

# 2019

## PROXY SEASON SURVEY



CENTER FOR CAPITAL MARKETS  
COMPETITIVENESS



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Presented by:



**CENTER FOR CAPITAL MARKETS**  
**COMPETITIVENESS**

Fundamental components of the U.S. capital markets are strong corporate governance laws and regulations that promote long-term shareholder value and encourage businesses to enter the public markets. When more businesses elect to go public, job creation accelerates and Main Street households are provided with greater opportunities to build and sustain wealth.

Regrettably, the past two decades have witnessed a steady decline in the number of U.S. public companies. There are now roughly half the number of public companies than existed 20 years ago, and the initial public offering (IPO) market remains a fraction of what it was in the latter part of the 20th century. This presents significant challenges to long-term economic growth and the ability of Main Street households to invest in successful American businesses.

Congress and the Securities and Exchange Commission (SEC) have taken actions in recent years to help stem this decline and make the public company model attractive again for entrepreneurs. The 2012 Jumpstart Our Business Startups (JOBS) Act scaled regulation for small issuers, and the recent agenda of the SEC has prioritized disclosure reform, expansion of certain provisions of the JOBS Act, and other initiatives intended to right-size regulation and encourage more businesses to complete an IPO.

One issue of increasing interest to policymakers is the outsized role that proxy advisory firms play in corporate governance and the challenges these firms pose to businesses that are already public or considering an IPO. While proxy advisory firms exist to provide institutional investors with analysis and vote recommendations for various proxy issues, past regulatory actions have helped the firms “control” a significant portion of the vote at public companies. As a result, many public companies—particularly small and mid-size issuers—are left to the mercy of decisions made by proxy advisory firms.

The proxy advice market is dominated by two firms—Institutional Shareholder Services (ISS) and Glass Lewis—which collectively control 97% of the industry. ISS and Glass Lewis have effectively become the standard setters for corporate governance in the United States, notwithstanding the fact these firms have a history of making errors, are rife with conflicts of interest, and provide little transparency as to how they develop vote recommendations.

This is the fifth year that Nasdaq and the U.S. Chamber of Commerce have conducted a survey to examine the experiences public companies had with proxy advisory firms during the most recent proxy season. The survey is intended to help inform current and future regulatory initiatives related to proxy advisory firms and their role within the U.S. proxy system.

# BACKGROUND

The practices and influence of proxy advisory firms have become an increasing topic of interest among policymakers over the past decade. Republicans and Democrats in Congress, as well as the SEC, have expressed concern over deficiencies within the industry, including

- a track record of making errors or misjudgments in analysis when developing vote recommendations, a flaw that ultimately misinforms investors and impairs voting decisions on proxy issues at public companies;
- a startling lack of transparency that leaves market participants guessing as to how ISS and Glass Lewis formulate voting advice;
- significant conflicts of interest that have the potential to taint voting recommendations and introduce biases into the voting process; and
- a “one-size-fits-all” approach that does not produce company-specific analysis or vote recommendations and instead applies uniform policies to nearly every public company.

In 2013—following the release of a report by the Chamber on best practices for the proxy advice industry—the first congressional hearing on proxy advisory firms was held.<sup>1 2</sup> Later that year, the SEC held a public roundtable to examine the use of proxy advisory firms by institutional investors and investment advisers. While Nasdaq was on record in 2013 with its own concerns about the behavior of proxy advisers, in May 2017, Nasdaq made proxy advisory reform a cornerstone of its blueprint to revitalize the capital markets.<sup>3</sup>

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1. Best Practices and Core Principles for the Development, Dispensation, and Receipt of Proxy Advice. (March 2013) Available at <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Best-Practices-and-Core-Principles-for-Proxy-Advisors.pdf>
  2. “Examining the Market Power and Impact of Proxy Advisory Firms” Subcommittee on Capital Markets and Government Sponsored Enterprises (June 5, 2013).
  3. The Promise of Market Reform Reigniting America’s Economic Engine (May 2017). Available at [https://www.nasdaq.com/docs/Nasdaq\\_Blueprint\\_to\\_Revitalize\\_Capital\\_Markets\\_April\\_2018\\_tcm5044-43175.pdf](https://www.nasdaq.com/docs/Nasdaq_Blueprint_to_Revitalize_Capital_Markets_April_2018_tcm5044-43175.pdf)

