



July 6, 2018

The Honorable Michael Crapo  
Chairman  
Committee on Banking, Housing and Urban Affairs  
United States Senate  
Washington, D.C. 20510

The Honorable Sherrod Brown  
Ranking Member  
Committee on Banking, Housing and Urban Affairs  
United States Senate  
Washington, D.C. 20510

Dear Chairman Crapo and Ranking Member Brown:

Thank you for holding the hearing on June 28, 2018 on “Legislative Proposals to Examine Corporate Governance.” Institutional Shareholder Services Inc. (ISS) thanks the Committee for its commitment to ensuring that corporate governance in the United States is robust and works to support our nation’s capital markets and economy. To this end, ISS respectfully submits this statement, as well as the enclosed document, for inclusion in the hearing record in order to help clarify misconceptions and to correct misinformation about ISS and the proxy advisory industry that were raised during last week’s hearing.

**FACT: ISS is a Registered Investment Adviser (RIA) and is subject to strict SEC oversight**

Contrary to the suggestions oft made in the hearing, ISS is a Registered Investment Adviser (“RIA”) and is therefore subject to the Investment Advisers Act of 1940 (“Advisers Act”) and the rules and regulations that the U.S. Securities and Exchange Commission (“SEC”) has promulgated thereunder. The Advisers Act and related SEC rules provide a mature and comprehensive regulatory regime that covers virtually every aspect of our business and that subjects ISS to the SEC’s continuing oversight and examination authority.

As an RIA, ISS is required to implement and maintain a comprehensive compliance program, including a mandatory requirement for a Code of Ethics, which is publicly available on our website.<sup>1</sup> The RIA regime also dictates that we provide clients with transparency about our internal operations, including how potential conflicts of interest are addressed. Indeed, ISS is already subject to and complying with rigorous federal legal requirements.

**FACT: Proxy advisory firms, including ISS, have a fiduciary obligation to their clients**

As an RIA, ISS has a fiduciary obligation to our investor clients, which means ISS and our employees must carry out our duties solely in the best interest of clients and free from any compromising influences and loyalties.

Further, we note that in 2010, the SEC confirmed that proxy advice is a form of investment advice subject to the Advisers Act and the rules and regulations thereunder.<sup>2</sup> The SEC restated this view just last month in a proposed interpretive release on investment adviser standards of conduct.<sup>3</sup>

**FACT: Proxy advisory firms *do not* set or regulate corporate governance disclosure standards, *do not* set shareholder meeting agendas, *do not* put forward shareholder proposals, and *do not* advocate for shareholder proponents, and *do not* vote proxies.**

ISS’ *only* job is to analyze proxy statements and provide informed research and vote recommendations based on the policies and guidelines that our institutional investor clients have selected, and in many cases developed, themselves. We are an independent provider of data, analytics and voting recommendations to support our clients in their own decision-making.

<sup>1</sup> Available at: <https://www.issgovernance.com/file/duediligence/iss-regulatory-code-and-exhibits-june-2017.pdf>

<sup>2</sup> Concept Release on the U.S. Proxy System, IA Release No. 3052 (July 14, 2010) (“Proxy Concept Release”) at 110.

<sup>3</sup> Proposed SEC Interpretation Regarding Standard of Conduct for Investment Advisers, IA Release No. 4889 (April 18, 2018) (“IA Interpretive Release”)

---

Indeed, it is proxy advisory firms' clients who control both their voting policies and their vote decisions.

Federal statutes and state law dictate most of the items that appear on proxy statements to be voted upon by shareholders. The remaining agenda items, including the selection of nominees for election to the Board, are overwhelmingly put forward by corporate management, or sometimes by a company's shareholders.

Further, as a disinterested fiduciary, ISS has no financial stake in the outcome of a particular vote. ISS does not choose the ballots or agenda items on which we render advice. Rather, at a client's direction, we are asked by our clients to analyze and provide a voting recommendation for each agenda item related to every equity security held in our clients' portfolios. In fact, we are agnostic as to whether clients support a proposal, reject the proposal or abstain from voting altogether. Indeed, ISS will recommend contradictory votes on the same issue if individual clients' policies conflict. We are similarly indifferent as to whether clients choose to follow an ISS vote recommendation or not.

**FACT: ISS' report error rate is minor, and what's often classified by the issuer as an error is in fact a fundamental disagreement in corporate governance philosophy.**

ISS is committed to ensuring the accuracy and quality of our reports. As an RIA and a fiduciary, we have adopted a number of policies and procedures designed to ensure the integrity of our data collection and research process, upon which our reports are founded. We have robust systems and controls designed to ensure that research reports and vote recommendations include high-quality, relevant information; are accurate; are correctly based on policies selected or developed by the client; and are reviewed by appropriate personnel prior to publication. ISS commissions regular SSAE 16 audits, conducted by a third-party auditor, to ensure compliance with our internal control processes, including our research process.

