

**Corporate Governance Update:**

**2017  
PROXY  
SEASON  
SURVEY**

**Fall 2017**



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

# 2017 PROXY SEASON SURVEY

Proxy advisory firms continue to play an outsized role in corporate governance in the United States, imposing their views of appropriate corporate governance on public companies and remaining demonstrably influential in how proxy votes are cast.

The proxy advisory firm industry is also alarmingly concentrated. In the United States, two firms—Institutional Shareholder Services Inc. and Glass Lewis & Co. LLC—constitute 97% of the proxy advisory industry and have become the de facto corporate governance standard setters for public companies. These firms have been criticized by U.S. and global regulators, academics, institutional investors, shareholders, and others for, among other things:

- Conflicts of interest that are frequently undisclosed, inadequately disclosed, or improperly managed;
- “One-size-fits-all” voting advice that ignores the unique circumstances of each company or the effect of recommendations on the economic well-being of shareholders;
- Industry concentration;
- Lack of transparency in the research and development of voting recommendations; and
- Repeated errors in analysis, data relied upon to make recommendations, and a lack of due diligence.

Because proxy advisory firms play an important role in our capital markets, it is clear that more needs to be done to reform the industry to ensure the public company model remains attractive. In fact, the number of public companies in the United States has declined by roughly 50% over the last two decades and proxy advisory firms’ influence is frequently cited as a challenge to public companies and their shareholders. For the benefit of our capital markets and broader economy and to reverse this trend, policymakers need to prioritize greater transparency and accountability for proxy advisory firms.

## 2017 Proxy Season Survey

### ***Issues Remain, while Communication between Companies, Firms, and Shareholders Continues to Increase***

The U.S. Chamber of Commerce’s Center for Capital Markets Competitiveness (CCMC) and Nasdaq partnered this fall for a survey of public company interaction with proxy advisory firms during the proxy season. This is the third annual proxy season survey and it is intended to help key stakeholders understand the public company experience during the 2017 proxy season, as well as highlight changes over time. More than 140 companies participated in this year’s survey.

The results of the survey show that while there has been a modest increase in communication between companies, proxy advisory firms, and institutional investors, many issues remain. For example, public companies find it difficult to have a substantive meeting with a proxy advisory firm regarding recommendations, and outreach rarely leads to a new recommendation being issued. And only about one third of companies believe that proxy advisory firms carefully research and take into account all factors in developing the recommendations. We believe this survey will help policymakers better understand the important relationship between public companies, proxy advisory firms, and institutional investors.

## Summary of 2017 Proxy Season Survey and Trends

### ***Corporate Engagement with Proxy Advisory Firms Increases with Little Difference in Outcomes***

- In 2017, 93% of surveyed companies had a proxy advisory firm make a recommendation on a matter featured in the corporate proxy statement—a 12% increase from 2016.
- Nearly all (92%) companies monitor proxy advisory firm recommendations for accuracy or reliance on outdated information.
- In 2017, 30% of surveyed companies formally requested previews of advisor recommendations—a 12% increase from 2016. Companies found proxy advisors willing to provide the previews 48% of the time. This is an increase over the 2016 survey (where proxy advisors provided previews 35% of the time) but is nearly identical to the results from the 2015 survey.
- 24% more companies reported making pro-active outreach to proxy advisory firms on issues subject to shareholder votes in 2017. Of the 52% of companies that did request a meeting, requests were denied 38% of the time and many were only granted a phone conversation rather than an in person meeting. While this denial rate was lower than in 2016, it is very similar to the rate of denials found in 2015. Companies that were given an opportunity to meet with a proxy advisor saw mixed results, with some noting the conversations were productive and resulted in better recommendations, while others had the opposite experience, citing that the meeting was with junior analysts and that the information was received with little comment.
- In addition, 51% of companies (up 13% from 2016) asked the proxy advisory firm for the opportunity for input both before and after the firm's recommendations were finalized. Companies reported a wide spread in the amount of time advisors granted them to respond, with anywhere from 30 minutes to a couple of weeks, with a majority having a one-to-two day turnaround.

### ***Corporate Engagement with Investors and the SEC Increases***

- The number of companies that have some form of year-round, regular communication program with institutional investors increased by 16% from 2016 to 91%.
- When a company did not believe it was afforded an adequate opportunity for input to proposed proxy advisor recommendations the company formally notified the firm and portfolio manager 28% of the time.
- When the company felt the firm relied on inaccurate or stale data, companies alert the firms, portfolio managers and/or the U.S. Securities and Exchange Commission (SEC) staff 65% of the time, an increase of 17% from 2016. Unfortunately, this outreach rarely results in a new report or new recommendations issued.
- If a company indicated to a proxy advisory firm(s) significant errors, misjudgments, noncurrent data, or mistaken assumptions, they also advised portfolio managers and others of that indication 53% of the time—an 18% increase from 2016.

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- Companies advised proxy advisory firms and their clients if specific recommendations did not advance the economic best interests of shareholders 53% of the time—a 23% increase from 2016 after a 17% decrease was seen between 2015 and 2016.

## ***Companies See Little Change in Proxy Advisory Firm’s Conflict of Interests or Issue Expertise***

- 17% of companies discovered significant conflicts of interest during the proxy season and of those, 14% advised the proxy firms of those perceived deficiencies, and 2% brought the issue to the attention of the SEC.
- Only 35% of companies believed the proxy advisory firm carefully researched and took into account all relevant aspects of the particular issue on which it provided advice, a 10% increase over 2016.

## ***Strong Support for “Corporate Governance Reform and Transparency Act of 2016”***

- An overwhelming 92% of companies say they support the proposed “Corporate Governance Reform and Transparency Act of 2016”, which would require proxy advisory firms to register with the SEC and become subjected to proper oversight.

## **Proxy Advice Best Practices**

In June 2014, U.S. Securities and Exchange Commission Staff published guidance<sup>1</sup> due to concerns surrounding the increasingly outsized role and influence of proxy advisory firms on corporate governance matters in the United States and globally. The guidance addressed issues and concerns raised by stakeholders and provided clarity about the SEC’s Proxy Voting Rule<sup>2</sup> and the availability of exemptions for proxy advisory firms from the SEC’s proxy solicitation requirements.

The SEC Staff Guidance structures its substantive advice as responses to specific questions. The three constituency groups affected by the SEC Staff 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 amongst 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 conflicts:** 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

<sup>1</sup> The SEC Staff Guidance can be found at <https://www.sec.gov/interps/legal/cfslb20.htm>

<sup>2</sup> Investment Advisers Act Rule 206-4(6), 17 C.F.R. §275.206(4)-6 (2014).

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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;

**Portfolio manager discretion:** Clarity is provided as to the scope of portfolio managers' obligations to exercise a vote on proxy issues, and it emphasizes 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; and

**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 SEC Staff Guidance, while public companies should make themselves aware of the direction provided to other stakeholders and consider it when developing policies and practices.