AVANT-GARDE RETURNS TO FRANCE: AN INTERVIEW WITH LOÏC DESSAINT

DON'T SHOOT THE MESSENGER: THE INFLUENCE OF PROXY ADVISERS

VOTING NEWS
It is the start of a new year, and the era of contentious politics in the Anglosphere shows no sign of abating any time soon. A new president now sits in residence at the White House, firing out executive orders left and right on such diverse issues as the Trans-Pacific Partnership and federal hiring rights.

In the U.K., the supreme court has finally ruled that a vote in parliament is required for Article 50 to be triggered. This is likely to further slowdown the process of the U.K.’s separation from the European Union.

Staying with the U.K., this year will see most British companies undergo their triennial binding say-on-pay vote on future remuneration policy, which was introduced in 2013.

Executive remuneration in the U.K. is increasingly viewed as having a harmful effect on business, numerous U.K. institutions, regulatory bodies, investors and think-tanks expressing their distaste with excessive or unregulated pay packets. However, it is yet to be seen if these rumblings will be converted into decisive action during the approaching proxy season.

Although 2017 is still young, there nevertheless have already been a number of companies that have suffered considerable shareholder revolts at their meetings. One of the most frequent proposals responsible for such investor dissent in the U.S. is advisory votes on golden parachutes.

Four companies have already this year suffered the wrath of their investors in proposing such contentious payouts to former executives, including AEP Industries, Datalink Corporation, PhotoMedex and Team Health Holdings, which received 43.18%, 27.66%, 32.41% and 52.56% of votes cast against their proposals respectively.

Our headline interview this month is with Loïc Dessaint, Chief Executive Officer of French proxy adviser, Proxinvest. In the interview, we not only debate the merits of some of the unique features of French corporate governance – including the presence of censors on French boards and the impact of the Florange Law on shareholder rights – but also discuss future reforms, which will be introduced over the next two years.

Although issuers have long denounced proxy advisers for their supposedly undue influence over investor voting, our analysis suggests that this influence is exaggerated.

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nick.dawson@proxyinsight.com.
Do you have an opinion on the binding say on pay vote that comes into effect this year in France? What do you think the long-term impact of the two new binding pay votes will be in France?

Indeed, France will become a new laboratory regarding shareholder rights to control executive pay. In 2016, say on pay votes were rejected at three French companies (Renault, Alstom, Solocal Group).

For each of them, the reaction of the board was very disappointing from Proxinvest’s point of view, which tends to demonstrate that self-regulation is still a cultural challenge in France.

With the Sapin 2 Law, it is now clear that directors can no longer enforce executive remuneration practices which are not approved by a majority of the shareholders. The distinct powers of the board of directors and of the general meeting of shareholders are now much clearer.

Starting this year, the board of directors, with the support of its remuneration committee, has to define the remuneration policy and the rationale behind it. This binding remuneration policy must then be approved by the company’s shareholders at the AGM.

As of the 2018 proxy season, shareholder approval of variable or extraordinary remuneration will also be required before such remuneration will be paid.

This introduction of this two binding vote system should avoid what happened at BP in the U.K. last year, where a board fails to implement properly a remuneration policy which was previously approved. Now in France, such egregious payments will not be allowed anymore without shareholder approval.

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Do you believe that the French system of voting on say on pay for each executive individually is superior in any way to the standard practice of voting on executive remuneration collectively?

Not really. It is not significantly different. We look at the same issues when we analyze such types of resolution.

Do you believe that the say on pay votes should be extended to independent directors, or should remain with just executives?

In France, the general meeting of shareholders already authorizes the maximum level of non-executive director fees, so an extension to the say on Pay votes to non-executive directors would be superfluous.

On the contrary, many chairmen are paid through fixed remuneration rather than fees. It is important that shareholders can also control the remuneration paid to the chairman.

How do you feel about the significant amount of state ownership in France, with specific reference to their recent push for adoption of the Florange Law and its ramifications for shareholder rights in French companies?

