Council of Institutional Investors®
The voice of corporate governance

Via Hand Delivery

February 27, 2018

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, DC 20510

Re: Proposed Legislation Relating to Proxy Advisory Firms and Institutional Investors

Dear Mr. Chairman and Ranking Member Brown:

On behalf of the Council of Institutional Investors (CII) and the undersigned 48 investors and investor organizations, we are writing to express our opposition to legislation that was recently passed by the House of Representatives. The legislation, H.R. 4015, "The Corporate Governance Reform and Transparency Act of 2017," was referred to the Senate Banking Committee following its passage in the House on a nearly party-line vote on Dec. 20, 2017.

CII is a nonpartisan, nonprofit association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding $3.5 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $25 trillion in assets under management.[1]

Many CII members and other institutional investors employ proxy advisory firms to obtain cost-effective independent research to help inform their proxy voting and engagement decisions, and to execute votes based on funds' own proxy voting guidelines. Proxy voting is a critical means by which shareowners hold corporate executives and boards to account and is a hallmark of shareholder ownership and accountability. The system of corporate governance in the United States relies on the accountability of CEOs and boards of directors alike to shareowners, and

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[1] For more information about the Council of Institutional Investors (Council or CII) and our members, please visit the Council's website at http://www.cii.org/about_us. We note that the two largest U.S. proxy advisory firms, Glass Lewis & Co. and Institutional Shareholder Services Inc. (ISS), are non-voting associate members of CII, paying an aggregate of $24,000 in annual dues—less than 1.0 percent of CII's membership revenues. In addition, CII is a client of ISS, paying approximately $19,600 annually to ISS for its proxy research.

ensuring unencumbered shareholder access to independent research is a crucial underpinning of effective corporate governance.

H.R. 4015 threatens to upend this very independence. It would require, as a matter of federal law, that proxy advisory firms share their research reports and proxy voting recommendations with the companies about whom they are writing before they are shared with the institutional investors who are their paying clients. While the stated goal of the proposed legislation is the "protection of investors," we believe the legislation would bias proxy advisory firms in favor of corporate management. We also believe that the new requirements it would impose are unnecessary, overly burdensome and counter-productive.

Further, the proposed legislation appears to be based on several false premises, including the erroneous conclusions that: (1) proxy advisory firms initiate many of the so-called "activist" hedge fund agendas; (2) proxy advisory firms dictate proxy voting results, and (3) institutional investors do not drive or form their own voting decisions. Indeed, while many pension funds and other institutional investors contract with proxy advisory firms to review their research, most large holders have adopted their own policies and may employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons.

In short, most large institutional investors do not "rubber stamp" the proxy advisory firms' recommendations. Rather, they vote their proxies according to their own guidelines. While many large institutional investors rely on proxy advisors to manage the analysis of issues presented in the proxy statements accompanying over 38,000 shareholder meetings annually, and to help administer proxy voting, this does not mean that they abdicate their responsibility for their own voting decisions.

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended against say-on-pay proposals at 11.92% of Russell 3000 companies in 2017, only 1.28% of those proposals received less than majority support from shareowners. Similarly, although ISS recommended votes in opposition to the election of 10.43% of director-nominees during the most recent proxy season, just 0.185% failed to obtain majority support.

We are particularly concerned that if enacted, H.R. 4015 would:

- **Grant companies the right to review the proxy advisory firms' research reports before the paying customers – investors – receive the reports;**
- **Mandate that proxy advisory firms hire an ombudsman to receive and resolve corporations' complaints**;
- **Require proxy advisory firms to publish a company's statement "detailing its complaints" in the proxy advisory firms' final reports to their clients, if the ombudsman is unable to resolve these complaints and if the company makes the request in writing;**
- **Increase barriers to new entrants and potentially lead some current proxy advisory firms to exit the industry altogether, and**
- **Provide no clear benefits to institutional investors.**

Giving corporate issuers the "right to review" the proxy advisors' work product BEFORE the reports go to the paying customers is unprecedented. It would give corporate management substantial undue influence over proxy advisory firms' reports. The approach would create a dynamic that would encourage proxy advisory firms to view management as their research clients, rather than the investors who contract for this research.

