

ISS Responds to Proposed Legislation Governing Proxy Advisers

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In a [strongly worded statement](#), Gary Retelny, President and CEO of ISS, testified before the House Committee on Financial Services about the Proxy Advisory Firm Reform Act. We previously covered the Act's requirements [here](#).

ISS believes that advisers themselves have become a proxy for the debate over the role of shareholders in the companies that they own, and that the proposed legislation heads in the wrong direction by turning away from an "investor-centric" federal regulatory regime to a "bureaucratic maze" that would ultimately allow corporations and their representatives to "pressure proxy advisers to back management positions." According to ISS, proxy advisers have become an "outsized target in obsessive efforts by a small number of corporate managers and their representatives to discourage institutional investors from using their voice in the corporate governance debate." Those individuals are trying to make it harder for investors to cast informed voting decisions by making it more expensive, cumbersome and time-consuming, so that if "information is equivalent to oxygen for proxy votes," then "entrenched managers seek to cut off its supply."

The firm annually covers more than 39,000 shareholder meetings in over 110 developed and emerging markets worldwide, and also implements custom voting policies for investors. Year-to-date, 68% of the ballots processed by ISS on behalf of clients globally were voted under clients' custom policies, representing 82% of the total shares processed by ISS during this period. As a result, Retelny disputes the view that shareholders are overly reliant on proxy advisers, and claims instead that a "lobbyist-promulgated myth" has led to the belief that investors who use them are "puppets who mindlessly do as they are told." ISS argues that investors use proxy advisory research to supplement their own research teams, as a screening tool to identify non-routine matters and as an information agent.

As a registered investment adviser governed under the Advisers Act, ISS already follows many of the requirements in the House bill, including disclosure to clients, an insider trading program and code of ethics, established compliance programs and record-keeping. The firm is also subject to SEC examinations. Since ISS believes that many of the bill's provisions are redundant with its existing practices, its primary concerns relate to the mandate to give issuers access to draft recommendations and comment periods during which they can provide details to the proxy advisers.

ISS argues that this is operationally impossible to achieve given the number of companies they analyze and would cause the firm to severely limit its coverage. A company could also simply prevent ISS from issuing recommendations by refusing to resolve its complaints. But the firm is most concerned that the ability for companies to seek damages under the bill would expose proxy advisers to unlimited legal liability under the threat of constant litigation from unhappy issuers, which in essence provides companies with an "effective veto-power" over any recommendations that they disagree with.

The Appendix attached to the statement provides a wealth of background information on the emergence of proxy advisers, the impact from the increased focus on the importance of investor voting and the resulting SEC guidance on how those votes may be cast independently by using third parties to assist. ISS discusses its process in issuing a research report, which may include communications with issuers and investors. In many cases, ISS has a contractual obligation to deliver proxy reports and vote recommendations to clients ten days to two weeks in advance of the meeting. While draft reports are only available to the S&P 500 companies in the United States, all issuers may obtain a free copy of the published report upon request.

ISS also addresses the criticisms surrounding the fact that ISS Corporate Solutions (ICS) provides services to issuers, and explains the firewall between its core business and ICS that includes physical separation and a list of other efforts to mitigate potential conflicts. Interestingly, besides the generic disclosure in research reports that a subject company may

be a client of ICS, any institutional investor can obtain more information about the relationship between ICS and the issuer that is the subject of a particular report. ISS clients are also provided with details about the amount that each ICS client has paid ICS and the particular products/services they purchased. Some clients receive lists of all ICS clients on a monthly, quarterly or annual basis.

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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