As a result of this public concern, SEC staff issued Staff Legal Bulletin 20 (SLB 20) in 2014 to provide guidance to investment advisers regarding their voting obligations under the Proxy Voting Rule, and to clarify the circumstances under which proxy advisory firms can obtain an exemption from the SEC’s proxy solicitation rules.<sup>4</sup> Importantly, SLB 20 reiterated that the fiduciary obligation of investment advisers permeates all aspects of proxy voting, including when investment advisers engage a proxy advisory firm for analysis and vote recommendations.

While the issuance of SLB 20 was a positive development, there are limitations as to the impact that staff-level guidance can have in practice. Congress therefore felt the need to become further involved as it considered legislation related to proxy advisory firms. In December 2017, the House of Representatives passed bipartisan legislation—H.R. 4015, the Corporate Governance Reform and Transparency Act—that would require proxy advisory firms to register with the SEC and become subject to an oversight and examination regime. Subsequent legislation introduced in Senate demonstrated there was a bipartisan and bicameral consensus that the regulatory status quo for proxy advisers needed to be changed.<sup>5</sup>

Over the past 18 months, the SEC has responded to these concerns and taken action on its own to update the regulatory framework that applies to proxy advisory firms and the institutional investors that hire them:

- In September 2018, SEC staff withdrew two no-action letters that were issued to ISS and Egan Jones (another proxy advisory firm) in 2004.<sup>6</sup> These letters received wide criticism for allowing institutional investors to outsource voting decisions to proxy advisers, thereby increasing the level of influence that proxy advisory firms hold over voting decisions.

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4. Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions From the Proxy Rules for Proxy Advisory Firms (June 30, 2014). Available at <https://www.sec.gov/interps/legal/cfslb20.htm>.

5. S. 3614, the Corporate Governance Fairness Act (Introduced November 13, 2018 by Sens. Reed, Perdue, Heitkamp, Tillis, Jones, and Kennedy).

6. Statement Regarding Staff Proxy Advisory Letters—Division of Investment Management (September 13, 2018). Available at <https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters>.

- The SEC held a roundtable on the U.S. proxy system in November 2018 that included a lengthy discussion of proxy advisory firms and their impact on corporate governance.<sup>7</sup> The SEC has also received hundreds of written comments related to the roundtable, including from issuers describing specific problems they have had with proxy advisory firms over the years. One of those submissions was a Nasdaq-coordinated letter, signed by over 300 companies and trade associations, calling on the SEC to take strong action to regulate proxy advisory firms.<sup>8</sup>
- In August 2019, the SEC issued Commission-level guidance (“Commission Guidance”) that built on SLB 20 and is intended to encourage reasonable due diligence by institutional investors when using proxy advisory firms, including taking steps to ensure that vote recommendations are based on sound analysis and data and are not tainted by conflicts of interest. The guidance also clarifies the circumstances by which proxy advisory firms are subject to the SEC’s proxy solicitation rules, and reiterates that even exempt solicitations are still subject to SEC rules that prohibit false or misleading statements.<sup>9</sup>
- In November 2019, the SEC proposed rules that condition proxy advisory firms’ exemptions from the proxy solicitation rules upon the firms meeting certain transparency and accountability requirements.<sup>10</sup> For example, the proposal requires that proxy advisory firms disclose material conflicts of interest to their clients, provide issuers with opportunities to comment on vote recommendations to ensure accuracy, and include in final vote recommendations a hyperlink or other medium to an issuer’s viewpoint regarding the proxy issue at hand. These steps will promote more objective proxy vote recommendations and ensure that investors receive all information necessary to make informed voting decisions.

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7. Spotlight on the Proxy Process (November 15, 2018). Available at <https://www.sec.gov/proxy-roundtable-2018>.

