

[Securities Regulation Daily Wrap Up, PROXIES—Roundtable panelists weigh in on the role of proxy advisory firms, \(Nov. 26, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [Amanda Maine, J.D.](#)

At the SEC's recent roundtable on the U.S. proxy system, representatives of the two major proxy advisory firms, Glass Lewis and Institutional Shareholder Services (ISS), defended the work of their firms. Glass Lewis CEO Katherine "KT" Rabin said that the primary job of a proxy advisory firm is to execute votes in accordance with the specific instructions of its clients, including a policy that is different from that of the advisory firm. ISS president and CEO Gary Retelny advised that investors have their own individual, custom policies that they have designed and want to implement with regards to the many thousands of securities they own in their portfolios. ISS helps them execute those votes, he explained. Retelny added that 87 percent of the shares ISS executes vote on their own custom policies.

Retelny also took issue with calling this process "robo-voting," since it seems to be used as a pejorative term. Instead of seeing it as "robo-voting," ISS prefers to think of it as artificial intelligence, he said.

Investment advisers and proxy advisory firms. Representatives from investment advisers were asked how they use proxy advisory firms. Scot Draeger of R.M. Davis Private Wealth Management said that his firm used to use their own analysts who did research on proxies and voting, but it grew to be a huge responsibility. These analysts were spending so much time on proxies that they lacked the time to look at the portfolio investments themselves, he advised. So, his firm turned to ISS to advise them on how to make decisions from an enormous amount of information, as well as use its services related to the mechanics of voting. Draeger added that while his firm uses ISS research, it also puts a great deal of work into reviewing that research. He also said that individual clients sometimes want the firm to customize their votes in a way that may be inconsistent with the firm's overall approach, and the ability to automate those votes for clients has been a huge time saver.

Rakhi Kumar of State Street Global Advisors said her firm uses proxy advisory firms in three ways. First, they help execute the firm's voting guidelines. Second, they provide research insights. Finally, her firm benefits from the operational ease the proxy advisory firms provide on their platform, which addresses many of the problems raised in during the roundtable's [first panel](#) on proxy voting mechanics and technology.

Competition and conflicts. Sean Egan, the president and founding partner of Egan-Jones Proxy Services, lamented that there are massive barriers for new firms trying to enter the proxy advisory business. Once a firm is on a voting platform, it is very resistant to change it, he said. His firm in the past eight years has "been stiff-armed" from getting onto these platforms. According to Egan, this is a restraint on trade. If you're not a top firm, it's difficult to be relevant over time, he said, even if you have the best information.

He also warned about the dangers of conflicts of interest arising when a proxy advisory firm is also in the consulting business. If the firm is getting paid to give corporations early indications on voting and then turns around and says how to vote, most people would find that problematic, Egan said. In response, Retelny said that ISS's corporate consulting arm does acknowledge that there are potential conflicts of interest, but added that ISS works extremely hard to mitigate those conflicts. The consulting side makes clear to issuers that there is no quid pro quo, he added.

Issuer access to reports. Adam Kokas, executive vice president of Atlas Air Worldwide, explained that once a proxy advisory firm issues its report, it is an uphill battle to correct any mistakes in it. He said that Atlas Air has found material errors in a proxy advisory firm report that directly impacted the recommendation. Atlas Air does not receive a proxy advisory report prior to it being published, he said, suggesting that all public companies

should be allowed to see it to correct errors. Retelny acknowledged that it is unacceptable that an error would go uncorrected, but observed that many ISS clients do not want them to share the reports because the client is the one that is paying for it. There would also be logistical issues in distributing reports ahead of time, he pointed out, noting that institutional investors vote thousands of securities during proxy season and getting information to clients in time could be difficult if proxy advisory firms have to wait for issuer comments.

Need for more regulation? The panelists were asked about calls for increased regulation of proxy advisory firms, including the registration of proxy advisory firms with the SEC, which would be required of the largest proxy advisory firms under a bill recently [introduced](#) by Sen. Jack Reed (D-RI). Retelny noted that ISS is already a registered investment adviser and feels like added regulation is unnecessary and would add costs and stress the logistics of the workflow. If there is additional regulation, it should be under the Investment Advisers Act, he added.

Rabin observed that Glass Lewis is not a registered investment adviser, but noted that proxy advisory firms created a best practices group that developed a code of conduct for firms. Proxy advisory firms do not present a risk to markets and we don't see the need for regulation, Rabin emphasized.

Egan noted that his firm is an NRSRO and as such is already heavily regulated, "so more regulation doesn't scare us." He said his main concerns are that of market access and market choices. Giving investors a choice is critical, and the SEC can either force a level playing field or encourage it. Either way, investors need more choices or they will get hurt, he added.

Somewhat surprisingly, the panelists did not seem to favor additional regulation of proxy advisory firms at this time. Former Sen. Phil Gramm (R-Texas), visiting scholar at the American Enterprise Institute, recommended that instead of requiring more registration, the situation could be improved by getting rid of safe harbors; that is, a fiduciary responsibility cannot be safe harbored if a firm is voting others' shares. Senator Gramm sees a conflict of interest where an index fund is exempted from fiduciary responsibility if it follows the advice of the proxy adviser, which may be making recommendations on social and environmental issues, and not those which, according to Gramm, directly relate to the profitability of the company.

The representatives from investment advisers expressed concern that more regulation of proxy advisors would lead to increased costs for the proxy advisory firms. These costs would then be passed on to the investment advisers that use the proxy advisory services, they warned.

However, comment letters submitted by organizations that had participated on the other panels during the roundtable expressed their support for more regulation, including the registration of proxy advisory firms. The Chamber of Commerce's Council on Capital Markets Competitiveness [noted](#) that in the past it has supported legislation that would require proxy advisory firms to register with the SEC and become subject to an oversight regime that would obligate them to disclose and manage any conflicts of interest and demonstrate that they are able to consistently provide proxy advice based on accurate information.

The Society for Corporate Governance's [letter](#) outlined several recommendations that would require more disclosures and transparency from proxy firms, including providing each public company with a copy of its draft reports in advance of dissemination to proxy advisory firm clients. Business Roundtable also [supports](#) rules requiring greater transparency and, in addition, urged the Commission to consider requiring proxy advisory firms to register under the Investment Advisers Act under a new regulatory framework that defines an "independent" third party advisor to more appropriately reflect the role proxy advisory firms perform in the proxy voting process.

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