



April 19, 2019

The Honorable Senator Mike Crapo
Chairman
U.S. Senate Committee on
Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Senator Sherrod Brown
Ranking Member
U.S. Senate Committee on
Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the Society for Corporate Governance, we thank the U.S. Senate Banking Committee for considering the important issue of proxy advisory reform. In November 2018, a strongly bipartisan group of Senators, including Senator Jack Reed, Senator David Perdue, Senator Thom Tillis, Senator Doug Jones, Senator John Kennedy and former Senator Heidi Heitcamp, introduced S.3614, The Corporate Governance Fairness Act of 2018 (the "CGFA"), to advance the regulation of proxy advisory firms by the SEC. We are hopeful that this legislation will be reintroduced in the 116th Congress. This legislation strengthens our capital markets and protects investors by addressing proxy advisor firm conflicts of interest, improving transparency and providing basic due process to public companies that will improve the accuracy of information provided to investors. The CGFA will improve investor access to accurate and unbiased information by requiring entities that meet the definition of a "proxy advisory firm" to register with the SEC under the Investment Advisers Act of 1940. It also directs the SEC to complete a targeted examination of the proxy advisory firms' communications to their clients, and policies and practices related to their management of conflicts of interest. Finally, the legislation requires the SEC to consult with all relevant stakeholders and produce a report to the Congress that reviews the same issues mandated by the targeted examination, and outlines whether the SEC should consider additional protections related to proxy advisory firms.

We urge support of the CGFA.

Background

Founded in 1946, the Society is a professional membership association of more than 3,700 corporate and assistant secretaries, in-house counsel, outside counsel and other governance professionals who serve approximately 1,700 entities, including 1,000 public companies of almost every size and industry. Society members are responsible for supporting the work of corporate boards of directors and the executive managements of their companies on corporate governance and disclosure matters.¹

¹ A more complete articulation of the Society's concerns regarding proxy advisory firms can be found in the Society's comment letter filed in connection with the SEC's Proxy Process Roundtable in November, 2018: <https://www.sec.gov/comments/4-725/4725-4640411-176449.pdf>



While there are five primary proxy advisory firms in the U.S., today the market is essentially a duopoly consisting of Institutional Shareholder Services (“ISS”), owned by private equity firm Genstar, and Glass Lewis & Co. (“Glass Lewis”), a portfolio company of the Ontario Teachers’ Pension Plan Board. The voting recommendations made by these proxy advisory firms are the single most influential pronouncements each year on the composition of a public company’s board, its executive compensation policies, and an increasingly diverse range of shareholder proposals.

Proxy advisory firms are one of the few participants in the proxy voting process that are not generally required to be registered or regulated by the SEC. Proxy statements are subject to regulation under the Securities Exchange Act of 1934 (including liability thereunder for misstatements or omissions); proxy advisory firm reports, however, are not. Yet, many institutional investors rely upon them just as heavily, if not more so, in making voting and investment decisions. There is little accountability by proxy advisory firms despite having an outsized impact on critical governance matters at widely held companies.

The Society’s concerns regarding proxy advisory firms fall into three categories: conflicts of interest, transparency and due process.

Conflicts of Interest

ISS, the largest proxy advisory firm, has a foundational conflict of interest—it provides clients with voting recommendations on a company’s corporate governance and compensation policies and also seeks to be hired by these same companies to provide paid corporate governance and/or compensation consulting services.

Society members have reported being contacted by ISS’ corporate consulting sales force suggesting that they have a unique ability to help fix any problems that the company has had with a previous vote if they hire ISS for a consulting engagement. And in these conversations with the sales force, companies are offered a tiered service level where more ISS involvement and insights come at a higher price. In addition, ISS now offers an environmental and social scorecard consulting service, for an added cost.

A conflict of interest applicable to all proxy advisors is that such firms provide voting recommendations on shareholder proposals that may have been submitted by their institutional investor clients without disclosing that such a conflict exists. Further, ISS has a paid service for shareholder proponents to help them craft proposals that will pass muster under SEC rules. In addition, proxy advisors also sell data and other analytical tools to institutional investors and hedge funds², and then simultaneously recommend votes on all matters, including these same hedge funds’ proxy contests.

These conflicts should be subject to regulation that would require specific and prominent disclosure to institutional investor clients in voting reports so that they may evaluate this information in the context of the proxy advisors’ voting recommendations.

