Nasdaq

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Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. 4-725, Roundtable on the Proxy Process

I am pleased to present the views of Nasdaq, Inc. ("Nasdaq") in connection with the Securities and Exchange Commission's ("SEC" or "Commission") Roundtable on the Proxy Process. It is an honor to be invited to participate in this event. I commend the Commission for focusing attention on the proxy process, which has not changed materially in decades. As Chairman Clayton noted, "shareholder engagement is a hallmark of our public capital markets and the proxy process is a fundamental component of that engagement."[1] Unfortunately, rather than enhancing shareholder engagement, today's proxy process can interfere with that engagement.

Nasdaq operates nineteen regulated entities in the United States and Canada, including the Nasdaq Stock Market, which is home to over 3,000 public companies and exchange traded products that drive the global economy and provide investment opportunities for Main Street investors. We collaborate with the public companies that have chosen to list on Nasdaq in the United States, and communicate with these companies and their investors about the public company model. Nasdaq is also a listed company and is subject to the same regulations as other public companies, including the proxy rules. Thus, Nasdaq is able to bring a unique perspective to these issues.

A common theme we hear as we talk to our listed companies, and our own experience confirms this, is that the proxy process is costly, inefficient, unduly complicated, and requires a disproportionate share of management's attention. In fact, companies routinely cite the proxy process as one of a series of complaints, which, in the aggregate, discourages them from joining the public markets.

Importantly, despite the cost and complexity, the current system results in a disproportionately few number of retail investors voting their shares. One recent study found that retail shareholder participation in proxy voting was just 28%; this stands in stark contrast to institutional shareholder voting participation, which was 91% during the same period.[2] In our experience, the current outdated process also suppresses retail shareholder participation because it limits a company's ability to

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[1] Statement Announcing SEC Staff Roundtable on the Proxy Process (July 30, 2018), available at https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process.

[2] See "2018 Proxy Season Review," by ProxyPulse, a Broadridge/PWC initiative (October 2018), available at https://www.broadridge.com/_assets/pdf/broadridge-2018-proxy-season-review.pdf.

communicate with shareholders, especially younger retail shareholders, in the digital way that they prefer to communicate.

In the remainder of this letter, I focus on the primary issues to be considered during the Roundtable's three panels: proxy voting mechanics and technology, shareholder proposals, and proxy advisory firms.

Proxy Voting Mechanics and Technology

We believe the primary purpose of all aspects of the SEC's proxy rules should be to facilitate communications between companies and their shareholders. In this digital age, it is notable how incredibly complex and expensive it is for companies to communicate with their shareholders, especially their retail shareholders. Problems with the current system fall into three broad categories:

- Lack of transparency as to beneficial ownership;
- Mechanics that do not work particularly well despite—or more likely because of—the complexity; and
- Lack of effective cost controls to reduce fees paid by issuers and, ultimately, investors.

These problems are manifest in a number of ways. Companies consistently report that there is over-voting and under-voting in their proxy elections, in part as a result of double-voting in connection with security lending. Shareholders express frustration that they have no way to verify that their votes have been counted.[3] Meanwhile, issuers have little ability to contest, or even deconstruct, the annual bills they receive.

At Nasdaq, we list companies that range in size from the five largest public companies in the world to small companies, from companies well over a hundred years old to brand new IPOs, and companies across all sectors. While these companies may have different perspectives on many issues, one constant is the focus of their boards of directors and management on shareholders' issues and their desire to understand and interact with the shareholders to whom they answer.[4]

But that is not easy. We often hear that the proxy process makes it impossible for companies and shareholders to communicate in a modern way – the way retail shareholders expect to communicate today. At Nasdaq, we have experienced firsthand the difficulty in communicating directly with our retail shareholders. We have a robust shareholder engagement program, and we recognize that shareholder engagement is a year-round process that should not occur solely in the weeks before the annual meeting. During 2017, we conducted outreach to a cross-section of shareholders owning approximately 75% of our outstanding shares. Our key stockholder engagement activities included 11

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[3] See Letter from Carine Smith Ihenacho, Chief Corporate Governance Officer, and Séverine Neervoort, Senior Analyst, Policy Development, Norges Bank Investment Management, dated November 2, 2018, available at https://www.sec.gov/comments/4-725/4725-4604660-176353.pdf ("As highlighted by the SEC in 2010, it can be difficult for investors to obtain confirmation that resolutions have been voted on in line with their instructions. This prevents investors from verifying that intermediaries have respected their direction and that the company has taken their vote into account.").

