

House Hearing Focuses on Role of Proxy Advisory Firms

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The controversy surrounding proxy advisory firms has reached Congress, as the House Capital Markets and Government Sponsored Enterprises Subcommittee held a hearing yesterday to examine the role proxy advisory firms play in corporate governance. In its [press release](#), the House Subcommittee indicated that the two largest firms control 97% of the market. Subcommittee Chairman Scott Garrett (R-NJ) expressed concern that proxy advisory firms were aligned with "special interest agendas" and have "increasingly teamed up with unions, pension funds, and other activist shareholders to push a variety of social, political, and environmental proposals that are generally immaterial to investors and often reduce shareholder value." In an [interview](#), he questioned whether ISS has empirical data to justify its promotion of annual say-on-pay votes, because "Congress wanted to create some flexibility in this issue and raised the point that all companies are not created the same, but apparently they think they know better than Congress does here."

ISS and Glass Lewis were not on the witness list. According to news reports, it appears they were not invited to participate. Instead, those giving testimony included representatives from the Chamber of Commerce, the Center on Executive Compensation, the Shareholder Communications Coalition, the Florida State Board of Administration, the National Investor Relations Institute, the Society of Corporate Secretaries & Governance Professionals, the Council of Institutional Investors and the Public Employees' Retirement Association of Colorado.

Witnesses debated the influence of the firms on proxy voting. [NIRI](#) claimed that the firms' recommendations can lead to a 15 to 30 percentage point differential and that small and medium-sized investors without separate governance staffs tend to follow the firms' advice in particular. Darla Stuckey from the [Society](#) stated that some investment managers openly admit to companies that they follow proxy advisory firm recommendations without questioning them, and for that reason see no point in engaging with companies on issues. Lynn Turner, a former chief accountant at the SEC and also a former head of research at Glass Lewis, agreed that not all investors are able to examine every proxy, but argued that most are using advisory firm recommendations as one factor in their decisions. [CII](#) believed that their importance has greatly declined in recent years, as investors have developed their own expertise in light of increased interest in proxy voting.

Almost everyone agreed, however, that the firms need to be more transparent in providing rationales for their policy decisions as well as methodologies for voting recommendations. Many also expressed concerns about errors in the reports, and potential conflicts of interests involving companies, proponents of shareholder proposals and activists who instigate "vote no" campaigns, who may be clients of the advisory firms while those firms are providing recommendations about matters in which those clients have an interest. Criticisms were also lobbed at the SEC for failing to provide any oversight of the advisory firms, while the regulatory agency itself has acknowledged the firms' significant influence on the proxy voting system. Witnesses disagreed as to the level of SEC involvement, and whether regulatory intervention is necessary at all.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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