² <https://www.sustainalytics.com/press-release/sustainalytics-glass-lewis-corporate-governance-data-services-offering/>

Transparency of Firm Procedures

Currently, proxy advisory firms are largely unregulated, resulting in a lack of transparency. There is no regulatory regime that governs the manner in which these firms develop their policies or form the recommendations or ratings they make. While ISS can be commended for incorporating a public survey of interested parties as part of its annual policy development, there remain issues with this process. For example, while the survey is indeed open to institutional investors, corporate executives, board members and any other interested parties, it is unclear how ISS determines the particular topics, survey questions and response options it publishes for comment each year. Further, ISS does not disclose how it weighs the survey responses in its final policy changes. Notwithstanding their time and effort in participation, corporates generally see little evidence that their points of view have been taken into account in ISS' development of its final policies. Thus, it is unclear how ISS actually internalizes the survey responses it does receive, including whether one group of respondents drives the ultimate policy changes or not.

Glass Lewis does not conduct a formalized survey solicitation process, although it does allow stakeholders to provide feedback on its proxy voting guidelines via its website on an *ad hoc* basis and relies on an "independent research advisory council," which includes limited corporate representation, for feedback on its voting policies. As with ISS, it is unclear how any of the foregoing feedback is ultimately reflected in Glass Lewis' decisions to make policy changes or in the substance of any changes made.

Balanced regulation by the SEC, as contemplated by the CGFA, could improve proxy advisor transparency.

Due Process

Proxy advisory firms make proxy recommendations on every public company in the United States, and thousands of public companies around the world. The scale and complexity of making proxy voting recommendations for thousands of companies during "proxy season" effectively requires proxy advisors to do all their analysis from February to June, with most recommendations coming out during a 6-8-week period.

Reading and accurately digesting thousands of proxy statements, annual reports, and – increasingly – corporate social responsibility and sustainability statements in a condensed time period creates an environment conducive to errors. Given the volume of analysis and the likelihood that errors or misjudgments may occur, it would be reasonable to assume that companies would have the opportunity – indeed, the right – to review and correct any inaccuracies in the proxy voting reports. To the contrary, there is currently no requirement for proxy advisors to provide companies with an opportunity to review and correct voting reports prior to their issuance.

As a result, most companies today are not able to see proxy voting reports about themselves until after each report has been issued. ISS provides its draft proxy voting reports to S&P 500 companies, but provides draft reports to smaller companies only on a discretionary basis or only after the companies have completed a paid subscription to their service. Further,



any draft report that is provided to a company is accompanied by a very short turnaround time of no more than 72 hours before final publication to ISS’ institutional investor clients. Additionally, ISS does not normally provide draft reports for any special meeting or any meeting where the agenda includes a merger or acquisition proposal, proxy fight or “any item that ISS, in its sole discretion, considers to be of a contentious or controversial nature.”³ Thus, in the situations where an ISS report may be the most consequential, companies often are not able to view a draft at all. Glass Lewis does not provide a copy of its final reports to any public company that does not pay for its reports or otherwise subscribe to its services.

The inability to review draft reports from proxy advisory firms as a matter of right means that companies who want factual errors or omissions corrected are often unable to get a response from proxy advisory firms until it is too late, i.e., until after votes have been cast on the basis of a recommendation that relied – at least in part – on inaccurate or incomplete information.

The balanced regulation contemplated by the CGFA would be a real step towards the due process required by traditional notions of fairness.

Conclusion

We commend this Committee for taking a detailed look at the regulation of proxy advisory firms and urge your support of the concepts embodied in the strongly bipartisan and balanced Corporate Governance Fairness Act of 2018. This legislation would help ensure that investors receive the transparency and regulatory protections they deserve, that public companies continue to thrive and create jobs, and that our capital markets remain the driver of economic growth in America.

Sincerely,

A handwritten signature in blue ink that reads "Darla S. Stuckey".

Darla S. Stuckey
President & CEO
Society for Corporate Governance

cc: The Honorable Senator Jack Reed
The Honorable Senator David Perdue
The Honorable Senator Doug Jones
The Honorable Senator Thom Tillis
The Honorable Senator John Kennedy

³ <https://www.issgovernance.com/contact/faqs-engagement-on-proxy-research/>