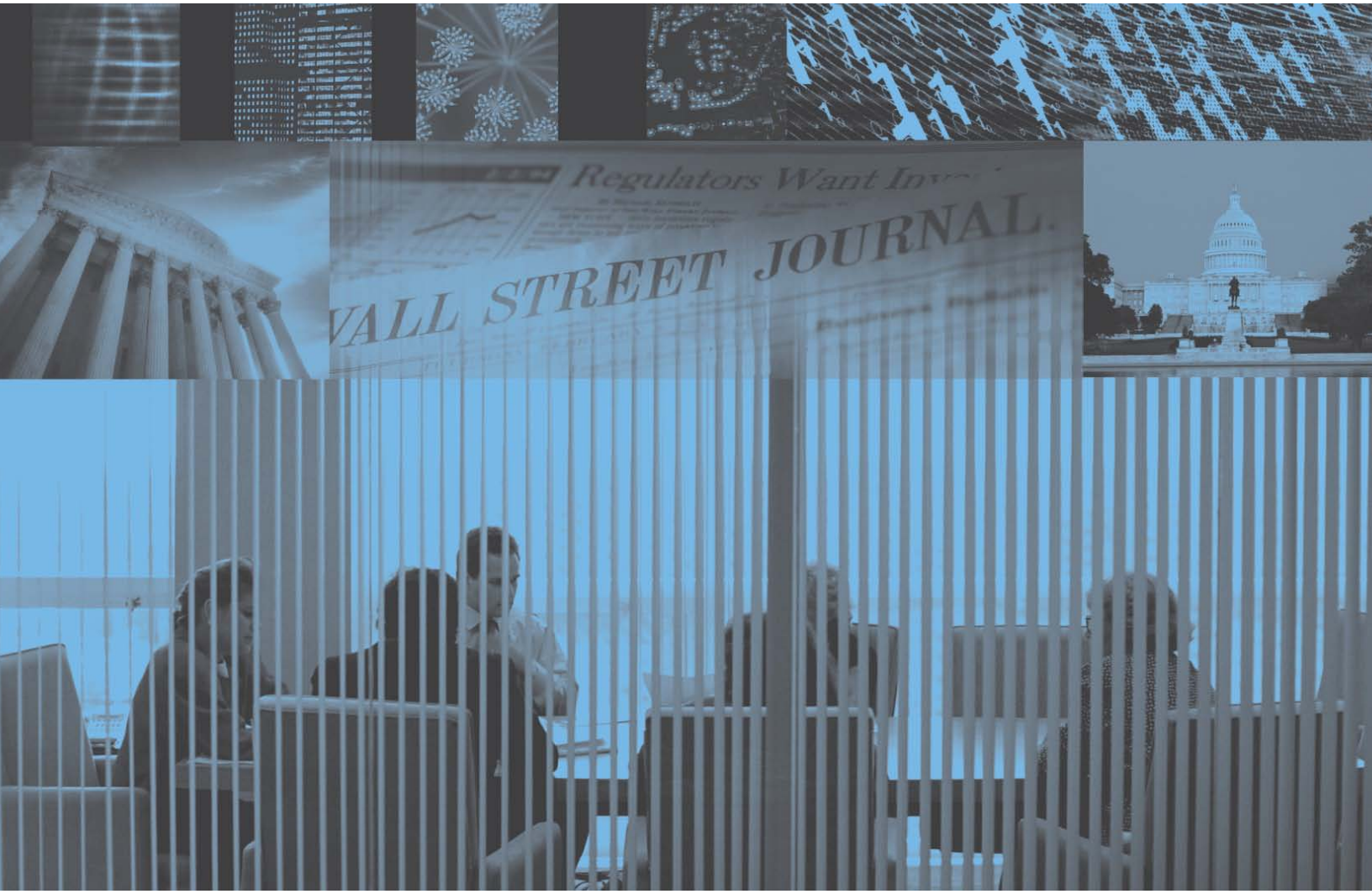
SPECIAL REPORT

Proxy Advisory Firms: The Debate Over Changing the Regulatory Framework

An Analysis of Comments Submitted to the SEC in Response to the Concept Release on the U.S. Proxy System

March 1, 2011



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S P E C I A L R E P O R T

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INTRODUCTION

Securities and Exchange Commission (SEC or "Commission") Chairman Mary Schapiro stated in November 2009 that one of the objectives of the Commission's review of proxy mechanics is to examine the role of proxy advisory firms in corporate voting: "Given the influence that these firms' recommendations have on corporate voting outcomes, we'll probe the need for rules to ensure that advisory firms are basing their research and recommendations on accurate and reliable information. And, that they are providing adequate disclosure of any conflicts of interest they may have in providing voting recommendations."[1] Letters to the SEC submitted in connection with the SEC's "Concept Release on the U.S. Proxy System" have provided not only new data and case studies on the role and influence of proxy advisory firms, but also increased pressure on the Commission to ensure that the accuracy of reports distributed by proxy advisory firms, as well as potential conflicts of interest at these firms, are carefully monitored and regulated.

- **SEC's Concept Release on the U.S. Proxy System**
  http://www.sec.gov/rules/concept/2010/34-62495.pdf
  http://www.sec.gov/rules/concept/2010/34-62495fr.pdf
- **Comment Letters on the Concept Release (File S7-14-10)**
  http://www.sec.gov/comments/s7-14-10/s71410.shtml

The Concept Release on the U.S. Proxy System presents the Commission's review of the role of proxy advisory firms as an examination of "whether our regulations play a role in the misalignment of voting power from economic interest." As the release noted, a major impetus for the review is that: "some have argued that proxy advisory firms are controlling or significantly influencing shareholder voting without appropriate oversight, and without having an actual economic stake in the issuer."[2] Curiously, despite the far-reaching foundation for the Commission's review, the issues and potential solutions discussed in the concept release focus almost exclusively on examining potential regulatory responses concerning the accuracy, transparency, and possible conflicts of interest of proxy advisory firms. There was little discussion in the release of potential regulatory responses affecting the institutional investors using services provided by proxy advisory firms.

The concept release did take note of the finding of a June 2007 GAO Report ("Corporate Shareholder Meetings—Issues Relating to Firms That Advise Institutional Investors on Proxy Voting"),[3] which found that the growing role and influence of proxy advisory firms has been due, in no small part, to the Commission's recognition of fiduciary obligations associated with

[1] SEC Chairman Mary Schapiro, "Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation," Nov. 4, 2009. http://www.sec.gov/news/speech/2009/spch110409mls.htm
[2] http://www.sec.gov/rules/concept/2010/34-62495fr.pdf
[3] http://www.gao.gov/new.items/d07765.pdf

voting proxies by registered investment advisers and the adoption of Advisers Act Rule 206(4)–6, which requires registered investment advisers to "adopt and implement written policies and procedures that are reasonably designed to ensure that you vote client securities in the best interest of clients."[4] However, the dearth of commentary in the concept release concerning potential changes to the regulatory environment for institutional investors using proxy advisory services, e.g., from changing the definition of "fiduciary" to potentially adopting mandates that would drive institutional investors to develop more internal staffing and resources (to ensure that no factual or procedural errors impact any of their proxy voting decisions or the execution of proxy votes), may reflect a bias on the part of the Commission against reconsidering or "turning back the clock" on some of its prior actions concerning the fiduciary obligations of registered investment advisers to vote proxies. Another possible reason is that the concept release reflects the interests of a Commission that is still moving up the learning curve in terms of understanding the influence and issues associated with the current role of proxy advisory firms in the proxy voting process. For example, the concept release asks such basic questions as: "How do institutional investors use the voting recommendations provided by proxy advisory firms? What empirical data exists regarding how, and to what extent, institutional investors vote consistently, or inconsistently, with such recommendations? Do proxy advisory firms control or significantly influence shareholder voting without appropriate oversight? If so, is there empirical evidence that demonstrates this control or significant influence?"

The Commission's "two principal areas of concern" concerning proxy advisory firms are as follows (quoting from relevant sections of the concept release):

1. Potential Conflicts of Interest

    a. When proxy advisory firms "provide both proxy voting recommendations to investment advisers and other institutional investors and consulting services to corporations seeking assistance with proposals to be presented to shareholders or with improving their corporate governance ratings." The proxy advisory firm risks a conflict of interest if the issuer purchases "consulting services from the proxy advisory firm in an effort to garner the firm's support for the issuer when the voting recommendations are made" or if a shareholder engages the proxy advisory firm for "advice on voting recommendations in an effort to garner the firm's support for its shareholder proposals." Moreover, the proxy advisory firm "might recommend a vote in favor of a client's shareholder proposal in order to keep the client's business."

    b. "A conflict also arises when a proxy advisory firm provides corporate governance ratings on issuers to institutional clients, while also offering

[4] http://www.sec.gov/rules/final/ia-2106.htm

consulting services to corporate clients so that those issuers can improve their corporate governance ranking."

2. Lack of Accuracy and Transparency in Formulating Voting Recommendations

   a. The Commission is reviewing whether to have a process to correct any flawed data or analysis on the part of a proxy advisory firm, but noted that such firms "may be unwilling, as a matter of policy, to accept any attempted communication from the issuer." However, the release later notes that "some proxy advisory firms have claimed that they are willing to discuss matters with issuers, but that some issuers are unwilling to enter into such discussions." The release went on to note that "some issuers have expressed a desire to be involved in reviewing a draft of the proxy advisory firm's report, if only for the limited purpose of ensuring that the voting recommendations are based on accurate issuer data." The release noted that Rule 14a–2(b)(3)'s exemption of proxy advisory firms "does not mandate that a firm relying on the exemption have specific procedures in place to ensure that its research or analysis is materially accurate or complete prior to recommending a vote." Moreover, "voting advice by firms relying on the Rule 14a–2(b)(3) exemption remains subject to the antifraud provisions of the proxy rules contained in Rule 14a–9." The Commission also noted that as "a fiduciary, the proxy advisory firm has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information."

   b. The concept release also discussed potential issues associated with claims that some proxy advisory firms use a "one-size-fits-all governance approach."

The concept release sought comments on a number of potential regulatory changes, in particular changes to existing proxy solicitation rules and Advisers Act registration provisions. The release noted that: "Revising or providing interpretive guidance on the proxy rule exemption in Exchange Act Rule 14a–2(b)(3) could be one potential solution to the concerns regarding a proxy advisory firm's disclosures about conflicts of interest." As the release explained, "the furnishing of proxy voting advice constitutes a 'solicitation' subject to the information and filing requirements in the proxy rules." However, Rule 14a–2(b)(3) exempts proxy advisory firms from the informational and filing requirements of the federal proxy rules, provided certain conditions are met -- the adviser must: render financial advice in the ordinary course of its business; disclose to the person "any significant relationship" it has with the issuer or any of its affiliates, or with a shareholder proponent of the matter on which advice is given, in addition to any material interest of the advisor in the matter to which the advice relates; "not receive any

special commission or remuneration for furnishing the proxy voting advice from anyone other than the recipients of the advice"; and "not furnish proxy voting advice on behalf of any person soliciting proxies."

The debate over the future of proxy advisory firms has focused primarily on potential conflicts of interest, the accuracy of reports, and disclosure requirements. A key issue before the Commission is whether the boilerplate language used by ISS concerning potential conflicts of interest would no longer be sufficient. Proxy advisory firms could be required to disclose specific relationships, including whether they are offering certain "consulting" services to a specific issuer or shareholder proponent. The release went on to explain that the Commission is also considering whether: "proxy advisory firms could provide increased disclosure regarding the extent of research involved with a particular recommendation and the extent and/or effectiveness of its controls and procedures in ensuring the accuracy of issuer data. Proxy advisory firms could also disclose policies and procedures for interacting with issuers, informing issuers of recommendations, and handling appeals of recommendations. We could also consider requiring proxy advisory firms to file their voting recommendations with us as soliciting material, at least on a delayed basis, to facilitate independent evaluation by market participants of the quality of those recommendations."

The Commission has the authority [Section 206(4)] to adopt rules designed to prevent fraudulent, deceptive, or manipulative acts and business practices. The concept release noted that the exemption of proxy advisory firms under Rule 14a–2(b)(3) "does not mandate that a firm relying on the exemption have specific procedures in place to ensure that its research or analysis is materially accurate or complete prior to recommending a vote." While the release noted that a proxy advisory firm acting in a "fiduciary" role has a "duty of care requiring" it to "make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information," the question is thus raised as to whether the Commission might consider mandating "specific procedures" to ensure that research and analysis used by a proxy advisory firm is materially accurate or complete. Defining standards for what constitutes "accurate and complete" information before making a voting recommendation could open the door to having the Commission defining what subject matter a proxy advisor must consider, at minimum, before making a voting recommendation.