The Florange Law is a law drafted by the French parliament. As a significant registered shareowner of many listed French firms, the French State had a direct interest to maximize its voting powers.

When the French State forced the adoption of the double voting right provision at Alstom, Renault and Orange, it acted selfishly and diluted the interests of the other co-shareholders which cannot register their shares for various reasons.

Even worse, the double voting right problem was not circumscribed to the state-owned firms, but was also adopted by other firms like Vivendi for example. We did our best with our allies at Phitrust Active Investors and the support of other investors to restore shareholder rights.
Now, I am pretty sure that the French State did probably not realize at an initial stage how much the reputation of the French market place would be impaired by this generalization of the double voting right provision.

During the 2016 French proxy season, Proxinvest observed 56 resolutions which failed to be adopted, but 48 other resolutions should have also failed if the “one share – one vote” principle be applied. These statistics illustrate that the double voting right provision is mostly used as a protective tool.

From an investor point of view, it may be scary to realize that the destination of their money is in the hands of the French State. Investors must tackle this issue, not only in France where they could co-file shareholder proposals but also in the U.S. where there are too many issuances of dual-class of shares or non-voting shares.

The equal treatment of shareholders should not be an option. One vote per share should be a basic listing rule worldwide, like it is under the U.K. premium listing rules.

The censor is a position that is unique to French corporate governance. Do you see any merit to this board position?

A censor is a non-voting director. It is tough to promote this role since it is a form of denial of the basic governance principles of responsibility and accountability: in theory, any director should have a voting right.

In practice, it is sometimes used to circumvent investor expectations on the size of the board, the long tenure or some conflicts of interests. In a sense, censors could be acceptable as permanent consultants sitting on the board alongside other consultants or as a one-year test period for a new director.

In any case, it is important that the board keeps full powers to decide to continue or stop the censorship and that’s rarely the case since many censors are elected by the general meeting and then protected against dismissal by their mandate.

You have been quite outspoken about foreign investors failing to adapt to the French market. What do you feel they could be doing better?

Following the introduction of the consultative Say on Pay votes in France four years ago, investors obtained significant improvements in the transparency and quality of performance conditions. However, they failed to curb executive pay levels.

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In 2015 the average total remuneration of a CEO in the SBF 120 index increased by 20%. This is a huge increase, which was far too large to be justified by the performance of French companies.

My experience is that our French clients seem to look far more closely at pay levels than other non-French investors which are accustomed to very high pay levels, for example in the U.S. and the U.K.

It is understandable that it is hard to adjust to local practices. It requires an internal governance team with diverse skills and probably the use of multiple proxy advisers to avoid the risk of over-reliance on a single point of view.

Case in point is that half of the CEOs of the SBF 120 French index earn less than €2.6 million per year, including shares and options. If overseas investors, which own 60% of the CAC 40, do not take into consideration this local reality, they will export high pay levels all over Europe, contributing accidentally to the dangerous widening gap between citizens and their business leaders.

Do you feel that there has been any improvement from companies with regards to suspending the right to increase share capital during a period of public offer, or does Proxinvest still believe that capital increases are being used as anti-takeover devices?

Following a fruitful dialogue, French issuers understood investor expectations and most of them decided to suspend the right to increase share capital during a public offer.

Of course, investors must remain watchful to avoid any proliferation of protective devices like Bons Breton, and to safeguard their rights to consider and accept a buyout offer.

Thank you Loïc.
SHAREHOLDER ENGAGEMENT

LONDON

Issuers and Investors Debate the Fine Art of Engagement and How It Will Play out in the UK and Europe in the Seasons Ahead

LONDON, ENGLAND
FEBRUARY 7TH, 2017
THE BLOOMSBURY
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#SkytopEngage
Following shareholder rebellions, far too often the go to response of issuers is to blame the undue influence of ISS and Glass Lewis for the dissent of their investors.