[4] It is the desire for companies to understand who their shareholders are and to communicate with those shareholders that has led Nasdaq to offer public companies a paid advisory service to help identify their shareholders. See https://business.nasdaq.com/intel/ir-management/Investor-Relations-Solutions.html. Other providers offer similar services.

non-deal investor road shows in 8 countries, 21 investor conferences and our Annual Meeting of Stockholders. We also conducted quarterly outreach to the governance teams at many of our top institutional holders. However, we would like to do more, especially with retail shareholders. Unfortunately, because of the complexities of the proxy system, and particularly the distinction between objecting beneficial owners ("OBOs") and non-objecting beneficial owners ("NOBOs"), we often don't know the identities of our retail shareholders, so it is impossible to contact them directly. And there are further process limitations on our communication with OBOs and NOBOs alike: even when we do know our shareholders' identities, for proxy-related matters we must contact them through intermediaries, which is expensive.

While retail ownership varies among our listed companies, the ability to have more effective communication between all shareholders and management, as a method to educate and engage, may help reverse the downward levels of retail participation. This feedback loop is important given the time constraints of the proxy process and the need for full vote counting, particularly as contentious proxy matters become more prevalent. All shareholder votes matter and the voice of retail is even more critical in light of the outsized influence proxy advisory firms have on a significant block of votes.

Another issue is the cost of the proxy process, and particularly of the use of intermediaries to print and deliver proxy materials. Issuers receive large, obscure annual bills from intermediaries that they did not select, for delivering proxy materials. In addition, while the notice and access process has improved the proxy system considerably, companies still pay a large amount in printing fees each year because intermediaries report that large numbers of stockholders have requested full set delivery of proxy materials. For a variety of reasons, companies would like to reach out to those stockholders to encourage them to use technology to receive materials, but again, the proxy system makes it difficult to identify and contact them. And even where they can use electronic delivery, the cost to do so, including for notice and access, remains high.

The opacity of this system is a common concern expressed by issuers. It is difficult to tie costs back to the size of the shareholder base. Issuers are dependent upon service providers who are in turn dependent upon brokers, to get information about shareholders. We often hear complaints that the total shareholder count billed to an issuer appears inconsistent with the total shares outstanding and known composition of shareholders. Issuers trying to reconcile bills often give up in frustration.

Companies are also frustrated that they are charged fees that they cannot negotiate. Other service providers maintain that they can be more efficient and cost-effective, but the primary incumbents have no reason to improve because their fees are set by regulation, and the service providers are selected by brokers who are able to fully recoup the fees from the listed companies.[5]

As a technology company, we know that this important subject deserves better—and, Nasdaq's eVoting initiative has shown that it is possible. We have conducted proof of concept tests in Estonia and South Africa that use a cryptographically secure transaction private ledger to address many of the current challenges of the proxy process, including the lack of transparency and traceability in the voting process.

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[5] See Letter from Carl Hagberg and Associates (October 12, 2010), available at https://www.sec.gov/comments/s7-14-10/s71410-68.pdf.

In 2016, Nasdaq completed a proof of concept in Estonia, where we operate the stock exchange and the central securities depository (CSD). The Estonian market has a lot of transparency, and we were able to use the national identity numbers issued to each resident to help establish each digital identity in this market where investors directly hold their securities.