ISS' research team does, infrequently, identify or receive notice of material factual errors in research reports that have already been published to our clients. ISS tracks such occurrences, which are rare. In 2017, for example, ISS covered over 6,400 meetings in the United States and the error rate was approximately 0.76% as measured by post-publication "Proxy Alerts" to clients notifying them of a material error within our benchmark proxy research that resulted in a change of a vote recommendation.

It is therefore particularly disconcerting that during the hearing Mr. Tom Quadman, Executive Vice President at the U.S. Chamber Center of Capital Markets Competitiveness, mischaracterized our engagement with Abbott Laboratories ("Abbott"). In fact, it is false that ISS "refused to meet with Abbott Labs or... correct the report." We are enclosing with this submission a letter which ISS sent to Abbott in response to their filing. As the letter explains, after sharing a draft report with Abbott, receiving Abbott's written comments and prior to publishing our final report, ISS, in fact, modified its report and corrected two minor factual inaccuracies: the date Abbott entered into an agreement to acquire Alere and the start year of Abbott's audit firm.

Further, even before Abbott published its proxy statement, ISS considered arguments made by Abbott that ISS should change its selection of "comparable corporations" (or peers) for purposes of evaluating Abbott's executive compensation program. After consideration of the merits of Abbott's comments and consistent with ISS' policy approach, ISS subsequently removed an ISS selected peer to instead include a company suggested by Abbott. This resulted in even greater overlap – 12 out of 16 corporations - between the final peer group used by ISS and Abbott's self-selected peers. In presenting the information to our clients in our report and consistent with our normal approach, we outlined in *side-by-side* fashion the peers selected by Abbott Labs and the ISS-selected peers.

Following this engagement, Abbott requested a meeting, a request which ISS acknowledged and to which it responded. Consistent with our stated engagement policies, and considering the proxy season had already begun, ISS responded the same day to let Abbott know that the company's comments were being reviewed, that we would reach out to Abbott if we had any questions, and asked Abbott to let us know if it had any additional comments. Our records show no other requests for engagement were received from Abbott in 2018 prior to the delivery of the draft ISS Report to Abbott for factual review.



This process and the change made based on Abbott’s feedback clearly demonstrate the extent to which ISS does engage with, and take into account, the input of the companies that it covers. While differences in approach and opinion may still exist, that is a far cry from the suggestion that the underlying analysis or vote recommendation results from a mistake or error.

Finally, we reiterate the findings of a 2007 GAO Report, which concluded that our clients trust us to provide “reliable, efficient services.”<sup>4</sup> The GAO’s follow-up report in 2016 addressed this further, stating “Both corporate issuers and institutional investors [the GAO] interviewed said that the data errors they found in the proxy reports were mostly minor...”<sup>5</sup>

**FACT: Proxy advisory firms do not “control” shareholder votes.**

Proxy advisory firms’ clients control both their voting policies and their vote decisions. As noted by the Council of Institutional Investors (CII), a leading nonpartisan and nonprofit association of public, corporate and union employee benefit funds and state and local entities with combined assets exceeding \$3.5 trillion: “Proxy advisory firm influence is exaggerated by analyses that confuse correlation with causation. ISS and Glass Lewis tend to follow investors on governance policy, not lead them....Their franchises are built on credibility with investors. As a result, advisors’ views reflect those of many funds.”<sup>6</sup> Indeed, as Ms. Darla Stuckey, President and CEO of the Society for Corporate Governance, acknowledged during the hearing, “proxy advisory firms...serve institutional investors.”

We note that this is consistent with the results of a 2012 survey of asset managers by Tapestry Networks that found proxy advisory firms’ “role as data aggregators” has become increasingly important to asset managers, and that even if smaller managers are more reliant on such advisory firms, they still acknowledge that responsibility for voting outcomes lies with investors.<sup>7</sup>

We also point you to the myriad of opposition letters to H.R.4015, “The Corporate Governance Reform and Transparency Act,” in which institutional investors, pension funds, state retirement systems, as well as state treasurers and comptrollers reiterate their opposition to the assertion that they are uninformed buy-side investors who outsource their investment and proxy voting decisions.

