February 24, 2014

The Honorable Mary Jo White  
Chair  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC  20549

Re: Proxy Advisory Services Roundtable File No. 4-670

Dear Chair White:

The U.S. Chamber of Commerce is the world’s largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness (“CMCC”) to promote a modern and effective regulatory structure for capital markets to fully function in the 21st century economy. An important priority of the CMCC is to advance an effective and transparent corporate governance system that encourages shareholder communications and participation. We wish to bring to you attention an issue that underscores need to have increased oversight, transparency and accountability of proxy advisory firms.

As you know, we look forward to working with the Securities and Exchange Commission (“Commission”) and its Staff in implementing those ideas raised at the Roundtable that the Commission ultimately concludes is worth pursuing. One of the principles on which it seemed all participants at the Roundtable agreed is that the prevalent conflicts of interest afflicting the major proxy advisory firms, as well as their lack of transparency and accountability, is troubling and growing worse, with the likely consequence that the continuation of these facets of present day proxy advisory firms will likely undermine public confidence in, and stall progress in the development of, strong corporate governance.
To remedy these circumstances, an examination of the actual roles proxy advisory firms play has become even more important as the number and complexity of issues required to be included on public company proxy ballots have grown exponentially. To assist you and the Commission’s Staff in understanding how far-reaching these problems currently are, and threaten to become, we have attached a letter the CCMC recently submitted to Institutional Shareholder Services (“ISS”) regarding its solicitation of views on its proposed amendment to its benchmark policies with respect to mandatory auditor rotation.

We request that this letter—and any comments on, or observations regarding, it you and the Commission choose to offer—be placed in the public file the Commission has established in connection with its Proxy Advisory Firm Roundtable, and that this letter be deemed part of the record to be considered by the Commission and its Staff in connection with logical follow-up efforts implementing Commission policies with respect to this powerful, yet unaccountable, industry affecting millions of U.S. shareholders, and potentially pretermittng the Commission’s own prerogatives in connection with its regulation of our securities markets.

As our letter makes clear, the CCMC has serious concerns about ISS’ proposal to override policy determinations made by Congress as well as the Commission and the Public Company Accounting Oversight Board (entities vested with, and that have exercised, the authority to formulate—and oversee the actual implementation of, policies affecting financial reporting). It should also be noted that a clear majority of investors do not support mandatory audit firm rotation. ISS’ efforts to override the policy decisions of those with actual authority and responsibility regarding financial reporting, in our view, is an inappropriate over-reach by a proxy advisory firm to impose its own worldview upon investors and businesses, especially since those views are not supported by public policy decisions made after extensive debate, academic studies and positions taken by investors.

As troublesome as this effort is, it is not a new development. Under the so-called “Say-on-Pay” provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, shareholders were given the opportunity to decide if “Say-on-Pay” votes should occur every one, two or three years. By permitting shareholders to decide the frequency of such votes, Congress clearly entrusted them with the power to decide how frequently they wished to vote on a public company’s pay schedule for senior executives. Notwithstanding that Congressional choice, and without any empirical evidence to
buttress their positions, ISS and Glass Lewis—who together account for approximately 97% of all the proxy advisory business in the U.S.—decreed that such votes should occur annually, irrespective of the circumstances affecting particular companies (such as the fact that, at many U.S. companies, executives’ salaries are set every three years, thus making an annual vote an inherently wasteful exercise).

Whatever the purported basis was for these two proxy advisory firms to mandate an annual “say-on-pay” vote and override Congress’ more flexible approach, it cannot be ignored that requiring annual “Say-on-Pay” votes for U.S. companies ipso facto generates the need for more proxy advisory firm services (and more frequently) than does triennial “Say-on-Pay” votes. As the de facto standard setters of corporate governance in the U.S., both ISS and Glass Lewis thwarted the intent of Congress, usurped the statutorily conferred right of shareholders to make those decisions, and generated more “business” for themselves than would have been the case if this decision had been left where Congress intended it to reside.

Our letter to ISS on mandatory auditor rotation, as well as these two examples, evidence the need to see proxy advisory firms adhere to the highest standards of conflict-free behavior, accountability and transparency, especially given their outsized influence over the governance of U.S. public companies. We look forward to working with you on this important issue.

Sincerely,

Tom Quaadman

CC:  The Honorable Luis A. Aguilar  
      The Honorable Daniel Gallagher  
      The Honorable Kara Stein  
      The Honorable Michael Piwowar  
      Keith Higgins, Esq.  
      Norm Champ, Esq.
February 14, 2013

Mr. Gary Retelny  
President  
Institutional Shareholder Services  
One Chase Manhattan Plaza  
New York, NY 10005  

Re: ISS Benchmark Policy Consultation—Auditor Rotation  

Dear Mr. Retelny:

The U.S. Chamber of Commerce’s (“Chamber”) is the world’s largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to function fully and properly in an economy of the 21st century.