8. Letter available at <https://www.sec.gov/comments/4-725/4725-4872519-177389.pdf>.

9. Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice (August 21, 2019). Available at <https://www.sec.gov/rules/interp/2019/34-86721.pdf> ; Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers (August 21, 2019). Available at <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>.

10. Amendments to Exemptions From the Proxy Voting Rule for Proxy Voting Advice (November 5, 2019). Available at <https://www.sec.gov/rules/proposed/2019/34-87457.pdf>.

# 2019

## PROXY SEASON SURVEY

The U.S. Chamber of Commerce’s Center for Capital Markets Competitiveness (CCMC) and Nasdaq partnered again to conduct a survey of public company experiences with proxy advisory firms during the 2019 proxy season. This is the fifth annual CCMC/Nasdaq proxy season survey and is intended to help policymakers and market participants understand how public companies engaged with proxy advisory firms, investors, and regulators throughout the most recent proxy season. A record 172 companies participated in the survey.

A notable finding from this year’s survey is that fewer issuers are requesting previews of vote recommendations or asking for opportunities to meet with proxy advisory firms on matters subject to a shareholder vote. This development has occurred at the same time proxy advisory firms are less likely than in previous years to grant such requests, leading several companies to believe that any attempt to correct factual errors or engage in substantive dialogue with proxy advisory firms is futile.

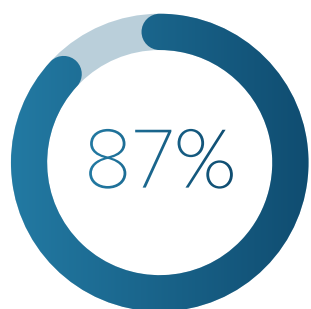
The survey also found—as did last year’s survey—that many companies report a significant portion of their shares are “robo-voted” by institutional investors within two days after an ISS or Glass Lewis vote recommendation is issued. Such automatic voting of shares has caught the attention of the SEC and Congress, and calls into question whether there is still an overreliance on proxy advisory firm recommendations.

The survey also highlights the increasing awareness that issuers have regarding conflicts of interest at proxy advisory firms. Nearly twice as many companies identified significant conflicts at proxy advisory firms, with some bringing them to the attention of institutional investors.

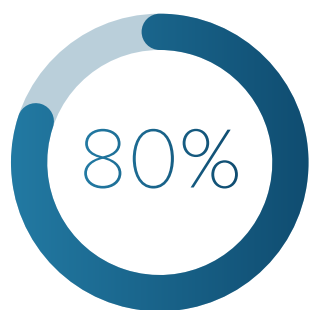
Notably, 58% of issuers reported that they have been approached by the corporate consulting arm of ISS in the same year that the company received a negative vote recommendation. As the Chamber, Nasdaq, and many others have long pointed out, the ISS business model—in which the company provides corporate governance consulting to the very issuers that it is issuing vote recommendations on—is inherently conflicted and creates the potential for biased voting advice. Regulators should be vigilant in ensuring that these conflicts ultimately do not harm investors, who rely on sound and objective voting advice to create long-term value.

## SURVEY RESULTS

### Corporate Engagement With Proxy Advisory Firms: Issuers Still Find It Difficult to Engage Constructively With Proxy Advisory Firms



Of companies surveyed, **87% had a proxy advisory firm make a recommendation** on an issue included in their proxy statements, a level that is 5% lower than in 2017 and 2018.

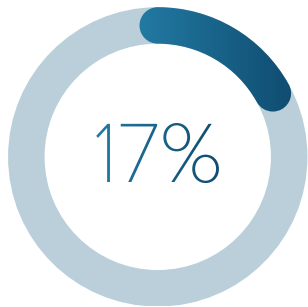


Of companies, **80% carefully monitored proxy advisory firm recommendations** for accuracy or reliance on outdated information, lower than in 2018 (83%) and 2017 (91%).

