



## FAQs

# Regarding Recent Guidance from the U.S. Securities and Exchange Commission Regarding Proxy Voting Responsibilities of Investment Advisers.

### **Background:**

On August 21, 2019, the U.S. Securities and Exchange Commission (“SEC”) issued Release Nos. IA-5325 and IC-33605, Commission Guidance on Proxy Voting Responsibilities of Investment Advisers (the “Guidance”).<sup>1</sup>

As articulated by the SEC, the Guidance was provided to “assist investment advisers in fulfilling their proxy voting responsibilities.” More specifically, in the words of the SEC “Fact Sheet” explaining the Guidance, it “clarifies how an investment adviser’s fiduciary duty and Rule 206(4)-6 under the Adviser Act relate to an adviser’s proxy voting on behalf of clients, particularly if the investment adviser retains a proxy advisory firm.

In ISS’ view, the Guidance reaffirms the SEC’s long-standing position that investment advisers who undertake to vote proxies on their clients’ behalf must do so in a manner consistent with the advisers’ fiduciary duties of care and loyalty to their clients. These duties cannot be abdicated when an investment adviser seeks the assistance of a proxy advisory firm and when an adviser does retain a proxy advisory firm it should consider taking certain steps to ensure that these duties are being fulfilled.

ISS will continue to provide its clients with the information and tools they need to help them fulfill their obligations with respect to proxy voting and their oversight of ISS as their proxy advisory provider.

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<sup>1</sup> On the same day that it issued the Guidance, the SEC issued Release No. 34-867721, a Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice. These FAQs focus on the Guidance, not Release No. 34-867721.

To assist clients in understanding and acting on the Guidance, below are a number of FAQs that highlight ISS' approach to the provision of its proxy research and vote recommendations in the framework of key topics and questions raised in the Guidance.

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**Q. How can investment advisers use “pre-populated” votes to ensure their voting policies and procedures are in the best interest of their clients?**

A. Through ISS' proprietary research and voting platform, ProxyExchange, ISS' clients have the ability in real time to examine their voting records, both historical and pending votes, along with historical and pending vote recommendations developed by ISS for the client based on the client's selected proxy voting policy guidelines. ProxyExchange provides clients with great flexibility to flag and sort items, such as by sector, industry or some other characterizing criteria, or select a topic, such as say-on—pay votes, that lie ahead, enabling the client to easily analyze the information to ensure that the voting recommendations align with the client's voting preferences and those of the investment adviser's underlying clients.

**Q. What are ISS' policies and procedures with regard to the consideration of additional information (other than the recommendation of a proxy advisory firm) that may become available regarding a particular proposal, such as an issuer's or a shareholder proponent's subsequently filed additional definitive proxy materials?**

ISS bases its proxy research and vote recommendations on publicly available information. With respect to U.S. companies (and proponents at U.S. companies) that file their proxy materials on the SEC's EDGAR site, ISS monitors these filings on a daily basis in order to capture and review both initial **and** any additional definitive proxy materials that are filed. This monitoring and review process takes place both before and after ISS has issued a proxy research report for a particular meeting.

When new information is made available that is material to a previously issued research report or to our clients' voting decisions, ISS issues a Proxy Alert.

Proxy Alerts are used to communicate to our clients material updates, adjournments, corrections and vote recommendation changes. A Proxy Alert is

structured as an overlay on the original report; the first few pages show the updated information and any related vote recommendation change, and the original report lies underneath, and will continue to reflect the original report and information. This allows our clients to see in one document the original report and any changes reflected in the Alert. Proxy Alerts are distributed to our clients in the same way our original (or initial) proxy analyses are distributed – through our ProxyExchange platform. The clients who received the original report will automatically receive any Proxy Alerts issued with respect to that original report.

**Q. Does ISS have the capacity and competency to adequately analyze the matters for which its clients are responsible for voting, including the adequacy and quality of our staffing, personnel, and/or technology?**

Yes. Approximately 1,400 global ISS team members are focused wholly on meeting the needs of clients. A nearly 250 strong research staff, including many possessing advanced degrees in business, finance and law, are focused principally on exception-based research with approximately 45 languages spoken across 13 global offices. ISS also invests heavily in cutting edge technology platforms to ensure workflow/processes operate optimally in support of human capital. ISS, moreover, does not outsource any of the research functions. Our research staff, wherever they are located, are subject to the same rigorous oversight and standards. Notably, with more than three decades of experience in the proxy business, ISS is uniquely qualified to understand and support investment advisers in the discharge of their fiduciary duties as it applies to stewardship of portfolio companies.