Nasdaq also built an eVoting solution for Strate, the South African CSD. Like the U.S., South Africa has nominee accounts and intermediaries and so Nasdaq's blockchain solution will create voting rights on the blockchain that can be subdivided to accommodate intermediaries. In some cases the beneficial owner may want to convey voting instructions directly to the issuer while in other cases custodians may vote based on instructions from beneficial owners whose identity remains shielded from the issuer. In the first scenario, the solution enables the custodian to distribute the voting rights to the next level in the chain of intermediaries. For the second scenario, the voting rights will remain at the custodian level and the custodian will cast aggregated (and split) votes based on voting instructions from the beneficial shareholder. It is worth noting that both scenarios can be applied in parallel for the same general meeting.

The eVoting solution is hosted on a private ledger where users are authenticated via an enrollment process that does not rely on authentication by outside miners. The system can accommodate the transmission of voting-related materials and, of course, the audit trail and immediate vote tally functionality is available through permissioned reports that provide different levels of information to issuers and shareholders and, if needed, auditors and even regulators. Best of all, users' access eVoting via a web enabled front end; the system records the data on the blockchain.

While these types of systems hold promise, transitioning to this type of system will take time and effort, would need buy-in from the many stakeholders in the proxy voting process, and must be done in a cost effective manner. However, companies have already suffered far too long. While we are hopeful that technology will one day enhance many aspects of the proxy process, the Commission should not wait and must address these important issues now. Foremost in the areas where the Commission should act are the following:

- Communications: Revise rules to permit direct communication between companies and their shareholders. The Commission should also consider assigning the cost of the OBO designation to those shareholders whose status force those costs.[6]
- Fees: Give issuers a say in selecting intermediary providers and ensure transparency to companies about the fees they pay, giving them the ability to ensure that those fees are correct. Acknowledge that Self-Regulatory Organizations are not suited for establishing fees for shareholder communications and provide alternatives that introduce market forces into these processes, which will allow listed companies a say in the fees they are forced to pay and provide accountability to companies from the providers of these services.

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[6] See Council of Institutional Investors white paper, "The OBO/NOBO Distinction in Beneficial Ownership: Implications for Shareowner Communications and Voting," prepared by Alan L. Beller and Janet L. Fisher (February 2010) at 17, available at https://www.cii.org/files/publications/white_papers/02_18_10_obo_nobo_distinction_white_paper.pdf.

- Accountability: Enhance the integrity of the shareholder vote by improving transparency and the mechanisms to reconcile long and short positions, thereby better limiting voting, and the cost of proxy solicitations, to only those persons entitled to vote.

Shareholder Proposals

Another cost that public companies face is related to the shareholder proposal process. Many companies spend thousands of dollars and countless hours of management time addressing proposals from proponents who own minimal amounts of their shares.

Nasdaq supports shareholder-friendly regulations that promote healthy interactions between public companies and shareholders. However, current regulations governing the way shareholders access a company's proxy statement can poison the company-shareholder relationship by amplifying the voice of a tiny minority over the best interests of the vast majority. Under SEC Rule 14a-8, a shareholder holding just $2,000 of company stock for one year or longer has the ability to include an issue on that company's proxy for a shareholder vote, even if the issue is not material, or even relevant, to the company's business. If that proposal is opposed by nearly 97% of the other shareholders, the shareholder can nonetheless re-submit the proposal in the following year. After three years, a proposal that is opposed by nearly 90% of the other shareholders can still be reintroduced again and again.

This process is costly, time-consuming and frustrating for companies, which in aggregate must address hundreds of such proposals each year, as well as countless more proposals that are threatened. In addition to legal expense, this takes significant time and attention of management and boards; time better spent focused on the operation and strategic direction of the business. Ultimately, it is other shareholders that bear these costs. Further, any consideration of the costs involved must also recognize that the threat of these proposals can change the dynamic of shareholder engagement, forcing discussions about these issues even where few of these proposals receive majority support.