This widespread conviction in the unrestrained authority of proxy advisers extends even to the U.S. Securities and Exchange Commission. Its commissioner, Daniel Gallagher, earlier this decade urging investors “to take responsibility for their voting decisions rather than engaging in rote reliance on proxy advisory firm recommendations.”

However, new data from Proxy Insight suggests that this influence is exaggerated, the correlation between the voting of investors on contentious resolutions and ISS and Glass Lewis recommendations being much lower than initially expected.

For the analysis, we took the top ten institutional investors and analyzed their voting on Advisory Say on Pay/Remuneration Report votes in the UK and US during 2015 and 2016. We then compared the recommendations of ISS and Glass Lewis for each resolution to calculate the correlation.

The recommendations of ISS were produced by our very own ‘synthetic vote’ system, whereas we received the Glass Lewis recommendations from the proxy adviser itself.

The correlation data

Table 1 illustrates the correlation between ISS and Glass Lewis recommendations and the actual voting of the institutional investors.

Although the table shows that the investors voted in line with the recommendations of ISS and Glass Lewis the vast majority of the time, the percentages are nevertheless much lower than expected.

This indicates that even at the aggregate level there is at least some disconnect between the voting of the institutional investors and the voting recommendations of ISS and Glass Lewis. It is also interesting to note that the correlation declined between the years of 2015 and 2016.

However, as Table 2 shows, if we constrain our analysis to contentious votes only – i.e. when at least one proxy adviser recommends against management – then the picture becomes far more interesting.

For contentious votes only a little over half – 54% of investors in 2015 and 51% in 2016 – voted in line with ISS when the proxy adviser recommended against management.

For Glass Lewis, the correlation fell even further, with just 34% of investor votes in 2015 and 30% in 2016 voting the same way as the proxy adviser’s recommendation.

<table>
<thead>
<tr>
<th>Year</th>
<th>ISS Percentage</th>
<th>Glass Lewis Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>90.3%</td>
<td>83.2%</td>
</tr>
<tr>
<td>2015</td>
<td>90.5%</td>
<td>84.4%</td>
</tr>
</tbody>
</table>

Table 1: Correlation between Top Investor Voting and Proxy Adviser recommendations on US/UK SoP resolutions

<table>
<thead>
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<th>Year</th>
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<tr>
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<td>51.4%</td>
<td>29.5%</td>
</tr>
<tr>
<td>2015</td>
<td>53.8%</td>
<td>33.6%</td>
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</table>

Table 2: Correlation between Top Investor Voting and Proxy Adviser Against recommendations on US/UK SoP resolutions
Even more surprisingly, since 2015, the institutional investors have only voted against management in 61.8% of say on pay resolutions where both ISS and Glass Lewis recommended against.

Deeper into the data

Analyzing the data down to an investor level allows us to see the voting behaviour of individual investors not only in comparison with proxy adviser recommendations, but also in relation to the different countries and regions in which they invest.

As Table 3 illustrates, all investors bar BNY Mellon correlate above 90% with ISS on Say on Pay overall.

By contrast, BlackRock, Vanguard, State Street, FMR, Goldman and Northern Trust all correlate with ISS less than 50% of the time on against only recommendations.

Moreover, Table 4 shows that the investors typically correlate less with Glass Lewis than ISS. This may be due to the fact that Glass Lewis is generally more aggressive than ISS, which in turn will inevitably lead to a larger diversion from the usually passive voting of institutional investors.

There are many conclusions that can be drawn from this data. Naturally, proxy advisers, tired of being the scapegoat of issuers, will jump on this as evidence that their influence over clients has been greatly exaggerated. Moreover, many observers will note that in general the institutional investors seem less aggressive than ISS and Glass Lewis.

However, this data is probably most relevant to regulators, as it suggests that the argument of the undue influence of proxy advisers – an assertion which in turn brought about the Proxy Advisory Firm Reform Act in the U.S. – is built on shaky ground.

