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Congress Increases Pressure on Proxy Advisory Firms

In the latest effort to enhance transparency by proxy advisory firms, six members of the Senate Banking, Housing and Urban Affairs Committee sent letters to Institutional Shareholder Services (ISS) and Glass Lewis & Co., which they noted control 97% of the proxy advisory industry, requesting information regarding their eligibility for exemption from the proxy rules, accuracy of reporting and potential conflicts of interests.

The Senators' letters reflect many of the concerns underlying the bill passed by the House of Representatives last December, titled the Corporate Governance Reform and Transparency Act of 2017, which would require proxy advisory firms to register with the U.S. Securities and Exchange Commission, disclose potential conflicts of interest and codes of ethics, and publicize their methodologies for formulating proxy recommendations.

The Senators' letters express concerns about reported inaccuracies in the proxy advisors' analyses, noting that ISS offers only S&P 500 companies some opportunity to review and correct reports, while Glass Lewis does not offer issuers any opportunity. The Senators asked the two firms a series of questions regarding the adequacy of their efforts to ensure that their reports are accurate and whether they would be willing to expand those efforts. The Senators also questioned potential conflicts of interest arising from their ownership structures and, in ISS's case, its consulting business. In addition, the two letters question whether the proxy advisors' use of automatic voting systems satisfy the standards expressed under SEC Staff Legal Bulletin 20 for exemption from the proxy rules. Glass Lewis is further asked to explain why it has not registered as an investment adviser, as ISS has.

Pro-business groups, including the New York Stock Exchange and Nasdaq, have been pressing for reforms to rein in the outsize influence wielded by ISS and Glass Lewis, both privately owned enterprises, in the corporate governance and proxy contest realm. Shareholder activist groups tend to oppose greater regulation of the proxy advisers, which they believe would be unduly burdensome on entities that they view as playing an important role in the corporate governance ecosystem.

The Senators' letters raise legitimate concerns regarding the proxy advisory firms and their substantial influence on proxy voting matters. If the proxy advisory firms do not address these concerns or change their business practices, they are likely to face increased regulation.

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