Chairman Clayton has acknowledged the problem with this system, noting "[a]nytime you have a deeply held view by a few people but it gets spread over a lot of people, you have a tendency to not look at who's bearing those costs." He continued by highlighting "the cost[s] that the quiet shareholder, the ordinary shareholder, bear for idiosyncratic interests of others."[7]

We agree and we therefore believe that the SEC should amend Rule 14a-8 to increase the minimum ownership amount and holding period to ensure that shareholders have a meaningful, long-term investment in the company before they are given access to the proxy. Deleting the meaningless $2,000 dollar threshold and instead requiring that a proposing shareholder hold a material investment in that issuer and increasing the holding period to a longer period, such as three years, would help ensure that management and boards spend their scarce time focused on shareholder proposals that come from shareholders who are aligned with other shareholders in the long-term success of the company.

We also advocate for increasing the resubmission thresholds so companies aren't burdened year after year with proposals that the majority of their shareholders don't support. In 1997, the SEC recognized that these resubmission thresholds were outdated and proposed updating them. In the 21 years since that proposal, things have only gotten worse. A study conducted by the Manhattan Institute

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[7] A recording of the discussion is available here: http://www.centerforcapitalmarkets.com/event/a-discussion-with-sec-chairman-jay-clayton/.

reported that one-third of shareholder-led proxy proposals at Fortune 250 companies in 2016 were driven by six small investors and their families.[8] Their proposals are often uncorrelated to enhancing long-term shareholder value and soundly defeated by shareholders, who bear the ultimate costs of their actions. In addition, shareholder proposals increasingly deal with social or political matters, which consistently receive low levels of support.[9]

Finally, over the past year, companies have faced a new misuse of the Commission's proxy rules, which should be addressed. Specifically, shareholder activists holding a de minimis number of shares are increasingly using Notices of Exempt Solicitation on Form PX14A6G to advocate for certain proposals and policy issues without subjecting their materials to review by the company or the SEC. This notice is designed for, and has traditionally been filed by, institutional investors to communicate with other shareholders in advance of a company's annual meeting and is mandatory when a filer holds over $5 million of the company's securities. As a result, communications about a shareholder proposal that would otherwise be excluded from a Company's proxy statement in accordance with Rule 14a-8 can nonetheless be presented to shareholders on a Form PX14A6G, which can be filed at any time prior to or after an annual meeting. [10]

The SEC recently issued two new Compliance and Disclosure Interpretations (the "C&DI") clarifying that a Notice may be filed on a voluntary basis and, therefore, filers of a Notice do not have to own $5 million of the company's securities.[11] Although the C&DI provides that certain procedural requirements must be met when voluntarily filing a Notice, the requirements do not go far enough to prevent investor confusion. At a minimum, the SEC should revise the "cover" in Rule 14a-103 to clearly identify the filing party, similar to Schedules 13D and 13G, and require the filing party to disclose the number of shares held and any interest in the proposal or policy issues it is advocating for. The SEC should also consider restricting the time period in which a voluntary Notice may be filed.

Proxy Advisory Firms

Given the number of public companies, the large number of proposals placed on each company's proxy, and the limited time to consider these proposals, institutional shareholders have come to rely on proxy advisory firms. While this service is valuable in theory, in practice the industry is a largely unregulated black box, rife with opacity, lack of accountability and conflicts of interest. And,

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[8] "Proxy Season Preview: Shareholder Activism *en Marche*, Proxy Monitor Report" (Spring 2017), available at: http://www.proxymonitor.org/Forms/pmr_14.aspx. See also "Grappling With the Cost of Corporate Gadflies" by Steven Davidoff Solomon (August 19, 2014), available at https://dealbook.nytimes.com/2014/08/19/grappling-with-the-cost-of-corporate-gadflies/.

[9] For example, out of 884 shareholder proposals received between 2006 and 2016 dealing with either corporate political spending disclosure or issues related to environmental policy, Proxy Monitor reports that only one received a majority support of shareholders. See Proxy Monitor 2016 Report at 3, available at: http://www.proxymonitor.org/pdf/pmr_13.pdf.