<table>
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<tr>
<th>Investor</th>
<th>All Recommendations</th>
<th>Against only Recommendations</th>
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<tbody>
<tr>
<td>BlackRock</td>
<td>91.0%</td>
<td>25.3%</td>
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<tr>
<td>Dimensional Fund Advisors, Inc.</td>
<td>93.6%</td>
<td>100.0%</td>
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<tr>
<td>Vanguard Group, Inc.</td>
<td>92.4%</td>
<td>35.0%</td>
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<tr>
<td>State Street</td>
<td>93.0%</td>
<td>44.6%</td>
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<tr>
<td>Fidelity Management &amp; Research</td>
<td>92.4%</td>
<td>34.6%</td>
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<td>BNY Mellon</td>
<td>67.5%</td>
<td>83.0%</td>
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<tr>
<td>Goldman Sachs Asset Management LP</td>
<td>95.8%</td>
<td>40.7%</td>
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<tr>
<td>Northern Trust</td>
<td>90.4%</td>
<td>12.7%</td>
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<td>T. Rowe Price</td>
<td>92.3%</td>
<td>56.5%</td>
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<tr>
<td>AllianceBernstein LP</td>
<td>97.7%</td>
<td>93.1%</td>
</tr>
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Table 3: Correlation between Top Investor Voting and ISS recommendations on US/UK SoP resolutions

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<td>Goldman Sachs Asset Management LP</td>
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<td>Northern Trust</td>
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<td>5.9%</td>
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<tr>
<td>T. Rowe Price</td>
<td>83.4%</td>
<td>27.8%</td>
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<tr>
<td>AllianceBernstein LP</td>
<td>83.6%</td>
<td>37.6%</td>
</tr>
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Table 4: Correlation between Top Investor Voting and Glass Lewis recommendations on US/UK SoP resolutions
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Nasdaq Baltic conducts e-voting tests

Nasdaq Baltic has conducted its first successful tests of blockchain technology, using a service that enables investors listed on Nasdaq Tallinn to vote at an AGM without being physically present at the meeting.

According to Nasdaq “We currently have a functioning proof of concept (PoC) with four web-based user interfaces in Estonia. The PoC can now identify users based on their Estonian digital ID – either via Estonian ID card or e-Residency card.” The voting system apparently allows investors to view information about meetings and vote before or during the meeting, use the system to transfer their voting rights to a proxy, monitor how the proxy voted on their behalf, and, if needed, recall the proxy, and review previous meetings and transactions based on the indelible record the system creates.

Nasdaq started the pilot system in February 2016. This is the second e-voting pilot system that Nasdaq has tested, after the Nasdaq Linq platform for trading in shares of non-public companies successfully launched last year.

Vanguard fails to disclose exec pay

Vanguard, as a ‘client-owned’ rather than a ‘public’ company, has managed to avoid disclosing the pay of its own senior executives since the 1990s. However, as one of the world’s largest asset managers, with $3.9 trillion assets under management, it is hard to see why many issuers will acquiesce to pay disclosures when such an important investor fails to do so.

This conundrum is expressed by a professor at the Stanford Graduate School of Business, David Larcker: although Vanguard has “begun actively challenging companies more” it would seem far less hypocritical if Vanguard first got its “own house in order.”

However, Vanguard’s current chief executive Bill McNabb argues that keeping the pay of senior executives secret has been a great competitive advantage for Vanguard, allowing it to attract the very best talent. In addition, Vanguard spokeswoman Arianna Stefanoni Sherlock declared in an email that “we believe that determining the specific structure and pay is a decision best left to the companies’ boards.”

PLSA demands tougher stance on exec pay

The Pensions and Lifetime Savings Association has recently called upon investors to demand a tougher stance on executive pay in newly published guidelines. These guidelines stressed the necessity of holding management and boards accountable to shareholders or pension funds for the remuneration given to company executives.

In practical terms, the new guidelines recommend that if shareholders vote against a company’s remuneration policy, they should also oppose the re-election of the remuneration committee chair as a company director. This follows from research conducted by PLSA, which revealed that 85% of pension funds were concerned by the pay gap between executives and ordinary workers.

