Statement of

Institutional Shareholder Services Inc.

To the

Securities and Exchange Commission Investor Advisory Committee

File No. 265-28

December 8, 2016

To: Members of the Committee:

Institutional Shareholder Services ("ISS"), a proxy adviser for more than thirty years and a federally registered investment adviser for almost twenty, is pleased to submit this statement in connection with the above-referenced meeting of the Securities Exchange Commission ("Commission") Investor Advisory Committee ("Committee").[1] Noting that the agenda for this meeting includes a discussion of investor protection priorities for the New Year, we respectfully request that this discussion address the appropriate regulation of proxy advisers.

As you may be aware, a bill known as H.R. 5311, the Corporate Governance Reform and Transparency Act of 2016 was reported out of the House Financial Services Committee earlier this year.[2] This proposed legislation would transfer the regulation of proxy advisers from an existing fiduciary-based regime under the Investment Advisers Act of 1940 ("Advisers Act") to a new, non-fiduciary regime under the Securities Exchange Act of 1934 ("Exchange Act"). For the reasons explained below, the new regime would make it difficult, if not impossible, for proxy advisers to provide independent and timely research on the broad universe of shareholder meetings they cover for their clients today. Thus, despite its name, the bill would deprive shareholders of the information they need to make informed voting decisions, thereby decreasing transparency in the corporate boardroom.

In furtherance of the Committee's mandate to advise on initiatives to protect investors and promote investor confidence in the U.S. securities markets, ISS asks the Committee to take two actions: First, we ask the Committee to recommend against passage of H.R. 5311. Second, we ask the Committee to recommend that the Commission take all action necessary to ensure that every firm providing proxy voting advice that purports to meet the objectives or needs of specific clients be regulated under the Advisers Act.

Proxy Advisers Play a Critical Role in the Protection of U.S. Investors

Over the past several years, proxy advisers have themselves become a proxy for the debate over the proper role of shareholders in corporate governance and the voice that shareholders should have in the companies they own. The Commission's 2013 Proxy Advisory Firms Roundtable ("Roundtable") highlighted the clear philosophical divide between investors and corporate management on this issue. While corporate representatives generally took a dim view of proxy advisers, investor representatives at the Roundtable emphasized the importance of

[1] ISS is the world's leading provider of corporate governance and socially responsible investment solutions for asset owners, asset managers, hedge funds, and asset service providers. As part of its suite of offerings, ISS serves as a full-service proxy adviser that helps institutional investors make informed proxy voting decisions, manage the complex process of voting their shares and report their votes to their stakeholders and regulators. ISS annually covers more than 39,000 shareholder meetings -- every holding in ISS' clients' portfolios -- in over 110 developed and emerging markets worldwide.

[2] H.R. 5311 has been incorporated into the Financial CHOICE Act, at Title X, Subtitle Q. ISS anticipates that 5311 – either alone or as part of a larger legislative initiative – will be reintroduced in the next Congress.

voting their shares as "a duty of good corporate citizenship"[3] and the vital role proxy advisers play in aggregating, synthesizing and making sense of the vast array of data found in proxy statements.[4] These institutional investors also showed a keen appreciation of their fiduciary responsibility to vote proxies in their clients' best interests, and a clear understanding that they cannot "offload" those responsibilities onto proxy advisers or other third parties.

A brief description of how proxy advisers like ISS operate shows why their services are so important to investors. Proxy season in the United States is concentrated primarily between mid-March and early June. This condensed schedule places enormous pressure on institutional investors, who may be called on to vote upwards of 25 - 30 meetings in a single day.[5] It also affects the process fiduciary advisers like ISS employ in producing proxy reports and formulating vote recommendations.

ISS collects and organizes data throughout the year on the roughly 39,000 public companies it tracks globally. When a proxy statement is issued -- typically four to six weeks before the shareholders meeting in the United States -- ISS assigns the statement to a member of its research and analytical team, which is organized by industry sector and subject-matter expertise (compensation or mergers/acquisitions, for example), who reviews the statement and begins to perform both quantitative and qualitative analyses on the issues presented. In the course of this process, ISS may communicate with issuers, investors and other interested parties; in contested situations, the firm routinely engages with both sides. Even in situations where ISS engages with interested parties, ISS relies only on publicly available information in preparing its research reports and making vote recommendations.

Once the review and analytical steps are complete, the analyst drafts the proxy research report. Insights gleaned from communications with interested parties are reflected in the reports if the analyst deems such information to be useful in helping institutional clients make more informed voting decisions. In some cases, ISS may include direct quotations from statements made by interested parties. At the discretion of the analyst, a brief "engagement summary" may be included as part of the analytical report.

ISS has adopted a number of policies and procedures designed to ensure the integrity of its research process. ISS' analyses and recommendations are driven by publicly disclosed and detailed policy guidelines and public information about the relevant proxy issues, in order to ensure consistency and to eliminate potential analyst implementation bias. In addition, before being delivered to clients, each proxy analysis undergoes a rigorous internal review for factual accuracy and to ensure that the relevant voting policy has been properly applied.