**FACT: ISS discloses all perceived and real conflicts of interest, and transparently complies with relevant SEC requirements. ISS is not aware of any instance in which a proxy research report or a vote recommendation was compromised by a conflict of interest.**

As an RIA, ISS takes its fiduciary duty of loyalty very seriously. We place primary importance on conducting our business in a transparent and responsible manner, and have developed a comprehensive program to manage potential conflicts of

---

<sup>4</sup> Jones, Y. D. (2007). *Issues Relating to Firms that Advise Institutional Investors on Proxy Voting*. (GAO-07-765). Washington, DC: Government Accountability Office (hereafter, “2007 GAO Report”), note 1 at 13.

<sup>5</sup> Clements, M. (2016). *Proxy Advisory Firms’ Role in Voting and Corporate Governance Practices*. (GAO-17-47). Washington, DC: Government Accountability Office at 29.

<sup>6</sup> June 13, 2016 letter from the Council of Institutional Investors to Rep. Hensarling, Chair of House Committee on Financial Services.

<sup>7</sup> Bew, Robyn and Fields, Richard, *Voting Decisions at US Mutual Funds: How Investors Really Use Proxy Advisers* (June 2012) at 2. Available at SSRN: <http://ssrn.com/abstract=2084231>. (“Across the board, participants in our research said they value proxy firms’ ability to collect, organize, and present vast amounts of data, and they believe smaller asset managers are more reliant on those services. Nonetheless, participants emphasized that responsibility for voting outcomes lies with investors”).

interest as required by the Advisers Act and related SEC rules. Moreover, ISS has adopted a significant relationship disclosure policy and took robust steps to enhance transparency following the promulgation of SLB 20.

As required by the Advisers Act's compliance program rule,<sup>8</sup> ISS has implemented, maintains and periodically updates a program designed to eliminate, or manage and disclose, conflicts of interest. This program includes appointing a chief compliance officer, establishing comprehensive compliance policies and procedures, and testing the adequacy of those policies and procedures and the effectiveness of their implementation on an ongoing basis. ISS has also adopted, as mentioned earlier, a comprehensive Code of Ethics as the Advisers Act regulatory regime also requires.<sup>9</sup>

Separate and apart from our compliance protocols, ISS addresses conflicts, in part, by being a transparent, policy-based organization, with research and voting recommendations based on publicly-disclosed information available to all shareholders. Contrary to Mr. Quaadman's claim, ISS provides our clients (and other stakeholders) with an extensive array of information to ensure that they are fully informed of our policies to manage conflicts of interests, and of any potential conflicts and the steps ISS has taken to address them. Among other things, ISS supplies a comprehensive due diligence compliance package, publicly available on our website, so that our clients (and other stakeholders) can confidently and fully assess the reliability and objectivity of our voting recommendations.

One measure that ISS has historically taken to ensure transparency is the disclosure of instances where a relationship between ISS and a party exists that may present a conflict of interest. This includes potential conflicts with ISS Corporate Solutions, Inc. ("ICS"), which is the subsidiary of ISS that provides governance tools and services to corporate issuer clients. ISS' standard institutional client contract contains specific disclosure regarding the work of ICS, ensuring our clients have full visibility into any significant relationships that may exist between ISS and the subjects of our proxy research reports.

ISS' institutional clients can readily identify any potential conflict of interest through ISS' primary client delivery platform, ProxyExchange (PX), which provides information about the identity of ICS clients, as well as the types of services provided to those issuers and the revenue received from them. Similarly, each proxy analysis and research report issued by ISS contains a legend indicating that the subject of the analysis or report may be a client of ICS. This legend also advises institutional clients about the way in which they can receive additional, specific details about any issuer's use of products and services from ICS, which can be as simple as emailing our Legal/Compliance department via [disclosure@issgovernance.com](mailto:disclosure@issgovernance.com).

One of the most important components of the ISS compliance program is the firewall maintained between the core institutional business and the ICS business. This firewall includes the physical and functional separation between ICS and ISS, with a particular focus on the separation of ICS from the ISS Global Research team. A key goal of the firewall is to keep the ISS Global Research team from learning even the identity of ICS' clients, thereby ensuring the objectivity and independence of ISS' research process and vote recommendations. The firewall mitigates potential conflicts via several layers of separation:

- ICS is a separate legal entity from ISS.
- ICS is physically separated from ISS, and its day-to-day operations are separately managed.
- The ISS Global Research team works independently from ICS.
- ICS and ISS staff are forbidden to discuss the identity of ICS clients.
- ISS' institutional analysts' salaries, bonuses and other forms of compensation are not linked to any specific ICS activity or sale.

---

<sup>8</sup> See Advisers Act Rule 206(4)-7.