According to Luke Hildyard, policy lead for stewardship and corporate governance at PLSA, the guidelines “are designed to ensure the individuals responsible for a company’s executive pay practices are held to account and we hope that this can at last deliver meaningful progress on excessive top pay.”

Legal & General to disclose pay ratio

Legal & General is planning to disclose the pay ratio between its chief executive and its average employee in March, thereby becoming one of the first U.K. companies to respond to the recent attempts to reform U.K. corporate governance.
According to Stefan Stern, director of the High Pay Centre, a U.K. research group: “Pay ratios aren’t a magic bullet but they would change the conversation in a constructive way. It’s like weight gain. If you never weigh yourself, you just get heavier and heavier.”

However, many other companies have opposed the introduction of pay ratios on the grounds that the ratio could be misleading due to the various different types of companies and the vast difference in employee skills and wages within the job market.

**BlackRock threatens investor dissent**

BlackRock, the world’s largest asset manager, is threatening to precipitate shareholder revolts in the U.K., unless Britain’s largest companies attempt to rein in excessive boardroom remuneration.

BlackRock’s demands include an end to enormous pay rises and director pension entitlements at U.K. companies. Moreover, BlackRock declared that it would only approve salary rises for top executives at U.K. firms if such companies increase their workers’ wages by a similar amount. In addition to these new guidelines, BlackRock’s head of investment stewardship in Europe, Amra Balic, once again reiterated that executive pay must be linked to performance:

“Executive pay should be strongly linked to performance, by which we mean strong and sustainable returns over the long-term, as opposed to short-term hikes in share prices. We consider misalignment of pay with performance as an indication of insufficient board oversight, which calls into question the quality of the board. We believe that shareholders should hold directors to a high standard in this regard.”

Approximately half of the U.K.’s largest companies face binding investor votes on their future pay policy this year.

**FRC seeks more powers**

The Financial Reporting Council (FRC), the U.K.’s audit and governance standards custodian, has asked for more oversight powers in an attempt to further its ability to tackle corporate governance issues.

The FRC has declared that although compliance with the U.K. Corporate Governance Code was high, “when boards choose not to follow provisions too many explanations are of poor quality. This suggests that some boards still need to do more than pay lip service to the needs of their shareholders and other stakeholders.”

As a result, the FRC has asked the U.K. government to expand its oversight powers, in particular around requirements for directors of public and private companies to promote the business’ success for the benefit of shareholders, and with regards to staff, suppliers, customers and other stakeholders.

According to the FRC’s executive director of corporate governance and reporting, Paul George, “we have some responsibility to hold actuaries and auditors to account, but we don’t have powers over all members of the board. And what we suggested to the select committee was that the enforcement of directors’ power in the U.K. was incredibly fragmented and could be pulled together by giving the FRC additional powers.”

**Executive pay once again an issue in Germany**

Following widely criticized bonus and pension deals for senior executives at Deutsche Bank and Volkswagen, executive pay is once again back on the agenda in Germany. It was recently revealed that former Volkswagen chief executive, Martin Winterkorn, who resigned following the Dieselgate scandal in 2015, is eligible for an annual company pension of €1.1 million ($1.2 million) - a move that has been criticized by all of Germany’s political parties.

This follows earlier calls for a clawback of bonuses from former Deutsche chief executive Josef Ackermann, as he is being held culpable for the bank’s current woes. However, despite widespread criticism in Germany, Mr Ackermann has managed to keep hold of his millions in bonuses.

According to Social Democratic Party (SPD) leader and current vice-chancellor Sigmar Gabriel, “we have to demonstrate clearly that we can set limits to greed.” Mr Gabriel even went as far as to suggest new legal limits for executive pay in Germany. As a result, it seems that executive pay is likely to become an election-year issue, as the German SPD is planning a slow, steady usurping of the Chancellery from Merkel’s Christian Democratic Union party (CDU).
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