The Commission is also looking at revising provisions of the Advisers Act to potentially expand the definition of "investment adviser," and thus require all proxy advisory firms to register and provide additional disclosures through Form-ADVs. The release asked for comments on "whether proxy advisory firms operate the kind of national business or have an impact on the securities markets that Advisers Act Section 203A(c) was designed to address, and whether, as a result, we should establish an additional exemption from the prohibition on federal registration for proxy advisory firms to register with the Commission as investment advisers." Currently, only certain proxy advisory firms are eligible to register because they qualify for one of the exemptions from the registration prohibition under Rule 203A–2. The release noted that "some proxy advisory firms may be able to rely on the exemption for 'pension consultants' if they have pension plan clients with an aggregate minimum value of $50 million." The release

went on to comment that the Commission: "could also provide additional guidance, if necessary, on the fiduciary duty of proxy advisors who are investment advisers to deal fairly with clients and prospective clients, and to disclose fully any material conflict of interest. We also could provide guidance or propose a rule requiring specific disclosure by proxy advisory firms that are registered as investment advisers regarding their conflicts of interest, including, for example, on Form ADV. Finally…we could consider whether additional regulations similar to those addressing conflicts of interest on the part of Nationally Recognized Statistical Rating Organizations ('NRSROs') would be useful responses to stated concerns about conflicts of interest on the part of proxy advisory firms. For example, such regulations could prohibit certain conflicts of interest and require proxy advisory firms to file periodic disclosures, akin to Form NRSRO, describing any conflicts of interest and procedures to manage them."

BACKGROUND

The Commission's current examination of proposed reforms of the proxy advisory industry comes after decades of complaints from many corporate issuers. So why is the SEC acting now? While some might be inclined to see the current review as a direct result of the influence of Chairman Schapiro, we would argue that the growing power and influence of proxy advisory firms had already reached a point at which closer scrutiny by the SEC was arguably inevitable. The proxy advisory industry scaled up in the late 1980s and 1990s around a business model based on delivering research and voting recommendations to clients, as well as delivering "consulting" services to issuers. Today, ISS has also built a significant business around serving as a "voting agent" for institutions (which facilitates record-keeping and reporting by institutions using the service).

The Commission is confronting, in part, issues created by the regulatory framework for institutional investors. As the SEC's Concept Release noted, the increasing "use of proxy advisory firms" by institutional investors has been driven "in many cases" because "institutional investors have fiduciary obligations to vote the shares they hold on behalf of their beneficiaries."[5] The growth of the proxy advisory industry has resulted largely from the Commission's recognition of fiduciary obligations associated with voting proxies by registered investment advisers and the adoption of Advisers Act Rule 206(4)-6, which requires registered investment advisers to adopt and implement written policies and procedures that are "reasonably designed to ensure that the adviser votes proxies in the best interest of its clients," as well as describe its proxy voting procedures to its clients (and provide copies on request) and disclose to clients how they may obtain information on how the adviser voted their proxies.[6] Professor Jill E. Fisch (University of Pennsylvania Law School), the co-author of a widely cited study on the

[5] SEC, Concept Release on the U.S. Proxy System, Page 105. http://www.sec.gov/rules/concept/2010/34-62495.pdf
[6] http://www.sec.gov/rules/final/ia-2106.htm

influence of proxy advisory firms on institutional votes,[7] noted in a letter submitted to the Commission: "(A)n ISS recommendation shifts 6-10% of shareholder votes…a major component of this influence may stem from its role as information agent – aggregating information that investors consider important in making their voting decisions…federal regulation has fostered the growth of these firms by creating a need for institutional investors to document the rationality of their voting procedures. Although our study suggests that not all institutions blindly follow the ISS recommendations, they nonetheless rely heavily on proxy advisors in making their voting decisions."[8]

State of the Proxy Advisory Industry in the U.S.

The dominant provider in the U.S. proxy advisory industry is ISS, which is a business unit of MSCI Inc. and currently describes itself (in its letter to the Commission dated Oct. 20, 2010) as follows: "More than 1,300 clients rely on ISS' expertise to help them make more informed proxy voting decisions, manage the complex process of voting their shares, and report their voting behavior to their stakeholders and regulators…ISS offers a wide range of proxy voting policy options to institutional investors, including vote recommendations based on a client's specific customized voting guidelines. In addition ISS provides enhanced analysis of contentious meetings (M&A and proxy contest) as well as governance data and analytics through its Governance Risk Indicators (GRId) product. ISS' ProxyExchange application and experienced account managers provide end-to-end management of the proxy voting process for our institutional investor clients. Our proxy voting solutions allow ISS' clients to control their voting policy and final vote decisions while outsourcing the processing and data management elements to an experienced service provider…ISS' Vote Disclosure Service was created in 2004 to help investment companies comply with their then-new Form N-PX filing obligations."[9] ISS has disclosed that it issued vote recommendations in 2009 for more than 37,000 shareholder meetings in 108 countries (including 10,000 U.S. companies). To handle that work load ISS indicates that it has a team of more than 600 research, technology and client service professionals.

The second largest provider, Glass, Lewis & Co. ("GL"), was founded in 2003 and is today a wholly-owned subsidiary of the Ontario Teachers' Pension Plan Board. GL has (as the firm notes on its website) "several hundred institutional clients on three continents."[10] Collectively, ISS and GL indicate that they have staffing of "more than" 700 professionals managing the research, reporting, technology, and voting agency services of more than 2,000

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[7] Stephen Choi, Jill Fisch, and Marcel Kahan. *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010) (*The Power of Proxy Advisors*) Available through http://www.sec.gov/comments/s7-14-10/s71410-35.pdf

[8] Her letter included two previously published studies of which Prof. Fisch was a co-author, along with Professors Stephen Choi and Marcel Kahan of NYU Law School. They were published as: *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649 (2009) and *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010). http://www.sec.gov/comments/s7-14-10/s71410-35.pdf

[9] http://www.sec.gov/comments/s7-14-10/s71410-154.pdf. See also http://www.issgovernance.com/about

[10] http://www.glasslewis.com/company/index.php

clients (impacting tens of thousands of companies worldwide). Other leading U.S.-based competitors in the proxy advisory industry include Marco Consulting Group (the "largest consultant to jointly trusteed benefit plans in the United States"[11] serving as "proxy voting agent to more than 300 institutional investors-primarily jointly-trusteed ERISA benefit plans (and)…also a growing number of public employee benefit plans"),[12] Egan-Jones Proxy Services,[13] and, until terminating operations in January 2011, PROXY Governance, Inc. (PGI).[14] ISS[15] and Marco Consulting Group ("MCG") are also registered investment advisers.[16] Governance Metrics International (GMI)[17] has described itself in a letter to the Commission as follows: "GMI is not a proxy advisory firm and we do not make voting recommendations in our reports. However, we do undertake research for our clients on many of the same issues that are examined by proxy advisory firms in making their recommendations."[18]

Controversies

Comments to the Commission showed that the single most controversial aspect of the role of proxy advisory firms has little to do with how they carry out their responsibilities for investors, and everything to do with business decisions made by ISS when it was a much smaller operation -- the sale of "consulting" services to the same corporate issuers that the firm rates and impacts by influencing shareholder votes. Letters to the SEC showed significant concern among issuers about existing and potential conflicts of interest on the part of ISS. Criticism has come not only from corporate issuers, *but also some institutional investors* (see below). A *Policy Briefing* from the Millstein Center for Corporate Governance and Performance, Yale School of Management, found that "the most vocal criticisms have been reserved for advisors that provide both voting advice to institutional investor clients and structural governance advice to the companies on which they also produce voting recommendations. There is an argument that this model allows companies that purchase governance guidance to 'game' the system, potentially tainting any voting recommendations to investors because the company in question might also be a client of the advisor."[19]

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[11] http://www.marcoconsulting.com/
[12] Letter to the Commission from MCG. http://www.sec.gov/comments/s7-14-10/s71410-148.pdf
[13] http://www.ejproxy.com/
[14] On Dec. 20, 2010, it was announced that PGI had entered an arrangement with Glass, Lewis & Co. to provide proxy voting and advisory services to PGI's clients. The release indicated that PGI would not be providing proxy voting or advisory services after the end of 2010. See http://www.glasslewis.com/downloads/1451-199.pdf. PGI's website now carries a notice that operations have ended. https://www.proxygovernance.com/
[15] http://www.mscibarra.com/news/pressreleases/archive/MSCI_Micro_and_All_Cap_Indices.pdf. See also http://www.adviserinfo.sec.gov
[16] See http://www.adviserinfo.sec.gov
[17] http://www.gmiratings.com/
[18] http://www.sec.gov/comments/s7-14-10/s71410-182.pdf
[19] Millstein Center for Corporate Governance and Performance, Yale School of Management, Policy Briefing No. 3 (2009), "Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry." http://millstein.som.yale.edu/Voting%20Integrity%20Policy%20Briefing%2002%2027%2009.pdf

It is also informative to note that select competitors to ISS publicly distance themselves from the ISS model of combining proxy advisory services with "consulting" services to issuers. From the MCG website: "Since MCG does not render consulting services to the corporate or investment management communities, it has no conflicts of interest."[20] Egan-Jones Proxy Services notes on its website that "the integrity of our recommendations is not clouded with the complication of also selling corporate directors and managers consulting services pertaining to these same shareholder proposals."[21] Gary Hewitt, identified as an ISS spokesman, has been quoted recently claiming that ISS has maintained a firewall between its corporate and institutional businesses: "A critical component of the firewall is the research team not knowing the identity of the corporate-issuer clients. Our proxy advisory clients do have access to the identities of our corporate clients."[22]

Not only is the SEC taking a closer look at potential conflicts of interest, but the Employee Benefits Security Administration of the U.S. Department of Labor (DOL) has also proposed a new rule (with comments that were due on or before Jan. 20, 2011) that would expand the definition of "fiduciary" to cover proxy advisory firms registered as investment advisers and providing advice to ERISA (Employee Retirement Income Security Act) plans or their participants.[23] The proposed rules could result in the corporate consulting services of ISS being interpreted as conflicting with services provided to ERISA plans and their participants.[24] Proxy voting rights are "plan assets" according to the DOL. As the Council of Institutional Investors (CII) explained in its letter to the Commission: "Ever since the Department of Labor's 1988 'Avon Letter,' which asserted that proxy voting rights are plan assets subject to the same fiduciary standards as other plan assets, pension fund managers have been on high alert to vote their proxies in the best interest of beneficiaries. Proxy advisory firms play an important role in helping pension fund managers fulfill their fiduciary duties…."[25]

The staffing levels at ISS and GL reflect another key source of controversy. The proxy advisory firms have gained scale mainly due to the need of thousands of institutional investment managers worldwide for assistance in managing the research and operational requirements for voting on tens of thousands of issues before thousands of companies worldwide. Most issues voted on by institutions are without controversy, but many institutional investors are required to vote in order to meet fiduciary obligations (whether on their own part or on behalf of clients they are managing investments for). The Council of Institutional Investors (CII) commented that "without proxy advisers, many pension plans—particularly smaller funds with limited resources—would have difficulty managing their highly seasonal proxy voting responsibilities for the thousands of companies in their portfolios."[26] ExxonMobil (in a letter from the company's VP for Investor Relations David Rosenthal) noted that: "Guidance from both the SEC

[20] http://www.marcoconsulting.com/2.3.html
[21] http://www.ejproxy.com/default.aspx
[22] http://www.pionline.com/article/20101101/PRINTSUB/311019973
[23] http://www.dol.gov/ebsa/
[24] See http://www.pionline.com/article/20101101/PRINTSUB/311019973
[25] http://www.sec.gov/comments/s7-14-10/s71410-80.pdf
[26] http://www.sec.gov/comments/s7-14-10/s71410-80.pdf

and the Department of Labor makes it clear that investment managers subject to regulation by those authorities have a legal duty to vote proxies in the best interest of the ultimate beneficial owners. At the same time, many managers are not able to devote sufficient in-house resources to enable them to analyze and make informed voting decisions with respect to the thousands of proxy issues these managers face each year. Given these realities, we understand why proxy advisors have come to wield such influence in the proxy process."[27]

Having had a burden imposed on them that would otherwise require large internal staffs and costs simply to keep track of all the non-controversial votes, many institutions have opted to outsource much of that process, while retaining ultimate decision-making authority over each vote. ISS and GL have benefited substantially from that outsourcing trend, but many critics question whether they have the capacity and business models appropriate for handling the resulting responsibilities. Indeed, one of the primary complaints from corporate issuers is that proxy advisory firms rely heavily on a "cookie cutter" or "one-size-fits-all" approach, and may base recommendations on inaccurate and unreliable information in particular cases. For example, a letter from Headwaters Inc. observed: "It is our experience that proxy advisors often base their analysis on poor comparisons of different companies. This comparative process is used because analysts cannot possibly understand the individual merits of each company they attempt to assess. There are simply too many companies to analyze."[28]

Comments submitted to the Commission from corporate issuers were filled with examples of recommendations by ISS based on inaccurate information (see below for examples). It is the latter that intensifies concern about the limited transparency offered by proxy advisory firms concerning their processes for developing voting recommendations. The "Report of the NYSE Commission on Corporate Governance" (September 23, 2010) recommended that proxy advisory firms: "be required to disclose the policies and methodologies that the firms use to formulate specific voting recommendations, as well as all material conflicts of interest, and to hold themselves to a high degree of care, accuracy and fairness in dealing with both shareholders and companies by adhering to strict codes of conduct. The advisory services should also be required to disclose the company's response to its analysis and conclusions."[29]

