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# Meridian Client Update

## Senate Banking Committee Requests Answers from Proxy Advisory Firms

**Earlier this month, members of the U.S. Senate Banking, Housing, and Urban Affairs Committee sent letters to the two major proxy advisory firms, Institutional Shareholder Services (ISS) and Glass Lewis (GL), requesting answers about their business practices.**

In these letters, Senator Dean Heller (R-NV) and his colleagues raise questions related to each proxy advisory firm's voting system, report inaccuracies and conflicts of interest. The letters also express concern about the proxy advisory firms' market concentration and significantly increased influence on shareholder voting. The letters direct ISS and GL to provide a written response to the questions posed by May 30, 2018.

The letters follow two recent Government Accountability Office issued reports (the "GAO Report") into the role of proxy advisory firms and their business practices. According to the Senators, "The findings of these reports, along with academic research, Congressional hearings and oversight by regulators, raise serious questions regarding business practices within the proxy advisory industry."

Each letter raises the following questions related to ISS's and GL's business practices.

- **Voting System.** *Whether the proxy advisory firm's proxy voting system is inconsistent with Staff Legal Bulletin No. 20, issued by the Securities and Exchange Commission (SEC) on June 30, 2014?* The Staff Legal Bulletin provides that a proxy advisory firm will **not** be exempt from the SEC's proxy solicitation rules if the proxy advisory firm offers "a service that allows the client to establish, in advance of receiving proxy materials for a particular shareholder meeting, general guidelines or policies that the proxy advisory firm will apply to vote on behalf of the client."
- **Report Accuracy.** *Whether company reports issued by proxy advisory firms to institutional clients are factually accurate?* The letters note that one of the GAO Report's recommendations "to solve mistakes or misunderstandings in proxy advisory firm reports is to provide each public company with a draft of the report before it is issued and request comments on any factual issues or incorrect assumptions." In that regard, ISS was asked about whether it is willing to expand its draft review process from S&P 500 companies to S&P 1500 companies. Similarly, Glass Lewis was asked why it does not initiate a draft review process to improve the quality of its reports and why it does not provide a company with a courtesy copy of its report after publication.
- **Conflicts of Interest.** *Whether proxy advisory firms are adequately disclosing conflicts of interest?* Each proxy advisor was asked to identify potential and actual conflicts of interest and the extent that such conflicts are disclosed in company reports. In addition, the proxy advisors were asked whether they disclose potential and actual conflicts of interests related to their private ownership by third parties. Specifically, they were asked about conflicts of interest arising from (1) cross-ownership,

where owners or executives of a proxy advisory firm may have a significant ownership interest in, or serve on the board of directors of, entities that have proposals on which the firm is offering vote recommendations, and (2) other financial interests of the owner(s) of the proxy advisory firm.

**Meridian Comment.** SEC Staff Legal Bulletin No. 20 was intended to address many of the issues raised in Senator Heller's letters. Nonetheless, many public companies continue to have concerns about the transparency of the proxy advisory firms' evaluation methodologies, the limited ability to engage with the firms about errors in their reports and the potential and actual conflicts of interest arising from proxy advisory firms' business practices and ownership. However, legislative proposals to regulate proxy advisors have not succeeded. In 2017, Congress introduced two bills that would regulate proxy advisory firms – one that died in the Senate (the Financial CHOICE Act) and another that was referred to and currently sits in the Senate Banking Committee (the Corporate Governance Reform and Transparency Act). It remains to be seen whether Senator Heller's letters signal that Congress is now ready to enact legislation that would expand regulatory oversight over the proxy advisory firms.

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The **Client Update** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or [dkalfen@meridiancp.com](mailto:dkalfen@meridiancp.com).

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