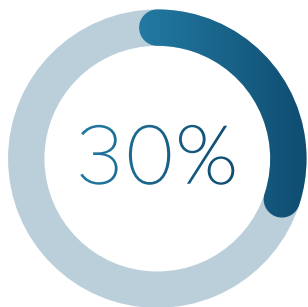




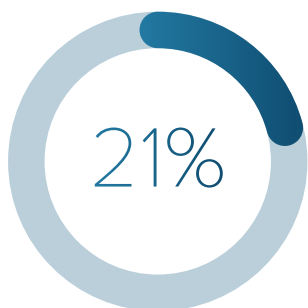
Of companies, **only 39% believed that proxy advisory firms carefully researched and took into account all relevant aspects of a particular issue** on which the firms provided advice, the same number as in 2018.



Of companies, **17% formally requested that proxy advisory firms provide them with a preview of vote recommendations**, down from 21% in 2018 and 30% in 2017. For companies that did request a preview, proxy advisory firms provided them only 39% of the time, down 5% from 2018.

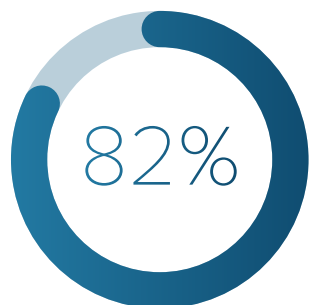


The number of companies asking proxy advisory firms for opportunities to provide input both before and after the firms' recommendations were finalized continues to decline. In 2019, **30% of companies made such requests**, down from 38% in 2018 and 51% in 2017. Once again, companies commonly reported that, if such a request was granted, they were often only given only one to two days (and sometimes only hours) to provide input.

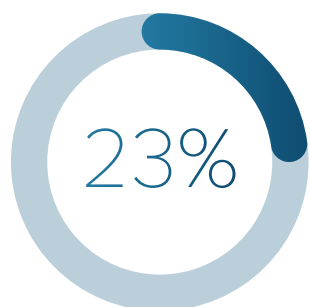


The number of companies pursuing opportunities to meet with proxy advisory firms on issues subject to shareholder votes also continues to decline. Of companies, **21% pursued meeting opportunities in 2019**, down from 29% in 2018 and 52% in 2017. For companies that asked for a meeting, their request was denied 60% of the time, a number that continues to grow from 2018 (57%) and 2017 (38%).

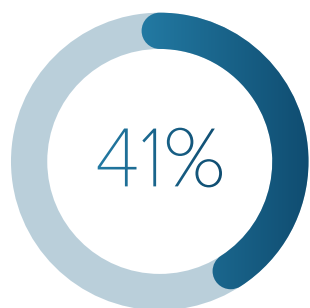
## Issuer Engagement With Investors and the SEC



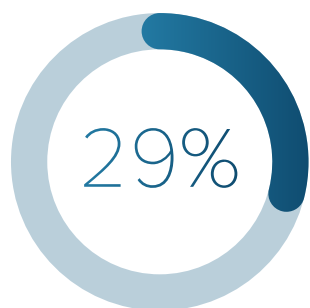
A large majority of companies still reported that they have some form of a year-round, regular communications program with institutional investors. Of issuers, **82% reported having such a program**, up from 78% in 2018. The companies that do regularly communicate with institutional investors throughout the year found such communication to be beneficial when it comes to proxy matters.



Companies that believed they were not granted adequate opportunities for input on a proposed proxy adviser vote recommendation **notified proxy adviser firms and portfolio managers 23% of the time**, a slight decline from 2018.

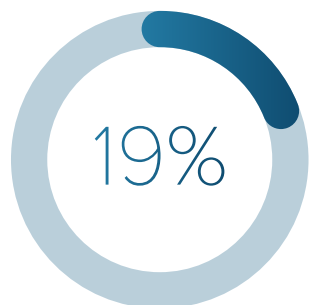


When companies encountered a vote recommendation they believed was based on inaccurate or stale data, they **alerted the proxy advisory firm, portfolio managers, and/or SEC staff 41% of the time**, a 5% decrease from 2018. Companies also reported making supplemental proxy filings with the SEC to alert the public to issues regarding the quality of vote recommendations or the process employed by the proxy advisory firms.