Another source of controversy is whether proxy "voting agent" services accurately implement the policies and instructions of clients that have hired them as both proxy advisers and voting agents (while also facilitating the collection of data for reporting on Form N-PX). A 2008 Compliance Alert from the SEC (based on the findings of SEC compliance examiners) found that: "Most advisory firms had adopted policies and procedures with respect to proxy voting as required under the proxy voting rule. However, in some instances, examiners discovered that the proxy voting policies and procedures seemed to contain inaccurate information or were not followed. In other instances, the firm could not say whether it voted on several matters or whether an accurate record of those votes was recorded on Form N-PX…In

[27] http://www.sec.gov/comments/s7-14-10/s71410-224.pdf
[28] http://www.sec.gov/comments/s7-14-10/s71410-60.pdf
[29] See Principle 8. See http://www.nyse.com/pdfs/CCGReport.pdf and http://exchanges.nyse.com/archives/2010/09/corporate_governance.php.

some instances, the funds had neither established controls to confirm that the proxy service providers' recommendations were consistent with funds' policies and procedures nor requested information regarding conflicts of interest at the proxy service providers."[30]

While some have proposed regulating the proxy advisors as either Nationally Recognized Statistical Rating Organizations (NRSROs), a concept that is under review as part of the SEC's concept release, or even organizations meriting oversight comparable to the Public Company Accounting Oversight Board (PCAOB),[31] such proposals may overrate the rigor and discipline of some analyses offered by proxy advisory firms. Indeed, proxy advisory firms generate recommendations that can be highly subjective, in particular with regard to unsettled controversies over "optimal" governance structures (such as whether the CEO and Chairman positions should be separate) or certain "social activist" agendas.[32] If proxy advisory firms were to be regulated as NRSROs, they would be prohibited, as rating agencies are, from rating issuers where the firm has made recommendations about that issuer's corporate structure, assets/liabilities, or activities of the issuer. The firms would also face significant new disclosure requirements, while analysts would be subject to stricter guidelines concerning their potential ownership of securities that they are rating. (Note that Egan-Jones Rating Company, the parent of Egan-Jones Proxy Services, is a NRSRO -- in connection with its business rating the credit worthiness of issuers).

New Data on the Role of Proxy Advisory Firms

Letters to the Commission have provided a wealth of new information on the role and impact of proxy advisory firms on the proxy voting process. A number of commenters have had experiences with ISS and GL in what could be termed "special situations," in which the influence of recommendations by ISS or GL far outweighed what their "typical" influence is when measured across a broad sample base. Whether recommendations from ISS strongly influence 1% or 30% of a shareholder vote is less significant than the fact that a third party investment adviser -- without a direct economic interest in a company facing a shareholder vote -- can wield considerable influence, if not outright control, over enough votes to determine the outcome in certain situations. In some cases, ISS can wield significantly more influence over the outcome of a vote than the single largest shareholder or even a group of the largest shareholders.

Before getting into specific estimates of the degree to which recommendations from ISS or GL may influence shareholder votes, it is important to note that the influence of ISS extends far beyond those client-adviser relationships in which recommendations from ISS tend to be the "primary" basis for voting decisions by an institutional investor. A letter from tw telecom noted

[30] http://www.sec.gov/about/offices/ocie/complialert0708.htm
[31] See Tamara C. Belinfanti, Professor, New York Law School, "The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control," New York Law School Legal Studies, Research Paper Series 9/10 #18. http://www.shareholdercoalition.com/Belinfanti_Article.pdf
[32] For example, ISS offers "guidelines to help institutional investors meet their fiduciary duties to vote proxies consistent with AFL-CIO guidelines." http://www.issgovernance.com/proxy/policyoptions.

that: "Our experience indicates that even those institutions with in-house compliance departments tasked with proxy voting tend to model their internal guidelines on those of proxy advisory firms or use the proxy advisory service recommendations as a significant input to their decision making process… the mandatory say-on-pay provisions of Dodd-Frank, the new proxy access rules and the elimination of the broker discretionary vote are likely to magnify the power of institutional shareholders and, correspondingly, the proxy advisory firms."[33] The Investment Company Institute (ICI) also took note of its massive 2008 study of proxy votes by funds, which found that while "funds vote proxies in accordance with their board-approved guidelines…fund voting patterns are often broadly consistent with vote recommendations of proxy advisory firms, although…funds do not reflexively adopt the recommendations of proxy advisors."[34] ICI also noted in its letter that certain "funds—such as those that are part of smaller fund families with more limited resources—may rely more heavily on proxy advisory firms to guide their votes."

Some issuers provided the Commission with analyses of shareholder votes showing the rather large degree of influence that ISS can have on vote outcomes in special situations. In one example, UnitedHealth Group estimated that "in conjunction with our 2010 annual meeting of shareholders, 16% of our outstanding shares were voted exactly in accordance with RiskMetrics' recommendation shortly after the issuance of the recommendation…In 2009, approximately 14% of our outstanding shares were voted exactly in accordance with RiskMetrics' recommendation shortly after of the issuance of those recommendations."[35]

Douglas K. Chia, Assistant General Counsel and Corporate Secretary at Johnson & Johnson submitted data showing the influence of ISS voting recommendations on voting behavior at Johnson & Johnson's annual meetings:[36]

Johnson & Johnson Date of Annual Meeting	Date of publication of ISS report for Annual Meeting	Average number of shares voted per day during 5 business days before ISS report published	Number of shares voted within 1 business day after ISS report published	Percent of shares voted within 1 business day after ISS report published that were voted in accordance with ISS recommendations	Percentage of shares beneficially owned by largest known shareholder (based on Sch. 13G filings)
April 22, 2010	April 1, 2010	93 million	388 million	**13.40%**	5.34%
April 23, 2009	April 3, 2009	88 million	332 million	**15.04%**	5.20%
April 24, 2008	April 9, 2008	87 million	396 million	**17.90%**	3.75%

[33] http://www.sec.gov/comments/s7-14-10/s71410-162.pdf
[34] http://www.sec.gov/comments/s7-14-10/s71410-167.pdf. Comments refer to the Investment Company Institute, *Proxy Voting by Registered Investment Companies: Promoting the Interests of Fund Shareholders,* July 2008, available at http://www.ici.org/pdf/per14-01.pdf
[35] http://www.sec.gov/comments/s7-14-10/s71410-235.pdf
[36] http://www.sec.gov/comments/s7-14-10/s71410-115.pdf

IBM,[37] which submitted one of the most detailed responses to the Commission on the subject of proxy advisory firms, provided data that it argues "is evidence of *de facto* control by ISS of" certain institutional votes, and "and of how institutional holders outsource their voting decisions to ISS." IBM publicized selected data, which was "provided by one of the Company's proxy service providers," to show a series of examples in which Fortune 500 companies saw "a significant number of shares held by institutions" voted in a "lock-step manner (i.e., 100% in accordance) with the ISS recommendation." IBM cites a number of unnamed companies as examples in its letter, but did disclose that for IBM the approximate % of "total votes cast" in "lock-step" with ISS "within one business day after" ISS recommendations had been: 13.5% in 2009, and 11.9% in 2010. As the letter went on to explain: "By comparison, for the previous five business days, no more than 0.20% and 0.27% of the total IBM votes were cast in any one day in 2009 and 2010, respectively. To put that into proper perspective, the IBM voting block essentially controlled by ISS has more influence on the voting results than IBM's largest shareholder…(a) voting block…controlled by a proxy advisory firm that has no economic stake in the company and has not made meaningful public disclosures about its voting power, conflicts of interest or controls."

Several other companies provided rough estimates concerning the influence of proxy advisory firms on proxy voting. Roderick A. Palmore, who is General Counsel at General Mills, explained that "approximately 20% of our outstanding shares" are voted by shareholders who either adhere to the voting recommendations of ISS or who engage ISS to vote on their behalf. In uncontested director elections and compensation plan approvals, where brokers are not permitted to exercise discretionary voting power, ISS: "controls 25% to 30% of the votes cast. In those instances, its recommendations are likely to determine the outcome of the shareholder vote."[38] ExxonMobil estimated that: "Based on our experience in recent proxy seasons, institutions representing approximately 20-25% of votes cast automatically follow proxy advisor recommendations on certain proposals. These numbers are likely higher at many other companies with a higher percentage of institutional ownership."[39] A letter submitted on behalf of the board of directors of Headwaters Inc. noted: "In our experience, the majority of the quorum at our annual meetings is controlled by the recommendations or voting of a single proxy advisory firm."[40]

The Council of Institutional Investors (CII) "disputes the view" that "proxy advisory firms' recommendations have too much influence on the outcome of voting at U.S. public companies." In their letter to the Commission, CII noted that: "According to Institutional Shareholder Services' (ISS) Voting Analytics search tool, ISS issued a baseline recommendation of 'against' for 28 out of 136 management-sponsored say-on-pay proposals in 2010. Only three

[37] Letter from Andrew Bonzani, Vice President, Assistant General Counsel and Secretary, International Business Machines Corporation (IBM). http://www.sec.gov/comments/s7-14-10/s71410-84.pdf
[38] http://www.sec.gov/comments/s7-14-10/s71410-160.pdf
[39] http://www.sec.gov/comments/s7-14-10/s71410-224.pdf
[40] http://www.sec.gov/comments/s7-14-10/s71410-60.pdf

of the 28 proposals actually failed to pass, and the average shareowner support of those 28 proposals was 74 percent…Of 15,044 ISS baseline recommendations for nominees in 2010, 13 percent were 'withhold' or 'against.' Of the 1,879 nominees receiving 'withhold' or 'against' baseline recommendations with available voting results, less than 5 percent failed to receive majority support from shareowners. The average shareowner support for nominees with a 'withhold' or 'against' baseline recommendation from ISS was 77 percent."[41] CII also noted that: "nine of the Council's 10 largest member funds (which collectively have more than $900 billion of assets under management) do not delegate their voting decisions to a proxy adviser. These nine pension funds, like many other institutional investors, use their own guidelines, which are updated continually or on an annual basis, to govern their voting decisions."

CII's analysis does not address the reality that proxy advisory firms can have substantial influence over voting outcomes in certain situations, and especially when votes are close. Moreover, one of the key sources of controversy is the extent to which decision-making over how to vote on a particular matter is either formally or effectively delegated by certain institutional investors to proxy advisers/voting agents. What may be true for 9 of the Council's 10 largest member funds is not necessarily the case for all institutions using proxy advisory firms.

Additional Research Submitted to the Commission

Multiple studies seeking to quantify the extent to which proxy advisers influence the direction of shareholder votes were submitted to the Commission by Professor Jill E. Fisch (University of Pennsylvania Law School), who forwarded copies of recent articles co-authored by her along with Professors Stephen Choi and Marcel Kahan titled "The Power of Proxy Advisors: Myth or Reality?" and "Director Elections and the Role of Proxy Advisors."[42] Their findings included the following (from "The Power of Proxy Advisors: Myth or Reality?"): "Although superficial analyses suggest that an ISS recommendation can have a marginal impact of as much as 20%, and press reports state that ISS has the power to shift 20% to 30% of the shareholder vote, we conclude that these numbers are substantially overstated. In particular, our findings reveal that although an ISS recommendation has independent value, this value is greatly reduced once we take into account the company- and firm-specific factors that are important to investors. Depending on the test, we find that the impact of an ISS recommendation ranges from 6% to 13% *for the median company*. Overall, we consider it likely that an ISS recommendation shifts 6% to 10% of shareholder votes—a material percentage but far less than commonly attributed to ISS. Furthermore, we find evidence that ISS's power is partially due to the fact that ISS (to a greater extent than other advisors) bases its recommendations on factors that shareholders consider important." (We added *italics* to emphasize that the findings are "for the median company" and have no relevance at all for special situations or issuers with shareholder

[41] http://www.sec.gov/comments/s7-14-10/s71410-80.pdf
[42] http://www.sec.gov/comments/s7-14-10/s71410-35.pdf

bases crowded with shareholders that are strongly influenced by proxy advisory firms). While some commentators were quick to jump on the study's findings as a reason to downplay the significance of certain issues associated with the power and influence of proxy advisory firms, the professors also included the following observation: The "influence" of proxy advisory firms "is troubling in light of the limited accountability…Proxy advisors do not have a financial stake in the companies about which they provide voting advice; they owe no fiduciary duties to the shareholders of these companies; and they are not subject to any meaningful regulation. Moreover, it is not clear that the proxy advisory industry is sufficiently competitive and transparent to subject advisory firms—ISS in particular—to substantial market discipline. Institutional investors, for the reasons outlined above, may lack sufficient interest in voting to scrutinize advisors' recommendations carefully."[43]

The Shareholder Forum (Gary Lutin, Chairman) submitted to the Commission an informative "Survey of Investor Communication Priorities for Voting Decisions," which was published in October 2010.[44] The results showed that: "significant proportions of investors will spend time...to consider voting issues, as distinguished from applying standard policies or recommendations…Professionals with buy-sell responsibilities were significantly more likely to allocate time to voting decisions." The results also showed that a significant minority of professional investors participating in the survey did not spend any time at all considering specific voting issues (with percentages varying based on the subject matter). The proportion of investors participating in the survey who would spend "any amount of time" on selected voting issues ranged widely depending upon the significance of the issue being voted on. While most of those participating saw reports from proxy advisers to be of "high value," only 17.1% of the sample base considered the reading of "details of proxy advisor reports" to be a "top priority."[45] In an earlier Shareholder Forum "Survey of Investor Voting Criteria for Compensation Issues," which was posted on Dec. 14, 2009, some 26% of the investors surveyed indicated that conformity with guidelines set by ISS or other proxy advisors is a "critical or important" criteria when voting on compensation issues.

