

Continued Debate on the Role of Proxy Advisory Firms

July 2, 2012 | Client Update | 3-minute read

Although proxy season has largely ended for most companies, the debate over the influence of proxy advisory firms, and whether containment is needed, continues. A recent [study](#) by Tapestry Network commissioned by the Investor Responsibility Research Center (IRRC) Institute examined the role of advisory firms at 19 large mutual funds that account for more than half of the assets under management in the U.S. According to this study, academic research shows that any direct correlation between proxy advisory firms' recommendations and voting outcomes is difficult to prove conclusively, although one paper suggests 20-50% of votes follow ISS, and other studies have found that the influence on mutual fund voting is particularly stark. However, it is clear even without being able to show a causal relationship that the advisory firms assert a significant influence, as represented by the key findings below:

- Proxy advisory firms play an instrumental role in acting as data collectors and aggregators for asset managers, especially smaller asset managers. Many investors cite the benefit of having firms that can succinctly summarize the overwhelming amount of data provided during proxy season. For example, in 2009 (before say-on-pay was mandatory) there were more than 20,000 proposals at Russell 3000 companies, and large investment funds cast over 3.9 million individual votes on those proposals. Given that most funds had 3-5 full-time employees making these decisions, it isn't surprising that proxy advisory firms' reports often serve as a starting point for funds' analysis, before they've ever picked up company proxy statements.
- Proxy advisory firms influence the voting policies of asset managers, either with the firms' policies being adopted wholesale, used to identify trends or as a source of input for voting decisions. When advisory firms flag issues or change positions, this can serve as the basis for the funds to examine their own guidelines for possible changes.
- Asset managers find that proxy advisory firms are particularly useful for say-on-pay and international votes. Among those that do not blindly follow proxy advisory firms' recommendations on say-on-pay, the firms' recommendations may be used to flag a company for further review or their methodologies may be a starting point for a fund's own customized system.
- Proxy advisory firms affect the actions of public companies and directors in advance of the proxy season, perhaps most starkly in the area of executive compensation. At a minimum, companies' awareness of the firms' policies are considered when drafting disclosure, but those policies may also cause actual changes to pay practices.

Owing to this influence, not only is the SEC continuing to examine the role of proxy advisory firms as outlined in the "proxy plumbing" concept release, but Canadian securities regulators have issued a consultation paper seeking comments on issues in Canada which sound eerily familiar: (a) whether providing consulting services to companies and voting guidelines to investors present potential conflicts of interest; (b) perceived lack of transparency in the formulation of voting policies; (c) potential inaccuracies and limited opportunities for issuer engagement; (d) potential corporate governance implications if these firms are essentially the standard-bearers for what constitutes "good" governance; and (e) the extent of reliance by institutional investors on recommendations.

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.

Ning Chiu

+1 212 450 4908

ning.chiu@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's privacy notice for further details.