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Insights

FRC RESEARCH ON THE INFLUENCE OF PROXY ADVISORS AND ESG RATING AGENCIES

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SUMMARY

The FRC has published research on the influence of proxy advisors and ESG rating agencies on the actions and reporting of FTSE 350 companies and investor voting. This makes interesting reading and highlights:

- the importance proxy advisors place on compliance with the UK Corporate Governance Code;
- the divergence of views amongst proxy agencies on specific resolutions;
- the influence of proxy advisors and ESG rating agencies may be less evident than previously assumed; and
- that ESG ratings may not actually inform voting decisions.

The research is based on in-depth interviews, survey responses and roundtable discussions with companies, investors, proxy advisors and ESG rating agencies.

In summary:

VOTING DECISIONS AND OUTCOMES

- Most investors will issue voting instructions based on proxy advisor recommendations without manual intervention where the resolution is uncontroversial. This is due to limited resources. However, those investors who were interviewed said they would review recommendations to vote against management and other resolutions where, for example, companies are over a certain size, they hold a certain percentage of shares or where they have previously engaged on governance concerns.

- There is some evidence of correlation between negative voting recommendations and voting outcomes in FTSE 350 companies but this is less extensive than thought. For example, in 2022 a vote of 20% or more against a director election or remuneration resolution occurred in only half of the cases where one or both of ISS or Glass Lewis had made such a recommendation. However, this increased to 77% of cases when both did.

- Investors without UK based teams tend to vote in line with their proxy advisor compared to investors with UK based teams.

- There is considerable variation in the differences taken by ISS and Glass Lewis on remuneration and director appointment resolutions with two-thirds of the cases where one recommended a vote against in 2022, the other took the opposite position.

- All proxy advisor interviewees confirmed that the UK Corporate Governance Code is one of the main sources for their UK benchmark policy.

ENGAGEMENT DURING THE AGM SEASON

- There is general frustration from all parties about the effectiveness of the AGM process due to time constraints and limited resources. Companies feel resolutions may not get the level of attention they deserve from proxy advisors and investors and would value the opportunity to comment on draft research reports produced by proxy advisors. This is not always the case. As a result, all companies felt that they should have a mandatory right to comment whereas only 56% of investor respondents thought they should.

- The majority of proxy advisors and many investors will not engage in face-to-face conversations with companies during the AGM season citing time and resourcing issues as the main reason.

ENGAGEMENT OUTSIDE THE AGM

- Just over 60% of companies that responded to the survey had attempted to engage with one or more proxy advisor in advance of the AGM in the last two years with 96% discussing remuneration and 23% board composition and ESG matters.

- There seems to be a mismatch between a company's desire to engage with its major shareholders and the willingness of shareholders to respond. Evidence suggests that a company's ability to engage with their major shareholders may be down to the size of the company and the composition of its share register. In contrast, investor interviewees stated that their decision on which companies to engage with was driven by their own priorities rather than in response to requests from companies.

THE INFLUENCE OF ESG RATING AGENCIES

- Companies were generally not concerned with receiving an adverse ESG rating when setting strategy etc. but were mindful that investors may place reliance on those ratings when voting. As a result, the majority of companies interviewed concluded that they had to 'play the game' by providing the information used by ESG rating agencies in their methodologies with the hope of receiving a positive rating. This seems to be misguided as research shows that investors primarily used ESG rating agencies as a source of data rather than relying on the rating to inform the voting decision.

- Both companies and investors would welcome greater transparency on the methodologies used by ESG rating agencies and raised concerns about the timeliness and timing of ESG rating agencies' updates to their ratings and research reports which do not always align with the reporting and voting cycles.

Source: FRC research report

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