We doubt that anyone in the proxy solicitation industry has been surprised by the results of those surveys. After all, the heart of the issue is about the degree of influence that proxy advisors have over the votes of a relatively small number of institutional investors that are large enough to determine the outcomes of close votes. Even 17%-26% of professional investors surveyed can be more than enough to be outcome determinative in a close vote (depending upon the composition of voting power in a particular security).

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[43] Stephen Choi, Jill Fisch, and Marcel Kahan. *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010) (*The Power of Proxy Advisors*) http://www.sec.gov/comments/s7-14-10/s71410-35.pdf

[44] http://www.sec.gov/comments/s7-14-10/s71410-64.pdf

[45] http://www.sec.gov/comments/s7-14-10/s71410-64.pdf

Proxy Advisory Firms on Their Influence Over Institutional Voting Behavior

The proxy advisory firms challenged perceptions that they are as influential as many believe they are. ISS offered this surprising comment: "While we do not formally track the extent to which our clients follow our voting recommendations, we believe that it is a misconception, albeit an often repeated one, that ISS' clients blindly follow ISS' recommendations." Perhaps they should "formally track" their influence, as many proxy solicitors and some corporate issuers do. ISS also attempts to downplay its influence by offering such vague observations as: "It is unclear to what extent investors vote consistently with the recommendations of proxy advisory firms, particularly since investors use vote recommendations differently and such use is not easily monitored or quantified…These assertions have no factual basis, but have taken on a life of their own as they are repeated by other commentators referencing the initial statement as fact." ISS then takes note of the estimate by Stephen Choi, Jill Fisch, and Marcel Kahan in "The Power of Proxy Advisors: Myth or Reality?" (quoting ISS) that: "an ISS recommendation shifts 6 to 10 percent of shareholder votes. The paper suggests that a major component of this influence may stem from ISS' role as information agent and this assessment is consistent with our experience of how our clients actually use our proxy research and vote recommendations."[46]

ISS went on to make a significant disclosure: "In addition to our benchmark policy guidelines (or 'house' view), ISS offers 'specialty' guidelines such as our 'Socially Responsible Investment' and Catholic 'faith based' policies. More significantly, ISS also manages and applies over 400 custom policies on behalf of its clients. These customized voting policies reflect clients' unique corporate governance philosophies. The vote recommendations issued under these policies often differ from those issued under our benchmark policies. We estimate that the majority of shares that are voted by ISS clients fall under ISS' custom or specialty recommendations."

Factual Errors by Proxy Advisory Firms

Numerous corporate issuers submitting comments have expressed concern about factual errors in the reports of proxy advisory firms. For example, UnitedHealth Group wrote that: "Glass Lewis & Co.'s 'proxy paper' for UnitedHealth's 2010 annual meeting of shareholders extensively but selectively summarized four-year old investigations, and omitted facts and conclusions of those investigations that were favorable to several directors. Glass Lewis used this incomplete and misleading information to support a recommendation to shareholders to vote against these directors. UnitedHealth, however, has no effective recourse against Glass Lewis for publishing this misleading information. Although we cannot know the prevalence of these kinds of issues, we believe that requiring all proxy advisory firms to allow issuers the opportunity to review the factual accuracy of reports in advance, will help prevent factual misrepresentations

[46] http://www.sec.gov/comments/s7-14-10/s71410-154.pdf

and provide shareholders a more reliable basis to form decisions."[47] A letter from Pfizer noted: "We have also experienced several situations in which proxy advisory firms' materials contain factual errors. For example, one firm issued a number of reports indicating that Pfizer requires a 'super-majority' shareholder vote on certain matters. The super-majority voting requirements were deleted from our Restated Certificate of Incorporation in 2006. However, it appears that the analysts reviewing our filings did not understand the various documents filed under the Delaware General Corporation Law to delete those requirements."[48]

A key issue for some companies is that they do not have an adequate opportunity to correct, either before distribution of a proxy adviser's report or after, any factual errors that may be published. For example, General Mills noted that ISS only: "provides limited opportunity for issuers to review and comment on its analysis and voting recommendations. Companies are required to provide feedback within 48 hours of receiving…(a) preliminary report, and factual clarifications can only be addressed by reference to information filed with the SEC. Glass Lewis does not provide issuers with advance copies of its reports and there is no opportunity for issuers to identify or correct errors before the report is issued to investors. Where the errors are not refuted through public disclosure (e.g. 8-K filings), the corrections are not reflected in the final report. Limited review and input from issuers creates the potential for misleading information and voting recommendations that are contrary to investor expectations and the stated voting policies of the advisory firms."[49] The issues raised by companies submitting comments extended well beyond concerns related to factual errors, which, as the SEC explained in the concept release, are already regulated through "the antifraud provisions of the proxy rules contained in Rule 14a–9" and the "fiduciary" responsibilities of proxy advisory firms to "make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information."

WHAT DO CORPORATE ISSUERS WANT?

Corporate issuers raising concerns in their comment letters about proxy advisory firms almost universally favored increased regulation of proxy advisers, including most notably increased transparency and regulatory changes designed to mitigate conflicts of interest. Roderick A. Palmore, who is general counsel at General Mills, explained (in what was a common request from corporate issuers) that "proxy advisory firms should be subject to federal regulation requiring greater transparency and accountability with respect to the formulation of voting recommendations and potential conflicts of interest."[50] A number of issuers and investors (as described below) expressed concern that there is an inherent, and thus unmanageable (regardless of any "firewalls" that ISS might have), conflict of interest when proxy advisory

[47] http://www.sec.gov/comments/s7-14-10/s71410-235.pdf
[48] http://www.sec.gov/comments/s7-14-10/s71410-277.pdf
[49] http://www.sec.gov/comments/s7-14-10/s71410-160.pdf
[50] http://www.sec.gov/comments/s7-14-10/s71410-160.pdf

firms sell consulting services to issuers concerning the same, sometimes highly subjective, criteria upon which the advisory firms generate recommendations. There are also concerns about the lack of transparency regarding the "consulting" contracts of proxy advisers with issuers, as well as any financial or other relationships with shareholders whose proposals the proxy advisor is issuing recommendations on.

As a group, the letters from corporate issuers (61 of them) were notable for how much emphasis was placed on a tangential issue: urging the Commission to enable full and open communications between a company and its shareholders. Of the 61 letters submitted, only 30 explicitly urged increased regulation of proxy advisory firms (while one expressed common concerns only to conclude that more "dialogue" between issuers, investors and proxy advisory firms would be better than additional regulation).[51] The remaining 30 letters did not mention proxy advisory firms at all, and focused instead on other issues contained in the SEC's concept release. Letters that did not mention proxy advisory firms tended to concentrate on proposals that would facilitate increased communications between issuers and shareholders. This should not be a surprise, since the most effective way for a corporate issuer to mitigate the influence of proxy advisory firms is to increase communications with the persons who control and influence decision-making on proxy voting at a company's top institutional shareholders. Indeed, some of the corporate issuers raising concerns about the accuracy of, or omissions from, reports distributed by proxy advisory firms complained of being put into a position of having little effective recourse in such situations except to communicate with all of the shareholders that might be influenced by such reports (while issuers are hampered by the fact that the identities of some beneficial owners [Objecting Beneficial Owners or OBOs] are hidden from them).

Some 30 letters from corporate issuers urged increased regulation of proxy advisory firms in order to promote greater transparency (to use the boilerplate language of some letters "regarding standards, methodologies, and conflicts of interest"), as well as other measures to ensure accuracy and address actual or potential conflicts of interest. The letters, which came not only from U.S. companies, but also a number of ADR issuers and Canadian companies, raised a wide range of proposals for the Commission to consider. While many of those letters contained only short and terse comments on the subject of proxy advisory firms, five of them (from IBM, [52] DuPont,[53] Exxon Mobil Corp.,[54] FedEx Corp.,[55] and General Mills)[56] delivered extensive analyses and recommendations.

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[51] Letter from DirectTV. http://www.sec.gov/comments/s7-14-10/s71410-145.pdf

[52] Letter from Andrew Bonzani, Vice President, Assistant General Counsel and Secretary, International Business Machines Corporation (IBM). http://www.sec.gov/comments/s7-14-10/s71410-84.pdf

[53] Letter from Corporate Secretary and Corporate Counsel Mary E. Bowler on behalf of DuPont. http://www.sec.gov/comments/s7-14-10/s71410-163.pdf

[54] Letter from VP (Investor Relations) and Corporate Secretary David Rosenthal of Exxon Mobil Corporation. http://www.sec.gov/comments/s7-14-10/s71410-224.pdf

[55] Letter from Executive VP, General Counsel and Secretary Christine Richards on behalf of FedEx Corporation. http://www.sec.gov/comments/s7-14-10/s71410-157.pdf

[56] Letter from Executive VP, General Counsel and Chief Corporate and Risk Management Officer Roderick Palmore on behalf of General Mills, Inc. http://www.sec.gov/comments/s7-14-10/s71410-160.pdf

Increasing Transparency

The single most significant concern on the part of issuers is for the Commission to increase transparency on the part of proxy advisory firms. Companies urged the SEC to increase required disclosures regarding the depth of a proxy adviser's research capabilities, methodologies, controls regarding the accuracy of issuer data, procedures for communications with issuers, and any review or comment process in the event of disagreements over information contained in a proxy advisers' report.

The Commission asked if proxy advisory firms should be required to disclose their "models" for decision-making with regard to the approval of executive compensation plans. General Mills responded by asking for disclosures concerning: "factual data and mathematical models and methodologies used to prepare recommendations about compensation programs and compensation plans must be publicly available to issuers and investors."[57] IBM asked for disclosures, at least annually, of proxy governance models, including the guidelines, processes and assumptions, as well as the methodologies and sources of information supporting their recommendations. A letter from tw telecom noted that: "the failure to disclose these models drives the demand for the consulting business of some of these firms, creating serious potential for conflicts…transparency…would provide issuers the opportunity to understand the factors that impact a score or recommendation that is not currently available. It would also allow institutions to evaluate the validity of the criteria being applied and thus the quality of the advice being rendered."[58] Comments from tw telecom also called for "additional transparency into rating or grading systems used to evaluate governance and pay practices…issuers have no basis for determining whether the grades are based on accurate or valid data and an issuer that wishes to improve its grade has no basis to determine how to do so" (that is, absent use of a proxy advisory firm's "consulting" services).[59] Exxon Mobil supported greater disclosure of the "policies and methodologies (including performance metrics) they use to arrive at specific voting recommendations."[60]

Some issuers urged the Commission to go much further in terms of imposing new disclosure requirements on proxy advisory firms. IBM asked that proxy advisory firms be required to immediately disclose any significant errors made in executing voting instructions with regard to a particular proxy vote. FedEx asked for proxy advisory firms to fully disclose (or have the SEC prohibit) any relationships (other than as subscribers to published reports) between proxy advisory firms and activist groups and unions. FedEx noted that "a small, but vocal, group of activists, unions, pension funds and hedge funds have the ability to unduly influence the voting policies and recommendations of the proxy advisory firms."[61] Pfizer also

[57] http://www.sec.gov/comments/s7-14-10/s71410-160.pdf
[58] http://www.sec.gov/comments/s7-14-10/s71410-162.pdf
[59] http://www.sec.gov/comments/s7-14-10/s71410-162.pdf
[60] http://www.sec.gov/comments/s7-14-10/s71410-224.pdf
[61] http://www.sec.gov/comments/s7-14-10/s71410-157.pdf

raised the subject of ensuring that an issuer can have timely access to all reports on the company that have been "distributed" by a proxy advisory firm to its clients.[62]

Another avenue for increasing disclosure is through Form ADVs filed by registered investment advisers (including ISS). While the SEC has recently adopted changes to Form ADV, which now require more discussion concerning potential conflicts of interest and what internal procedures are in place to manage such conflicts, IBM argued that the Commission should also require "any institutional investor who subscribes to a proxy advisory firm" to disclose that relationship in its Form ADVs (as well as "post the advisory firm's Form ADV on its website").

