CENTER FOR CAPITAL MARKETS COMPETITIVENESS

U.S. Chamber of Commerce Foundation

Corporate Governance Update

2016 Proxy Season Survey

Background

Over the years, proxy advisory firms have played an increasingly outsized role in imposing their views of appropriate corporate governance on corporations and their shareholders. These firms claim the ability to evaluate every issue for which a corporate proxy may be solicited, in the United States and globally, and their recommendations are demonstrably influential in how proxy votes are cast.

In the United States, two proxy advisory firms—Institutional Shareholder Services Inc. and Glass Lewis & Co. LLC—constitute 97% of the proxy advisory industry and have become the de facto corporate governance standard setters for public companies.

Despite their disproportionate influence on corporate governance, proxy advisory firms have been criticized by U.S. and global regulators, academics, institutional investors, shareholders, and others for, among other things,

- Conflicts of interest that are frequently undisclosed or inadequately disclosed;
- "One-size-fits-all" voting advice that ignores the unique circumstances of each company or the effect of recommendations on the economic well-being of shareholders;
- Industry concentration;
- Lack of transparent policymaking; and
- Errors in analysis, facts relied upon to make recommendations, and a lack of due diligence.

The U.S. Chamber of Commerce and Nasdaq have long supported policies that promote effective shareholder participation in the corporate governance process. Strong corporate governance is a critical cornerstone for the healthy long-term performance of public companies and their positive promotion of long-term shareholder value.

Summary of 2016 Proxy Season Survey and Trends

The U.S. Chamber of Commerce, the U.S. Chamber of Commerce Foundation, and Nasdaq partnered this fall for a survey of public company interaction with proxy advisory firms during the

proxy season. This is the second annual proxy season survey and was intended to help people understand the public company experience during the 2016 proxy season, as well as highlight changes in that experience over time. More than 120 companies participated in this year's survey.

Notable Results and Trends

- In 2016, 81% of surveyed companies had a proxy advisory firm make a recommendation on a matter featured in the corporate proxy statement—a 13% decrease from 2015.

- Approximately 11% fewer companies reported making pro-active outreach to proxy advisory firms on issues subject to shareholder votes in 2016. Of the 38% of companies that did request a meeting, that request was more likely to be denied in 2016, with 15% fewer requests resulting in a meeting. Companies that were given an opportunity to meet with a proxy advisor saw mixed results, with some noting the conversations were productive and resulted in better recommendations, while others had the opposite experience.

- Only 19% of companies formally requested previews of advisor recommendations, while companies found proxy advisors notably less willing to provide them, with fulfilled requests dropping 13% from 2015.

- Roughly the same percentage of companies (13%) took steps to verify the nature of proxy advisory firm conflicts of interest, but, in an unwelcome trend, identified conflicts more than doubled from 6% in 2015 to 14% in 2016.

- However, the most profound and striking shift in corporate behavior was amongst companies that found conflicts of interest. Last year, 100% of companies that discovered apparent conflicts advised the proxy firms of those perceived deficiencies. But that number plummeted in 2016 to 12%.

Areas Experiencing Little to No Change

- Exhibiting little change from 2015, only 25% of companies believed the proxy advisory firm carefully researched and took into account all relevant aspects of the particular issue on which it provided advice.

- In 2016, companies asked to provide input to advisory firms about their recommendation 38% of the time, a decrease of about 9%.

- For companies seeking to provide input, companies reported a wide spread in the amount of time advisors granted them to respond, with anywhere from one hour to a month being reported. 24 to 48 hours seemed most common.

- For companies that believe they had insufficient time to respond, only 26% of companies expressed their dissatisfaction to the advisory firm and portfolio managers.

- Slightly less than half of companies (47%) notified the proxy advisory firm when it relied on inaccurate or stale data, with only 35% of companies notifying portfolio managers in this situation. A disappointing 3% of companies reported bringing their concerns to the attention of the SEC—although that is an improvement over last year when no companies went to the SEC.

- Similar to last year, approximately 81% of companies monitor proxy advisory firms for accuracy and reliance on outdated information.

- The number of companies that have some form of year-round, regular communication program with institutional investors remained steady at around 74%.

New and Notable

- In a new question for 2016, 71% of company respondents reported being aware of the proposed "Corporate Governance Reform and Transparency Act of 2016," and the overwhelming majority—more than 98%—supported the legislation.

Proxy Advice Best Practices

In June 2014, U.S. Securities and Exchange Commission Staff published guidance[1] due to concerns surrounding the increasingly outsized role and influence of proxy advisory firms on corporate governance matters in the United States 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.

The 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 amongst 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

[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), 17 C.F.R. §275.206(4)-6 (2014).

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 as to the scope of portfolio managers' obligations to exercise a vote on proxy issues, and it 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; and

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 make themselves aware of the direction provided to other stakeholders and consider it when developing policies and practices.