The CCMC appreciates this opportunity to comment on Institutional Shareholder Services’ (“ISS”) 2014 Benchmark Policy Consultation (“Consultation”) on Auditor Ratification (“Auditor Rotation Proposal”).1 CCMC has submitted a separate letter on the other aspects of ISS’ 2014 Benchmark Policy Consultation. CCMC supports strong corporate governance policies as a foundation for appropriate business practices and efficient capital formation, and strives to advance accountable and transparent corporate governance regimes.

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**Introduction**

Despite what may be admirable objectives, CCMC believes serious concerns are raised by ISS’ Auditor Rotation Proposal—which would predicate ISS’ recommendations whether shareholders should ratify the retention of their company’s outside auditors (in whole or in part) upon the length of time the auditor has already served the company.\(^2\)

Mandatory auditor rotation has been the subject of numerous and extensive reviews by Congress, U.S. government agencies, quasi-governmental self-regulatory bodies, professional firms, academicians, private companies and others in the U.S. for over seventy-five years,\(^3\) and continues to the present time.\(^4\) Each time the issue has been considered by an instrumentality of the U.S. government, the decision reached has been to refrain from imposing mandatory auditor rotation. Given ISS’s enormous

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2 The Consultation does not provide a specific policy outcome or draft policy language, but makes clear that ISS is considering the revision of its current policy to provide that ISS will not deem a company’s outside auditors to be independent if the auditor has served a certain number of continuous years. The proposal states:

- **ISS is exploring potential approaches to its policy on auditor ratification for 2015 or beyond:**
  - A. Update the policy to consider auditor tenure as a factor in determining the vote recommendation on proposals to ratify auditors.
  - B. Maintain the status quo—do not change the current policy.

The release specifies that commenters should comment on whether they prefer the status quo or a change to a specific tenure at which they believe the auditor is no longer independent (the release suggests “5, 10, 15, 25, other—please specify,” but does not ask respondents for the basis of whatever choice they make). A third catch-all question requests comments on any other factors that should be considered in assessing auditor independence. Moreover, the inclusion of a “catch-all” question in a survey or consultation such as this typically suggests that the questioner believes it has adequately considered all potential possibilities known to it. In this instance, however, the lack of any discussion concerning this third inquiry strongly suggests that other policy outcomes have already been effectively precluded, if considered at all.

3 The issue was first raised during the McKesson Robbins Congressional Hearings in the late 1930s. *See e.g.* M. Barton, *Analysis of the Mandatory Auditor Rotation Debate,* U. of Tenn. Senior Thesis Project (2003), at p. 3, available at [http://trace.tennessee.edu/cgi/viewcontent.cgi?article=1512&context=utk_chanhonoproj](http://trace.tennessee.edu/cgi/viewcontent.cgi?article=1512&context=utk_chanhonoproj).

4 The most recent consideration of the issue was undertaken by the Public Company Accounting Oversight Board (“PCAOB”), whose Chairman recently advised the Securities and Exchange Commission (“SEC”) that, after a nearly three-year review, the PCAOB did not intend to take any action to mandate auditor rotation. *See* E. Chasan, “PCAOB’s Auditor Rotation Project is Essentially Dead,” CFO JOURNAL, Wall St. Jl. (Feb. 5, 2014), available at [http://blogs.wsj.com/cfo/2014/02/05/pcaob-auditor-rotation-project-is-essentially-dead/](http://blogs.wsj.com/cfo/2014/02/05/pcaob-auditor-rotation-project-is-essentially-dead/). Copies of the letters the Chamber filed with the PCAOB are annexed for your convenience.
influence over voting on proxy issues, its Auditor Rotation Proposal would effectively mandate auditor rotation for U.S. public companies.

The consequence of ISS’s adoption of the Auditor Rotation Proposal, therefore, would be to substitute ISS’ judgment—which does not appear to be based on any independent study of the issue and which would occur without any mandate for ISS to do so—for the judgments reached by those whose portfolio includes regulation of the U.S. accounting profession after repeated U.S. governmental studies of this issue. Whatever role ISS may appropriately play, it should not put itself in a position to exalt its judgments over those whose mandate it is to regulate the accounting profession.