<sup>9</sup> See. Advisers Act Rule 204A-1.



Yet another element of the conflict mitigation procedures is the “blackout period,” pursuant to which ICS staff may only have limited interactions with issuers or their representatives when a “live” voting issue is pending for review by ISS. The “blackout period” runs from immediately after definitive proxy materials are filed with the appropriate regulatory body through the date of the issuer’s shareholders’ meeting. During this period, interactions between ICS and its corporate clients are limited. During the blackout period, ICS is precluded from providing advisory services to, or otherwise interacting with, issuers with respect to matters that are “live” or pending on the issuer’s proxy statement. In addition, during the blackout period, ICS does not engage in marketing or selling efforts to issuers (whether they are existing ICS clients or prospects).

Moreover, ICS explicitly tells its corporate clients, and also indicates in their contracts that ISS will not give preferential treatment to, and is under no obligation to support, any proxy proposal of an ICS client. Contrary to Ms. Stuckey’s statement, neither ISS nor ICS “help you to draft your proxy if you’re an issuer.” ICS further informs its clients that ISS’ Global Research team prepares its analyses and vote recommendations independently of, and with no involvement from, ICS.

Finally, ISS is not aware of any instance in which a proxy research report or a vote recommendation was compromised by a conflict of interest, nor any instance where a regulatory body has reached that conclusion. We are heartened by the fact that the most vocal critics of ISS on this point are those who speak on behalf of corporate management, and not the investors who rely on ISS’ research and vote recommendations. We see this as a strong indication that we are managing this potential conflict extremely well.

Furthermore, provisions of HR4015 would be in fact undermine the firewall between these two firms.

**FACT: Proxy advisory industry is competitive and there are no artificial barriers to entry**

There are no artificial barriers to entry into the proxy advisory industry in the United States. We operate in a competitive market and, as Mr. Quaadman himself stated during the hearing, we have seen entrants come and go within the industry. Moreover, institutional investors are not required to purchase our services. In the free market, institutional investors purchase our services because they choose to do so, and find value in the products we provide.

ISS is indeed an industry leader and has earned its market share by virtue of the quality of its work and the level of service it has provided for more than a quarter century. The GAO report entitled “Issues Relating to Firms that Advise Institutional Investors on Proxy Voting” concluded as much when it wrote that ISS has “gained a reputation with institutional investors for providing reliable, comprehensive proxy research and recommendations.”<sup>10</sup> While we have seen the widely circulated conjecture that two firms “control” 97% of the proxy advisory industry, this is not a statistic we have verified or can confirm.

Ultimately, as noted at the hearing by Harvard Law Professor John Coates, no one is required by law or regulation to consult a proxy advisor. Similarly, there is no requirement to follow our vote recommendations. The ultimate voting decision for each resolution at a company meeting remains the responsibility of our clients, the owners of the corporation, as we believe it should. Our clients are sophisticated institutional investors who owe a fiduciary duty to their plan beneficiaries.

With regard to H.R.4015 and any similar legislation, we agree with many of the concerns about the negative impacts of this legislation that were raised during the hearing. We believe the litmus test for any federal intrusion into the free market is whether it targets a proven problem and seeks to address it cost-effectively. The proposed bill does not pass either test. Further, we have not heard from any institutional investor who supports H.R.4015 or the underlying arguments upon which the legislation is founded.

The investors who use proxy advisory services do not see the “problem” the proposed legislation purports to address. In

---

<sup>10</sup> Jones, Y. D. (2007). *Issues Relating to Firms that Advise Institutional Investors on Proxy Voting*. (GAO-07-765). Washington, DC: Government Accountability Office (hereafter, “2007 GAO Report”) at 13.



**Institutional Shareholder Services Inc.**

1177 Avenue of Americas, 2<sup>nd</sup> Floor

New York, NY 10036

T: +1.646.680.6300 | F: +1.646.417.6090

---

fact, as Mr. Silvers stated, institutional investors are concerned that the legislation, as written, seeks to “impose a new regulatory scheme designed to make [proxy advisory firms] disloyal to their clients” and would “essentially defeat the corporate governance system.”

In conclusion, ISS appreciates this opportunity to set the record straight and underscore the rigorous regulatory system and internal compliance program under which we operate. If there is any additional information I can provide or if you have any follow-up questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Gary Retelny", is written over a horizontal line. The signature is stylized and includes a long horizontal stroke extending to the right.

Gary Retelny, President and Chief Executive Officer

CC: Members, Committee on Banking, Housing and Urban Affairs, U.S. Senate