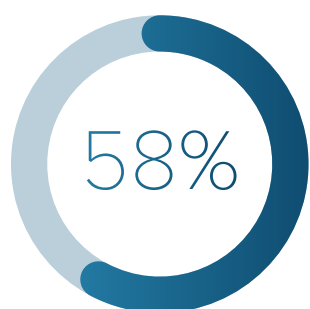


Of companies, **29% advised proxy advisory firms and their clients of recommendations that did not advance the best economic interest of shareholders**, a 10% decrease from 2018.

## Conflicts of Interest a Rising Concern for Companies

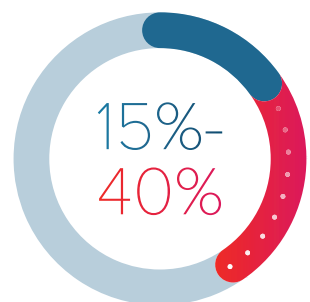


Nearly twice as many companies identified conflicts of interest at proxy advisory firms in 2019 than in 2018. Of companies, **19% identified significant conflicts of interest**, up from 10% in 2018. While 16% of those companies that found conflicts brought them to the attention of institutional investors, a smaller number brought them to the attention of SEC staff (7%) and the proxy advisory firms themselves (8%).



A striking **58% of companies reported being approached by ISS Corporate Solutions during the same year in which the company received a negative vote recommendation**. Of companies, 19% reported that they have hired ISS Corporate Solutions for advice on structuring executive compensation plans, improving ESG ratings, gauging proxy advisory outcomes, or other corporate governance matters.

## Significant Percentage of Shares Voted in Line With Proxy Advisory Firm Recommendations



As in 2018, many issuers reported that a large percentage of their shares were robo-voted in the 24 to 48 hours after an ISS or Glass Lewis vote recommendation was released. When an ISS recommendation was issued, several companies reported that between 15% and 40% of their outstanding shares were voted in line with the recommendation within two days. The same issue arose with Glass Lewis, although on a smaller scale, with several companies reporting that between 5% and 10% of their shares voted automatically with a Glass Lewis recommendation.

# PROXY ADVICE BEST PRACTICES

The three constituency groups affected by the recently issued SEC guidance—proxy advisory firms, portfolio managers, and public companies—must focus their attention on five overarching principles:

## **Fiduciary duty**

Fiduciary duties permeate and govern all aspects of the development, dispensation, and receipt of proxy advice. Some investors use proxy advisory reports as one data point among many in an independent process to determine how or when they should vote their shares. Unfortunately, other investors may outsource their voting to proxy advisory firms without any due diligence.

## **Shareholder value**

Enhancing and promoting shareholder value must be the core consideration in rendering proxy voting advice as well as making proxy voting decisions.

## **Freedom from conflict**

The proper role of proxy advisory firms vis-à-vis proxy voting is to provide accurate and current information to assist those with voting power to further the economic best interests of those who entrust their assets to portfolio managers and are the beneficial shareholders of public companies. If proxy advisory firms exceed that role—for example, by effectively exercising or being granted a measure of discretion over how shares are voted on specific proposals, or by failing to make proper disclosure regarding specific conflicts of interest afflicting a proxy advisory firm in connection with voting recommendations it is making—the proxy advisory firms so employed, and those engaging them, incur serious legal and regulatory consequences. The August 2019 Commission Guidance suggests that institutional investors should assess whether proxy advisory firms they hire have policies in place to identify, disclose, and address actual or potential conflicts of interest.

## **Portfolio manager discretion**

Clarity is provided regarding the scope of portfolio managers' obligations to exercise a vote on proxy issues, and the obligations emphasize the broad discretion portfolio managers have—subject to appropriate procedures and safeguards—to refrain from voting on every, or even any, proposal put before shareholders for a vote.

## **Compliance**

In light of the direction provided, proxy advisory firms and portfolio managers need to reassess their current practices and procedures and adopt appropriate changes necessitated by the Commission Guidance, while public companies should be aware of the direction provided to other stakeholders and consider it when developing policies and practices.



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