Moreover, ISS’ Auditor Rotation Proposal would increase the risk that public company shareholders could confront accounting frauds, and would undermine one of the most critical components of corporate governance—the exercise of judgment by independent audit committees. Exhaustive reviews of this issue by audit policymaking bodies over the years have repeatedly confirmed that the objectives sought to be achieved through imposition of mandatory audit firm rotation will not be realized, will affirmatively pose significant risks to shareholders, cannot be pursued in a cost effective manner and, even if one assumed that auditor independence could be improved through mandatory audit firm rotation (a presumption not supported by empirical data), there is a very real threat that any theoretical benefit would be overwhelmed by a panoply of unintended consequences.

Finally, CCMC expresses its serious concerns about the format of ISS’ solicitation of informed comments. Given the complexity of the issues surrounding mandatory auditor rotation, the most recent solicitation of views on this issue—embodied in the PCAOB Auditor Rotation Concept Release—is forty-one pages

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long, with extensive citation of existing authority contained within the Release’s ninety-five footnotes.

In contrast, ISS’ consultancy solicitation is barely more than one page long, contains no analysis, provides no insight into the reasons—if any—that ISS has determined to consider tenure of auditor service as a factor in determining whether to vote in favor of a company’s proposal to retain its outside auditors, and provides absolutely no details on how this policy—if it were adopted—would actually be implemented. By merely lobbing a possible change in ISS’ voting policies over the transom, devoid of any rationale, analysis or details, commenters are denied a meaningful opportunity to address the specific concerns, conclusions or suppositions that moved ISS to initiate this process. The lack of a meaningful exposition of the basis or bases for the Proposal makes the solicitation of public comments a cosmetic exercise rather than a substantive one.

Discussion

A. Governmental Policymakers Have Repeatedly Rejected Mandatory Audit Firm Rotation

ISS’s Auditor Rotation Proposal purports to justify the need for auditor term limits by cursory reference to unspecified concerns allegedly expressed by “some shareholders, the [PCAOB], and other audit industry observers.”7 Without any indication of the specific concerns to which the Consultation is referring, commenters are unable to address them directly. Moreover, it is revealing that the only entity specifically referenced—the PCAOB—did not express its own concerns, but rather noted categories of concerns as well as countervailing points of view, merely to facilitate a discussion. And, since the publication of the PCAOB Auditor Rotation Concept Release, the PCAOB has abandoned any consideration of imposing mandatory auditor rotation term limits.8

Notably, the Consultation does not address the fact that the PCAOB observed that a preliminary analysis of its own audit firm inspection results did not show a correlation between longer auditor tenure and the number of issues identified in

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7 See Auditor Rotation Proposal, supra n. 3.
8 See n. 5, supra.
inspections. Nor does the Consultation acknowledge that the PCAOB held public hearings on the issue of mandatory auditor rotation, but those hearings failed to produce empirical data regarding the benefits, if any, of adopting mandatory audit firm rotation in the U.S., or any basis to conclude that any purported benefits from such a policy would outweigh the costs attendant to imposing such a requirement.

In its analysis of the PCAOB’s Auditor Rotation Concept Release, the Government Accountability Office (“GAO”) observed that, even if it could be established that a lack of auditor independence impaired audits of U.S. public companies (a conclusion the GAO did not embrace), the imposition of mandatory audit firm rotation might not provide an appropriate policy response:

[W]e are not convinced that the audit quality issues identified by the PCAOB in its Concept Release are caused by a lack of auditor independence or professional objectivity. The PCAOB’s Concept Release identifies serious audit deficiencies that it has found during its inspections, but does not provide compelling evidence that the root cause of the audit quality issues is related to a break down in auditor independence. In fact, the PCAOB acknowledges in its Concept Release that the root causes of audit deficiencies are complex, vary in nature, and that audit deficiencies may not have necessarily resulted from a lack of objectivity or professional skepticism.

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9 See PCAOB Auditor Rotation Concept Release, supra n. 7, at p. 16.
12 See 2011 GAO Letter, supra n. 12.
Moreover, the GAO’s initial study of the prospects for mandatory auditor rotation in 2003 concluded that the benefits of mandatory rotation—if any—were difficult to predict, but additional costs, estimated to be 20%,\textsuperscript{13} were certain.\textsuperscript{14}

Congress as a whole has explicitly declined to adopt mandatory audit firm rotation on two occasions in little over a decade. In passing the Sarbanes-Oxley Act,\textsuperscript{15} Congress explicitly declined to enact provisions requiring mandatory firm rotation, opting instead to order a study to weigh the potential costs and benefits of that policy.\textsuperscript{16} The resulting 2003 GAO Report, as noted above, confirmed the appropriateness of Congress’ approach.\textsuperscript{17} In the Jumpstart Our Business Startups Act (“JOBS Act”),\textsuperscript{18} emerging growth companies were explicitly exempted from any potential rules requiring mandatory audit firm rotation.\textsuperscript{19}

