

**MEMO# 30468**

December 12, 2016

# GAO Issues Report on Proxy Advisory Firms

[30468] December 12, 2016 TO: ICI Members SUBJECTS: Compliance  
Fund Governance  
Investment Advisers RE: GAO Issues Report on Proxy Advisory Firms

In November, the Government Accountability Office (“GAO”) submitted its report on proxy advisory firms’ role in voting proxies and corporate governance practices to the U.S. Senate’s Subcommittee on Economic Policy (and Chairman) and Committee on Banking, Housing, and Urban Affairs (the “Report”).<sup>[1]</sup> Proxy advisory firms continue to be criticized in some quarters,<sup>[2]</sup> prompting the request for this Report. The Report discusses (i) the influence proxy advisory firms may have on proxy voting and corporate governance, (ii) how firms develop and apply policies to make vote recommendations, and (iii) the SEC’s oversight activities. In preparing the Report, GAO reviewed literature, analyzed the firms’ policies and SEC policies and examinations, and interviewed the five proxy advisory firms<sup>[3]</sup> along with a number of other interested parties, including ICI.

GAO makes no recommendations in the Report, but its notable findings include the following:

- The increased demand for proxy advisory firms’ services stems from several factors, including the growth in the proportion of shares owned by institutional investors, the number and complexity of voting issues, and increased shareholder activism and regulation.
- Recent studies, market participants, and other stakeholders agree that proxy advisory firms have influence on shareholder voting and corporate governance practices, but had mixed views about the extent of their influence.
- Some point to a decline in proxy advisory firms’ influence as institutional investors increase their in-house proxy voting expertise. Smaller institutional investors, however, often do not have their own in-house research staffs and tend to rely more on the research and vote recommendations of firms before making voting decisions.
- Proxy advisory firms develop their general voting policies and update them through an iterative process involving analysis of institutional investor and corporate issuer input, industry practices, and discussions with other stakeholders.
- Proxy advisory firms have taken steps to communicate with corporate issuers when developing specific voting recommendations and have allowed some to review draft reports on a limited basis for data accuracy before they are final.
- Compared to policies of other reviewed market participants (*i.e.*, NYSE, NASDAQ, and

a large institutional investor), proxy advisory firms' voting policies were similar or stricter on the following corporate governance issues: board independence, overboarding (*i.e.*, the practice of serving on multiple boards), chair independence, and proxy access. Market participants viewed proxy advisory firms' corporate governance policies as stricter than other industry standards but reflective of institutional investors' interests.

- Corporate issuers and investors interviewed by GAO said that the data errors they found were mostly minor, but some errors can lead to negative recommendations.
- The SEC staff included as 2015 exam priorities (i) select proxy advisory firms and how they make recommendations on proxy voting and how they disclose and mitigate potential conflicts of interests, and (ii) investment advisers' compliance with their fiduciary duties in voting proxies. The initiative is ongoing. As of August 2016, 41 percent of the examinations were completed, with none resulting in serious violations leading to an enforcement action.

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#### endnotes

[1] *Corporate Shareholder Meetings: Proxy Advisory Firms' Role in Voting and Corporate Governance Practices*, GAO, November 2016, available at [www.gao.gov/assets/690/681050.pdf](http://www.gao.gov/assets/690/681050.pdf).

[2] See Institute [Memorandum No. 28238](#), dated July 7, 2014, for a summary of these criticisms and the SEC staff's 2014 guidance to investment advisers regarding their use of proxy advisory firms. In 2015, ICI and IDC released a joint *Report on Funds' Use of Proxy Advisory Firms*, available at [www.ici.org/pdf/pub\\_15\\_proxy\\_advisory\\_firms.pdf](http://www.ici.org/pdf/pub_15_proxy_advisory_firms.pdf).

[3] Institutional Shareholder Services (ISS) and Glass Lewis & Co. are the largest proxy advisory firms. GAO also interviewed Egan-Jones Proxy Services, Marco Consulting Group, and ProxyVote Plus, three smaller firms.