[10] See Bloomberg BNA, "Exempt Proxy Solicitations: A New Twist on an Old Form," August 1, 2018, available at: https://www.bna.com/exempt-proxy-solicitations-b73014481310/. See also Gibson, Dunn & Crutcher LLP: Securities Regulation and Corporate Governance Monitor, "New Twist for Old Shareholder Proposal Tactic", March 16, 2018, available at: https://securitiesregulationmonitor.com/Lists/Posts/Post.aspx?ID=316.

[11] See Questions 126.06 and 126.07, https://www.sec.gov/corpfin/proxy-rules-schedules-14a-14c-cdi.

when shareholders rely on the voting recommendations of the proxy advisory firms, it further distances companies from their shareholders.

Absent requirements to fully and completely explain their criteria or to provide companies a means to question analysis or even correct factual errors, the outcome of critical decisions is often unpredictable and at the whim of impenetrable advisory firms. Additionally, these firms are not even required to disclose whether they have a financial relationship or ownership stake in the companies on which they report. The SEC took preliminary steps to address these concerns with the proxy advisory industry several years ago by issuing Staff Legal Bulletin 20, and again earlier this year when it withdrew two no-action letters concerning the ability of investment advisors to rely upon recommendations by proxy advisory firms in voting their clients' securities.[12] But additional guidance is needed about the impact of this withdrawal and the important underlying concerns that other market participants have with proxy advisory firms.

Proxy advisors must have a line of communication with the companies they analyze and clear transparency around ownership of, or short interest in, covered companies. The conflicts and unresponsiveness of proxy advisory firms is an area where Nasdaq has been engaged for many years. In 2013, we asked the SEC to require the proxy advisory firms to make public the models and methodologies that frame their vote recommendations, and to mandate public disclosure of any and all business relationships that may give rise to conflicts of interest.[13] Since then, Congress[14] and the Wall Street Journal Editorial Board[15] have joined in voicing concerns.

This is such an important issue that for the past four years, Nasdaq and the U.S. Chamber of Commerce Center for Capital Markets Competitiveness have conducted an annual survey of public company experiences with proxy advisory firms. A copy of the results of the 2018 proxy season survey are attached. In the 2018 survey, we found:

- Of the companies surveyed that requested a preview of the advisor’s recommendations, proxy advisory firms provided them only 44% of the time.
- Thirty-eight (38%) of the companies surveyed asked proxy advisory firms for opportunities to provide input both before and after the firms’ recommendations were finalized. Companies reported being given anywhere from 30 to 60 minutes to two weeks.

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[12] See “Statement Regarding Staff Proxy Advisory Letters,” IM-Info-2018-02 (September 2018), available at https://www.sec.gov/divisions/investment/imannouncements/im-info-2018-02.pdf.

[13] See letter from Mr. Edward S. Knight, Executive Vice President, General Counsel and Chief Regulatory Officer, Nasdaq, to Ms. Elizabeth M. Murphy, Esq., U.S. Securities and Exchange Commission, dated October 8, 2013, available at: https://www.sec.gov/rules/petitions/2013/petn4-666.pdf. See also *Raising the Curtain on Proxy Advisers* by Edward S. Knight (October 7, 2013), available at https://www.wsj.com/articles/raising-the-curtain-on-proxy-advisersraising-the-curtain-on-proxy-advisers-1381179479?ns=prod/accounts-wsj.

[14] In 2017, the House of Representatives passed a bill that would increase the transparency and accountability of proxy advisory firms by, among other things, requiring them to register with the SEC.

[15] See The Editorial Board, "The Proxy Advisors’ Veto," The Wall Street Journal, August 10, 2018, available at https://www.wsj.com/articles/the-proxy-advisers-veto-1533941976.

- Only thirty-nine (39%) of the companies surveyed believed that the proxy advisory firms carefully researched and took into account all relevant aspects of the particular issue on which it provided advice.
- Twenty-nine (29%) of the companies surveyed pursued opportunities to meet with proxy advisory firms on issues subject to shareholder votes. Of those companies that sought a meeting, their request was denied 57% of the time.
- An overwhelming 97% of companies surveyed support the Corporate Governance Reform and Transparency Act of 2017, which passed the House of Representatives in December 2017 and would require proxy advisory firms to register with the SEC.

