hermes hired ex-CFO Peter Butler.

BIBLIOGRAPHY

Alogna, Steve and Davis, Stephen. *Talking Governance: Board-Shareowner Communications on Executive Compensation,* Millstein Center for Corporate Governance and Performance. New Haven: December 2008.

Clapman, Peter (Chair). *Committee on Fund Governance: Best Practice Principles.* The Stanford Institutional Investors' Forum. Palo Alto: May 31, 2007.

Cohen, Lauren H. and Breno Schmidt. "Attracting Flows by Attracting Big Clients: Conflicts of Interest and Mutual Fund Portfolio Choice." Harvard Business School Working Paper 08-054; January 2008. Available at: www.hbs.edu/research/pdf/08-054.pdf.

Grant, Gavin. "Beyond the Numbers: Corporate Governance: Implication for Investors." Deutsche Bank AG: April 1, 2004. Available at:
www.unepfi.org/fileadmin/documents/materiality1/cg_deutsche_bank_2004.pdf.

Harris, Roy. "Proxy Firm, Heal Thyself." *CFO.com:* June 1, 2007. www.cfonet.com/article.cfm/9277795?f=search Last accessed May 16, 2008.

International Corporate Governance Network. *ICGN Statement on Global Corporate Governance Principles.* London: May 8, 2005.

International Corporate Governance Network. *ICGN Statement of Principles on Institutional Shareholder Responsibilities.* Cape Town: July 6, 2007.

International Organization of Securities Commissions (IOSCO) Technical Committee. *Code of Conduct Fundamentals for Credit Rating Agencies.* Madrid: December 2004.

Jones, Adam. "Riddle of the missing Unilever votes solved." *Financial Times,* August 15, 2003. Available at:
http://search.ft.com/ftArticle?queryText=unilever+proxy&y=0&aje=true&x=0&id=030815005114&ct=0 Last accessed May 8, 2008.

Kahan, Marcel and Rock, Edward B. "The Hanging Chads of Corporate Voting". U of Penn, Inst for Law & Econ Research Paper No. 07-18. August 13, 2007. Available at SSRN: http://ssrn.com/abstract=1007065.

Morgenson, Gretchen. "Pfizer and the Proxy Adviser." *New York Times,* April 21, 2006; www.nytimes.com/2006/04/21/business/21proxy.html?pagewanted=print
Last accessed May 8, 2008.

Rose, Paul. "The Corporate Governance Industry". Journal of Corporation Law, Vol. 32, No. 4, Summer 2007. Available at SSRN: http://ssrn.com/abstract=902900.

Taub, Jennifer S. "Able But Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights." (October 2007). Available at SSRN: http://ssrn.com/abstract=1066831.

Verdam, Albert. "An Exploration of the Role of Proxy Advisors in Proxy Voting" (December 2006). Available at SSRN: http://ssrn.com/abstract=978835.

Wilcox, John on behalf of Georgeson Shareholder Communications. Letter to the Securities and Exchange Commission, "Re: Rule No. 4-493, Business Roundtable Petition for Rulemaking Regarding Shareholder Communications." May 3, 2004.

Yaron, Gil, "Acting Like Owners: Proxy Voting, Corporate Engagement and the Fiduciary Responsibilities of Pension Trustees." June 28, 2005. Available at SSRN: http://ssrn.com/abstract=772184.

"Proxy Voting: Making Sure the Vote Counts." Brandes Institute. October 2003. www.brandes.com/NR/rdonlyres/57DE4F3E-9211-430B-8803-C0019553BA73/0/BI_ProxyVoting.pdf Last accessed May 15, 2008.

United States. Government Accountability Office. *Corporate Shareholder Meetings: Issues Relating to Firms That Advise Institutional Investors on Proxy Voting: Report to Congressional Requesters.* GAO-07-765. Washington: June 2007.

APPENDIX A—DRAFT CODE OF CONDUCT FOR THE PROXY ADVISORY INDUSTRY

Currently, there is no code of conduct for the proxy advisory industry as a whole pertaining to accountability, transparency, ethical practices and management of actual or potential conflicts of interest. Proxy advisors are aware of the conflicts they face, and have in place policies that articulate how they deal with them. However, each advisor has its own exclusive policy, which makes comparison of the policies more challenging. And two developments have strengthened the case for such a code: a collapse in investor confidence in market intermediaries, and the rising impact of voting service recommendations. The adoption of an industry-wide code of conduct could bring more comfort to market parties, including regulators, investors, issuers and other stakeholders.