Most recently, in July 2013, the House of Representatives passed a bipartisan bill, the Audit Integrity and Job Protection Act (H.R. 1564), which would prohibit the PCAOB from requiring mandatory audit firm rotation for any public company.\textsuperscript{20}

As a result, ISS’s proposal to impose \textit{de facto} mandatory audit firm rotation would fly in the face of the overwhelming findings of impartial governmental bodies that purported benefits of mandatory auditor rotation are elusive and incapable of empirical demonstration, whereas the costs of such a proposal are clear and significant. Beyond this, if ISS were to adopt such a policy, it would effectively


\textsuperscript{14} 2003 GAO Study, \textit{supra} n. 14 at p.6 (“GAO believes that mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence and improve audit quality considering the additional financial costs and the loss of institutional knowledge of the public company’s previous auditor of record, as well as the current reforms being implemented. The potential benefits of mandatory audit firm rotation are harder to predict and quantify, though GAO is fairly certain that there will be additional costs”).


\textsuperscript{17} See 2003 GAO Study, \textit{supra} n. 14.


\textsuperscript{19} JOBS Act, §104 “Auditing Standards”, available at \url{http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf}.

overturn the measured judgments of Congress, the PCAOB, the GAO, and significant numbers of institutional shareholders.

B. Investors Would Be Harmed by the Application of a Mandatory Auditor Rotation Standard

In soliciting comments on its Auditor Rotation Concept Release, the PCAOB conceded that it was unable to conclude that the benefits of mandatory audit firm rotation would outweigh the benefits.²¹ Moreover, PCAOB Member Jay Hansen cast doubt on whether any data available to the PCAOB could establish a statistical link between audit firm performance and tenure sufficient to justify the certainty of additional costs that would be imposed on public companies and their shareholders,²² which the GAO has estimated at approximately 20%.²³ Additionally, while ISS’s Auditor Rotation Proposal makes passing reference to unspecified concerns expressed by “some investors,” the GAO’s data tells a very different story—a majority (53%) of institutional investors surveyed by the GAO²⁴ and 94% of all commenters to the PCAOB Concept Release—opposed imposition of mandatory audit firm rotation. Only three out of approximately 600 letters submitted to the PCAOB were from investors.²⁵ ISS’s reference to the concerns of “some investors,” pales when compared to the empirically supported dated gathered both by the GAO and the PCAOB.

C. The Judgment of Independent Audit Committees Would Be Usurped and Denigrated

²¹ PCAOB Auditor Rotation Concept Release, supra n. 7, at p. 3.
²⁵ See Ernst & Young, Respondents to PCAOB overwhelmingly oppose mandatory audit firm rotation (Jan. 5, 2012), available at http://www.ev.com/Publication/vwLUAssets/TechnicalLine_BB2256_AuditFirmRotation_5January2012/$FILE/TechnicalLine_BB2256_AuditFirmRotation_5January2012.pdf. Additionally, academic research confirms investors’ dim views of audit firm rotation, as evidenced by an observed negative market reaction to announcements of forced audit firm rotation. See e.g., J.Carcello & L.Reid, Investor Reaction to the Prospect of Mandatory Audit Firm Rotation (Jan. 23, 2014), at pp. 3-4, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2384152 (The study concludes that the market reacts negatively to the prospect of forced rotation. In particular, the market reacts more negatively if the current auditor is an industry specialist or a Big 4 firm. The reaction is also more negative if the company has high audit quality proxied via abnormal accruals. Moreover, the market’s reaction is more negative given longer auditor tenure).
S-OX introduced significant changes to the corporate governance and financial reporting processes of public companies, with critical attention focused on strengthening the role of public company audit committees.\(^{26}\) The operating logic of S-OX is the recognition and enhancement of the critical role of audit committees.\(^ {27}\) To ensure auditor independence and audit quality, S-OX reinforced the independence and authority of audit committees, and assigned to them—as opposed to management, outside standard-setters or other parties—the ultimate responsibility for selecting and overseeing external auditors.\(^ {28}\)