**Q. Does ISS have an effective process for seeking timely input from issuers and proxy advisory firm clients with respect to, for example, its proxy voting policies, methodologies, and peer group constructions, including for “say-on-pay” votes (e.g., if peer group comparisons are a component of the substantive evaluation, the investment adviser should consider how the proxy advisory firm (1) incorporates appropriate input in formulating its methodologies and construction of issuer peer groups, and (2) takes into account the unique characteristics regarding the issuer, to the extent available, such as the issuer’s size, its governance structure; its industry and any particular practices unique to that industry, its history, and its financial performance)?**

*Benchmark Voting Policy Input.* ISS conducts an annual policy review process with respect to the update of its benchmark and thematic policies, designed to

create voting policies that reflect investor and market views, accepted good governance practices, and helps ensure the inclusion of regulatory changes and practical implementation matters. All of ISS' benchmark and thematic proxy voting policies are reviewed annually, taking into account evolving perspectives, best practices, and related legal and market-specific developments. The annual review and development process generally starts mid-year each year and generally ends in November when policy updates for the next year's proxy season are released publicly, with transparency to clients, to companies and to the market generally.

The inclusive and thoughtful approach to policy development is designed to ensure that ISS policies are informed by a broad set of relevant inputs and expertise, combining ISS expertise with views and feedback from a diverse range of market participants through multiple channels, including:

- Ongoing dialogue with and feedback from investor clients, and other participants in the capital markets, including companies, regulatory agencies and the academic community.
- Roundtable and other similar sessions with clients and relevant industry groups.
- An annual policy survey open to all interested parties, and designed to elicit a variety of inputs from institutional investors, companies and others to test policy development ideas and obtain feedback.

ISS uses all this input to consider draft policy updates on key emerging and new issues each year. The process is overseen, and all final policy changes agreed, by the ISS Global Policy Board. Before finalizing policy changes, ISS also publishes proposed, key updates for an open review and public comment period. All comments received during the open comment period are considered and are also posted to ISS' Policy Gateway at [www.issgovernance.com/policy](http://www.issgovernance.com/policy), in order to provide the highest level of transparency into the market's feedback. Final policy guidelines for most markets are published in Q4 each year to apply to meetings held on or after February 1st of the following year.

Additional information regarding policy development and application can be found [here](#). In particular, the full text of ISS' benchmark and thematic proxy voting guidelines are made available on our public website.

***Peer Group Construction.*** ISS' peer group methodology maintains its focus on identifying companies that are reasonably similar to the subject company in terms of industry profile, size, and market capitalization. ISS' selected peer group generally contains a minimum of 12 and maximum of 24 companies based on the following factors:

1. the GICS industry classification of the subject company

2. the GICS industry classifications of the company's disclosed benchmarking peers
3. size constraints for both revenue (or assets for certain financial companies) and market value

Subject to the size constraints, and while prioritizing companies that keep the subject company's size closer to the median of the peer group, peers are selected from a potential peer universe in the following order:

1. from the subject's own 8-digit GICS group
2. from the subject's peers' 8-digit GICS groups
3. from the subject's 6-digit GICS group
4. from the subject's peers' 6-digit GICS groups
5. from the subject's 4-digit GICS group

Peers generally will not be chosen from an 8-digit or 6-digit GICS group belonging to only one of the subject company's peers. When choosing peers, priority is given to potential peers within the subject's "first-degree" peer group (the companies that are either in the subject's own peer group, or that have chosen the subject as a peer), and companies with numerous connections (by choosing as a peer or being chosen as a peer) to these first-degree peers. All other considerations being equal, peers closer in size are preferred.

In addition and to ensure ISS' peer selection process is of the highest possible quality, ISS gives companies an opportunity to indicate changes to their self-selected peer groups since the fiscal year covered by ISS' last report. Taking this extra step of collecting updated information will help produce a better outcome for investors and issuers alike.

Additional information regarding ISS' U.S. peer group selection methodology and issuer submission process can be found [here](#).

*Company Specific Input.* ISS engages in dialogue with issuers (and sometimes other relevant market participants) when doing so is likely to help inform our research reports (and our clients' voting decisions). While vote recommendations are based on publicly available information, ISS believes that targeted engagement can contribute to more informed research reports and voting decisions. The decision whether and how to engage with any issuer is made at the discretion of ISS and there is no fee charged for such engagements.

ISS is transparent about its issuer engagement and indicates on each research report if it engaged with the company and why. ISS research reports include, on the front page or soon thereafter, a summary of any engagement that took place as part of the analysis, which may include key information disclosed on dialogue with companies, shareholder proponents or other stakeholders, including the date(s) of dialogue, the topic(s) covered, and the initiator of the dialogue, and

some accompanying notes and the outcome of the dialogue. As part of the research report content, this information is made available to clients as soon as the research report and voting recommendations are released.

Information regarding the engagement process is disclosed on the ISS website and can be found [here](#).