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[3] Remarks of Eric Komitee, General Counsel, Viking Global Investors, LP, Transcript of Proxy Advisory Firms Roundtable (December 5, 2013) ("Roundtable Transcript"), available at www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt at 74.

[4] Remarks of Michelle Edkins, Managing Director and Global Head, Corporate Governance and Responsible Investment, BlackRock, Inc., *Id.* at 45; remarks of Damon Silvers, Director of Policy and Special Counsel, AFL-CIO, *Id.* at 63.

[5] Remarks of Michelle Edkins, *Id.*at 45.

Given the important role proxy advisers play in assisting institutional investors fulfill their "duty of good corporate citizenship," ISS believes that proxy advisers should be subject to formal regulatory oversight of the type that is already provided by the Advisers Act.

Proxy Advisers are Appropriately Regulated under the Advisers Act

More than seventy-five years ago, the Advisers Act established a principles-based regulatory regime, the essence of which is the fiduciary relationship between an investment adviser and its clients. The statute defines the term "investment adviser" to mean any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities, or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports about securities.[6] This broad definition encompasses not only those who manage client portfolios, but also those who advise about ways to maximize the value of those portfolios.[7]

In its 2010 Concept Release on the U.S. Proxy System, the Commission confirmed the applicability of the Advisers Act to proxy advisers, saying:

> *[P]roxy advisory firms receive compensation for providing voting recommendations and analysis on matters submitted for a vote a shareholder meetings. . . . We understand that typically proxy advisory firms represent that they provide their clients with advice designed to enable institutional clients to maximize the value of their investments. In other words, proxy advisory firms provide analyses of shareholder proposals, director candidacies or corporate actions and provide advice concerning particular votes in a manner that is intended to assist their institutional clients in achieving their investment goals with respect to the voting securities they hold. In that way, proxy advisory firms meet the definition of investment adviser because they, for compensation, engage in the business of issuing reports or analyses concerning securities and providing advice to others as to the value of securities.*[8]

The SEC went on to explain the fiduciary implications of this characterization as follows:

> *The Supreme Court has construed Section 206 of the Advisers Act as establishing a federal fiduciary standard governing the conduct of investment advisers. The Court stated that '[t]he Advisers Act of 1940 reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a*

[6] Advisers Act Section 202(a)(11) [15 USC 80b-2(a)(11)].

[7] Although the statute excludes from the definition of investment adviser a publisher of a bona fide newspaper or news magazine or business or financial publication of general and regular circulation, this exemption is not available to parties who tailor their publications to the needs of individual clients. *Lowe v. Securities and Exchange Commission,* 472 U.S. 181 (1985) (in order to qualify for the publisher's exemption, the publication must, among other things, provide *impersonal* advice, as opposed to advice tailored to the individual needs of the customer).

[8] Concept Release on the U.S. Proxy System ("Concept Release"), SEC Rel. No. IA-3052 at 109-110, 75 Fed. Reg. 42981, 43010 (July 22, 2010).

> *congressional intent to eliminate or at least to expose, all conflicts of interest which might incline an investment advisers -- consciously or unconsciously -- to render advice which was not disinterested.' As investment advisers, proxy advisory firms owe fiduciary duties to their advisory clients.*[9]

The SEC's views on the fiduciary status of proxy advisers align with the long-standing and recently confirmed views of the U.S. Department of Labor ("DOL") on this topic. In its Release announcing a final regulation defining who is a "fiduciary" of an employee benefit plan under the Employee Retirement Income Security Act of 1974 ("ERISA"), the DOL noted that it

> *has long viewed the exercise of ownership rights as a fiduciary responsibility because of its material effect on plan investment goals. 29 CFR 2509 08-2 (2008). Consequently, recommendations on the exercise of proxy or other ownership rights are appropriately treated as fiduciary in nature.*[10]

The Advisers Act and the Commission's rules thereunder establish a robust and comprehensive regulatory regime that entails formal registration; the appointment of a chief compliance officer; the implementation of a comprehensive compliance program; the adoption of a code of ethics and procedures to prevent insider trading; extensive disclosures to clients, including disclosures regarding conflicts of interest and the mitigation thereof; recordkeeping requirements and regular compliance inspections and examinations.

As it stands today, three of the five U.S. proxy advisers, including ISS, are registered with the Commission under the Advisers Act. H.R. 5311 would upend this stable regulatory landscape to the detriment of investors.

