Council of Institutional Investors
The Voice of Corporate Governance

June 13, 2016

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
4340 Thomas P. O'Neill, Jr. Federal Office Building
Washington, DC 20515

Re: Corporate Governance Reform and Transparency Act of 2016 (HR 5311)

Dear Mr. Chairman and Ranking Member Waters:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our Associate Members include a range of asset managers with more than $20 trillion in assets under management.[1] This letter has been co-signed by 27 CII members and other institutional investors.

We strongly oppose HR 5311, which aims to tighten regulation of proxy advisory firms to the detriment of investors. We believe the bill could weaken public company corporate governance in the United States; lessen the fiduciary obligation of proxy advisors to investor clients; and reorient any surviving proxy advisors to serve companies rather than investors. The U.S. system of corporate governance relies on accountability of boards of directors to shareholders, and proxy voting is a critical means by which shareholders hold boards to account. We believe that proxy advisory firms play an important and useful role in enabling effective and cost-efficient

[1] For more information about the Council of Institutional Investors and our members, please visit the Council's website at http://www.cii.org/about_us. [1] We note that the two largest U.S. proxy advisory firms, Glass Lewis & Co. ("Glass Lewis") and Institutional Shareholder Services ("ISS"), are non-voting members of CII, paying an aggregate of $24,000 in annual dues—less than 1.0 percent of CII's membership revenues. In addition, CII is a client of ISS, paying approximately $19,600 annually to ISS for its proxy research.

independent research, analysis and informed proxy voting advice. In our view, the bill could undermine advisory firms' ability to provide a valuable service to investors.

We would emphasize the following:

- **Current Securities and Exchange Commission (SEC) guidance makes clear that investment advisors have a duty to maintain sufficient oversight of third-party voting agents, and there is no need for a further heavy-handed regulatory solution**. The SEC has been intelligent and effective in its approach to proxy advisory firms, under existing authority.
    - CII welcomed the SEC staff's 2014 guidance on proxy advisors. The staff affirmed that investor advisors are not required to vote all proxies, a view that the CII has long shared. CII welcomed the staff's reminder that investment advisors have a duty to maintain sufficient oversight of third-party voting agents. We believe the guidance was positive and we do not see the need for further action by the commission.
    - Other securities regulators also have provided effective guidance. Six leading global proxy research firms (including Institutional Shareholder Services (ISS) and Glass Lewis) now subscribe to best practice principles developed at the prompting of the European Securities and Markets Authority.

- **The view that the two leading proxy advisory firms, ISS and Glass Lewis, dictate proxy voting results is simply incorrect.** For example, ISS recommended against "say on pay" proposals at 12 percent of Russell 3000 companies in 2015, according to Semler Brossy (an independent compensation consulting firm).[2] But only 2.8 percent of "say on pay" proposals at Russell 3000 companies that year received less than majority support from shareholders. We believe there is no compelling empirical evidence that institutional investors are abdicating and outsourcing their voting responsibilities

- **Proxy advisory firm influence is exaggerated by analyses that confuse correlation with causation.** ISS and Glass Lewis tend to follow investors on governance policy, not lead them. In setting their policy frameworks, the two firms have a business interest to ensure they reflect investor (client) perspectives, in part through extensive consultative processes, and to consider empirical evidence. Their franchises are built on credibility with investors. As a result, advisors' views reflect those of many funds. Indeed, if there were a sharp divergence, we would expect to see advisors punished in the marketplace.

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[2] Semler Brossy, "2015 Say on Pay Results: End of Year Report," January 26, 2016 (http://www.semlerbrossy.com/say-on-pay/entire-2015-proxy-season/).

- **Discussions of proxy advisory firms often assume that a proxy advisor makes a single recommendation for each ballot item, and clients follow in lockstep. That is not the case.** Many funds vote internally using their own staff, and proxy advisor research and recommendations are among the data they consider in making proxy voting decisions. Even funds that delegate their voting to a proxy advisor are not "outsourcing" their voting policy. These funds are generally notified of proxy advisors' recommendations and retain the ability to change the vote cast on their behalf. The client may perform a case-by-case review of certain highly complex proposals, such as a proposed merger, while instructing the advisor to vote in accordance with the fund's customized proxy voting guidelines for other proposals. These guidelines are fund-driven, not advisor-driven, and have the sophistication to take into account numerous factors relevant to the vote.

- **Proxy advisory firms' role is less central than it was 10 years ago.** Direct engagement by investors with management and with boards of portfolio companies has stepped up substantially, particularly in the last few years. Asset managers, pension funds and other investors have taken greater interest in proxy voting, and have strengthened in-house expertise to address proxy-related issues.