In crafting proposed principles, the Center consulted other existing codes in related industries. In 2004, the International Organization of Securities Commissions (IOSCO) produced a consultation report entitled "Code of Conduct Fundamentals for Credit Rating Agencies" which presented a draft code of conduct for credit ratings companies for use in handling conflicts of interest. Although it is not mandatory that credit rating firms adopt the IOSCO Code, IOSCO expects that all will incorporate the Code Fundamentals in their own codes of conduct. Credit ratings companies are expected to report back on an annual basis as to how each provision in the Code Fundamentals is addressed, and compliance is on a "comply or explain" basis. Market pressure to adopt the Code Fundamentals has resulted in voluntary compliance by the largest firms, including DBRS, Fitch Ratings, Moody's and Standard and Poor's. Other codes available in other fields dealing specifically with conflicts of interest were deemed to be too industry-specific or indeed dealt only with the conflicts faced by a particular company. The code proved unable to prevent manifest failures by rating companies in the run-up to the 2008 financial crisis. Had the code contained stiffer provisions relating to conflicts of interest, it might have done, and it might have headed off what is now expected to be significant new regulation of credit companies.

Using the IOSCO Code Fundamentals as a baseline model, but with more robust provsions on conflicts of interest, below is a draft Code of Conduct for the proxy advisory industry. Compliance should be on a voluntary basis, with disclosure taking the form of a publicly available annual document posted on the advisor's website. Disclosure against the Code should be done on a "comply or explain" basis, which would allow clients, prospective clients and other stakeholders to draw their own conclusions as to how effectively the Code has been implemented. Since the initial draft of this paper, support for the introduction and adoption of the draft Code (with amendments) has been expressed by Glass Lewis, the Society of Corporate Secretaries & Governance Professionals, and Proxy Governance. The text below has been updated to reflect results of the consultation.

Providing adequate and appropriate resources

I. QUALITY AND INTEGRITY OF THE RECOMMENDATION PROCESS

A. Quality of the Recommendation Process

A.1. The proxy voting advisory service ("Advisor") should adopt, implement and enforce written procedures and methodologies to ensure that the opinions it disseminates are based on a thorough analysis of relevant information reasonably available to the Advisor.

A.2. The Advisor should use methodologies that are rigorous, systematic, and, where possible, result in proxy voting recommendations ("recommendations") that can be subjected to some form of objective validation based on historical experience.

A.3. The Advisor should disclose how it arrives at decisions concerning its proxy voting policies and who makes final decisions on such policies. It should supply explanations for why it has chosen each policy. The Advisor should disclose any arrangements it has to solicit outside advice from individuals on such policies, including the identity and professional backgrounds of such individuals, why there are selected, any terms of their position, and whether they have any personal or business ties to the Advisor or its executives. The Advisor should disclose the extent to which such individuals act as advisors or as decision makers in respect to proxy voting policies.

A.4. Recommendations should be made by the Advisor and not by any individual analyst employed by the Advisor. However, the Advisor should make the identity of the individual analyst available to clients if requested.

A.5. Recommendations should reflect public and non-public (if utilized) information known, and believed to be relevant, to the Advisor.

A.6. Recommendations from the Advisor should be developed by analysts who individually or collectively have appropriate knowledge and experience in developing recommendations for the jurisdiction in which the company covered by the recommendation is based.

A.7. The Advisor should maintain internal records to support its recommendations for a reasonable period of time.

A.8. The Advisor and its analysts should take steps to avoid issuing any recommendations or reports that contain misrepresentations or are otherwise misleading.

A.9. The Advisor should ensure that it has and devotes sufficient resources to carry out high-quality recommendations for all companies on which it makes recommendations.

A.10. The Advisor should, wherever possible, structure its teams of analysts to promote continuity and avoid bias in the rating process.

A.11. The Advisor should implement a rigorous fact checking process for its recommendations and set out how fact checking is performed.