**Q. Has ISS adequately disclosed to the investment adviser its methodologies in formulating voting recommendations, such that the investment adviser can understand the factors underlying the proxy advisory firm's voting recommendations?**

Yes. Please see above.

**Q. What is the nature of any third-party information sources that ISS uses as a basis for its voting recommendations, and what steps the investment adviser should take to develop a reasonable understanding of when and how the proxy advisory firm would expect to engage with issuers and third parties.**

Most information used in ISS' proxy research reports is sourced directly from the subject company's filed proxy materials and other information made publicly available by the company (such as on the company's website and in press releases). ISS also uses a variety of third-party data from a small number of vendors to facilitate and enhance our research reports. Most third-party data used in ISS research is sourced from FactSet, S&P, and Bloomberg, although we do use a small number of other vendors on a regional or specialized basis. Key types of third party data used include company entity information (to determine which regional ISS voting policy applies to the subject company), stock price data (to determine total shareholder return), and company accounting and demographic data (including revenue, market capitalization, assets, and industry, all used in the formation of ISS compensation peer groups used in pay for performance assessments).

Vendors of this data and the types of data we employ, including:

*FactSet*

- Company entity data
- Entity structure data
- Security identifiers
- Company type (public, private, investment fund, etc)
- Company status (Active/inactive)
- Company location (incorporation and primary operations)
- Security classification and attributes

- Institutional ownership data

*S&P (Including XpressFeed and CapitalIQ)*

- Security Identifiers
- Company accounting data
- Stock price data
- Common shares outstanding
- Dividend payments (amounts, ex dates, types)
- Company first trading date
- Index data
- General Industry Classification System (GICS)

*Bloomberg*

- Company performance data
- Company accounting data
- Sell side analyst data
- Individual biographical data

In addition, ISS also uses third parties for certain specialist data sets, including index constituent data, and regional (Japanese) director data.

*Engagement with Issuers and Third-Parties.* Please see above.

**Q. Does ISS maintain policies and procedures regarding how it identifies and addresses conflicts of interest are appropriate, such as:**

- 1. conflicts relating to the provision of proxy voting recommendations and proxy voting services generally (such as the provision of recommendations and services to issuers as well as proponents of shareholder proposals regarding matters that may be the subject of a vote);**
- 2. conflicts relating to activities other than providing proxy voting recommendations and proxy voting services; and**
- 3. conflicts presented by certain affiliations, such as whether a third party with significant influence over the proxy advisory firm [e.g., as a shareholder, lender, or significant source of business] has taken a position on a particular voting issue or voting issues more generally.**

**Also and specifically, does ISS disclose details on:**

- **Whether the issuer has received consulting services from the proxy advisory firm, and if so, the amount of compensation**

**paid to the firm (if any), and whether a proponent of a shareholder proposal or an affiliate of the proponent is or has been a client of the proxy advisory firm; and**

- **Whether they utilize technology in delivering conflicts disclosures that are readily accessible (for example, usage of online Portals or other tools to make conflicts disclosure transparent and accessible).**

ISS is a registered investment adviser with the SEC under the Investment Advisers Act of 1940.

ISS addresses conflicts, first and foremost, by being a transparent, policy-based organization. Our use of a series of published voting policies provides a very practical check and balance that ensures the integrity and independence of ISS' analyses and vote recommendations. While these policies allow analysts to consider company- and market-specific factors in generating vote recommendations, the existence of a published analytical framework, coupled with the fact that vote recommendations are based on publicly-available information, allows ISS clients to continuously monitor the integrity and consistency of ISS advice.

Furthermore, ISS has undertaken a comprehensive risk assessment to identify specific conflicts of interest related to its operations and has adopted compliance controls reasonably designed to manage each of those risks. In order to ensure the effectiveness of these controls, ISS conducts periodic training sessions for employees and conducts a range of transactional and forensic tests to monitor compliance. We refer you to our public website for information about the policies and procedures we have implemented to help ensure the integrity of our business operations.<sup>2</sup>

*Conflicts in Connection with Affiliated Corporate Consulting.* ISS Corporate Solutions, Inc., a wholly-owned subsidiary of ISS ("ICS"), provides governance tools and services to corporate issuer clients. Left unchecked, this potential conflict could result in analyses and vote recommendations that are biased in favor of corporations that have decided to avail themselves of ICS' services. The primary control for this risk is the "firewall" ISS maintains between the core institutional business conducted by ISS 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 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

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<sup>2</sup> <https://www.issgovernance.com/compliance/due-diligence-materials/>



- are separately managed.
- ISS Global Research team works independently from ICS.
  - ICS and ISS staff are forbidden to discuss the identity of ICS clients.
  - Institutional analysts' salaries, bonuses and other forms of compensation are not linked to any specific ICS activity or sale.
  - ICS explicitly tells its corporate clients and 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. ICS further informs its clients that ISS' Global Research team prepares its analyses and vote recommendations independently of, and with no involvement from, ICS.
  - ISS makes available to its institutional clients, either through ProxyExchange or through ISS' Legal/Compliance department, details regarding the identity of ICS' clients, including the identity of those clients and the amounts they spend with ICS.