Mitigating or Eliminating Conflicts of Interest

Some issuers argue that more transparency is necessary to mitigate the impact of inherent conflicts of interest resulting from certain actions by proxy advisers, in particular with regard to both: (1) the relationships between proxy advisory firms and certain shareholder proponents whose policies or proposals the proxy adviser is either issuing recommendations in support of or voting shares as a "voting agent" of the shareholder proponent; and (2) the delivery of "consulting" services to issuers at the same time that the proxy adviser is making voting recommendations regarding issues being voted on by shareholders of those same issuers. For example, UnitedHealth Group urged the Commission to consider requiring that reports containing voting recommendations disclose any arrangements between a proxy advisory firm issuing such reports and any shareholder of a targeted company in which the proxy advisory firm votes the shares of that shareholder exactly in accordance with the recommendations of the proxy adviser.[63]

While disclosure of such relationships would be a major step forward in terms of promoting transparency, some issuers want to see steps taken that would effectively prohibit activities that create an inherent conflict of interest. For example, DuPont asked that proxy advisers "be prohibited from providing issuer governance ratings to institutional clients while also providing consulting services to corporations to help them improve their governance ratings." Short of outright prohibition, several ADR issuers argued, as BP did, that when proxy advisory firms engage in the "inappropriate" conduct of giving "advice to an issuer on governance and issues that might be put to shareowner vote, while at the same time providing recommendations to shareowner clients of that issuer on whether to support a resolution" the "full nature and scope" of the proxy advisory firm's relationship with an issuer should be disclosed.[64]

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[62] Pfizer: "We were informed that the erroneous reports were not distributed, *but we have no independent way of confirming that*." http://www.sec.gov/comments/s7-14-10/s71410-277.pdf

[63] http://www.sec.gov/comments/s7-14-10/s71410-235.pdf

[64] http://www.sec.gov/comments/s7-14-10/s71410-226.pdf.

Accuracy of Reports by Proxy Advisory Firms

Numerous issuers asked the Commission to consider steps designed to ensure that the research, analysis, and voting services delivered by proxy advisory firms are accurate. Short of a major change in the regulatory architecture for proxy advisory firms, such as regulating proxy advisory firms as NRSROs, issuers offered a range of proposals for the Commission to consider.

Some issuers are pressing for steps that would greatly expand upon the obligations of proxy advisory firms to avoid actions that are "fraudulent" and to ensure that their internal processes are adequate to meet "fiduciary" obligations. The most significant proposal in this regard presented by corporate issuers is to have the Commission formalize a process by which issuers would have an adequate opportunity to review and comment on draft reports generated by proxy advisory firms in order to challenge any factual errors (see letters from CIGNA, tw telecom ["issuer involvement in the research and modeling process"], General Mills, UnitedHealth Group,[65] Exxon Mobil Corp. ["advisors should also be required to maintain reasonable procedures for receiving and resolving complaints and correcting errors before issuing reports to shareholders"],[66] Corning,[67] and Energy Conversion Devices).[68] Some issuers asked that such a review process establish a reasonable timeframe for them to review and comment on the reports.

Some corporate issuers want to be able to do more than simply review and comment on draft reports by proxy advisory firms. Amid the controversy over new "proxy access" rules, it was interesting to see some companies pressing for what amounts to access to the reports distributed by proxy advisers. Wells Fargo & Company advocated the creation of a process designed so that "to the extent the proxy advisory firm determines not to make changes based on the issuer's comments, the issuer's comments should be disclosed to the proxy advisory firm's clients."[69] FedEx argues that "issuers should be granted the opportunity to respond to the proxy advisory firms' recommendations, and the proxy advisory firms should be required to disclose such issuer responses."[70] CIGNA wants the proxy advisers to "disclose our response to their recommendations and analysis so that our shareholders have complete information to evaluate the voting recommendations."

The tendency of certain proxy advisers to use a "one-size-fits-all" (what ISS calls a "policy-driven") approach to analyzing certain issues and "best practices" is also a major concern for corporate issuers. Thus, we find recommendations from issuers that advisory firms should be required to consider the best interests of investors and portfolio companies on a "case-by-case basis…rather than issuing across-the-board recommendations on particular issues"

[65] http://www.sec.gov/comments/s7-14-10/s71410-235.pdf
[66] http://www.sec.gov/comments/s7-14-10/s71410-224.pdf
[67] http://www.sec.gov/comments/s7-14-10/s71410-164.pdf
[68] http://www.sec.gov/comments/s7-14-10/s71410-237.pdf
[69] http://www.sec.gov/comments/s7-14-10/s71410-205.pdf
[70] http://www.sec.gov/comments/s7-14-10/s71410-157.pdf

(letter from General Mills). Pfizer noted in its letter that: "(I)n most cases, there is not just one best practice that should be followed; there is likely to be a range of acceptable practices, and a company should be able to adopt an acceptable practice that is appropriate for its individual circumstances and those of its shareholders. When this occurs, we believe that the proxy analysis should, at a minimum, disclose – with equal prominence – the company's practice and why the company believes that its practice is acceptable and/or appropriate."[71] IBM argued that: "Any proxy advisory firm that adopts a one-size-fits-all approach on any significant issue should be required to disclose its rationale for the belief that every single company, regardless of its particular facts and circumstances, should have the same policy (and)…publish all of this information in a prominent location on their website and update the information periodically."

Regulatory Framework for Proxy Advisory Firms

From a rule-making perspective, the most significant issue before the Commission is how to classify proxy advisory firms. Many related issues and concerns can be addressed through a potential change in the treatment of proxy advisory firms, which currently have an exemption from proxy solicitation rules (Rule 14a-2(b)(3)).

A number of issuers urged the Commission, as did Carol Ann Petren (Exec. VP, General Counsel, and Corporate Secretary of CIGNA Corporation), to consider imposing new "disclosure requirements under the proxy solicitation rules, the rules applicable to investment advisors, and/or new rules akin to those governing credit rating agencies."[72] Some issuers have urged the Commission to require that proxy advisory firms register as investment advisers,[73] while others are pressing for the Commission to eliminate the exemption that proxy advisers have from proxy solicitation rules – a step that would put proxy advisers into the position of having to file their voting recommendations with the Commission as soliciting material (see letters from DuPont, Pfizer, and General Mills).[74] Pfizer argued that: "Subjecting proxy advisory firms' recommendations and reports to the disclosure obligations under the proxy solicitation rules, including the obligation to disclose all material information necessary to a voting decision, would be the most efficient means of ensuring that such reports are complete and accurate in all material respects and would greatly enhance proxy advisory firms' accountability for these reports. At the same time, this approach would avoid the need to develop a separate regulatory scheme for the sole purpose of overseeing proxy advisory firms."[75] Other issuers are asking the Commission to regulate proxy advisory firms as NRSROs, that is, in a manner comparable to credit rating agencies (see letters from DuPont, tw telecom,[76] Western Digital Corp., Corning

[71] http://www.sec.gov/comments/s7-14-10/s71410-277.pdf
[72] http://www.sec.gov/comments/s7-14-10/s71410-171.pdf
[73] See letters from FedEx and General Mills.
[74] See letter from OtterTail Corporation. http://www.sec.gov/comments/s7-14-10/s71410-28.pdf
[75] http://www.sec.gov/comments/s7-14-10/s71410-277.pdf
[76] http://www.sec.gov/comments/s7-14-10/s71410-162.pdf

[subject them to "greater disclosure requirements…similar to those for credit rating agencies"]).[77]

Most of the discussions concerning changes in the classification, or exemptions, of proxy advisory firms fell within existing frameworks. There were some notable exceptions. FedEx was among the few to raise the possibility of creating an entirely new and unique regulatory framework for proxy advisory firms under the Investment Advisers Act of 1940.[78] IBM suggested a new process for annual audits of proxy advisory firms that would presumably be independent of oversight processes for registered investment advisers. Those audits would go to, as IBM explained: "the reliability and accuracy of the voting services they provide…proxy advisory firms should be required to have their work audited periodically, no less than once per year, by independent audit firms to assess the accuracy of the votes they have cast on behalf of their institutional investor clients." IBM also raised the possibility of defining certain proxy advisory firms with "de facto control over voting" of more than 5% of the shares of a class of equity securities as "beneficial owners of the shares in question" (as governed by Rule 13d-3).

Role of ISS in the Marketplace

Curiously, while some letters from corporate issuers complained of the over-concentration of influence in the hands of ISS, there was little pressure to increase competition among proxy advisory firms. Leggett & Platt Inc. (letter from Chief Legal & HR Officer and Secretary John G. Moore) raised the issue of how the scale and "monopolistic influence" of a single proxy advisory firm, ISS, is itself a key factor contributing to the concerns raised by many corporate issuers: "The market dominance of ISS brings with it substantial pressure on small and large issuers alike to conform to a check-the-box, one-size fits-all form of corporate governance that fits the ISS mold…Nowhere is ISS's monopolistic influence more intense than its recommendations on shareholder approvals for equity plans. And it's in this area that ISS's policies and practices are the least transparent, relying on a proprietary 'black box' formula to award thumbs up or down to a proposed plan. ISS uses this position to gain a substantial portion of its business by offering fee services and access to the black box to the issuers being evaluated."[79] The bottom line: companies already have their hands full managing issues raised by one "monopolistic" adviser and a handful of smaller competitors.

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[77] http://www.sec.gov/comments/s7-14-10/s71410-164.pdf

[78] http://www.sec.gov/comments/s7-14-10/s71410-157.pdf

[79] The letter goes on to explain: "As a case in point, ISS recommended that its clients vote against four of Leggett's Compensation Committee members this past proxy season. In correspondence objecting to the recommendation, we referenced ISS's own voting guidelines and governance policy update which were contrary to the recommendation. ISS neither responded to our appeal nor provided any justification for its conclusions. The only quality control is internal to ISS and the only recourse for an issuer is to contact the thousands of shareholders that have received ISS's reports. In all likelihood, this mistake on ISS's part (and their lack of corrective action) simply resulted from the crush of work they face during proxy season; nonetheless, the errors are not excused and the consequences for issuers are no less real. External oversight should be brought to bear so that ISS, along with all other proxy advisory firms, has the necessary incentive to ensure accuracy." http://www.sec.gov/comments/s7-14-10/s71410-119.pdf

Putting the Spotlight on Institutional Investors

Only a handful of corporate issuers submitting comments focused on the role of institutional investors, which exercise control over voting authority and generally do not depend solely on the advice of proxy advisory firms before executing votes. If one looks back over the evolution of the proxy voting system over the past 40 years, it is clear that a root issue is whether institutional investors are exercising enough diligence and care when it comes to overseeing and managing relationships with proxy advisory firms, as well as meeting obligations to vote shares in the best interest of investors.

Some corporate issuers asked for the Commission to extend its review to reexamining regulations that require certain institutional investors to vote on particular matters. Kinross Gold Corporation asked the Commission to consider revisiting "the various regulatory interventions in the area of voting by institutional shareholders," and in particular "whether it is truly in the public interest to effectively force passive or short-term investors that might not otherwise be inclined to participate in the voting process to do so (thereby effectively delivering their votes to ISS and other intermediaries)."[80] CIGNA urged the Commission to consider ways to ensure greater oversight by institutional investors with respect to any delegation, either expressly or implicitly, of their voting rights to a proxy advisory firm.[81] IBM also urged the Commission to increase oversight of institutional investors' activities with respect to proxy voting, including with regard to the processes and staffing required to ensure that any proxy voting agent is executing instructions as directed by the investment adviser.

One proposal seemed particularly relevant for the Commission's current review of proposed rules regarding additional disclosures through a revised Form N-PX concerning institutional votes on "say-on-pay" resolutions and "golden parachute" arrangements. DuPont urged the Commission to modify Form N-PX to require disclosure of whether a proxy advisory firm was used by the investor, and if so, which one, and whether the investor voted in accordance with that firm's recommendation. This recommendation was in line with that of the Society of Corporate Secretaries & Governance Professionals, which commented that: "Form N-PX currently includes a column that requires institutional investors to disclose if their vote on each proxy item was consistent with management's recommendation on that voting item…The logic for similar disclosure is therefore equally strong when applied to proxy advisory firms, since they are also making recommendations as to how to vote on the agenda items…Form N-PX should be amended to require institutional investors to identify by name the proxy advisory firm(s) to which they subscribe with respect to their portfolio holdings. Further, the form should include additional columns requiring disclosure of whether the institution voted 'with' or 'against' the recommendation of each such proxy advisory firm with respect to each voting item."[82]

[80] http://www.sec.gov/comments/s7-14-10/s71410-222.pdf
[81] http://www.sec.gov/comments/s7-14-10/s71410-171.pdf
[82] http://www.sec.gov/comments/s7-14-10/s71410-276.pdf

INSTITUTIONAL INVESTORS

The dominant theme in letters from institutional investors is that concerns expressed by some companies may be overstated, while noting that investment managers do retain ultimate control and authority over their proxy votes.[83] The ICI, which "question(s) the need for additional regulation of proxy advisory firms," commented that "fund advisers do not blindly follow possibly inaccurate proxy advisory firm recommendations. Given the (existing) processes and regulatory protections that govern fund voting…we do not believe the potential issues identified in the Release raise significant concerns in the fund context."[84] BlackRock wrote that the: "assertion that the use of proxy research represents a disconnect between voting power and economic interest is an affront to investors who utilize proxy research to spot potential issues for review and to enhance the quality of their voting processes…we reach an independent conclusion on the proxies that we review; we do not blindly follow any proxy advisory firm's advice."[85] Their point is that while the views of ISS and other proxy advisers are certainly influential, institutions retain a significant level of independence and flexibility in terms of how they utilize proxy advisers.[86] Thus, the argument goes, there is no need for discussing regulations of proxy advisory firms as if they are NSRSOs or eliminating the exemption to proxy solicitation rules, since proxy advisory firms are simply not as influential as such proposals assume.