A.12. The Advisor should state whether it sends a draft copy of the recommendation to the issuer in advance for correction of any material errors. If this is part of the recommendation process, the issuer should be given a reasonable amount of time prior to release of the recommendation to correct any errors. If the Advisor does not send pre-release copies of recommendations to the issuer, it should explain why.

B. Updating Recommendations

B.1. Should there be any material change in information regarding the company of which the Advisor is aware on which the recommendation was made that would have resulted in a different recommendation had the information been available at the time it was published, the Advisor should make known changes to its recommendation in time for its clients to consider the revisions and change their vote, if desired.

B.2. If the Advisor makes recommendations available to other parties, including the issuing companies and the public, these parties should also be informed in a timely manner.

C. Integrity of the Recommendations Process

C.1. The Advisor and its employees should comply with all applicable laws, rules and regulations governing its activities in each jurisdiction in which it operates.

C.2. The Advisor and its employees should deal fairly and honestly with its clients, issuers and the public.

C.3. The Advisor's analysts should be held to high standards of integrity, and the Advisor will not employ individuals with demonstrably compromised integrity.

C.4. The Advisor and its employees should not, either implicitly or explicitly, give issuers any assurance or guarantee of a particular recommendation prior to its release.

C.5. The Advisor should institute policies and procedures that clearly specify a person responsible for the Advisor's compliance with the provisions of the Advisor's code of conduct and with applicable laws and regulations.

C.6. Upon becoming aware that another employee or entity associated with the Advisor is or has engaged in conduct that is illegal, unethical or contrary to the Advisor's code of conduct, an employee of the Advisor should report such information immediately to the individual in charge of compliance or an officer of the Advisor, as appropriate, so proper action may be taken. Its employees are not necessarily expected to be experts in the law. Nonetheless, its employees are expected to report the activities that a reasonable person would question. Any officer of the Advisor who receives such a report from a employee of the Advisor is obligated to take appropriate action, as determined by the laws and regulations of the jurisdiction and the rules and guidelines set forth by the Advisor.

II. ADVISOR INDEPENDENCE AND AVOIDANCE OF CONFLICTS OF INTEREST

A. General

A.1. The Advisor and its analysts should use care and professional judgment to maintain both the substance and appearance of independence and objectivity.

A.2. The determination of a recommendation should be influenced only by factors relevant to the evaluation of each company's corporate governance practices and proxy proposals.

A.3. The Advisor should not forbear or refrain from making a recommendation based on the potential effect (economic or otherwise) of the action on the Advisor, an issuer, an investor, or other market participant.

A.4. The recommendation an Advisor makes should not be affected by the existence of or potential for a business relationship between the Advisor (or its affiliates) and the issuer (or its affiliates) or any other party.

A.5. The Advisor should separate that part of its business which creates recommendations and those analysts who develop such recommendations from any other businesses of the Advisor, including consulting businesses, that may present a conflict of interest.

A.6. The Advisor should not provide consulting services to any corporate entity for which it also provides recommendations on how investors should vote their shares.

B. Advisor Procedures and Policies

B.1. The Advisor should adopt written internal procedures and mechanisms to (1) identify, and (2) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence the recommendations and analyses the Advisor makes or the judgment and analyses of the individuals the Advisor employs who have an influence on recommendations. The Advisor's code of conduct should also state that the Advisor will disclose such conflict avoidance and management measures.

B.2. The Advisor's disclosures of actual and potential conflicts of interest should be complete, timely, clear, concise, specific and prominent.

B.3. The Advisor should disclose the general nature of its compensation arrangements with entities upon which it makes a recommendation. The Advisor should disclose where it (or any parent, subsidiary or affiliate company) receives compensation from such an entity (or any parent, subsidiary or affiliate company of the entity), such as compensation for consulting services, and the level of compensation received unless this would require the disclosure of sensitive, proprietary pricing information.

C. Advisor Analyst and Employee Independence

C.1. Reporting lines for the Advisor's employees and their compensation arrangements should be structured to eliminate or effectively manage actual and potential conflicts of interest. The Advisor's code of conduct should also state that an Advisor analyst will not be compensated or evaluated on the basis of the amount of revenue that the Advisor derives from issuers that the analyst makes recommendations upon or with which the analyst regularly interacts.

C.2. The Advisor should not have analysts initiate, or participate in, discussions regarding fees or payments with any entity upon which they make recommendations.