- **HR 5311 would limit competition**, imposing serious barriers to entry for potential new proxy advisory firms. In fact, if enacted, HR 5311 is likely to reduce the number of firms offering independent proxy advisory services in the United States, possibly to just one or even zero.
  - If there is no market source of expertise to support proxy statement analysis for voting purposes, and all investors must conduct basic review and analysis for thousands of votes in-house, the costs would be substantially higher for asset managers and asset owners.
  - If only one proxy advisor is left standing, we believe that firm will have greater influence than at present. This should be troubling to companies that complain that the leading proxy advisory firm has too much influence now. Moreover, investors likely would pay not only for enhanced costs flowing directly from HR 5311, but also for monopoly pricing of the surviving firm.

- **It is troubling that there appears to be no cost/benefit analysis** of HR 5311, given the likelihood of significant financial impacts and the potential for unintended consequences.

- **HR 5311 appears premised on the faulty assumption that the primary role of proxy advisory firms is to serve "companies."** A key provision (subsection (g) of the proposed new Sec 15H) seeks to enable "companies receiving proxy advisory firm recommendations" opportunity to pre-clear

recommendations on their firms, and to delay, obstruct and provide the right of private action on publication of reports on which they have complaints.

- Proxy advisory firms currently primarily serve institutional investors, who are the recipients of proxy advisor research, analysis or recommendations. Accountability of boards to shareholders clearly would be undermined if company management becomes the primary focus and "customer" for proxy voting recommendations, or if companies are afforded the opportunity to litigate to bury proxy adviser reports that are critical of management.

- **HR 5311 would give companies the right to preview proxy advisory firm reports and lobby the report writer(s) to change their recommendations.** Financial Industry Regulatory Authority (FINRA) rules specifically prohibit the same type of pre-review of financial analyst reports. We believe this right of pre-review will give company managements substantial editorial influence on reports on their companies, particularly combined with the threat of publication delay through the heavy-handed ombudsman construct (discussed below), and the right to sue if "aggrieved" by a vote recommendation.

- **Each proxy advisory firm would be required to employ an ombudsman** to receive complaints on the accuracy of voting recommendations from "the subjects of the proxy advisory firm's voting recommendations," and resolve those complaints prior to the vote date. **This would appear to make the proxy advisory firms highly vulnerable to ill-founded or trivial complaints from issuers.** Our concern is that companies facing criticism may seek to delay or disrupt the timely analysis and information from proxy voting firms to their investor clients. Such interruptions would be particularly problematic in the highly concentrated spring "proxy season," when time constraints that are dictated by corporate reporting requirements and state law rules prescribe when annual meetings must take place.
    - It is notable that there apparently is no requirement for the ombudsman to hear complaints from investors, who pay for the service. We are concerned that this provision would substantially tilt influence in proxy voting toward management.

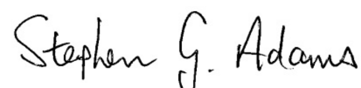
- **Notwithstanding a contradictory subsection head title, the bill would give an "aggrieved" "subject" of a vote recommendation a right to sue a proxy advisory firm**. If the bill intends "subject" to include both sides presenting proposals at the meeting, then this would give a right of action to boards, shareholder proponents and investors who nominate dissident nominees. If, as seems more likely is intended, this private right of action (as well as power to use the scheme's "ombudsman" mechanism) is limited to companies and their management, then the effect of the legislation will be to tilt the scales heavily in favor of management influence in voting, in all situations. We think it highly

> likely this one-sided right to sue will have a chilling effect, particularly where companies are poorly governed or where there is poor or abusive management that potentially is vulnerable to active and informed shareholders using their votes to call management to account.

Thank you for considering these views. We would be very happy to discuss our perspective at more length. I am available at ken@cii.org, telephone (202)-822-0800.

Sincerely,

Kenneth A. Bertsch
Executive Director, Council of Institutional Investors



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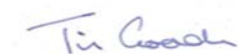

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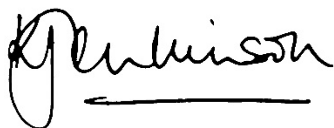

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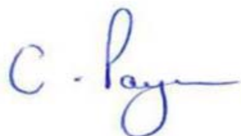

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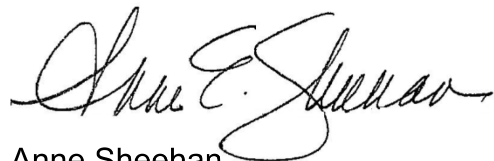

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