The stories we hear from public companies further bear this out. In one case, in two successive years, a proxy advisory firm based its recommendations on an erroneous and incomplete understanding of the relevant facts. In each instance, the company was told that it could avoid some such issues by subscribing to (and paying for) the proxy advisory firm's corporate services.[16]

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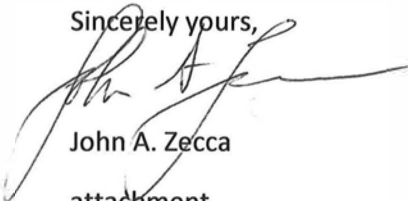
The issues to be discussed at the Roundtable are central to the willingness of companies to join the public markets and to retail investors' ability to interact with the companies whose shares they own. The current system limits that communication and imposes unnecessary costs on companies, and ultimately their shareholders. We urge the Commission to address the cost and difficulties of communicating with shareholders; update the rules related to shareholder proposals; and require transparency about the methodologies and conflicts of proxy advisory firms, as well as a mechanism for companies to address errors by the firms. Thank you for inviting me to participate in this important conversation and I look forward to the Roundtable discussion.



[16] Details about this company and its situation are available to the Commission Staff upon request.

PROXY SEASON 2018

Examining Developments & Looking Forward

Center for Capital Markets Competitiveness

2018 PROXY SEASON SURVEY

Presented by:

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

Momentum continues to grow for reform of the proxy advisory industry in the U.S. Despite being plagued by conflicts of interest, a lack of transparency, and prone to making significant errors in voting recommendations, proxy advisory firms continue to carry a significant amount of influence over the manner in which public companies are run.

Two proxy firms—Institutional Shareholder Services (ISS) and Glass Lewis —control roughly 97% of the proxy advisory industry, constituting a duopoly that have become the de facto standard setters for corporate governance in the U.S.

In recent years, problems with the proxy advisory industry have garnered the attention of U.S. and global regulators, Republican and Democrat members of Congress, institutional investors, academics, and others. Proxy advisory firms have been criticized on a number of issues:

- Rampant conflicts of interest that can impact the objectivity of voting recommendations made to institutional investors.
- A one-size-fits-all approach to voting recommendations that ignores the unique characteristics and operations of individual companies.
- A lack of willingness to constructively engage with issuers, particularly small and midsize issuers that are disproportionately impacted by proxy advisory firms.
- A lack of transparency throughout the research and development of voting recommendations.
- Frequent and significant errors in analysis and an unwillingness to address errors.

These issues with the proxy advisory industry are often cited as a challenge to the willingness of businesses to go and stay public. The U.S. is home to roughly half the number of public companies that existed 20 years ago, and reform of this industry is essential to reversing this troublesome trend. Having fewer public companies not only jeopardizes the growth prospects of businesses, but it limits the investment opportunities for Main Street investors who depend on vibrant public markets to create and sustain wealth.

Fortunately, problems with proxy advisory firms have not been lost on policymakers. In June 2014, the staff of the Securities and Exchange Commission (SEC) published guidance[1] owing to concerns surrounding the increasingly outsize role and influence of proxy advisory firms on corporate governance matters in the U.S. and globally. The guidance addressed issues and concerns raised by stakeholders and provided clarity about the SEC's Proxy Voting Rule[2] and the availability of exemptions for proxy advisory firms from the SEC's proxy solicitation requirements.