C.3. No Advisor employee should participate in or otherwise influence the determination of the Advisor's recommendation on any particular entity if the employee:

a. Owns securities or derivatives of the entity or any related entity thereof;

b. Has had an employment or other significant business relationship with the entity within the previous twelve (12) months;

c. Has an immediate relation (i.e., spouse, partner, parent, child, sibling) who currently works for the entity; or

d. Has, or had within the previous twelve (12) months, any other relationship with the entity or any agent of the entity that may be perceived as presenting a conflict of interest.

C.4. The Advisor's analysts and anyone involved in the recommendation process (or members of their immediate household) should not buy or sell or engage in any transaction in any security or derivative based on a security issued, guaranteed, or otherwise supported by any entity within such analyst's area of primary analytical responsibility, other than holdings in diversified mutual funds, while a recommendation for the entity is being drafted or within twenty (20) days after the recommendation is published..

C.5. Advisor employees should be prohibited from soliciting money, gifts or favors from anyone with whom the Advisor does business and should be prohibited from accepting gifts offered in the form of cash or any gifts exceeding a minimal monetary value.

C.6. Any Advisor analyst who becomes involved in any personal relationship that creates the potential for any real or apparent conflict of interest (including, for example, any personal relationship with an employee of a company upon which a recommendation has been made or is likely to be made or agent of such entity within his or her area of analytic responsibility), should be required to disclose such relationship to the appropriate manager or officer of the Advisor, as determined by the Advisor's compliance policies.

III. ADVISOR RESPONSIBILITIES TO ITS CLIENTS AND ISSUERS

A. Transparency and Timeliness of Recommendations

A.1. The Advisor should distribute in a timely manner its recommendation decisions regarding the companies upon which it makes recommendations.

A.2. The Advisor should disclose its policies for publishing recommendations and reports.

A.3. The Advisor, without compromising proprietary processes or procedures, should make available to its clients and other parties on a selective basis sufficient information about its procedures, methodologies and assumptions so that they may understand how the Advisor developed the recommendation.

A.4. When publicly releasing a recommendation, Advisors should explain in their press releases and reports the key elements underlying their recommendation decision.

A.5. Subject to the Advisor's policy on communicating with an issuer, where feasible and appropriate, prior to issuing or revising a recommendation, the Advisor should advise the issuer of the critical information and principal considerations upon which a recommendation will be based and afford the issuer an opportunity to clarify any likely factual misperceptions or other matters that the Advisor would wish to be made aware of in order to produce an appropriate recommendation. The Advisor will duly evaluate the response.

A.6. The Advisor should disclose when and to what extent the issuer participated in the recommendation process.

B. The Treatment of Confidential Information

B.1. The Advisor should adopt procedures and mechanisms to protect the confidential nature of information shared with them by a client, issuer or other party under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. Unless otherwise permitted by the confidentiality agreement or required by applicable laws or regulations, the Advisor and its employees should not disclose confidential information in press releases, to future employers, or conversations with clients, investors, other issuers, or other persons, or otherwise.

B.2. Where an Advisor is made aware of non-public information of the kind required to be disclosed under applicable laws and regulations, depending on the jurisdiction, the Advisor may be obligated to make this information available to the public. However, prior to doing so, the Advisor should indicate to the issuer its intent to release this information and permit the issuer to immediately disclose this information itself. The timeframe an Advisor should provide an issuer to make this disclosure should be limited.

B.3. Advisor employees should take all reasonable measures to protect all property and records belonging to or in possession of the Advisor from fraud, theft or misuse.

B.4. Advisor employees should be prohibited from engaging in transactions in securities when they possess confidential information concerning the issuer of such security.

B.5. In preservation of confidential information, Advisor employees should familiarize themselves with the internal securities trading policies maintained by their employer, and periodically certify their compliance as required by such policies.

B.6. Advisor employees should not selectively disclose any non-public information about recommendations or possible future recommendations of the Advisor.

B.7. Advisor employees should not share confidential information within the Advisor except on an "as needed" basis.

B.8. Advisor employees should not use or share confidential information for the purpose of trading securities, or for any other purpose except the conduct of the Advisor's business.