H.R. 5311 Is an Aggressively Anti-Investor Bill

In the ongoing debate regarding the proper role of shareholders in corporate governance, H.R. 5311 clearly sides with corporate managers over the interests of tens of millions of Americans who entrust their retirement and investment dollars to pension funds, mutual funds, asset managers and other fiduciaries who hire proxy advisers. The proposed legislation would move proxy advisers out of the Advisers Act regulatory regime into a yet-to-be-created non-fiduciary regime under the Exchange Act. In many respects, the new regime is merely a pale imitation of the Advisers Act and related rules.[11]

However, H.R. 5311 differs from the Advisers Act in one glaring respect that interposes corporate management between proxy advisers and the investor clients they serve. Disguised as a safeguard of the "reliability" of proxy advisory services, proposed new Exchange Act Section 15H(g) would compel proxy advisers to furnish issuers with "reasonable" access to draft

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[9] *Id.* at 110 *(internal citations omitted), quoting SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-192 (1963).

[10] DOL, Employee Benefits Security Administration, *Definition of the Term "Fiduciary"; Conflict of Interest Rule - Retirement Investment Advice*, RIN 1210-AB32, Final Rule (April 1, 2016) at 77-78, 80 Fed. Reg. 21928, 21939 (April 20, 2016).

[11] ISS would be pleased to provide a side-by-side comparison of the existing and proposed regulatory requirements, if the Committee so desires.

recommendations and an opportunity to provide "meaningful" comment thereon, including the opportunity to present "details" to the person(s) responsible for developing the recommendations. “Draft recommendations” would mean not only the specific vote recommendations themselves, but also any “substantive analysis” affecting those recommendations. This provision would also require proxy advisers to employ an ombudsman to receive complaints about the "accuracy" of voting information used in making recommendations from the issuers subject to those recommendations, and would require those complaints to be “resolved” before the matter in question is voted on.

The ultimate power to define what is “reasonable” access or “meaningful” opportunity for comment about “details” would effectively rest with self-interested corporations, as would the power to decide when their complaints about the accuracy of voting information are “resolved.” Given that what issuers consider to be factual errors are often philosophical differences or outright disagreement with voting policies,[12] we believe that the proposed legislation is a thinly-veiled effort to give corporations effective veto-power over any vote recommendations they do not like. *Corporate issuers are not now and should not ever be the arbiters of proxy voting advice.*

The issuer review provision of H.R. 5311 is untenable from an operational standpoint as well. Given proxy season’s tight schedule, it would be extremely difficult for a proxy adviser like ISS that annually covers more than 39,000 shareholder meetings to afford each issuer the opportunity to review a draft proxy report for factual accuracy before delivering that report to clients. While difficult for a large firm like ISS, affording issuers the right to pre-review voting recommendations could be an impossible task for the three smaller proxy advisers, who might be compelled to exit the market altogether.

For these reasons, H.R.5311 has been opposed by the dozens of institutional investors and investor groups identified in Appendix A.

Conclusion

ISS respectfully asks the Committee to issue a formal recommendation opposing H.R. 5311 and any other legislation that would break the fiduciary bond between proxy advisers and investors. ISS also asks the Committee to recommend that the Commission take appropriate steps to ensure that all proxy advisers whose advice purports to meet the needs and objectives of specific clients are regulated under the Advisers Act. In this regard, the Commission could either enforce existing registration requirements or adopt new regulations to close perceived gaps in such requirements.

We would be happy to supply the Committee with additional information regarding any of the matters discussed above. Please direct any questions about this statement to Steven Friedman, our General Counsel, who can be reached at 301.556.0420 or our outside counsel, Mari-Anne Pisarri of Pickard Djinis and Pisarri LLP, who can be reached at 202.223.4418.

[12] Remarks of Anne Sheehan, Roundtable Transcript at 155 (“What I have found, that many times the errors are really differences of opinion”).

Appendix A

Opponents of H.R. 5311 Include:

- Americans for Financial Reform
- Australian Council of Superannuation Investors
- BMO Global Asset Management
- California State Teachers' Retirement System
- The Canadian Coalition for Good Governance
- Colorado Public Employees Retirement Association
- Connecticut State Treasurer
- Consumer Federation of America
- Council of Institutional Investors
- CtW Investment Group
- Environment Agency Pension Fund
- Fife Council Pension Fund
- Florida State Board of Administration
- Hermes Equity Ownership Services Limited
- Industriens Pension
- International Brotherhood of Teamsters
- Investment Company Institute
- Kames Capital
- Kapitalforeningen Unipension Invest
- Lawndale Capital Management
- Legal & General Investment Management Limited
- National Association of State Treasurers
- Newton Investment Management
- New York City Comptroller
- New York State Comptroller
- Ohio Public Employees Retirement System
- Ohio School Employees Retirement System
- State of Oregon
- Public Citizen
- RBC Global Asset Management
- RPMI Railpen
- Seattle City Employees' Retirement System
- Standard Life Investments
- TIAA
- UAW Retiree Medical Benefits Trust
- UK Local Authority Pension Fund Forum
- UNITE HERE
- United Brotherhood of Carpenters
- United Nations / Principles for Responsible Investment
- US SIF and US SIF Foundation
- USS Investment Management

- Vermont Office of the State Treasurer
- Walden Asset Management
- Washington State Investment Board
- Wespath Investment Management