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1. The SEC Staff Guidance can be found at https://www.sec.gov/interps/legal/cfslb20.htm
2. Investment Advisers Act Rule 206-4(6)

In December 2017, the U.S. House of Representatives passed H.R. 4015, the Corporate Governance Reform and Transparency Act of 2017. This bipartisan legislation would require proxy advisory firms to register with the SEC and become subjected to a robust oversight regime. Given the amount of influence that proxy advisory firms have and the flaws in their business model, it is striking that this remains a significant segment of our economy with very little oversight. Under H.R. 4015, proxy advisory firms would have to disclose and manage any conflicts of interest, demonstrate they have the capability to provide sound research and recommendations, and provide public companies with sufficient time to respond to errors or flaws in voting recommendations.

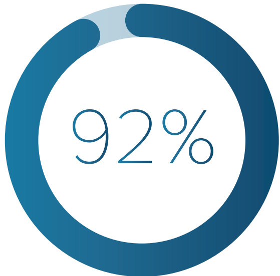
In September 2018, the SEC took a significant step by withdrawing two no-action letters that were issued to ISS and Egan-Jones, another proxy advisory firm, in 2004. These no-action letters have had the practical effect of allowing investment advisers to outsource their voting responsibilities to proxy advisory firms, thereby increasing the amount of influence that ISS and Glass Lewis have over corporate governance. Withdrawal of these no-action letters is a necessary first step by the SEC that will facilitate further reforms.

2018 PROXY SEASON SURVEY

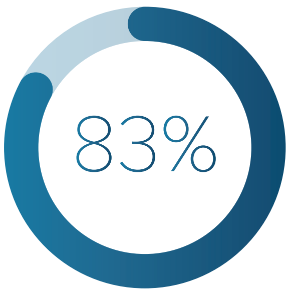
The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) and Nasdaq partnered again this summer for a survey of public company experiences with proxy advisory firms during the 2018 proxy season. This is the fourth annual CCMC/Nasdaq proxy season survey, and it is intended to help policymakers understand how public companies have navigated the 2018 season. One hundred sixty-five (165) companies completed this year's survey.

If there is a theme to the survey results this year, it is that notwithstanding the 2014 SEC guidance, few material improvements have been observed in the proxy advisory system. Companies are bringing more issues to the attention of proxy advisory firms, but they still find it difficult to engage in constructive discussions that lead to better informed voting recommendations. Conflicts of interest still pervade the industry, and many report a lack of transparency into how recommendations are developed. We believe that this survey will serve as an important tool to help inform policymakers about the next steps of reform for the proxy advisory industry.

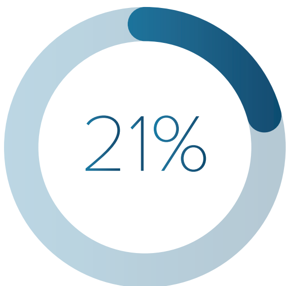
Corporate Engagement with Proxy Advisory Firms — Requests Still Made to Engage but Little Change in Outcome



Ninety-two (92%) of companies surveyed had a proxy advisory firm make a recommendation on an issue featured in their proxy statements, nearly identical to 2017, but an 11% increase over 2016.



The vast majority (83%) of companies carefully monitor proxy advisory firm recommendations for accuracy or reliance on outdated information.



Twenty-one (21%) of the companies surveyed formally requested previews of advisor recommendations—a 9% decrease from 2017, but little changed from 2016. For companies that requested a preview, proxy advisory firms provided them only 44% of the time, a 4% drop from 2017.

Thirty-eight (38%) of the companies asked proxy advisory firms for opportunities to provide input both before and after the firms' recommendations were finalized. However, as in previous years, the amount of time companies were given to respond to recommendations varied. Companies again reported being given anywhere from 30 to 60 minutes to two weeks. In 2018, 1 to 2 days was a common response among companies.

Only thirty-nine (39%) of the companies believed that the proxy advisory firms carefully researched and took into account all relevant aspects of the particular issue on which it provided advice, up from 35% in 2017.

Twenty-nine (29%) of the companies pursued opportunities to meet with proxy advisory firms on issues subject to shareholder votes, a significant decrease from 52% in 2017. Of those companies that sought a meeting, their request was denied 57% of the time, significantly more often than in 2017. Companies reported mixed results from meetings they had.