IV. DISCLOSURE OF THE CODE OF CONDUCT

A.1. The Advisor should disclose to the public its code of conduct and describe how the provisions of its code of conduct are consistent with the provisions of this code. The Advisor should also describe generally how it intends to implement and enforce its code of conduct and disclose on a timely basis any changes to its code of conduct or how it is implemented and enforced.

A.2. If an Advisor's code of conduct deviates from the provisions of this code, the Advisor should explain where and why these deviations exist, and how any deviations nonetheless achieve the objectives contained in the provisions of this code. The Advisor should also describe generally how it intends to enforce its code of conduct and should disclose on a timely basis any changes to its code of conduct or how it is implemented and enforced.

A.3. The Advisor should establish a function within its organization charged with communicating with clients, market participants and the public about any questions, concerns or complaints that the Advisor may receive. The objective of this function should be to help ensure that the Advisor's officers and management are informed of those issues that the Advisor's officers and management would want to be made aware of when setting the organization's policies.

APPENDIX B – DRAFT CODE OF CONDUCT FOR INSTITUTIONAL INVESTORS

As Roundtable participants noted, it is not only the proxy advisory services, but the institutional investors themselves, who must contend with market concerns over accountability, transparency and conflicts of interest, whether real, perceived or potential.

Two recent documents include attempts to outline investors' responsibilities in this area: the International Corporate Governance Network "Statement of Principles on Institutional Shareholder Responsibilities," and the Stanford Institutional Investors' Forum Committee on Fund Governance "Best Practice Principles."[39] Both documents make strong cases for identifying and disclosing conflicts on a regular basis, and the importance of having a process for doing so. The Stanford document comes down more firmly than the ICGN paper on the side of public disclosure of both a policy for dealing with conflicts and the conflicts themselves, while the ICGN includes more detail on best practices in fund governance and oversight of engagement. But both argue convincingly that institutional investors should practice what they preach to companies and advisory services.

To date there have been no examples of sizeable or high-profile funds adopting either of these sets of principles. The Center recommends that boards of institutional investors endorse one of these policies, or develop a bespoke document that borrows heavily from one or both of these, provided that the principles contained are not weakened. Once adopted, the policy should become a working document, regularly evaluated and not left on the shelf. Boards should also take a "comply or explain" approach to the code where they feel they cannot meet the expectations of the code. At the very least, boards should make an annual disclosure to their beneficiaries of how they meet the principles of the code they endorse.

Below are selections from both the ICGN and Stanford papers; for the sake of brevity, the entire codes are not reproduced here. Complete documents are available online at the addresses mentioned in Appendix C.

39 Both documents were released in 2007; weblink references to both documents are in Appendix C.

ICGN statement of principles on institutional shareholder responsibilities (pp 4-5)

3.1.ii. Transparency and accountability

This requires regular disclosure to ultimate beneficiaries about material aspects of governance and organisation. Governing bodies should develop clear standards with regard to governance of investee companies and its link to the investment process through its impact on value, and for voting of shares and related issues like stock lending. The standards should inform their selection of portfolio managers and other agents.

Governing bodies should be critical both in the selection of consultants and in evaluating the advice they receive from them, and ensure they receive value for the fees they pay, including for brokerage. Where they or their agents outsource services, they should disclose the name of the provider of the services in question, the nature of the mandate they have been given and procedures for monitoring performance of the provider.

Governing bodies should hold their portfolio managers and other agents employed to account for adhering to the standards set for them. They should develop clear channels for communicating their policies to beneficiaries, their portfolio managers and the companies in which they invest. They should regularly evaluate and communicate their achievements in meeting these policies.

Asset managers and others in a similar agency position should also develop clear decision-making procedures and policies with regard to the governance of investee companies and for voting of shares held on behalf of clients. Their incentive structures should reflect the interests of the beneficiaries. Charges incurred on clients' behalf, for example brokerage commissions and payment for research should be justifiable. Asset managers should encourage brokers and research analysts whose services they use to factor governance considerations into their reports.

3.1.iii. Conflicts of interest

Conflicts of interest will inevitably arise from time to time. It is of paramount importance that these are recognised and addressed by governing bodies and other agents in the chain, if the overarching principle of safeguarding the interest of beneficiaries is to be respected.

Those acting as agents should disclose all known potential conflicts of interest to their principal and explain how these are dealt with so as to protect their clients' interests.

