Compensation
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SEC Withdraws Proxy Advisory Letters

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In anticipation of the SEC's upcoming "Roundtable on the Proxy Process," the SEC has withdrawn letters issued in 2004 to Egan-Jones Proxy Services and Institutional Shareholder Services, Inc. (ISS) that many argue were responsible for entrenching the influence of shareholder advisory firms. The SEC's roundtable is expected to be held in November 2018, and more recommendations to the Commission regarding proxy advisory firms from investment advisors and corporate issuers may result.

On Thursday, September 13th, the SEC's Division of Investment Management released this statement: "(it) has been considering (among other topics) whether prior staff guidance about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms should be modified, rescinded or supplemented." The statement went on to assert that "staff guidance is nonbinding and does not create enforceable legal rights or obligations." Under this rationale and with the upcoming roundtable in mind, the letters were withdrawn to encourage and facilitate debate on the most appropriate role for the proxy advisory firms.

How did we get here?

In 2003, the SEC issued rules which required mutual funds and investment advisors to design and implement policies and procedures intended to ensure that proxies are voted in the best interests of their clients, i.e. to avoid a conflict of interest influencing decisions made on their behalf. In 2004, Commission staff issued the now withdrawn letters which allowed the outsourcing of fiduciary obligation of investment advisors to independent proxy advisory firms. This allowed advisors to rely on proxy advisory firm recommendations to fulfill their fiduciary responsibility to clients. Since then, we have witnessed the significant increase in power and influence of companies like ISS and Glass Lewis, the leading proxy advisory firms. For example, today an ISS "Against" recommendation on a Say on Pay proposal will typically reduce shareholder support by about 30%.

Proxy advisory firms play an important role in developing acceptable governance practices for companies and boards. Yet they are often criticized for applying a rigid, "one size fits all" model to companies across all industries that often disregard market conditions. While there are instances where recommendations against compensation programs and the directors responsible for them are warranted, this cookie cutter approach has led to some unfair recommendations. Companies are then left scrambling to respond, trying to draw attention to faulty analysis and salvage the shareholder vote. The frustrations produced in these instances are amplified further by the apparent conflict of interest that arises when the proxy advisory firm responsible for the "against" vote recommendation charges fees for consulting services intended to avoid similar outcomes in the future.

Impact of the Withdrawal?

While the withdrawal of these letters does little other than provide a clean slate for an open discussion in the fall, it feels like a solid punch landed for those in the corporate community lobbying for greater oversight of the proxy advisory firms. House Financial Services Committee Chairman Jeb Hensarling, R-Texas, welcomed the move this week saying, "The proxy advisory firm duopoly is in serious need of reform and SEC attention. The market power of proxy advisory firms demands greater accountability for these firms' actions and the information that they provide institutional investors."

In response, both ISS and Glass Lewis issued public statements that they have never relied upon these no-action letters and the withdrawal has no impact on the services they are providing or how investors use their advice.

We anxiously await the discussion at the SEC's roundtable in November. Perhaps the withdrawal of these letters will lead to a renewed and meaningful discussion on an appropriate level of oversight, transparency, and accountability of proxy advisory firms that ultimately strengthens corporate governance.