There is a not-so-fine line between maintaining ultimate "control" over "voting authority" and "outsourcing" decision-making on proxy votes (as some funds have reportedly informed corporate issuers).[87] Note that MCG publicly describes itself as operating: "more as a

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[83] The Commission's concept release noted that institutional investors use proxy advisory firms to perform a variety of functions, including: "Analyzing and making voting recommendations on the matters presented for shareholder vote and included in the issuers' proxy statements; Executing votes on the institutional investors' proxies or VIFs in accordance with the investors' instructions, which may include voting the shares in accordance with a customized proxy voting policy resulting from consultation between the institutional investor and the proxy advisory firm, the proxy advisory firm's proxy voting policies, or the institution's own voting policy; Assisting with the administrative tasks associated with voting and keeping track of the large number of voting decisions; Providing research and identifying potential risk factors related to corporate governance; and helping mitigate conflict of interest concerns raised when the institutional investor is casting votes in a matter in which its interest may differ from the interest of its clients."

[84] The ICI also opposes additional regulations based on a cost argument. See pages 15-16 of their letter. http://www.sec.gov/comments/s7-14-10/s71410-167.pdf

[85] http://www.sec.gov/comments/s7-14-10/s71410-254.pdf

[86] The Colorado Public Employees' Retirement Association (COPERA) noted that while it relies heavily on proxy advisory firms, because "it would be impossible for staff to research every director nominee and evaluate the myriad of proposals that are presented for consideration…Vote recommendations provided by proxy advisory firms should not be confused with or viewed as providing investment recommendations." http://www.sec.gov/comments/s7-14-10/s71410-192.pdf. In addition, a letter from the International Corporate Governance Network (ICGN), which describes itself as a "a global membership organization of over 500 institutional and private investors, corporations and advisors from 50 countries," asserted the following: "We know of no research that confirms the views expressed by some critics that institutional investors passively accept the vote recommendations of proxy advisors or that proxy advisors exercise too much power by 'controlling' a large percentage of institutional votes." http://www.sec.gov/comments/s7-14-10/s71410-89.pdf

[87] Letter from the Society of Corporate Secretaries & Governance Professionals: "Some funds readily state to issuers that they 'outsource' their decision-making responsibilities on proxy voting matters to such firms. Other funds state they just 'consider' the recommendations made by proxy advisory forms." http://www.sec.gov/comments/s7-14-

proxy agent than as a proxy voting advisory firm. Most of our clients delegate complete proxy voting authority to us and we apply our clients' proxy voting policies to proxy issues. We do, however, have some clients that reserve proxy voting authority on certain case-by-case issues and we send them vote recommendations on those issues. In those limited instances, we do function like such proxy voting advisory firms as ISS, Glass Lewis...."[88]

Data presented by companies (and described above) concerning the timing of votes, that is, votes that quickly follow the release of reports/recommendations by ISS, is not necessarily evidence of "control" over voting discretion. It is certainly evidence that many institutional clients of ISS and other proxy advisory firms wait to hear what the proxy advisers have to say before making a final decision. Indeed, many of those same institutional decision-makers often make decisions based primarily on previously determined internal policies or even data presented by other proxy advisers, but were simply waiting to see what ISS had to say. However, some of that correlation between the date ISS issues a recommendation and the voting of shares may be related to institutions using ISS as a "voting agent." Glass, Lewis & Co. noted in its submission that: "As a proxy research advisor, we do make proxy voting recommendations. However, since we are not beneficial owners, we do not have authority to make voting decisions. The power to instruct votes resides with our institutional investor clients."[89]

Insights into How Institutional Investors Use Proxy Advisory Firms

TIAA-CREF offered one of the most detailed explanations of the role played by a proxy advisory firm, both as an adviser to an institutional investor on proxy issues and as a proxy voting agent: "TIAA-CREF subscribes to the corporate governance research publications of several firms, and utilizes the electronic voting services offered by one of these firms. In addition, we prepare and follow our own internal proxy voting guidelines, using proxy advisory firm research solely as an informational tool to supplement our internally produced research. Moreover, we formulate our own voting decisions in-house, and use the third-party voting platform only as a convenient and cost-effective instrumentality for transmitting our voting instructions to Broadridge, the agent for our custodial bank. In sum, these services inform and facilitate, but do not substitute for TIAA-CREF's exercise of independent judgment in arriving at our own decisions on how to direct the voting of portfolio company shares in the best interest of our beneficiaries… While the proxy advisors offer a standard voting policy, they also give their clients the option to view specialized policies such as those geared…to social investors or develop a custom policy based on an institution's internal guidelines. In this way, the vote mechanics and record keeping are technically 'outsourced,' but the institution itself retains the ability to customize the policy in furtherance of what the institution believes as a fiduciary to be

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10/s71410-276.pdf. In contrast, BlackRock wrote: "We see no evidence to suggest that investors are not acting of their own free will in making voting decisions, even for those investors who may voluntarily adopt the guidelines of a proxy advisory firm." http://www.sec.gov/comments/s7-14-10/s71410-254.pdf

[88] http://www.sec.gov/comments/s7-14-10/s71410-148.pdf

[89] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf

in the best interests of their clients. In short, the institutional shareholder -not the proxy advisory firm- is making the ultimate voting decision."[90]

The Pension Investment Association of Canada (PIAC) wrote: "We disagree with the notion that proxy advisory firms are controlling or significantly influencing shareholder voting without appropriate oversight or accountability…While proxy advisory firms provide vote recommendations, it is ultimately the investors hiring the proxy advisory firms that have control over the vote and the advisory firm is accountable to its clients. As noted in the Concept Release, the advisory firms owe a fiduciary duty to their clients; while we would not be opposed to a registration requirement, we do not believe it is necessary to impose additional regulation on proxy advisory firms."[91]

It was interesting to note that few institutional investors were prepared to go on the record and admit weaknesses in their business models with regard to the supervision and management of their "fiduciary" responsibilities concerning the voting of shares. A number of corporate issuers were eager to point out, as Pfizer did in its letter: "in our experience many smaller institutional investors lack the staff and other resources needed to carefully evaluate matters being voted on, and such investors base their votes largely or entirely on proxy firms' recommendations."[92] TIAA-CREF, which is certainly not a "small" institution, also indicated that its obligations to vote shares created a substantial administrative burden: "Though we dedicate a significant amount of resources to corporate governance research and the voting of proxies, we still would have difficulty processing the 80,000 plus unique agenda items voted by our staff annually without utilizing this research. Particularly for routine meetings, the underlying information contained in these reports is organized in such a way as to allow our staff to more efficiently apply our internal policies." [93]

Investment managers have some responsibility to ensure that there is adequate staffing and processes in place to catch problems/errors by proxy advisory firms, but few feel that additional regulations are necessary. Perhaps such views are biased by the fact that some large institutions are far better staffed, equipped and managed than others to analyze the information sent by proxy advisory firms and to manage the proxy voting process. BlackRock noted that while there is a significant issue related to the accuracy and reliability of reports by proxy advisers, there is not enough of a cause for concern to justify additional regulation: "Issuers sometimes raise concerns about inaccurate or incomplete data appearing in a proxy advisory firm's report. In our experience we have sometimes found this to be an issue, though the quality of proxy research, in our view, has generally improved over time. This is also an issue on which investors regularly engage and provide feedback to the proxy advisory firms. We believe that substantial additional regulation of proxy advisory firms would likely impose costs that will ultimately be borne by investors. We encourage the Commission to allow investors, and the

[90] http://www.sec.gov/comments/s7-14-10/s71410-263.pdf
[91] http://www.sec.gov/comments/s7-14-10/s71410-288.pdf
[92] http://www.sec.gov/comments/s7-14-10/s71410-277.pdf
[93] http://www.sec.gov/comments/s7-14-10/s71410-263.pdf

market for proxy research, to impose discipline on providers…improvements in the quality of proxy research over the past several years suggest that the discipline of the market is working."[94]

Some institutions expressed opposition to a proposal from some companies to create a process by which issuers would be able to review and comment on draft reports by proxy advisory firms. Norges Bank Investment Management (NBIM) summed up the counter-argument succinctly: "Suggestions that the proxy research firms must publish their analysis and allow companies a right to review research and recommendations represent risks to the independence and efficiency of the services."[95]

What Additional Regulations Could Selected Institutional Investors Support?

Despite a number of large institutions and certain industry groups, such as ICI, opposing additional regulation of proxy advisory firms, some commenters from the institutional investment community found common ground with particular concerns expressed by corporate issuers, while some left the door open to supporting new rules concerning proxy advisory firms. For example, the California Public Employees' Retirement System (CalPERS) wrote that it is "supportive of efforts to ensure advisory firms are transparent and accountable."[96] CII also indicated that while it "opposes regulatory involvement in methodologies used by proxy advisers to determine vote recommendations," it "supports the registration of proxy advisory firms."

The most significant issue upon which many corporate issuers and some institutions submitting comments found common ground was agreement that the practice of some proxy advisers (ISS in particular) of providing consulting services to issuers with regard to the same matters that they are making voting recommendations on presents an inherent conflict of interest. CalPERS urged the Commission to require "full and complete disclosure of all conflicts of interest on the part of proxy advisory firms, especially as such conflicts relate to consulting services in conjunction with providing proxy vote recommendations" and the "disclosure of policies and procedures for interacting with both issuers and shareowners, informing issuers and shareowners of recommendations, and handling appeals of proxy advisory firm vote recommendations."[97] Capital Research & Management Company noted that: "Concerns about conflicts do occur when an advisory firm provides services both to an issuer and to shareholders, without sufficient disclosure related to the exact nature of the services provided. Whether through new or existing rules, we believe additional disclosure about potential conflicts is warranted. Additionally, more transparency surrounding the research and decision process at the various firms likely would mitigate existing concerns about the independence and thoroughness of the analysis."[98] Standard Life Investments "would welcome a clear policy regarding conflicts

[94] http://www.sec.gov/comments/s7-14-10/s71410-254.pdf
[95] http://www.sec.gov/comments/s7-14-10/s71410-251.pdf
[96] http://www.sec.gov/comments/s7-14-10/s71410-177.pdf
[97] http://www.sec.gov/comments/s7-14-10/s71410-177.pdf
[98] http://www.sec.gov/comments/s7-14-10/s71410-233.pdf

of interest of proxy advisory firms."[99] New York City Comptroller[100] John Liu supports increased regulation compelling additional disclosures regarding potential conflicts of interest: "Currently, the disclosure provided by proxy advisory firms is generally limited to a disclaimer that they provide consulting or other advisory services to an issuer. The integrity of the system would be strengthened if proxy advisory services are required to provide full disclosure of all conflicts of interest, particularly regarding relationships with issuers on which proxy analyses are conducted and vote recommendations are provided."[101] Treasurer Denise L. Nappier (Connecticut) also wrote that she supports "initiatives to clarify disclosure obligations around actual or potential conflicts of interest on the part of proxy advisory firms."[102] Hermes Equity Ownership Services (EOS) finds: "the current system of 'fire walls' and vague disclosure presently employed by advisory firms to be insufficient. We support the Commission's consideration of regulations aimed at addressing this issue by requiring increased transparency of proxy advisory firms to eliminate or reduce conflicts of interest by establishing detailed disclosure requirements relating to their fees, client relationships, conflicts and research procedures."[103] The Pension Investment Association of Canada (PIAC) noted in its letter that: "generic disclosure statements are inadequate and proxy advisory firms should make specific disclosure regarding the presence of a potential conflict of interest."[104] Even the AFL-CIO's Office of Investment recommended that: "proxy advisory firms should disclose to their clients when corporate issuers purchase consulting services."[105]

One institutional investor wrote in to urge the effective carving up of ISS due to potential conflicts of interest. The Universities Superannuation Scheme ("USS"), which is the second largest pension fund in the United Kingdom, wrote: "USS is concerned about the potential conflict of interest experienced by some proxy voting advisory firms in providing proxy voting recommendations to shareholders and consulting services to corporations. USS believes that these service areas should be completely separated."[106]

Of all the public pension funds submitting comments, it was the State Board of Administration (SBA) of Florida, which manages assets of the Florida Retirement System, that advanced the broadest agenda for changing the regulatory environment for proxy advisory firms. The SBA urged: "transparency surrounding the application of policies and varied analytical methodologies used by proxy advisory firms and supports additional regulation of the industry, including requiring all proxy advisory firms to register with the Commission as investment advisors. The Commission should reexamine the applicability of Rule 14a-2(b)(3) to proxy advisory firms and related solicitation activity exemption. Because of the possibility for conflicts