The governing body should have clear policies for managing conflicts and ensure that they are adhered to. This in turn requires an appropriate governance structure as set out above.

Stanford institutional investors' forum committee on fund governance best practice principles (p.13)

D. Approach to Addressing Conflicts of Interest and Related Disclosure Policy

SUMMARY:

» *A fund should* **establish and publicly disclose its policy for dealing effectively and openly with situations that raise either an actual conflict of interest or the potential for the appearance of a conflict of interest.** *A fund should clearly identify the persons subject to its conflict policy ("covered persons") and should provide appropriate training to those covered persons.*

» *In order for a conflict of interest policy to be effective, appropriate authorities with the ability to act independently of any potential conflict must have access to information that adequately describes trustee and staff interests and relationships that could, at a minimum, give rise to an appearance of impropriety. A fund should therefore* **establish a regular, automatic, process that requires all covered persons to report and disclose actual or potential conflicts of interest**.

» *Trustees and staff should periodically affirm and* ***verify compliance*** *with conflict rules, regulatory reporting requirements, and other policies intended to protect the fund against the actuality or appearance of interested transactions and conflicts.*

» *Trustees and staff should* ***under no circumstances pressure anyone, whether or not a covered person, to engage in a transaction that creates an actual conflict or an appearance of impropriety.*** *Trustees and staff should be required to disclose any such attempts to a proper compliance authority as determined by the board.*

» *A fund should* ***publicly disclose necessary information*** *as specified below to ensure that trustees and staff are fulfilling their fiduciary duties to beneficiaries.*

APPENDIX C – RELATED GOVERNANCE DOCUMENTS

- California Public Employees' Retirement Service – CalPERS Shareowner Forum
  http://www.calpers-governance.org/
- Colorado Public Employees' Retirement Association – Proxy Voting Policy
  https://www.copera.org/pdf/Policy/proxy_voting.pdf
- Connecticut Office of the State Treasurer Proxy Voting Guidelines
  http://www.state.ct.us/ott/proxyvotingpolicies.htm
- Council of Institutional Investors Corporate Governance Policy
  http://www.cii.org/UserFiles/file/council%20policies/CII%20Corp%20Gov%20Policies %204-11-08%20Final.pdf
- Florida State Board of Administration – Corporate Governance
  http://www.sbafla.com/corpgov.aspx
- Hermes Responsible Investment Publications
  http://www.hermes.co.uk/publications/publications_corporate_governance.htm
- ICGN Statement on Global Corporate Governance Principles
  http://www.icgn.org/organisation/documents/cgp/revised_principles_jul2005.php
- ICGN Statement of Principles on Institutional Shareholder Responsibilities (2007)
  http://www.icgn.org/organisation/documents/src/Statement%20on%20Shareholder%20Responsibilities%202007.pdf
- International Organization of Securities Commissions report "Code Of Conduct Fundamentals For Credit Rating Agencies" (October 2004)
  http://www.iosco.org/library/pubdocs/pdf/IOSCOPD173.pdf
- Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance
  http://www.oecd.org/dataoecd/32/18/31557724.pdf
- Office of the Connecticut State Treasurer – Proxy Voting Guidelines
  http://www.state.ct.us/ott/proxyvotingpolicies.htm
- RiskMetrics 2008 Policy Information
  http://www.issproxy.com/issgovernance/policy/2008policy.html
- The Stanford Institutional Investors' Forum Committee on Fund Governance Best Practice Principles
  http://www.law.stanford.edu/clapmanreport
- TIAA-CREF Policy Statement on Corporate Governance
  http://www.tiaa-cref.org/pubs/pdf/governance_policy.pdf

APPENDIX D – OTHER USEFUL WEBSITES

- Broadridge Financial Solutions, Inc.
  http://www.broadridge.com
- Glass, Lewis & Co.
  http://www.glasslewis.com
- Governance for Owners LLP
  http://www.governanceforowners.com
- Hermes Equity Ownership Services
  http://www.hermes.co.uk/EOS/eos_introduction.htm
- Marco Consulting Group
  http://www.marcoconsulting.com
- ProxyDemocracy.org
  http://www.proxydemocracy.org
- Proxy Governance, Inc.
  http://www.proxygovernance.com