Audit committees require discretion, latitude and authority to meet their responsibilities to shareholders. The investment of trust, confidence and authority that our regulatory system has made in public company audit committees mandates that their authority and discretion not be revoked by the non-transparent efforts of a private-sector body pursuing its own notions of what effective corporate policy should be.\(^ {29}\) If ISS were to adopt its Auditor Rotation Proposal, it would not only contravene the repeated judgments of those entrusted with the resolution of these issues, it would also undo the breadth and scope of discretion S-Ox so carefully confided to audit committees. There is no apparent basis for ISS to arrogate to itself that kind of power or authority.\(^ {30}\)


\(^{28}\) S-OX §301, codified as §10A(m) of the Securities Exchange Act of 1934, 15 U.S.C. §78j-1. This provision incorporated a number of mechanisms aimed at enhancing the powers of audit committees as a means of improving the independence of outside auditors of public companies, including: requiring all members of audit committees to be independent (§10A(m)(3)); requiring audit committees procedures to obtain and respond to complaints relating to accounting and auditing matters (§10A(m)(4)); vesting responsibility in audit committees to select, monitor and oversee external auditors (§10A(m)(2)); authorizing audit committees to engage outside advisers they determine are necessary to facilitate their performance of their duties, (§10A(m)(5)); and giving audit committees the authority to determine the appropriate funding for their functions and requiring the issuer to abide by such determination, (§10A(m)(6)). See also Blakely Remarks, supra n. 28, at p. 156 (“[W]ith proper training and education, proper maturity and experience, team outreach, and dynamic a proper process can be established which goes an awful long way to deal with the [auditor independence] issues which are the reference of the talk today”).

\(^{29}\) See Blakely Remarks, supra n. 28, at p. 156.

\(^{30}\) The negative consequences of the Audit Firm Rotation Proposal swing in both directions. Not only are independent audit committees the best arbiters of the independence of their outside auditors, the adoption of the Proposal might result in auditors thought to be substandard being retained for whatever the mandatory period is. Defining absolute
D. Even if there Were Evidence Supporting Mandatory Audit Firm Rotation, There Is No Compelling Reason for ISS to Act Now\textsuperscript{31}

Existing data demonstrates that imposing mandatory audit firm rotation could harm investors through numerous unintended consequences, including:

- Reducing audit quality by depriving shareholders of the benefits flowing from the institutional knowledge, experience, and industry specialization gained by continuing audit service;
- Imposing significant costs of auditor changes on companies;
- Diminishing the ability of audit committees to fulfill their responsibilities;
- Curtailing the ability of companies to secure specialized expertise;
- Saddling shareholders of companies with complex accounting issues with auditors that are less familiar with their companies, and;
- Curtailing the ability of auditors develop client-specific knowledge.\textsuperscript{32}

Academic studies have reached similar conclusions.\textsuperscript{33}

\textsuperscript{31}In addressing the timing of ISS’ consideration of this issue, we do not mean to suggest that it is appropriate for ISS to undertake the development of its own policy on this subject. Given the constant governmental scrutiny of this subject, we believe ISS should \textit{not} undertake this issue at all. But, in the interest of assisting ISS in sorting through the difficult policy issues, we deem it appropriate to address the timing of any ISS action, assuming that ISS intends to act in any event.


\textsuperscript{33}See D. Jenkins & T. Vermmer, \textit{Audit Firm Rotation and Audit Quality: Evidence from Academic Research}, 26 Accounting Research Journal 75 (2013), available at http://econpapers.repec.org/article/emearjpps/v_3a26_3ay_3a2013_3ai_3a1_3ap_3a75-84.htm (Finding that, overall, the collective evidence from academic research is inconclusive at best vis-à-vis any purported benefits from mandatory auditor rotation).
Given the numerous potential unintended consequences that would flow if ISS’ Auditor Rotation Policy were adopted, ISS should consider whether it is even appropriate to address this issue at present. Rather than proceed without regard to the possible consequences, especially given the very recent abandonment of the PCAOB’s consideration of this issue, ISS should allow more data to be gathered, consider the effects of alternatives that have been suggested to mandatory auditor rotation, and watch the development of empirical data that surely will flow from the implementation of mandatory audit firm rotation in the European Union (“EU”).

Especially when considering a subject as constantly evaluated, and as complex, as mandatory auditor rotation, ISS need not worry that, if it doesn’t act immediately, investors will be harmed. By awaiting the development of empirical data, and observing the experience of the EU’s implementation of mandatory auditor rotation, ISS and the many U.S. audit policy making organizations that have already studied this issue will be able to refine their approach to this issue in the future.

Conclusion

The CCMC appreciates this opportunity to comment on ISS’s 2014 Benchmark Policy Consultation respecting auditor rotation policies. We would be happy to discuss the issues addressed in this letter in greater detail.

Sincerely,

Tom Quaadman

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