

# Will Congress Act to Rein in Proxy Advisory Firms?

June 23, 2014 | Client Update | 3-minute read

Congressman Patrick McHenry (R-NC) indicated that Congress will step in if the SEC fails to act to curb investors' reliance on proxy advisory firms, in his keynote speech at a panel discussion hosted by the American Enterprise Institute. He stated that the issue of proxy advisory firms is of significant interest to himself and his colleagues, Representative Jeb Hensarling (R-Texas), House Financial Services Chairman, and Representative Scott Garrett (R-NJ), Chairman of the Subcommittee on Capital Markets and Government Sponsored Enterprises.

According to news reports, both Congressman McHenry and former SEC Commissioner Harvey Pitt, who organized the discussion, blamed two SEC no-action letters that we previously [explained](#) for allowing investment advisers to depend on proxy advisory firms in making their voting decisions. The letters were issued in response to rules that require investment advisers and portfolio managers to develop voting policies. Pitt believes the staff went beyond merely providing guidance by appearing, in those letters, to permit advisers to delegate voting to others in response to stated concerns about the advisers' own conflicts of interest.

Congressman McHenry also emphasized that investors should not be obligated to vote on every proposal. Some are concerned that the burden to cast so many votes on complex issues leads to over-reliance on proxy advisory firms and in fact, investors, particularly smaller ones who lack their own expert resources, may presume that voting in accordance with advisory firms' recommendations will insulate them from criticism, or worse, liability.

Former SEC Commissioner Paul Atkins reportedly suggested that the SEC may be releasing guidance on the role of proxy advisors shortly, and also that he would like to see a lawsuit against a firm for using incorrect information.

For a different perspective, Jill Fisch, a University of Pennsylvania law professor, is one panelist who has traditionally been less critical of the role of proxy advisers, arguing that alternatives to those firms will likely be less efficient and more costly, and may actually result in more negative votes for companies if investors undertook independent examinations of matters that ISS currently favor, which constitute the bulk of the recommendations. Since ISS provides less explanation for their positive endorsements, it is assumed that investors tend not to review or question them as much.

In her [research](#) collaboration with other law professors on director elections published in 2011, they concluded that the "power of ISS has been greatly overstated," and that an ISS recommendation shifts 6 to 10% of the votes for director elections rather than 20 to 30% as estimated by others. The study examined two of the largest mutual funds, Putnam and Vanguard, and found that both voted against directors at a much greater rate than ISS recommended, with Putnam voting against 671 directors though ISS recommended against only 115 (17%) of the candidates in that sample, and Vanguard voting against 1,435 directors though ISS recommended against only 345 (24%) of the directors in that group. One reason is that certain ISS policies regarding the election of directors, the study contended, tend to correspond with the views held by most investors.

Interestingly, the study identified four somewhat unexpected factors where if ISS recommended against the director and at least one of the factors was present, then the director had an almost 50% likelihood of facing 30% or more withhold votes, including whether: (a) the director missed more than 25% of meetings; (b) Fidelity cast a negative vote; (c) the board failed to implement a majority-supported shareholder proposal; and (d) the director had business ties to the company and received a negative vote from Vanguard. By comparison, a director who faces a negative ISS recommendation but without the presence of one of these four factors had only an 18% likelihood of receiving 30% or more withhold votes.

See SIFMA's [summary](#) of the panel discussion.

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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