Another concern is that such forced pre-publication review may not be consistent with First Amendment rights to freedom of speech. Regardless, the attempt by government fiat to interpose corporate management between investors and those whom investors voluntarily hire to provide them with independent research is highly questionable as a matter of public policy and inconsistent with free-market principles.

Practically, the additional regulatory hurdles imposed would: (1) increase the complexity of the challenges faced by the proxy advisory firms; (2) impose even more severe time constraints on the production of reports, and (3) without a doubt, add significant resource burdens that would increase the cost of their services. The higher costs would likely be passed along to their institutional investor clients.

Under H.R. 4015, pension funds and other institutional investors would have less time to analyze the advisor's reports and recommendations in the context of their own adopted proxy voting guidelines to arrive at informed voting decisions. Time is already tight, particularly in the highly concentrated spring "proxy season," due to the limited period between a company's publication of the annual meeting proxy materials and annual meeting dates. Simply put, the proposed legislation is not constructive regulatory "reform," and is not supported by institutional investors.

Moreover, H.R. 4015 does not appear to contemplate a parallel requirement that dissidents in a proxy fight or proponents of shareowner proposals also receive the recommendations and research in advance. This would violate an underlying tenet of U.S. corporate governance that where matters are contested in corporate elections, management and shareowner advocates should operate on a level playing field.

H.R. 4015 would also require the Securities and Exchange Commission (SEC) to assess the ability of proxy advisory firms to perform their duties and to assess the adequacy of proxy advisory firms' "financial and managerial resources."

The entities that are in the best position to make assessments about whether any service provider – including proxy advisory firms – are adhering to contractual terms negotiated with clients are the clients themselves, not the government. Pension funds and other institutional investors that choose to purchase these services are sophisticated consumers who are fully capable of making prudent choices based on free-market principles.

In 2014, the SEC staff issued guidance reaffirming that investment advisors have a duty to maintain sufficient oversight of proxy advisory firms and other third-party voting agents. CII and many institutional investors publicly supported that guidance. We are unaware of any compelling empirical evidence indicating that the guidance is not being followed or that the burdensome federal regulatory scheme contemplated by the proposed legislation is needed.

If enacted, the proposed legislation would increase costs for pension plans and other institutional investors with no clear benefits.

The costs could rise substantially if investors seek to maintain current levels of scrutiny and due diligence around proxy voting amid the exit of some or all proxy advisory firms from the business. Proxy advisory firms, while imperfect, play an important and useful role in enabling effective and cost-efficient independent research, analysis and informed proxy voting advice for large institutional shareholders, particularly since many funds hold shares of thousands of companies in their investment portfolios.

We believe that the cost estimate provided by the Congressional Budget Office (CBO) to the House Financial Services Committee in December 2017 underestimates the costs that this bill would impose through private-sector mandates. The CBO should analyze the probable effects of the proposal on competition, and the costs to investors if: (1) competition is reduced and the pricing power of a surviving proxy advisory firm is enhanced, and (2) if all present firms exit the market and the services they provided are no longer available, forcing individual investors to use internal resources not subject to the new regulatory mandate.

Finally, we note that in October 2017, the United States Department of Treasury (Treasury) performed outreach to identify views on proxy advisory firms in connection with its report to the President on "A Financial System that Creates Economic Opportunities, Capital Markets." In that report, the Treasury found that "institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements." More importantly, the Treasury *did not* recommend any legislative changes governing the proxy advisory firm industry.

Thank you for considering these views. CII would be very happy to discuss its perspective in more detail. Jeff Mahoney can be reached at jeff@cii.org or by telephone at (202) 822-0800.

Sincerely,

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The Honorable Mark Warner, Ranking Member, Subcommittee on Securities, Insurance and Investment, Committee on Banking, Housing, and Urban Affairs
The Honorable Richard Shelby, Committee on Banking, Housing, and Urban Affairs
The Honorable Bob Corker, Committee on Banking, Housing, and Urban Affairs

The Honorable Patrick J. Toomey, Committee on Banking, Housing, and Urban Affairs
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