[99] http://www.sec.gov/comments/s7-14-10/s71410-102.pdf
[100] The city's comptroller is the trustee of four of the five New York City pension funds, and the investment adviser to all five funds.
[101] http://www.sec.gov/comments/s7-14-10/s71410-187.pdf
[102] http://www.sec.gov/comments/s7-14-10/s71410-124.pdf
[103] http://www.sec.gov/comments/s7-14-10/s71410-150.pdf
[104] http://www.sec.gov/comments/s7-14-10/s71410-288.pdf
[105] http://www.sec.gov/comments/s7-14-10/s71410-149.pdf
[106] http://www.sec.gov/comments/s7-14-10/s71410-214.pdf

of interest to arise for proxy advisory firms who consult companies on some of the same issues for which they provide shareowner recommendations, SBA staff supports proxy advisory firms being subject to regular audits…Independent external audits of proxy advisory firms' models and advice would also serve to ensure to clients the soundness and proper application of stated analyses and policies….SBA staff fully supports the proposal for expanded investor disclosure of the proxy advisory firm(s) it has utilized in its proxy voting decisions, the extent to which the fiduciary has voted in accordance with the recommendations of proxy advisory firm(s), and the procedures employed by the investment fiduciary to make voting decisions."[107]

It is also notable that some institutional investors writing to the Commission pointed out that they have a stake in ensuring that reports by proxy advisory firms are accurate. As TIAA-CREF noted: "Because of the way we utilize the services of the proxy advisors, TlAA-CREF has a significant stake in the accuracy and completeness of the research reports we purchase to aid our internal voting determination processes…the SEC's considerations concerning proxy advisors also must focus on whether or not institutional investors are using these services properly given their fiduciary duties in ensuring that they are voting in best interests of their clients. We believe that institutional investors have a responsibility to ensure they use proxy advisors in a way that is consistent with being a responsible investor." Thus, TIAA-CREF recommended that: "Rather than confining itself (the Commission) to the 'either/or' proposition of amending the current exemptive provision, Rule 14a-2(b)(3), regulating these firms as investment advisers or creating an 'NRSRO-style' model for regulation of the firms' subscriber paid business, the SEC should proceed to publish proposed rule amendments soliciting specific comment on all three approaches." In contrast, Capital Research & Management noted that while it shares issuers' concerns with "with respect to advisory firm accuracy because we occasionally have found errors in data included in their reports" any "process that allows issuers to review an advisory firm's recommendations should be carefully considered…to avoid the appearance that negotiations are taking place which might create an additional conflict."[108]

The investment manager for one of the world's largest sovereign wealth funds indicated that it would like to see measures taken to promote competition among proxy advisory firms. Whereas corporate issuers were largely silent on the question of competition, institutions are basically consumers of information from the proxy advisory firms and may want to see more, not less, from proxy advisers. NBIM commented: "We believe that ensuring competition is the best avenue to avoid the risk that any one research firm will exercise unreasonable influence over vote outcomes. We also note that there is currently significant competition in this field of services, as evidenced by the way the supply side of the landscape has evolved over the last decade…regulations of proxy research firms may drive up costs and barriers to entry."[109]

[107] http://www.sec.gov/comments/s7-14-10/s71410-180.pdf
[108] http://www.sec.gov/comments/s7-14-10/s71410-233.pdf
[109] http://www.sec.gov/comments/s7-14-10/s71410-251.pdf

Impact of Say-on-Pay Votes and Related Institutional Reporting

On January 25, 2011, the SEC adopted new rules regarding shareholder advisory votes on executive compensation (say-on-pay) and so-called "golden parachute" arrangements.[110] Unfortunately, many of the letters from institutions discussing issues related to proxy advisory firms are now somewhat dated in that they did not factor in the Commission's new rules for implementing certain Dodd-Frank requirements. The role and influence of proxy advisory firms, and the burden imposed on institutions for managing proxy voting, is expected to increase sharply starting this year: now that many institutional investors will be voting on more say-on-pay resolutions each year (and may soon be required, via a revised Form N-PX, to disclose and report on all such votes). Pursuant to Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Section 14 of the Securities Exchange Act of 1934 now includes a provision requiring that institutional investment managers that are subject to 13F filing requirements (firms exercising investment discretion over $100 million or more of "13F-eligible" securities) file public reports on a revised Form N-PX concerning how they voted proxies related to "say-on-pay" resolutions and "golden parachute" compensation arrangements. The disclosures will cover 13F-eligible shares over which the manager exercised "voting power," that is, even if the manager does not exercise investment discretion over a particular share. The SEC is expected to decide on its proposed rules for implementing the new reporting requirements within the next month. (For further details, please see The Altman Group's recently published Client Alert on these developments, which is available on our website.)[111]

OTHER NOTABLE COMMENTS

The Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce ("Chamber") submitted details on a proposal that it delivered to ISS directly – one that presents a significant alternative to meeting the concerns of some corporate issuers about having a process in place to ensure a higher degree of accuracy and completeness in the generation of reports by proxy advisory firms. The Chamber's proposed solution is the: "development of a Code of Standards in the formulation and annual updating of ISS' benchmark U.S. corporate governance policies…These standards will establish a process to allow for input by all parties as well as to provide clear rules of the road to prevent arbitrary and capricious decision-making."[112] The standards developed would involve the following:

[110] The SEC's final rule on "Shareholder Approval of Executive Compensation and Golden Parachute Compensation" is available at http://www.sec.gov/rules/final/2011/33-9178.pdf.
[111] http://www.altmangroup.com/pdf/SayonPayTAG.pdf
[112] See memorandum from Thomas Quaadman (VP, CCMC) to Ethan Berman, Advisory Director, RiskMetrics Group, Inc., Martha Carter, Global Head of Governance Research at RiskMetrics and Patrick McGurn, Special Counsel. http://www.sec.gov/comments/s7-14-10/s71410-268.pdf

- "Publish written standards for policy development which require that policies and amendments be based in an objective and balanced manner based on input from interested parties, as well as statistical and other evidence that may be available.

- Require advance notice of any proposed changes to ISS' voting policies and an opportunity for public input on any proposed changes before implementation. Also, specified proposed changes should be published for public comment for a minimum specified period, allowing for a uniform system of written input from companies, investors, and other interested parties**.**

- Require that all other contacts with interested parties on specific proposed changes be documented and included in the public file, along with any other submitted evidence, including completed questionnaires and other surveys that have been submitted by interested parties. All other evidence relevant to the policies in question should also be placed in a public file.

- Conform to other basic requirements for transparency and due process similar to those contained in the Administrative Procedures Act, including transparency of any deliberations about new or amended policies. Accordingly, an open process should be developed to allow companies to appeal decisions made in policy development and recommendations.

- Provide for an annual review of existing policies to determine whether change is needed and to solicit input on any identified current developments. For example, hold an annual discussion forum with industry constituencies, academics, and other interested parties to address specific or localized topics.

- Provide for an annual industry-wide review of impact on policies on proxy voting and to identify potential issues in the voting recommendation process. Review identified industry-wide impediments to the efficient and accurate use of these voting recommendations."

The Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association (ABA) urged the Commission to tighten regulations concerning proxy advisory firms with respect to the following: "(1) the services performed by the proxy advisory firm; (2) the objectives of any advice or recommendation and the expected connection between the recommendation or advice and the stated objectives; (3) actual voting recommendations and any responses received from companies; (4) the controls in place regarding execution of votes, and any failures the firm has experienced in vote execution; (5) the procedures used to ensure that such advice or recommendation is developed with due care and based on factually accurate information (and the degree to which companies and other

interested parties are encouraged or permitted to confirm or otherwise comment on such information); (6) the monitoring processes, if any, used to test whether and to what extent such advice or recommendation in fact achieves the stated objectives over time; and (7) any relevant conflicts of interest."[113] The Committee opposes a system that would enable the proxy advisory firms to make disclosures available only to a firm's clients or paid subscribers: "We would prefer to see the Commission require this type of disclosure to be publicly available, through the Commission's website or other freely available website…we would encourage the Commission to develop a framework that would provide for such disclosure, which we think the Commission could do under its existing authority. This disclosure might be accomplished, for example, through mandatory registration of proxy advisory firms under the Investment Advisers Act of 1940 (the "Advisers Act")…and then with specific rule changes to mandate certain disclosure or a version of Form ADV….the Commission could consider defining assets under management, for purposes of the registration threshold, as including assets as to which voting advice or recommendations are provided." Consistent with the ABA Committee's recommendation to require registration of proxy advisers as investment advisers, the Committee noted that a proxy advisor should be required to discharge its "responsibilities according to the same standards that would be applicable to its principal" with respect to the voting of shares. Either that, or arrangements between investors and proxy advisors should "clearly delimit the extent of the delegation or agency."

WHAT DO THE PROXY ADVISORY FIRMS HAVE TO SAY?

Comments and recommendations from ISS,[114] GL,[115] Egan-Jones,[116] and Marco Consulting Group reflect contending interests in a highly competitive industry that is both under the microscope and facing potential changes to the regulatory environment that will shape the future of their industry. While comments from ISS offered a largely pro forma description and defense of its business model, GL urged significant regulatory changes (while opposing any regulation that would require them to register as an investment advisor under Section 203A(c), since "proxy advisors do not provide investment advice"): "We believe the S.E.C. should adopt rules to eliminate, reduce or require disclosure of conflicts to the greatest extent possible. Since conflicts can arise not just in the provision of services but even in the solicitation of them, the cleanest and most effective way to manage conflicts is to not have them. Recognizing this, we were founded with the core policy of not providing any consulting services for corporate issuers. As a result, Glass Lewis does not solicit nor provide consulting services to the corporate issuers whose proxy proposals we analyze. We believe this is a model the S.E.C. should consider…advisors should specifically disclose information about their conflicts arising from

[113] http://www.sec.gov/comments/s7-14-10/s71410-283.pdf
[114] http://www.sec.gov/comments/s7-14-10/s71410-154.pdf
[115] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf
[116] http://www.sec.gov/comments/s7-14-10/s71410-293.pdf

selling consulting services to issuers, just as public companies must disclose conflicts from buying services from providers such as audit firms and compensation consultants… Alternatively, since we believe requiring more specific disclosure regarding conflicts would be the most effective means, apart from prohibiting certain conflicts altogether, to address conflicts, we believe proxy advisors could be made subject to Exchange Act Rule 14a-2(b)(3), wherein advisors would disclose any significant relationship with issuers."[117]

ISS argued that while it opposes "additional regulation at this time," if the Commission seeks to change the regulatory environment then the "best approach would be to make appropriate adjustment to the Advisers Act, an existing structure that (as the Commission notes in the Release) already covers half of the industry's current providers."[118] ISS, which is already a registered investment adviser, concludes that: "the Advisers Act provides an appropriate means for overseeing proxy advisory firms and protecting the interests of investors and other stakeholders…the recently revised investment adviser disclosure document, Part 2 of Form ADV, is ideally suited to proxy advisory firms…many clients of proxy advisory firms are themselves registered investment advisers who look to the proxy firms for assistance in satisfying their own fiduciary obligations. We believe that investors benefit from having proxy advisors subject to the same regulatory regime (including Advisers Act Rule 206(4)-6) as their clients….we advocate an exemption clarifying and affirming the ability of all proxy advisory firms to register as investment advisers….the conflict of interest disclosures required by the new Form ADV, Part 2 are as rigorous as those required by Form NRSRO, if not more so…Codes of Ethics are not mandatory for NRSROs."[119] MCG, which is also a registered investment adviser, wrote that it "sees no reason why all proxy advisory firms should not also be so registered."[120]

Glass, Lewis & Co., which is not a registered investment adviser, pressed for reforms in keeping with its business model. The firm urged the Commission to "create a new exclusion from the definition of investment adviser in Section 202(a)(11) (similar to the publisher's exception), whereby proxy advisory firms would be exempt from registration but instead would be required to comply with certain rules which would (i) preclude them from carrying out certain activities that conflict with their role as proxy advisors (e.g. consulting with issuers) and (ii) require the implementation of a formal conflict disclosure process to address existing and unavoidable conflicts of interest."[121]

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[117] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf
[118] http://www.sec.gov/comments/s7-14-10/s71410-154.pdf
[119] ISS also challenges arguments about regulating proxy advisers as NRSROs by pointing out that the: "NRSRO regulatory regime addresses the conflicts of interest faced by 'subscriber-paid' rating agencies…conflicts of 'issuer-paid' firms. Since issuers do not pay proxy advisory firms to supply vote recommendations to investors, many NRSRO rules are inapposite to proxy advisors." http://www.sec.gov/comments/s7-14-10/s71410-154.pdf
[120] http://www.sec.gov/comments/s7-14-10/s71410-148.pdf
[121] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf

Addressing Conflicts of Interest

The submission from ISS started with a diplomatic note: "ISS acknowledges that it, like many businesses, is not immune from potential conflicts of interest….The Release discusses in particular the potential for a conflict between ISS' core business of analyzing the proxies of corporate issuers and making vote recommendations for the benefit of institutional investors, and the work of an ISS subsidiary, ISS Corporate Services, Inc. (referred to as "ICS"), which sells tools and advisory services directly to corporate issuers." ISS went on to address related concerns with a declaration that: "We effectively manage potential conflicts, including the one relating to the ICS business, through a combination of the consistent and transparent application of our voting policies, a robust compliance program, implementation of a 'firewall' to mitigate conflicts around the ICS business, and disclosure."[122]

Some commenters want to see more than just boilerplate disclosures concerning conflicts of interest. ISS explains that: "Each proxy analysis and research report issued by ISS contains a legend indicating that the subject of the analysis or report may be a client of ICS. Specifically, each proxy analysis discloses to investor clients that the issuer that is the subject of such analysis may be a client of ISS, ICS, or another MSCI subsidiary or the parent of, or affiliated with, a client of ISS, ICS or another MSCI subsidiary. Additionally, each analysis notes that one or more proponents of a shareholder proposal may be a client of ISS or one of its affiliates, or may be affiliated with a client of ISS or one of its affiliates."[123] In contrast, GL explained that: "when an institutional shareholder client solicits votes via a shareholder proposal, contest, or a director 'vote no' campaign, we disclose that on the front page of our report. We also specifically disclose when an investment manager subsidiary of a public company on which we are writing a report subscribes to our research. Furthermore, where our parent, Ontario Teachers' Pension Plan, has a significant, reportable stake in a company, has publicly announced its ownership in a company or Glass Lewis becomes aware through public disclosure of OTPP's ownership stake in a company we are covering, we disclose that on the front page of our report for that company."[124]

GL resists pressure for additional disclosures. GL commented: "We do not believe public disclosure of our research either in general or relating to executive compensation plans in particular would provide any benefit in regard to conflicts…the best way to address conflicts is to not have them; the next best method is robust disclosure about the relationship."[125] GL went on to explain that it does "not believe that giving away our research, even after a company's

[122] http://www.sec.gov/comments/s7-14-10/s71410-154.pdf
[123] In its letter to the Commission, ISS details its compliance program, code of ethics, training, and "firewall," which: "includes the physical and functional separation between ICS and the rest of the organization, with a particular focus on the separation of ICS from the ISS Global Research team…quarterly tests of the ICS/ISS firewall, new hire orientation and review of certain marketing materials and disclosures. There is an ethics hotline available to both ICS and ISS staff for reporting potential issues of concern." http://www.sec.gov/comments/s7-14-10/s71410-154.pdf
[124] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf
[125] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf

shareholder meeting, is an effective way, never mind the best way, to address potential risks…public disclosure may (also) encourage companies to match their practices to advisers' models rather than designing programs that are in the interest of shareholders."[126]

While some commenters want more issuer-specific disclosures available in published reports, ISS notes that it has set up a process whereby "institutional clients" can get access to "specific details about an issuer's use of ICS products and services" through ISS' Legal and Compliance department, "including the amount of compensation that the firm has received or will receive from the issuer."[127] According to ISS, "this process ensures that the identity of an ICS client is not readily available to a research analyst as she prepares vote recommendations and other research."[128]

Accuracy

When addressing the subject of accuracy, ISS noted that it uses a "policy-based" approach in which the firm already has an open process (with an open comment period): "To our knowledge, ISS is the only proxy advisor to gather, assess and incorporate market feedback into its institutional proxy voting policies. ISS remains committed to enhancing its policy formulation process through this interaction." Of course, key issues before the Commission are whether ISS' "firewall" is enough to mitigate conflicts, and whether there needs to be additional regulations to ensure that issuer-specific information, and not just policy-based analysis, is accurate. In addition, a number of corporate issuers want to see regulations providing them with an opportunity to review and comment on draft reports in a timely manner.

ISS goes on to describe how it: "goes to great lengths to ensure that…reports are complete and accurate." The letter details the firm's processes: "Prior to delivery to our clients, each proxy analysis undergoes a rigorous internal review for accuracy and to ensure that the relevant voting policy has been applied. In the United States, companies found in the Standard & Poor's 500 index generally receive an opportunity to review a draft analysis for factual accuracy prior to delivery of the analysis. ISS reviews other requests for review and comment on a case-by-case basis. All issuers may request and receive at no charge a copy of the published ISS analysis of its shareholder meeting. In the event new information becomes available or if ISS determines that a report contains a material error, ISS sends an updated version of the report to its investor clients. ISS also conducts periodic SAS-70 audits to ensure compliance with our

[126] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf

[127] The SEC provided guidance in 2004 to both Egan Jones Proxy Services and ISS suggesting that "an investment adviser require a proxy voting firm to disclose to the adviser any relevant facts concerning the firm's relationship with an Issuer, such as the amount of the compensation that the firm has received or will receive from the Issuer." As the SEC explained in its response to ISS (Sept. 15, 2004): "In the Egan-Jones Letter, we stated that an investment adviser should obtain information from any prospective proxy voting firm to enable the adviser to determine that the firm is in fact independent, and can make recommendations for voting proxies in an impartial manner and in the best interests of the adviser's clients. We suggested that an investment adviser also obtain such information on an ongoing basis from any proxy voting firm that it employs." See http://www.sec.gov/divisions/investment/noaction/iss091504.htm

[128] http://www.sec.gov/comments/s7-14-10/s71410-154.pdf

internal control processes. Our research process is included in these audits. We believe that these controls reduce the likelihood that an analysis will be published with material errors but also provides a correction mechanism after a report has been delivered."

ISS also considers its "policy-based approach" to be a factor enabling "ISS clients (and non-clients alike) to continually monitor and assess the integrity of ISS' reports by making sure that ISS is faithfully and thoughtfully applying its policy guidelines." However, both the concept release and some corporate issuers have raised questions about a "one-size-fits-all" approach to generating voting recommendations. ISS counters that its "policies allow analysts to consider company- and market-specific factors in generating vote recommendations."[129]

Egan-Jones Ratings Company, in a narrowly focused letter from Managing Director Kent S. Hughes, objected to the very concept of communicating with issuers prior to the publication of a proxy research report due to "the importance of independence in our proxy services." Egan-Jones does not want to contact issuers "in advance of publishing a proxy research report, as we believe it would risk compromising our independence."[130]

Glass, Lewis & Co. also responded to the controversies over accuracy and "one-size-fits all" analytical approaches. GL commented that it conducts "a detailed analysis of each issue at each company while eschewing a one-size-fits-all approach."[131] GL went on to explain that the publication of its reports well in advance of meeting dates: "allows for sufficient time for us to revise reports, if necessary, in response to input from issuers and their representatives. Furthermore, just as we disclose specific information about conflicts on the front page of our reports, we describe the exact nature of all report revisions, including changes to our recommendations, on the front page of our reports. While we post summary versions of our guidelines and approach to evaluating compensation on our public website, we only share our guidelines and proprietary approaches to evaluating compensation with our paying clients."[132]

CONCLUSION

The record developed by comments submitted in connection with the SEC's Concept Release on the U.S. Proxy System suggests that there is no debate over the proposition that proxy advisory firms have strong influence over proxy votes by certain institutions. Whether the actions of ISS, GL, Egan-Jones, MCG, or other proxy advisory firms can, either independently or as an industry, swing 0.1% of a shareholder vote or 30% of a vote is less relevant to the regulatory questions presented in the concept release than whether proxy advisory firms can affect the outcome of a close shareholder vote. There is little question that the actions of proxy advisory firms could be outcome determinative in close votes. Indeed, if there is risk that there could be a single instance in which the conduct of a proxy voting agent or proxy adviser might

[129] http://www.sec.gov/comments/s7-14-10/s71410-154.pdf
[130] http://www.sec.gov/comments/s7-14-10/s71410-293.pdf
[131] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf
[132] http://www.sec.gov/comments/s7-14-10/s71410-100.pdf

affect the outcome of a shareholder vote, then there is a need for the Commission to ensure that the regulatory architecture minimizes factual errors contained in reports distributed by proxy advisers, mitigates or eliminates conflicts of interest, and promotes a level of transparency on the part of proxy advisory firms that will increase confidence in the overall proxy voting system.

Letters to the Commission were remarkable for the fact that there were certain areas of common ground on some regulatory options between not only selected corporate issuers and institutional investors but also certain proxy advisory firms. For example, ISS and MCG were open to having proxy advisory firms registered as investment advisers (and thus required to implement certain required processes, such as codes of ethics, in order to mitigate conflicts of interest and enhance disclosures through Form ADVs). On the other hand, GL is open to adopting rules to "eliminate, reduce or require disclosure of conflicts to the greatest extent possible," including consideration of a business model that does not involve proxy advisors providing consulting services to the corporate issuers covered in the reports of an advisor. Failing that, GL charted some common ground with certain issuers and investors when arguing that "advisors should specifically disclose information about their conflicts arising from selling consulting services to issuers, just as public companies must disclose conflicts from buying services from providers such as audit firms and compensation consultants."

There was significant common ground between selected corporate issuers and investors on the need for new rules related to disclosures concerning potential conflicts of interest and the accuracy of analytical processes, "models," and data used by proxy advisory firms. The path of least resistance in this regard is an expansion of required disclosures in Form ADVs (even if all proxy advisory firms are not required to be registered). However, significant controversy remains over whether to have a formal review and comment process on draft reports open to issuers. Moreover, in our opinion the demands of some corporate issuers for a regulated review and comment process (or even a form of what could be called "proxy report access" [potentially requiring proxy advisers to include comments from issuers in their distributed reports]) may present more problems than it would solve (e.g., with regard to creating responsibilities on the part of issuers to correct known errors in such reports and any potential liabilities for errors introduced by issuers).

The debate over potential regulatory changes impacting proxy advisory firms has also highlighted what some institutional investors and proxy advisory firms noted in their letters is a significant gap in understanding about exactly how proxy voting decisions are arrived at by institutional investors. While the decision-making and implementation processes for institutional proxy votes vary widely among institutions, the most significant point made by commenters is that every investment manager retains ultimate control over the processes (internal or outsourced) by which proxy voting decisions are made. Most institutions do use a wide variety of resources for analyzing information related to each vote, and have key decision-makers within their firms that can intervene to exercise their own influence and override choices driven by the recommendations of ISS or GL. While some issuers may not like the results of institutions following the ISS "policy-driven" model, which does result in voting decisions that some companies see as poorly reasoned, issuers can, do, and should work harder to influence the

development of such policies and to increase communications with key decision-makers at the institutions that are their top shareholders. Indeed, The Altman Group has been a leader in the effort to inform issuers (through our Governance Risk Assessments and vote forecasts) of the exact level of influence that ISS, GL, and other proxy advisory firms (worldwide) have in shaping institutional voting behavior. Moreover, we encourage issuers to explore ways of increasing communications with those persons at top institutional shareholders who are open to having discussions with issuers on corporate governance topics (e.g., through Governance Roadshows).

On a final note, while commenters may argue over the degree of influence exercised by proxy advisory firms over institutional voting behavior, a record has now been clearly established in the proceedings of the Commission showing that third parties that do not have a direct economic interest in vote outcomes can, nonetheless, wield substantial influence over the results of shareholder votes. In this context, the Commission should consider reform options that would increase voting participation rates in general, and particularly so among retail investors, in order to reduce the impact on vote outcomes of third parties having no direct economic interests at stake. In addition, current regulations enable proxy voting agents to have more information than corporate issuers do concerning which institutions are eligible to vote shares and the potential voting power of those shareholders (e.g., voting record date information on positions held by clients of proxy voting agents, as well as other ownership information that may not be available to issuers through public filings or lists of Non-Objecting Beneficial Owners [NOBOs]). For these reasons, as well as others detailed in letters submitted by The Altman Group to the Commission,[133] we believe that the SEC should restore balance to the proxy voting system by adopting an All Beneficial Owners (ABO) process for limited event-based disclosures of beneficial ownership (note: a similar "annual NOBO" [ANOBO] process was discussed in the concept release).[134] An ANOBO/ABO process would enable issuers to identify and enhance communications with all of their shareholders as of voting record dates, and in particular those shareholders eligible to vote which are, under current regulations, known at that time only to their proxy voting agents and not to issuers.

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[133] See Ken Altman's most recent submission to the Commission concerning the Concept Release on the U.S. Proxy System dated Oct. 20, 2010. http://www.sec.gov/comments/s7-14-10/s71410-159.pdf

[134] The concept release describes a similar "annual NOBO" option as follows: "an issuer would be entitled to a list of all beneficial owners, but only as of the record date for a particular meeting. In such a system (an "annual NOBO" system), objecting beneficial owners would not be able to shield their identity for purposes of a shareholder meeting. At any other time during the year, objecting beneficial owner information would not be available to the issuer or any other party." http://www.sec.gov/rules/concept/2010/34-62495.pdf