Corporate Engagement With Investors and the SEC

- The number of companies reporting that they have some form of year-round, regulator communications program with institutional investors dropped from 91% in 2017 to 78% in 2018. However, many of these companies that have such a program find it extremely beneficial, with several having had one in place for years.

- When companies felt that they were not afforded adequate opportunities for input to a proposed proxy advisor recommendation, they notified the proxy advisory firm and portfolio managers 26% of the time, a small change from 2017.

- When companies believed that a proxy advisory firm relied on inaccurate or stale data, they alerted portfolio managers and/or the SEC 46% of the time, a 19% decrease from 2017 but nearly identical to the 2016 survey. As in previous years, for companies that alerted portfolio managers or the SEC, new reports are rarely issued.

- Companies advised proxy advisory firms and their clients if specific recommendations did not advance the economic best interests of shareholders 39% of the time, lower than 2017 but still higher than the 30% that reported doing so in 2016.

More Companies Bring Conflicts of Interest to the Attention of Proxy Advisory Firms

- Of the companies surveyed, 10% identified significant conflicts of interest at proxy advisory firms, and 21% of those that did find conflicts brought them to the attention of the firms—a 7% increase from 2017. A few companies said that ISS' business model, which includes both a research and a consulting arm, was inherently conflicted and in some cases have been approached by ISS' consulting arm soon after a negative recommendation was issued.

Continued Strong Support for the Corporate Governance Reform and Transparency Act

- An overwhelming 97% of companies support the Corporate Governance Reform and Transparency Act of 2017, which passed the House of Representatives in December 2017 and would require proxy advisory firms to register with the SEC.

Large Percentage of Shares Voted in Line With Proxy Advisory Firm Recommendations

- One perceived problem with the proxy advisory system has been a trend toward "robo-voting" where a company's outstanding shares are voted in line with an ISS or Glass Lewis recommendation in the 24-hour period after the recommendation is issued. With ISS, several companies reported that 10%-15% of their shares would vote automatically in line, while others estimated that between 25%-30% fell into that category. The problem seemed to be less apparent with Glass Lewis, with many companies reporting that less than 10% of their shares would be voted in line within 24-hours.

The 2014 SEC Staff Guidance structures its substantive advice as responses to specific questions. The three constituency groups affected by the SEC Staff Guidance—proxy advisory firms, portfolio managers, and public companies—must focus their attention on five overarching principles:

Fiduciary duty

Fiduciary duties permeate and govern all aspects of the development, dispensation, and receipt of proxy advice. Some investors use proxy advisory reports as one data point among many in an independent process to determine how or when they should vote their shares. Unfortunately, other investors may outsource their voting to proxy advisory firms without any due diligence.

Shareholder value

Enhancing and promoting shareholder value must be the core consideration in rendering proxy voting advice as well as making proxy voting decisions.

Freedom from conflicts

The proper role of proxy advisory firms vis-à-vis proxy voting is to provide accurate and current information to assist those with voting power to further the economic best interests of those who entrust their assets to portfolio managers and are the beneficial shareholders of public companies. If proxy advisory firms exceed that role—for example, by effectively exercising or being granted a measure of discretion over how shares are voted on specific proposals, or by failing to make proper disclosure regarding specific conflicts of interest afflicting a proxy advisory firm in connection with voting recommendations it is making—the proxy advisory firms so employed, and those engaging them, incur serious legal and regulatory consequences.

Portfolio manager discretion

Clarity is provided regarding the scope of portfolio managers' obligations to exercise a vote on proxy issues, and the obligations emphasizes the broad discretion portfolio managers have—subject to appropriate procedures and safeguards—to refrain from voting on every, or even any, proposal put before shareholders for a vote.

Compliance

In light of the direction provided, proxy advisory firms and portfolio managers need to reassess their current practices and procedures and adopt appropriate changes necessitated by the SEC Staff Guidance, while public companies should be aware of the direction provided to other stakeholders and consider it when developing policies and practices.

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