ISS maintains a robust training and monitoring program regarding the firewall. This program includes quarterly tests of the firewall's integrity, new-hire orientation, and review of certain marketing materials and disclosures. There also is an ethics hotline available to both ICS and ISS staff for reporting issues of potential concern.

*Other Conflicts.* ISS has adopted, implemented and enforces policies and procedures to address other conflict situations as well. Such conflicts also may arise within the institutional advisory business where an ISS client is, itself, a public company financial services company whose proxies are the subject of analyses and voting recommendations, or other advisory research reports or where the Company is called upon to analyze and vote on shareholder proposals propounded by a Company client. Or, conflicts may arise from an ISS analyst's stock ownership or in connection with ISS' ownership structure. Finally, issuers' review of draft proxy analyses may give rise to conflicts.

*Disclosure Regarding Potential Conflicts.* ISS provides its investor clients with an extensive array of information to ensure that they are fully informed of potential conflicts and the steps ISS has taken to address them. In addition to making full disclosure in its Form ADV brochure, ISS supplies on its public website a comprehensive due diligence compliance package to assist clients and prospective clients in fulfilling their own obligations regarding the use of proxy advisory services. This package includes a copy of ISS' Code of Ethics, a description of other policies, procedures and practices regarding potential conflicts of interest and a description of the ICS business. A copy of the ISS Board of Directors Conflicts of Interest Policy related to Director-Affiliated Companies is also available through the ISS web site.

Any institutional client that wishes to learn more about the relationship, if any, between ICS and the subject of a particular analysis or report may do so through functionality available on the client-facing side of ProxyExchange. This process allows ISS' proxy voting clients to receive the names of ICS clients without

revealing that information to research analysts as they prepare vote recommendations and other research. ISS clients are provided with details about the amount that each ICS client has paid ICS and the particular products/services they purchased. Were the ICS relationship explicitly identified on the face of, or within, a proxy analysis or report, this critical information barrier would be destroyed. This functionality is also available by contacting ISS' Legal and Compliance Department for relevant details.

In addition to obtaining report-by-report conflict information, institutional clients of ISS can obtain a list of all ICS clients. Some clients may receive a list on a monthly basis, while others may receive the list on a quarterly basis. They also obtain a range of additional information regarding our information barriers, our data centers, and other aspects of our operations. Many clients meet with ISS staff on an annual basis to discuss conflicts and other due diligence matters.

ISS' *Policy Regarding Disclosure of Significant Relationships* is available [here](#).

**Q. How does an investor assess whether ISS' advice is subject to potential factual errors, potential incompleteness, or potential methodological weaknesses, including whether they engage with issuers to ensure complete and accurate information, correct any identified material deficiencies in their analysis, disclose the sources of information used in formulating recommendations and consider factors unique to the issuer or proposal when making recommendations?**

We take reports of errors seriously and address them through: (1) identification; (2) investigation; (3) correction, clarification and/or more context; and (4) if warranted, a Proxy Alert to clients.

With respect to final reports that have already been published, if an error is identified (whether by ISS, the issuer or an investor), or updated relevant information is publicly released by the issuer (for example, through supplemental proxy material filed with the SEC), ISS promptly issues a "Proxy Alert" to inform clients of any corrections, new information available and, if necessary, any changes in the vote recommendations as result of those corrections or updates. Alerts are distributed to ISS' clients through the same ProxyExchange platform used to distribute the regular proxy analyses. This ensures that the clients who received an original analysis and recommendations will also receive the related Proxy Alert.

On the issue of engagement, ISS maintains mechanisms to address issuer complaints and disagreements. First and foremost is that all companies can contact ISS either via e-mail with a contact e-mail provided on each proxy research report, or via the Help Center and Research HelpDesk that are designed to provide assistance with queries on ISS research, data, and other

services. The Help Center is a portal that provides a secure framework for companies to submit questions on annual meeting research, engagement requests, submissions/disclosures relating to company data, and a number of other matters of import to stakeholders. The Research HelpDesk is staffed by ISS personnel to handle those same issues.

ISS also maintains a Feedback Review Board, which serves as a secondary channel for any market participant to communicate with ISS with any concerns or disputes. This can include accuracy of research, accuracy of data, policy application and general fairness of ISS' policies, research, and vote recommendations. The Feedback Review Board, chaired by ISS' President & CEO, is typically used by stakeholders to escalate issues previously raised via the Help Center.